CS HB 247:
IMPACT OF PROPOSALS

House Resources Committee
Saturday, March 19, 2016

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CS HB247 SUMMARY

North Slope Provisions

- Remove impact of GVR in calculating NOL to ensure 35% support for North Slope spending
- $200mm per-company cap on credits to protect against potential liability of major new developments

Cook Inlet Provisions

- Maintain 20% Qualified Capital Expenditure (QCE) Credit, sunset in 2022
- Reduce 40% Well Lease Expenditure (WLE) to 30% in 2017, effectively phased out after 2018
- Reduce 25% NOL Credit to 10%

General Provisions

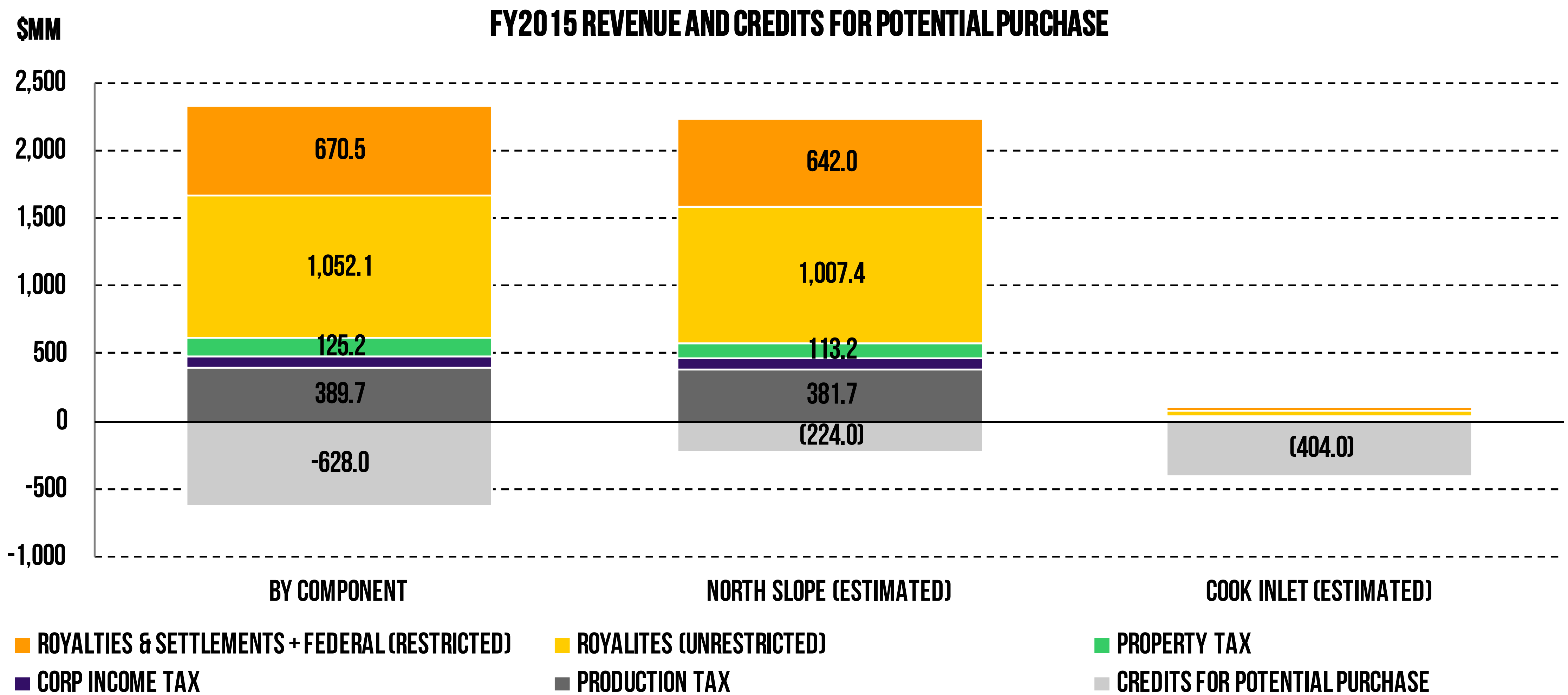
- Compound Interest on delinquent taxes
- Existing liabilities to state from oil & gas production withheld from refundable tax credits
- Working group to develop new Cook Inlet tax regime and present to 2017 regular session

BIG DIFFERENCE BETWEEN NORTH SLOPE AND COOK INLET

The majority of refundable credits go to Cook Inlet producers

Cook Inlet production, however, generates limited direct revenue for the state

Credits on the North Slope are more limited but also a far smaller fraction of total value generated



SOURCE: ALASKA DEPARTMENT OF REVENUE, REVENUE SOURCES BOOK; TAX DIVISION; ENALYTICA ESTIMATES

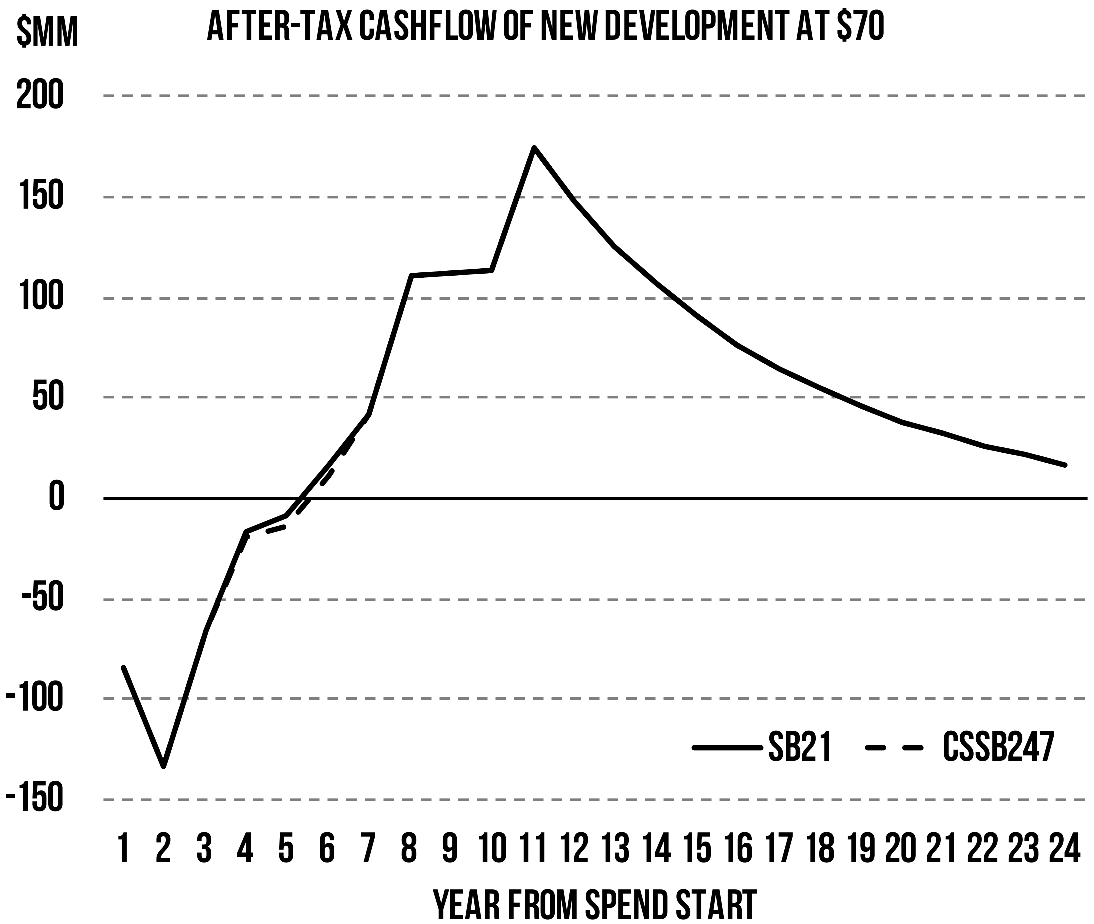
GVR RAISES NOL CREDIT ABOVE 35% OF ACTUAL LOSS

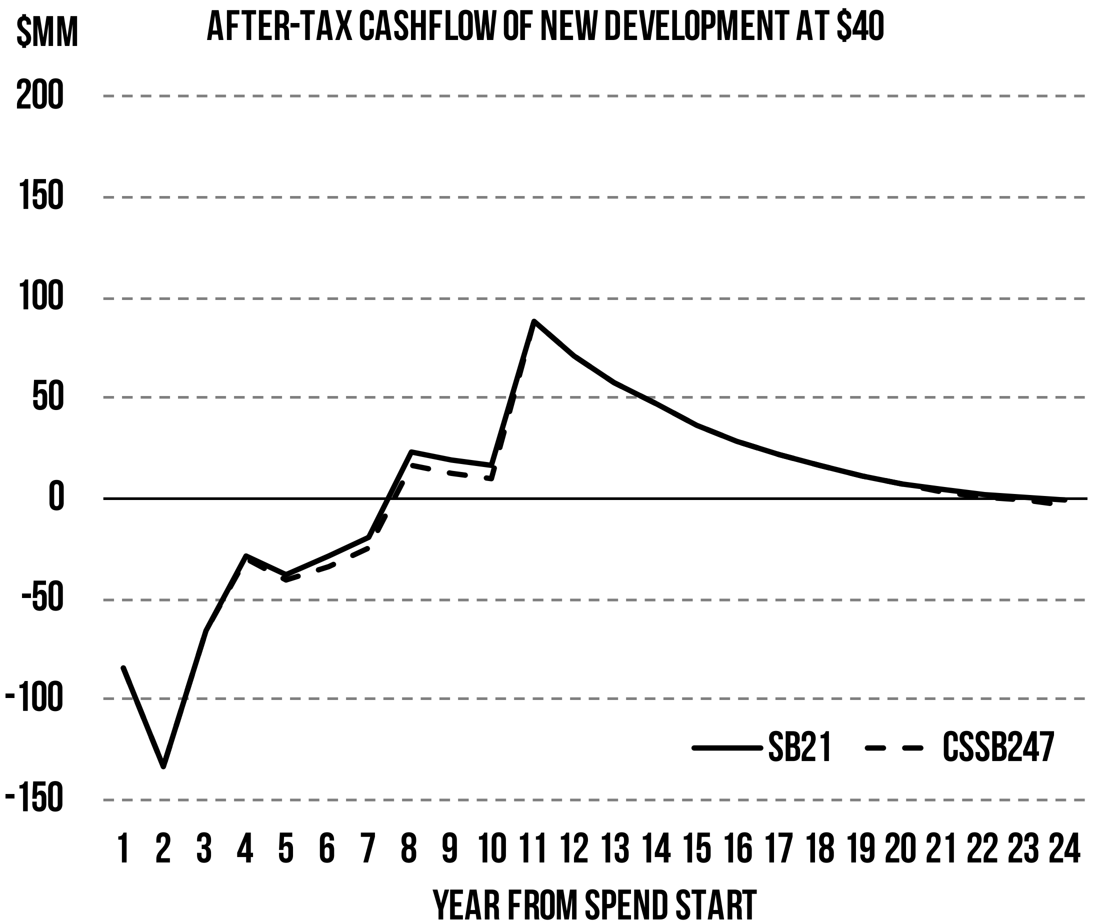
The purpose of the Gross Value Reduction (GVR) is to lower the effective tax rate on new production

One surprising and counter-intuitive effect is to raise the effective rate of the NOL credit

Issue after production from new development starts, but ongoing drilling costs mean NOL eligible

Exacerbated at low prices, but impact <$10mm yr for 20mb/d new development





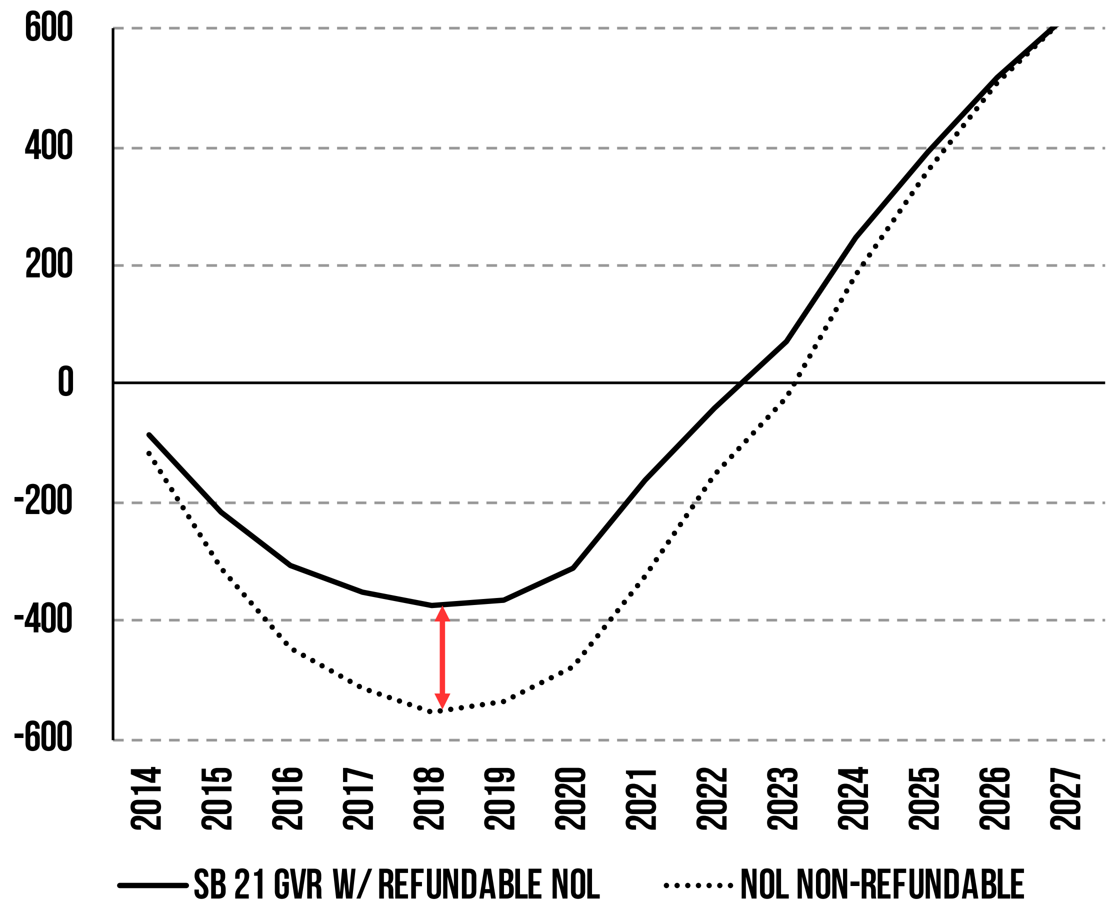
REFUNDABILITY LIMIT FOCUSED ON FUTURE LIABILITIES

Impact of low ($25mm) refundable credit limit is to lower IRR / raise target price to meet hurdle IRR

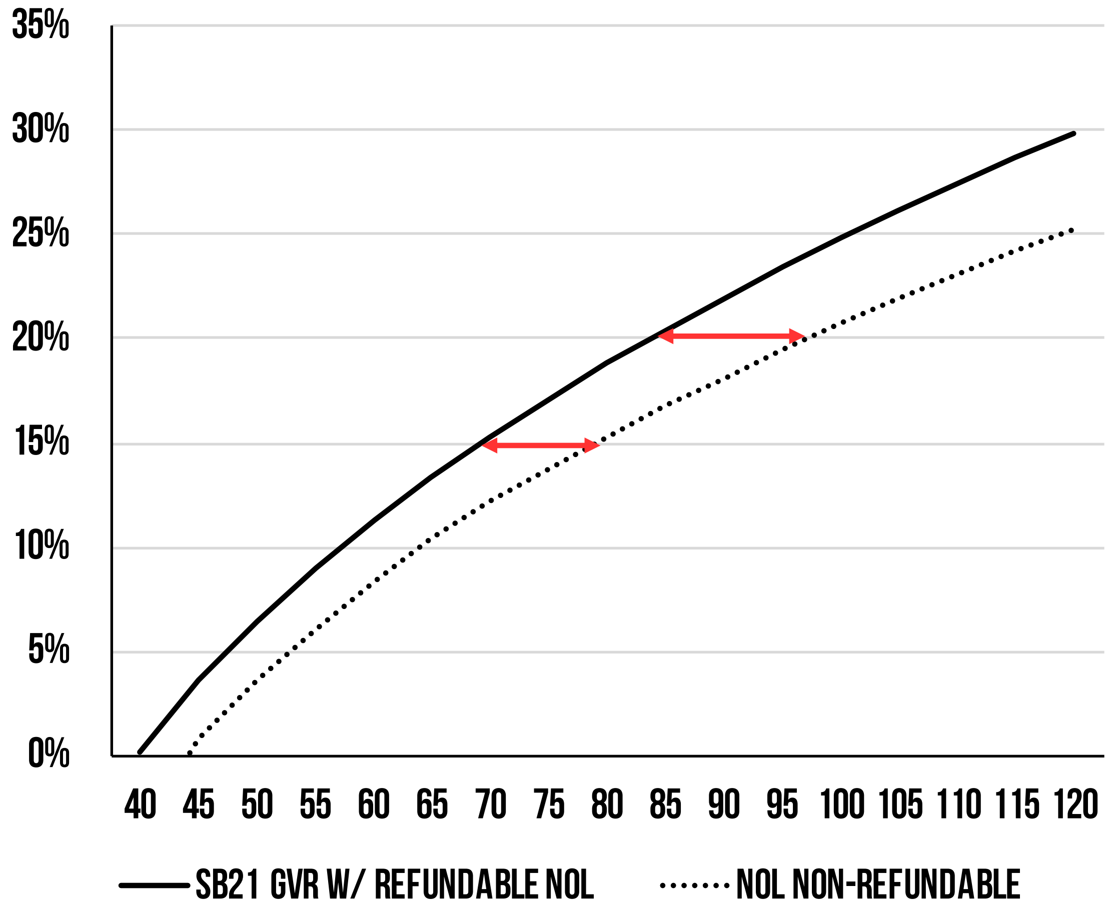
Near-Kuparak-sized new development could easily incur >$2bn in NOL credits in development years

High $200mm limit avoids impacts on current investments, while protecting against such 'outliers'

CUMULATIVE CASHFLOW ($70/BBL)



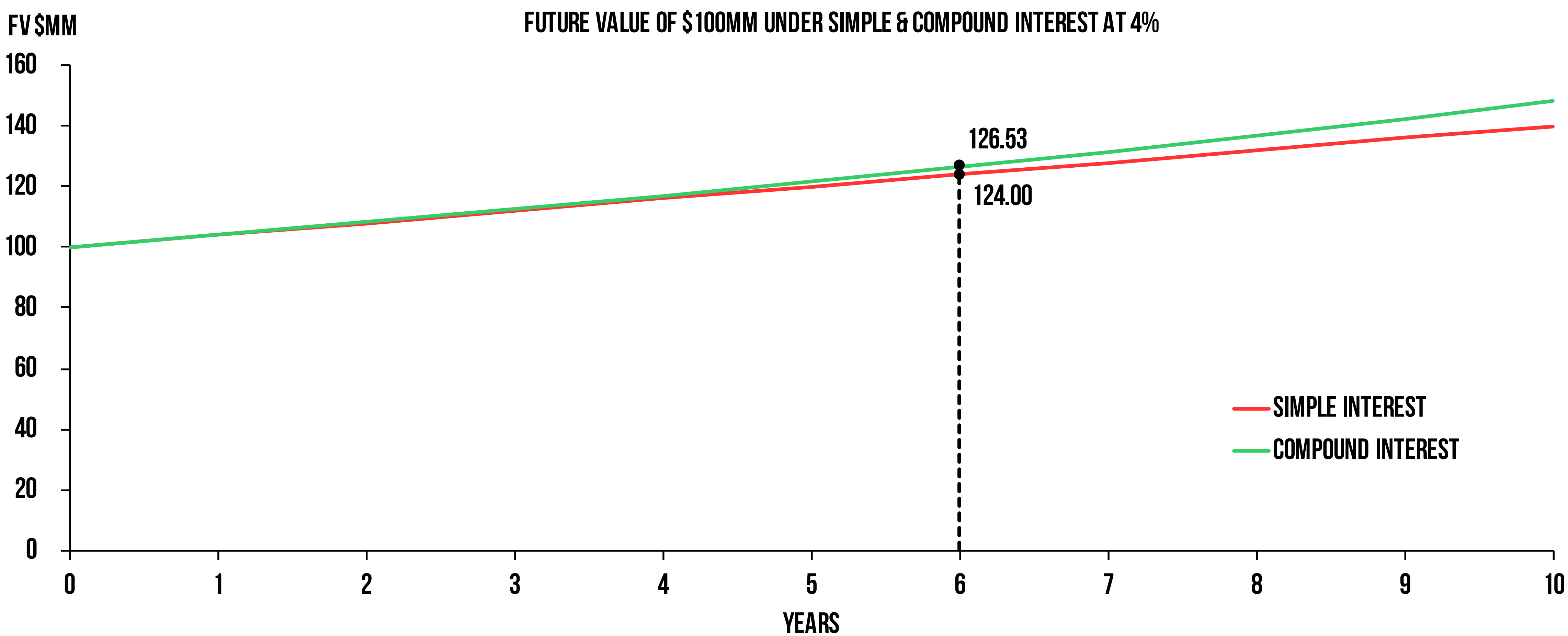
IRR SENSITIVITY



COMPOUND INTEREST AND CREDIT WITHHOLDING

Move to compound interest increases penalty for delinquent taxes only marginally at current rates

Taxpayers with outstanding liabilities related to oil & gas production have that liability withheld from any refundable credit certificate



REDUCTION IN COOK INLET SPENDING SUPPORT

Currently 3 credits in Cook Inlet

- 25% NOL credit for carried-forward annual loss, ‘stackable’ with either:

- 20% QCE credit for all qualified capital lease expenditures; or

- 40% WLE credit for well-related capital lease expenditures

On average, roughly 55% support for spending under status quo

Under CS, 10% NOL credit for carried-forward annual loss, ‘stackable’ with 20% QCE credit

WLE credit reduced to 30% in 2017, effectively phased out after that point

Effect is to:

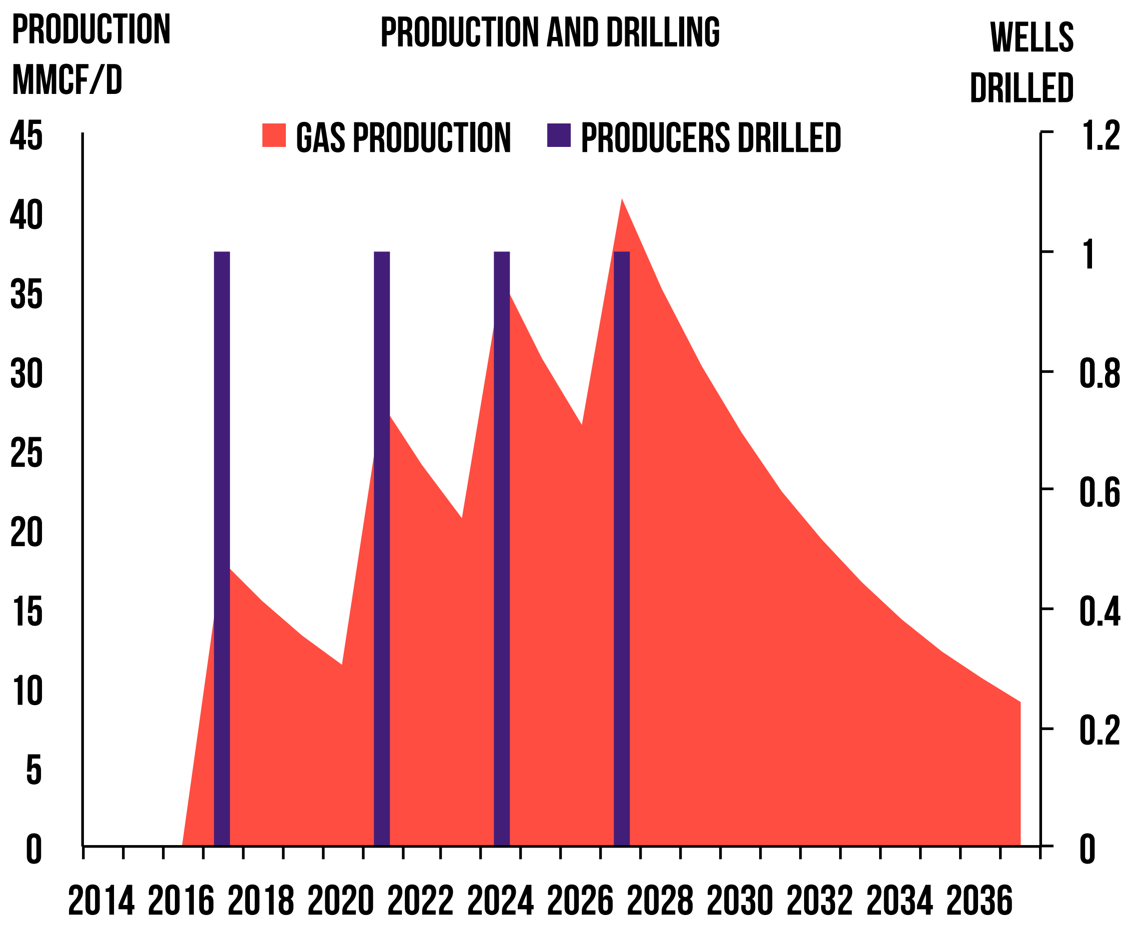
- reduce spending support to 30% (vs 55% under status quo 25% in original bill) for new developments

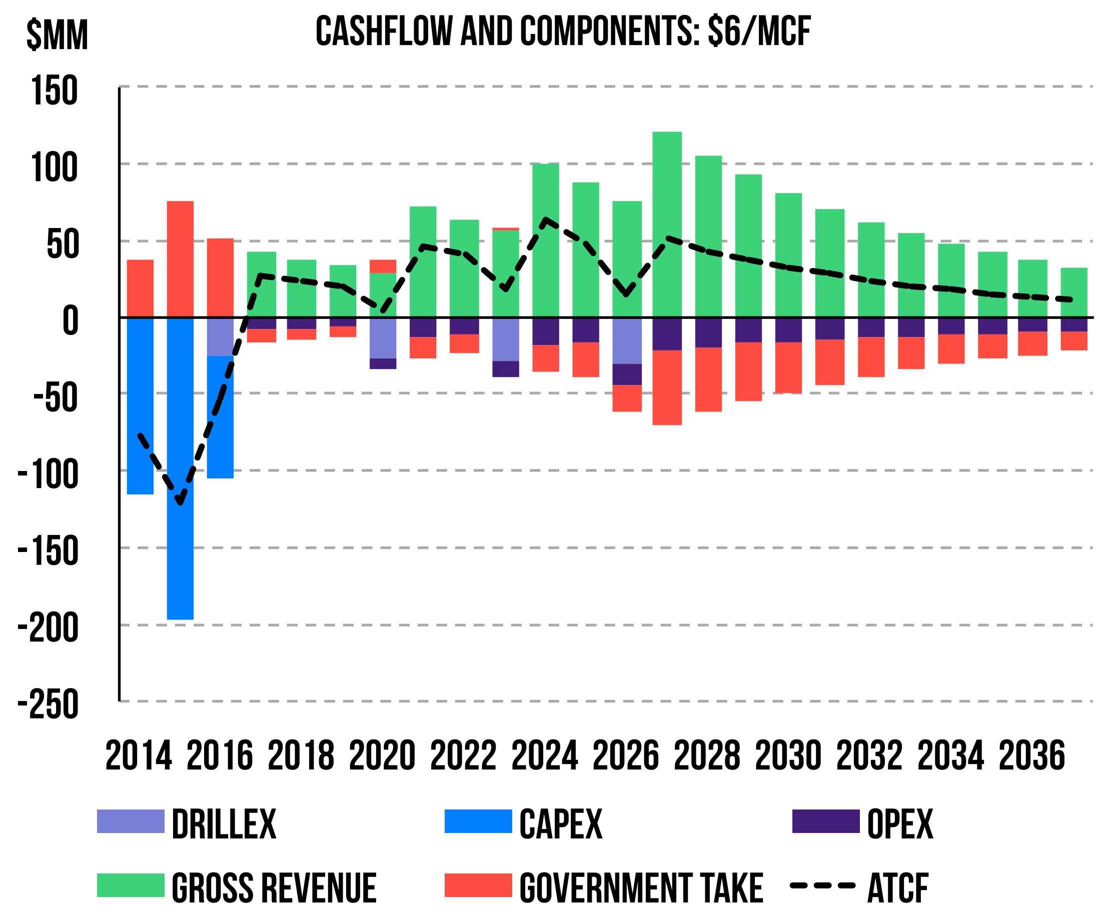
- reduce spending support to 20% (vs 30% under status quo, 0% in original bill) for current production

COOK INLET #1: MARKET CONSTRAINED (ASSUMPTIONS)

Large upfront investment but constrained gas market

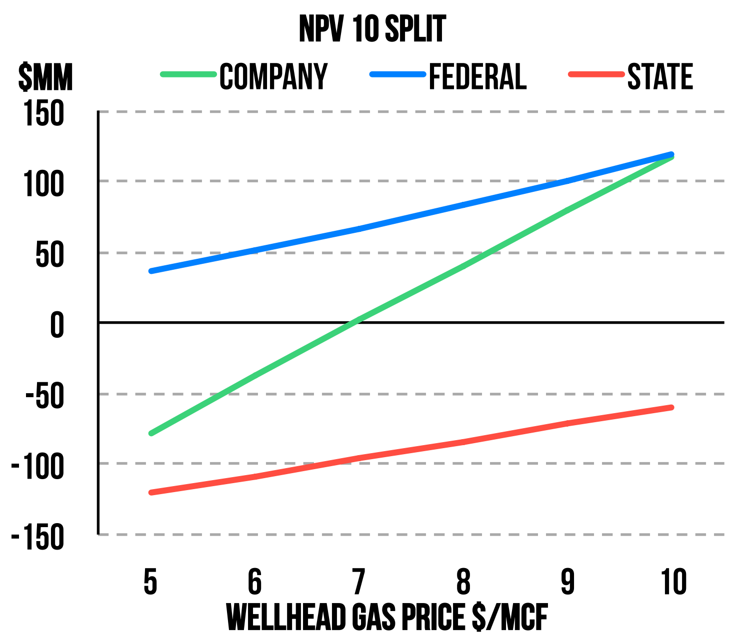
Limited ability to sell gas: can only drill a well every few years

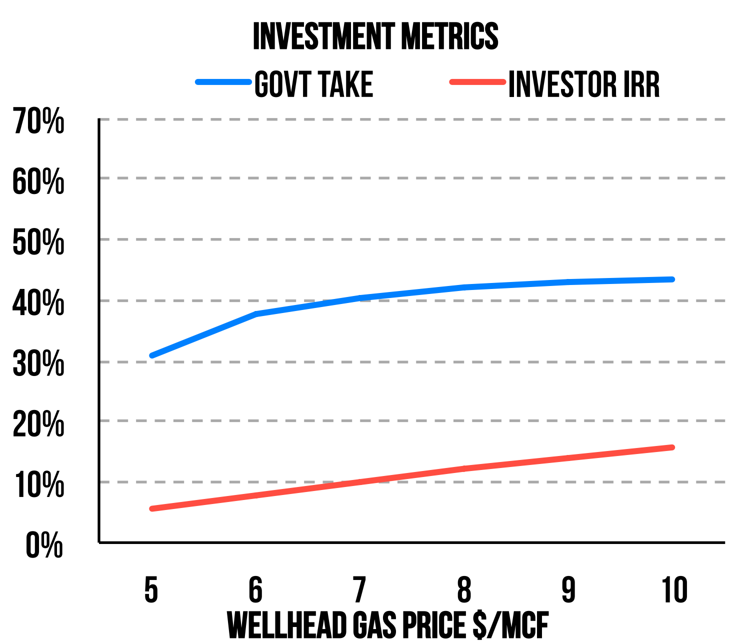




COOK INLET #1: MARKET CONSTRAINED (RESULTS)

STATUS QUO





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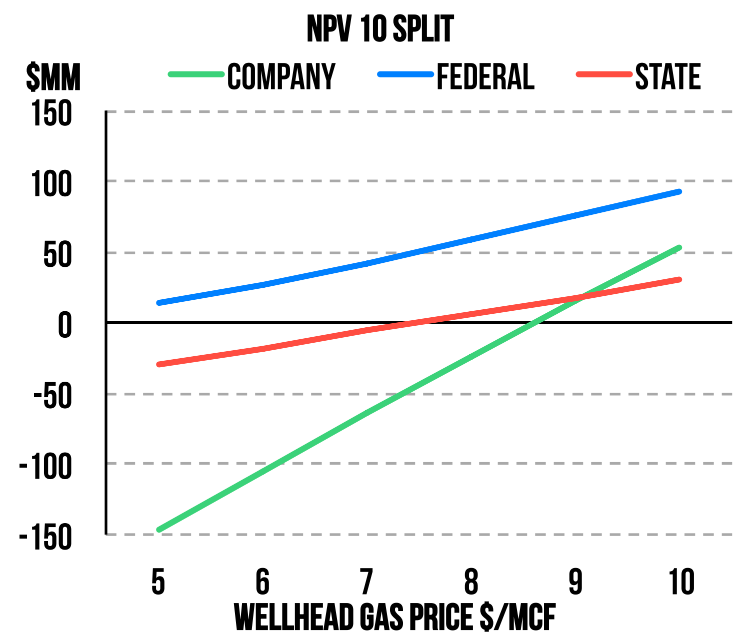
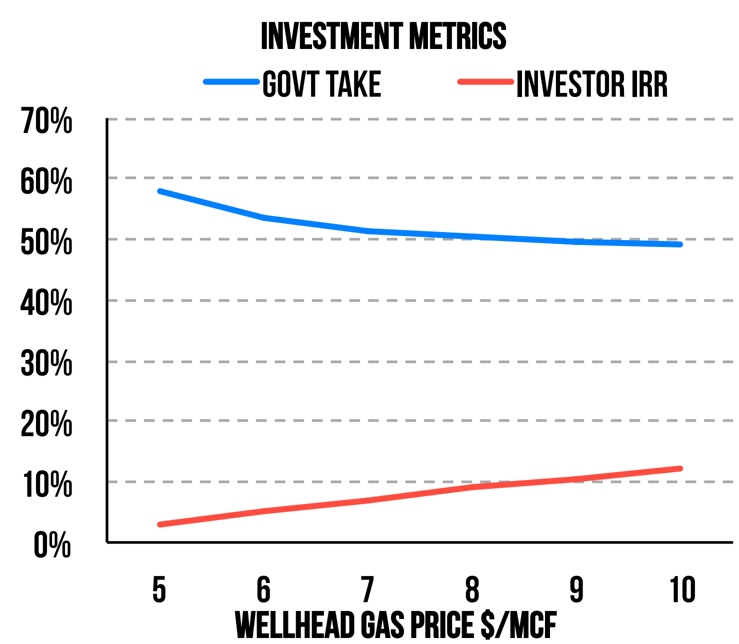
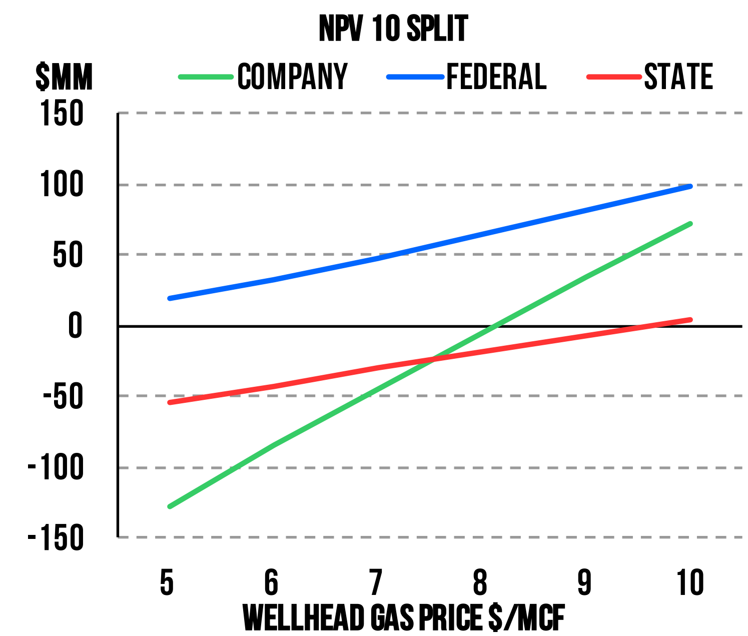
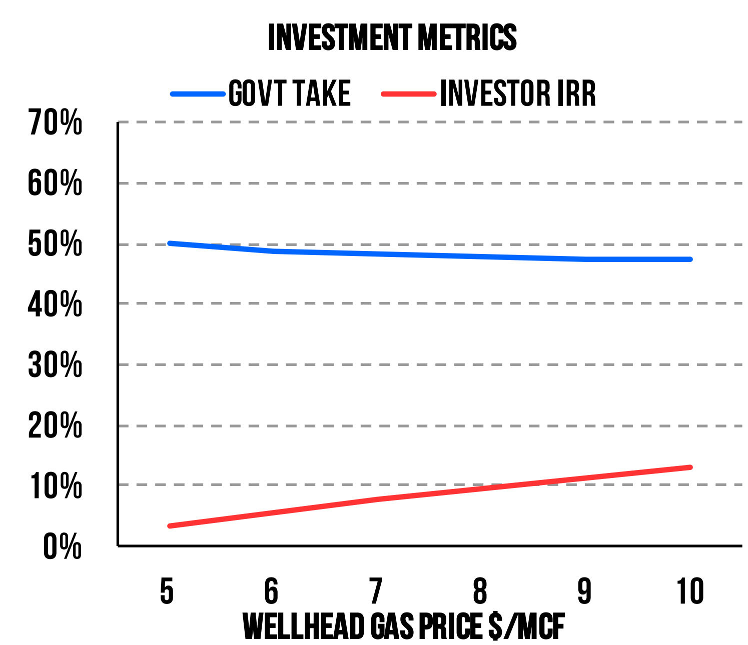




CS HB247: 10% NOL. 20% CAP

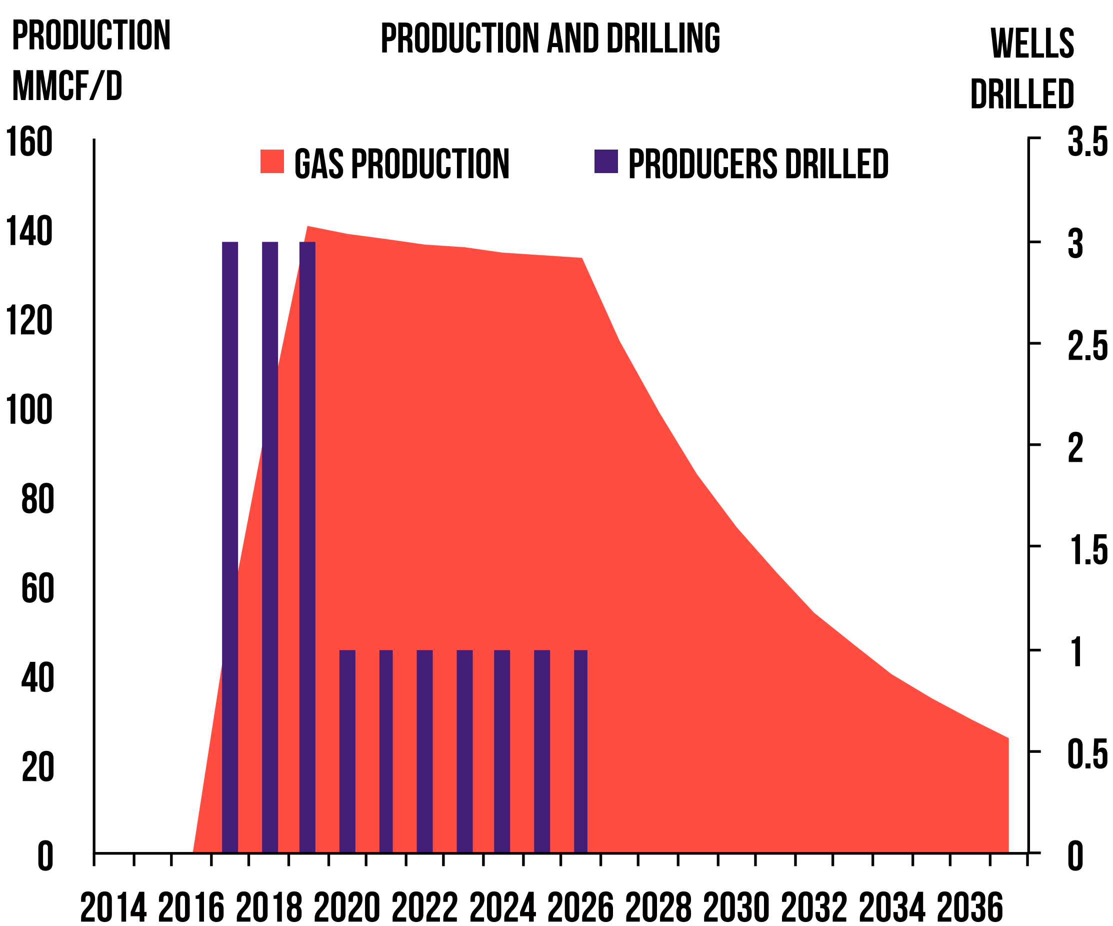


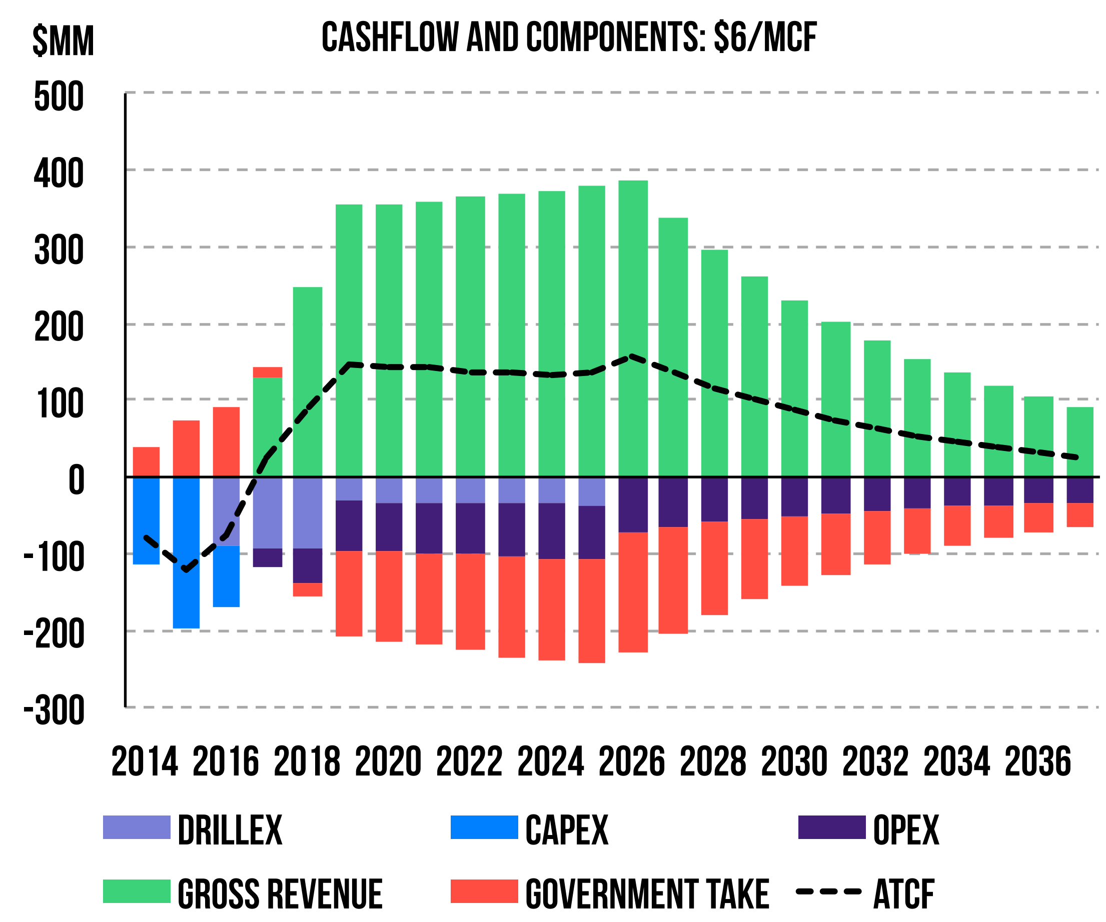


COOK INLET #2: UN-CONSTRAINED (ASSUMPTIONS)

Large upfront investment but un-constrained gas market

Continued drilling lead to a plateau of 130 mmcf/d





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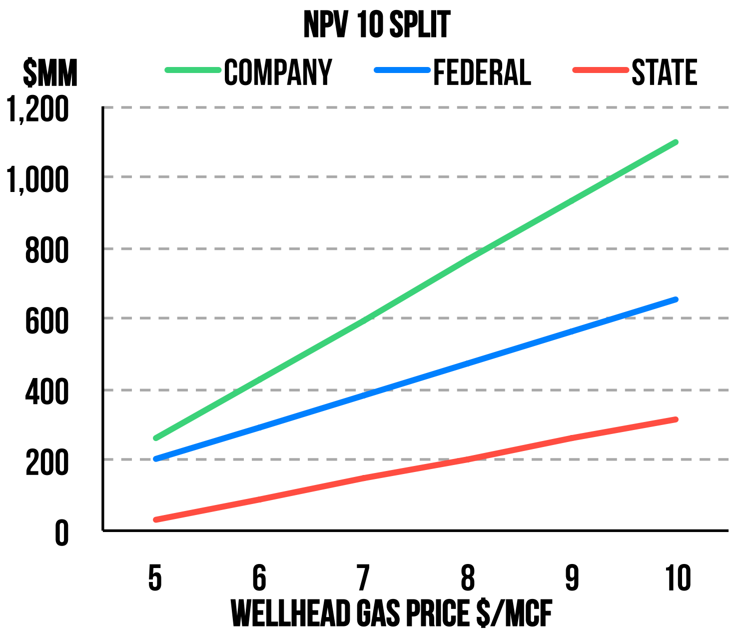

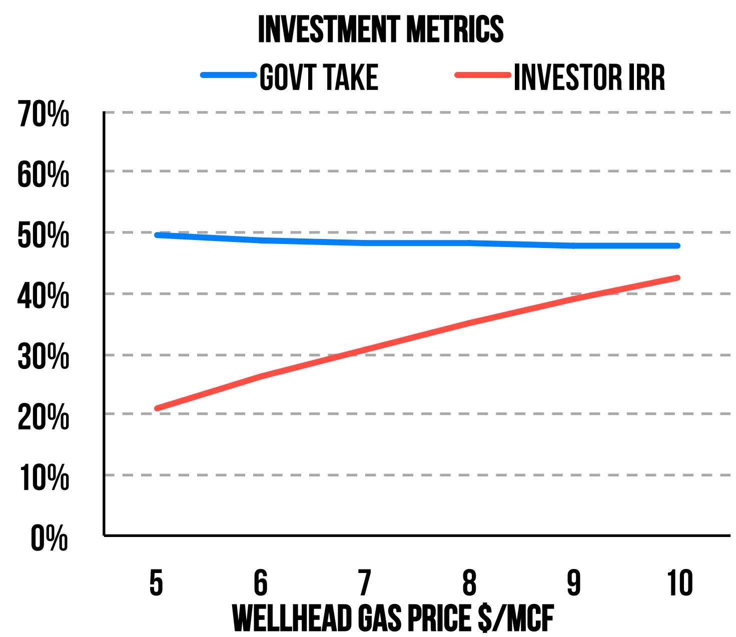

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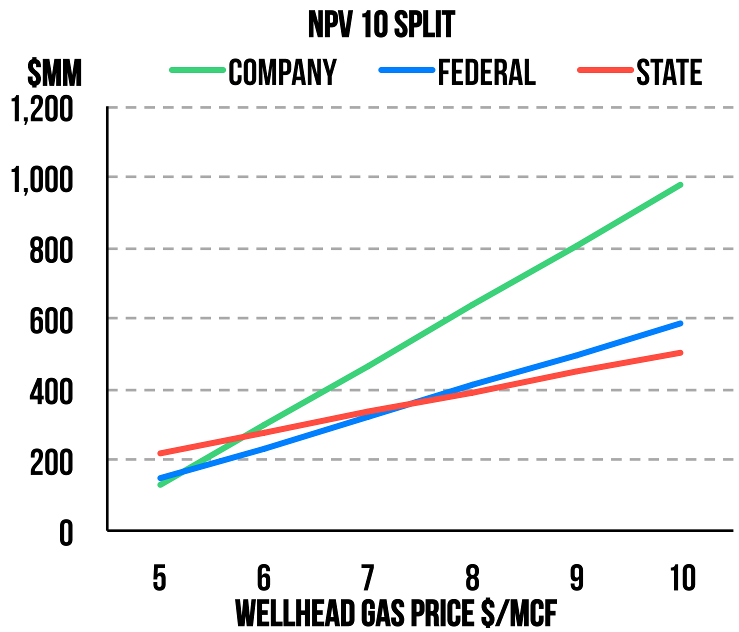
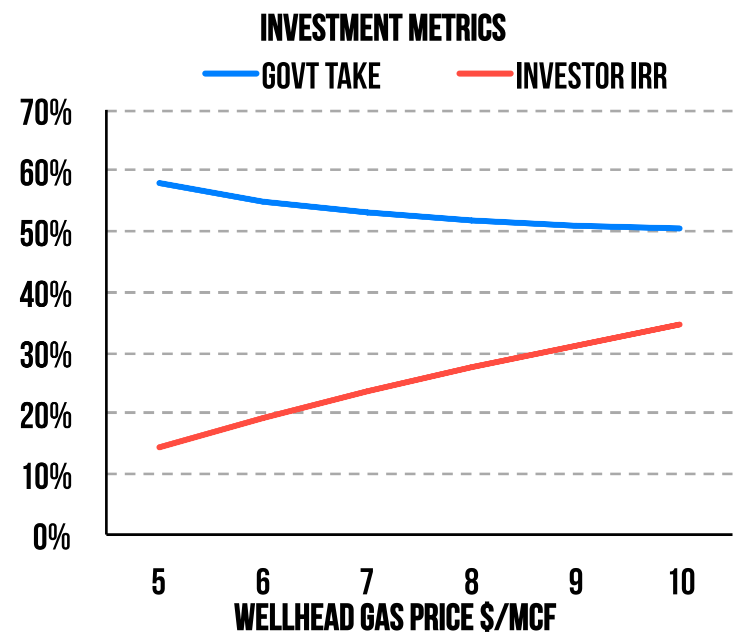
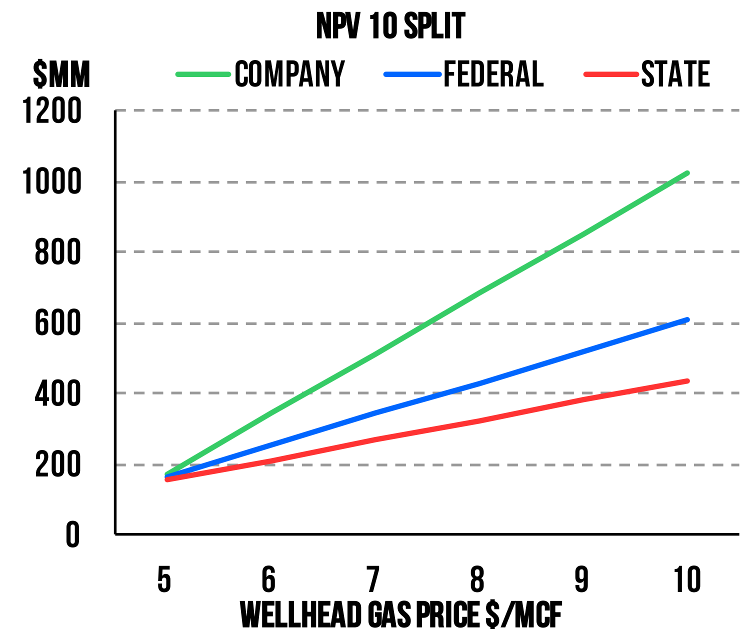
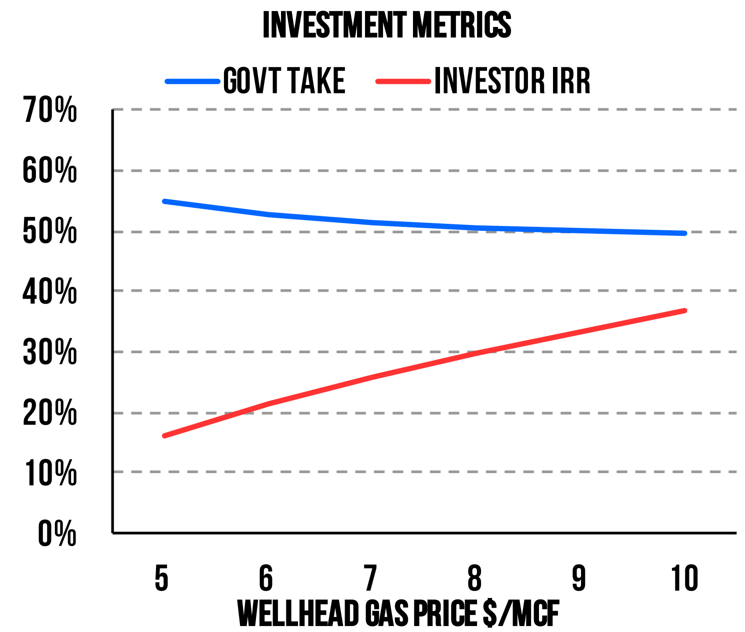




CS HB247: 10% NOL. 20% CAP



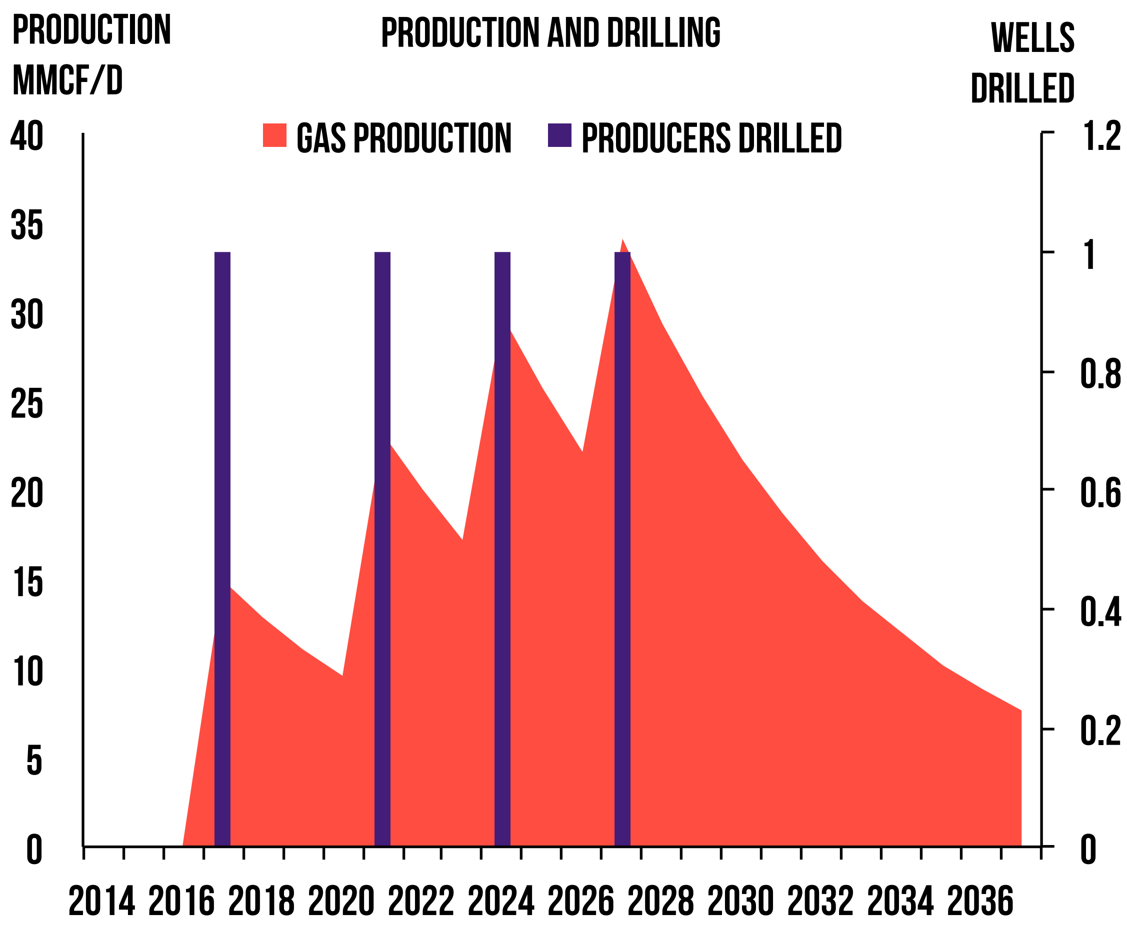


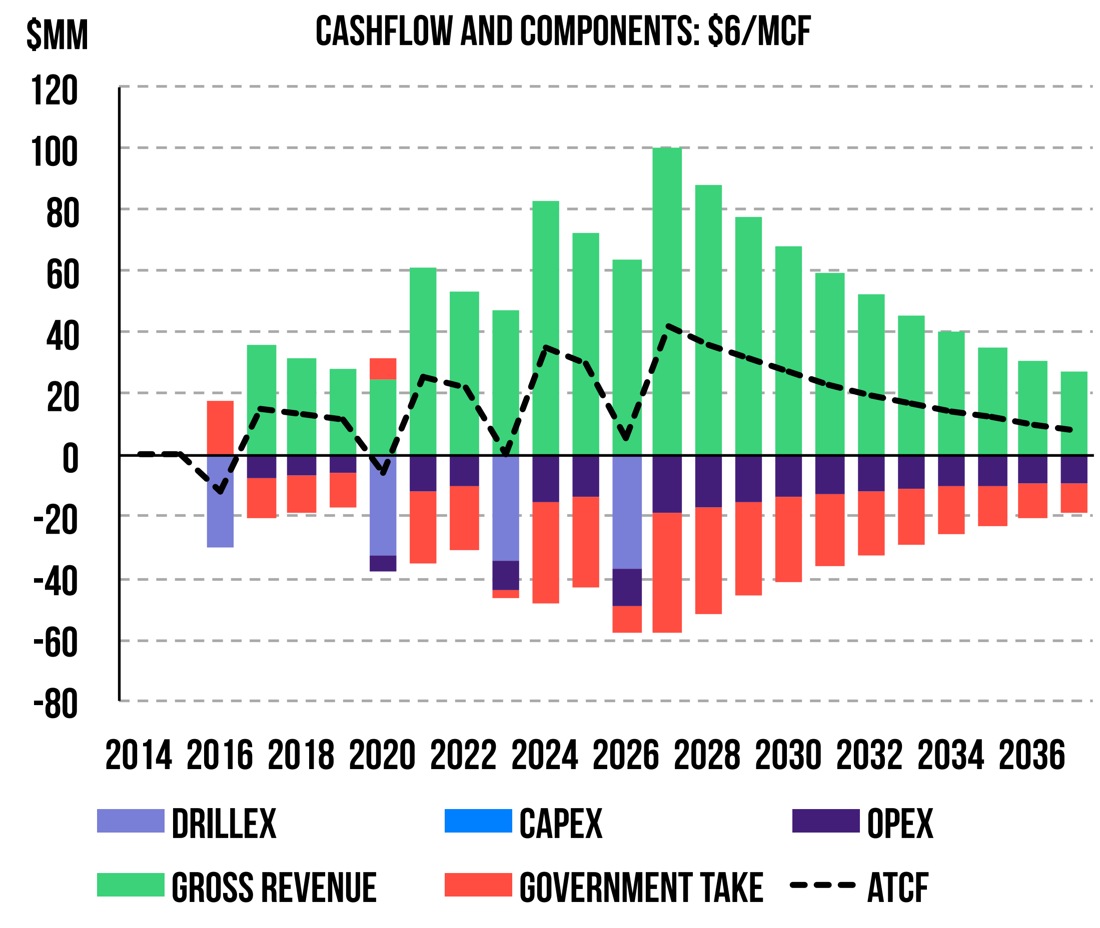
COOK INLET #3: DRILLING EXISTING FIELD (ASSUMPTIONS)

Drilling expenditures at existing production—smaller upfront investment

No market constrains assumed

This is a point-forward analysis—it ignores sunk, entry or acquisition costs





COOK INLET #3: DRILLING EXISTING FIELD (RESULTS)

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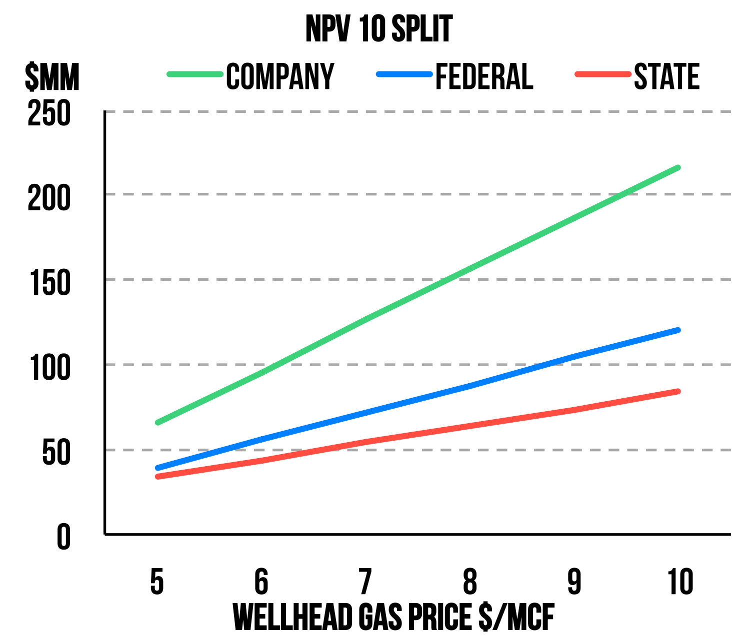
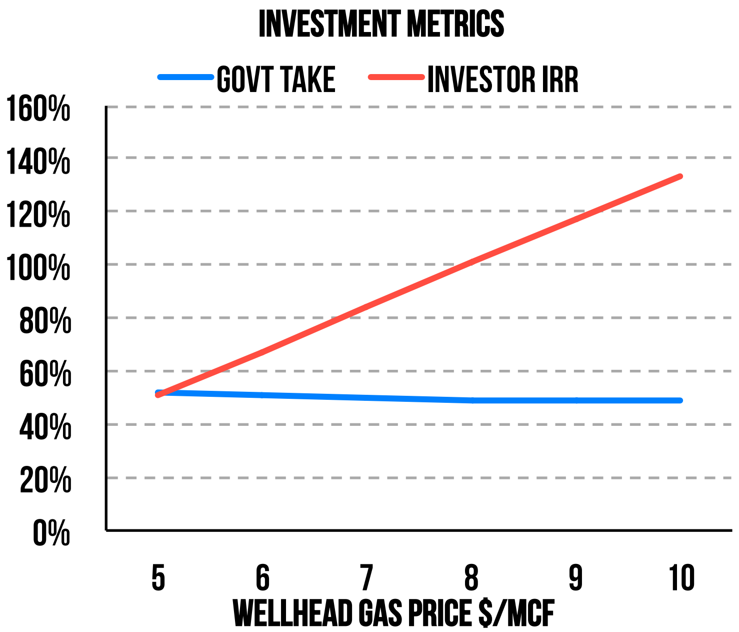
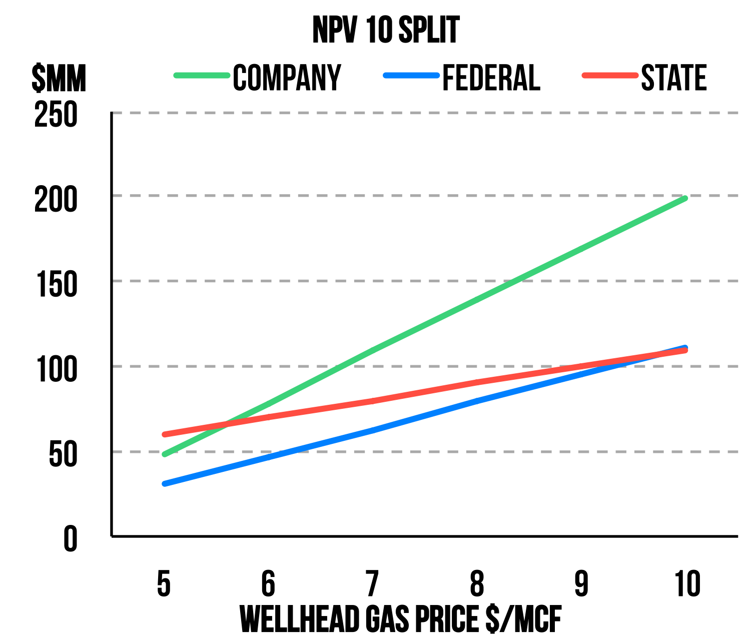
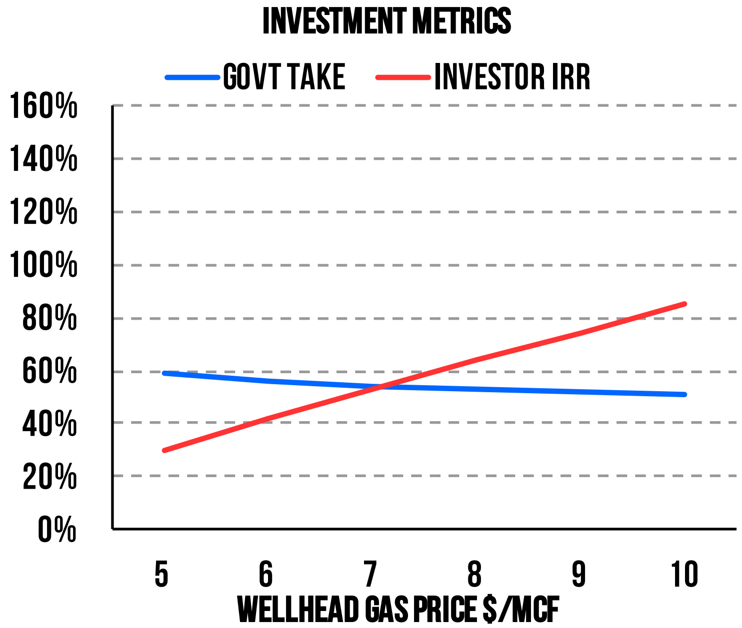




HB 247: NO CREDITS





CS HB247: 20% CAP