



Republic of Namibia



# COMPETING FOR H2 CAPITAL.

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# Overview.

As Government (GRN) was conceiving a dynamic response to some of the economic challenges post the 2019 drought and the COVID-19 pandemic, a key approach that was consensual between both private sector and public sector was that where possible, GRN needed to move in a manner that attracted much needed foreign direct investment from the private sector. This consensus was driven by the narrative that public expenditure levels were to remain muted given limited fiscal space and the private sector was heavily indebted. The other key part of the formula for gross domestic product, a simple measure for the economic output of a country, was of course net exports, which was deemed to be an expected output from key investments made. This left the investment arm of the formula as the key lever GRN was to pull.

One effort GRN embarked upon was to spark the development of the green economy. The now much spoken about Green Hydrogen opportunity and more than N\$2 billion mobilised in foreign direct investments in less than two years is a direct result of GRN led efforts.

Scepticism from local economists and members of the economic association of Namibia have been heard, with some public advocacy supporting approaches that would, in GRN's view, make Namibia less attractive in its bid to attract foreign direct investment in what is a very globally competitive space where some countries are offering up billions of US dollars in subsidies. It is foreign direct investments that drives economic growth, as for every dollar that foreign investors earn, the Namibian economy will earn several. If foreign investors choose to invest their hard earned capital elsewhere, it is those countries, and not Namibians, who will benefit. Given the sheer scale of capital required combined with the complexity of implementing projects that are a first of their kind in the world,

requires skills and financial resources that Namibia just does not have, which is why Namibia has turned to foreign investors to help in launching this new industry.

## The question is, how is Namibia looking to fund its 24% negotiated equity stake in the Hyphen Project?

First, we need to answer the question of why, in this industry, a direct equity stake is preferred over a free carry (also referred to as carried interest). The most elementary assessment of a free carry reveals that it reduces the returns available for private investors as this capital still needs to be paid for by someone. The effect of a free carry, i.e. a profit reduction, is relatively benign for sectors that require relatively small capital investments, where the resource is very scarce (can be found only in a specific place) and that have a steep cost curve between low and high cost producers. Examples of such industries are oil, copper, cobalt and diamonds. For example, in the oil industry, some countries can produce oil at US\$5/barrel, and others at US\$80/barrel. This leaves a lot of room for free carry for those industries with a low-cost base as the value of the resource in those countries is higher.

Green hydrogen projects have different economic structures and requires a more intricate and dynamic approach. You will agree that all countries have the required resource: the sun, wind and land. Some are better than others, but the difference between Namibia, Mauretania, Australia and Chile, for example, are small.

This means large hydrogen projects can be built in many countries around the world. As there is limited capacity globally to build these projects, there is a global race for projects to be first to market. Given the size of the green hydrogen opportunity, various governments in wealthier nations have in fact resorted to providing billions of US dollars in subsidies and tax credits to make those countries more attractive to developers in order to attract investment.

There is broad recognition that this is an emerging industry and that public sector policy support is required before it is mature enough to stand on its own two feet. While the European Governments have led the way with billions of Euros in subsidies to establish this industry, the most recent subsidies established under the Inflation Reduction Act in the US has been the most staggering. This piece of legislation offers up to US\$3/kgH<sub>2</sub> in tax credits (money back to the developer) for a green hydrogen project developed in the US if various conditions are met. Bearing in mind that cost estimates for projects could range anywhere between US\$4/kg to US\$6/kg, this subsidy is massive. This is on top of billions of dollars of investment incentives already advanced in the US in 2021 for the establishment of renewables generation capacity under the Infrastructure Act. When one considers that these incentives will last for 10 years, over which period costs of green hydrogen could drop to below US\$2/kg.

So when our Namibian sceptics advocate that GRN must ask for 24% free carry because the wind and the sun is ours, they are doing so without possibly fully appreciating all the facts and the globally competitive market dynamics that we operate in. Additionally, these calls for free carry are made without considering the fact that Namibia will earn land rentals, royalties from green hydrogen sales and taxes, on top of the job creation and localisation targets that the project has been tasked with delivering. A few points are therefore relevant:

1. Wind and sun alone does not produce ammonia – rather, it is 10 billion US dollars' worth of equipment in building out the full value chain, all operated by capable and trained Namibians under very high precision, that produces ammonia, which we will sell, the profits of which will be used to repay

capital providers for the funding availed to design, develop, build and operate such a complex project.

2. Unlike mining or oil where GRN traditionally receives next to nothing for leasing out the land (for mining exploration licences for example, GRN gets paid N\$10,000 per licence), GRN is going to net a quarter of a billion Namibian dollars over the next two years. This means GRN is already being compensated for availing the land for development.
3. The margins in green hydrogen are likely to be much lower than traditional sunset industries like oil and gas or even commodity extraction. So there is less space to be 'generous' with project returns. With massive amounts of capital required to establish this industry, calling for a free carry in Namibia where other competing countries are not, just reduces the competitiveness of the Namibian industry, which is the opposite of what competing countries are doing who are offering massive incentives to attract investment.
4. GRN negotiated hard to maximise the benefit that Namibia will receive in cold hard cash from the establishment of its green hydrogen industry, ensuring that a combination of fixed and variable revenue streams are secured, including:
  - a. Land rentals that escalate with an index amount and depending on the developmental phase of the project
  - b. Environmental levies that escalate by an index amount
  - c. Revenue royalties that ensure GRN receives benefits before any operating expenses are incurred
  - d. Income taxes
  - e. Dividends from any equity stake that GRN holds

Furthermore, indirect and induced economic impacts will ensue from the project, which remain to be quantified. From all direct revenue lines, GRN expects that it will receive over 40% of all the distributions available from the project, increasing to over 50% including its 24% equity stake. This means that for every dollar that a private investors earns, Namibia is likely

to earn the same despite only providing a quarter of the requisite capital. This excludes any other indirect and induced economic impacts, which should be several times this amount.

5. In addition to these direct and indirect economic benefits, the project has been tasked with implementing the project in way that ensures that 90% of all jobs and 30% of all procurement, will be from Namibians.

6. Based on the our early estimates, the Hyphen project alone could generate up to 20% of Namibia's current fiscal take every year for the next 30 – 40 years. Importantly, however, GRN is focused on establishing a competitive and scalable industry, with conservatively 15 to 20 or more equivalent sized projects. Therefore, rather than trying to maximize its returns on one project, Namibia is trying to maximise the probability of success of the establishment of this transformative industry in Namibia.

Indexed to 100	Government participation scenarios				Benchmark
	100% Private Sector	10% Free Carry	24% Free Carry	10% Paid Equity Stake	US IRA Subsidy
<b>Total Capital</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
Of which Private	100	100	100	76	100
Of which GRN	0	0	0	24	0
Subsidy	0	0	0	0	35
<b>Equity</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>65</b>
<b>Profit</b>	<b>20</b>	<b>20</b>	<b>20</b>	<b>20</b>	<b>20</b>
Of which Private	20	18	15	15	20
Of which GRN	0	2	5	5	0
<b>Return on Equity - Private</b>	<b>20%</b>	<b>18%</b>	<b>15%</b>	<b>20%</b>	<b>31%</b>
<b>Private - Investor Ranking</b>					
Return on Equity					
Speed of Implementation					
Percieved risk / Return					

**Table 1:** Various scenarios depicting returns investors would enjoy in Namibia, depending on GRN policy on GRN Equity participation all based to 100.

An objective consideration of Table 1 quickly shows how returns for the private investor deteriorate as the amount of 'free carry' given to GRN escalates. Similarly, it shows how returns for investors looking to build green hydrogen projects in relatively wealthier countries like the United States are much higher, de-risking this strategic industries in those jurisdictions significantly.

The European Union has taken a different approach: while they have provided incentives for the production of green hydrogen in Europe, they have also provided incentives for green hydrogen projects on the African continent as part of the Just Energy Transition, as a "once in a generation" opportunity for African states to industrialize and, at the same time, make the most of Africa's renewable energy potential to combat climate change. It is this approach that is espoused in the Global Gateway Initiative and what has led to the N\$2 billion in grants received to date from Team EU in a bid to help Namibia compete with relatively wealthier nations as we seek to establish a competitive synthetic fuels industry.

So what has transpired practically? The development budget of the project up to final investment decision is €93 million. GRN was able to negotiate to acquire a 24% stake in Hyphen which results in a funding obligation for GRN of €23 million (€93mn x 24%). Namibia already received €40 million from the Dutch government in grants to help with the development of this and other projects in Namibia, which means that GRN still has €17 million to use to de-risk other hydrogen projects. We have placed the €40 million in the SDG Namibia One Fund and intend to raise another €60 million from other sources around the world, all to be used to de-risk the development of this industry in Namibia.

When the project takes its final investment decision and prior to financial close of phase one of the project, GRN will consider whether to retain all of its equity or reduce some of its stake and allow other investors to buy a now de-risked interest in the project at a profit to GRN. This would include local pension funds, banks and

other local strategic investors. All this is possible because GRN had the foresight to recognize that the world is moving strongly to combat climate change and was looking to avail help from any countries that were willing and able to contribute to this effort which requires us all to hold hands amongst ourselves at home and with the global community at large. To fund its equity at financial close, GRN has secured a letter of intent from the European Investment Bank (EIB) of €500 million in funding, which should be sufficient to fund 100% of GRN's equity requirements for phase one. GRN will evaluate other funding options for its' equity at financial close, including grants and debt funding from other financiers should they be more favourable than the terms being offered by the EIB.

In summary, we urge all Namibia's to consider supporting GRN's humble efforts to provide jobs and livelihoods to the people of Namibia, while at the same time meeting its policy objectives to industrialize, diversify the Namibian economy, improving employment and livelihoods, and to become a responsible citizen of the global community.

The indefatigable Wangari Maathai appropriately exclaimed, "we all share one planet and are one humanity, there is no escaping this reality." Namibia, like many other governments, is taking this advice to heart and are moving in ways that espouse Ms Maathai's wise words while retaining the mission our founding father gave us back in 1994 through Vision 2030. If we move as one people, it is ALL possible and you know what, it is extremely exciting too!



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