

Q4 2016 Earnings Call

Company Participants

- Blener Mayhew, Chief Financial, New Business Development and IR Officer

Other Participants

- Phillipe Souza, Private Investor

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the conference call for the Fourth Quarter 2016 results of Petro Rio. Thank you for standing by. (Operator Instructions) This event is also being broadcast simultaneously on the Internet via webcast. And may be accessed through PetroRio's investor relations website at www.petroriosacom.br, by clicking on the banner for Q 2016 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 international growth are based on the beliefs and assumptions of PetroRio's management and on information currently available to the Company. While forward-looking statements are not a guarantee of performance, they involve risks, uncertainties and assumptions as they are related 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, Finance, Investor Relations. And (New) Business Development officer. Please, Mr. Mayhew, go ahead.

Blener Mayhew {BIO 19502444 <GO>}

Thank you. Good morning, to all. This is (Blener). I would like to thank you all for joining us in this conference call for the full-year 2016 and for the interest that you've shown regarding our Company. I will start talking about the highlights for 2016.

2016 was a very, very challenging year for the industry as a whole; not only for PetroRio. But for all oil and gas companies. It was a year where we saw the oil price deteriorating to an all-time low, reaching \$27 per barrel in the month of January of 2016. This was

unprecedented: the lowest price in the last 10 years. And it was indeed a very difficult moment for the industry and for PetroRio.

At this time some (analyst markers), some renowned banks pointed to a possible reduction in the oil price to even \$15 a barrel. It was indeed a very challenging and very constraining year to everyone.

Despite the reduction in the oil price, we were also dealing domestically with a very unstable macroeconomic and political situation, with changes in the government, the President Rousseff's impeachment, et cetera. And that made exchange rate -- the real to depreciating -- in dollars to depreciating, impacting that Company. Our operating costs, 50% of those, are denominated in reals; and G&A, 100% is in the real. So we had a negative impact on our costs.

Despite all that, we believe that we were able to manage those challenges. And end the year with excellent results. So we started the year, as I said, in January of 2016 with 1 barrel costing \$27. And we knew that we would have to work very hard to deliver good results. We knew that we had a very challenging year ahead of us.

I'm going to put slide one and talk about the positives. Towards the end of the year, we were able to complete and announced to the market the acquisition of Brasoil. Brasoil is one of our competitors. And it is a company that has four assets. And later on, I will speak about Brasoil assets. And Brasoil was an interesting acquisition, because it was rather complex.

Some of our competitors had tried to acquire Brasoil in the past. And given their ownership structure, with a number of different shareholders, they each wanted something else; they each located in a different country with different legislations -- well, it was a complex deal. And we were able to complete it. We were very happy that we were able to do it still in 2016. And we were able to announce it in the market.

We began the negotiations in May. It was at the end of the year when we were discussing contracts with a proposal on the table. We weren't the two heavyweight competitors who were still trying to make a higher offer to acquire Brasoil. But we were very nimble, competent; and we were able to complete the deal before another company could buy them out.

Talking about our lifting costs, this was the lowest lifting cost ever for the Polvo Field, at least since 2013: \$30 per barrel lifting cost. And you have to take into account that this is indeed a very important mark, the lowest in our track record. We are looking at a field that in 2013 produced 13,000 barrels. And then had a decline. When you do the cost equation per barrel, we are doing quite well in that field.

As I mentioned earlier, not to mention this dollar depreciation and the cost of barrel, where you have a declining production and increasing costs, given that proportion of 50% of our costs are in BRL. So the whole thing was very difficult for us. If they dollar rate had been static, our cost per barrel would be about \$26 to \$27.

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PetroRio's EBITDA was BRL329 million. What makes up this EBITDA? As explained in our explanatory notes in the balance sheet, a good deal of that, at BRL309 million, is due to an exchange reversal that we had. This does not have a cash effect on the Company.

But of those BRL329 million, BRL47.9 million are tax credits of PIS and COFINS taxes that we are recognizing here has a revenue; but it will actually become cash, because it will be savings for the Company in 2017. So where we would have to pay PIS and COFINS in 2017, the Company will use the tax credits and will benefit from this. We will save money: BRL47.9 million in the EBITDA that will be converted into cash.

This was very nice work done by our tax and financial team. We were able to find these credits that we were entitled to in the past. And we were able to approve and have these tax credits now available for use in 2017.

Another important point was the extension of Polvo's lifespan. We had a cost reduction compared to 2015 which was quite relevant: \$109 million from \$91 million. But not only that, we redeveloped the field. We had three re-entries in the First Quarter. And that includes production by around 20%. This was a very successful project that we started.

Today we are producing 8,500 barrels. And if you look at that curve that we presented in 2015, if we hadn't had this redevelopment we would be producing today 6,900 barrels. This was a production increase, not only when we redeveloped; but it is an increase to production that has been maintained for the Company. And very beneficial for the Company.

Not only did it increase production. But also it was possible to get geological samples from new areas, new sands that we believe have potential for new prospects, new wells. And our team is looking into that. And we're quite advanced in those studies. And this reentry opened a whole new array of investments for Polvo Field.

And my fifth highlight has to do with operating efficiency. It is important to highlight that we had a number of hurdles, a number of challenges. We had pumps that failed in the first half. The boiler failed given some BW operating problems that have been addressed. And we had to have some stoppages in wells to make investments for those re-entries that I mentioned that increased production.

Adding all that altogether, we had moments of stoppages for the field. And especially during the 12-day scheduled maintenance stoppage, instead of doing all the maintenance in 12 days, given a lot of effort by the teams, we reduced 12 days to five days. So we could make it up for all of the challenges and obstacles that we faced in the past with minus seven days of maintenance.

But that we got an operating efficiency of 93.4%. This is an excellent result, an excellent benchmark in the oil and gas industry. In 2013, the old operator had an operating efficiency of 80%, 8-0. And the average of all companies in the Campos Basin is 80% operating efficiency. So PetroRio operating Polvo Field with a 93.4% operating efficiency, that is proof and evidence of our competence and operating excellence.

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Moving on, let's talk a little bit about the Brasoil acquisition. Brasoil is a company that has cash-generating assets, assets under development. And exploration assets. So the acquisition of this company undoubtedly brings a blend to PetroRio's portfolio of assets. Not only because now we have another cash-generating asset, Manati; we don't rely only on the cash flow coming from Polvo. But also we have Pirapema, an asset under development. And have the potential of Camarao Norte, where there has been a significant gas discovery. And it's going through a unitization process.

And we also have the exploratory blocks in the Equatorial Margin. This is not the current core focus of PetroRio. But it is an asset that can be valued later on with Total and the Exxon discoveries. There are a number of companies working in neighboring blocks. So this is, strategically speaking, it's very interesting acquisition, where PetroRio's portfolio now became more diversified.

And now we have a critical mass to address these new projects -- Pirapema, Camarao Norte, Equatorial Margin blocks -- to bring on partners to help us invest, develop the field, the projects. And to start producing these fields.

One point that is worthwhile remembering regarding Manati, today if you look at 2016, Manati's revenue was about BRL120 million, an EBITDA margin of (70%). So this is indeed a cash-generating asset with a very high margin. It has a take-or-pay contract with Petrobras which protects it from possible shocks in demand.

It is a natural hedge for PetroRio, because now we'll not realize -- what we used to be solely reliant on oil extraction and lifting; now we have a take-or-pay contract with Petrobras for a determined price, adjusted by contract indexed to IGP-M. So we can -- and it's in reals. So we're protected from variations in demand, exchange rate. And Brent oil price. We're not so exposed to the volatility of Brent.

Another interesting point is that Manati is a declining field. But Camarao Norte in Camarao that have gas discoveries are quite close to Manati. This conversation going on with all operators so that when Manati production, if I'm not mistaken, by 2020 reaches a certain limit below the demand for gas of the region, we can connect Camarao to Manati and use the whole gas pipeline from Manati to the continent to sell that gas. So there's a lot of potential synergies. We now have Manati, the gas supply from Manati. And we have Camarao Norte quite close to it. It makes a lot of sense to us.

Going now to slide 7, to speak a little about the macroeconomic scenario. If we look at the Brent price, the average was about \$51 in the Fourth Quarter 2016; and oil, (\$50.29). So as we see Brent in January was \$27. For a long time it fluctuated at around \$40, \$50, between those. And it ended the year with an increase, \$55. This increase, \$45, \$47, to \$55, was due to the agreement -- the OPEC agreement regarding a reduction in production. And given this OPEC agreement to reduce production, oil prices were at \$45, increased to \$55. Still a very low mark, historically speaking; but for a company like PetroRio that gave us a financial and operational relief that was quite substantial.

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Moving on, let's talk a little bit about production and offtakes. As I mentioned in the First Quarter, where we had some pumps that failed, had to be replaced, plus we had the redevelopment of the field as a well. So we can see that operating efficiency was slightly low in the First Quarter. In the Third Quarter we had the scheduled maintenance shutdown. And again, as mentioned, we had scheduled 12 days for maintenance. But that was reduced to five days.

And in the Fourth Quarter, there was a boiler failure that was quickly fixed and repaired. This was an operational BW failure. And all of the measures set forth in the contracts are being taken.

We have 2,980,000 barrels; our average selling price was \$47.55. And so had a year in which we were able to enjoy this increase in oil price. And in which we were able in our strategies to postpone some offtakes. And that strategy proved to be right.

For example, we had a scheduled offtake for January. Oil was costing around \$27. And we were able to postpone that offtake to March. We had to change some operational issue at the FPSO to release some tanks. And by releasing some tanks, we were able to store more oil than we could before. So we didn't sell in January; we didn't sell in February; but we had to sell in March. But in March we sold at \$36.29.

So that strategy to postpone the offtake gave us \$10 per barrel. Then we had offtakes in April, May, between \$40-\$50; in June, \$46; in July, \$46. In September we sold above \$50; November, dropped a little; and December, it was best offtake, \$54.88 per barrel.

Moving on, we have our reserves report. This is an interesting number. When we look at the 2015 certification report, I'm going to talk just about one piece, which is the production that we are more sure will happen. I'm not going to be talking about 2P or 3P reserves. But when we look at 2015, the DeGolyer-MacNaughton's reserves certification report indicated that Polvo had a reserve of 12.6 million barrels. Net of the 3 million that we produced in 2016, this 12 million drops to 9.6 million; 12.6 million dropping to 9.6 million.

So after 2016, after producing 3 million barrels which the report lists 13 million barrels. So 12.6 million pro forma with a production of (2.6) we get to 9.6 million. 9.6 million compared to the 13 million that we have today is an increment in reserves -- in 1P reserves of 35%. That's a very high number and a very significant one.

Taking into account that we have an outlook for oil price that is low, this reserves would go to \$55, \$56, the Brent. So if we get an increase in the oil price in the future, the number for the reserves can be even higher than 13 million barrels.

Please move to the next slide. We talk about the Company's costs versus the Brent. Let's focus on the Fourth Quarter, which is the new part, what we're addressing on this call. Lifting cost was about \$31.28; and average price, \$51. Now here we have a great contribution margin from Polvo to this result. But there are other costs here -- G&A,

royalties. And others -- which increase the total cost for the Company, as you can see at the bottom -- the bottom chart, at \$43.68.

So with an offtake price of \$51 -- and there is a discount, given the heavy oil quality of Polvo and some logistics costs to export the oil -- we are quite close to our breakeven point. (You can see that) our breakeven is about \$50. So this is more or less a snapshot that we have today.

We generate some cash with the oil price over \$50. We don't lose money. And in the current scenario, with so many companies in areas in the US going bankrupt, I think that if we are able to generate cash, that's already quite a positive result. And I would want to remind you that now we are going to have Brasoil assets.

That deal was closed. It has been paid. So it's already reflected in our balance sheet, the cash generation and revenue from Manati. And that number is going to improve our breakeven as a company dramatically. And I'm going to explain, later on, why.

Please move on and let's talk about Polvo Field costs and the costs of the Company. In 2013, when the old operator was in charge, we had \$240 million. Now we're operating at \$91 million, instead of \$240 million. It took about 4 1/2 years to be able to renegotiate all of the contracts and to get to the number of \$91 million. We believe that for 2017, there should not be new reductions to \$91 million or \$90 million; \$91 million is more or less a steady level.

G&A expenses, likewise. In 2013, where we have offices in Namibia, Canada, Solimoes; we have an office in Houston, (four bases in the forest). And a lot more employees. So we downsized the Company. We renegotiated a number of contracts. We changed our headcount, our focus, our strategy. And now we practically got our G&A expenses down to one-third of what it was, \$19 million for the full-year 2016. This should be a static number. We shouldn't see more reductions later on.

Let me remind you that both the \$91 million for direct Polvo Field costs -- \$91 million -- and the \$19 million for G&A expenses, these numbers were also affected by the exchange rate. So it can increase a little, decrease a little, depending on the exchange rate variation. Here we have been negatively impacted by the exchange rate. So I believe that these numbers will remain stable or will improve a little, depending on the exchange rate.

Now talking about 2016 results, I will be very brief. This slide is busy with a lot of figures. But I would like to highlight our revenue and our volume. What we had in December of 2015, 1.8 million barrels; and in December 2016, 3 million barrels. This is a 66% increase in production. The first stems from redevelopment of the field that increased the production by 20%. And also the acquisition of 40% stake from Maersk.

So if we think of a company that is able to grow production 66% in a year in one of the most challenging moments for the industry, this is a remarkable mark. Not to mention that are not considering here the acquisition of Brasoil. For 2017, we will start with an even higher production than this.

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Our average selling price, as I mentioned, was \$47.55 compared to December 2015, \$49.85. Even in the worst Brent price, we were able to have very strategic offtakes. And we were able to maintain an average price of the same as the prior year that have much higher selling prices. We can see the revenue, BRL397 million, 57% up. Royalties, as we can see; G&A expenses, BRL74 million, were lower. But still within the (spice) exchange variation that I mentioned. Then we have other revenues and expenses, as I mentioned: exchange rates, Namibia, extension; and we get to an EBITDA of BRL328 million.

Depreciation and amortization, basically for Polvo Field. And we have the financial income, BRL54 million. And this was negatively impacted by the exchange variation. We come to a net income of BRL241 million, a very important number for the Company.

Some critics might say that a good deal of this is not a cash effect but an accounting effect. Still, we believe that this reflects the whole work that our team is doing to clean up the issues of the past, to have a more lean company. And this is reflected in our balance sheet.

Cash flow for 2016. We started the year with a final cash of 2015, BRL500 million. We had BRL385 million in oil income, BRL183 million of divestments; and Bijupira and Salema. What are these divestments and BJSA? A good deal is related to our sale of our stake in Solimoes to Rosneft. And we received payment of the second installment in 2016. We also sold aircraft, not very much; nothing representative. And with the (known) conclusion of the purchase BJSA with Shell, we received the prepayment we have made. So all together, we get to BRL183 million.

Financial results, BRL71 million. Operating costs and G&A expenses, BRL321 million. Investments, BRL62 million. Exchange variation, BRL77 million. So we end the year with BRL615 million, a 15% increase in our cash generation. Considering the most Brent price in the last 10 years, a negative foreign exchange variation.

So are very proud to be able to deliver this kind of results to our investors. We worked very hard to get here in the (fedex) curiosity. Net of the exchange rate variation, our cash position would be close to BRL730 million; it would be even more significant.

I will now speak a little bit about new businesses, because I know this is interesting to everybody. It's the main growth matrix of the Company. In 2016, we announced that we participated and bid for Bauna. As you know. And you probably read in the media, Petrobras' divestiture program suffered a number of challenges, both internal and external. So a lot -- or a lot of the upstream assets that they put for sale in the market were not sold, with the exception of Carcara. And I don't remember any others.

We participated in about four processes. We bid in four processes in 2016. And of the four bidding processes that we participated, none came through. All of them came to a halt for which additional reasons, good reasons, or because of upcoming court decisions. So it's quite a complex situation for the companies that wanted to acquire assets from Petrobras.

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And still not relying only on Petrobras' divestiture programs, we were able to look at other things, get other things in our radar. And we were able to acquire Brasoil in 2016. For 2017, obviously Petrobras has quite interesting assets. Perhaps this is the biggest opportunity of growth in Brazil for PetroRio.

However, as a business strategy, we don't want to depend solely on Petrobras to grow. So we are quite active. We are looking at other companies. We are trying to think out of the box, enjoy other opportunities; looking not only to the Brazilian assets. But also of the Gulf of Mexico opportunities and opportunities in Paraguay, Colombia. And we are currently participating in about 10 bidding processes.

Of these 10 bidding processes, we believe that along 2017 we should add more assets to our business pipeline, or more prospects to our pipeline. And we should be able to close one or two more deals along 2017. But again, this process of asset acquisition is quite competitive. And these are complex deals. It depends on ANP and CADE, the antitrust agency, approval. And sometimes with just an acquisition of an asset, it might take 16 to 18 months to get approval. So even if we have some things quite advanced this year, we cannot be sure that we will be able to close the deals along 2017.

So this is kind of what's happening. I cannot give you more color on the new business that we have in our pipeline. But this is a very interesting moment for the industry. We feel that some companies are re-gauging and resizing their portfolios, because the crisis is there. And people know that the price of the oil will be at \$50, \$55. So this is a very interesting moment to acquire assets.

Our goal of 100,000 barrels by the end of 2017 is becoming more and more aggressive, more and more challenging. To hit that mark, we were counting on the acquisition of Petrobras assets. Bauna alone produces 50,000 barrels a day. But we're not going to change this goal. We will continue to pursue 100,000 barrels. This remains our target. And we're going to try to get there.

Right. So this is it. I would like to thank you for joining us. And now I will open the floor for questions. Think you very much.

Questions And Answers

Operator

(Operator Instructions) (Phillipe Souza), investor.

Q - Phillipe Souza

My name is Phillipe Souza. I'm an autonomous agent. And I would like to understand a little more your headcount. How many people are working in operations. And how many people in office job positions?

A - Blener Mayhew {BIO 19502444 <GO>}

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Phillipe, hello. Today we have at the Company, considering office and our support base in Niteroi, about 100 people. Our outsourced offshore operations has -- we have a fixed platform with about 40 people, 4-0, on board. And we have about 80 people at the FPSO. So it's 80 people at the FPSO operated by BW. And 40 people in the fixed platform.

Q - Phillipe Souza

Thank you very much.

Operator

(Operator Instructions) This concludes today's question-and-answer session.

I would now like to invite Mr. Blener Mayhew to proceed with his closing remarks. Please go ahead, sir.

A - Blener Mayhew {BIO 19502444 <GO>}

Well in a nutshell, I'd like to say that 2016 was a very challenging year. But we rolled up our sleeves and delivered excellent results, excellent economic and strategic results in terms of all of the acquisitions. And we are quite excited about 2017. The year started very well with a lot of things happening. And we believe that this is going to be a very promising here.

With this, I close. And I would like to thank you for your interest in our Company. If you have any further questions please call our Investor Relations department. And we are always at your disposal. Thank you very much.

Operator

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

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