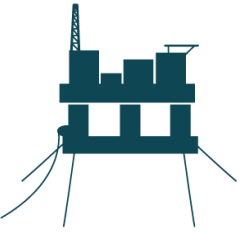


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# Upstream O&G Financing Alternatives

Daniel Green

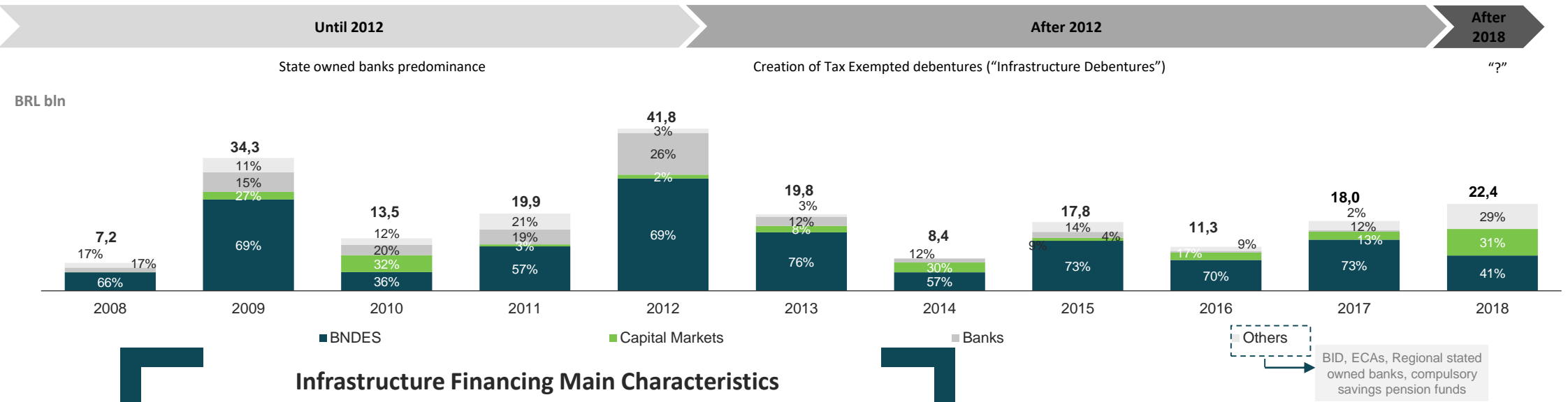


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# Brazilian Infrastructure Financing in a Nutshell

Historically, Brazilian infrastructure has been primarily financed through subsidized public funding

Sources of long term financing in Project Finance<sup>1</sup>



## Infrastructure Financing Main Characteristics

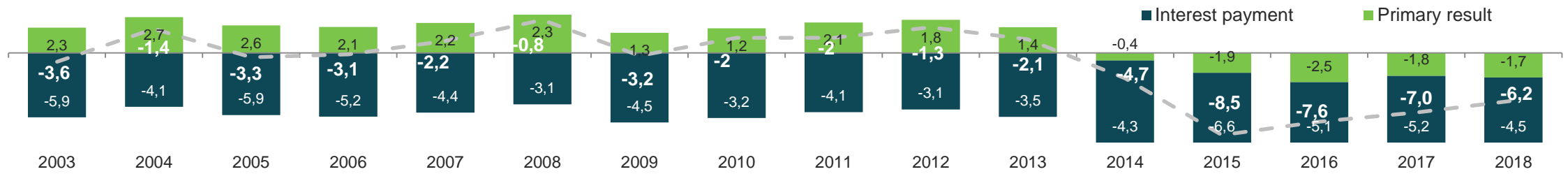
- Subsidized price and long tenors
- Lack of Project Finance Structures (non or limited recourse)
- Corporate Guarantees or Bank Guarantees until Project Completion

In the last 11 years, 63% of long term project finance debt came from Public Banks<sup>1</sup>

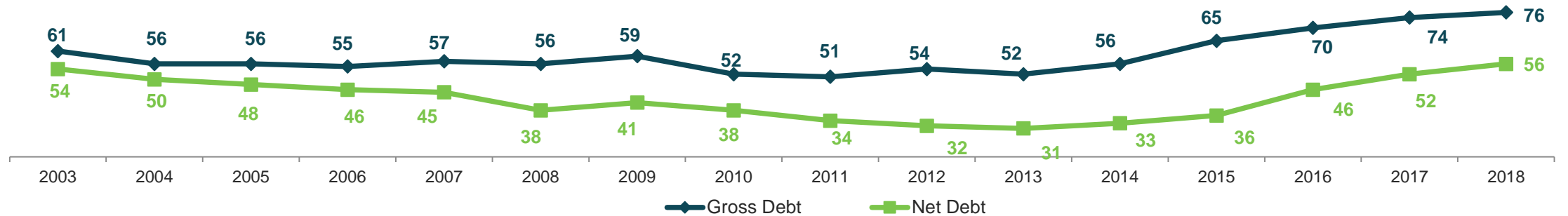
Source: ANBIMA

# Brazil's Largest Recession Ever Created an Urgent Need for Reform

Federal Government Fiscal Result (% from GDP)



Public Debt (% from GDP)



## Measures Adopted by Government

- Reduction of BNDES financing subsidies
- Long Term Interest (TLP) creation: Gradual reduction of subsidies with total extinction by the end of 2022
- Social Security Reform approval

## Intended Model (ongoing implementation)

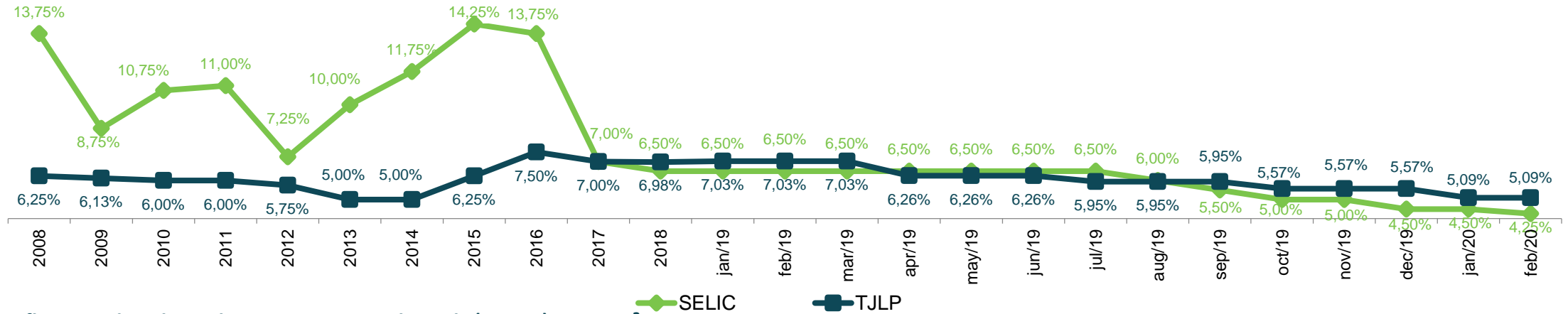
- Commercial banks and capital markets to become primary sources of project financing
- Development and state owned banks to cover private funding gaps – longer tenors, very large projects, sectors with strong social impact, etc

Source: Central Bank

# Recent Base Rate Stabilization Create the Perfect Landscape for Private Funding Development

The reduction in interest rates is boosting private funding participation in the infra sector

## SELIC (Base Interest Rate)<sup>1</sup> and TJLP (Long Term Interest Rate)



## Inflation Indexed Brazilian Sovereign Local Bonds (NTN-B) 10 years<sup>2</sup>



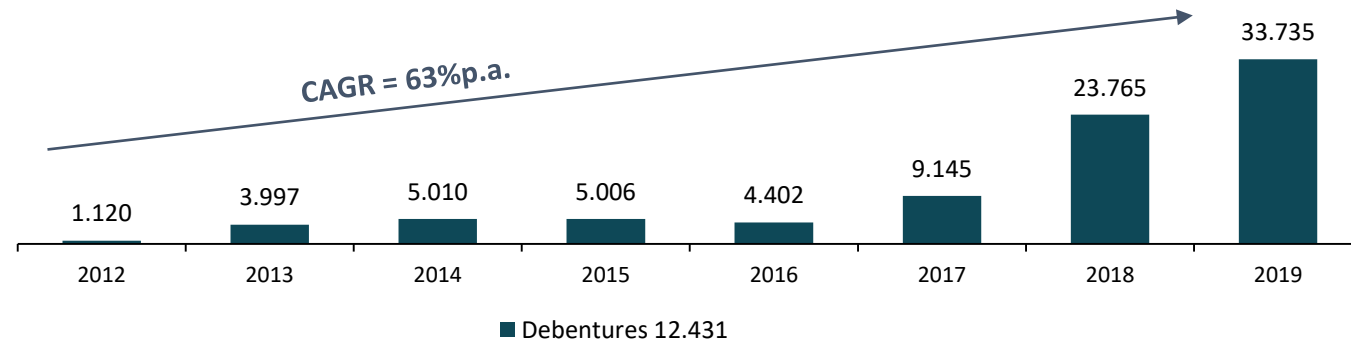
Source: Central Bank (1) Santander Economia (14/02/2020) (2) NTN-2024/NTNB-2026



# Local Tax Exempted Bonds Have Been Shining, Although Far From Being a Perfect Solution

Infrastructure debentures were created in 2011 to encourage capital markets participation on infrastructure financing, offering tax exemption to individuals and foreign investors

## Infrastructure Debentures Issuance (BRL million)<sup>1</sup>



In 2012-2019 period, ~10% of total infrastructure spending was financed with tax exempted debentures;

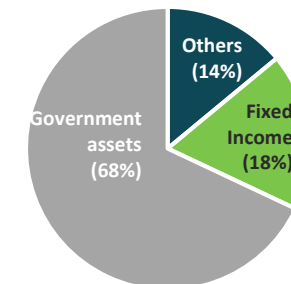
## Complementary role

Despite increasing issuance in last years, **the volume is still low** comparing to Brazil's investment needs (~R\$133bn p.a. current vs R\$~300bn p.a. goal)

### Limitations

- **Institutional Investors** do not benefit from tax exemption, despite better capacity of understanding the risk and sizeable AUM
- Restrictions set by law 12.431 and ICVM 555 **hamper dedicated investment funds creation (24 month capex timeframe / minimum % of fund allocation)**
- Individuals financing complex projects / Issues with general assembly of debtholders

### Institutional Investors Base (R\$ 4,7 tn)



# Upstream Project Financing Alternatives in Brazil

*Historically, the upstream sector has been dominated by IOCs that use corporate funding for project financing;*

*The opening of such sector to smaller O&G companies will create additional incentives for the development of new asset based solutions*

## RBLs

- Secured loan collateralized against borrower's reserves
- Widely used in Europe and US
- Recent legal framework improvement by ANP
- Demand currently fueled by Petrobras sale of mature assets to independent O&G companies
- Three operations executed in 2019 (Enchova & Pampo, Bauna e Riacho da Forquilha)

## Pros

- Extensive track record in other geographies
- Flexibility – could be adapted to tailor both onshore and offshore assets with different profiles
- Very dynamic due to the ongoing ability to redetermine the lending base

## Challenges

- Higher structuring costs
- Oil below ground still cannot be pledged in Brazil
- Potential liabilities for indirect polluters ("Law 6.605 / BACEN Regulation 4.327)
- New ANP step-in framework still untested
- Enforcement of guarantees in Brazil
- Secondary market liquidity

## Infrastructure Debentures

- Tax exempted capital markets instruments issued locally in Brazil
- O&G projects are eligible
- Petrobras has already executed 6 different issuances using this instrument
  - Over BRL 7bln raised with tenors ranging from 5 to 15 years

## Pros

- Tax exemption allows for competitive prices and tenors;
- Very appealing to individuals as well as foreign investors
- Mechanics already well known in local markets

## Challenges

- Still untested for non recourse financing in the O&G sector
- Rating
- Cannot be issued in USD (potential mismatch on revenue vs debt service)
- Enforcement of guarantees in Brazil

## USD Projects Bonds

- Issuance of project bonds in the international capital markets
- Historically, such bonds have not played a significant role in upstream financing
- However, with the main risk factors mitigated, strong ratings could be achieved
  - only PDP reserves
  - None/small development Capex
  - No Oil Price risk (100% hedged) or very strong DSCRs

## Pros

- Access to international capital market investors for small/medium players
- Competitive prices and tenors

## Challenges

- Still untested for O&G non recourse financing in Brazil
- Rating - potential country rating cap
- Underleverage due to challenging sizing metrics
- Enforcement of guarantees in Brazil

**Exciting developments happened in Brazil in 2019  
However, there's still a lot to be done**