

Q1 2018 Earnings Call

Company Participants

- Blener Braga Cardoso Mayhew, Chief of Financial, New Business Development & IR Officer
- Nelson Queiroz Tanure, Chief Executive Officer

Other Participants

- Raphael Figueredo, Analyst
- Raul Grego, Analyst
- Unidentified Participant

Presentation

Operator

Good afternoon, ladies and gentlemen. Welcome to PetroRio's Conference Call to discuss First Quarter 2018 Results. Thank you for standing by. At this time, all participants are in a listen only mode. Later, we will conduct a question-and-answer session for analysts and investors. When further instructions to participate will be provided. (Operator Instructions)

This event is also being broadcast simultaneously over the Internet and may be accessed through PetroRio's Investor Relations website at www.petrوريا.com.br/ir by clicking on the banner 1Q '18.

As a reminder, this conference is being recorded. The presentation will be available. 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 or performance. They involve risks, uncertainties and assumptions as they are related to future events, and therefore, depend on circumstances that may or may not occur. Investors should understand that general economic conditions, industry and other operating factors could also affect the future results of PetroRio and could cause results to differ materially from those expressed in such forward-looking statements.

I would now like to turn the conference over to Mr. Nelson Tanure, CEO of the company, and then to Mr. Blener Mayhew, CFO, New Business and Investor Relations Officer. Mr. Tanure, you may proceed.

Nelson Queiroz Tanure {BIO 20365123 <GO>}

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Good afternoon, everyone. This is Nelson Tanure, CEO of the company. I would like to thank all of you for your interest in getting to know more about PetroRio and for joining us to discuss first quarter '18 earnings. Before speaking about the first quarter of the year, I think it's worthwhile quickly looking at the history of PetroRio, which essentially looked buoyant in the beginning of 2015, and since then, the company has had a very positive track record.

In 2015, we had only one asset Polvo Field, and since then, we have added another three assets to our portfolio. We currently produce oil at Polvo. We produce gas at Manati, where Petrobras is the operator and have another two fields being developed in Foz do Amazonas Basin. In this period, we were also able to significantly improve our cash position and to preserve the balance sheet of the company. So looking back at the last three years, we believe this was a very positive period.

And always thinking about the long-term and creating value to the company and consequently to our shareholders, we believe that we have good years ahead of us. There are some highlights for our company that I believe is worthwhile sharing with all of our shareholders. Recently, we were included among the best companies to work for in Brazil and in the State of Rio de Janeiro, that made us very proud.

Another very relevant point is the complete alignment between the vision of the company to create value, and this alignment involves all PetroRio employees, the vision of the company itself and its investors. A tangible example to mention is that approximately 70% of all PetroRio employees are shareholders, just like you, who are participating in this call. Please note that we are also investing in the company and we believe in the outlook for the company in the long-term.

Some other important points, and I'm already talking about the first quarter of '18. We have a very successful track record in terms of our operations and health, safety in the environment. These have remained at very high levels. Recently, we completed almost six years with no accidents leading to stoppages at Polvo Field, a landmark that makes us very proud.

We are now speaking more specifically about the first quarter '18, and just to mention the highlights for the period before I turn the floor to our CFO, Blener, who will give you more details on our figures and performance.

So starting with Polvo Field. Polvo had a very good performance. The results were good enough to give us confidence to now drill a producing well at Polvo. As soon as the company has tangible results about the performance of the first well, we will inform the market immediately.

The second big point about our field is that unlike 2017, when we were able to negotiate with BW, the FPSO operator, not have any scheduled downtime for equipment maintenance of the FPSO. This year it was necessary to do maintenance, therefore, for six days in the first quarter, the field stopped for maintenance of the FPSO. And that explains a little, our production that was slightly lower than last year. However, due to the

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increasing Brent oil price and the good commercialization of our oil we were able to generate results that were good enough and that practically offset the loss that we had during these six days of scheduled shutdown.

Moving to our second asset, Manati. The field performed very well. Petrobras has shown to be an excellent partner in this asset, so no novelties there. And finally, and going beyond the financial results that will be explained momentarily, it is worth saying that, as always, PetroRio is dedicated to prospecting new businesses, both in Brazil and abroad. And currently, the company is negotiating the acquisition of many different assets. These negotiations are at different stages of progress. As soon as we have any concrete facts to inform our shareholders, we will do so. But the take-home message is that all of our investors can be sure that the company is looking for new investments for intelligence acquisitions, just like Polvo has proven to be.

Hopefully, the wells that we are drilling at Polvo will also be successful, as was the acquisition of Manati. Well, ladies and gentlemen in terms of the highlights to introduce our first quarter '18, this is it. I now turn the floor to Blener. Thank you very much.

Blener Braga Cardoso Mayhew {BIO 19502444 <GO>}

Thank you, Nelson. Good afternoon to all. Again, I would like to thank you for your interest in PetroRio.

Let' us go to the first slide, please. Here are the highlights for the first quarter of 2018. In the first quarter of this year, net revenue was BRL117 million, up 56% from first quarter '17. Gross selling price was \$64.70 compared to \$52.50 in the 1Q '17, EBITDA of 14.8 million and operating efficiency of 84.8%. It is important to underscore that this operating efficiency includes a scheduled shutdown for maintenance that we do once a year. We were able not to do the scheduled maintenance stoppage last year, so we joined last year's and this year's scheduled shutdown. So we have this discount of days when the operation stopped. However, if we were to exclude this event, our operating efficiency would be 94.6%.

But the scheduled shutdown is behind us now. So our operating efficiency should go back to about 94%, 95% or even higher for the remaining of the year.

Now let us go to slide two. Here, we speak a little about the macroeconomic outlook for the Brent oil price. The quarter was marked by a strong appreciation of Brent price, reaching the highest level since 2014. Average Brent price in the 1Q increased 23% compared to the average price of the 1Q '17. Brent price appreciation is explained by good fundamentals, both in terms of demand and supply as well as by geopolitical factors consistently balancing the market.

On the supply side, OPEC has maintained the expected production cut, primarily due to Saudi Arabia's commitment to the agreement and production from Venezuela. The demand for oil also shows resilience, estimating a growth of 1.5 million barrels per day.

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Going to slide three. We had one offtake of 463,000 barrels. The gross value of this offtake was \$64.71. And even having a lower volume offtake compared to last year's first quarter, our revenue was 57% higher. This is explained by the increasing Brent oil price.

I would like to remind you that we sold at \$64, and today, looking at the screen in front of me, Brent price is at \$75, \$76 per barrel. So we expect that in 2018, in the second quarter, our results will be even better.

Please go to slide four. Let us speak a little about our production. We had a scheduled downtime, like I said in my initial remarks, that led to a reduced operating efficiency. However, as I said, this maintenance stoppage was expected and planned. We produced on average 6,100 barrels per day, and our operating efficiency was 84.8%. This downtime is now in the past, and we shouldn't see any reduction in operating efficiency for the remaining of the year.

Going to slide five, please. Direct operating costs for Polvo Field were very much in line with what was expected. We had \$23 million in 2016, \$22 million in 2017, \$24 million for 2018, and considering that there are some temporary and exchange rate fluctuations, we believe that these costs are in keeping with what was expected. But since production was reduced due to the scheduled maintenance, when they calculate the cost per barrel, the cost per barrel was \$44. However, this is temporary and temporal, and we believe that these costs will go back to normal levels in the coming quarters.

There is still a possibility that these costs will be even lower than before, historically, the lowest for the field depending on the results of the drilling campaign.

On slide six, we speak a little about Manati Field. It is clockwork, as you know, always producing gas and producing according to the demand. Petrobras is both the buyer and the operator of the field. According to the demand for gas, they produce more OS [ph] gas at Manati.

Also regardless of this -- regardless of the demand, we have an offtake contract that protects us against negative fluctuations. So Petrobras always sells gas to itself at least at the level of take or pay.

Please turn to slide seven for the company's income statement. Here, we can see it's clear that there was an 8% reduction in the offtake. So we had a revenue increase of 57%, so we have BRL117 million of revenue in the quarter, direct cost of the field of BRL66 million, royalties, BRL10 million. That gives us an operational result of BRL39 million, a 108% higher than last year.

G&A and G&G expenses were BRL28 million, other revenues BRL3 million, and an EBITDA of BRL14 million. Here we have depreciation, financial results, reaching a net income of BRL2.6 million.

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Here on this slide, it is important to highlight the EBITDA, which is a cash generation metric. It is worth emphasizing that the company generated BRL14 million even in a period when the offtake did not correspond to our whole production in the period. We still have a balance of oil in our inventory. We also have accounts receivable related to gas sales to Petrobras. And we have the scheduled maintenance that reduced the production of the field. When we factor all of these into the equation still we had a significant cash generation that, once again, shows that the company is able to generate cash from its operations.

So we expect this year, we will have a progressive EBITDA. Quarter-after-quarter, we believe we will deliver higher and higher EBITDA, not only due to the increase of Brent price that we have seen, but also with the expectation to have increased production vis-a-vis the three wells that we are drilling. So I hope that every quarter of the year, we will have a higher and more robust EBITDA.

Moving to slide eight. Here, we are talking about general and administrative expenses. 29 million compared to 18 million last year. Here, there are some one-time off issues and some expenses that were to be recorded in the fourth quarter and ended up being posted now. There were some expenses that we expected to happen along 2018, that ended up happening before we expected. We had some labor terminations and also the payment of bonuses to the company. So a number of factors explain this higher G&A expense. We also have a temporary team that is helping us with the drilling campaigns of the well.

However, we don't believe that this is a true G&A expense increase. We expect that G&A expenses will be at a much lower level by year-end, but of course, since the company is growing and expanding, we are budgeting G&A expenses perhaps 15% to 20% higher than in 2017, but not 54%. G&A expenses should be around 15% to 20% higher.

Now moving to slide nine, please. We started the quarter with BRL622 million. We had 130 million of revenue from sales of gas and oil. Operating costs, G&G and G&A expenses of BRL141 million, royalties, BRL13 million, financial result and funding, BRL23 million, and M&A and CapEx, BRL12 million. That results in a final balance of BRL562 million. But when we add our oil inventory and our accounts receivable from gas sales to Petrobras, that gives us BRL640 million. This is the result of our cash flow in the quarter. And we believe, like I said, that considering the whole context when we sold a volume of oil that was not too significant, only one offtake in the quarter, with that production stoppage and some higher costs, all together, we think that this is a phenomenal result for the company.

Now on slide 10, we have our outlook for 2018. We are very excited with the recent oil price increase. A little while ago, the price was at \$50 or \$55 at the [ph] most. When it hit 58, we were very happy. And now oil prices are increasing to \$60, \$65, \$68, \$70, \$72, now reaching \$77, \$78. This is indeed a good recovering moment for the industry.

Our costs are fixed, so every dollar increase in the Brent price is one more dollar in the company's EBITDA. It is the contribution margin that increases for the company. So we are very excited about 2018.

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We also have the beginning of the drilling campaign, like we said, in the beginning of March, three wells. And despite geological risks, the company is very optimistic about the results. We think that this can be transformational for the company, and I hope to be able to inform you about the results of the first well still in May.

We have also advanced in negotiations of M&A processes that we are participating in, and acquisition of assets. Many of these negotiations started in 2017. These are seeds that we planted. But these are long and complex negotiations, so they naturally take a lot of time to come to fruition. They are very time consuming, but we believe that we are advancing well, and hopefully, in the coming months, we will be informing the market about the acquisition of some fields. We are at advanced stages of negotiations in more than one process and there are negotiations happening in parallel.

Finally, and this comes as a surprise, we have seen increased interests by investors and shareholders in our stock. Our shareholders base is more and more diversified with more professional investors. We have seen hedge funds from Europe and the United States buying our shares, we have seen pension funds, foreign pension funds, so more and more investors, who are far away investors from different geographies are hearing about PetroRio, have looked at our numbers, have studied our success story and are buying shares of the company, sometimes with significant positions. And they are betting on the future of the company. We are very pleased with that.

Well, I would like to thank all of you for your attention for joining us today. I will close now, and open the floor to questions. Thank you very much.

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 was asked via the web by Marcello Coutinho Porto [ph] a shareholder.

Q - Unidentified Participant

I would like to know what is the current perspective regarding additional drilling at Polvo. What is your expectation?

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

Good afternoon, Marcello. Thank you for your question. Well, we can't give you any tangible perspective. But when we have production flow into the platform, that's when we are going to have some tangible visibility. But what we believe, according to our estimates, is if you look part of the certificate of reserves, we have 1P, 2P, 3P reserves.

We think that we can add reserves that are at 2P and 3P, and they can be added to 1P reserves, reaching perhaps 24 million barrels of reserves, transforming 2P into 1P. Polvo is at around 10 million, 12 million. Perhaps we can double the size of Polvo reserves that

potentially can extend the lifespan of the field until 2026, '27. I'd like to remind you that our concession for Polvo stretches until 2032.

We're drilling three wells. We're in the -- drilling the first one, and we believe that we will be able to inform you very soon about our results, hopefully in May. Thank you.

Operator

(Operator Instructions) Our next question is by Raul Grego, Eleven Financial

Q - Raul Grego {BIO 20134068 <GO>}

Hello, good afternoon. My question has to do with investments. The company has a lot of cash, and for a while, you've been talking about new acquisitions. Could you give us a timeframe, so that we can -- so that you can help us with our modeling? When can we expect an acquisition? And are the negotiations at an advanced stage?

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

Good afternoon, Raul, well, unfortunately, it's part of our business to maintain these negotiations confidential, not only for regulatory reasons, but also because of the confidentiality and strategy of the company. We want to avoid competition. And we want to make sure that we will win the project that we are interested in and that we will make things happen, so sometimes confidentiality is fundamental.

What I can tell you, though, just to illustrate, I can speak a little about the Brasoil. Brasoil, we started talking with Brasoil board in January of 2016, and we only signed the contract with Brasoil in November of 2016, so 11 months of conversations until we executed the contract. We were able to complete the acquisition, buy the stake of other shareholders, have get approval from CADE by March of 2017. So until we have the figures in the balance sheet of the company, it's 15 to 16 months, and this was in a project that was reasonably simple, we, a accretive [ph] company. And so the whole ANP approval process, things related to abandonment, et cetera, were a lot simpler.

And we also bought the stake of a non-operator asset. We do take on some responsibilities regarding the operation, and in this case, this process has become a lot more complex. Oftentimes, they involve Petrobras that is a state-owned company. It is regulated by a number of bodies, the Federal Court of Accounts, IBAMA and others. And sometimes we negotiate with international companies and we negotiate with the Brazilian counterpart, but decisions are made abroad. So these processes tend to drag. So we ask you to please be patient. We know we've been talking about this for a while. We say that we are at advanced stages of negotiation. Our cash position is ready for acquisition. But we are very optimistic, we are very optimistic that we will be delivering good news very soon. Thank you.

Q - Raul Grego {BIO 20134068 <GO>}

Thank you.

Operator

Our next question was asked via the web from Edward (inaudible)

Q - Unidentified Participant

Do you have a fair price target for your share?

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

Well, this is a question that varies from investor to investor. I cannot give you a price. I don't think that we should point to a target price. But I think that an interesting way of looking at this is thinking about the company's buyback plan. If the company, with our treasury opted to buy back shares in the market it is because we think that the current price is attractive and that it has the potential to appreciate. This is kind of the metric that I would ask the market to look at.

Operator

(Operator Instructions). Our next question is from Raphael Figueredo, Eleven Financial.

Q - Raphael Figueredo {BIO 20386918 <GO>}

Good afternoon. Congratulations on the results for the first quarter '18. I have actually two questions. The first is more of a broad view. What is your broad view about oil -- barrels of oil for this period, that we are living now, not only now, but looking more to the mid to long term?

The reason I asked is that I have a concern, if there is any international movement that will drive down the price of oil. If that happens, what measures can be taken internally, so that this will not hurt the company? My second question has to do with the FPSO stoppages. How do you do maintenance to avoid failure in the future and so that unscheduled maintenance will not come?

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

Good afternoon, Raphael. Thank you for your questions. Well, this is not a \$1 million question, it's more like a \$1 billion question. I think no one in the oil market can predict the price of oil. I mean, this depends on macroeconomic factors, supply and demand and also geopolitical factors.

We see threats of wars with Trump and all, Korea, North Korea, that drove up the price of oil. Kind of hard to do some guesswork here. What we do is prepare, prepare us all, have operating efficiency, reduce costs, lifting costs and extract as much oil as possible and trying to sell our oil for the best price possible. We've been trying to do this for the last three years. We've had periods of oil costing \$27, \$35, \$40 and we survived. We weathered the storm.

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Now we are in a period of a little more comfort. But undoubtedly, the company is always studying the market. We look at our hedge options. And we try to take advantage when we have an upswing in the market. We are studying possible ways of enjoying the current prices and to hedge the price for some months. But this is still being studied.

As for your second question, well, there was no shutdown at the field, okay? It is natural to have some downtime in the field, but it wasn't an emergency. It wasn't something bad. It was regular operation. If you look at any oil field, if they are under 100%, we are at 95% efficiency. This 5% between 95% and 100% is the natural operation. Sometimes you have a change of shift, you have a machine failing, something that happens here and there, but nothing out of the ordinary. It's business as usual. There was no failures, different failures, in the first quarter.

Q - Raphael Figueredo {BIO 20386918 <GO>}

Thank you very much.

Operator

(Operator Instructions). The next question was asked via the Internet by Rodrigo, investor

Q - Unidentified Participant

Regarding new investments. In the last meeting, you said that \$1 billion would be available for acquisitions based on cash plus borrowings. Is this still the number? Or is it possible to increase it?

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

Thank you, Rodrigo for your question. Yes, this amount is still in the horizon. This is the combination of company's cash and leverage, because when we buy producing assets, we can use our cash flow and the target asset to help pay for part of the debt.

So this is still in the horizon. However, this is a theoretical account. We look at the leverage of 5 times. In other words, with 200 million, I can leverage 5 times and I can buy an asset up to \$1 billion. But the company has G&A, working capital, Manati, Polvo, so we don't want to zero our cash for an acquisition. That would not be responsible on our part. That is a theoretical account. The value should actually be a little under that. We need to keep a cash balance at the company to keep the company working.

Operator

(Operator Instructions). This concludes today's question-and-answer session. I would like to invite Mr. Blener Mayhew to proceed with the closing remarks. Please go ahead, sir.

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

Well, everyone, I would like to thank all of you for your ongoing interest in our company, for joining us until the very end of the call. This was the first quarter '18.

PetroRio today is a profitable company that generates cash from our operation. We have two producing assets, one being developed and one in exploration. And we are trying to grow organically with more drilling at Polvo. And we are trying to grow via acquisition, buying assets that are in Brazil and abroad. We are very excited. I think 2018 will be a transformational year for the company, and hopefully, it will be a transformational year for the shares of the company and for our investors.

Thank you very much. Have a good weekend.

Operator

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

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