MONEDA

INDUSTRY REVIEW

IMPACT OF COVID-19 ON OIL AND GAS PLAYERS

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Executive Summary

It is said every scar tells a tale. The novel coronavirus pandemic will undoubtedly leave lasting scars on the Nigerian oil and gas industry. Scars that will tell tales of struggle and survival, scars that will tell tales of transformation and adaptability and most importantly, scars that will tell tales of opportunities, both those taken and those left untaken. The impact of the pandemic was heightened by a price war initiated by major oil influencers – Russia and Saudi Arabia, which combined with the pandemic to drive oil prices to a 20-year low. Although our projection for the average oil price for the year is $42/barrel, which came at the price of production cuts, it pales in comparison with last year's $65.85/barrel.

This report aims to assess the effect of this double whammy on players in the Nigerian oil and gas industry including; producers, oil service contractors, banks and the government. Quantitative and qualitative analysis were carried out utilizing available data obtained from credible sources.

Without a doubt, every player is expected to feel the negative impact of the pandemic, albeit some more than others. The industry that was otherwise poised for growth would see a huge contraction this year and potentially, a number of bankruptcies, as we have seen in many other countries.

The role of banks, as a major provider of finance to this industry cannot be overemphasized. A survey conducted by Moneda in Q2 2020 revealed that 46% of oil and gas contractors depend solely on Nigerian banks for funding. As a result of lessons learned from the 2008 financial crisis, we project that banks would not be hit as hard as initially feared. However, we foresee a drastic change in the risk appetite towards the oil and gas industry and this would instigate a ripple effect extending across the horizon of other players. As a matter of fact, the interplay among all players ensures that a change in habit in one is felt by at least one other, necessitating an in-depth research on all players. The loss in revenue for the producers, projected to be as high as 45.85% YOY, would cause a change in spending habit which would affect many contractors. A change in fiscal, monetary and operational policies by the government would affect all three other players. All these are explored in this report.

On the average, it will indeed be a very rough year for the Nigerian oil and gas industry, but we believe with the stabilization of prices by the OPEC+ production cuts, recovery is not far-fetched. There would definitely be casualties and with the pressure being exerted by other players, the contractors might have nowhere to bleed off this overpressure and could eventually cave in. As a result, this is the only player whose conversation may involve bankruptcies as it has already begun to occur in other countries.

Government's Gamble

Regulations in hard times

The government, through various agencies and parastatals, reacted to the pandemic by enacting laws and policies aimed at preventing the crash of the economy. Just how much can these policies remedy the situation?

The Department of Petroleum Resources (DPR) recently announced its strategic plan for the survival and success of the oil industry post-COVID-19.

We expect this plan to translate to a long-term positive impact for oil and gas players as it aims at profit maximization. We expect defaulters to be fined if the policy is strictly enforced by the government.

DPR announced a marginal oil field bid round recently aimed at indigenous oil and gas companies for the exploration and production of 57 fields. Capacity to operate and maintain the fields will be important in evaluating bidders. It is important that prospective bidders look for innovative solutions that will help them maximize production, operation and maintenance of the fields. More government revenue would be accrued from this process during these challenging times.

The Central Bank of Nigeria attempts to aid the economy via fiscal and monetary changes.

Due to the pandemic, interest rates on all applicable CBN intervention facilities have been reduced from 9% to 5% per annum, with effect from March 1, 2020. A one-year extension was also granted to loan beneficiaries. Nigerian banks were encouraged to restructure as much as 41% of their loans to customers. Extensions to credit deadlines were granted to businesses and households affected by the coronavirus outbreak. Credit to the oil and gas sector currently accounts for about 21% of the industry's total loans and advances, making the sector the single most important in terms of credit exposure to the banking industry.

The CBN sold dollars to banks trading at the "market-determined" Investor and Exporter (I&E) window at N360/$1 on the 20th of March initiating an 18% devaluation in the currency.

DPR'S STRATEGY

Cost control and management: entails the realignment of cost of production per barrel as well as corporate, business and financial stewardship.

Portfolio rationalization and asset optimization. For this, there would be project screening and maturation and contract renegotiation.

Achieve strategic repositioning and business optimization: through new business and operational resilience, which includes vertical integration model, covering the refineries, operational excellence, and compliance.

Strategic partnership: contracting models, service provider open access and shared risks & returns.

The I&E window is the official market where forex is traded between banks, the CBN, foreign
investors, and businesses. In August, this trade occurred at N380/$1 in a move signifying a further devaluation of the currency. The value of the naira depreciated at the I&E window by 5%, having moved from N360/$1 to N380/$1.

It is our considered opinion that with the unification of the official exchange rate, the central bank can establish itself as the stabilizer of the Naira as the parallel market follows suit. The effect of this devaluation on the nation's currency means imported goods are now more expensive, hence, contributing to the rising inflation in the country. With the importation of 19.18 billion litres of petroleum products in 2019 alone, the country is heavily dependent on importation of oil and gas products. Importers could see a shrinkage in their purchasing power for these products.

Treasury bills sold to foreign investors yielded zero demand from its auctions in the open market.

These treasury bills are occasionally sold by the government to maintain its foreign exchange reserve. As reported by the CBN in August, Nigeria's 364-day treasury bills was offered at 3.2%, the 182- day treasury bills sold for 1.5% and the 91-day treasury bills at 1.2%. Nigeria's inflation rate, on the other hand, stood at 13.22% which means returns on 91-day Tbills sits at an undesirable rate of -12.02%.

Low interest rates on foreign debt has created an incentive for domestic Nigerian banks to borrow from their foreign counterparts. This results in an increased access to long term funds used to extend credit facilities in foreign currency and enhance the capital base of Nigerian banks. The Central Bank of Nigeria would most likely impose strict restrictions on dollar denominated debts in order to protect banks from foreign exchange risks. This would also lead to a reduction in dollar denominated loan facility available to oil and gas players.

Nigerian Content Development and Monitoring Board (NCDMB) continues to preach local content.

Oil and Gas loans received from the Nigerian Content Intervention Fund (NCIF) would continue to be set at affordable interest rates even after extensions to loan maturity deadlines in order to support local businesses affected by COVID-19.

Nigerian National Petroleum Company (NNPC) declares 2020 the year of gas.

The initiative taken by NNPC to spearhead local development of natural gas could also serve as a catalyst for energy diversification and foreign export which would improve the nation's oil revenues.

Revisions to the budget are unlikely to salvage the country's finances.

In response to the pandemic, the already approved 2020 budget was revised to align with current realities. Oil benchmark price was reduced from $57/barrel to $25/barrel and crude production was reduced from 2.18 million to 1.94 million bpd. N5.365 trillion of the new budget is expected to be funded by borrowing and N5.158 trillion by direct revenue funding.

We expect government revenue from oil sales in 2020 to be around $7.936 billion, a 61% drop compared to the amount initially expected.

While it would be wise to reduce foreign borrowing from international financial organizations and countries, the nation might find it difficult servicing its loan obligations until oil revenues and exports improve drastically.

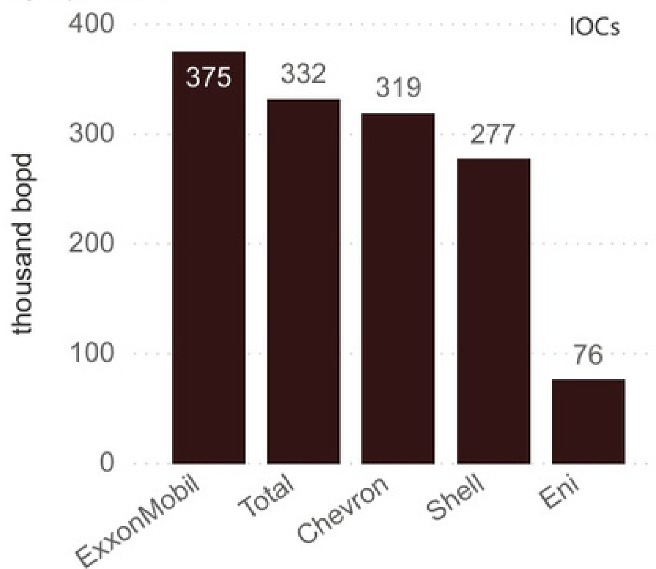
The Producers' Puzzle

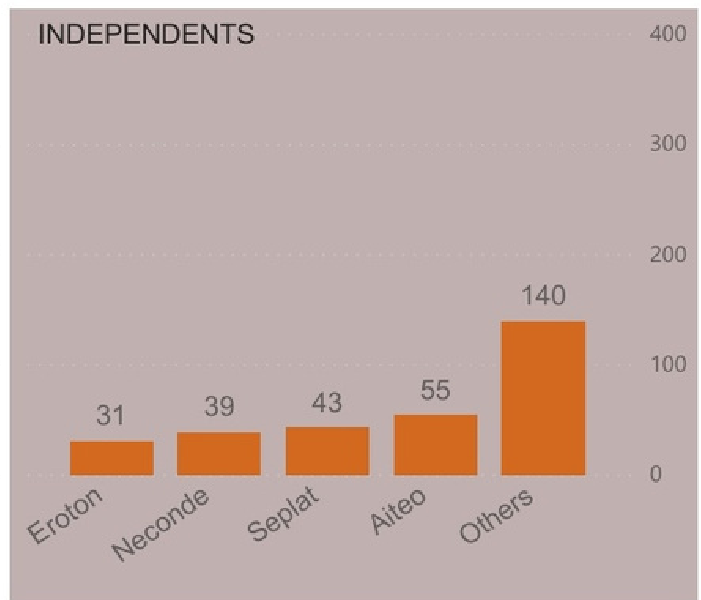
A Scramble for Safety

The frontline of the oil and gas industry consists of the producers who actually extract the crude oil from the subsurface and, as such, dabble in the crashed markets. Decision makers are faced with the uphill task of shielding their companies from havoc.

Production figures for operators are expected to average lower this year due to OPEC+ output cuts

2020 average daily crude oil production forecast by operator





Source: DPR and Moneda R&I estimates

Based on current happenings and assuming no subsequent price crash, we expect the Brent crude price to remain at or below $50/barrel till the end of year; hence, averaging $42/barrel for the whole year.

This, which is a 36% decline compared to 2019's average of $65.85/barrel, would result in a decline in revenue for producers and could have been a lot worse if the OPEC+ production cuts which have stabilized prices had not been initiated. As a result of the agreed production cuts, Nigeria was expected to scale back production by 417,000 bpd between May and July after which the production cuts were eased slightly. This development also translates to a reduction in potential revenue for producers. Although the country has struggled with compliance in the first few months of the agreement, we expect full compliance to be reached before the end of the year and the production level to average 1.803 million bpd (including condensates) which is 10.42% less than the previous year's average.

The International Oil Companies (IOCs), the national oil company (NNPC via its subsidiary, NPDC) and the independents all

make up the producers in Nigeria. The extent of the damage done by this uptick in events is expected to hit these players differently.

Could the IOCs swift response completely shield them from the storm?

We expect IOCs revenue from oil sales to drop markedly YOY by as high as 45.87% to just about $9.95billion. In our considered opinion, the losses could be shared in the same proportion as company exposure in the country (based on net oil production). As a result of this, ExxonMobil is expected to experience the highest drop in revenue and Eni to have the least. This loss in revenue is non-inclusive of gas sales as the IOCs play a major role in the production of gas in the country with Shell leading the pack. Shell-operated fields churn out about 24% of the country's total gas production and the company has a 25.6% stake in Nigeria LNG (NLNG) with Total and Eni having 15% and 10.4% respectively. The pandemic has also impacted the gas market as global prices fell about 14% during the year. Demand was also impacted as Nigeria had about 12 LNG cargoes without buyers in March. Gas prices have recovered and as such, we expect a loss in gas revenue YOY but a lot less compared to oil.

The IOCs net production in the country is expected to fall slightly to about 36% of total production in the country as we expect IOCs to bear the brunt of the production cuts. Total's Egina is alone contributing 80,000 bpd to the cuts. These estimates assume the OPEC+ quota was shared in proportion to daily production. The actual cut is largely politically driven and cannot be estimated with certainty, however, we believe it would not deviate significantly from the above assumption.

With respect to expenditure, we expect the spending pattern of the IOCs to change. We envisage that attempts will be made to trim excess spending and margins on contracts could be slashed to free up room for more cash. We expect a reduction in workforce, another area in which operating cost could be trimmed. Personnel deployment on-field has been adjusted countrywide as a result of the pandemic. Restrictions have been placed on the number of personnel on the field, so as to afford room for social distancing. Companies are mandated to isolate field workers before and after their hitch which was also extended from 14 days to 28 days. It is our considered opinion that IOCs would incur some additional cost as a result of this development (organization of tests and isolation of field personnel).

As a result, operational cost could fall slightly from the year before and our

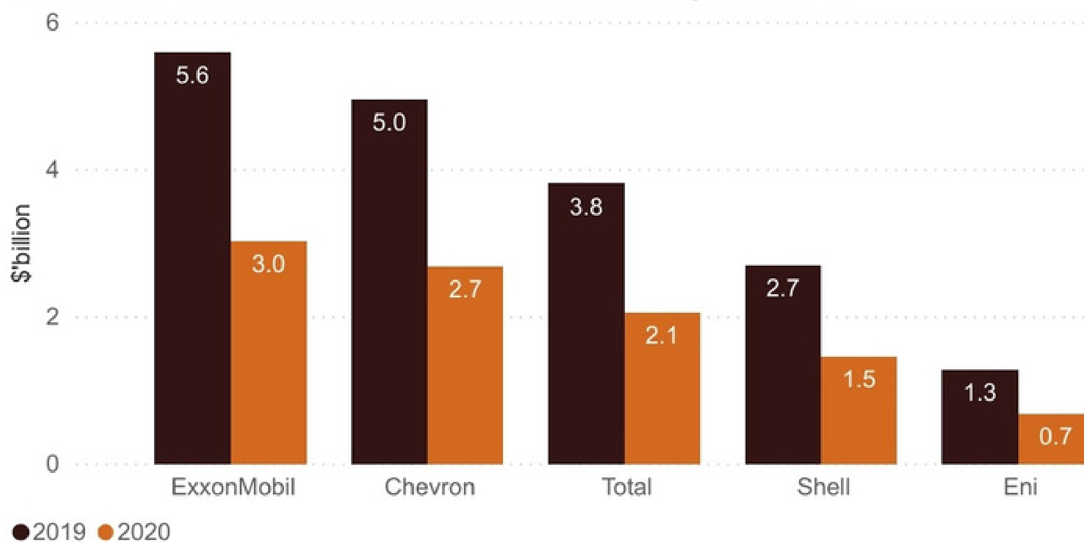
Key Figures

- **Brent crude to average $42/barrel, a 36% drop YOY.**
- **Average daily crude oil production - 1.803 million bpd, 10.24% decline YOY.**

- **5 IOCs analyzed - ExxonMobil, Chevron, Total, Shell, Eni**
- **IOCs revenue from oil sales - $9.95 billion, 45.87% decline YOY.**
- **IOCs CAPEX and OPEX - $5.15 billion (average of 28% CAPEX cut) and $4.896 billion respectively.**
- **Expected operating profit for IOCs - negative earnings of $96 million**

- **Independents' revenue from oil sales - $2.488 billion, 42.84% drop YOY.**
- **CAPEX and OPEX - $1.2 billion and $1.974 billion respectively.**
- **Expected operating profit for independents - negative earnings of $686 million**

A huge slump in revenue is expected for all IOCs compared to 2019 levels



Source: Company financial reports and Moneda R&I estimates

estimates show that this figure would average $10/barrel among all IOCs; hence, these companies are likely to collectively incur a production cost of $4.896 billion.

Capital expenditure, on the other hand, has undergone significant cuts. Globally, IOCs have reduced CAPEX by an average of 28% of the initial amount budgeted. Just how much of this scarce investment would make its way to Nigeria is uncertain as this is subject to management decision. However, our forecast for the capital expenditure for IOCs is capped at $5.15 billion in 2020.

Backed by the figures obtained from our analysis, we are of the opinion that the structural and operational plugs put in place by the IOCs will not necessarily save their upstream balance sheet from losses this year but would be just enough to mitigate a disaster. Estimated operating profit for these IOCs is negative $96 million, however, this is the worst-case scenario as the figures estimated does not include revenues from gas sales. Also, the capital expenditure forecast is an upper limit and actual value could be lower. They also possess the cash reserves to weather the storm should the events in the subsequent months, especially with respect to the spread of the virus, eventually turn out worse than envisaged.

Independents are smaller in size but would that make their slump less painful?

The independents may experience pain levels similar to that of the IOCs as average oil price and production level would be lower than the previous year. Lekoil reported in April that it expects to reduce general administration costs by as high as 40% or $8 million including staff layoffs in all its fields excluding OPL 310. We expect this to hold true for most of the independents and we estimate operating cost to be cut by an average of 35%. The GMD of NNPC, Mallam Mele Kyari stated that independents tend to inflate their production cost in order to reduce tax and he gave a target of $10/barrel production cost in the country by 2021. This makes forecasting actual production cost for the year very difficult, however, our projections show that $20/barrel is feasible as an average value for the independents. Production cost could, therefore, total $1.974 billion for the independents. CAPEX cuts would be a lot more pronounced with the independents as lack of access to

finance would cripple their ability to carry out major projects. It was reported in April that Eroton E&P suspended a 50-well drilling campaign worth $1.5 billion and Seplat plans to drill two gas wells, a huge reduction from the 15-20 wells planned across all their assets. We forecast the total capital expenditure for the independents to be $1.2 billion.

Estimates for the independents net share of the country's production is pegged at 9% and with the average oil price at $42/barrel, revenue is estimated to be $2.488 billion. This translates to a revenue drop of 42.84% YOY shrinking the operating profit of the independents down to negative $686 million. These estimates are non-inclusive of gas revenues but only Seplat currently has a huge footprint in this area. It is our considered opinion that gas revenues are unlikely to significantly improve these estimates.

Would proximity to the government make NPDC suffer any less?

We expect the state oil company to struggle in the market just like any other producer. Based on our estimates for the average oil price and oil production in the country, of which we expect NPDC's contribution to be around 8.21%, revenue from oil sales is estimated to sit at around $2.27 billion which is 35% less than 2019's estimates.

We forecast operating cost to be $12.6/barrel as we expect staff strength to remain the same; hence, total operating cost for the year would be $682.93 million. The most uncertainty hovers around capital expenditure as the company did not release details on planned cuts. Our worst-case projection for capital expenditure is around $1.5 billion which is only 15% less than the previous year, however, it is likely that actual CAPEX could be lower.

Despite the gloomy market, our estimates show a $90 million operating profit for NPDC, the only positive projection for this metric compared to IOCs and independents. Furthermore, actual figures could be slightly better as a result of our worst-case estimate for capital spending.

"Despite the gloomy market, our estimates show a $90 million operating profit for NPDC, the only positive projection for this metric compared to IOCs and independents."

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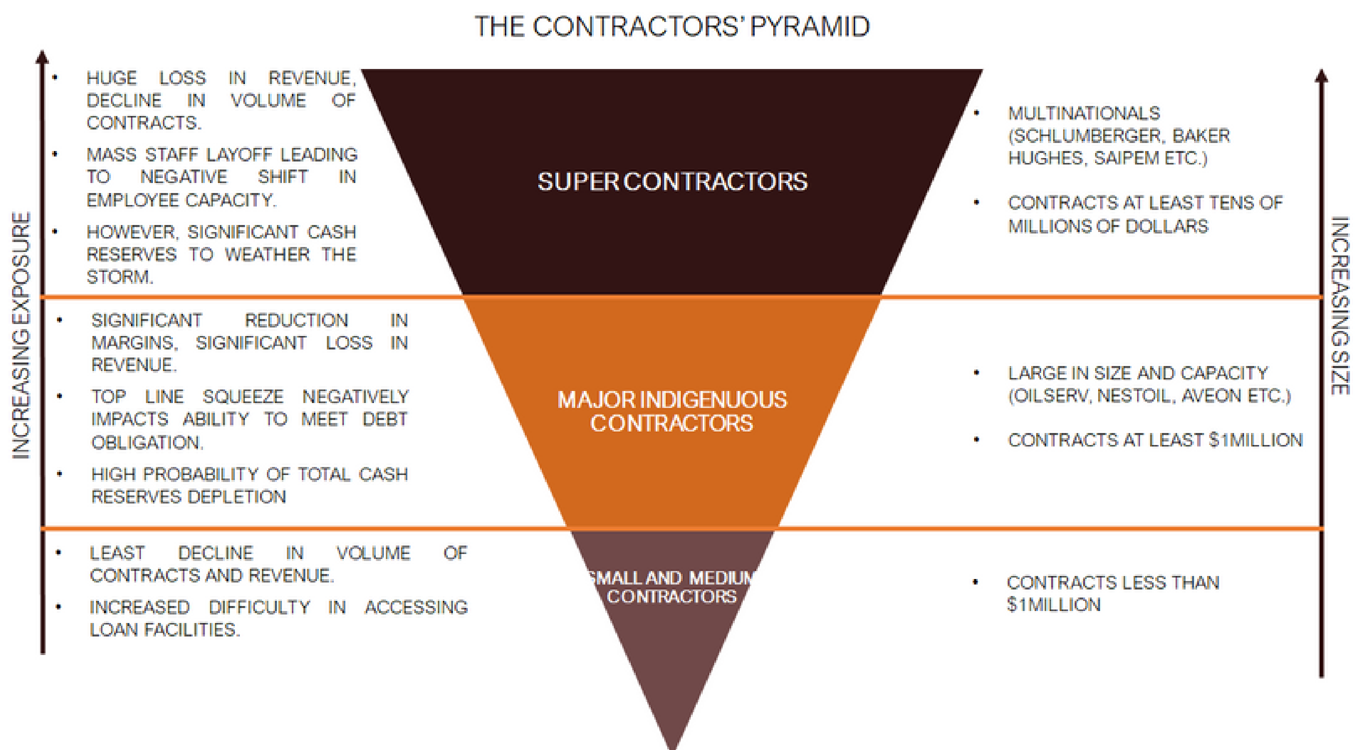
The Contractors' Conundrum

At the tipping point

The operators' scramble for safety would initiate a ripple effect that would be felt by all oilfield service providers. Contractors' position on the pyramid shows just how much this impact would be felt.

The Contractors' Pyramid highlights the impact of a downturn on oilfield service providers



Source: Moneda R&I

A significant part of the expenditure cut by producers was aimed at reducing the amount of exploration, drilling and completion activities on the fields. This aspect of field development over the years has accounted for more than 40% of the capital expenditure. The cuts would ultimately impact the oilfield service providers in the country; however, the quantitative extent of the damage remains uncertain. They represent the most under reported players in the industry leading to the unavailability of representative data. Hypotheses could, however, be made using trends and observations from historical occurrences. Although we foresee a decline in revenue, contractors are quite optimistic that the recent marginal field bid round would provide some kind of solace. Eventually, the success of this bid round will give room for more contracts and increase their revenues but the timeline for this is uncertain and very unlikely to materialize during the year.

Contracts executed by oilfield service providers can be broadly classified as any of these: Service contracts (Inspection, Repair, Maintenance), EPC contracts (Engineering, Procurement and

Construction), Drilling and well services and Logistics contracts.

A sinking ship: would drilling and well service contractors survive?

We expect the worst hit to be the drilling contractors. Oil rig activity in the country was on a steady decline from March up until July when it hit a three-year low. IOCs have terminated contracts with drilling companies in an effort to protect their own balance sheet, the most pronounced being ExxonMobil's termination of Borr Drilling's Gerd and Groa rigs and Shelf Drilling's Trident XIV rig. This low rig oil activity could continue up until the end of the year and we do not foresee a significant recovery as the independents have also cut capital expenditure. We forecast that the average rig count for the year would be lower than that of the previous year by 5 rigs which will mean a reduction of $82.125 million in revenue YOY for the rig supplying contractors.

A handful of contractors provide the personnel and equipment for drilling and well services. They would be largely impacted as a result of reduced rig activities. Multinationals (Schlumberger, Halliburton, Baker Hughes etc.), have a larger footprint in this space, and as a result would feel the impact more. Their deeper pockets would most likely ensure their survival. We expect staff strength to reduce significantly within these companies as staff layoffs is the most likely shield to be employed by the multinationals to mitigate the impact of this slump in revenue. A very high percentage of the indigenous companies that play in this space do not have as strong a financial backing as the multinationals and as such may reel in the effects of the pandemic throughout the year and probably beyond.

What lies ahead for EPC contractors?

EPC contracts would also take a significant hit. We expect the volume of contracts to reduce as well as margins on these contracts. At the heat of the pandemic, with lockdowns imposed on at least one-third of the world's population, procurement of goods became difficult and freight rates skyrocketed. Now lockdowns have been eased in most countries, margins are showing signs of recovery. We predict that it will not get to pre-pandemic levels this year but could go up slightly regardless. In terms of number of contracts, EPC contractors would most likely be hit as producers look to only sanction the most important projects so as to reduce expenditure.

The major indigenous contractors that play in this space would see a significant reduction in revenue as quite a number of potential contracts are candidates for operators' CAPEX cuts. Financing contracts would also pose a huge threat to their balance sheet as we expect already high debt levels to continue rising despite the slump in revenue.

The supercontractors (multinationals) that play in this space are poised to experience the highest drop in number of contracts, however, the average size of contracts may be enough for them to get by. A significant reduction in revenue is also expected. They would most likely find it the least difficult funding contracts, as their investment comes from outside the country; however, foreign investors' waning interest in the country and the oil industry is a cause of concern. The supercontractors' significant cash reserves would play a very important role in helping them weather the storm.

The size of an average small and medium contractor is very likely to limit its exposure to the heat caused by the pandemic. However, the large number of these contractors would probably be their only disadvantage because there are only a

hand full of contracts available compared to the number of contractors bidding. The contracts available to these contractors possess limited risk to banks and private equity firms, as a result they are likely to remain within the range of the risk appetite of these financial institutions.

The sky is not so gloomy for service and maintenance contractors.

A huge chunk of service contracts involve operations on existing facilities which have to be maintained. As a result of this, it is our considered opinion that service contractors would not be as impacted as EPC contractors. Contract margins are likely to be affected but we are optimistic they could recover late in the year. Number of available contracts would be affected slightly as additional service contracts that could have otherwise been accrued from new developments and EPC subcontracting would be scarce.

The worst may be over for logistics contractors.

Logistics contractors would also get hit but would be the least affected. Supply of vessels and crude offtake services would continue as long as production continues. Our forecast is only a slight reduction in margins which we expect could recover before the end of the year.

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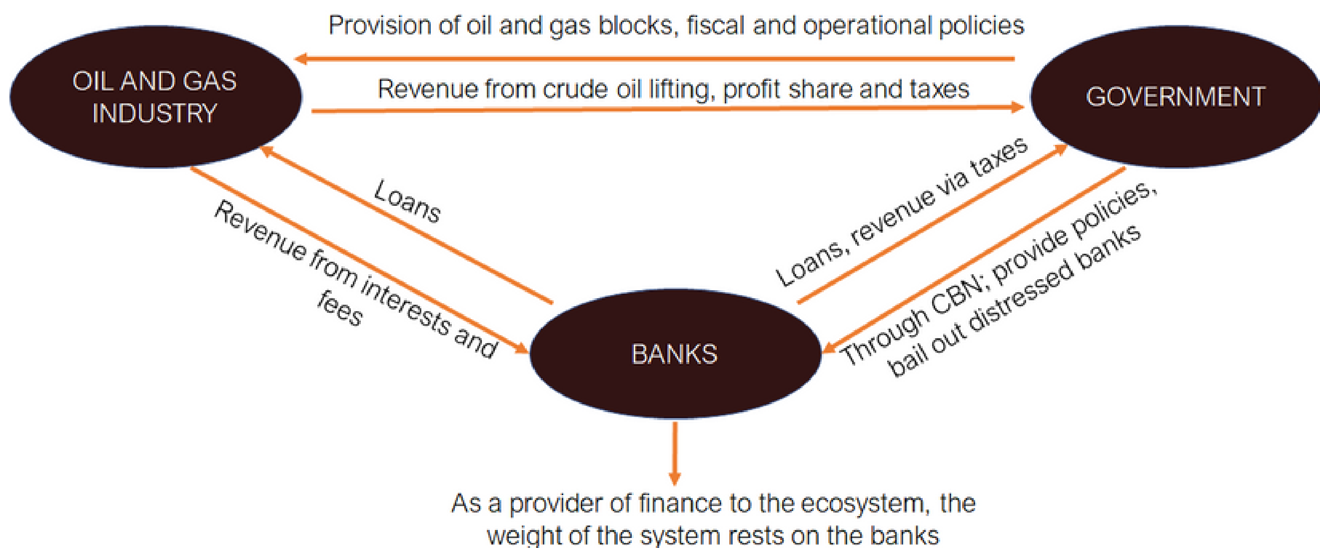
A Banking Bubble?

The heart of the system

The soundness of Nigerian banks and their credit profiles face severe risks from the plunge in oil prices and disruptions in the operating environment as a result of the pandemic. Will all banks survive?

The ecosystem of the industry shows the interaction of players and the weight on banks



Although the Nigerian economy has buckled under the pressure of the pandemic, the banking industry hasn't performed as badly as we all originally anticipated. It can be argued that lessons have been learned from both the financial crisis of 2008 (where the global banking system was at the epicentre of the economic downturn) and the oil price crash of 2015-2016 which left quite a few banks on the verge of insolvency. In an attempt to restart the economy
and restore consumer confidence, the Central Bank of Nigeria (CBN) injected $2.6billion into the banking industry and restructured the rules and regulations that governed the system.

The 2015-2016 oil price crisis saw banks place added attention on improving asset quality. This means most banks have stepped into this challenging scenario on a much sounder footing than they did in any of the previous economic recessions. Foreign currency deposits as a percentage of the foreign currency loans on bank's books are in excess of 80 percent. This essentially means banks are more financially flexible to endure the various policy changes the Central Bank of Nigeria (CBN) will likely introduce to manage access to the foreign exchange market.

Now more than ever, it is glaring that a collapse of the banking sector poses more danger to economic prosperity than rising inflation or exchange rate oscillations. With most of the country's income coming from oil exports, the nation anxiously waits for the 'COVID-19 storm' to settle to see the complete domino effect of an oil price crash on the different sectors of the economy and the varying industries within those sectors (especially the banking

industry). Fears exists as to if the COVID-19-induced economic crisis will have a snowball effect leading to a financial crisis.

Is the love story between banks and the oil industry about to turn sour?

The oil and gas industry is incredibly capital intensive typically requiring a copious amount of debt or equity to fund projects, which will naturally be left to the country's banking industry to handle. It should therefore not be alien in nature that loans to the oil and gas sector accounted for about 31% of the banking sectors total loan portfolio as at 3Q2019, and their borrowing took about 24% of all non-performing loans in Nigeria.

It is crystal clear that there has been too much lending to the oil and gas industry, especially to those that play in the downstream sector. The financial health of Nigerian based energy firms and their resolve to service their debts are now extremely vital to the survival of the Nigerian banking.

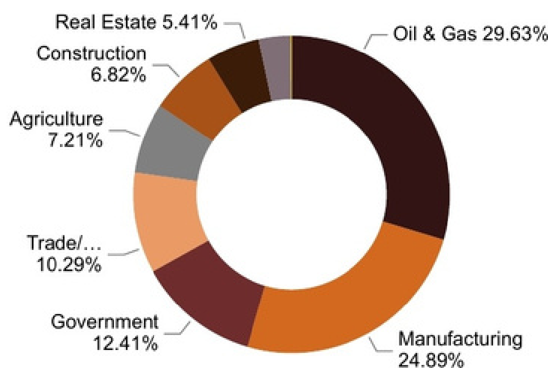
With total assets equaling N40 trillion as of September 2019, the Nigerian banking industry is the second largest in the sub-Sharan Africa region, trailing only behind South Africa. Depending on the severity and the duration of the oil price shock, the Nigerian banking industry could lose its number two position in the face of an increased risk of asset value erosion and a decimation.

In order to meet the Loan-To-Deposits Ratio (LDR) of 65% set by the Central Bank of Nigeria, Nigerian banks increased lending to riskier and more vulnerable sectors like oil and gas, retail, agriculture and SME's, therefore reducing the quality of their retail portfolio and exacerbating asset quality risk. The weighted average cost of risk for Nigerian banks rose by 200 basis points during the 2015-2016 oil price crisis and a similar scenario should also be the expectation for this year.

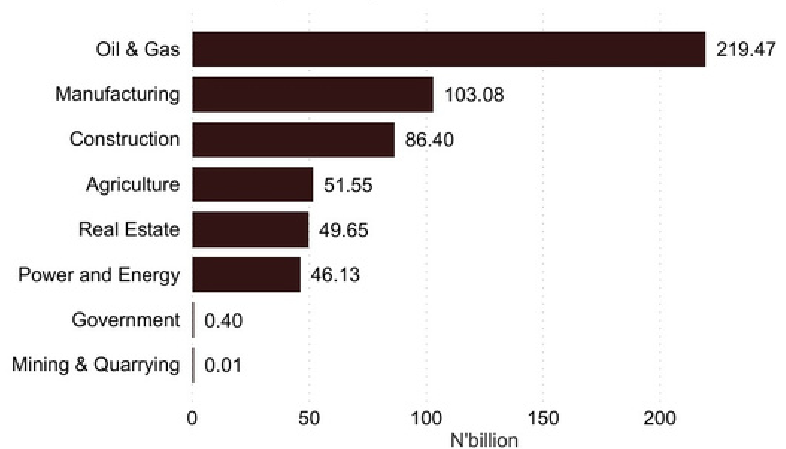
It's a little too premature to put a figure on what the impaired loan to non-performing loan (NPL) ratio for the year will look like, but if we use the 2015-2016 oil price crash as a model, we can expect a steep increase in the NPL ratio. This will in turn feed into the cost of risk and these loan impairment charges will in turn pile pressure on the profitability of banks. Banks will also notice a sharp drop in Interest and non-Interest Income as new debt to oil companies shrink. Combine all those with the pedestrian pace of loan growth rates and reduced client activity and you get a rather clear picture of what the impaired loan to NPL ratio should look like for the year.

The banking industry's exposure to the oil and gas industry is frightening.

Banking industry credit exposure by sector H1 2020

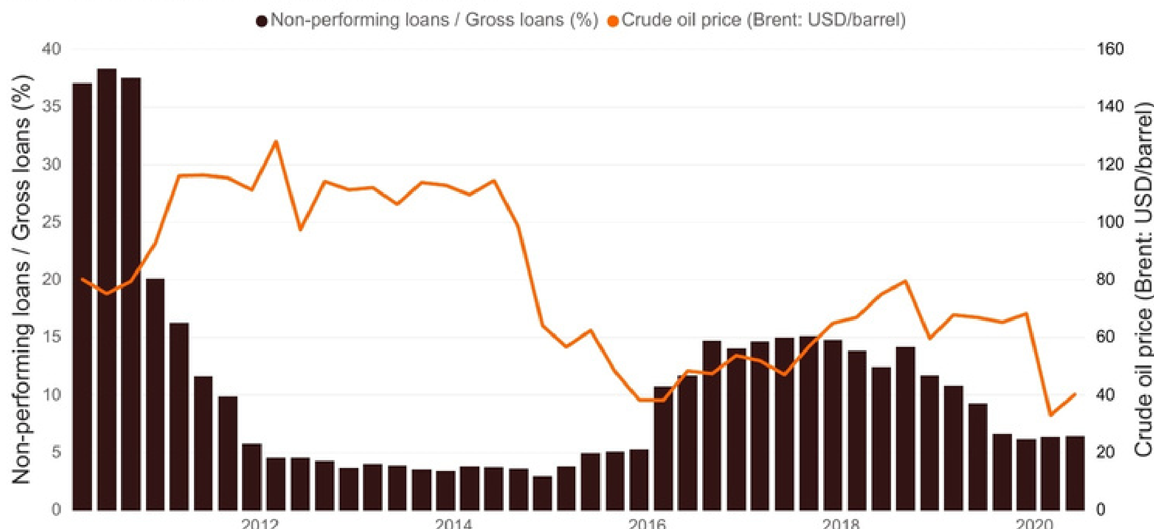


Non-Performing Loans by sector as at December 2019



Source: National Bureau of Statistics

Historical data vividly shows an inverse relationship between oil price and NPLs



Source: National Bureau of Statistics

Non-performing loans from the oil and gas sector declined from N878.41 billion in Q4 2018 to N219.47 billion in Q4 2019 (a decline of 75.02%).

What remains uncertain is if this decline was as a result of write-offs, repayments, or of these non-performing loans returning to performing status. Another question that comes to mind is the role securitization played in all of this. If handled efficiently, securitization can be an effective tool to reduce debt burden, improve liquidity and presents investors with additional means of portfolio diversification. This should present banks with the increased ability to extend more loans to the oil and gas sector.

Members of the elitist group of 'Tier 1 banks' popularly referred to as 'FUGAZ' (First Bank of Nigeria, United Bank for Africa, Guaranty Trust Bank, Access Bank and Zenith Bank) have the heaviest exposure to bad loans from oil producers, with Access Bank and First Bank of Nigeria leading the pack in terms of vulnerability to the oil and gas industry. With the crash in oil prices in the wake of COVID-19, these tier 1 banks will be able to weather the storm through even a long-term recession, the tier 2 banks can only pull through a medium-term recession and tier 3 banks can unfortunately only survive a relatively short-term recession. They may be constrained to rebuild capital levels going forward as their business will continually face difficulties trying to repay loans.

Long-Term Issuer Default Ratings (IDRs) and Viability Rating (VR) of the three highest rated Nigerian banks (Zenith Bank, Guaranty Trust Bank and United Bank of Africa) were downgraded form 'B+' to 'B' by Fitch Ratings. The quality of oil companies loan assets on banks books will continually deteriorate as the pandemic continues. Fitch also placed the Long-Term IDRs, VRs, and National Ratings of all 10 rated Nigerian banks (excluding Stanbic IBTC Holdings and Stanbic IBTC Bank which are not assigned VRs and IDRs) on Rating Watch Negative (RWN). The RWN is indicative of Fitch's beliefs that Nigerian banks will face a substantial amount of pressure over the coming months rising from a deteriorated operating environment as a result the oil price crash, potential further devaluation of the Naira and the impacts of the pandemic on individuals and businesses.

Avoiding the Crush

Data from the National Bureau of Statistics reveals that as of 4Q2019, loans to the oil and gas sector sat at a mindboggling N4.5 trillion down from its previous year's value of N4.6 trillion, with N3.4 trillion attributable to the upstream sector.

According to data from the Central Bank of Nigeria (CBN), about a third of loans by Nigerian banks were given to oil firms. In an attempt to mitigate the adverse effects of any future oil price crash, a large number of banks hedged oil production at the $45 per barrel range and integrated that structure into their loan terms. Less forward-thinking banks have slashed their CAPEX and the probability of reducing their dividend pay-out ratio in 2020 remains pretty high as they try to manage their costs of operation.

Banks are also relying on restructuring, collateral and the quality of debtors (avoiding exposure to indigenous oil companies and focusing on international oil companies instead) to shield themselves against an imminent crystallization of oil and gas loans. Some banks took on cash collaterals against their borrowers as added protection in the event of oil companies defaulting on their loan repayments.

One of the short-term goals for both commercial banks and indigenous oil and gas companies (as hinted at by the government) would be re-negotiating and restructuring their loans terms to match the current economic and financial realities they both find themselves in. The conundrum that banks are faced with is the short-term nature of most loan structures (typically one year in duration), with only about 3-5 percent of loans structures being long-term. This means most banks will also lack the flexibility to renegotiate loan terms to their favor.

Restructured loans are expected to soar to 25% to 30% of gross loans in 2020 to 2021. We can also expect that all banks will move a significant portion of oil companies' exposure due within the next year from stage 1 to stage 2 (based on the IFRS 9 requirement) as credit risk exposure increases, therefore also increasing the likelihood that small companies will default.

It is evident that both parties need each other. Banks need revenues generated from charges placed on loans to the oil and gas industry, and the oil and gas industry needs banks to fund their contracts. However, considering the level of exposure banks are open to, it should come as no surprise that they have grown increasingly reluctant at extending loans to the oil and gas sector during these unprecedented times. Their focus is now to diversify their loan portfolio.

This has left oil and gas companies twiddling their thumbs as to where to source finances, therefore creating an opportunity vacuum that can be filled by certain financial intermediaries (such as private equity firms and investment banks), also naturally tailored to take on such activities.

Taking a deeper look at the performance of the FUGAZ

First Bank Nigeria Holding (FBNH)

First Bank of Nigeria's exposure to the oil industry sits at N1.7 trillion of which 18% belongs to the upstream industry, 8 percent to the services sector and 9% to the downstream sector. It is however not clear if actions were taken to hedge any of its loans.

United Bank for Africa (UBA)

UBA's total loan portfolio as of 2020 is N2.1 trillion. N371 billion of the total loan amount

was to the oil and gas industry. The bank failed to separate its oil and gas exposures into the upstream, downstream or services sector.

Guaranty Trust Bank (GTB)

With a total exposure of N606 billion, 41% of its total loans (out of which exposure to the upstream sector is 28%), GT bank has the highest exposure to the oil and gas industry. However, it was one of the few banks that took out a hedge against a decline in oil prices, pegging its upstream loans at $50 per barrel until 2021.

Access Bank

Access Bank is easily Nigeria's' largest bank in terms of balance sheet size. It also carries one of the largest debt burdens to the oil and gas industry. Of its total debt portfolio of N3.1 trillion, about N240.9 billion or 7.7 percent are exposed to the upstream sector, N480 billion is exposed to the oil and gas services sector and N148.7 billion is exposed to the downstream sector. Although no mentions were made on any hedging instruments used by Access bank if any, the bank did mention that 1.1% of its non-performing loans were from the oil and gas upstream sector.

Zenith Bank

In order to insulate itself, Zenith bank restructured about N406.4 billion of its loans. Its total exposure to the oil and gas industry as of December 2019 was about N619 billon, representing just under a quarter (24%) of the bank's total credit of N2.46 trillion. 14.6 , and 10.6% of the bank's exposure belonged to the upstream and downstream sectors respectively. Roughly 30% of Zenith banks' 4.3% of non-performing loans are from the oil and gas industry.

Although the bank states it did put some hedges in place to protect itself from oil price crashes, it didn't reveal what specific hedges it did put in place.

Interesting Stats

Credit Exposure

- The Oil and gas industry accounted for 29.63% of the total banking credit exposure as at Q2 2020.
- Manufacturing came in at a close second with 24.89%.
- The government accounted for 12.41% of the banking industry's credit exposure

Non- Performing Loans

- Oil and Gas industry had the highest NPL on the banking industry's loan book at N219.47 billion
- The manufacturing industry holds 103.08 billion of the industry's total non-performing loans
- The government held 400 million of the banking industry's total non-performing loans

FUGAZ Exposure

- First Bank of Nigeria's total exposure to the oil and gas industry was roughly N1.7 trillion
- United Bank for Africa's total exposure to the oil and gas industry was about N371 billion
- Guaranty Trust Bank had a total exposure of approximately N606 billion to the oil and gas industry
- Access Bank also had one of the highest exposures to the oil and gas industry at about N869.6 billion
- Representing just under a quarter of its total credit, Zenith banks total exposure to the oil and gas industry was roughly N619 billion.

The Way Ahead...

Economic recessions can sometimes be predicted and therefore efforts can be made to insulate an economy from the shocks that come with it. Today, the world has been forced to find strength in its diversities as we stand together to fight against a common enemy. We are in the middle of a global recession, one that poses a different threat and one that no economy could prepare for. The economic effects brought on by the novel coronavirus has left its mark on every sector in the economy; from the oil sector to the banking industry.

Although major economic, financial and industrial sectors are making efforts to heal, the effect would still be felt for years to come. Nonetheless, oil & gas companies must take strategic measures to ensure survival as policies affecting its stakeholders are made. Prior to the pandemic, there were funding gaps in the oil and gas ecosystem and as this report has succinctly highlighted, we project that the pandemic would widen these gaps.

Moneda was born to fill such gaps – providing alternative credit and execution expertise to oil contractors abandoned by traditional credit. Since 2015, we have developed core expertise in restructuring and capitalizing oil and gas operators in the West African sub-region – executing over $200million in credit trades for our clients and partners in Nigeria. Even as loan facilities for oil and gas projects are becoming increasingly difficult to obtain, we are uniquely positioned, and well equipped with forward thinking strategies to finance projects during these uncertain times.

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