

Q3 2017 Earnings Call

Company Participants

- Blener Braga Cardoso Mayhew, Chief of Financial, New Business Development & IR Officer

Other Participants

- Unidentified Participant, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. Welcome to the conference call to discuss PetroRio Third Quarter 2017 Results. Thank you for standing by. (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.petroriossa.com.br, by clicking on the banner 3Q '17 earnings release.

Before proceeding, let me mention that forward-looking statements that might be made during this conference call relative to the company's business perspectives on operating and financial projections and growth 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 performance. They involve risks, uncertainties and assumptions as they relate 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 our results to differ materially from those expressed in such forward-looking statements.

I would now like to turn the conference over to Mr. Blener Mayhew, CFO, IRO, M&A and Business Development Officer. Mr. Mayhew, you may proceed.

Blener Braga Cardoso Mayhew {BIO 19502444 <GO>}

Thank you very much. Good afternoon, everyone. Thank you for joining us in PetroRio's Third Quarter '17 Results Conference Call.

I would like to highlight that this quarterly result repeats results of prior quarters (when) again we are delivering very strong operational profit. I'm talking about the profit that comes from our operations. Gas sales from Manati and oil sales from Polvo. We have BRL

37 million operating profit, BRL 108 million year-to-date. If we get BRL 108 million, when compared with the same period as last year of BRL 26 million, we are more than increasing our operating profits by 4x, a very strong result. And that shows the capacity that our assets have to generate cash and value.

Here, we are looking at value creation of assets. We are not talking about financial liabilities, accounting reversals, nothing. This is purely the value that we generate with our core business, selling commodities, selling gas and crude oil. So it's a very strong result. And we're very proud to deliver it.

Let's move to our first slide. In the Third Quarter, our net revenue was BRL 110 million, BRL 340 million in the nine months of '17, 20% up compared to the first nine months of 2016. Operating efficiency in Polvo was 98.4% in the quarter. This is confirming that we are the most efficient operator in the Campos Basin in the month of August. And in the month of October, which is the Fourth Quarter, we achieved 100% operating efficiency.

Production at Manati was 5.2 million cubic meters of natural gas, 30% higher year-on-year. EBITDA was BRL 21 million, net income of BRL 16.4 million in the Third Quarter. Our cash position, including cash, cash equivalents and our oil inventories, which is highly liquid, is BRL 751 million, 33% higher than the same period of last year.

Moving to Slide four now, please. When we all saw the volatility in the Brent price the prior quarter -- in the prior quarter, Brent price was \$43, \$44. And that's recovering. It's higher than \$50. Brent price was quite volatile. And we even got to the price of \$57 today. If I'm not mistaken, it's just around \$63, \$64. So crude oil and actually Brent price is recovering for a number of macroeconomic reasons, particularly, in Saudi Arabia. But I'm not going to dwell on that. Or we can talk about the future expectations for oil in the next quarter when we disclose our full year results.

So here, the average for the quarter was \$52.17. And I am going to speak a little bit about our hedge strategy that we adopted during this period. Let's go to Slide five now.

Here, we talk a little bit about production and offtake. We began the year with 8.2 in the First Quarter, 8.040 in the Second Quarter, now we're at 7.6. This is the natural decline of the fields. If no investments were made, the field has a natural decline curve. We work on operating efficiency and workovers to mitigate decline effects. But that is natural. It occurs in all oilfields worldwide.

Still our operating area, where we had a scheduled maintenance some time for September, we were going to stop for 12 days. And we were able to do part of that maintenance while the field was still operating and active.

What we could not do during that period, we will postpone to January of next year. So there was no downtime, thus, operating efficiency was a lot better, which drove our production. This was an effort made by the company to do beyond what was planned. So that we could achieve an exceptional result. In the month of August, we have sold almost

600,000 barrels. And the gross selling price was \$51.87 -- gross selling price, not considering discounts.

On Slide 6, (inaudible) we talk a little bit about the lifting cost at Polvo. Our lifting cost for the quarter is at \$32; for the full year, around \$30 -- not for the full year, year-to-date. Although, the Brent price is around the \$55 to \$60 compared to a lifting cost of \$30, we still have a lot of room to improve at Polvo. Obviously, with the natural decline of the field and fixed cost as they are -- the trend is that the cost will increase, however, if we're successful in reviewing the royalties and with our investments, I will speak more about that later. This proportion can be reduced as we will increase production.

On Slide 7, Manati and its production. In the Third Quarter, we produced 525,000 cubic meters of gas.

This production has been increasing compared to the first half of the year. This is not something that we control. This has to do with supply and demand. And Petrobras Energia places an order for gas. While they have been asking for more gas in the second half of the year, obviously, that comparing with the first half of the year, the average should be very close to the take-or-pay contract, which is a contract by Petrobras. It says that the minimum -- it sets forth a minimum payment of gas contracted.

On Slide 8, we have our income statement. In here, we can see more detail, the earnings of this quarter and all the nine months of '17 year-to-date. Here, we have BRL 110 million revenue and operating results at BRL 37 million, G&A at EUR 15 million. Coming back kind of through the normal level as we had last year, in keeping with last year, we have some other revenues and expenses here. This is an accounting reversal.

And finally, we get to an EBITDA of BRL 21 million with an EBITDA margin of 19%. Therefore, capping year-to-date nine months of '17 BRL 87 million EBITDA with an EBITDA margin of 25%. When put into perspective that the average oil price was (50) year-to-date, (inaudible) EBITDA is a very solid result. 25% EBITDA margin in a scenario where oil prices are low is, indeed, a very strong result. A result that the company, the management and all employees celebrated.

After EBITDA, we have our profit or loss of BRL 14 million -- financial results, BRL 14 million; income tax, BRL 2 million; and the profit of BRL 16 million.

Year-to-date, BRL 67 million profit. As we see, it is a dramatically positive result compared with the same period of last year, when we had to take a loss of almost BRL 45 million. So I think that this is an important slide to show how the company's becoming more and more solid, delivering consistent results quarter after quarter.

We have an operating profit, we have profit selling commodities. And that is important to underscore. And we have been delivering those. And our goal is to deliver this quarter after quarter, regardless of a reduction of royalties and M&As. We have to do as best as we can with what we have in-house now.

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On Slide 9, you see our G&A expenses. G&A is little bit increasing compared to the nine months of '16. We had some one-off events, nonrecurring items in the quarter. We also had the integration of Brasoil due, some business (inaudible) to redundancy costs, some office changes. But these are not recurrent. We have stabilized our G&A. And hopefully, this -- 32% reduction will be reduced when we consider the full year, including, the Fourth Quarter. There will be an increase still compared to last year. And hopefully, this gap will not be that wide.

On Slide 10, we see our cash flow illustrated here. We ended the Second Quarter '17 with BRL 678 million. We had revenue from operations, BRL 142 million; operating costs, royalties and G&A, minus BRL 107 million; financial result, minus BRL 7 million; CapEx, minus BRL 3 million; and exchange variation, minus BRL 8 million.

Here, we have a cash balance, BRL 694 million in the Third Quarter '17. Adding our oil inventory, oil, because we didn't sell in September for strategic reasons, we ended up selling them in -- selling this inventory in October. So adding everything, we have BRL 751 million in cash.

Let's go to slide 11. This is our last slide. And it talk about our expectations for the Fourth Quarter. Perhaps the most important thing that we have to keep in our (radar) at PetroRio is this request for reduction in royalties for Polvo. Now obviously, we would not place a request without first talking with a number of stakeholders, consulting with them, ANP, (EP). And a number of agencies, local government. We've been talking a lot with all of these stakeholders. And we felt that we could get there. And based on this, we filed a request for reduction in royalties payment. And we're quite positive about the possibility to reduce royalties as well as the possibility of making more investments in Polvo to increase production and expand its lifespan.

The (complexion) of Polvo extends until 2022. So if we were able to make a number of investments along the years, it will not be in 1 or two years but in several years, if we can increase production to expand the useful life of the field until 2032 -- 2032, that would be a challenge that, definitely, we'd like to pursue. Second highlight, oil prices starting to stabilize within \$55 and \$65. That's quite interesting, because as I mentioned before, our cost just (inaudible).

If we sell at \$30 or \$65, our costs remain at \$32. So every extra \$1 that we get in our offtakes, will give us a contribution margin for the company. It will increase our EBITDA. In addition with that, we are increasing our cash generation with Petrobras increasing the demand for Manati gas in the second half of the year.

There is something -- a hot topic, which is the acquisition of new fields and new companies. We remain quite excited. But these negotiations are long and complex. Oftentimes, they involve international companies that have headquarters overseas. So decisions come and go to the Brazilian office.

These are naturally complex and long-lasting processes. But most of the negotiations that we've started working on at the beginning of the year are still unfolding. We are more

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advanced or less advanced, depending on the case, in the negotiation. But we remain optimistic that we will be bringing new assets for the company to not only increase production but to improve our balance sheet, our revenues and maintaining our operating efficiency.

And finally, my last highlight we think this is public domain. Our shares have been appreciating a lot this year. It's at BRL 60, BRL 62 per share. When we were down to BRL 18 or BRL 20 last year. So we see a lot of interest -- increased interest in our shares. And this is the result of the good work that we're doing to deliver results and to build a good company.

In our shareholder base, not only (inaudible). But we see now institutional investors and international asset management firms -- asset management firms in São Paulo, in Rio. So it's not just individuals. Of course, we welcome all individual investors. But when we see sophisticated institutional investors considering the company, looking at our numbers and making a decision to invest, that makes us really proud.

These were my initial comments. We're very happy with our results because these are consistent results that we've been posting in the recent quarters. We're here to put the balance sheet with the company, to improve our revenues. And we're very happy about Manati. We have 2 other assets that came with Brasoil in development Exxon (inaudible). And we're going to look into what to do with that in 2018.

One is exploration. The other one is in development. And we might bring in some partners, perhaps bigger partners, that can help us invest. But so far, the year has been fairly good for PetroRio. And hopefully, in the Fourth Quarter, we reporting even better results and other good news in addition to our results.

I would like to thank you for your interest. And we would like now to open the Q&A.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Raul (inaudible), (inaudible) Financial.

Q - Unidentified Participant

I would like to ask 2 questions. First, regarding the acquisition of new wells. You're considering a lot more of those mature wells and the Brent price is currently increasing. Does this make negotiations a little more difficult? Or this is not such a relevant point? And my second question has to do with a reduced daily production of the Polvo wells that you currently have. Up to what level of production would it be interesting for PetroRio to continue to operate this well?

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

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Thank you, Raul, for your question. Your question is very good. In the first place, let's talk about terminology. When we talk about by buying new oilfields, we are talking about acquisition of new assets. When you're talking about wells, wells would be -- would mean drilling a well. And that's why recently we asked to reduce the royalties that we pay so that we can drill new wells at Polvo. So we should not use the word well so as not to confuse investors. New oilfields, well, I guess that for those, we created an expertise in mature fields. There's no doubt about it. There's no one doing this in Brazil. No one else, at least not that we can see and at least not as successfully as we've done it. We currently have the expertise, the technology and the track record. So honestly, we are looking at mature fields. But we do not want to limit ourselves to mature fields. We have an opportunistic view. If we see a good deal around, we want to get it. So the field is in the beginning, middle or end of production, if we see that it is a good business, if we see an upside either at the entry price or through a new drilling or perhaps the field is at the mid; of its (lifespan). But there might be other possible wells to drill that the current owner did not choose to drill for hit quotas reasons, for oil pricing reasons, for a number of possible reasons. So we're not a company only focused on mature fields. We're a company focused on the acquisition of producing fields, whatever the current lifespan of a field. And what was your second question?

Q - Unidentified Participant

My question was about the reduction in the daily production at Polvo.

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

Right. You asked about a threshold, a limit. Well it doesn't have a threshold because we have an estimate of a declining production. But we adjust the decline practically every week. So we cannot really tell you accurately how much the field will be producing in two years. So we work with estimates. And we cannot really tell what would be the oil price in two years from now. And there are a number of investments -- possible investments to be made in the field. In addition to the reduction of royalties to make investments in new drilling wells -- these are more robust investments -- but if we opt not to do that, we can do water injection. We can do other possible measure -- minor, smaller measures that cost less. But now we're focusing on reducing the royalties so that we can make more robust investments that will bring substantial changes. We're talking about changes, not as the investments we made last year which were, by the way, very successful and increased production by 20%. We're talking about new wells that can more than double production. At the same time, there's a geological risk involved. But these are much more solid investments. And that bring about a much greater growth potential. Thank you very much. Excellent.

Operator

(Operator Instructions) We are ending this question-and-answer session. I would like to invite Mr. Blener Mayhew to proceed with his closing remarks. Please go ahead, sir.

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

Well I would like to thank all of you for your interest in our company, for your attention for joining us in this conference call. We'd like to remind you that we're here in the final

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stretch for the year. There's a lot to do. The team is working hard. They're working longer hours every day so that we can deliver excellent results in the next quarter. That's it, folks. Thank you very much and hope to see you next time.

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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