

Q3 2016 Earnings Call

Company Participants

- Renato Jerusalmi, Head of Finance and Investor Relations

Other Participants

- Albert Sebastian, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the conference call for the 2016 third quarter results of PetroRio. Thank you for standing by. At this time, all participants are in a 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 via webcast and may be accessed through PetroRio's Investor Relations website at www.petroriosacom.br by clicking on the banner 3Q16 Earnings Release.

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 it depends 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. Renato Jerusalmi, Head of Finance. Please go ahead, sir.

Renato Jerusalmi {BIO 19910567 <GO>}

Good morning, everyone. Let us begin our conference call to discuss the third quarter results of PetroRio. It is a great pleasure to be addressing you again. I will start on slide three.

FINAL

Bloomberg Transcript

FINAL

Here we talk about the main highlights for the quarter. The first point is that we were awarded Best E&P Company in Latin America in 2016 by World Finance magazine. We are very happy with that recognition. Second, our production reached 771,000 barrels in the quarter, 13% higher when compared to the third quarter of '15 and very much in line quarter-on-quarter, slightly lower. And this was due to scheduled maintenance stoppage that happened in September, which I will explain later on.

Our lifting cost was \$28.37 per barrel. This was the lowest lifting cost ever in Polvo, 26% lower than the third quarter of '15 and 42% lower than the third quarter lifting cost of 2014. Adjusted EBITDA was BRL15 million. Basically here we had a provision for Rosneft receivables, which I will explain later on which justify [ph] an adjusted EBITDA of BRL15 million. Our net income was BRL71.5 million. We had a higher operating efficiency, 94.1%, despite the scheduled maintenance stoppage in September. If we were to adjust our operating efficiency, net of this stoppage would be an operating efficiency of over 99%, which is very good.

On slide four, please, I will tell you a little bit about this award by World Finance magazine. This award was based on the total turnaround of the company that reinvented itself with our new exploration strategy, moving to a production strategy. And we were able to redevelop Polvo to continue to generate cash even in the fields that have been producing till 2013. This is an important year where we improved the lifting cost, reduced the G&A, the same story we told you here and which we will detail later on.

So we think that we got this award based on all of those improvements. If you're interested, there is a link of an article of that magazine that tells a little bit the story of this award. We think that this article is really good. And we had an interview in London to speak a little bit about our business case. If you are interested, please access our website and have a look at this article.

Moving on to slide five, we have here the Brent prices. We are seeing a huge volatility in Brent prices which is really impressive, the kind of volatility. We had, in the last four months, more than 10% difference in the price of Brent. We had a shooting downwards in August of about \$10 per barrel. Brent reached a minimum of \$41 per barrel and this was due to international pessimism due to Brexit, the excessive producers in the US, a reduction of 480 million barrels versus 360 million barrels in the last five years. So we are way above that. And an increase in OPEC countries' production.

Then we had a shooting upward, reaching a maximum of \$53 per barrel in just 10 days. This was after OPEC's meeting in Istanbul in the end of September where they signed an agreement to reduce production. OPEC September was about 32.2, 33.3. And it would have a reduction by 1 million barrels per day. And that obviously was very favorable for Brent price which increased very quickly in that period and Russia also signaled that they would get into this agreement to freeze production. And then we had a shooting downward in the last 15 days of October when Brent went down to a level of \$46 per barrel. The market started doubting that this agreement, OPEC agreement, will be followed and the OPEC countries continued to increase production reaching an all-time high of 34 million barrels.

Recently, we had the surprise election of Donald Trump which appreciated the dollar. And yesterday we had a 5% appreciation. The market is very volatile in the short term. Our vision is that we are in this binary position according to the OPEC agreement. If the agreement goes through, we believe that the Brent will be at around \$50 per barrel. If the agreement doesn't come through, we expect Brent price at \$40 per barrel or less. So, this is extremely important for the credibility of the market.

We continue to be optimistic in the mid to long-term. Our thesis [ph] remains that supply repositioning after strong cuts in investments and exploration (inaudible) development will not be enough compared to a natural deviation of production (inaudible) demand growth which is relatively stable. If you look at the demand, it's growing about 1.5% per annum.

I think it is important to highlight here that we, in the financial area, follow-up close all oil data. We're really on top of things. We were able to have a successful commercial strategy during this quarter because we have postponed the sale of two offtakes to September, which were priced at the higher Brent average of October rather than the Brent average price of September and thus enabling the company to increase gross selling price by \$4.2 per barrel, multiplying by 771,000 barrels in the quarter we are talking about \$3 million more and we were quite happy with our decision.

Moving to the next slide; slide six, please. We talk about production and offtakes. Production had an average of 8,300 barrels per day in the quarter, that represents a slight decline of 4% compared to the second quarter of 2016. And this drop is due to the scheduled maintenance stoppage in September. We stopped for five days. And if we were to adjust the production, net of the stoppage, we would have an average production greater than the one in the second quarter of 2016. Just keep that in mind, if we haven't stopped our production, it would have been higher than the production of the second quarter '16.

We can observe in the bottom chart, production month by month in the quarter. In August, when we completed our interventions in the end of July through the month of August, there was a full month of production after the [ph] redevelopment program in our production was approximately 9,000 barrels per day. The operating efficiency reached exceptional levels in July and August, over 99%. And if we were to adjust for the scheduled maintenance stoppage efficiency, operating efficiency would be 99.5% in the quarter. As you can see, these are fairly significant numbers.

Accumulated production through September totaled 2.2 million barrels and we project for 2016 a total production of 3 million barrels. 25% is the production estimated in our latest reserve certificate. It's a significant result for mature fields and this shows our excellence in operating mature fields. We had two offtakes in the period. The bottom table shows that there is [ph] in July and September totaling about 1 million barrels. And our average gross selling price was approximately \$50 per barrel.

Please go to slide seven. These are the charts that we always show you every quarter. The first is Brent versus lifting cost. This is a managerial one. And the second is Brent versus

our total costs. We think that this chart is very interesting, both the charts, because they show the improvement in the operational margin of the company which has been impacted by Brent prices as of 2014 and our lifting costs have been falling quarter after quarter. We didn't have great changes compared to the second quarter, so we can see that Brent remained -- average Brent is at about \$47 and our lifting cost is at about \$28. In the bottom chart same thing, Brent and our total costs about \$38 per barrel.

And we think it's worthwhile highlighting here that our average sale was \$50 per barrel, slightly higher than the average Brent price in the quarter and with that we were able to get an adjusted EBITDA of BRL15 million versus an adjusted EBITDA of 12 million in the second quarter of '16. This result was slightly better in terms of our adjusted EBITDA compared to the second quarter.

Let's go to slide eight, please. Here we show you our absolute cost, lifting costs. These are managerial costs, not accounting costs of COGS. And we can see -- and here we can show the efforts by the company to reduce the OpEx, reducing the lifting costs by more than 60% since 2013 and 17% reduction year-on-year. We can see in the left bar, in gray, we can see our lifting costs in the third quarter 21.9 and if we can maintain the same level in the fourth quarter of 2016, we are going to deliver our goal of \$19 million of COGS for the year.

Same goes for G&A, the gray bar shows our G&A of \$3.3 million in the quarter and if we are able to maintain the same performance in the fourth quarter, we will deliver our goal of \$14 million. I think that the most important thing is that all investors understand that we are going to enjoy the relevant synergies when we acquire assets because all of our back office and technical structure is already in place and can handle all of our assets. So we are going to have a significant cost reduction, but with growth and it's really important that you get this message.

On slide nine, please. I'm going to speak about our numbers. Focusing on the third quarter, we had the offtakes of 1.056 million barrels and you can see our selling price, you can see our revenue, our COGS and we can see BRL30 million positive as a result of our operations above the second quarter '16, so an improvement year-on-year and quarter-on-quarter, an interesting operational result.

We had G&A expenses remaining stable at around 14 million, BRL14 million, BRL15 million and had the other expenses amounting to BRL16 million which is very concentrated. We made provision for Rosneft receivables and even some contract provisions which I will explain later on. So this is a non-cash expense. And if we exclude this effect, our adjusted EBITDA would be BRL15 million, compared to an adjusted EBITDA of 12.2 million in the second quarter.

Just to remind, in the second quarter of the 36 [ph] million, that provision for the rigs in the second quarter of about BRL6 million and this is why we have an adjusted EBITDA of over 12 million in the second quarter. I think it is important to mention because this is a recurring question of whether Polvo generates cash or not and we are showing that Polvo does generate cash at this level of Brent prices over \$45, \$46 per barrel, so we are

FINAL

generating an EBITDA of about BRL12 million, so which is what we generated in the second and third quarters of this year.

And then we have depreciation, the 15 million financial results, also concentrated in our fixed income investments and equity investments. And we can see the deferred tax and net income of BRL71.5 million. If we were to exclude foreign exchange variation from our net income, our net accumulated net income in the nine month of 2016 if we were to exclude foreign exchange variation, instead of having a loss of BRL45 million, we would have a net income of BRL10 million. This is just for you to have an idea of the results if we were to exclude foreign exchange variation.

I'd like to remind you that foreign exchange variation, in our case, since we have assets in dollars, when the dollar -- when the real appreciates, we have a negative impact, which is what happened this year basically. We are now seeing the dollar appreciating. This is going to give away an opposite effect in the fourth quarter if the dollar remains at the current level.

Moving on to slide 10, we show you the dollar variation, the variation in cash flow. I think that the slide is self-explanatory. I don't have to go through every point, but we have calculated that the final cash is about BRL500 million and we ended the third quarter with a cash of BRL529 million. I think it is important to mention here that in closing the third quarter we had receivables referring to offtake of 53 million which we received in the beginning of November. So, if we adjust for receivables price, our cash would be about BRL580 million. So we're able to increase our cash production even in a very challenging scenario for oil prices and markets.

And I think that to end the call, I'd like to make a final remark, which is a doubt about -- that always comes about M&A. We remain focused on acquisitions that will generate value to our shareholders and we have interesting opportunities, the pipeline is full. We have some negotiations underway, but these are complex ones. And it's an M&A process, so we don't know whether we are going to get the deal.

And with that, I would like to end and thank you all for joining us. And now we would like to open the floor to questions.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session for analysts and investors. (Operator Instructions) Our question in English comes from Albert Sebastian from Prospect Advisors.

Q - Albert Sebastian {BIO 1786077 <GO>}

Yes. Good morning, gentlemen. I have two questions. First, can you give the status of the return of the deposit from Shell for the fields that you're going to purchase, but you did

Bloomberg Transcript

not? And second, what is the status of the final payment from Rosneft for the Solimoes?

A - Renato Jerusalmi {BIO 19910567 <GO>}

Could you please repeat the second question, Albert? We couldn't hear.

Q - Albert Sebastian {BIO 1786077 <GO>}

Yes. My second question is the final payment from Rosneft for the purchase of Solimoes.

A - Renato Jerusalmi {BIO 19910567 <GO>}

Perfect. Thank you. Albert, it is a pleasure to have you with us again in the third quarter 2016 earnings conference call. Thank you for the question. Let's start with the question about Shell. We are still negotiating with Shell about the 7 million. They see the contract differently than us, so in the sense that they could retain this amount and we are here evaluating whether we are going to go to court against Shell. We haven't gotten a lot of novelties about this in addition to what I mentioned in the second quarter conference call.

As for the final payments from Rosneft, we have advanced a lot with Rosneft. We are quite optimistic that we will get paid about \$11 million by year-end. All of the contracts are basically finalized and I think it's just a final process of having them actually make a payment. But we are confident that by year-end we'll get paid, hopefully this month. But I don't want to promise anything, but we are confident that we will get paid by Rosneft. And you might have a question about negotiations on the rigs. We are advancing quite a lot with them regarding the rigs and we expect to close the sale of two rigs by year end with payments to be received, half in the end of the year or during the first quarter of 2017.

Q - Albert Sebastian {BIO 1786077 <GO>}

Thank you.

Operator

(Operator Instructions) We are now closing today's question-and-answer session. I would like to invite Mr. Renato Jerusalmi to proceed with his closing remarks. Please go ahead, sir.

A - Renato Jerusalmi {BIO 19910567 <GO>}

Well, I would like to thank all of you for joining us. It is a pleasure to have one more conference call with you. We remain available for any further questions that you might have; you can call our Investor Relations department. And thank you very much and have a good day.

Operator

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

FINAL

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

Bloomberg Transcript