

Q3 2019 Earnings Call

Company Participants

- Nelson Queiroz, Chief Executive Officer
- Roberto Monteiro, Chief Financial Officer
- Unidentified Speaker

Other Participants

- Analyst

Presentation

Operator

Good day, ladies and gentlemen. Welcome to the Conference Call to discuss Third Quarter 2019 Results of Petro Rio. 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 will be provided. (Operator Instructions) This event is also being broadcast simultaneously over the Internet via webcast and may be accessed the PetroRio's Investor Relations website at ir.petrorio.ir3.com.br by clicking on the banner 3Q '19 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 their beliefs and assumptions of Petro Rio's management and information currently available to the company.

Positive statements are not a guarantee of success same both risks and uncertainties and assumptions that 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 that review, it 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.Nelson Queiroz Tanure Mr.Roberto Bernardes Monteiro, COO and Mr.Roberto Monteiro, CFO. Mr.Monteiro, please go ahead.

Roberto Monteiro {BIO 16616322 <GO>}

Good morning, everyone. Thank you all for participating on our Q3 call. I can see again that there are a lot of Petra Rio's employees on this call and so folks this is excellent. Most of us those are shareholders of the company. So, it is only natural that we take an interest

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in the company's results successful and I'm very pleased to see so many of you want to bother[ph] as always.

Such as speak about the quickly results again, and we had a third quarter of sustainable growth across our assets. We could place it six months with project yields under our management. And, we were able to improve all health environment and safety indicators of the field. That were already very good and we improved even further.

So that's very positive, overfilled to continues to operate and to produce with a very positive production. That's very satisfactory. Then we are now also speak, so this will not be reflected in our future results. In the middle of a drilling campaign has resolved, I hope to be able to share with you all very soon, which has also been operating really well, like clockwork. It's running to the bills operator and we have a 10% interest in that field, but we are very pleased with the performance of the assets. I want to mention just a couple of highlights.

For the first time in the company's history, our revenue hit the mark of BRL1 billion, more than BRL1 billion. So, this is very important. In five years of this company this is the first time that the company exceeds mark and so we has three month ahead of us. Many things to point out, that the company has been growing, both by its by position and by developing the assets, so we already had.

So, this growth which we experiencing which is very positive, which simply the company's plan. Continue to acquire or producing assets with an outside potential both in terms of management's efficiency and the drilling of wells. And so, we have had a very positive growth.

As I mentioned, we had very positive results, better again has been the very best ever for the company to-date up lifting cost or cost per barrel. At the end of the day, the best strategy we can have to cope with Brent's price variability is to keep our costs as low as possible with them successful in this strategy.

By the way, it is worthwhile mentioning that we completed the acquisition of the remaining 18% stake of product yield, which belongs to Impact. This deal took a longer than we would have liked, but we can do the closing now and the asset is 100% ours and soon the results of the field will be reflected in our income statement. For this quarter, this is not yet the case, which makes make that very clear that from now on.

In other words that the fourth quarter will have 70% of projects production reflected in our numbers. But still we have a lot of good news to come sooner and we expect to share with you all the results of the drilling at four producer wells. We are starting to examine a possible drilling campaign at private field. This should happen sometime next year more towards the second half of the year. Although, we're very excited for the possibility to drill again at that field. And to conclude as the CEO. I'm very happy that the company's performance and everyone's engagement and constant dedication.

All of us at Petro Rio, how difficult it is to integrate a new asset, into have a very safe transition. So I would like to thank all of you who worked here at this little he was well as all of those who acquisition of Frade field. And I'd like to thank Chevron for helping us, promote a very safe and smooth transition and for being very professional. We can say that because of them and also because of the work by our own staff, we are now able to know the effects really well and to operate at very safe life.

With that I would like to thank all of you and I now turn the floor to (inaudible). Thank you.

Unidentified Speaker

Thank you, Nelson. Let's try talking about the company's operational performance. Starting on Slide 3. Well, I consider the main highlights of the quarter because the addition of Frade's Fields operation at project Field. We now have no more ties with a prior operator and at the same time, we now understand that more and more of the field geology, so that now we can schedule new operations and initiatives to improve the fields production.

At the same time, I would have been effectively managing our listing costs already reaching across the below \$23 a barrel, 14% lower than the third quarter of 2018 showing that we are on the right track. Operating efficiency at the field remains at satisfactory level above 98%, which is also the result of our day-to-day work. Synergies on land and air logistics have been duly captured with all of our pending items to be resolved this month and all related to see logistics in the beginning of Polvo drilling campaign, which is already starting.

Moving to Slide 4 to have this map with a general view, showing all assets that we operate and I would like to focus specifically on production. We can, you can see the project yield unlike what would normally happen considering the decline of appeals? We can see that. Since Perta Rio started to work on the field indirectly and then directly, we have been able to reverse the decline in production. And in Q3 '19 compared to Q3 '18, we see production increasing by 15% and this is the result of our work.

On the other hand at Polvo, we see a reduction of production. For this is explained by one, the difference between peak production the startup of production, of the world's trailed last year, which is network carbonate wells.

We have a high initial production with a subsequent mind decline and two, a low performance of some submersible pumps EBS and their failure in the end of September. They were to wealth, which in fact that production -- but have performed in a relatively stable fashion given the clients demand for gas. So this fuel has behavior we know quite well, it will deliver as planned.

Moving to Slide 5, we see our lifting cost, which shows that we have been doing our part producing slowly but steadily, we're still on a journey. This is not final yet. We were able to capture a good deal of synergies and now we have to optimize our resources and apply

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them to the field, mainly project field and we continue and our plan to reach a lifting cost of BRL20 per barrel by the end of December or beginning of next year

On Slide 6, we will speak a bit about our operational performance. We can see and focus on production of our fields both Frade and Povel and we can see both the fields operating efficiency that can see operating efficiency as stable and well control the levels with no recent red flags.

And you can see production with an excellent performance of Frade field where we're happy and optimistic about the way in which the field has been responding to our actions. We had some short-term initiatives already implemented such as gas injection bow head for well cleaning and estimation.

The reopening of the well with hydrate formation in addition to -- and reservoir management. For the matron[ph], number of initiatives are underway that we have started to bring about improvement. So, there is a plan for BSW reduction in some of the well. We'll have to inject polymers and some products. It's a slightly complex operation that we are planning with the production and reservoir team. Connections to stimulate the well aiming to increase productivity. With that what that activity is carried out and completed so far we can proceed with a considerable increase in projects production compared to what was expected considering the natural decline of the field.

So we are very happy with that and we assure that the actions that are being implemented for bring us the expected effects.

On Slide 7, in Polvo's Drilling Campaign, a change was made to its initial scope submersible pumps into well but in the end of September or in the beginning of October. And in well which related to change the EPS and next will operation for the peers among the others, EPS (inaudible) have been producing for 10 years. But we have (inaudible) an opportunity to re-completion similar to that it which have to be relative behind for pay, this again this weekend and we'll need a couple of things, to better assess production from these results. In terms of free schedule, we expect around 60 days for each well, so if we start now we should go until the end of December or beginning of January. To have the result that's been investments, we expecting approximately BRL20 million for the first stage.

We are very aware of these figures are so now it's just about giving up, moving on with the project and leading the troops in the future. On the side Frade Field, 8. I want to speak about the plan and schedule for the drilling campaign that probably should happen by the end of 2020-2021. Well, we will find these plants.

We already know the numbers. How many wells will drove[ph] for production in two injection wells and it will be divided in 2 phases and this is because we have a lot of supplies in our inventory so we can accelerate the drilling of these post well and then later at in second stage, we'll need to commission some items and it will take a lot longer. So for the first phase around \$190 million to \$100 million started in the house is simplified map for you to see where we will drill the producing the well, injection wells, where the

current ones[ph] are located. I just want to focus on this reservoir, where we will drill -- which will be offered to producing well, it is a known reservoir and a version one, has it was never used to full production. So we have high expectations for this reservoir. With that said, I turn the floor to the CFO of the company Mr.Roberto Monteiro to present our financials. Thank you and have a good day.

Roberto Monteiro {BIO 16616322 <GO>}

Thank you very much (inaudible). I will go over our financial highlights and analyze our financial performance as a whole in Q3. Well, the first thing I would like to highlight is the company's net revenue BRL1 billion, in the first nine months of the year or BRL1.4 billion in the last 12 months. So two very interesting and very strong record marks of the company which shows how well we have been growing and performing. In Q3 more specifically, we had a net revenue of approximately BRL400 million, as 78% increase over Q3 '18.

Our EBITDA was around BRL215 million above not the highest in absolute terms of a reported, posted the highest ever adjusted EBITDA margin which speaks very much in favor of these successful cost reduction campaign that we've been implementing as well as, in favor of the acquisition of Frade. As regards our leverage today and net sales over EBITDA ratio is at 1.2 times. In other words, that's leverage reduction mentioned in prior calls is becoming a reality.

Please stay to Slide 10. The most interesting point of highlighted is in the second column, related to a special result of negative BRL98 million, when we look at this company with its revenue in US Dollars and it's EBITDA practically falls in dollars. These BRL98 million of financial expenses which includes BRL79 million related to foreign exchange variation.

This is definitely not concerning to us and has no impact whatsoever and be financial soundness of the company. So I'd say this is the take home message. The company has been performing well with a very strong at EBITDA. However, the company's net income was strongly impacted by an accounting adjustment of foreign exchange variation. That does not impact the companies have at all from this analysis is valid both for our results net of IFRS 16 and for our results already considering the effect of IFRS 16.

Moving on to the next Slide, Slide 11, we show you to very important graph. The first is our EBITDA per barrel. We hit the mark of BRL31.5 per barrel. Even with a lower branch of oil prize along the third quarter, the company posted the highest ever EBITDA per barrel. So as I mentioned before it is underscores our success in bringing down cost, thanks to the synergies between the operations at Frade and Polvo and also as the result of acquisition of Frade and of itself, this is the field with a very good performance and already we had a very low operating cost.

As well leverage, we are at 1.2 times and it is important to remember that this 1.2 times net debt over EBITDA ratio takes into account only 6-months, or since Frade's acquisition. In the 6-months of Frade's operation considered a 52% working interest that the field as the disclosed in the beginning of October. However, working interest that Frade field

improved from 52% to 70% with no increase in our net said related to this acquisition as these level of leverage has nowhere else to go, but down.

Now, moving to our last slide, slide on funding. I want to draw your attention to adjust this loan here on the right from Citibank of \$48 million, which is a prepayment of receivables of Frade Field and we were all very excited about this possibility offered by a world-class bank believing in our company. Well to sum up this quarter, I guess, I have four points that I would like to stress. First, the company's financial statements improved quarter after quarter as it continues to improve every quarter.

This quarter's bottom line was impacted by foreign exchange variation both considering IFRS16 effects and excluding IFRS16. And IFRS is an accounting rule, which does not impact the company at all because they're saying that our revenue in dollars are nominated as well as our EBITDA, because reduction past there we have set that we have planned and proposed since the beginning of the year is being followed very successfully.

This this can be seen, in our EBITDA margin in our EBITDA for -- and in our lifting cause the basically in any angle your work we can see that our culture's reduction efforts have been very well executed.

And finally, the company is gaining more and more muscle, to prepare for possible acquisitions, new acquisition and getting ready to continue to grow. Till then thank you very much to all and I'd like now to start the question-and-answer session.

(Question And Answer)

Operator

Ladies and gentlemen, we will now begin the question-and-answer session for analysts and investors. (Operator Instructions) First question from (inaudible)

Analyst

Thank you. My first question has to do with M&A. Are you considering many good opportunities, I would like to have an update regarding what you have been thinking a vision for the future? Second question is about driving campaign. I think you gave us a better idea now, I'd like to know whether you are already negotiating with possible suppliers, vendors, drill providers. If you could give us some color on that it would be interesting. Thank you.

Unidentified Speaker

Good morning, Rodrigo[ph]. How are you? Well, let me speak about M&A and then I'll speak about pricing. Our M&A pipeline and I'm being very general here has never been so large. There are always many opportunities and there may be many possibilities to allocate capital.

Many opportunities of course never come to fruition but in addition to the Petro Rio's divestment program and which is the most traditional one. It's what people normally talk about and participate in with the other companies in the industry taking advantage of this interesting Brazilian moment.

When companies are buying Orange Blocks, Pre-sold, Blogs, the major trends and with that they are reformulating their portfolio and starting to divest different fields, which is the path were unthinkable to let go.

But this is a movement that we see as a natural one and very good for the competition there and many opportunities out there. We are working on many possibilities for Mergers and Acquisitions. Our pipeline is quite complete. As far as the private campaign, we have designed this container was divided into two stages as contamination. And obviously, we have started talking with some suppliers, but we haven't placed any formal order yet to these suppliers.

We are now at a moment of talking to them to understand pricing, to understand the market and so on and so forth. Of course this drilling campaign will strike next year most likely more towards the middle of the year and the end of the year. And we will be strongly funding for this drilling campaign. Thank you.

Analyst

Thank you for the answers. It was very clear. We have a question on (inaudible), two questions actually. The listing caused the (inaudible).

When do you think you will achieve it in the fourth quarter '19? And the second question, thinking about a successful drilling campaign at (inaudible). What would be a possible listing cost number after both campaign?

Unidentified Speaker

Hello, Rodrigo[ph]. Let's speak about (inaudible) Regarding the lifting cost what we said on the prior call and that remains valid. I will try to just to get you \$20 consolidated lifting cost (inaudible).

So this is actually the target that we have for the company and that we are pursuing. Of course, if we get to lifting cost lower than filling, it would be more than welcome. So it is always important to think about this number does not take into account production increases resulting from the purple or drilling campaign. So the number would be \$20 per barrel considering the company as it is and considering the natural decline of production.

Regarding, listing cost target after both campaigns. Well, since we don't give in oil production guidance after the drilling of the well, I think it's easier to think about our consolidated OpEx. Linking cost is nothing but a consolidated OpEx divided by the number of barrels produced along a certain period.

So when we think about the consolidated OpEx, we should get to a number close to \$170 million for a 100% of Polvo plus or 100% of Frade. It is important to consider that a tragedy we don't have 100% yet, we have 70% of projects.

So if we were to think about OpEx of the company only, it would be around \$150 million, perhaps \$145 million. This would be OpEx net for Petro Rio. Net for Petro Rio means 100% of Polvo plus, 70% stake of Frade.

Operator

We have one more question by (inaudible)

Analyst

What are the funding options up for the acquisition? And what is the status of the bond issuer at Norway -- in Norway?

Unidentified Speaker

Probably for regarding funding for acquisition, this is an acquisition is an opportunistic thing. Our trend is not to have a totally structured long-term funding pre-acquisition. For us, it is more interesting to use our own resources and if possible doing the bridge of loan or a loan based on an existing asset for the acquisition.

So this is our funding strategy. If you think about Frade, what we did was very similar to that. We had funding based on an existing asset Polvo and then we used our cash. And we took money likely a loan, but we were financed partially by Chevron[ph]. Maybe compare that to a bridge loan. And now what we are doing and this is getting to the second part of your question.

We are now extending the duration of the Chevron loan and having the opportunity of issuing a bond at Norway. We have a -- we are quite advanced in this process of a bond issue, what we call an information memorandum and at the right timing we will disclose it to a market. All \$60-\$58 today. The price was increasing, or at least it was before we started the call for that help. But if we keep apprised say \$60-\$58 and a lot of volatility, it gets a little in the way. So we have to work to find the right timing and sometimes this is more art than technique, but we are waiting for the right timing for those issuance.

Operator

Next question is from (inaudible)

Analyst

Over the listing cost that has been reduced and the EBITDA per barrel increased. Cost reduction is not impacting the EBITDA margin, the bottom line, what happened? What are

the expected cost reductions resulting from the synergies between truck, cargo and trolley?

Unidentified Speaker

Hello (inaudible). I think that there's a little confusion in here and it is really important that we clarify. The companies listing cost is dropping dramatically because of all of the synergies we've captured. And we're shipping to our original plan to capture these synergies. We are actually doing a little better than expected. So this drives down the lifting cost.

The counterpart of that, is that, that our EBITDA per barrel will increase and that's why we posted the best ever EBITDA per barrel even with the with a lower Brent oil price. So, this is very, very healthy for the company.

Now, when you talk about the EBITDA margin bottom line, I think you mean the company's bottom line, which would be net income. What exists between EBITDA and net income is a huge impact of foreign exchange variation. We reported our results in Brazilian Real, BRL, but all of our debt is dollar-denominated.

So when have a currency variation fluctuation as it happened in this quarter. We had \$1 to BRL400 and then \$1 to BRL420, around that we reported. We report this exchange effect on foreign currency liability as a financial expense, but the company is dollar-denominated. Our revenue is in dollar our EBITDA is in dollar and that's why it doesn't impact at all, just outlets at the company.

Operator

(Operator Instructions) Next question comes from (inaudible)

Analyst

Could you comment on the provision for decommissioning?

Unidentified Speaker

Hi, William[ph], yes, of course. The decommissioning provision works in the following way, but as posted in our balance sheet, is a dollar liability for decommissioning of the deal. This is an -- investment for them to call it. What happens at the end of the lifespan of the field and this is updated from time to time.

(inaudible) Today, the company is virtually 100% covered regarding the fund for the provision for abandonment or decommissioning. The company is 100% covered for that.

Analyst

In the case of all of it?

Unidentified Speaker

By the way based on the ex-inventory -- in our balance sheet about that is \$1 million more on that. But look all over, we have practically all covered since it's going to beyond of decommission provision for that we have a provision of \$52 million more than \$40 million given as guarantee. And when you see, the balance sheet is net for Petro Rio. And then what we have been in the balance sheet, what you saw in the closing of September was a 52% of the provision for decommissioning of Frade when we announced the deal with impact which increased our stake from 52% to the 70%, but provision will include as to capture 70% for the decommissioning provision for private deals.

It is important to remember that this provision for decommissioning is reviewed from time to time by AMT considering market condition. So decommissioning provision that existed in the past with it that they considered very high prices for the drill ships for these were always use to downward because of market conditions, that is normal that this will be reviewed from time to time.

Operator

This concludes today's question-and-answer session. I would like to turn the floor back to Mr.Nelson Queiroz for the closing remarks. Please go ahead, sir.

Nelson Queiroz

Well everyone thank you very much for the questions and for your interest. We are very confident about the company. We're very excited, very optimistic, and we hope to continue to deliver very relevant results. Thank you very much.

Operator

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

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