

Q1 2016 Earnings Call

Company Participants

- Blener Mayhew, Chief Financial, New Business Development and Investor Relations Officer

Other Participants

- Gustavo Allevato, Analyst
- Mariana Bertone, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the audio conference call for the First Quarter 2016 Results of PetroRio. Thank you for standing by. At this time all participants are in listen-only mode. Later we will conduct a question-and-answer session for analysts and investors, when further instructions to participate will be provided. (Operator Instructions)

This event is also being broadcast simultaneously over the Internet and may be accessed through PetroRio's Investor Relations website at www.petroriossa.com.br/ir by clicking on the banner Q1, '16 earnings release.

As a reminder, this conference is being -- before proceeding, let me mention that forward-looking statements that might be made during this conference call relative to the Company's business perspective, projections and operating and financial goals are based on the beliefs and assumptions of PetroRio's management and on information currently available to the Company.

Forward-looking statements are not a guarantee of success. They involve risks, uncertainties and assumptions as they relate to future events, and therefore, depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of PetroRio and could cause results to differ materially from those expressed in such forward-looking statements.

I would now like to turn the conference over to Mr. Blener Mayhew, Chief Financial, New Business Development and Investor Relations Officer of PetroRio. Please go ahead, sir.

Blener Mayhew {BIO 19502444 <GO>}

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Thank you. Good morning, everyone. I would like to thank you analysts, investors, journalists for joining us in this call. I would like to begin talking about 2015 and about an important cycle which came to an end in 2015. 2015 was for us an year of restructuring, a year of many changes and a year that would be challenging in and of itself due to the upcoming changes. And it was also a year when our major commodity, our only commodity plummeted from \$110 plummeting to under \$40.

This was a very difficult year for us. In addition to restructuring a whole company which was in financial distress, we also had to deal with our revenue dropping to one-third of its regular level.

So 2015 -- in 2015 we left our exploratory assets, we renegotiated all of the company's contracts for Polvo and corporate. We shutdown our offices in Manaus, Namibia, Houston [ph], some bases in Solimoes we outsourced some offshore operations, all aiming to optimize costs and operations.

We called a cash burn of the company, which was expected to end the cash of the company in very little time. And more importantly, we consolidated our strategy in producing assets when we completed the acquisition of 40% stake belonging to Maersk. This acquisition was very, very important because it gave us a 100% stake of the field and we were able to unlock all of the investments that we planned for the field, and Maersk did not want to invest for their own strategic reasons.

So looking at 2015, it was a very important year, and because of 2015, now in 2016, we have a company which is prepared to grow with the company focused on returns, acquisition and production of assets.

Now, let me tell you a little bit about 2016. 2016 was a year where Brent prices tested the nerves of our industry. Brent prices dropped from \$40 in December to \$26 in January. This was a record low in the last 10 years, a price level that really scared the industry. And at PetroRio, we were able to hold back our inventory so as not to sell at this very low price -- and I will speak about this later on -- and we were successful in this strategy to hold back our inventory.

The most important thing about 2016 was the beginning of re-entry, the beginning of the redevelopment of the field. It was exactly when we were able to implement our strategy to revitalize the field that we wanted to do in 2015, but we're not able to because of Maersk -- they were holding us back.

So this is the first [ph] stage; we call it Phase 1 in the redevelopment of the fields. We are assessing new areas with the existing wells -- there are three wells, three different wells. We are also including an investment in polymer injection and the goal is that we will reduce the production of water in the field, and consequently, we will produce more oil.

The result of these re-entries cannot be felt by the company yet, but we believe that in the coming weeks we will be completing our third well. We've re-entered two wells, so in about a couple of weeks we should see the results of that.

If nothing had been done at the field, production would be at around 7,000 -- 7,000 barrels -- 7,100 barrels, but by completing the re-entries we will get to 10,000 barrels a day. Of course, these barrels have a natural decline. At the end of the year, we don't expect 10,000 barrels, but if we do reach 10,000 barrels per day, we will have been successful in our re-entries.

However, the downside of the re-entries is that in order to redevelop the field, we had to stop some wells so that we could finish the completion. And this dynamic of stopping the wells, reopening, stopping another well, reopening led to the failure of some pumps that were old -- they had 1,500 days of operation when pumps normally last a 1,000.

So these re-entries and investments to revitalize the field -- the field led us to the failure of five pumps and we had to exchange these pumps. Many of them we had in our inventory. When a pump fails, the field's production stops temporarily. So in addition to making the re-entries longer, the company expected to complete the re-entries -- to have all of the re-entries completed by now.

And also production was lower than expected, so that did impact the quarter of the company. But on the other hand, we are confident that the results of the re-entries despite the impacts in production in the first quarter will be very beneficial for the company in the coming quarter.

Speaking a little about our offtakes. As we mentioned in January, the oil price was \$26, so we were able to hold our production a little and we sold in March. In March, Brent had recovered a bit and had increased from \$26 to \$36 and we were able to capture that price increase. It's still a very low price for Brent. This was our second lowest sale historically speaking. But compared to \$26 in January, we think that this was a very good sale, 380,000 barrels, and that was the only offtake in the quarter. And this is what is captured in our revenue.

Talking about costs, I'm on page seven now, because of our production which was on average 7,500 [ph] barrels in the quarter, our lifting cost was way above what we had expected. It was \$35, practically in line with our offtake. But we believe then after the re-entries and after we reach a production of 10,000 barrels a day, our average lifting cost for the year is expected to be between \$26 and \$28.

And the same goes for corporate costs. Since we take into account production, the total cost of the company per barrel was 44 when we sold oil for 35 and that explain somewhat the negative results for the quarter. But again, with our successful re-entries, if we reach 10,000 barrels, we believe that the total company cost will be on average for the year \$32. In other words, the whole company would cost \$32 including corporate expenses and royalties.

Talking about costs to operate Polvo Field, we showed in 2015 an ability to renegotiate contracts and to optimize operations and reduce costs. We had a cost metrics from the old operation of \$240 million per year and in 2015 to \$108 [ph] million. But with the oil

crisis stretching, as I mentioned in the last call, we opened a second round of renegotiations with all of our suppliers, that was in the fourth quarter of 2015.

And the results of these renegotiations should bring another discount in contrast, more cost reductions and we believe that for the year Polvo Field cost will be around \$90 million. G&A also posted a reduction vis-a-vis 2015. This is expected to be \$14 [ph] million for year, \$3.5 million for this quarter.

Now, speaking a little bit about our results. As I mentioned, we sold 380,000 [ph] barrels; our selling price was 36; revenue was BRL42 million; cost of goods sold BRL50 million; 5 million in royalties; G&A of BRL15 million; a negative EBITDA of BRL31 million.

I just wanted to mention -- I'd like to take this moment to mention that we had a sale in April and we have already enjoyed this last oil increase. In April, we sold BRL400,000 -- 400,000 barrels for \$43. And the next offtake for the end of May, beginning of June, we will be able to probably sell at 48, which is the current Brent price. So the margin tends to increase as the oil prices rally.

Depreciation, 11 million, negative financial income of 22, and we ended with a loss of -- with a loss. And cash remains in line with December, BRL500 [ph] million. And it is important to mention that our cash is free of any obligation. We are a debt-free company and we have the ability to still leverage the company with debt. But we expect that with a positive result, the expected positive result of re-entries, Polvo will be a cash generator at this current oil level. And for the year, our goal is that the company will be a cash generator.

Talking about the results for the quarter, this would be the snapshot.

Now, talking a little bit about the future, the company has actively been talking with companies, investment banks and we are actively pursuing our growth strategy through acquisition. We speak with a lot of people. We have a lot of conversations ongoing for acquisitions in Brazil and abroad. The goal of the management is to complete at least to sign, at least one deal until the end of the year, but this is a goal. We all know that there are a number of factors beyond our control.

So I will close my initial remarks. I would like to thank all of you for your attention for joining us in this webcast. And I will now open the floor for questions. Thank you very much.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session for analysts and investors. (Operator Instructions) Our first question comes from Mariana Bertone, GBM.

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Q - Mariana Bertone {BIO 18830531 <GO>}

Good morning. Thank you for the opportunity. I would like to know for how long will Polvo production be impacted by the redevelopment of the field and exchange of pumps? When will we be able to see the results of this investment in production and what would be the estimated production for 2016 and '17?

And my second question has to do with acquisitions. News were published about a possible bid for the Bauna Field, and I would like to know how is the negotiation unfolding? Do you expect to have an answer soon and what would be the difference between the Bauna Field and Bijupira and Salema Fields that would make approval by ANP easier? Thank you.

A - Blener Mayhew {BIO 19502444 <GO>}

Thank you for the questions. Very good ones. I would like to begin saying that it is very hard to predict the operating challenges that we have had and will still have in Polvo. But I can risk saying that within three to four weeks we should see the results in terms of a production increase -- we should be able to start measuring that. But to give you a guidance in terms of what production will be like in 2016, '17, I think it's still too early to say, too early. We still have to see the results of the re-entries. Now, one thing that I did not mention and which is quite encouraging for us is that the results of these re-entries will not be good just to increase production in the short-term. We are starting some sandstones that were not producing in the field and these sandstones, if we are successful, if we find oil and if we produce oil well, this will open a new frontier for fields in the -- for wells -- a new frontier for wells in the field.

We've identified prospects in these sandstones and by year-end we should be able to perhaps have one new well or perhaps two new wells for these re-entries. In addition to increasing production now in the short term, they will give us a geological confirmation for Polvo Field.

We are conducting the studies and it is possible that we will invest more until the end of the year. It's important to remember that we have a fixed platform in the field and we have a drilling rig. So when we talk about a new well, we are talking about an investment of \$20 [ph] million to \$30 [ph] million. It's not like other companies that have to rent a drilling rig.

As for Bauna, I think that the report you read was a bit misleading because this is a competitive process that we are participating in. But never did we inform or give a guidance regarding the bid or the value of the asset, and again this is a competitive process. It wouldn't make any sense for the company to disclose our commercial strategy. So I believe that the report was a bit misleading.

And the process is moving ahead. Petrobras has a schedule. They are following their schedule and we are still awaiting some news from them.

Q - Mariana Bertone {BIO 18830531 <GO>}

Bloomberg Transcript

Thank you.

A - Blener Mayhew {BIO 19502444 <GO>}

Thank you.

Operator

Our next question comes from Gustavo Allevato with Santander.

Q - Gustavo Allevato {BIO 18933135 <GO>}

Good morning. I have a question regarding acquisitions too. I would like to understand to what extent do you feel comfortable in spending your cash? To what extent is this cash considered comfortable considering acquisition value and financial assets?

And my second question is related to again to acquisitions, the assets that you are considering, are they all close to Polvo Field or would you consider making an acquisition away from the Polvo Field region? Thank you.

A - Blener Mayhew {BIO 19502444 <GO>}

Thank you for the questions, Gustavo. What was the first question?

Q - Gustavo Allevato {BIO 18933135 <GO>}

So the level of comfortable cash?

A - Blener Mayhew {BIO 19502444 <GO>}

Okay. Our cash is in line with \$130 million, \$150 million. We should receive \$20 million from the sale of Solimoes to Rosneft and we should receive that inflow this month. And when we look at acquisitions, we look at a proportion of 80-20. We have talked with funds and investment banks and we can have perhaps a five time leverage. So, for example, with \$100 million, I can buy an asset worth \$500 million. With \$200 million, I can buy an asset worth \$1 billion.

And I'd also like to remind you that the company is debt-free and Polvo is an asset where we can take some debt on because Polvo has no debts on it, it's totally paid for. So there are some opportunities for Polvo. We could have a prepayment agreement to have reserves lending and we believe that with Polvo we will be able to raise about \$100 million. So with our cash of \$150 million and Polvo with a possibility of \$100 million, we will have \$250 million, which would lead us to an acquisition of a little over \$1 billion.

Now, this model works well, it works for the banks. Mostly likely the banks that would be financing the acquisition of the asset would also be structuring the financing for Polvo so that we can raise the additional \$100 million.

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But we are very cash responsible and we have a minimum cash policy. So very likely we are not considering to dry out our cash in an acquisition. We would use everything that we can, get some debt and maintain a minimum cash for the company for our operations.

Your second question, well we obviously find some synergies if we are in the Campos Basin, but we are looking at everything. We are looking at other basins. We are looking at other countries. We look at onshore, offshore. So we are really active right now. If it is in the Campos Basin, there are some synergies to be derived, but if not and if it's a good deal, we will be considering just about any basin. Thank you.

Q - Gustavo Allevato {BIO 18933135 <GO>}

It's clear. Thank you very much.

Operator

We are now closing the question-and-answer session. I would like to turn the floor back to Mr. Blener Mayhew for his final statement.

A - Blener Mayhew {BIO 19502444 <GO>}

Very well. I would just like to finish saying that as soon as we have some news about production, redevelopment, we will let you know. And I want to say that we do believe in Polvo. We believe that there are opportunities in addition to the first stage of redevelopment and we are convinced that the future is good -- the future is good for PetroRio.

There are many assets available for sale, many acquisition opportunities and a lot of appetite from funds and banks to finance new acquisitions. So the future is promising. Let's wait and hope that we will have a better next quarter. Thank you very much.

Operator

PetroRio's conference call is now closed. We would like to thank you all for participating and have a good day.

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