Nigeria Investment Opportunities and Risks in the Oil Sector

Africa's greatest oil power and potential

Nigeria is the largest oil producer in Africa, and ranked 13th globally. The country's official output is around 2 million barrels per day (mbpd). Oil reserves in Nigeria are among the world's top ten, totaling 37.2 billion barrels. Nigeria produces four grades of oil: Bonny Light crude oil, Brass River crude oil, Forcados crude oil, and Qua Iboe crude oil. The light (i.e. low density) and sweet (i.e. low sulfur) Bonny Light crude from the Niger Delta Basin is the highest and most desirable grade. It is easy to refine, causes little wear and tear to refineries (i.e. low corrosiveness) and has a relatively low environmental impact in terms of its byproducts from refining.

A mismanaged resource

Nigeria has little to show for its rich oil resources. Although it overtook South Africa to become Africa's largest economy in 2014, and can boast of a 7% growth rate, over a third of its population of 170 million lives in poverty and the poverty rate is growing. Nigeria is at the bottom of the UN Human Development Index (153 out of 187). Its transportation and energy infrastructure is woefully inadequate. Of the little infrastructure in place, most is in a state of disrepair. Around $800 million worth of natural gas is flared every year because of the lack of pipes to deliver it to power plants or any other end users. Even though Nigeria has four refineries, they are only operating at partial capacity due to poor maintenance and obsolete equipment, forcing the country to import 70% of its fuel. Nigeria has seen little investment in oil itself, as witnessed by its stagnant output. The state-owned Nigerian National Petroleum Corporation (NNPC) has failed to invest in the country's oil resource development. Because it receives state subsidies to import fuel, the NNPC also has no incentive to upgrade refining capacity. Meanwhile, regulatory uncertainty has precluded much-needed foreign investment in oil production and refining.

Nigeria's primary internal challenge: entrenched corruption

Lack of transparency and accountability has allowed corruption to become deeply entrenched within the NNPC, which is responsible for oil exploration, production, refining, and regulation. The NNPC records oil production volumes at export terminals rather than at wellheads, creating a large gray area where oil is siphoned to the tune of over 100,000 barrels per day. In 2013, then-Central Bank governor Lamido Sanusi claimed that $20 billion in oil revenue was missing from state coffers as a result. He was immediately fired, suggesting the corruption ran much deeper in the government. Then-President Goodluck Jonathan's administration subsequently hired PricewaterhouseCoopers to audit the NNPC but then refused to release the full results. The pervasive sense of state incompetence and cronyism is directly responsible for the rise of various separatist movements, including the Movement for the Emancipation of the Niger Delta, and the terrorist organization Boko Haram.

The new market challenge

Nigeria has experienced an oil export market shock this year due to a confluence of factors. First, the value of its Bonny Light has precipitously fallen. Given that oil accounts for 90% of Nigeria's exports and 70% of its budget, the recent drop in global oil prices has led to a budget crisis. Prices would need to almost double for Nigeria to be able to balance its budget. Second, Nigeria has lost market share. Since the U.S. shale revolution domestic shale oil, which has very similar characteristics to Bonny Light crude, has replaced Nigerian imports in supplying U.S. refineries. U.S. oil imports from Nigeria have dropped from 1 million bpd in 2010 to less than 60,000 bpd in 2014. Nigeria's efforts to develop new markets have been stymied by OPEC's decision in November 2014 to stop supporting oil prices in favor of increasing market share. Nigeria has arguably been most adversely affected by this strategic shift since Middle Eastern oil is cheaper. As a result of all these development the premium for Bonny Light crude oil has fallen. It commanded a premium of $2/barrel over Brent crude oil prices in 2014, but the premium dropped to a ten-year low of 74 cents/barrel in 2015. Nigeria is expected to lose over $30 billion in oil export revenue this year versus 2014.

Political breakthrough and promise

In a peaceful transition at a turbulent time, General Muhammadu Buhari was elected to the presidency on an anti-corruption platform in April this year. His sterling credentials and an unsullied background helped propel his candidacy. He has pledged to "kill corruption", more equitably share the fruits of economic growth, develop infrastructure, and end the Boko Haram insurgency. However, Buhari has few resources to work with given the aforementioned developments and the fact that Nigeria's Excess Crude Account sovereign wealth fund, intended to serve as an additional source of funds in the event of an oil price fall, was raided when prices were high. It is unclear how he will address this challenge and what allies he will work with. He has promised to select his cabinet by September.

A new NNPC or two

President Buhari has vowed to increase transparency, improve management, and introduce market principles to the oil sector, his primary anti-corruption target. As a first step, the NNPC will be divided into two entities: regulatory and investment. President Buhari has appointed former ExxonMobil executive and Harvard-trained lawyer Emmanuel Kachikwu head of the NNPC. Kachikwu has fired the NNPC's leadership. Many of his new hires have private sector backgrounds. In addition to Kachikwu, the NNPC's new executive board includes three NNPC veterans (Maikanti Baru, Isiaka Abdulrazaq, and Dennis Nnamdi Ajulu) and Total veteran Babatunde

Victor Adeniran. The executive board is currently reviewing all NNPC contracts and agreements. This process will reveal new opportunities for investment in the Nigerian oil sector, on new terms.

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