Q1 2017 Earnings Call

Company Participants

- Renato Jerusalmi, Head of Finance & IR
- Unidentified Speaker, Analyst

Other Participants

- Robert Valencia, Analyst

Presentation

Unidentified Speaker

(interpreted)

Good morning, ladies and gentlemen. Welcome to Petro Rio's conference call to discuss First Quarter 2017 results. Thank you for standing by. (Operator Instructions)

This event is also being webcast simultaneously over the Internet and may be accessed through Petro Rio's investor relations website at www.petroriosa.com.pr by clicking on the banner 1Q 2017 earnings release.

Before proceeding, let me mention that forward-looking statements that might be made during this conference call relative to Petro Rio's (inaudible) rejections [ph] operating and financial goals technical difficulty) management and on information currently available to the Company. Forward-looking statements are not a guarantee of performance. They involve risks, uncertainties. And assumptions as they related to future events and therefore with elements [ph] recompense [ph] that may or may not occur in the future.

Investors should understand the general economic conditions, industry conditions. And other operating factors that affect the future results of Petro Rio and could cause results to differ materially from those expressed by forward-looking statements.

I would now like to turn the conference over to Mr. Renato Jerusalmi, Head of Finance and Investor Relations. Please, Mr. Jerusalmi, go ahead.

Renato Jerusalmi {BIO 19910567 <GO>}

(interpreted)

Thank you very much. Good morning, everyone. It is a pleasure to be talking to you about our First Quarter 2017 results. Thank you very much for joining us.

Let us begin with our slides. Let's start with slide three (sic-slide 1) on the First Quarter 2017 highlights. We conclusion of the acquisition of 100% of Brasoil on March 20. So on the balance sheet at the First Quarter, we had just 11 days of consolidation. So in the First Quarter, we cannot incorporate all Brasoil raw numbers. As of the Second Quarter, we are going to have our results of Brasoil reflected in our balance sheet.

Our oil production was 740,000 barrels in the quarter, 14% higher than First Quarter 2016. We produced [ph] with an average of 8,200 barrels per day of oil production. It is increasing by around 14% year on year because of the redevelopment campaign that we executed around the Second Quarter of last year which translated into a 20% productivity gain, as we announced before. And this shows our effort that despite the natural depletion with the field, we can still increase the production at Polvo Field.

Lifting costs at around $30 per barrel, 14% lower. We had very high lifting costs in 2016. The % [ph] lifting cost has been reduced. And we believe this is a lifting cost which is quite good for a mature field like Polvo. And behind here [ph], again, 14% lower than First Quarter 2016.

Our operating efficiency was 95.2%, very high operating efficiency. The last quarter results are very high and we are maintaining an interesting operating efficiency. We estimate that the effort for the Campos Basin is of around 80% operating efficiency and we are at around 95%.

And finally our net profit was BRL4 million positive profit against the loss BRL65 million in the First Quarter of 2016. I'd like to remind you that in the First Quarter of 2016, that was our most challenging quarter that happened in the whole history at the Company.

The Brent price was an all-time low. And our uptake in the First Quarter was $36, a fairly low price. And we were starting our recoveries in the field. And this was indeed a very challenging time. But now we are reversing the situation. We will have a positive net profit of BRL4 million. We are very happy with this result.

Going to slide four (sic-slide 2), please, let's talk a little bit about the Brent price. Focusing on the first two quarters, which is what is highlighted in bright blue on the chart, we can see that soon after the OPEC agreement at the end of November, crude oil increased to a level of $56, $57 a barrel. Then it shows a drop in March to around $51 a barrel.

So again, dipping a little bit to the rest of the market, you will probably remember the agreement. This was an agreement where OPEC countries decided to reduce production the marketing in the First Quarter, then started facilitation [ph] -- compliance of the OPEC agreement. And compliance was quite high. At the end of March, it was at around 19%. And it's [ph] strong as the record is from [ph] one history of both packets [ph] around 60%, 70%.

So we've done 90% compliance with the agreement and I can understand (inaudible). In April, it was around 100% compliance. So OPEC countries are doing what they committed to do.

With this spike, you can compliance that mega [ph] we're looking in new inventories that have been increasing until the end of March. But I'm (inaudible) confused. How is it that we have a reduction of 1.5 million barrels a day in the market and navy force [ph] continue to grow.

So the market started doubting the agreement a little and that is why crude oil prices started to reduce a little. Actually, the Brent price started reducing. And the OPEC agreement aimed at sequelares [ph] and inventories that were way too high.

The market now is following up close. Both US oil production and rigs say that US production has been improving strongly. They have more than 9 million barrels a day. We estimate that they have increased 500,000 barrels a day since last year. And we believe that the market will continue with this kind of dynamic comparing inventories versus US production.

Inventories started to creep in April. For five weeks in a row, inventories dropped and we believe that inventories will continue to decrease from now. There is a certain seasonality in the US as well. Refineries there will behave differently and we believe that the market will start seeing a reduction in inventory, as was expected with the OPEC country agreement.

In our deal, Brent prices should be at around $50 a barrel. We are estimating something between $55 and $60. But as you know, the oil market is quite complex, quite difficult to predict and forecast. But we believe that our price of oil will be around at $55, $60 for the whole year. The average for the quarter was $54.60 and we can take assistance [ph] compared to the First Quarter of 2016.

Brent prices are at a different level now at around $50 last year. At this time last year, it was around $40. So it tends to be a better year for Polvo.

Moving on to slide five now please, we will speak a little about production and all stakes [ph]. Our production in the First Quarter was 1,213 barrels a day. A little higher than what we had in the First Quarter of 2016. And this reflects the record wealth [ph] that we had last year to increase productivity.

So we had an estimate here that if we had not done the redevelopment campaign, our production would be at around 6,700 barrels a day, 18% lower. So we try to convey this to investors to show the results of our redevelopment campaign. We invested about $17 million last year in this redevelopment. We had an update in March: 503,000 barrels at a gross selling price of $52.54 per barrel.

Please go to slide six (sic-slide 4), here we talk a little about our lifting costs. On the first chart on the left, we see the lifting costs for Polvo. We see the annual cost, the drop to 91 million, from 108 million to 91 million. And in lighter blue, we see the lifting cost year on year. $23.2 million in the First Quarter, down 3% to $22.6 million. So we are maintaining a stable lifting cost at around $22 million, $23 million that's lighter [ph].

And on the right, we have our G&A expenses. Year on year, it was reduced from BRL81.2 million to BRL74.7 million. And comparing with the First Quarter of 2016, fees had an increase of 24%. We look here at our expenses in Brazilian real, BRL, not in dollars, because all of our expenses are denominated in Brazilian reals.

On this bottom chart, well, we always show this chart every quarter. In green, Brent price; in dark blue, our lifting costs. The bigger the gap, the better for our margin. If we compare year on year to the First Quarter of 2016, that was the worst moment in terms of margin for the Company. We see the green line matching the blue line around $35 a barrel and we can see the evolution, the gap increasing. Amazing [ph] the lifting costs at around $30 a barrel and Brent price picking up from $35 to around $55 a barrel.

If you go to slide seven (sic-slide 5). Here we talk about the acquisition of Brasoil. As I mentioned at the beginning, we closed the operation on March 20. That's all within compound with the 18th. And the cash on cash equivalent of almost BRL11.4 million.

And we will reach heavy not [ph] convertible debentures BRL40.7 million when we closed the deal. That was the total debt. The debenture has matured in June of this year and another maturity in January of 2018.

Camarao [ph] has BRL23.1 million revenue, which grew G&A, with an (inaudible) grew dramatically gain extension [ph]. We closed down the vessel [ph] office, for example. And we can see some G&A synergies to be derived from the deal. This will be reflected particularly in the Second Quarter.

In the First Quarter, we had some costs related to that and we estimate an EBITDA margin of around 70% when we exclude the G&A expenses. Just a reminder that Camarao [ph] has served with others [ph].

We are developing a different stage of Manati. Here we're also talking about Camarao Norte, which is the field that is in the process of being re-acquired [ph] by ANP. The nine-day [ph] consolidation was our structure at Manati. And this is for a re-envision and upside here.

There's two solution blocks and it falls around our conversation [ph]. One block we can see is in quite a very hot area in Brazil exploration. We tend to wait a little before we tend to make an investment this year. We're going to look at some slower corish deals [ph] over all to see how successful they will be to see how this block of ours can appreciate.

And another block is an exploratory block in the Pirapema Field that has been discovered. We have adjusted second consolidation. Over there, there is more of a monetization challenge than a geological challenge. It's an offshore field; we need to have somebody to buy the gas so that we can monetize the deal.

We are waiting to see how we can monetize the Pirapema Field. That's where Manati production in the First Quarter has an average of 4.2 million cubic meters a day for 100% of the field. And as a reminder, that take-or-pay is about 5 million cubic meters a day.

So (inaudible) this take-or-pay and this is stemming from the thermal electric part plan consuming less energy now, given the dry season visual [ph]. So there's some seasonality there as well. The expectation is that for the traveling [ph] crude. It's slightly higher now in April and we believe that over the year, allowing the oil production should be close to the take-or-pay. We believe that production will be improving as of the second half of the year.

On slide eight (sic-slide 6), we have our First Quarter 2017 results. For the column of the First Quarter 2017, we can see offtakes 503,000 versus 380,000. So it's up a little more year on year. Average selling price: $52.54 a barrel, much higher than last year, generating total revenue of rounding up BRL75 million.

Our cost of products and services sold, BRL48 million and royalties BRL7 million. And we have an operating result of BRL18.5 million, a positive operating result. Although it is generating cash, operationally speaking, was a net of this operating result in the First Quarter of 2016. So we see good [ph] generating cash with a transfer in prices.

Then we have G&A expenses, BRL18 million. This year has an EBITDA of zero. The depreciation line of BRL12 million, financial income of positive BRL21 million. And here I think it's worthwhile mentioning a hedge operation. We hedged the price of the market uptake at $51 a barrel.

Since the Brent price is dropping much and we've zeroed [ph] the hedge, we had a gain of about BRL8 million that contributed to our financial results. It was the right decision by our commercial international team and we were able to generate revenues at this hedging operation.

And income tax, social contribution BRL5 million. And factoring everything, we have with a net profit of BRL4 million in the quarter versus a financial loss of BRL65 million year on year. So here again, we are operating at positive levels for the Company.

Let's go to slide nine (sic-slide 7), our last slide. This is a slide we always show to try to explain significant fluctuation of our cash flow. We started the year with BRL571 million. And this is self-explanatory. We have the oil income, financial results, exchange variation and loans, OPEC, CapEx ending the year with BRL663 million.

We always add here the oil inventory. This is pro forma and if we add the oil inventory that we have at the end of the quarter, we would have a final cash plus BRL63 million totaling BRL726 million. The balance sheet is very solid, healthy. Our cash position is also very solid so that we can be prepared to expand [ph] acquisitions that will generate value to our shareholders.

Here we all have to remember that we have two new acquisitions in keeping with the Brasoil acquisition. So that 115 [ph] for the Company.

And with that, Alliente [ph] and I would like to open the floor for the questions. Thank you very much.

Questions And Answers

A - Unidentified Speaker

(interpreted)

Ladies and gentlemen, we will now begin the question-and-answer session for analysts and investors. (Operator Instructions) Robert Valencia [ph].

Q - Robert Valencia

I was just asking whether you guys have -- I just wanted to ask that I've heard that you guys at Petro Rio is thinking about submitting or placing in the near future. There's some press report that indicate that it will be up to $200 million.

And I was just wondering if you already have a plan in motion in terms of a road show? Do you know you are going to be meeting with, whether it is going to be here in the United States or in Europe?

And if you have a group of book runners that are already marketing the deal and you have a specific date in which we should be aware of, whether you're going to be issuing the bonds Or if you have any specific things that you want to share with us in terms of bond issuance. Thank you.

A - Unidentified Speaker

(interpreted)

Thank you for the question, Robert. No. We are not in the process of putting together a road show. What we do have is we are always looking at some possibilities.

As you know, we have a very deleveraged capital structure. (inaudible) would be interesting because we will have to debt much [ph], have to get more cash if we need to do some acquisitions. But we are always assessing our bets to be at the leverage whenever possible. So it is a possibility to get some funding to issue bonds. But we are at some preliminary (inaudible).

Q - Robert Valencia

Thank you.

A - Unidentified Speaker

(interpreted)

This concludes today's question-and-answer session. I would like to invite Mr. Renato Jerusalmi to proceed with the closing remarks.

A - Renato Jerusalmi {BIO 19910567 <GO>}

(interpreted)

Thank you very much for joining us. As my final statement, I would like to stress that it would behoove [ph] to go through acquisitions that will create value such a holded [ph]. With the position of Brasoil, we were able to diversify the portfolio. We can reduce our exposure to the volatility after oil mic [ph] because we'll have the take-or-pay contract.

And in addition to diversifying our portfolio, we can diversify our revenue dollar in terms of good execution for the Company. And we will considering further acquisitions in the future.

I think another piece of news is that we ended the sale of two rigs to Rosneft. And this was also positive means [ph], which I mentioned during the call. We are currently finishing all the divestments that we set out to do since we began the Company's turnaround.

We still have two rigs for sale. This is a difficult market to sell rigs because it all depends on the oil market. Things are handling [ph] transport of our rig. But they are for sale and we are waiting to sell these two remaining rigs.

And that's a sale (inaudible) finish our divestment plan that began from the time of HRT when they bought a lot of assets during their final on [ph] campaign. With this, I would like to thank you very much and I expect to have you onboard in the next two quarters.

That does conclude Petro Rio's conference call for today. Thank you very much for your participation and have a good day.