

## Q4 2017 Earnings Call

### Company Participants

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

### MANAGEMENT DISCUSSION SECTION

#### Operator

Good morning, ladies and gentlemen. Welcome to the Audio Conference Call of Petro Rio for the Fourth Quarter of 2017 Results. Thank you for standing by. At this time, all participants are in a listen-only mode. Later, we will conduct a Q&A session for analysts and investors, and further instructions will be given at that time.

This event is also being broadcasted simultaneously over the Internet via webcast and may be accessed through Petro Rio's Investor Relations website at [www.petroriosa.com.br](http://www.petroriosa.com.br) by clicking on the banner 4Q 2017 earnings release. Before proceeding, let me mention that forward-looking statements are based on beliefs and assumptions of Petro Rio's management and on information currently available to the company.

They involve risks, uncertainties and assumptions as they are related in future events and therefore, depend on circumstances that may or may not occur in the future. Investors should also understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Petro Rio and then could reach results that differ materially from those expressed in such forward-looking statements.

I would now like to turn the call over to Mr. Blener Mayhew, Director of Finance, Investor Relations, M&A and Business Development. You may proceed, sir.

#### **Blener Braga Cardoso Mayhew** {BIO 19502444 <GO>}

Good morning, everyone, and thank you very much for joining us today. We are here to discuss the results of the year of 2017 as well. And I would like to start by saying that we had an exceptional year for the company. Also, this has been a very challenging year vis-à-vis the oil prices. Now, we see a slight recovery that occur at the end of last year, but throughout the year, we still experience a very challenging environment.

Now, moving to slide 1 now, we have the main highlights for 2017. We had record net revenue higher by 34%, reaching BRL 534 million. There was an increase in revenue that has been continued on an annual basis.

(00:02:45) of M&A, in 2015, if you recall, we only had 60% of Polvo and we had revenues of BRL 253 million. In 2016, we acquired the remaining 40% interest at Polvo and then we

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had BRL 397 million. And now, in 2017, we reached revenues of BRL 534 million at 100% Polvo and 10% of stake at Manati. Polvo had production. And despite that, we were able to increase revenues year-on-year.

Operational efficiency at Polvo was 97.4% in 2017, the highest in the field's history. And for three consecutive months, we had an operational efficiency of 100%. In the past, we operated at 80% (00:03:42) and 97%. This is still very above average for the (00:03:47). We're still very proud of these results and this certainly demonstrates our operational efficiency to manage mature fields.

We also concluded the acquisition of Brasoil in March 2017. We announced that in December of 2016, the acquisition of the Goldman Sachs in 2016. On the first quarter of 2017, we start to negotiate the acquisition of the other stake, and we finally concluded 100% of acquisition of Brasoil. We concluded both negotiations and the acquisition of the company itself, and so we had full control of the company on March 20. We were able to acquire 100% interest, and with that, we were able to deploy all of our measures and decisions in a very independent fashion.

And right in the initial month, this - what really gave us an important financial result was the reduction of costs because we shifted the office, and we just met many or all Brasoil employees because they were many functions that overlapped. And the size of G&A cost of BRL 8 million a year was eliminated. So, that BRL 8 million yearly cost was set down to zero, and this brought about great economic benefits.

Our EBITDA was BRL 132 million and net income of BRL 51 million. It is important to highlight that this price affected every year. We promote accounting adjustment in some lines that are noncash. Here, out of the BRL 132 million, only BRL 40 million are noncash effect. So, in fact, the company generated BRL 90 million in its operation. So, this is cash. It's EBITDA cash.

So, BRL 90 million in a very challenging environment as that of 2017 where the field produced 7,500 barrels. This is an exceptional figure and despite the entire backdrop of the industry (00:06:12), that's why we're very pleased with this result. Cash position was BRL 663 million, 10% higher vis-à-vis 2016.

Moving to the next slide. We see that oil price went to \$66.87. It's nearing \$70 in January, and we went back a bit now. It's around \$63 to \$65. But in fact, this is a very comfortable level for the company. Last year, in 2017, oil was close to \$42. So, now, with \$65, that is a very relevant margin for the company.

Moving to slide 3. 2017 was the first year where we sold oil by ourselves last year. In past years, we had an agreement with the trading company and the trading company did all the brokerage on our behalf. And then, we made a strategic decision to terminate that contract, and we hired experienced traders. And, therefore, we are selling the oil ourselves. That was the very assertive strategy because we were able to have a 41% cost reduction in the discount.

And we are selling our oil much better. Not only that, we have more flexibility in terms of selling our (00:07:57) co-load it when you get together with another operator to share the vessels or share the ship. So you can – some of them have 500,000 barrels and then we can come up with another 300,000 barrels and then we split the cost and do a (00:08:22) cost depending on the amount of the oil that each one put in. So we are either selling alone by ourselves or through partners. And this has helped us bring cost down and this had a direct impact in our revenue.

Moving to slide 4, next slide. Here, we see the growth of operational efficiency. We have fourth quarter of 2016 and a comparison with 4Q 2017. Now, the operational efficiency and the average daily production is 99.1%. And as far as we are so proud of this figure and we see several indications to participate in seminars and congresses because they want us to explain how we move from 80% in 2014 and 2013 to almost 100% now.

So for the second year in a row, we were awarded a price in London for the Best Independent Company in Latin America and this really pays off all of the efforts we put into that and we're able to deliver great figures every 1% in addition means that we are extracting more oil from the ground. More oil so more revenues and better returns to our shareholders.

In August, October and November, our operational efficiency reached 100%.

Now, moving to slide 5, here, we have listing costs at Polvo field. It was slightly up from \$30.7/bbl to \$ 33.3/bbl. This is just natural because this is a decline in fuel. And even with fixed costs, et cetera, once the field is declining, this equation raises the cost per barrel. And we believe that considering the size and dimension of the operation, this is still a very attractive cost per barrel.

Looking on the left, the cost per barrel, we have absolute cost of \$91 million and 2017 was \$95 million. Everything is denominated in U.S. dollars. And this small difference happened because part of the contracts, especially for FPSO, at a variation, they vary according to brent. There was the valuation that occurred in 2015 with our supplier, aiming at reducing the cost of FPSO, and oil prices were down.

And in that negotiation, the trader said okay, I'll give you a discount, but once all your prices go up, I want an increment in the rent of FPSO. So, starting at, I think, \$35, whenever prices are above \$55, there is a table that provides for price adjustment. So, as there was an increase, there was a slight price adjustment.

Moving to slide 6, we have Manati's production. Manati is an asset where we do not operate. Petrobras operates that asset at site, there isn't (00:11:53) much to say in terms of those assets. First is just like a highly lucrative and profitable asset we sell all the gas we produce to Petrobras, and Petrobras protects us for any market or demand fluctuations, so regardless of demand, so we always sell at the minimum level.

And in 2017, we're very much in keeping with the minimum level set up in the contract. But we really favor those asset because it provides a natural hedge for the company, that's

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an agreement where it is directed by IGPM and the revenues are in BRL. So, it's a natural hedge that is according to the volatility when you look at the sales from Polvo, you have more volatility with bulk in terms of oil prices and also exchange variations.

Now moving to slide 7, here we have our P&L. We can see that the revenue was 34% higher than in 2016, there was a natural decline from Polvo, a slight increase in oil prices than we have eight or nine months of Manati's production. So, this addition was BRL 397 million to BRL 333 million - BRL 133 million as explained by the factors that I just said, so from BRL 397 million to BRL 533 million, therefore our gross result is BRL 186 million which is 3 times higher than the figures from the year before. Now, G&A and G&G was BRL 95 million. We have other revenues and expenses of BRL 41 million, and EBITDA was BRL 131 million. It looked smaller than last year, but in fact, it's higher because if you look at other revenues and expenses, these are the noncash effect items. These are accounting reversals so that our BRL 344 million number is noncash and that BRL 41 million in 2017 is also noncash.

So, once you eliminate that BRL 344 million and BRL 41 million from the down below EBITDA, EBITDA is then much higher in 2017. We went from a negative EBITDA in 2016 to an EBITDA of BRL 90 million in 2017. EBITDA margin went to 24.7%, and we have depreciation and discounts of BRL 90 million. So, the financial results fixed income tax too and then net income was BRL 240 million.

We are very pleased with that position. We are still a small company with many challenges ahead of us, challenges both from the industry and also from the countries, especially when it comes to regulatory environmental measures. And we've been doing all we can to deliver good results and to grow the company and in fact, give good returns to our shareholders.

And I believe that this is also reflected in the price of our shares. And if you look at the share price, I think according to Economat Survey, we are considered the third best investment in the stock exchange. We were just behind Magazine Luiza, and another company. So, if you think in terms of a company that back in 2013 didn't even have revenues and now in 2017 is considered the third best investment according to (00:15:55) that really illustrates that we are doing a good job.

SG&A was 20% higher. This number also includes some nonrecurring events like royalties. We also have some arbitration under way since last year in previous management. That also includes payment of bonuses. And also, we still have some severance costs because of Brasoil. So, we still have some recurring expenses that we hope that in 2018, this will be lower, lower than BRL 95 million but it should be higher than BRL 75 million because the company is growing a lot, and therefore, we are investing in our expansion. We are hiring people and it's the company growth, it's natural for G&A to grow in that same proportion. So, this BRL 95 million figure is certainly non-recurrent, and we hope that this figure will not be repeated in 2018.

Moving to slide 9. We have our cash flow for 2017. We started with BRL 570 million. The oil and gas sales, BRL 544 million in sales; operating costs, SG&A, minus BRL 432 million;

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minus BRL 48 million in royalties; financial result and funding, BRL 99 million; M&A and CapEx, minus BRL 111 million. M&A because we acquired Brasoil, there were three assets as part of Brasoil. There was an exploratory field in Amazon as well.

So, in addition to that, we have CapEx and Polvo maintenance that's BRL 111 million. And at year-end, our cash balance was BRL 702 million, considering account receivables and oil prices. It's a very sound balance sheet. Our cash position is what we still have installed for the M&A. And once we are ready and with a signing contract, we will have BRL 700 million, it's about \$7 million to use - to conclude the M&A without having to resort to any additional funding.

What is the outlook for 2018 now? We hope and we wish to drill. In Polvo, we did a workover in 2016 when we had a 25% production increase. And based on the results from this workover and also based on all of the geological material collected during the workovers, we believe that we have a very good project to give the next step in Polvo for new wells, exploratory wells, but still within the range (00:19:13) Polvo.

This is a process we would like to start drilling in 2018, but will still depend on two negotiations with public authorities. One is with ANP where we are claiming for a royalty reduction from 10% to 5% in exchange for new investments, mainly because of the severity (00:19:36) of the field which is a mature field that would have been abandoned if it were not for our efforts because it was supposed to be abandoned in 2016. And so that's why we can now have a return from the regulatory agencies.

And other aspect is that even if ANP agrees with the reduction in royalties, we still have to negotiate with IBAMA when we're diligently working with IBAMA both in - here in Brazil so that we can go on with the drilling in Polvo. But unfortunately, this has been a very lengthy and hard process. It is not an easy task and we're facing several hurdles, and I think the industry as a whole is also finding it difficult to negotiate with IBAMA.

But we believe that after some time diligently working with that, we may be able to see some light at the end of the tunnel, maybe by the end of April. We hope that with this environmental license, all of that is to finalize the royalty discussions and then maybe we will be ready to drill the wells in the first half of the year. Now, oil prices stabilized between \$60 to \$65 range and we believe that this will be the range for 2018, and this puts us in a very comfortable position for Polvo as well.

In terms of cash generation, there was an improvement in Manati. Manati production usually follows the economic growth. We came from two or three year period of recession and now we are seeing not a total rebound, but I could say that there was a gradual improvement in the economy. And with that, in 2018, industries like Camaçari and the surrounding areas of Bahia, they will produce more. They will demand more gas. And as they demand more gas, we will be able to sell more. 2017, we were within the specs of the contracts so maybe, in 2018, we may be above the contract levels due to the growing demand stemming from the economic growth.

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Now, still talking – now talking about M&A, which is something very important for the company and for the company's growth and, certainly, this will interest all of our investors. We've been working diligently since 2017. These are oftentimes competitive and lengthy processes. These processes involve also headquarters from international companies where all decisions have to be made both in Brazil and abroad at the same time. And therefore, these are decisions that take some time, but we are very optimistic.

I would tell you that we are very close to do planting or through planting the seeds or reaping the benefits of the seeds planted in 2017. There are many things happening. However, when it comes to acquiring oil fields, you know that you have to wait until everything is signed until you are very certain that the business has been concluded.

Nothing is said and done until the contract is signed, but we are very optimistic and it's still referring to M&A. We have that very aggressive goal because we have that big dream to – by the end of 2017, we would be able to produce 100,000 barrels. This hasn't happened yet. And that was mostly due to delays in the sale of assets of Petrobras. And when we put that goal before us was – it was not a firm goal. It was just a dream at that time, but we were looking at the assets that would allow us to reach the landmark of 1,000 barrels.

Starting 2016, Petrobras cancelled all of the asset divestments that they had in the pipeline. But now in 2017, they now reviewed and resumed that process. And we are participating in some of those. I would say, however, that is not bad. We left that goal on the side. The only thing is that, it is now delayed, but we're still pursuing those goals as one of our targets.

We want to acquire assets from Petrobras, there were fields that produce 40,000 barrels, some others 17,000 barrels, others 50,000 barrels and some others 25,000 barrels. Therefore, there are still strong possibility because we have the necessary capital and I believe that we – our cash position, plus leverage, we may not even have to do any follow up – follow on or raise any additional capital. We will be able to acquire assets amounting to up to \$1 billion using what we have in our cash, and plus another \$800,000 in leverage our debt.

We will be acquiring – producing assets and with the cash flow, you can use part of your cash flow from a target to leverage the purchase. So, we have \$300 million, and with that, we will be able to buy assets amounting to \$1 billion. Then we also have partners and investment funds. So, in Brazil and abroad, we also have the support from trading companies and we – if we use all of our resources in order to acquire an important asset, we can also resort to the capital market (00:25:52). But at first, we believe that with BRL 1 billion, we will be able to acquire a new asset.

So, let's say, I think in 2018, we'll be able to give you good news, and we are seeing now that Petrobras is advancing in that area. They have made some very – they have given clear step towards that and the market is clearly seeing that. And we believe that by August or September of this year, almost all processes where we are engaged in should

be concluded. These are all competitive processes, and you know that the best price will win. We will work hard to have a win.

And as the last item here, we were interested in previously and with all of the appreciation and the interest rates, the market is recognizing our efforts. We had an increase in the daily volume of shares. Sometimes, we had 10 million, 15 million, 20 million of shares (00:27:08) trading volumes. But more importantly, we have our shareholder base. We constantly have new shareholders coming in, institutional shareholders, asset managed, management funds, international funds, Canadian funds, U.S. funds.

Certainly, we see now that we have more professional investors, they're analyzing the numbers and they are realizing pre-authorization (00:27:37) is a good investment. And therefore, they are acquiring shares. And we are very proud of that fact because not only we are delivering good results year-on-year, quarter-on-quarter, but also we know that our investors believe in our promising future.

I would like to thank you all very much. And I am now concluding the presentation and we are ready to take your questions. Thank you very much.

## Q&A

### Operator

Ladies and gentlemen, we will now initiate the Q&A sessions for analysts and investors. Our first question is from (00:28:31).

Good afternoon.

**A - Blener Braga Cardoso Mayhew** {BIO 19502444 <GO>}

Good afternoon, Gustavo (00:28:40).

**Q - Operator**

Do you have any forecast for proceeds?

**A - Blener Braga Cardoso Mayhew** {BIO 19502444 <GO>}

Could you ask again?

**Q - Operator**

Do you have any forecast for proceeds or dividends or anything like that?

**A - Blener Braga Cardoso Mayhew** {BIO 19502444 <GO>}

Well, no, not at first. Our M&A pipeline is quite interesting and we believe that the money could be best used if we reinvested in our business.

## Q - Operator

Thank you.

Next question from (00:29:15), shareholder.

Good morning.

## A - Blener Braga Cardoso Mayhew {BIO 19502444 <GO>}

Good morning, (00:29:20).

## Q - Operator

How much do you estimate in terms of investment for the revitalization of the Polvo sales in case you get the approval.

## A - Blener Braga Cardoso Mayhew {BIO 19502444 <GO>}

Well, we are looking at an investment of around \$50 million to \$60 million. \$60 million which in the case of success, in case we have a commercial discovery and then we will spend \$60 million. In case there is no commercial discovery or in case we are not successful, then the cost would go down to \$25 million. It's pretty much like that. You drill and you drill and if you find oil, you will then put the well to work. And if you only drill, it's \$25 million to drill and to make it productible, you add \$35 million more. 00:30:12

## Q - Operator

Thank you. I got it.

We now conclude the Q&A session. I would like to give the floor to Mr. Blener Mayhew for his final remarks. You may proceed, sir.

## A - Blener Braga Cardoso Mayhew {BIO 19502444 <GO>}

Well, once again, I would like to thank you all for joining us today and I would like to stress that 2017 was a very good year, a very sound year for the company, and we're very optimistic for 2018. The company is growing, we've been growing the company since 2015 when the new management took over. We went through a very difficult time when we had a turnaround of the company, even at the trend the oil prices and when oil prices reached \$40 was even more difficult, but we were able to increase revenue, to reduce costs, to increase operational efficiency, to increase our cash position, and at the same time, we won several awards.

We attracted good talents. And so, we are very excited. We think that we find ourselves in a very comfortable position (00:31:40) that the company certainly has to grow. And I think that, today, we have a very good growth platform. And if we are able to replicate what we did in Polvo in other fields, we will certainly produce exceptional results.



I think that year 2018 will be a year with many good promises from well drilling and to new acquisitions, acquisition from Petrobras assets, and also acquisitions coming from the private sector, acquisitions also in Brazil, in the Gulf of Mexico on the U.S. side. And, also, we are looking at other prospects in Northern Africa. So, there are so many good things coming and it will be a transformational era, I'm sure. It may be the last chance for investors to buy shares at the current level today. I would like to thank you very much. All the best, and have a nice weekend.

## Operator

Petro Rio's conference call is now concluded. I would like to thank you for participating, and have a good day.

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