Q2 2020 Earnings Call

Company Participants

- Emiliano Fernandes, Legal Director
- Francisco Francilmar Fernandes, COO
- Roberto Monteiro, CEO & CFO
- Unidentified Company Representative, Company Representative

Other Participants

- Christian Audi, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

(Translated) Good day ladies and gentlemen, welcome to the conference call to discuss second quarter 2020 results of Petro Rio. (Operator Instructions). This event is also being broadcast simultaneously over the internet via webcast and may be accessed through the Petro Rio investor relations website at ir.petroriosa.com (inaudible) by clicking on the banner, Q2 '20 earnings release.

Before proceeding, let me mention that forward-looking statements that might be made during this conferee call relative to the company's business perspectives, projections and operating and financial calls are based on the beliefs and assumptions of Petro Rio'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 are related to Q3 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 Petro Rio 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. Roberto Monteiro, CEO, CFO and new business officer; Mr. Francisco Francilmar Fernandes, COO and Mr. Emiliano Fernandes, head of legal regulatory and management. Mr. Monteiro, please go ahead.

Roberto Monteiro {BIO 16616322 <GO>}

(Translated) Hello everyone, good afternoon. I see here a large number of investors following the conference call, and among them, many investors who are Petro Rio employees and who are also our shareholders; so thank you very much for joining us.

Before I move to the highlights of the second quarter 2020, I would like to mention more encompassing and broad point, recreating the culture of Petro Rio and the Petro Rio team.

I think that this was a very hard quarter from the global standpoint with COVID-19 pandemic and all that, but I would also like to point out the Petro Rio culture; a culture of efficiency, results, low costs, teamwork, empowerment and so on and so forth.

This culture led us to many achievements, even in this very challenging outlook. So I think this shows the company's resilience and the resilience of our business models. Now moving to the main highlights of the second quarter 2020. I would like to begin with our lifting [ph] costs.

Here for the sixth consecutive quarter, we saw a reduction in our lifting [ph] costs, it is now at $13.7 per barrel company-wide. We are reaching better and better lifting [ph] costs with still room for improvement. We will now integrate Tubarão Martelo, TBMT, and we will derive even more synergies. So a lot has been done, but there's still a lot more to do.

So this is the number one point, which I believe is very important in the quarter also to support our cash generation, debt reduction, and so on and so forth. The second important highlight of the quarter is obviously the forum [ph] in of Tubarão Martelo.

It was approved by the regulatory agency AMP just yesterday. So as of today, we are officially responsible for Tubarão Martelo and its operation. TBMT is producing now 7,000 barrels a day or very close to 7,000 barrels a day. As we speak, we are connecting one well to BMT-4 [ph], so perhaps in the next few weeks, production will increase.

And we will be connecting and doing the tie bank approval [ph] into BMT and we'll be connecting yet another well to BMT-10, but we will be giving you more detail on that later. In addition, we completed the renegotiation of our debt with Chevron.

We extended the payment schedule of our debt with Chevron. We had some strong and heavy payments to made along the second half of the year and we renegotiated with Chevron so as to have a little more time to service the debt and this stretched our cash flow a little.

This obviously brought some relief to the company's cash flow and was all around very interesting. The other two important points that we show here are the reduction of the net debt over EBITDA ratio from 2.3 to 2.1 times.

Again, that shows the company's ability to generate cash, even in such a challenging environment. And a final highlight, which is very relevant and which is linked to that, which is the reduction of our net debt.

We reduced our net debt by almost $100 million among Q2, so that painstakingly summarizes a good deal of what was done in this quarter. We were able to generate a lot of cash and reduce our net debt. I will now move to slide 4 and we'll address another highlight of the quarter, another very important point that needs to be mentioned. And of course this has to do with the initiatives related to COVID-19 pandemic.

All along the quarter, we maintained and continued to maintain total focus on safety and health and liquidity of the company. The operation along Q2 unfolded most of the time, I would say, coag [ph] normally tends to stain [ph] of late, but we had one event, one event that was concerning. We had to shut down the Polvo FBSO due to a small onboard coronavirus outbreak.

So if I'm not mistaken, the FBSO was shut down for seven days. We are now converting a third party review of the incident to verify the effectiveness of the service provider at the Polvo FBSO DW [ph] offshore, of course, always aiming to implement measures to prevent that from happening again.

Other than that, I would say that our operations were quite good and Francilmar will give you more on that in a minute. Other points that I would like to highlight, we continue to do rapid casts and pre-boarding screening. Along June and July, we gradually resumed our activities here in Rio de Janeiro.

And moving to slide five, I'd like to point out two numbers, we did more than 2,000 tests at the company, considering pre-boarding [ph] testing of all personnel boarding [ph] on our platforms and rapid testing then [ph] here in the Rio de Janeiro head office.

We test everyone working at the office, twice a week we test all of the employees here at the head office, all of us, and this has ensured gradual and safe return of our activities with these 2,000 tests performed, we found 41 cases, which were then confirmed and all protocols were followed so that we would not have COVID-18 disseminating, spreading at the company and as part of our operations.

So I would say that the companies blocking actions have been working really well. We are more and more confident to resume our operations and activities. With that, I will turn the floor to Francilmar to speak about our operations. After him, Emiliano will give out us a regulatory update and then I'll come back for the financials and closing remarks. So thank you, Francilmar, over to you.

Francisco Francilmar Fernandes {BIO 21185801 <GO>}

(Translated) Thank you Roberto, hello everyone. Let us move to the operating highlights. On slide five, joining with the most important highlight, the reduction of the company's lifting [ph] costs are now at $13.5 per barrel.

As previously mentioned by Roberto, an almost 50 percent improvement year on year and 20 percent improvement quarter on quarter. Later on, I will detail all these figures, so we can understand what happened and what's coming in the future.

PetroRio's production was 23.5 thousand [ph] barrels of oil equivalent in the quarter, and that is excluding TBMT and the Petro (inaudible) working interest of the 30 percent stake up Friday [ph].

With the completion of the TBMT acquisition deal, we get to the final stage of this transition and we'll start operating the field in the beginning of August and we'll start the process of optimizing resources and capturing synergies. I will also give you an overview of how this is going to happen. (Inaudible) production was 20 percent higher than the declining curve expected for the field.

We can still work and (inaudible) the natural decline of the field. We have increase production of pull [ph], a 30 percent increase related to the startup of the new well in the (inaudible) sandstone reservoir. And now I'm going to stress [ph] that in this case, we pay only 5 percent royalties as was approved.

And I would say that one of the most important highlights that has to do with the maintenance of the efficiency and production levels at the fields despite all complications related to COVID-19 pandemic. This stems [ph] from hard and intense work by all the principles [ph] of the company, particularly EHS and the whole operating team in this critical moment.

On slide six, we see the performance of our assets. It is important to compare the production level even in these turbulent times, we were able to maintain and even increase production a little, and always keeping our costs at an exceptionally low level.

Moving to slide seven, let's deep dive to understand the lifting [ph] cost. We at PetroRio understand that there’s no better strategy to protect from the price of the commodity than having an extremely efficient cost.

This is key to us, for that we have been acting on several fronts (inaudible) but one of the most important actions in recent times has been the review of the scope of several projects and services at our unit’s decreasing costs whenever possible.

We also internalized a number of services so that the company’s personnel can take over whenever possible, so as to avoid having to hire third parties. We renegotiated the value of many conference [ph] and postponed some nonessential services, those that do not compromise production or operating safety.

So, they were postponed so we can do them when better times come. And we see that those lifting cost reductions does not include the 30 percent working interest reduction of Frade, nor the inclusion of TBMT.

We will be working strongly in the coming months to capture synergies that TBMT and the extra Frade production which will give us some comfort regarding the lifting cost with a possible further reduction. Work should be intense in the coming months for us to achieve these goals.

Please go to slide eight for a detailed explanation of Frade fields operating performance in Q2, despite all hurdles and challenges we achieved one of the best operating efficiency rates of the field, 99.8 percent.

We did not have any production halt or shutdown problems, despite the reduction of people onboard. We kept only the essential crew onboard to handle production and maintenance at the unit with excellent results.

With that, as far as production goes we were able to reduce production decline to the natural decline of the field and we are maintaining around 20 percent of what we expected in the beginning when we acquired the field.

Obviously we were not able to do some actions to increase production, or to mitigate the field's natural decline, given the current situation. But the plans are still on our radar and will be executed in the near future as soon as [ph] conditions improve.

Moving to slide nine office [ph] operating performance we see that there was production increase as a result of the trailing campaign, but unfortunately we had a reduction in operating efficiency caused by a one time event and lower performance of the Polvo leased FPSO.

In addition to shutdowns due to equipment failure, unfortunately we had a number of COVID-19 cases onboard that vessel and had hoped productions replaced the crew with someone and so forth.

So we had a seven day shutdown until we were able to resume operations safely on that production unit. But we are back in business now, and we are now investigating the event to understand the root causes of the problem and to address the issue and prevent new occurrences which are highly undesirable.

Moving to slide 10, I would like to give you an update on the behavior of the well in the EOC [ph] and reservoir which started production in March. We can see this map of Polvo field from the top. Part of poll L [ph] this green part is the (inaudible) so we see on the bottom left hand corner that pressure has been maintained, practically stable in this period.

We've had five months of production. And considering other important data such as production, BSNW [ph] and other characteristics of the reservoir that gives us a lot of confidence in a robust analysis for us to continue with new wells in the same reservoir.

The reservoir and geology team is still carrying out some studies but very soon we should have a final position of what to do in the EO [ph] scene reservoirs present at Polvo Field and then we'll start evaluating possibilities at Turbarao Martelo Field.

Moving to slide 11 we will speak about Turbarao Martelo Field, TBMT. With the transfer of riots, process of the field approved, we are answering the final phase of transition that allows us to start the process of sharing resources and optimizing all resources linked to logistics, operation, and maintenance, technical, and operational support.

This should be accelerated in the coming months. The PEI, the individual emergency program has already been approved by Obama [ph], resulting from another agency [ph]. And that authorizes us to start reducing the number of vessels and helicopters and to optimize our logistic space.

Our next steps are to deepen our understanding of the asset to understand both the operation of the FBSO, as well as the geology reservoir and production pieces of the puzzle so as to expect the best out of the field and to accelerate the capturing of synergies.

Please go to slide 12 for an update of the Tie Back Project. In other words, the connection between Polvo and Turbarao Martelo Field.

We got a green light to resume and accelerate this project so the whole process of accusation of flexible and the umbilical lines and all the necessary steps, the equipment as well as the top side piece happen to resume and we would like to accelerate this to complete the tie back as soon as possible.

Lastly, I would like to thank all of our front line workers, both our own and third party personnel despite our difficulties and obstacles during the pandemic, they were able to prove the company's resilience will remain firm and strong throughout this period. I'll now turn the floor to my friend, Emiliano.

Emiliano Fernandes {BIO 21353218 <GO>}

(Translated) Thank you, Francilmar. Well, I'm going to start my part giving you a regulatory update focused particularly on the transfer of rights left to TBMT [ph] and fragile [ph] assets, these are the most relevant topics to date.

Well, as you know and this closed yesterday on the material fact, we signed the amendment to the transfer of rights contract so we completed the process to increase are waking interest of Turbarao Martelo. This process is complete. The process unfolded fast and we were able to impose a good pace in our dealings with the ANP [ph], despite the coronavirus issue that is getting in everyone's way.

But anyway, the process is complete and we are now moving towards the closing of the operation. There are no more objections by the agency regarding the closing of the deal, so on ANP's [ph] side of the whole issue is resolved. Now, we just have to go through the legal finalities and contract formalities to complete the operation. This should happen very soon.

As transformation [ph] on the technical side, we are 100 percent able to start operating the ass the asset. Regarding human resources, we are very anxious to get started. Our people are ready, prepared and standing by so that we can quickly start operating this very important asset.

Now, moving to Frade Field, as you know, the first half of the year was very much impacted by the coronavirus, prices, remote working, et cetera. But we took this moment to reevaluate the value of the abandonment provision. Our team carried out a number of studies on that topic and we have started this discussion with the agency. This will be, I should say, the central point in the process of transfer of rights.

In the coming months, we will focus on defining the abandonment provision and then on the guarantee. After the guarantee, the natural result will be the transfer of rights itself which we believe will happen by year-end, being optimistic, possibly stretching into the beginning of 2021 but hopefully happening by year-end.

And lastly, speaking a little bit about our people and the coronavirus crisis, we are now this week entering phase 2 of our returning-to-work plan. We'll have around 60% of the onshore [ph] people back in their offices.

Of course, some people will continue to work remotely. But we are moving ahead very cautiously using international benchmarking barriers, not only what is required by the Ministry of Health and the national benchmark but also international benchmarking measures.

We have adopted a number of safeguard measures to improve safety of the building such as a decontamination booth, very intense cleaning, hospital standard air conditioning filters, rapid testing twice a week for 100% of the people coming to work at the head office. Even if somebody not part of our team comes for a meeting, for example, they are also tested.

And these barriers have shown to be effective. We identified a few cases of people who were ill, or are ill or are immunized [ph], and positive and suspected cases were sent home for quarantine. This is proof that these barriers are effective.

This week, a great number of our associates are here at the office, physically present. And we are very happy to inform that this was being done carefully and safely. We are very happy to commend [ph] these people and also those who are still are still working remotely. With that, I turn the call back to Roberto. Thank you very much.

Roberto Monteiro {BIO 16616322 <GO>}

(Translated) Thank you, Emiliano. I will now address our financial highlights. The first highlight, as could be expected, is our EBITDA of BRL300 million with hedges included. Hedging results in the second quarter -- actually, this hedging led us to have an oil price equivalent to $51 per barrel along [ph] the second quarter of the year, a lot higher than what really happened considering the coronavirus pandemic and so on and so forth.

Another very important highlight in the quarter is our cash position in the end of June at $113 million. In addition to this cash position which is quite robust, we ended the quarter with $76 million in oil inventory or the equivalent to $76 million in oil inventory.

And we postponed off-takes deliberately. We postponed these off-takes exactly to seek better oil discount conditions and to avoid selling in this very complicated and difficult moment. And this proved to be a very wise decision as, today, oil prices are a lot higher than they were in Q2.

And a very important highlight which I kind of mentioned in the beginning of the call is the renegotiating of our debt with Chevron that improved the company's liquidity quite a lot for the second half of the year in 2021.

We reduced our net debt by almost $100 million and reduced our net debt over EBITDA [ph] ratio to 2.1 times from 2.3 times.

Let's go to the next slide, slide 13, here what I'd like to show you is our adjusted EBITDA. We had an EBITDA margin of almost 70% in Q2 and an adjusted EBITDA of almost 306 million real when we include the hedging results.

And in our results for the second quarter, I'm looking at the ex-IFRS results considering the negative financial results of 190 million real we have more than 100 million real related to exchange rate variation as we know the exchange rate dropped from 5.14, if I'm not mistaken, to 5.04 or something close to that. So the exchange variation corrected our dollar denominated debt and out abandonment numbers or better yet, our abandonment provision.

And that whole impact is seen in our bottom line. But again this impact is merely an accounting one. At the end of the day the company's revenues pack [ph] to the dollar. It is dollarized because we sell oil. So we have, I should say, a nature hedging to protect us from this kind of impact. This impact is not concerning to us it is actually quite healthy to have a good deal of our assets denominated in the same currency as our revenue.

While I'm now moving to slide 14 to speak a little about funding. But I actually need to show is how our funding and loans are better distributed. If we look at the upper right hand corner graph we see a better debt amortization schedule for the coming years. We can see in rounded numbers for the next 12 months, 800 million real plus 900 million real in the second year and 300 million in the third year.

On the back of the renegotiation of our vendor finance with Chevron another important funding is the Prisma loan, $100 million. In June we postponed payment of this loan to the end of July and now in the end of July we extended the loan for another 60 days aiming to convert this short term funding into a longer term debt. So this is moving ahead and I believe that this was the last extension of this funding. We are very close to turning this into a long term debt.

Moving to the next slide, slide 15, please. We show you our leverage. Leverage is totally under control, the ratio dropped from 2.3 to 2.1 times and it is the comment I made in the previous quarter call.

One does well to remember that this ratio of 2.1 times net debt over EBITDA includes the whole debt that we took on for the funding of Tubarao Martelo, $100 million however it does not include one single real from the corresponding EBITDA.

Starting today we will begin adding EBITDA from Tubarao Martelo and then we'll have a better correspondence, a better matching in terms of debt versus EBITDA. By matching I meaning including the same things or more less the same things. So leverage is very healthy, no yellow flags here and as we have mentioned in previous earnings conference calls our focus is to extend the debt. But there is no concern regarding the size of the debt.

Moving to the next slide, I will speak about the next steps. The international part is over but regretting [ph] the next steps I believe that the company did quite well in the second quarter of this year. Our business model proved itself, proved to be extremely resilient. The company proved to be extremely robust supported by our culture, our people, our methodologies and everything we have in place.

And now looking forward what I think is important to highlight is that with continuous focus on our employee's health and safety. This is obvious but never losing sight of the company's liquidity.

We will continue to rationalize and improve our costs as has been our habit as we have always done. And some interesting things looking forward are that now with Tubarao Martelo we are starting – I'd say that well we'll be connecting another well, well number four and this is already in progress.

And also, looking forward another interesting point is that we are resuming some investments, among them the tie back of [ph] Tubarao Martelo and Polvo, or better yet the tie back [ph] of Polvo with Tubarao Martelo as well as the connection of well number 10.

I want to stress that these two investments are already underway and we are now starting to look at some mergers and acquisitions opportunities. We do see some opportunities popping up in our radar screen. So things are going back to normal little by little.

The company continues to grow. The company continues to do well, continues to be resilient. So this is my take-home message for you. I would like to thank all of you for joining us today and we'll start the Q&A session. Thank you.

Questions And Answers

Operator

(Translated) Ladies and gentlemen, we will now begin the question and answer session for analysts and investors. (Operator Instructions). Our first question comes from Mr. Christian Audi with Santander.

Q - Christian Audi {BIO 1825501 <GO>}

(Translated) Thank you. Hello, Roberto. Congratulations on the results. I know that this was a difficult quarter but the resilience you mentioned is translated into your results. So congratulations to you and your team.

I have three questions that I would like to ask. The first going back to funding regarding the Prisma loan, do you think that in the next 60 days you will have the chance of turning that debt into a long-term debt -- did I understand you correctly -- and whether you are considering other funding options? How is this process unfolding?

My second question has to do with the company's cash. Could you give us an update on a potential drilling campaign at Frade? How do you see the dynamics there regarding timing given that, as you say, the margin is normalizing a little more and this gives you visibility in the future?

And my third question is also related to using cash in M&A opportunities. We have heard news about Papatea [ph] and I would like to understand if you envision more accelerated moves in the Brazilian market that could perhaps open a door for you to do what you have been doing really well, which is building assets.

A - Unidentified Company Representative

(Translated) Hello, Christian. Good afternoon, thank you for the questions. Let me try to address all three questions you raised. For starters, I actually think all three points are kind of interconnected.

For starters talking about funding and talking about the Prisma loan, yes, within 60 days we should be able to turn this loan into a long-term funding. No problems there. The process is quite advanced. We haven't done that yet because in the middle of this process of converting the debt to long-term we had the pandemic and everything that it brought along. So things are taking a little longer but there are no great concerns or stress here.

Something else that we are doing regarding Prisma, Christian, and regarding funding is the bond issuance. We have a firm intention of issuing bonds in the United States, 144A bonds. We already have the book-runners here and Santander is one of them. And things are unfolding well.

We are working now on updating the prospectus with our second quarter earnings. And with that, we have a window of a couple of months to issue that debt. It is on our radar to do this along the third quarter.

And I should say that this will not happen only case the market closes for whatever reason, in case the market conditions are worsened. But this is not what we are seeing. We see the opposite. We see a gradual and steady improvement in the market. So I should say that it is very likely that we will have this bond issuance.

And we would use the proceeds to extend all our liabilities, not only the Prisma loan but all of the debts of the company. Initially, extend five years and this in and of itself will release a lot of cash. And this cash flow would be used for the Frade drilling campaign and also for possible M&A opportunities. So this is what we're thinking right now.

Now, whatever we do now, Christian, regarding CapEx and oil, I can tell you [ph] with the current oil prices and the way the company is structured, we have a green light to proceed with the tie back of Polvo into Tubarao Martelo and the connection of well number 10 at TBMT.

This CapEx will happen regardless of the bond issuance or not. This CapEx, these investments are already happening. We have everything in place for it to happen. It broadly depends on the bond issuance. And M&As, well, it depends on the size -- on the size of the opportunity.

And it depends on the bonds issuance of the possibility of a capital increase with a follow on or something like that. We see M&A activity coming back. You mentioned Papa Taiha [ph]. There are others in our raters. So things are coming back.

Some major oil companies had some write-offs in their balance sheets just like petrol price in [ph] all oil companies. And some of them have major write-offs in their balance sheets and now they are resuming M&A activities and we see this very positively.

Q - Christian Audi {BIO 1825501 <GO>}

(Translated) Perfect. Very clear. And one follow on question regarding the drilling campaigns, Roberto. Could you comment -- of course you were highly successful in all the improvements made at Polvo.

As you move toward a drilling campaign at Frade Field, could you comment on differences comparing the fields? What can be harder to improve Frade compared to Polvo? Are they very different?

Is Frade more complex versus Polvo or not? Could you comment on possible differences? We just want to get a sense of whether the successful results of Polvo can be replicated at Frade.

A - Roberto Monteiro {BIO 16616322 <GO>}

(Translated) Well, Christian, I think that this is an excellent point. Well, the first thing we need to consider here is the science of CapEx for each one of the wells compared to the expected production increase at Polvo.

We talk about 15 to $20 million per well. And if we are successful we're considering extra two to 3,000 barrels a day in the AOC [ph] reservoir we had a good result. So that's kind of what we can expect in terms of operating complexity.

I'm going to speak about operating complexity. In the case of Frade, we're talking about a cost of 50 to $70 million. I'm giving you a wider range because with COVID and everything else we have to redo the pricing, et cetera. But pre-COVID-19 this was close to 70.

Today, I think it is closer to 50 million per well at Frade. So these wells are a lot more expensive. They cost triple the price of Polvo. But these wells produce three times as much, close to 6,000 barrels a day, around that.

So it's a game with bigger numbers. Big CapEx but also greater production. What I can tell you is that at Frade I think that the drilling campaign is low risk because one of the Frade wells has been drilled already.

And we have discovered the reservoir. So this is a low risk well. The other wells, some of them involve water injection. And we've tested water injection at Frade with positive results. So it seems to me that although the numbers are bigger, the risk profile is quite interesting when we take everything into account.

In terms of operating complexity I would say that Polvo is even more complex because in the case of Polvo -- this sounds a little weird but in the case of Polvo, I went through [ph] the whole integration of the work, the drilling and all is petrol heal [ph]. Most of the drilling team is petrol heals [ph].

We didn't hire a drilling rig to drill. In the case of Frade, we'll hire a drilling rig. So although [ph] these are different contracts, the good part of the CapEx involves the drilling rig. But we will hire the service.

So if we have a problem with the drilling rig at Polvo, petrol heal [ph] is in charge of dealing with that. The downtime is on petrol heal [ph]. Maintenance of the drilling rig is on petrol heal [ph]. And Francilmar came from that. So I would say that in the case of Frade, we do have a challenge of having deep wells.

But on the other hand, in terms of hiring those services, contracting those services; it seems a little simpler.

Q - Christian Audi {BIO 1825501 <GO>}

(Translated) Understood, very clear. Thank you, Roberto.

A - Roberto Monteiro {BIO 16616322 <GO>}

(Translated) Thank you, Christian, for the questions.

Operator

(Translated) Our next question comes from Marcelo Costa with XP Investimentos. Mr. Costa [ph], please ask your question. Next question from the web by Mr. Rodrigo Siqeda [ph]. It has to do with integration of Tubarão Martelo.

What will be the economics of the asset, since the (inaudible). Can you give us an estimate of amount and the inventories that will be integrated to PetroRio?

(inaudible) campaign that [ph] Tubarão Martelo, there is only Tubarão Martelo for H.P. [ph] and the expectation that Tubarão Martelo will achieve 100,000 barrels per day is maintained, what about the continuation of the current [ph] campaign and the CapEx of the current campaign (inaudible) PetroRio and to tie back basis still [ph] much of 2021, any possibility that this will be brought forward? The (inaudible) CapEx is still estimated at $50 million. What is the production volume expectation of TBMT 10HBB [ph], interconnected together with a tieback?

A - Unidentified Company Representative

(Translated) Good afternoon Rodrigo [ph], thank you for the questions. I'll start with the economics of the asset. We're integrating TBMT with expected 7,000 barrels a day in the beginning until the tie-back.

We'll have 80 percent of that oil produced. And the production costs, the OPEC [ph] of this cluster -- because now we look at this as a cluster, as a production cluster, so in economic terms, it makes sense to talk about a production cluster so the 7,000 of Tubarão Martelo, we'll have 80 percent of that, plus these 10,200, 10,500 barrels from Polvo, and the OPEC [ph] will be $120 million per year until the tie-back. So this is the economics we have in mind.

Very soon, (inaudible) Tubarão Martelo will interconnect oil (inaudible). So it'll take a few weeks, the drilling rig is there, it is working. (Inaudible). So TBMT should increase from 7,000 to close to 10,000 -- between 9,000 and 10,000, perhaps more towards 10,000 when we connect well number four.

And if we look at the track record of Tubarão Martelo, we can have a positive surprise, but we want to be a little more conservative. (Inaudible) production cluster until we have the tie-back.

When the tie-back happens, the economic change (inaudible) little. PetroRio will have 95 percent of Tubarão Martelo production, OPEC [ph] will be all PetorRio's and we will interconnect Tubarão Martelo 10 [ph] (inaudible) for Tubarão Martelo and RJS [ph], we could imagine it would be similar to number four, close to 3,000 barrels -- between 2,500 to 3,000 barrels.

Again, we're being conservative here and there will the increase in production. And regarding cost, we should bring the [OPEC] off the fields to close to $70 million and $80 million per year.

Why? Because we will return the Polvo FBSO [ph], the tie-back cost dropped. Francilmar and his team did good work during the pandemic and now we are close to $40 million to $45 million to be expended for the tie-back and Tubarão Martelo, (inaudible) the connection will cost about $20 million. So this is the economics of the field. Regarding March of 2021, that would be the deadline, right?

Actually, the FBSO [ph] is expected to be returned in July. Our base case is to (inaudible) until July, we are considering returning it in the end of June, beginning of July, but this is our base case because our contract would be (inaudible) every July; mid-July to be more precise. So imagine we will end the chartering contract of FBSO [ph] at this time of the year. And this is it, thank you very for the questions.

Operator

(Translated) Next question from the web by Bruce Barbosa [ph]. Hello. Congratulations on the excellent results. Could you comment on the issuance of bonds in the United States please?

A - Roberto Monteiro {BIO 16616322 <GO>}

(Translated) Hello, Bruce [ph]. Yes, the issuance of the bond – I mentioned a little bit in Christian's [ph] questions, but this process is being analyzed. We are debating the – the offering reprimanded, which is the document required for the issuance, and we're updating it with Q2 earnings; and it's all ready – practically everything is ready.

We are at an advanced stage. Now, it's just a matter of finding the right opportunity. The right opportunity to issue the bond; the market is improving gradually – little by little, so we have to follow market conditions and proceed with the issuance. The issuance will be practically 100 percent to refinance our liabilities, so that all short term debt will disappear.

And this is it, but I can tell you is that the process is under control. It's well outlined, and we made the decision together with the banks to not give the issuance now, but mainly because of market conditions; and so we updated our results now, so that we can quickly update the perspectives of the reprimanded and so that we can proceed with the issuance. So it's all unfolding well as expected.

Operator

(Translated) Next question from (inaudible) regarding the (inaudible).

Q - Unidentified Participant

(Translated) When do you expect to resume drilling? When you mentioned that the new discovery in the EOC in Oakland Frontiers for infill [ph] drilling – does this mean production in the same reservoir and if we drill other wells in the same EOC (inaudible) if we use a more powerful pump – can production be greater than 2,500 of pull; and would you be able to drill faster?

A - Francisco Francilmar Fernandes {BIO 21185801 <GO>}

(Translated) Thank you for the question, Rodrigo. Again, giving you more color on the EOC in reservoir. Firstly regarding the drilling – the drilling team is anxious to resume work, but we are waiting for the right timing and the right conditions.

As regards to using reservoir, I showed you a chart on the presentation. This reservoir has been showing at falling [ph] conditions in terms of volume and quality. When we talk about infill [ph] drilling it means drilling the same reservoir.

When we said that we have a new horizon at powerful field [ph] it means that with this level reservoir – in this geological age. It's the first time that we have production and this is breaking down the paradigm because up until recently we did not assign any value to this reservoir, but now we are proving the productivity of this reservoir; and this opens up a whole new range of opportunities.

So the next steps are – if we confirm everything and we complete some (inaudible) studies – we'll move ahead with the drilling of some new wells in the same reservoir; and then with the existence of similar reservoirs with good conditions, and this will be a new chapter to be explored.

Regarding how long it would take, the engineering team of PetroRio devoted to designing a project with cheaper wells. In PetroRio, we handle all the drilling and that gives us more flexibility. We have some new ideas in house and if they work, we'll have to – we'll be able to drill cheaper wells in well under 68 days. Thank you for the questions.

Operator

(Translated) Next question by Tiego Nowell [ph].

Q - Unidentified Participant

(Translated) Congratulations on the results. What is your expectation for initial production of well number 4F (inaudible)? When is the timing for production and the additional CapEx for the campaign is 100 percent in the hands of (inaudible), right? If the – the deal with Freddie [ph] until year ends – I believe that I'd like to know more on the deal of Freddie [ph] please?

A - Francisco Francilmar Fernandes {BIO 21185801 <GO>}

(Translated) Hello, Tiego [ph]. I must try to answer the operational question regarding well number 4F (inaudible). We are at a final stage. Tubarao Martelo is executing the CapEx and they are operating expenses are in the hands of (inaudible).

This operation is expected to end in the short term – in the next two weeks – maybe even earlier; and that's how PetroRio is referencing the operation up close because we'll take over afterwards. Now I'll turn the phone to Roberto.

A - Roberto Monteiro {BIO 16616322 <GO>}

(Translated) Regarding Frade, Tiego [ph], thank you for the question. Regarding Frade, (inaudible). Next I'll take (inaudible) that will happen in September, or close to that. So this is all a cash cost. So soon after this off-take (inaudible) that will happen in around September, we mentioned that with the price adjustment it will be close to $35 million to $40 million as soon as we have the closing.

And this amount will remain at that level for a while because we won't have any off-takes from the field until January or February, and then when we have another off-take the price will drop. So it drops, and then it increases a little because of the cost and it stops [ph] again, and so on and so forth. This is what I can tell you about Frade. Thank you.

Operator

(Translated) Next question from the web by Mr. Bruce Barbosa [ph]. PetroRio has just gone through a huge challenge, but we can see that the company is already deleveraged with plans to change the profile of the debt, do you see new opportunities arising, new (inaudible) fields to be acquired, or is the company focusing only on developing the fields that are already in the company's portfolio? Thank you.

A - Unidentified Company Representative

(Translated) Bruce, yes, they've just gone through a challenge and with sales quite well through these challenging times and yes, we are now seeing new opportunities in the market.

(Translated) (Inaudible) most common opportunities, divestments by PetroRio and so on and so forth, and also we see other assets from other major oil companies. And so there are opportunities in the market.

I think that things are picking up again with this oil price at $40 to $45 a barrel. I mean, it's not the price we would like to have, but it's a price in which the company can start thinking about acquisitions. So yes, M&A activity is picking up again, and I would say that we are considering the possibilities that are appearing for us.

Operator

(Translated) Next question from Lucas Chavez [ph] with (Inaudible).

Q - Unidentified Participant

(Translated) To start, congratulations on the results. The lifting [ph] cost of 13.7, but is it close to the bottom line? If so, now with the new integrations tied back (inaudible) can the lifting costs drop even further?

A - Unidentified Company Representative

(Translated) Lucas [ph], thank you for the question. Regarding lifting costs of $13.07 per barrel, well, I think it reflects the past. When we think about future expectations for the company, when we think about Tubarao Martelo, well four [ph], and then the connection of well 10 with the synergies in the tie back, we perhaps in the summary can expect this number to continue to drop in the coming quarters.

On the back of Tubarao Martelo acquisition and the capturing of synergies that will continue to happen from now until next year. And next year we're going to have a major reduction when we have the tie back, but until then we will see the lifting costs falling a little more.

We haven't gotten a second wave of reduction but we're going to have the Frade (inaudible) there will be some reduction in the lifting costs, then we are going to have to use same drilling campaign. So you know, we have a lot of room here to reduce our lifting costs even further.

Operator

(Translated) Next question from Mr. Arthur Martinez [ph].

Q - Unidentified Participant

(Translated) Hello. Congratulations on the results. I would like to have more color on the net loss of approximately $99 million. In your opinion, what led to this negative result?

A - Unidentified Company Representative

(Translated) Hello, Arthur [ph]. What led to this result was basically the exchange variation. If you look, the dollar rated increase from 5.14 to 5.40. Most of our liabilities are packed to the dollar, both in debt and abandonment provision. And I'm talking about ex-IFRS numbers, so these liabilities fall out it's exchange rate, and the exchange rate variation was almost -- amounted to almost R$110 million.

When we include IFRS, this non-cash amount increases even more so that we can get to this loss of 99. So, in a nutshell, as part of the 99 million, we have more than R$130 million related to non-cash factors. When we talk about non-cash, here's what we can tell you about non-cash. Our EBITDA was not adjusted by the dollar price at the end of the period, it was adjusted according to an average dollar price.

On the other hand, the whole liabilities are adjusted according to the dollar at the end of the period. So there are some exchange variations in these effects. The saying goes if the real appreciates, it would be the opposite. So, the fact that this is a non-cash effect, well, could mean that the company remains solid and healthy. This is mirrorly an accounting effect more than anything else.

And if the exchange rate tends to in verge and if we tend to have an appreciation of the real, we'll deliver a positive result, and this will be a natural accounting effect.

Operator: (Translated) Next question from Victor [ph].

Q - Unidentified Participant

(Translated) Are there other plans to invest in new wells to be drilled in TBMT and OVAL [ph] after the tieback?

A - Unidentified Company Representative

(Translated) Yes, we do plan to drill more wells. Soon after the tieback, we'll connect to better Martel [ph] or number 10, which is drilled, and with completion already installed. And after that, a marquee [ph] and not really precise or that's going to be soon after or perhaps more to little up before. We are going to drill at Polvo Field particularly in the EO scene [ph] sandstone.

This region that started producing is quite promising. Francilmar showed the pressure graph of that well. It's something they normally don't show, but in the specific case, we wanted to prove that point, and it's a big reservoir. We've been producing for several months and pressure remained constant. It actually increased a little and there was an initial reduction, but then the well recovered the pressure.

So this seems to be a very promising area, and just to answer your question, I think yes we are going to have more trailing particularly in the EO scene [ph] sandstone.

Operator

(Translated) This concludes today's question and answer session. I would like to invite Mr. Roberto Monteiro to proceed with the closing statements. Please go ahead sir.

A - Roberto Monteiro {BIO 16616322 <GO>}

(Translated) Well, I would just like to thank all of you for your participation. I'd like to thank all of you for joining us in Q2 earnings conference call, and I would like to especially thank the whole PetroRio team. A good point of our team is participating in the call, listening to our results as partners and as investors of the company.

So I would like to thank all of you for your determination, for your efforts along this past quarter. And again, thank you all for participating in this call. Thank you very much, and I hope to see you onboard in the next conference call.

Operator: (Translated) That does conclude PetroRio's conference call for today. Thank you very much for your participation and have a good day.