

Q3 2018 Earnings Call

Company Participants

- Milton Rangel, Head of Finance
- Roberto Monteiro, Chief Operating Officer

Other Participants

- Gustavo Allevato, Analyst
- Unidentified Participant

Presentation

Operator

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

This event is also being broadcast simultaneously over this Internet via webcast and maybe accessed through PetroRio's Investor Relations website at www.ri.petroriosa.com.br by clicking on the banner 3Q18 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, projections and operating and financial goals are based on the beliefs and the 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 substantially from those expressed in such forward-looking statements.

I now would like to turn the conference over to Mr. Roberto Monteiro, COO, and later to Mr. Milton Rangel, Head of Finance. Please Mr. Monterio. Go ahead.

Roberto Monteiro {BIO 16616322 <GO>}

Thank you very much. To begin, I would like to thank everyone for joining our quarterly call to discuss the Third Quarter '18 Results. I would like to clarify that the other two

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officers of the company, Nelson and Blener are not in Brazil and that's why Milton and I will be leading this conference call Milton Rangel, Head of Finance. I will begin the presentation with the highlights for the quarter. And then we'll speak about the operational highlights and from Milton will go over our financials.

Starting on slide two, I'd like to mention the third quarter '18 highlights. The first one is obviously our net revenue of BRL224 million in the third quarter, operating result of BRL130 million, the highest ever operating results of the company. Our EBITDA totaled BRL107 million in the quarter, the highest ever adjusted EBITDA in the company's history. We have the highest contribution margin, what we call net-back of \$33 per barrel, almost 50% net-back, which in our opinion is a very significant number. All of these numbers will be detailed later on the by Milton.

Another point that I would like to highlight in the quarter is the end of the drilling campaign that will be conducted in 2018, and we're going to give more color on that in the coming slides. And the last point, which is not really about the quarter, it's a subsequent fact, which is this timing for the acquisition of 18.26% of Frade field which happened two days ago. Well, first, I will speak about the acquisition we are now on the next slide, I'll speak about. The acquisition of these 18.26% working interest of Frade Field from impact. As you can see in this timeline that the company, this is part of our DNA, this is part of our growth strategy to acquire yields to have deals in 2018, we were able to sign this deal. This was quite an interesting deal for PetroRio. We are starting to decentralize our operating risk, now encompassing other assets we had, also 100% mandatory and now we have one more asset joining our portfolio.

Unfortunately, we cannot disclose more details. I know that we are going to have questions about this we cannot disclose the price for contract reasons. This amount will appear of course in the future income statements, but I cannot disclose anything at this point. We've considered this acquisition very efficient and interesting. In terms of dollar per barrel, both in terms of dollar per barrel produced and in terms of dollar per barrel in reserves. This is a profitable field and need to use the field that perfectly fits our portfolio. We're talking about adding a neutral over 3,000 barrels a day of production and adding something around 12 million and 15 million barrels of reserves for the company with this deal.

Moving on to the next slide, let's talk about our operational highlights for the third quarter of 2018. The first highlight that I would like to draw your attention towards Manati. Manati producing above the take or pay contract reproduced 44.3 million cubic meters in this quarter. And talking about also our operating efficiencies, were above 98% in the quarter. In other words, maintaining the high levels of operating efficiency they will achieved it in 2017.

Our lifting cost at Polvo was \$26.6 per barrel in the quarter. We had a month when it was 25, so the average for the quarter was 26.8. And like I said, the completion of the 2018 trailing campaign which extended quite a lot like spin off the field of Polvo and we will speak more about that momentarily.

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On the next slide, let's speak a little about Manati. Here, we can see Manati's production, both month-by-month and day after day. That is important to understand that Manati has quite a stable production very close to the fields capacity. The gas from Manati is in high demand, there are two important factors to explain this high demand for the gas from Manati.

Number one, the fact is that the South and the Southeast of Brazil needed dispatch so much gas to the North and the North East. And so Manati is used to supply this demand for gas in the Northeast. The second point is that our -- the contract of Manati is in Brazilian reais and so the depreciated real also gets -- has a competitive price in the market.

Finally, one last point about Manati is that the company, but that review is working strongly as operator has the field and working well with the other consortium players. We review the provision for abandonment of the field just like what we did with over in the past. We are proposing to review the provision for abandonment.

Moving on to the next slide, we will talk more about Polvo. To begin, operating efficiency. We can see that it's coming back to normal levels 98.1% operating efficiency and that was up 10,081 barrel produced in the quarter. If we adjust by the scheduled stoppages that we had in January, we can consider a 50% increase in production, since the beginning of the drilling campaign for now. When we started the campaign or we were producing about 7,000 barrels a day, and now, our output is around 10,350 barrels a day -- 10,300 barrels a day. So this was a significant increase in production. The operating efficiency is totally under control.

Please go to the next slide. Let's speak a little about the cost of Polvo. Polvo is one of the great achievements of the company, one of the great achievements was to become a lean operator, a lean low cost operator. We were able to substantially reduce our operating cost. Now we are at a cost of \$26.6 barrel per day of lifting cost. Obviously, the big driver of this cost. And the reason reduction in lifting cost that was the increase in production.

When we look at the absolute cost, there was a slight increase in the third quarter.

I mean we can explain in the increase is that some of our costs are pegged to oil price. And the daily cost to operate the FPSO, well, there was an increase in the price to \$100,00 a day. We had an escalation with oil. Now we don't have oil escalation. We have a fixed price of 100,000 a day for the FPSO. So these two items were the main "offenders" here. But we were more than offset by our increase in production which results from the exploratory campaign, which is the next slide of the drilling campaign of 2018.

Here we have a summary of the drilling campaign. We have a CapEx of \$42 million. With these \$42 million, we increased 3.7 million barrels of probably reserved 1P. And this provides us the field, if you take into account the certification of reserves. We are talking about the useful life of 1P reserves until 2024. So we expanded the lifespan of the field. This increase in reserves by 3.7 million barrels, the \$42 according to our estimate has a payback of approximately six months.

And the useful life of the field can be extended a little more with new wells drilled. You've been considering a possible drilling campaign for 2019. Most likely considering three to four new wells to be drilled. Of course everything has to be submitted for approval by the Board, everything has to be stated at length, but this is more of the direction that we are following.

Thank you very much. I turn the floor now to Milton Rangel, our Head of Finance, to give you with summary of our financial highlights.

Milton Rangel

Regarding the financial highlights at the third quarter, we had a net revenue almost BRL125 million more than twice that of the third quarter '17. It is important to highlight that this level of net revenue was very close to what we achieved in the second quarter '18, although we've sold about 100,000 barrels less. We also achieved the highest operating result in the company's history, BRL130 million. To us, this is quite significant, it reinforces the cash generation capability of our generation, of our operations. Highest adjusted EBITDA, which is EBITDA, net of non-recurring effects that sometimes do not have a cash effect, well, it was the highest ever, BRL107 million in the quarter. Very strong results, our margin close to 47%, 48% in the quarter. Underscoring the strong result that we achieved in this quarter. Contribution margin for Polvo as Roberto mentioned regarding the net-back that was close to 50% and this was the highest net-back margin in our history, so this is another great deal for the company. So in a nutshell, this slide just shows very strong results that we posted in the number of record mark being achieved by the company in this quarter.

Moving on, here we have Brent price performance since September 2017. We can see a continuous increase in oil price an average of almost \$76 per barrel in the third quarter '18, which is obviously tailwind for our results. As for our off take, so we chose to have enough take performance 61,000 barrels in August, 231,000 barrels in September. A lot less because we have the next opportunities we saw an affluent opportunity to have a commercial discount below market average, foreign oil with the characteristics of the oil from Polvo. So we talk about thousands of barrels sold, but we have to take into account the quality of the (inaudible). We ended up with a high inventory at 130,000 barrels in our inventory.

Next slide, we have the income statement. In the quarter and year-to-date, then I talked about a strong revenue, the highest revenues for our history, almost BRL300 million barrels year-to-date. Again reinforcing a point that I mentioned before. It is not just about increase in sales and revenue, but above all profitability. This net back margin of almost 50% is the best ever in the history of the company, it really reinforces our financial discipline, reinforces the quality that we try to add to our results.

Something which is not in this slide, that if we compare the different return indicators (inaudible) shares which are non-equity and which are non-assets, we observed that PetroRio numbers start to stand out among the best in the industry for listed oil and gas companies. In a lower expense from this -- from the high margins that we are delivering, from a high asset turnover which happened given an increased revenue vis-a-vis the low

investment made. So a level of revenue generation with low CapEx, particularly after the investment in both and that makes us very satisfied with our results.

Moving on, we have our net cash flow in our final net cash balance. I'd like to show you that if we add these first three columns, revenue from operations, cost and expenses with royalties, we've guided to an operating cash generation of BRL35 million. This was the highest ever reported in our history. Again this is a very important deal for us, an important achievement. It's also important to observe that we were able to maintain our final net cash of the company higher than BRL500 million, which is a high level despite the drilling campaign and over in this quarter. Alone, we spent a little over BRL60 million.

So again, our cash generation and investment made optimized investment I must say. Still we have a very strong net cash balance, we have a very solid balance sheet, a credit rating profile very good. So if we need to increase leverage of the company to supply new acquisitions of new assets, we are well positioned for that and we are well positioned to grow the company.

I'd like to highlight that through this acquisition, some impacts that we announced with the need to get any debt -- with the need to increase the debt of the company which reinforces our position for future acquisitions.

Finally, moving on next slide on the outlook, there are three main points to mention. First is the closing and integration of FRADE JAPAO's results. After we close the deal, we'd be able to disclose more on that. Secondly, new M&A opportunities in fields with clearly in our SG&A, we continue very active in the search of new targets with a mindset to diversify portfolio, generate cash in value for our shareholders. And thirdly, planning for the 2019 drilling campaign at Polvo, as Roberto mentioned we've seen Polvo with optimism for 2019. Pursuing possible new wells to be drilled always trying maximize the recovery factor of this asset but always in a profitable manner. We are very happy with these results that we delivered. Although we hit a number of record months. We know that when we do that, we raised the bar and that increases our responsibility and motivation to go even further. So I'm going to turn the floor back to -- for his final remarks. Thank you.

Roberto Monteiro {BIO 16616322 <GO>}

Thank you, Milton. That's my last point. I would like to highlight this year we had the 2018 drilling campaign that might look trivial might look, we might look simple, but it is important to remember that Polvo field was for almost 10 years with no new drillings. The company this year in 2018 decided to conduct a drilling campaign. We were able to have this drilling campaign with no negative events. It was a very safe campaign with full respect for the environment and in compliance with all of the rules.

This was a significant achievement for the whole PetroRio team. In here, I would like to publicly acknowledge our people, because you know, our company is made of people, not just of assets. The company is made of people too and people are no doubt about that our main asset, so I want to give a big thank you to all PetroRio employees regardless of their area, their road, their department. Thank you very much team for your effort, for

your (inaudible) discipline and dedication. And as you all know, a good part of our employees more than 70% of our headcount are partners of PetroRio. So thank you very much.

Again, thank you for your dedication. And your effort is for the benefit of all of us. Thank you very much. We now open for questions.

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 sent over webcast by Rodrigo Sequeira [ph] .

Q - Unidentified Participant

At Polvo, the prospects identified in the 2018 drilling campaign, are they in the report 2P and 3P or are they prospective resources and/or contingent with resources which are not included in the report?

A - Roberto Monteiro {BIO 16616322 <GO>}

And we accessed in the 2018 campaign was primarily we called the 2017 reserves, the undeveloped, proved non developed reserves, and this is what we access the primarily 2018, but we also access a little bit of two things. But the bulk that we access was proved reserves, proved non-developed reserves. A new drilling campaign, our goal was to look for reserves that are classified today as in 2P.

Operator

Next question, Mr. (inaudible) Grego [ph] , Eleven Financial [ph]

Q - Unidentified Participant

Hello thank you for taking my question. Actually I have two questions, one is related to possible new drilling campaigns in 2019 at Polvo. What two new prospect and how much would that require in terms of investment. Could we expect something close to the 2018 drilling campaign or with investment to be more relevant, would it require more cash. My second question has to do with the acquisition of Frade. Of course whatever you can tell us about it would be appreciated. What do you expect from this deal, and are there any restrictions to explore Frade field since there was an episode of an oil leak in 2011. So if you could give us some color on that acquisition that would be appreciated as well.

A - Roberto Monteiro {BIO 16616322 <GO>}

Okay. And then to begin talking about 2019 CapEx. Well this year, we achieved very substantial CapEx marks. I would think of CapEx for 2019. We're still trying to the drilling

campaign and so on and so forth. But I would think of something close to \$55 million, a range between \$55 million and \$60 million, which was the CapEx for the campaign this year.

Like I said, it would be more or less in that range. I think that this year, we were exceptionally efficient. Of course, we will pursue this next year as well. But the targets are little far away in so on and so forth. So I would say that something approximately \$55 million to \$60 million. Regarding Frade, Frade field, the Frade field has two things. We are entering Frade as non-operators, we'll not be operators. We chose the participants of a consortium. We do participate in this difficult decision, but we are not operators. So what we can bring to Frade today is just joint work with the other consortium players, Petrobras and Chevron.

So that we can bring to the consortium our operational culture, so that we can make suggestions and so on and so forth.

What we think we can get from Frade, yes, there was an oil leak. But after this oil leak, the field reduced dramatically, it's output. Given the discontinuity of water injection. Remember in 2011, when there was this oil leak, it was because of water injection. And so the field in our view has a lot of reserves vis-a-vis the production. It produces about 17,000 barrels a day where the reserve is absolutely huge vis-a-vis the production. So we believe that in the future, there will be opportunities to improve the recovery factor of the field and the field will -- other production will increase or the last spin of the field can be very perennial, this is our opinion about Frade today.

No we cannot speak on behalf of the consortium. We can not talk about a new drilling campaign at Frade, we're not the operators, we are not the only owners of the field, we have 18% --18.26%, we'll participate in the committee of operations, of investments and so on and so forth.

Q - Unidentified Participant

Excellent, thank you. If I can have a follow-on question please. PetroRio (inaudible) do you intend to have more M&A activities, do you want to have a more relevant participation or are higher working interest at Frade to perhaps become the operator of the field or would you be considering other M&A deals of other producing assets?

A - Roberto Monteiro {BIO 16616322 <GO>}

Well, as part of our strategy. Well -- that reveals strategy is to grow through M&As. And if possible, capturing the operation of the field. So obviously if the possibility exist, PetroRio will work into this possibility with a lot of attention. So all we can say is that, if this possibility exists, we'll look into it. If the possibility does not exist, the PetroRio will try to expand to other fields to other possibility.

We currently operate over field, it is a profitable, very profitable field. We extended life span of the field, we did a number of things, we hit a number of record at Polvo, Manati in that operators, but Manati is also very profitable field for the company are very interesting

assets. We participate actively in the operational meetings. We are always making suggestions of improvement, we have always put those in actions to drive down costs and so on and so forth. So our culture will always be there. Our culture of being a lean operator will always prevail.

Q - Unidentified Participant

Perfect, thank you.

Operator

Next question from Gustavo Allevato with Santander.

Q - Gustavo Allevato {BIO 18933135 <GO>}

Hello. Good day, everyone. I have a question regarding production for 2019. To what production do you expect you could produce of oil and gas with M&A considering Manati? And my second question is, when do you expect to finalize the deal with Frade Japao

A - Roberto Monteiro {BIO 16616322 <GO>}

Could you repeat the final part of the question, please. I think you want to have a timeline to close the deal of acquisition of Frade field?

Q - Gustavo Allevato {BIO 18933135 <GO>}

Yeah. So when do you expect to conclude the acquisition of Frade in the first quarter of next year, second quarter? And what are the procedures, what are necessary, say, steps that you need do to go through to complete the deal?

A - Roberto Monteiro {BIO 16616322 <GO>}

No regarding production, we never gave any output guidance. But I can tell you though is with the acquisition of these three assets in terms of barrels of oil equivalent (inaudible) which is something close to 16,000 barrels. That would be the idea. If you look separately, today, our production of share of Frade production in January should begin at about 3,000 barrels a day. Overall production, like I said, it's currently at same 350 and 1,350 barrels. So we can have the client calculation based on that. And Manati will be little lower this year, but not too much lower. So -- and that can give you a pretty good idea of our production. When I look at Polvo, because of the drilling campaign this year, if we extrapolate this 10,300 barrels for next year, even considering the natural decline of the field, the 2019 production even do an exploration, the company will be equal or perhaps a little higher than 2018.

Just because the wells started operating in the middle of the year, as for Frade field, our expectation is that in the first quarter, the whole year will be closed. The expense closing to happen in the first quarter '19 more towards the beginning of the quarter than towards the end of the quarter.

Q - Gustavo Allevato {BIO 18933135 <GO>}

Okay, thank you.

A - Roberto Monteiro {BIO 16616322 <GO>}

Thank you.

Operator

Our next question sent via webcast by Mr. Rodrigo Sequeira [ph] .

Q - Unidentified Participant

In the fourth quarter '18, do you expect it to sell the whole inventory that was left in the third quarter '18 plus the production of the fourth quarter. What inventory do you expect to hold in the fourth quarter?

A - Roberto Monteiro {BIO 16616322 <GO>}

As a strategy, year-after-year, the company tries to change the year with the minimum inventory possible or to end of the year with the minimum inventory possible. Now having said that, we can tell you there remains variance from 200,000 to 250,000. This is what normally remains in the FPSO. So the sales of the fourth quarter considering, that should be fourth quarter production class. The off take of the inventory that still remains currently at the FPSO. Now it is important to remember, that we only go into have an uptick. If there are favorable conditions but favorable discounts and so on and so forth. So our expectation (inaudible) we are thinking of ending the year with a low inventory, but it will really depend on the market and will really depend on the discounts that have been applied at that moment.

Operator

We are now closing the question and answers session. PetroRio's conference call is finished. We would like to thank all of you for your participation and have a good day.

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