Q1 2020 Earnings Call

Company Participants

- Emiliano Fernandes Lourenco Gomes, Head of Legal Regulatory
- Francisco Francilmar Fernandes, Chief Operations Officer
- Nelson Queiroz Tanure, Chairman
- Roberto Bernardes Monteiro, Chief Executive Officer and Chief Financial Officer

Other Participants

- Bernardo Schoichet, Analyst
- Rodrigo Almeida, Analyst
- Unidentified Participant

Presentation

Operator

Good afternoon, ladies and gentlemen. Welcome to PetroRio's Conference Call to discuss First Quarter 2020. 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 and instructions to participate will be provided. (Operator Instructions) This event is also being broadcast simultaneously over the Internet via webcast and may be accessed through PetroRio's Investor Relations website at www.ri.petroriosa.com.br, by clicking on the banner Q1 '20 Earnings Release.

Before proceeding, let me mention that forward-looking statements, that might be made during this conference call are based on the beliefs and assumptions of PetroRio's management, and on information currently available to the Company. Forward-looking statements are not a guarantee of success, they involve risks, uncertainties and assumptions as they 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.

And I would like to turn the conference over to Mr. Nelson Tanure, Chairman of the Board; Mr. Roberto Monteiro, CEO, CFO of new [ph] business; Mr. Francilmar Fernandes, COO; and Mr. Emiliano Fernandes; Head of Legal Regulatory and Management. Mr. Tanure, please go ahead.

Nelson Queiroz Tanure {BIO 20365123 <GO>}

Yeah. Hello, everyone. Welcome to our First Quarter 2020 Earnings Conference Call. I'd like to send special greetings to all PetroRio employees, those who work at the office and (inaudible). It's been a while since we've been together face to face, we only meet using Zoom. So I hope that you're all well and healthy and respecting the recommendations of the authorities regarding social distancing and adopting responsible behaviors to care for yourselves and your families. I hope to be able to see you soon.

Here at the Company, we adopted a number of measures to ensure the continuity of our excellence in operating safety. Among them, we reduced the number of employees at all the fields operated by PetroRio and -- office personnel is now working from home. We adopted a number of measures to help us weather this difficult corona virus outbreak, and lower oil prices. Among them reduced POB, People On Board and the extension of onboard periods at our fields. We also adopted several pre-boarding monitoring procedures and protocols, as well as rapid tests to ensure the safety of all personnel boarding our platforms.

Among other measures, we also reduced the salaries of all onshore employees by 25% and reduced those salaries of the management by 50%. We also postponed all CapEx, which is not exclusively linked to maintenance. In other words, drilling new wells, both at Polvo and Frade is postponed until further notice. Our goal is to resume these plans as soon as possible, but for now, they are on hold. And lastly, but also relevant, we worked hard to roll over the Company's debt. So that -- all that will have a long-term maturity. We believe that we will be successful in all of these efforts. They have been progressing, some are complete, others are underway and close to completion, and we hope to weather the storm well.

So to speak about our first quarter, the period was essentially very good. Despite a Brent price decline, which started in March of this year, the Company had hedging arrangements. In the first two months of the year, we're positive. The first two months of the quarter were positive. So the impact of all this crisis, coronavirus and OPEC, Russia and Saudi Arabia having trouble coming to an agreement. Their debt did not impact the company. Our oil was hedged, so the offtakes in Q1 were at $65 per barrel. In addition, the fields operated with high operating safety, both Polvo and Tubarao Martelo, TBMT and also just stress the results of the first quarter that were positive. We drilled a new well at Polvo Field, which proved to be very successful. This is a well in our reservoir, which was not producing until then in the -- you've seen region, this reservoirs posting a very high productivity, at the higher end of our expectations. So this is very encouraging for us, both due to the result itself and to what we can represent for new drilling campaigns by PetroRio.

And worth of note, still in Q1 we embraced a very important acquisition, which will bring better and better results for the Company in terms of optimizing costs and increasing production, which was the acquisition of TBMT field, Tubarao Martelo. First it will be reflected in our figures with a production level reach and ideally we'll go weigh [ph] beyond 40,000 barrels. For now, we are recognizing in our income statement and balance sheet only the debt related to this acquisition. But it is important to keep in mind the counterpart, i.e., a very relevant incremental production of this asset. So overall, our results were very positive for the reasons that I mentioned.

And before I end my part, I just have a couple of more comments to make. The first, I would like to thank PetroRio's Board of Directors, that guided the Company for almost five years. The Board was renewed recently. There was a significant renewable and some Board members, who have been with us for a long time left. So I was going to thank each and everyone of you for your contribution, your vision and the ease with which you have always supported PetroRio's growth. And I would like to welcome the new Board members, to have a very positive individual experience. All of them, and I am sure they will have a lot to add to the Company in this phase. And this is of turbulence that we are facing now due to COVID-19 and low oil prices. And when this is behind us, when we resumed the growth that we were having so, welcome aboard and I am very happy.

And then just two more comments. The first is that, the first quarter of 2020 was actually my last as PetroRio's CEO. And to me, it was always a matter of a lot of pride even before I took over as CEO of PetroRio, along the last five, almost six years that I have been working with PetroRio to meet, it makes me proud to come to work every day with very competent and dedicated people in his streams are part of PetroRio to a great extent. And I have contributed so much to the growth we have experienced, all over this time.

And I want to congratulate Roberto Monteiro, who is taking over as CEO, in a company where we have so many leaders, strong and very skilled leaders, Roberto, definitely stands out. He has been a great leader, a very positive influence at the company throughout this period, that he has been with the company almost as long as myself. And I ensure that he is the right choice. He'll be a great leader. And he has been actually a great leader at the company at present, people admire that I myself admire, so Roberto, congratulations. I'm sure that you are more than ready. You've been preparing for this a long time. All of us have high expectations and I know that you also have very high expectations regarding what you'll will deliver. (inaudible) me for support and on all the company's staff, we've always went as a team and we'll continue to do so, to support you. Congratulations, you do deserve this position.

I now turn the floor to Francilmar.

Francisco Francilmar Fernandes {BIO 21185801 <GO>}

Thank you, Nelson. Good afternoon everyone, I hope you're well and healthy.

Let us begin with the operational highlights on Slide 5. This first quarter was another exceptional quarter for the Company. We increased production by a 102%. We doubled production in the yearly comparison, while we cut lifting cost by almost half, reaching $17.3 per barrel, an all time low lifting cost. This results from the ongoing work to optimize resources, increased to production at Polvo Field and maintenance of projects production. Lastly, we were able to complete the Company's reserves stratification report increasing 1P reserves by almost seven times and 2P reserves by practically eight times.

On the next slide, Slide 6, let us focus on production. Frade field performed practically stable quarter-on-quarter, reflecting production stability at the field. Polvo Field had a slight production increase which does not totally reflect the contribution of the new wells, given that the last well flowed first oil in the end of March. Manati Field had to shutdown due to the clients lack of demand for gas and we are waiting for new developments to resume production at the field.

Moving to Slide 7, please. It is important to observe the graph with the historic revaluation of the lifting cost per barrel, which is a historic low for the company. This stems primarily from all of the actions to optimize our assets, i.e. cost reductions, personnel optimization, as well as it also reflects increased production at Polvo and maintenance of production at Frade Field. This does not yet considered the 30% working interest of Frade acquired from Petrobras, that is waiting for ANP's approval, not all of the actions for Tubarao Martelo field. We believe that as soon as we put all of this into action. Several initiatives are being implemented particularly related to TBMT Field, which will contribute to reduce lifting costs even further. We are working to reduce the lifting cost to $15 per barrel a little less.

On Slide 8, focusing on operating performance, we see that Frade continues to perform very well above 99%. The operating unit is performing really smoothly, no problems there. Production is responding really well to all initiatives that we have implemented so far, which are short-term actions. Mid-term actions which were planned namely in the certification program, chemical injection to reduce BS & W [ph] are at the final stage of planning and have been put on hold, given the current situation that prevents any action at this point.

Long-term actions mainly linked to drilling campaigns. What can be done in-house has been done. All the part related to project designs, studies, et cetera, all of that continues and is quite advanced. The final part related to commissioning et cetera will be postponed until we can have more visibility on what's to come. It is quite interesting to observe that after a year of production the Company kept output at practically the same level as when we took over 18% higher than what we ourselves had estimated in the beginning. We are very happy and proud to have operate at the field for one year, shown that both the strategy and its execution are unfolding really well.

For Polvo Field on Slide 9, we see a considerable improvement in operating efficiency of the field, as a result of resumed production of the wells. I'd like to remind you that in the previous quarter we had several wells that failed exactly when we were drilling other wells. And due to wells competing for drilling rig time, we were not able to use the rig immediately and it ended up impacting the fields operating efficiency. And another important point to remember is that Q1 '20 does not include production from these new wells, given that the last well drilled only started production in the end of March.

On Slide 10, we have more detail on the drilling campaign carried out at Polvo Field. The final result of the campaign was exceptional, because in addition to being on budget, we were able to expand the scope of the project level. We had originally planned to drill two wells with only one being a producing well. In the end, we were able to put two wells into production. And mainly because, well POL-L, you can seek POL-L in green on the schematic. Our POL-L is a reservoir of excellent quality, although the oil is a bit more viscous, it has proven to be of good productivity. We've been producing for practically two months with very stable pressure, showing that the reservoir has indeed a considerable volume even greater than we expected and this has been confirmed day-by-day.

We can see in the drawing that the reservoir is quite large, one of the largest of all the field. And this gives us a lot of confidence and a lot of data obtained during the whole drilling campaign to dive into the study of this reservoir. And it is likely that we will have infill drilling in the same reservoir to be able to flow all the oil. This will definitely be at the target, the goal of the new wells since this is gaining more relevance in the Company's portfolio. It is very important to stress that the campaign in addition to the good economic result had no accidents or incidents of any sort. That reaffirms the Company's focus on safety, that we are able to enforce in all of our operations.

Finally, I'd like to address the fight against the coronavirus outbreak. It is fundamental for the Company to ensure safety and health of all personnel working aboard, in our platforms, both our own and third-party partners. With that in addition to many actions already mentioned by Nelson, several other initiatives we're implemented too. First, prevent any one who has the virus from Boarding our facilities. And second, if someone does go aboard and we were not able to identifying that they have the virus to prevent them from contaminating their peers. So several other measures have been taken on the platforms and vessels to improve the level of hygiene and to keep the necessary distance.

So far the result has been good. We have had no positive cases in our facilities, and very few cases of people who were off-duty. So that allows us to maintain normal production with no downtime. And this is our goal, we want to keep it that way.

With that, I turn the floor to my friend, Emiliano.

Emiliano Fernandes Lourenco Gomes

Thank you, Francilmar Fernandes. I believe, everyone is curious about the process of transfer operates of Frade and TBMT. I thought because of their importance to PetroRio or because of the pandemic and the possible impact, that this may have on these processes. Well, I'd like to let everyone know straight away that these processes are unfolding, well, normally. ANP has not been very much impacted, mainly due to the commitment of its Directors and civil servant who continue to work normally. So the processes are unfolding as expected, so far, so that we do not envision any problems related to these processes because of COVID-19 pandemic on the part of ANP.

We also believe that because the acquisition of Frade, TBMT (inaudible) deep discussion of the guarantee for abandonment. We should expect approval by the end of the second half of the year with TBMT approval perhaps happening in the third quarter, and which is good.

As a reminder that unlike Frade where we are the operator of the asset, the acquisition of TBMT will bring synergies with the joint operation of both assets, as well as allow us to place claims that will be essential for a unified production system of Polvo and TBMT. Another important piece of news in the regulatory arena is related to royalty reduction on incremental production of Polvo. But I think you all followed this results from ANP's Resolution 749 of 2018, and it was approved in February of this year. I guess we will remember that PetroRio was the first oil company to have a royalty reduction period based on this new resolution. And was ANP's leading case in the enforcement of this royalty percentage reduction, as an incentives to production at mature fields, which was the case of Polvo.

On Slide 11, I draw your attention to a graph where the gray band represents the base curve of the field, before investments made. And the green band represents new production. All production represented in green and all incremental production resulting from additional investments that we have been making at Polvo Field will be subject to 5% royalties, which is very good news and the result of this new public policy implemented by ANP, that will entail a very good results in which (inaudible) the case of Polvo. There is no doubt that this royalty reduction makes investing more attractive and has a direct impact on the lifespan of Polvo, and on the lifespan of other assets that might come to enjoy the same benefits.

I believe these are the main updates and I turn the floor to our CEO, Roberto Monteiro. Thank you very much.

Roberto Bernardes Monteiro {BIO 16616322 <GO>}

Thank you, Emilliano. Well, I will be starting on Slide 12 please. We'll start focusing on some financial highlights and then we'll move to our earnings leverage and reserves.

Well, the first thing -- the first thing I would like to highlight is that in Q1, we had an EBITDA, and here I'm adjusting EBITDA by our hedging result of BRL239 million, 7.2 times higher than Q1 2019. So I guess this is an important indicator. We chose quite well everything that the Company has done. Obviously, the current scenario is challenging, globally speaking, which I believe that this number represents, well everything we have achieved.

As regard to hedging contracts in the first quarter we posted BRL206 million and realized hedge income. This is hedging that has been settled we make money with it. This is money that flowed into our cash BRL206 million. For Q2 hedging, this income has not been realized yet, but we already recorded marked-to-market income of more than BRL130 million. Another highlight was the strong negative impact of foreign exchange variation, more than BRL417 million, it is worth noting that we are dollarized the Company. Our revenue was 100% in dollars or almost 100% in dollars. So our liabilities, have to be in dollars as well in order not to have a currency problem in a steep foreign exchange variation up or down, which is what happened. Here in our earnings, we correct, all our liabilities adjusting to the new exchange rate, but see past result is not adjusted, it is the historic result.

So with that, we always have these sharp effects, but there are non-cash effects, at the end of the day. And these are not worrying facts because our EBITDA is essentially in dollars. And lastly, I would like to highlight our strong cash position. We ended April with $158 million in cash. The accounting number for the quarter is slightly lower than this. The quarter ending in March because of accounts receivable and hedging contracts to be settled which were all posted as receivables in March. In April that's when it actually turned into cash and we reached these $158 million in cash.

Moving to the next slide, Slide 13, we will speak a little about the Company's financial performance in the quarter. More specifically our numbers. And here I should make a general comment, we always report ex-IFRS 16. So we'll be focusing on this column here related to Q1 2020 ex-IFRS. I guess, there are some points here to be highlighted, of course, our income of $128 million. This income was very much negatively impacted by foreign exchange variation.

FX and variation is included in this line item of other financial income expenses that is posted at $317 million but FX variation was much greater than this. And some positive points that we had such as hedge contract exercised of BRL206 million. This hedge has already been turned into cash, there was $158 million already include these hedging operations. These BRL206 million are already included in that number. And the marked to market hedging, there will be an effect to be recognized next quarter in Q2, we are now in the second quarter, which on March 30 amounted to BRL134 million.

And finally one last point to mention here in that line item of other operating income expenses amounted to positive BRL164 million. Here we had a small amount which reflected an increase of the discount rate of our provision for abandonment mainly, and in the case of IFRS of IFRS leases. This was determined by the new auditors Ernst & Young, that started working with us in this quarter. This quarter was already audited by EY. So they asked us to make this adjustment when you increase the discount rate of items in reliability -- the liabilities end up being reduced net present value, thus we had a gain related to this discount rate change, which is nothing really -- it's merely an accounting effect. But there you have it. It is what it is. So these are the points to be highlighted regarding income. But like I said on the previous slide, the number that best summarizes the quarter is adjusted EBITDA of $238 million to $239 [ph] million, 7 times higher year-on-year. And I think this number is what best reflects the work that we did in the past few months related to M&A redevelopment of Polvo Field, acquisition of Frade and Tubarao Martelo and strong work to cut costs, then by the company.

Moving to the next slide, number 14, I will speak a little about our leverage. Looking at the chart on the left with no adjustments of any sort, our net debt over EBITDA ratio was 2.3 times. Even with this number being totally under control in our point of view, it is important to underscore some factors which are included in this number and that is excluded, this ratio would be a lot lower. Firstly, the BRL528 million loan from Prisma, $100 million. Well, it was recognized in Q1 balance sheet without any corresponding counterpart in the EBITDA, which is normal when you resort to debt for an M&A deal, which was the case here.

We acquired the FPSO and head of farm-in, $440 million and borrowed $100 million. So when we do that, 100% of the debt is posted to our balance sheet without the corresponding EBITDA or revenue resulting from the duo. So this alone accounts for BRL528 million. Another point is accounts receivable, up to BRL113 million. What we did here was our offtakes were concentrated in the month of March, both related to Polvo and Frade. So although these sales happened in March at a low price hedging, helped keep the price at $65 per barrel. So no problem there. But you sell and post the offtakes as accounts receivable at the turn of the quarter, which is exactly what happened. Net accounts receivable amounting to BRL213 million and this was not included when we closed the quarter. This had not been turned into cash as this was still a receivable.

Another thing that happens, which I also alluded to in the previous slide, the foreign exchange variation restates the Company's liabilities, it's debt, as well as its cash. And when you're in a position of more net debt, the whole position is adjusted, according to the exchange rate at the moment of quarter closing. But EBITDA -- EBITDA of the last 12 months is obviously not restated according to the foreign exchange rate. So that leads to some imbalance, enrollments out dramatic currency fluctuations. Finally, the hedging contracts that we exercised in Q1 2020 had a gain of BRL206 million, but it was settled in April. Cash was accounted for in the first days of April, so this was not accounted for in the EBITDA of the first quarter either, nor in the Company's cash position.

Now, if we were to adjust for all of these factors, our net debt over EBITDA ratio would have been approximately 0.8 less than one time. So we believe that this number in absolute trends is a number that is under control and reflects a number of things that in moments of high effects of volatility, do distort the number a little.

Moving to Slide 15. The next slide still on funding and leverage. We would like to make a point here. Actually, we already mentioned this, that ratio is not, I mean, there is nothing pointing to any problems, nothing of that sort the ratio is totally under control, in terms of the absolute leverage of the company. Now the work we have ahead of us, there will be a focus for the Company in the coming months is short versus long-term.

Now, having a short term data is not a great problem if the company is financially sound, which is our case. We are very healthy from the operating standpoint. We generate cash, with oil prices at $30, we generate cash. So, it is not a problem for the company to have that concentrated in the short term as is our case here as we can see. However, this is more labor intensive, we have to keep rolling over the debt and so on and so forth. So, considering that we are implementing two major actions, we will be focusing on two major actions at the company.

The first, the Prisma loan, that loan of BRL528 million that we mentioned, should be converted to the long-term. The bridge loan contract that was signed when we acquired the field set forth the replacement of guarantees in the arrangement of so called project finance, for to (inaudible). So now the FPSO is in our name, it's ours, the field merger should be approved by ANP eventually, and we will be able to give all guarantees to convert this loan to the long-term. Thus Prisma should be converted to the long-term.

In principle, we're thinking of January 2023, with our amortizable installments, starting amortization in 2021, and stretching all the way to 2023. So this is the Prisma loan, that we're working on with the Prisma people. Our relationship with them is great and we should be focusing on this in the coming months. So we should have some news on that front in the second quarter, perhaps Q3, but this loan should be converted to a long-term debt.

And something else that remains in our radar, no doubt it, is the issuance of bonds in the United States. In the past, we considered Norway, the Norwegian Law, but we were not able to go forward with the issuance for a number of reasons. And we are now looking into the possibility of issuing debt securities in the United States.

We are in informal content with some banks and some players and so on and so forth. Obviously now it's not the right timing, but we believe the market will reopen sometime this year. And then we will be able to go through with the issuance to refinance a good deal of our debt and this is not about increasing our leverage -- the Company's absolute leverage. This is about rolling over a debt to the long-term.

Now moving to the last slide actually to the one before the last slide, Slide 16. I would like to share with you the Company's reserves. And I believe this is perhaps the slide, that best summarizes everything we've done in recent times, as you can see we reached 114 million barrels of proved reserves, 1P reserves and this is now Q1 2020. A year ago we had 17 million barrels of 1P reserves. So a very significant increase in terms of proved reserves. Basically Frade deal added 60 million barrels of 1P reserves for the company. And it is important to remember that when we acquired Frade, the reserves report was $60 million. We have production for one year at Frade sustaining production levels at $68 million, that stems mainly from more accurate management and monitoring the reservoir more closely and so on and so forth.

Additionally, the Tubarao Martelo deal, actually two things happened at that cluster, the TBMT deal and the revitalization of Polvo. They added 14 million barrels to this cluster of Tubarao Martelo plus Polvo. Well, number one, we have a dramatic cost reduction because of the tie-back of both productions. And we had the Eocene campaign, that opened up a new infill drilling opportunities for Polvo, we reached 114 million barrels.

If we look at the bottom right hand corner we have the reserve life table. In other words, how long these reserves will last? And you can see that, in Polvo and this is because of 2P reserves, we had a line span of nine years stretching up to 25 years. And this extension is due to these two effects. You've seen reservoir in particularly that Tubarao Martelo deal.

Now moving to my last slide, let's talk about the next steps. I would like to end the presentation on these four points, which will be the focus of our attention in the coming months. The main point right now is a continuous focus on health, safety and efficiency. This will be undoubtedly, our main focus in the coming months, in the foreseeable future of the company. This will progress hand-in-hand with a meticulous and ongoing management of costs and expenses as to preserve the Company's liquidity. This is the name of the game, this is what we do.

We will also work strongly on obtaining approval for Tubarao Martelo and Frade acquisitions. This is the main focus of Emiliano's agenda with ANP. The regulatory agency has been working very closely with those even during this pandemic moment. And lastly, helps not in the coming months, this is not happening in the next few months, although it is ongoing work against the effort to convert our funding profile into long-term debt. This is not going to happen overnight, but it is going to be a major focus of ours in the coming months.

To conclude, I would like to truly thank PetroRio's employees and PetroRio's staff and there are many of our people listening to this webcast. I would also like to thank Nelson very much and the Board of Directors for trusting me to take on this new role, as of the next quarter I will be presenting as CEO of the Company.

And with that, let me open the Q&A session. Thank you very much and I hope you stay healthy and very serene and calm in these challenging times.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session for analysts and investors. (Operator Instructions) Our first question comes from Rodrigo Almeida with Santander.

Q - Rodrigo Almeida {BIO 20698362 <GO>}

Good day everyone. Just to start, Roberto congratulations on your new position as CEO of the Company. It is well deserved. I have a couple of questions on my end. Well, firstly, just speak about the strategy, the mid to long-term. You have some options to grow organically with Tubarao Martelo, the Frade campaign. So it's like to know from you, what is your priority? What do you use is more likely to happen in the mid term and mid 2021?

And my second question has to do with the debt. You talked about the Prisma debt that negotiations are unfolding well. So, could you comment on the debt with the Chevron, if this is moving ahead, if there is anything on the table? I'd like to have some color on that and update please? Thank you. And thank you for the call.

A - Roberto Bernardes Monteiro {BIO 16616322 <GO>}

Good afternoon, Rodrigo. Well, so let's begin with our organic growth possibilities. Well, we have, I should say -- and as you said it to yourself we have Tubarao Martelo and the tie back with Polvo. And with the Tubarao Martelo tie-back, we could add another Tubarao Martelo well into production, so that's a possibility. There is another project revitalization of Frade Field and there is another project, revitalization -- new revitalization rounds at Polvo. Now with that list, well, we have a work for at least two years, perhaps more.

Q - Rodrigo Almeida {BIO 20698362 <GO>}

With the main driver for us, is the cost to add 1P proved reserves. Among all of those possibilities, what seems to us to be more efficient in terms of CapEx, is the tie-back of Tubarao Martelo TBMT?

A - Roberto Bernardes Monteiro {BIO 16616322 <GO>}

This seems to be our most accretive project. We believe we can add barrels and the tie back project for Tubarao Martelo at less than $5 per barrel, something between $5 and $6 per barrel, so very low. And I would say that, perhaps this would be our top priority. Well after that, we have Frade and Polvo fields. Their revitalization, each field has its own particularities, but I should say that, they're kind of equivalent at around $6 to $7 per barrel, slightly higher. But they're also excellent projects. With our main project, our top project right now is -- Tubarao Martelo tie-back.

That was the second question, our debt profile. What have been doing? We've been working at length with Prisma. Our relationship with them is great, but you know rolling over a short-term debt to long-term is not something that happens overnight. Since January both parties had clear that, we would be moving this to the long-term. Even the bridge loan a contract, already said forth a rollover of the debt, to the long term. But the process tends to be sluggish.

The FPSO became ours. Just a little while ago, we are in the middle of the transfer of rights process. So there are some hiccups here and there, but everything will be put behind us and we'll be able to turn the debt into long-term finance. You asked about Chevron, well we are not talking with Chevron about exchanging the loan or rolling over or increasing the debt. What we do have is excellent relationship with them. This is what we have.

We are in constant contact with them. They're always very diligent. They want to know how our operation is unfolding, how Frade is doing, and so on and so forth. But we are not talking specifically about the debt when we design our cash flow and everything else.

Why don't include Chevron stat as one of our priorities? Our priority right now is the Prisma loan and turning that funding profile into long-term. And to resolve the short and long-term issue we have to issue bonds in the United States, 144A. So we are preparing the company for that. We have the auditors and we are taking many steps to get the company prepared. So that we can have the issuance in the United States. This is not going to increase the size of our debt, but it will definitely change our debt profile.

Q - Rodrigo Almeida {BIO 20698362 <GO>}

Thank you, Roberto. I just would like -- just a follow-up question. Talking about Manati, there are many things happening with that asset. But Petrobras is possibly selling their working interest of the assets. And perhaps Manati will be turned into our gas storage reservoir. Could you give us an update on that? What are you thinking about that? What you think about this project? And what do you think about the claim of force majeure [ph] by Petrobras to (inaudible) by their commitment to buy the gas.

A - Roberto Bernardes Monteiro {BIO 16616322 <GO>}

Okay. The way we see the force majeure of claim by Petrobras is a forced interpretation of the contract. This is how we see this. And because you are not foreseeing the take or pay contract, make us decided not to comply with the take or pay contract. We are taking the necessary measures at this point. But again to us, Manati accounts for a very small share of our revenue. It's a very small share of our EBITDA. So this doesn't really change anything for us. And in terms of the Company's economics, but yes, we are taking the necessary measures that we think are applicable at this moment.

Again we see that this is it -- we see this as a forced interpretation of the contract, that does not apply at all. And that will dictate our actions. As regards the sale of Petrobras stake of Manati, we'll look into it. Indeed whoever is considering, buying that working interest at the PetroRio or any other player, well, they should think about this not as an E&P asset. As an E&P asset, a few more years, perhaps that fit in one hand in the figures of one hand. So there is not a great upside in that gas asset, now create upsides, in terms of E&P. This it's -- there its move -- its productive, works well, it has a Petrobras take or pay contract, abandonment has been covered. So the asset is beautiful and round, but it will be very hard for people to pay great upsides for this asset. If you think about E&P -- as extreme we can have a different value proposition for the asset. So yes, we'll be looking into this. We'll look at the deal, we'll consider this from the midstream point of view. But I think there is a lot of water to go down this bridge, we'll always be attentive to all M&A possibilities. But like I said before, we do any deals, there is a lot of water under the bridge.

Q - Rodrigo Almeida {BIO 20698362 <GO>}

Thank you Roberto. Very clear answers.

Operator

Next question from Bernardo Schoichet with Vista Capital.

Q - Bernardo Schoichet

Hello. Good afternoon. Thank you for the call. Could you please elaborate on possible M&A deals, you mentioned Manati. And do you continue to see traditional possibilities as you have in recent quarters and years? And of course comparing what you have done and with the in-house opportunities that you currently have in this moment when you have to be very cautious about capital allocation.

And second, could you talk about your hedging strategy. Looking forward, hedging operations helped your results and earnings on a lot. Now, what kind of level seems to make sense to hedge prices of future off-takes? Do you have any preference for any specific instrument or structure? Thank you.

A - Roberto Bernardes Monteiro {BIO 16616322 <GO>}

Thank you, Bernardo. I'll speak a little about M&A and then I'll talk about hedging. Regarding M&A, well, there are some processes out there in the market. Something from Petrobras divestment, there is Manati, there you see (include) to cluster, a shallow water cost the Campos basin. So there are some other, some other assets they put in the market. There has been talk about Papa-Terra and Petrobras. So (inaudible) for us. So things happen.

So we -- PetroRio's oil, is more of a long-term approach. We should be thinking about oil prices at $20 -- actually today, the price has increased, I think it has reached $34 or $35 per barrel. But it's no use, evaluating things at the heat of the moment. We have to look things taking a step back. And perhaps right now, we should not consider oil prices at $50 or $60 per barrel, but still we continue paying a lot of attention to M&A opportunities.

I think it is only natural to step a little on the brakes that the market will step on the brakes of M&A activities, because if we have cash and if you have financial health, to hold on to the asset, you will do so. Because we see this as a cycle, this decline in oil prices is seen as the cycle, at least oil companies that we talk to think that way. So those that have financial help to hold on to their assets they will, so they won't have to sell the assets at such a bad moment in terms of oil prices, because that does depreciate the value of assets.

From our standpoint, we'll continue to look at M&A possibilities. I believe that our M&A -- our M&A pipeline will be on hold for a while. We won't be doing anything in the foreseeable future, but these things will naturally resume growth. We believe the oil price will be ranging from $40 to $50 and that's when the market will resume function. Our projects are very accretive. We have a low production cost -- no lifting cost, so if the oil is at $40 or $50 with a little more visibility and consistency, we believe that a good deal of the market, we'll go back to working as it was before.

As for hedging I have a clear preference for this instrument, put options. It's not, the spread of the color, our preference is oil put option. This is what we did since the beginning of the year, in Q1. And our oil put option strategy was always, when we see some atypical oscillations, when we see some price appreciation, our strategy was always to hedge as much as the market allows. Now what we mean by that? As much as market volatility, we will not make prices impossible.

In the beginning of the year when oil was at $69, we were able to hedge for six months, a 100% in the first quarter and half for the second quarter. And this was because of the put option prices. At the time we had a very high volatility. So we believe that we will resume hedging operations but definitely and certainly after oil prices pick-up again. Of course, we won't wait until the Brent oil gets to $60 to $70, to hedge our up takes, but it should be at $45, $50. And then we should try to buy some protection in terms of oil put options. To protect our cash and so on and so forth. But this is our strategy. Put options and ready for oil prices to rally [ph] a level. To date we have hedging [ph] until the end of July, 50% of our volume is hedged at $65. So for now, we are doing well, from the hedging point of view. And now I think we have to wait a level to see what's going to happen. It's a little hard right now to forecast what's going to happen.

Q - Bernardo Schoichet

Okay. Thank you.

A - Roberto Bernardes Monteiro {BIO 16616322 <GO>}

Thank you, Bernardo.

Q - Unidentified Participant

Next question was sent by Mr. Rodrigo Sequeira [ph], what's the status of the Polvo campaign? POL-L, well, can it increase production along to the -- beyond 2,500-what about Polvo and with Discovery reducing agents, what were the results?

A - Roberto Bernardes Monteiro {BIO 16616322 <GO>}

Rodrigo, thank you for the questions. Okay. So let me start with the Eocene project. You've seen is POL-L, and you go back to the presentation, to make sure that this is right. Yes, have you seen this POL-L reducing 2,500 barrels, which started with a little more than 2,500, it was a 2,800, 2700. Now, it's at 2,500, it could produce more, if we had a bigger pump at the bottom of the well. But our ESP is of a mid-size for Polvo. So we are at the maximum speed limit of the bunk producing 2,500. Now, it is a very positive surprise for the company. It is a sandstone reservoir with a lot of permeability. The oil is a bit more viscus but given the high permeability of the sandstone the oil flows and it flows well, and it is good quality oil too. And I believe -- actually, I don't believe our reservoir team thinks we at PetroRio believe that in the future there might be an opportunity to drill to do an in-fill drilling in this reservoir. Apparently this reservoir is large. So there is a possibility of drilling another well in that same reservoir, to help drain that reservoir. And the cost would be very low because the reservoir is well known. So that's one possibility. And there are other prospects of (inaudible) with the company. These prospects have always existed, they've always been there. But we will always exploring what we knew more about the Eocene. This POL-L is the first one that is put into production.

We always talk twice, because we knew that in the (inaudible) reservoir the order was a little more viscus [ph]. So we've always delayed that investment. But since we could put that well into production successfully, now that opens up a whole new work front for the next campaigns. As regards, all and the dependent on tests with viscosity-reducing [ph] agents, we started running some tests, which has had one or two products, they did produce viscosity but carbonate is less permeable.

So it's more difficult to feed the well. So at this point we haven't managed to get a new thing that would make a lot of sense. We managed to produce 200 barrels a day in this well a little over that, but nothing that made a lot of sense. So we stopped production at first well and we start testing really because we suspended that campaign. So we got all the drilling rig personnel, we demobilize them and we suspended everything. So perhaps in the future we might go back and consider another viscosity-reducing product. But right now, I don't think that we will be taking this well into consideration.

So it's a bad combination, heavy oil and low permeability. And this is limiting as much has improved the viscosity, of the oil pumped, you cannot do anything inside the well.

Operator

(Operator Instructions) Next question was sent by Mr. (inaudible).

Q - Unidentified Participant

Good afternoon. I have two questions. What about short-term debt? Are you able to elongate the funding profile and with the lifting cost are under $15. What would be the profitability of the Company, if we consider an average price of $45 as of the second half of 2020?

A - Roberto Bernardes Monteiro {BIO 16616322 <GO>}

Well, good afternoon. Well, I guess that with answered the question about the debt, short-term debt versus long-term debt. In a nutshell, our main effort has been to throw (inaudible) to Prisma debt, according to the contract and according to our expectations from the beginning. And eventually the U.S. bond market will open, we don't know exactly when, but it will eventually open. So we'll probably refinance our debt in that market.

As regards to your second question indeed our lifting cost will be under $15. So if you think about the Company consolidated numbers, we need to do the math, in terms of price per barrel. But I would say that we have the lifting cost. Let's turn with the Brent oil price and average Brent of $45. So an average Brent price of $45. So let's suppose, we sell considering Farde and Polvo, let's suppose we sell at a discount of $5 is against the brand, perhaps a little less than right now.

Let's consider this, Polvo little more, Farde a little less discount. Well that's suppose we'll sell with an average discount of $5. This involves the quality of the oil and logistics, so we would be selling for $40 per barrel. We would pay 10% royalties and this has been reduced to under 10% as Emiliano mentioned. We pay 10% royalties on everything which is not using production. And of the Eocene production and all of the incremental production coming from Polvo, we'll pay 5% royalties. So lots of those $40 per barrel. And let's suppose we'll pay around 8% royalties, so that would be $36, $37 -- $3 discounted due to royalties, just to round this calculation. So we would be at $37 net of quality and logistics discounts and royalties discount. So, with $37, we have to deduct our lifting cost, which would be $15. With that $37 minus $15, we would end up with $22 per barrel. This would be what we call net-back of the Company, $22 per barrel. And here from this, we have to deduct the fixed G&A of the company. It's hard to do the math per barrel, because you end up getting fixed cost of (inaudible).

Well, let's say, for a minute that we have $2 per barrel worth of G&A. So we had $22 minus $2, $20, so cash generation with a Brent of $45 will be $20 per barrel of cash generation for the Company. So just, this is the math, number calculation can improve now with TBMT, because our lifting costs at the company tends to fall a little under $15, the average lifting cost for the company will drop, because we'll start enjoying some synergies, et cetera. But this is a starting point for you.

Operator

(Operator Instructions) Next question sent by Rodrigo Sequeira.

Q - Unidentified Participant

What is the strategy to pay the 30% of working interest to Petrobras, any date when you would make payment?

A - Roberto Bernardes Monteiro {BIO 16616322 <GO>}

(inaudible) Rodrigo. Good afternoon. As regards Frade, payment will happen when we get the field transferred to us. We relied primarily on the regulatory agency, A&P for the process of approval is unfolding. This approval process is a little different than Tubarao Martelo, it entails a discussion on amounts for abandonment -- provision for abandonment and not only guarantees but it will happen normally ANP has been working throughout this pandemic period, our relationship with ANP and with Petrobras is excellent.

So we mentioned that this will happen, some time along the second half of the year. And since the closing, actually since we signed, we have an effective date for that field and its effective date for the field, if I'm not mistaken was July of last year. So the whole economic benefit of the field and Frade does generate value and generates cash, not the economic benefit of the fuel is already, sensitive company by a price reduction, so the longer it takes to approve it, however will this value be. This is a very complicated calculation, so I don't want to give you any guidance on values, because this involves Petrobras as well. But what I can tell you is that this value is reduced over time.

To remember the case of impacts, the 18% stake of Frade, that we acquired -- is doesn't because of ANP approval, but for other reasons. If it comes two years between signing and the closing. And then in the end, what we had to pay was zero. So this is the mechanism. The mechanism with Petrobras is similar. Since mid of last year, the economics after field is ours. So let's see it. We imagine that this will be happening more towards the second half of the year -- more towards the end of the second half.

Operator

We are now closing the Q&A session, I would like to invite Mr. Roberto Monteiro to proceed with the closing remarks.

A - Roberto Bernardes Monteiro {BIO 16616322 <GO>}

Well thank you very much. Here I would like to thank all of you for participating in this call for your questions and for the very constructive relationship we have with all of you. I would like to thank all of our employees and associates for their great work. I'd like to thank the Board of Directors and in particular, I'd like to thank you, Nelson. For the opportunity that I was given, I would like to say that PetroRio is 100% prepared, to serve through this moment. It is not an easy moment from the personal standpoint. It is not an easy moment to any one, but this will be behind us eventually. We shall overcome and the company is 100% prepared to weather the storm. And we'll leave this moment a lot stronger than when we started. Moments like this make companies reflect on processes, on simplifying processes, making processes more efficient, and so on and so forth. So even amidst this whole mess, we believe that there are lessons to be learned, when we look at things from that angle. Thank you very much and I hope to see you on next quarter's call.

FINAL

Operator

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

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