

COMPETITIVENESS, PROJECT PATHWAYS, ALIGNMENT & MIDSTREAM OPTIONS

Prepared for House Labor & Commerce Committee
Juneau, Alaska › February 26, 2014

Janak Mayer, Partner › janak.mayer@enalytica.info
Nikos Tsafos, Partner › nikos.tsafos@enalytica.info

<http://enalytica.info>



JANAK MAYER
PARTNER

enalytica

JANAK.MAYER@ENALYTICA.INFO

Before co-founding **en**alytica, Janak led the Upstream Analytics team at PFC Energy, focusing on fiscal terms analysis and project economic and financial evaluation, data management and data visualization.

Janak has modeled upstream fiscal terms in all of the world's major hydrocarbon regions, and has built economic and financial models to value prospective acquisition targets and develop strategic portfolio options for a wide range of international and national oil company clients. He has advised Alaska State Legislature for multiple years on reform of oil and gas taxation, providing many hours of expert testimony to Alaska's Senate and House Finance and Resources Committees.

Prior to his work as an energy consultant, Janak advised major minerals industry clients on a range of controversial environmental and social risk issues, from uranium mining through to human rights and climate change. He has advised bankers at Citigroup and policy-makers at the US Treasury Department on the management and mitigation of environmental and social impacts in major projects around the world, and has undertaken macroeconomic research with senior development economists at the World Bank and the Peterson Institute for International Economics.

Janak holds an MA with distinction in international relations and economics from the Johns Hopkins School of Advanced International Studies (SAIS), and a BA with first-class honors from the University of Adelaide, Australia.



NIKOS TSAFOS
PARTNER

enalytica

NIKOS.TSAFOS@ENALYTICA.INFO

Nikos Tsafos has a diverse background in the private, public and non-profit sectors. He is currently a founding partner at **en**alytica. In his 7 ½ years with PFC Energy, Nikos advised the world's largest oil and gas companies on some of their most complex and challenging projects; he also played a pivotal role in turning the firm into one of the top natural gas consultancies in the world, with responsibilities that included product design, business development, consulting oversight and research direction.

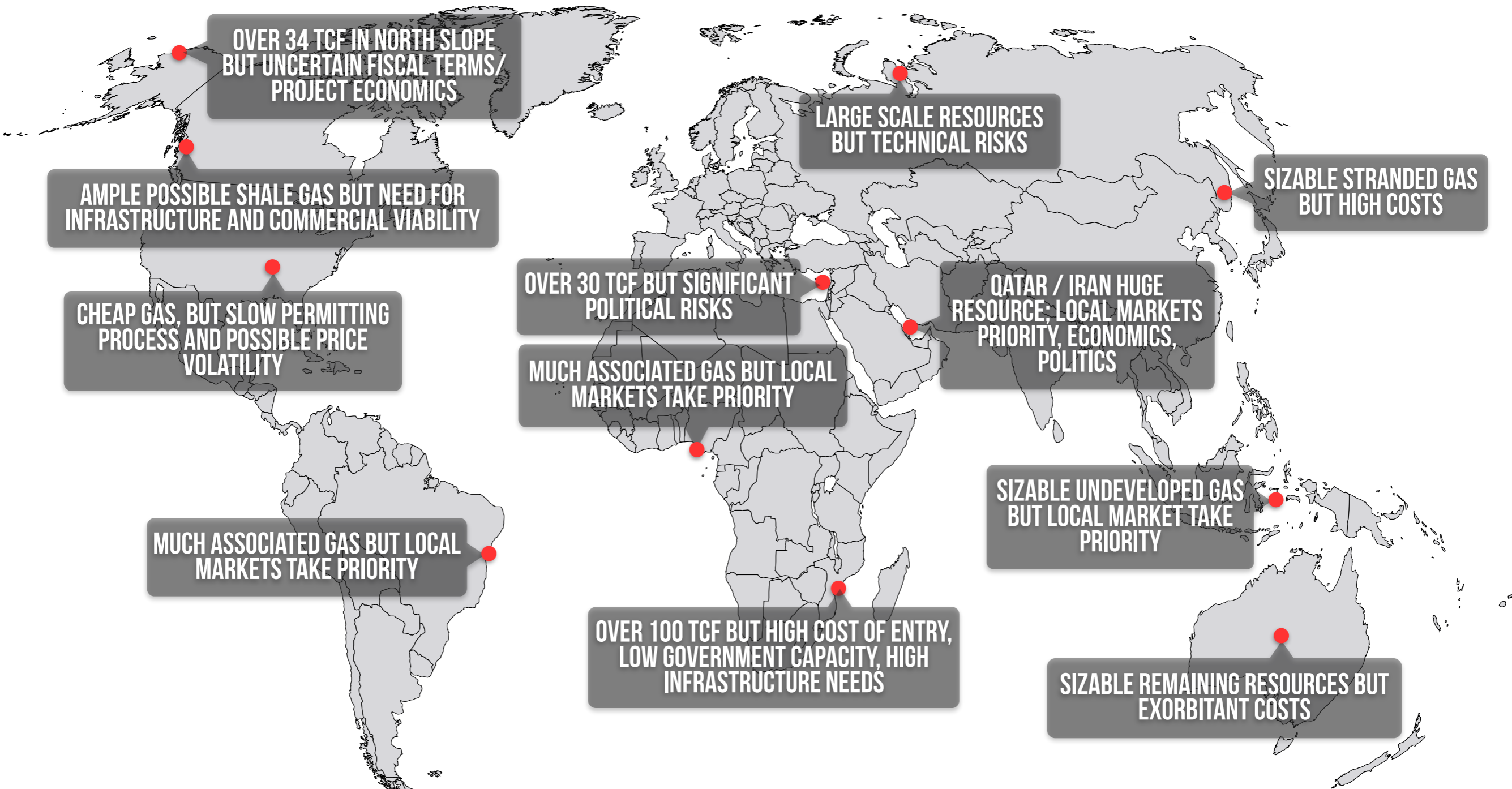
Prior to PFC Energy, Nikos was at the Center for Strategic and International Studies (CSIS) in Washington, DC where he covered political, economic, and military issues in the Gulf, focused on oil wealth, regime stability and foreign affairs. Before CSIS, he was in the Greek Air Force, and prior to his military service, Nikos worked on channeling investment from Greek ship-owners to Chinese shipyards.

Nikos has also written extensively on the domestic and international dimensions of the Greek debt crisis. His blog (Greek Default Watch) was listed as one of "Europe's Top Economic Blogs" by the Social Europe Journal, and his book "Beyond Debt: The Greek Crisis in Context" was published in March 2013.

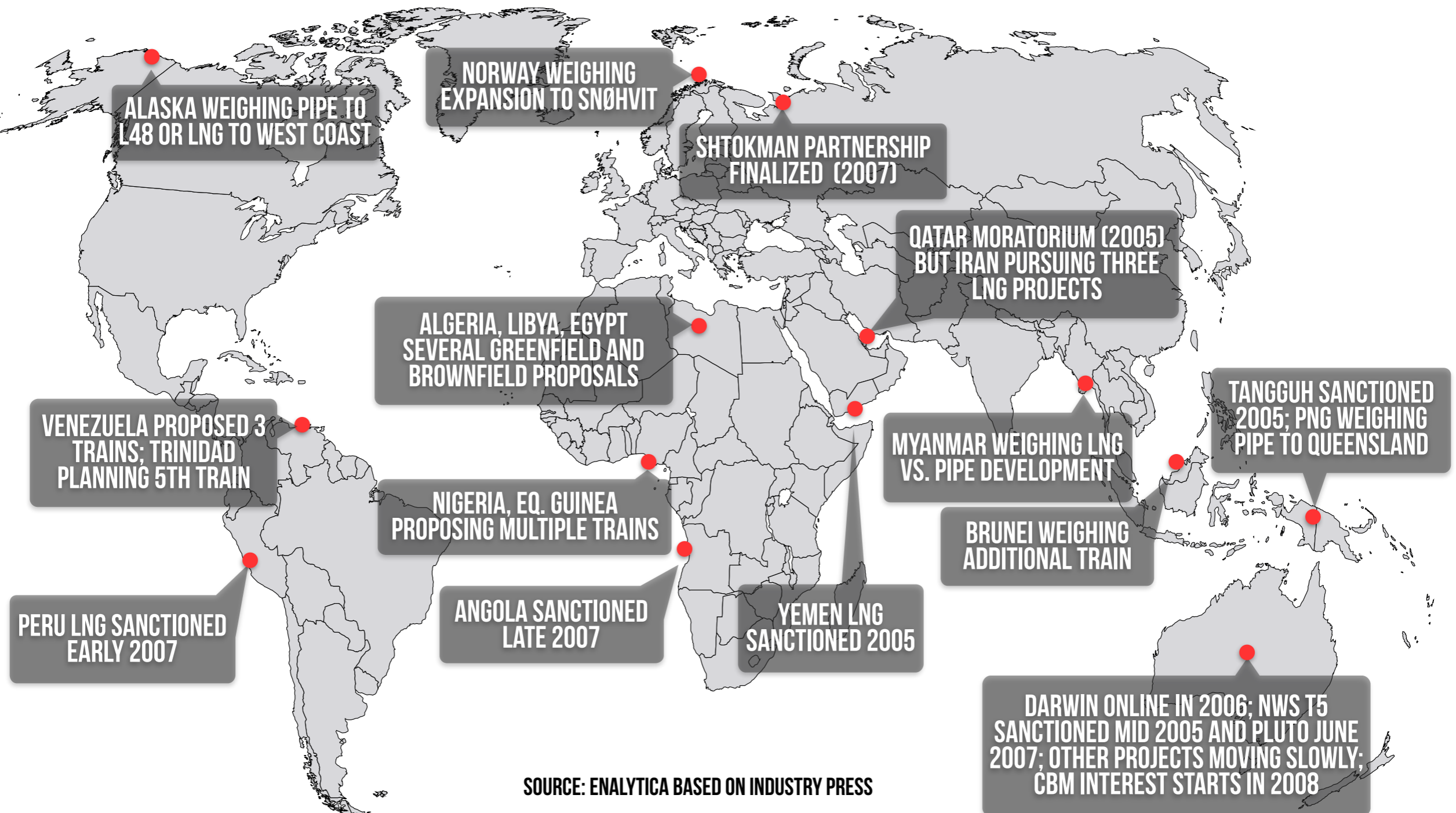
Nikos holds a BA with distinction in international relations and economics from Boston University and an MA with distinction in international relations from the Johns Hopkins School of Advanced International Studies (SAIS).

prospective suppliers › but not all prospective supply works out

AK LNG IS COMPETING IN A WORLD WITH MANY CHOICES



BUT WE'VE BEEN HERE BEFORE IN THE MID/LATE 2000S



LNG PROJECTS EVOLVE: QC LNG (AUSTRALIA) CASE STUDY

	FEED (JULY 2008)	FID (OCTOBER 2010)	JANUARY 2014
Size	One train: 3-4 mmtpa Expandable to 12 mmtpa	Two trains 8.5 mmtpa	Two trains 8.5 mmtpa
Upstream	BG owned 9.9% of QGC and 20% of QGC's coal-bed methane in Surat Basin	All BG except CN00C 5% and Tokyo Gas 1.25% in parts of Surat Basin	Gas from AP LNG; Same as FID plus CN00C 25% in Surat and Bowen Basin
Liquefaction	T1: BG 70%, QGC 30%	T1: BG 90%, CN00C 10% T2: BG 97.5%, Tokyo Gas 2.5%	T1: BG 50%, CN00C 50% T2: BG 97.5%, Tokyo Gas 2.5% T3: CN00C option for 25%
Off-take*	BG Group: 100%	CN00C: 3.6 mmtpa* Tokyo Gas: 1.2 mmtpa* BG Group: balance	CN00C: 8.6 mmtpa* Tokyo Gas: 1.2 mmtpa* Chubu Electric: ~0.6 mmtpa*
External Financing			JBIC: 175 mn to Tokyo Gas US EX-IM: \$1.8 billion

** Off-take is supplemented by BG's global portfolio—not all LNG will come from Australia*

SOURCE: BG GROUP DATABOOK 2008—2013 EDITIONS, INDUSTRY PRESS

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Project Stage	Pre-FEED		FEED		Construction						Online		
Project Milestones	Move to FEED		FID								Debottleneck / expansion		
Marketing	MOU/HOA SOA Plan		HOA/SPAs SOA Plan		SPAs for any unsold LNG								
Financing	Initial talks		Defining terms / signing loans		Possible additional financing						Refinance		
Project Structure & Ownership	Define initial structure		New partners / redefine ownership		New partners / redefine ownership						New partners possible		
Investment (Project)	\$400–\$500 mm		\$1,500–\$2,000 mm (Equity)		\$45–65 billion (Debt and equity)						O&M Met from cash flow		
Investment (SOA)	\$50–\$125 mm		\$200–\$500 mm (Equity)		\$6–\$15 billion (Debt and equity)						O&M Met from cash flow		

	<u>System</u>	<u>SOA ownership percent</u>			<u>SOA share of CAPEX & OPEX</u>			<u>SOA cash commitments</u>	
	Value / Kind	Upstream	GTP & Pipe	LNG	Upstream	GTP & Pipe	LNG	Debt	Tariffs
Status Quo	in value	0%	0%	0%	Indirect (taxes)	0%	0%	No debt	Tariff matters for valuation
HOA	in kind	0%	25%	25%	Indirect (taxes)	25%	25%	Principal and interest	Tariff only notional
MOU Option 1	in kind	0%	10% (40% x 25%)	25%	Indirect (taxes)	10% (40% x 25%)	25%	Principal and interest	Tariff payable to T/C
MOU Option 2	in kind	0%	0%	25%	Indirect (taxes)	0%	25%	Principal and interest	Tariff payable to T/C



FY 2015 PRODUCTION TAX ESTIMATE USING INCOME STATEMENT FORMAT

	Price	Barrels (Thousands)	Value (\$ million)
Avg ANS Oil Price (\$/bbl) & Daily Production	\$105.06	498	\$52.4
Annual Production			
Total		181,912	\$19,111.7
Royalty, Federal & other barrels		(23,301)	(\$2,448.0)
Taxable bbls from companies w/ tax liability		158,611	\$16,663.7
Downstream (Transportation) Costs (\$/bbl)			
ANS Marine Transporation	(\$3.46)		
TAPS Tariff	(\$6.18)		
Other	(\$0.40)		
Total Transportation Costs	(\$10.03)	158,611	(\$1,591.0)
Deductable Lease Expenditures			
Deductible Operating Expenditures	(\$17.91)		(\$2,840.3)
Deductible Capital Expenditures	(\$28.08)		(\$4,453.4)
Total Lease Expenditures	(\$45.99)	158,611	(\$7,293.7)
Production Tax			
Gross Value Reduction			(\$63.8)
Production Tax Value (PTV)	\$48.64		\$7,715.2
Base Tax (35%*PTV)			\$2,700.3
Total Tax before credits			\$2,700.3

OIL VALUE CHAIN



Oil ~\$105/bbl

Midstream costs ~\$10/bbl



Lease expenditures \$46/bbl



Production tax on ~\$49/bbl netback



SOURCE: DEPARTMENT OF REVENUE, REVENUE SOURCES BOOK, FALL 2013, P. 106

FY 2015 PRODUCTION TAX ESTIMATE USING INCOME STATEMENT FORMAT

	Price	Barrels (Thousands)	Value (\$ million)
Avg ANS Oil Price (\$/bbl) & Daily Production	\$105.06	498	\$52.4
Annual Production			
Total		181,912	\$19,111.7
Royalty, Federal & other barrels		(23,301)	(\$2,448.0)
Taxable bbls from companies w/ tax liability		158,611	\$16,663.7
Downstream (Transportation) Costs (\$/bbl)			
ANS Marine Transporation	(\$3.46)		
TAPS Tariff	(\$6.18)		
Other	(\$0.40)		
Total Transportation Costs	(\$10.03)	158,611	(\$1,591.0)
Deductable Lease Expenditures			
Deductible Operating Expenditures	(\$17.91)		(\$2,840.3)
Deductible Capital Expenditures	(\$28.08)		(\$4,453.4)
Total Lease Expenditures	(\$45.99)	158,611	(\$7,293.7)
Production Tax			
Gross Value Reduction			(\$63.8)
Production Tax Value (PTV)	\$48.64		\$7,715.2
Base Tax (35%*PTV)			\$2,700.3
Total Tax before credits			\$2,700.3

PRICE FOR ALASKAN GAS WILL BE:

**Less transparent***no readily available published price like ANS WC***Less consistent by destination***contract-by-contract differences can be large***Likely link to Japan Crude Oil Cocktail, JCC***in 2004-2013, JCC traded at \$0.22/bbl discount to ANS***Lower value vs. oil (thermal equivalency)***e.g. \$100/bbl ≠ \$100/boe of LNG**\$100/bbl = \$78–\$90/boe (13%–15% “slope”)*

SOURCE: DEPARTMENT OF REVENUE, REVENUE SOURCES BOOK, FALL 2013, P. 106

FY 2015 PRODUCTION TAX ESTIMATE USING INCOME STATEMENT FORMAT

MIDSTREAM COSTS WILL BE:

	Price	Barrels (Thousands)	Value (\$ million)
Avg ANS Oil Price (\$/bbl) & Daily Production	\$105.06	498	\$52.4
Annual Production			
Total		181,912	\$19,111.7
Royalty, Federal & other barrels		(23,301)	(\$2,448.0)
Taxable bbls from companies w/ tax liability		158,611	\$16,663.7
Downstream (Transportation) Costs (\$/bbl)			
ANS Marine Transporation	(\$3.46)		
TAPS Tariff	(\$6.18)		
Other	(\$0.40)		
Total Transportation Costs	(\$10.03)	158,611	(\$1,591.0)
Deductable Lease Expenditures			
Deductible Operating Expenditures	(\$17.91)		(\$2,840.3)
Deductible Capital Expenditures	(\$28.08)		(\$4,453.4)
Total Lease Expenditures	(\$45.99)	158,611	(\$7,293.7)
Production Tax			
Gross Value Reduction			(\$63.8)
Production Tax Value (PTV)	\$48.64		\$7,715.2
Base Tax (35%*PTV)			\$2,700.3
Total Tax before credits			\$2,700.3



Order of magnitude higher

Gas is significantly more expensive to transport

Tariff not regulated by FERC

FERC will regulate permitting, not rate-setting

Tariff highly sensitive to capital structure

return on equity and /or assumed debt/equity ratio

SOURCE: DEPARTMENT OF REVENUE, REVENUE SOURCES BOOK, FALL 2013, P. 106

INDICATIVE TAX BEFORE CREDITS FOR ALASKA LNG PROJECT @ ANS

	Price	Barrels (Thousands)	Value (\$ million)
Avg LNG Price (\$/boe) & Daily Production	\$81.00	384	\$31.1
Annual Production			
Total		140,306	\$11,364.8
Royalty, Federal & other barrels		(19,643)	(\$1,591.1)
Taxable bbls from companies w/ tax liability		120,664	\$9,773.8
Downstream (Transportation) Costs (\$/boe)			
Marine Transporation	(\$6.00)		(\$724.0)
Pipeline & GTP Tariff	(\$24.18)		(\$2,917.6)
Liquefaction Tariff	(\$36.00)		(\$4,343.9)
Total Transportation Costs	(\$66.18)	120,664	(\$7,985.5)
Deductable Lease Expenditures			
Deductible Operating Expenditures	(\$3.00)		(\$362.0)
Deductible Capital Expenditures	(\$3.00)		(\$362.0)
Total Lease Expenditures	(\$6.00)	120,664	(\$724.0)
Production Tax			
Gross Value Reduction			\$0.0
Production Tax Value (PTV)	\$8.82		\$1,064.3
Base Tax (35%*PTV)			\$372.5
Total Tax before credits			\$372.5

INDICATIVE LNG CHAIN: \$100/BBL

At \$100/bbl, LNG price ~\$81/boe (13.5%)

Midstream ~\$66/boe

Upstream ~\$6/boe

Limited netback to tax (less than \$9/boe)

SOURCE: ENALYTICA ANAL OF REVENUE, REVENUE SOURCES BOOK, FALL 2013, P. 106

INDICATIVE TAX BEFORE CREDITS FOR ALASKA LNG PROJECT @ ANS

INDICATIVE LNG CHAIN: \$89/BBL ANS

	Price	Barrels (Thousands)	Value (\$ million)
Avg LNG Price (\$/boe) & Daily Production	\$72.18	384	\$27.7
Annual Production			
Total		140,306	\$10,127.3
Royalty, Federal & other barrels		(19,643)	(\$1,417.8)
Taxable bbls from companies w/ tax liability		120,664	\$8,709.5
Downstream (Transportation) Costs (\$/boe)			
Marine Transporation	(\$6.00)		(\$724.0)
Pipeline & GTP Tariff	(\$24.18)		(\$2,917.6)
Liquefaction Tariff	(\$36.00)		(\$4,343.9)
Total Transportation Costs	(\$66.18)	120,664	(\$7,985.5)
Deductable Lease Expenditures			
Deductible Operating Expenditures	(\$3.00)		(\$362.0)
Deductible Capital Expenditures	(\$3.00)		(\$362.0)
Total Lease Expenditures	(\$6.00)	120,664	(\$724.0)
Production Tax			
Gross Value Reduction			\$0.0
Production Tax Value (PTV)	\$0.00		\$0.0
Base Tax (35%*PTV)			\$0.0
Total Tax before credits			\$0.0



A drop to \$89/bbl ANS ...

... wipes out any production tax value



INDICATIVE TAX BEFORE CREDITS FOR ALASKA LNG PROJECT @ ANS

	Price	Barrels (Thousands)	Value (\$ million)
Avg LNG Price (\$/boe) & Daily Production	\$81.00	384	\$31.1
Annual Production			
Total		140,306	\$11,364.8
Royalty, Federal & other barrels		(19,643)	(\$1,591.1)
Taxable bbls from companies w/ tax liability		120,664	\$9,773.8
Downstream (Transportation) Costs (\$/boe)			
Marine Transporation	(\$6.73)		(\$812.4)
Pipeline & GTP Tariff	(\$27.13)		(\$3,274.2)
Liquefaction Tariff	(\$40.40)		(\$4,874.7)
Total Transportation Costs	(\$74.27)	120,664	(\$8,961.3)
Deductable Lease Expenditures			
Deductible Operating Expenditures	(\$3.37)		(\$406.2)
Deductible Capital Expenditures	(\$3.37)		(\$406.2)
Total Lease Expenditures	(\$6.73)	120,664	(\$812.4)
Production Tax			
Gross Value Reduction			\$0.0
Production Tax Value (PTV)	\$0.00		\$0.0
Base Tax (35%*PTV)			\$0.0
Total Tax before credits			\$0.0

INDICATIVE LNG CHAIN: HIGHER COSTS



A 12.2% hike in costs / tariffs



... wipes out any production tax value

INDICATIVE TAX BEFORE CREDITS FOR ALASKA LNG PROJECT @ ANS

	Price	Barrels (Thousands)	Value (\$ million)
Avg LNG Price (\$/boe) & Daily Production	\$81.00	384	\$31.1
Annual Production			
Total		140,306	\$11,364.8
Royalty, Federal & other barrels		(19,643)	(\$1,591.1)
Taxable bbls from companies w/ tax liability		120,664	\$9,773.8
Downstream (Transportation) Costs (\$/boe)			
Marine Transporation	(\$6.00)		(\$724.0)
Pipeline & GTP Tariff	(\$24.18)		(\$2,917.6)
Liquefaction Tariff	(\$36.00)		(\$4,343.9)
Total Transportation Costs	(\$66.18)	120,664	(\$7,985.5)
Deductable Lease Expenditures			
Deductible Operating Expenditures	(\$3.00)		(\$362.0)
Deductible Capital Expenditures	(\$3.00)		(\$362.0)
Total Lease Expenditures	(\$6.00)	120,664	(\$724.0)
Production Tax			
Gross Value Reduction			\$0.0
Production Tax Value (PTV)	\$8.82		\$1,064.3
Base Tax (35%*PTV)			\$372.5
Total Tax before credits			\$372.5

IMPLICATIONS FOR STATE OF ALASKA



Fair market price critical for top line

Midstream, midstream, midstream



Upstream secondary to midstream



Wellhead insufficient to drive state take



	<u>System</u>	<u>SOA ownership percent</u>			<u>SOA share of CAPEX & OPEX</u>			<u>SOA cash commitments</u>	
	Value / Kind	Upstream	GTP & Pipe	LNG	Upstream	GTP & Pipe	LNG	Debt	Tariffs
Status Quo	in value	0%	0%	0%	Indirect (taxes)	0%	0%	No debt	Tariff matters for valuation
HOA	in kind	0%	25%	25%	Indirect (taxes)	25%	25%	Principal and interest	Tariff only notional
MOU Option 1	in kind	0%	10% (40% x 25%)	25%	Indirect (taxes)	10% (40% x 25%)	25%	Principal and interest	Tariff payable to T/C
MOU Option 2	in kind	0%	0%	25%	Indirect (taxes)	0%	25%	Principal and interest	Tariff payable to T/C



HOW COULD ALASKA STRUCTURE THE MIDSTREAM?



PATH OF THE MEMORANDUM OF UNDERSTANDING (MOU)



**PRODUCER-SOA
ALIGNMENT**

Minimize disputes over where value is allocated
Tariffs reflect value maximization across the entire chain

**THIRD-PARTY
EXPANSION**

Midstream becomes an enabler for further exploration and development
Expansion principles favor development of additional transportation capacity

**IN-STATE
DELIVERIES**

Alaskan consumers receive cost at the lowest cost possible (given adequate returns on investment)

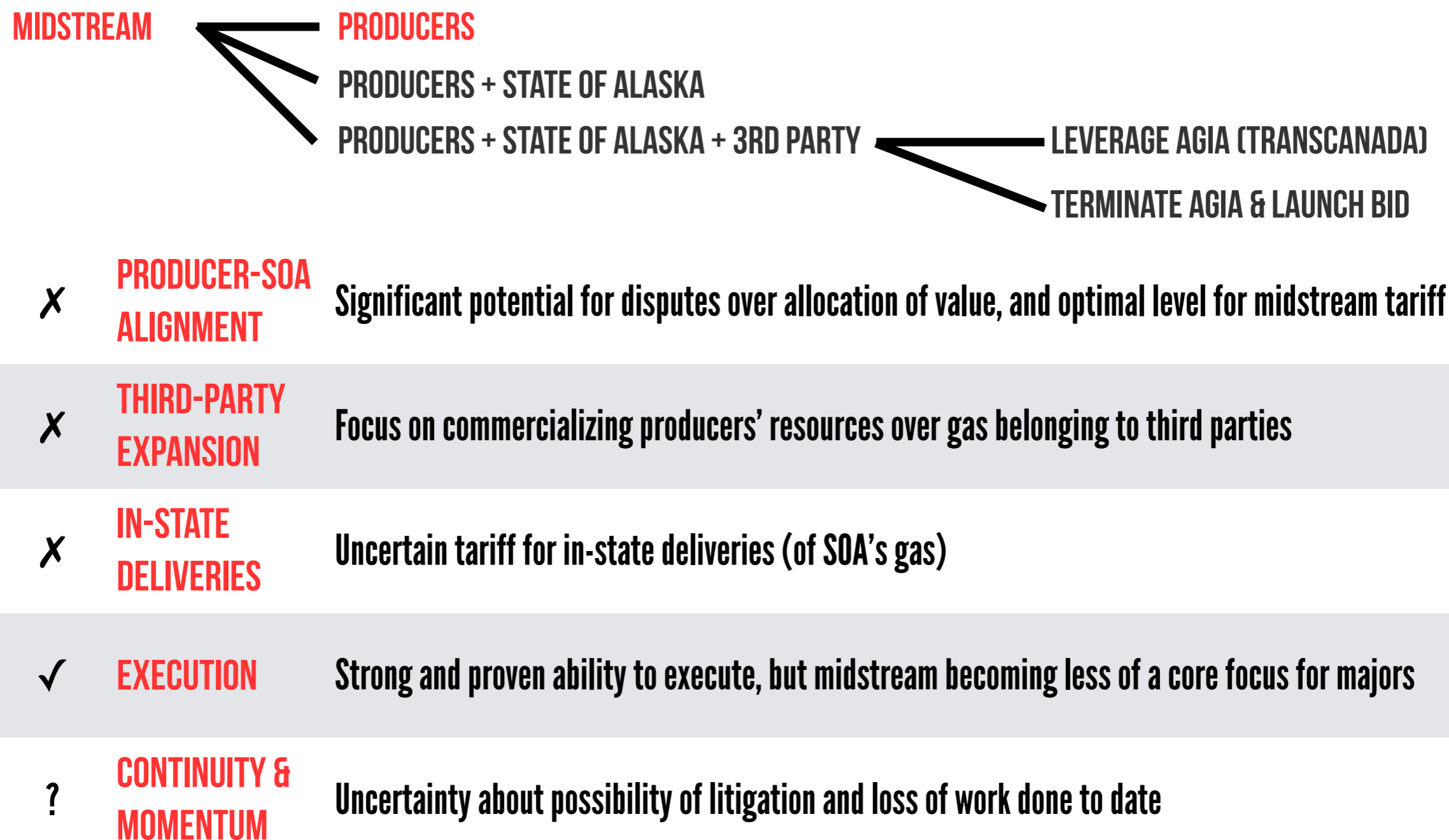
EXECUTION

Pipeline is delivered on time and at the lowest possible cost

**CONTINUITY &
MOMENTUM**

Project maintains and accelerates current investment interest
Project leverages work to date and is not delayed by possible litigation

PRODUCER ONLY: ALIGNMENT / EXPANSION WEAK POINTS



SOA EQUITY: MORE EXPANSION BIAS BUT BURDEN ON SOA



✓ **PRODUCER-SOA ALIGNMENT** Strong alignment between producers and SOA

? **THIRD-PARTY EXPANSION** Relies on SOA to drive expansions, seeking new entrants and / or new partners; SOA may not be best placed to fill this role

✓ **IN-STATE DELIVERIES** SOA can use its equity-entitled capacity to carry gas to local markets at lower cost

✓/? **EXECUTION** Strong and proven ability to execute for initial investment; expansion will depend on securing capabilities and/or another party

? **CONTINUITY & MOMENTUM** Uncertainty about possibility of litigation and loss of work done to date

MOU: EXPANSION BIAS & MOMENTUM; BUT BEST DEAL?



✓ **PRODUCER-SOA ALIGNMENT** Strong alignment between producers and SOA; capital structure for rate-setting purposes appears within norm, but unclear if new bidding could have produced lower tariff

✓✓ **THIRD-PARTY EXPANSION** TransCanada will be advocate for a project structure that encourages expansion and will have incentive to drive expansion of the infrastructure based on market interest

✓✓ **IN-STATE DELIVERIES** SOA can use its equity-entitled capacity to carry gas to local markets at lower cost; pro-expansion bias further incentivizes possible in-state deliveries

✓ **EXECUTION** TransCanada brings execution knowhow and expertise, while producers reinforce cost discipline (to ensure lowest possible tariff)

✓ **CONTINUITY & MOMENTUM** Project maintains and accelerates investment interest and leverages work done to date

BID: WILL REWARD COMPENSATE FOR COST IN TIME AND \$?



✓/? **PRODUCER-SOA ALIGNMENT** Strong alignment between producers and SOA; new bid could lead to a lower tariff, but it could also lead to a higher one; low investor interest could also slow down entire process

✓ **THIRD-PARTY EXPANSION** Third party will have incentive to drive expansion of the infrastructure based on market interest, but would likely have less influence over current negotiations

✓✓ **IN-STATE DELIVERIES** SOA can use its equity-entitled capacity to carry gas to local markets at lower cost; pro-expansion bias further incentivizes possible in-state deliveries

✓ **EXECUTION** Third party would presumably bring execution knowhow and expertise, while producers would reinforce cost discipline (to ensure lowest possible tariff)

✗ **CONTINUITY & MOMENTUM** Uncertainty about possibility of litigation and loss of work done to date; HOA negotiations could slow down in anticipation of new bidding process and license award

SOA NEEDS TO CAREFULLY WEIGH KEY QUESTIONS

What **compensation** might the SOA have to pay and what **intellectual property** will Alaska LNG retain?

Will the **HOA process slow down** if the midstream is tied in litigation?

What are the odds that a new selection process will deliver **better terms** than those available today?

To what extent was the AGIA process **representative** of the industry's interest in an Alaskan pipeline?

*Would a new tariff **offset** absence from negotiating table; reduced momentum; cost to dissolve AGIA?*

	PRODUCERS	PRODUCERS + STATE OF ALASKA	PRODUCERS + STATE OF ALASKA + TRANSCANADA	PRODUCERS + STATE OF ALASKA + 3RD PARTY
PRODUCER-SOA ALIGNMENT	X	✓	✓	✓ / ?
THIRD-PARTY EXPANSION	X	?	✓ ✓	✓
IN-STATE DELIVERIES	X	✓	✓ ✓	✓ ✓
EXECUTION	✓	✓ / ?	✓	✓
CONTINUITY & MOMENTUM	?	?	✓	X

<http://enalytica.info>