LATIN AMERICA ADVISOR

ENERGY ADVISOR

A WEEKLY PUBLICATION OF THE DIALOGUE

www.thedialogue.org

November 13, 2020

FEATURED Q&A

How Is Petrobras Weathering a Year of Uncertainty?

Production in Brazilian state oil firm Petrobras' pre-salt area, pictured above, has supported the company's increase in output this year. // File Photo: Brazilian Government.

Q **Brazilian state oil company Petrobras expects to sign only one refinery sale agreement by the end of the year, well below its initial goal of five, due to scheduling problems caused by the Covid-19 pandemic as well as oil market volatility, Argus Media reported in October. However, the company's oil and gas output in Brazil has grown 9 percent in the first nine months of the year, with production in the pre-salt area up by 32 percent. How is Petrobras weathering the challenges brought on by the pandemic? To what extent have the company's divestment plans been derailed this year, and what implications could this have for Petrobras' finances? What accounts for the increase in the company's oil and gas production this year, and will this trend continue?**

A **Adriano Pires, founding partner and director of the Brazilian Center of Infrastructure (CBIE):** "Third-quarter results showed that Petrobras' rapid response to the global recession is starting to pay off. Despite the expected accounting loss, operational and financial performance improved significantly, as demonstrated by the increase in oil and natural gas production and the utilization factor of refineries, and by the strong cash generation and reduction of net debt. Choosing to focus on the pre-salt area, Petrobras began the process of selling mature fields, refineries and assets in the natural gas market. Despite Covid-19, divestment plans are being implemented. Through September, the company raised $1 billion from asset sales, signaling that Petrobras remains focused on generating value through

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Colombia's ISA Posts Net Profit Increase in Q3

Colombian electric utility ISA's net profit increased 19.2 percent year-on-year in the third quarter.

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Venezuela Output Hit by End of Diesel Exemption

Venezuela's oil production began November below last month's average as companies stopped lifting crude there as a result of U.S. sanctions, which now also include diesel transactions that were previously exempted.

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OIL & GAS

DR Converts Oil-Based Plant to Natural Gas

The country's independent power producer has converted one of its oil-based power plants to burn natural gas. New President Luis Abinader is set to continue plans to convert power plants in a bid to end a chronic power supply deficit.

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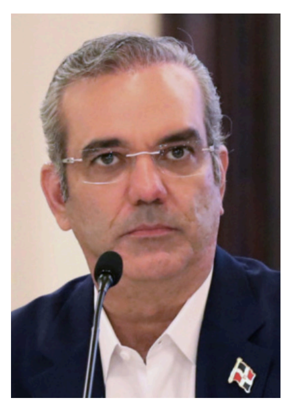

Abinader // File Photo: Government of the Dominican Republic.

OIL AND GAS NEWS

IMF Calls for 'Urgent' Changes to Pemex's Business Strategy

The International Monetary Fund has advised the Mexican government to revisit state oil company Pemex's business strategy, according to a report published last week. In the report, directors of the IMF executive board provided a series of recommendations to the government of President Andrés Manuel López Obrador in order to accelerate Mexico's recovery from the economic fallout wrought by the Covid-19 pandemic. Among them, directors said Pemex needs "urgent modification" of its business strategy and a reform to its governance and procurement, as its current state weighs on the country's economic growth, S&P Global Platts reported. Despite missing financial goals, the company's strategy has remained mostly the same, even amid the Covid-19 pandemic, and it will likely need additional budget support, the directors added. They also wrote that Pemex is unlikely to reach its midterm crude production goal and "at best" will stabilize its current production. The company has set a production goal of 2.4 million barrels per day (bpd) by the end of López Obrador's six-year term in 2024, though analysts believe actual output will range between 1.5 million and 1.6 million bpd, S&P Global Platts reported.

Venezuela Oil Output Hit by End of Diesel Supply Exemption

Venezuela's oil production kicked off November below last month's average of 350,000 barrels per day (bpd) as Spain's Repsol, Italy's Eni and India's Reliance stopped lifting crude there as a result of U.S. sanctions, Argus Media reported last week, citing unnamed Venezuelan oil industry sources. The three companies halted operations in Venezuela after the administration of U.S. President Donald Trump declined to renew an exemption to sanctions that allowed their operations to continue in exchange for diesel supply to Venezuela. The exemption had been in place on humanitarian grounds since the United States slapped sanctions on Venezuelan state oil company PDVSA in January 2019. The blocking of diesel supply has resulted in PDVSA having very few export options, Argus Media reported. Crude exports from Venezuela plummeted last month to roughly 350,000 bpd, half of its exports in September. Still partially operating in Venezuela is PetroPiar, a heavy crude upgrading project in which U.S. company Chevron holds a 30 percent stake. Another source of fuel for Venezuela as it has faced severe gasoline shortages in recent months is Iran, whose foreign minister visited the Andean nation last week. Iranian Foreign Minister Javad Zarif met with his Venezuelan counterpart, Jorge Arreaza, as well as President Nicolás Maduro in Caracas. Arreaza described Venezuelan ties with Iran as at a "climax," adding that the Maduro government could in the future acquire Iranian weapons if it was considered necessary, Reuters reported. While in Caracas, Zarif said the United States can no longer control what's happening in the world," adding that the era of "Western hegemony has ended." His remarks came two days after the U.S. presidential election on Nov. 3, as ballots were still being counted in key states and the results were yet unknown.

POWER SECTOR NEWS

DR Converts Oil-Based Power Plant to Natural Gas

The Dominican Republic's independent power producer, CESPM, has converted its 300-megawatt (MW) San Pedro de Macorís oil-based power plant to burn natural gas, Argus Media reported Monday. This brings the volume of oil-to-gas conversions promoted by the previous administration to 750 MW. New President Luis Abinader, who took office in August, is set to continue plans to convert power plants in a

NEWS BRIEFS

China's CGN Plans to Boost its Renewables Capacity in Brazil by 2024

China General Nuclear Power Group, or CGN, is planning to boost its renewables capacity in Brazil to three gigawatts by 2024, CGN Brasil Energia's vice president, Gabriel Luaces, told Reuters last week. The company's current 1.1-gigawatt portfolio in Brazil includes operation plants acquired from British private equity investor Actis and Italian utility Enel, Renewables Now reported. In total, CGN expects to invest nearly 11 billion reais ($1.9 billion) in Brazil to reach the targeted capacity, according to the report.

243 MW of Wind, Solar Projects Begin Operations in Brazil in October

Wind and solar farms with nearly 243 megawatts (MW) of capacity received approval to begin operations in Brazil last month, power sector regulator Aneel announced last week, Renewables Now reported. In total, the country added 318.34 MW of capacity last month, with wind amounting to 147.28 MW, or 46 percent of the total. Meanwhile, solar plants added 95.68 MW, and small hydro plants and thermal plants contributed the remaining 75.38 MW, Aneel said. Brazil has connected about 3,763 MW since the beginning of the year.

Hess Sells Gulf of Mexico Stake, Plans to Invest in Guyana Instead

New York-based independent energy company Hess Corporation said Friday that it has completed the sale of its 28 percent working interest in the Shenzi Field in the deepwater Gulf of Mexico to BHP, the field's operator, for $505 million. In a statement, chief executive John Hess said the proceeds of the sale will be used to fund the company's "world class investment opportunity in Guyana."

bid to end a chronic power supply deficit and reduce retail power rates, Argus Media reported, citing policy statements from Abinader's Modern Revolutionary Party. The Caribbean nation's electricity industry is relying less and less on petroleum derivatives, which currently account for just 8 percent of the country's generation matrix, according to figures from the Dominican Electrical Industry Association, or ADIE, Dominican Today reported last week. Petroleum derivatives are set to produce just 4 percent of the Dominican Republic's electricity matrix next year, ADIE said. In the first six months of the year, natural gas was the country's number-one source of electricity, with 27.6 percent of the generation matrix, followed by coal at 36.3 percent and oil derivatives at 19.1 percent, ADIE added.

Colombia's ISA Posts Net Profit Increase of 19.2 Percent in Q3

Colombian electric utility ISA's net profit increased 19.2 percent in the third quarter of this year as compared to the same three-month period last year, up to about $128.5 million, the company said, Reuters reported last Friday. The increase was largely driven by some electric road projects' entry into operation as well as lower expenditures, ISA added in a statement. "The lack of refinement [amid the Covid-19 pandemic] allowed for the third quarter of the year to observe a greater execution of capex than that of previous quarters, completing more than 60 percent estimated for all of 2020," the company said, Reuters reported. ISA added that, "to date, all the projects have been reactivated." ISA's operating income grew 21.3 percent between July and September to $637.6 million, while its earnings before income, taxes, depreciation and amortization, or EBITDA, also rose, by 18.8 percent to $398.5 million, year-over-year. The company's investment during the third quarter reached $451.6 million, amounting to $929.9 million so far this year. Of that investment, 88.4 percent went into the conglomerate's energy business, while 9.7 percent went into its roads

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the reallocation of capital in more profitable assets. Refinery sales, endorsed by the Supreme Federal Court, is in an advanced process and is expected to be completed, as are other divestments. Petrobras also sped up its strategy of focusing on the exploration and production in the pre-salt area, its core business. The company's extraction costs fell from $7.90/boe, in Q3 of 2019, to $4.50/boe in Q3 this year. Approximately 60 percent of the cost reduction was due to efficiency gains, increases in production and active portfolio management, while the rest is due to the depreciation of the real against the dollar. In the pre-salt area, Petrobras' extraction cost was $2.30/boe in this year's Q3, which suggests a low breakeven. The pre-salt is becoming more representative and is already responsible for 70 percent of production. This has brought greater resilience to the results, even in the current scenario, with oil prices ranging between $40 and $45. Production is expected to continue growing."

A **Mark Langevin, senior advisor to Horizon Client Access:** "Petrobras CEO Roberto Castello Branco's efforts to make his company profitable are working, despite the demand and price declines for crude oil. The company's divestment strategy is paying down its unsustainable debt while managers fully resource the pre-salt exploration and production (E&P) drive. The coronavirus has slowed down the effort to sell off refinery capacity, but the sheer size of Brazil's transportation fuel market continues to tease investors around the world. If the Brazilian government continues to allow Castello Branco a free hand, then the company will conclude more refinery sales in 2021. It has already adjusted to the new normal by shedding marginal assets and personnel, and will continue to cut operating costs, waiting for the market to rebound while the company drills down on the highly lucrative pre-salt play. The Búzios field promises to fuel company earnings well into the future, as other pre-salt fields, including Atapu, are added to boost crude oil production toward the three million barrel-per-day mark. This scenario pleases stockholders, who anticipate greater future earnings, but the increasing application of the company's assets in Rio de Janeiro, São Paulo and Espírito Santo will intensify regional rivalries and stoke new concerns about Petrobras' role in national development. The Federation of Petroleum Workers (FUP) challenged Castello Branco, and his divestment strategy, earlier this year, but failed to elevate their grievances to the national political stage. However, the prospects of continued high unemployment coupled with inflation, especially fuel price hikes, could reverse the politics of Petrobras during the run-up to the 2022 presidential election. For now, Petrobras is poised to take full advantage of a worldwide demand rebound, but Brazil's misery index will frame its future as a government-controlled enterprise."

A **Raphael Portela, corporate research senior analyst for Latin America at Wood Mackenzie:** "Petrobras went into this crisis on much better footing than last time around. The years following the 2014-15 downturn saw the Brazilian national oil company work diligently to deleverage its balance sheet and high grade its portfolio. But the company has not emerged from the latest crisis unscathed. The price collapse has forced it to sharpen its focus even more, with the pre-salt and financial discipline eclipsing all other priorities. The expected returns for other assets (post-salt) or activities (exploration) are no match for the advantaged pre-salt barrels, warranting its outsized allocation of capital as purse strings tighten. Resilience remains its overarching principle. And it is also the main reason behind the latest positive results, which saw the company churn $7.5 billion of free cash flow for the quarter versus a 2019

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business and the remaining 1.9 percent into telecommunications projects, ISA said. The company has operations in Colombia, Brazil, Chile, Peru, Bolivia, Argentina and countries of Central America.

POLITICAL NEWS

Peru Swears in New President a Day After Vizcarra's Ouster

Manuel Merino, who had been serving as the head of Peru's Congress, was sworn in Tuesday as the country's new president, a day after lawmakers swiftly and overwhelmingly ousted his predecessor, Martín Vizcarra, El Comercio reported. "This is a difficult moment for the country," said Merino, who placed his hand on a Bible and donned the red and white presidential sash along with a face mask, the Associated Press reported. "Today, the country does not look at the future with hope, but with worry." Merino vowed to proceed with the country's presidential election, scheduled for next April, and also work to improve the economy, fight crime and improve health care to help Peru become better prepared for another wave of coronavirus infections. 'We can't divide the country,' he said. However, in Lima and other cities, divisions were clear. Hundreds of anti-Merino protesters gathered outside Congress, banging pots and pans as the new president was inaugurated, the AP reported. Protesters and police clashed in Lima and other locations, with some carrying signs reading, "Merino isn't my president," The Wall Street Journal reported. Daily newspaper La República called Vizcarra's ouster a coup, and many analysts and residents agreed. "It's a coup d'état," taxi driver Paul Mendoza told the AP. "Now we're going to have inflation, a recession, and we won't be able to get ahead because of the pandemic." Merino is Peru's third president in less than three years. In March 2018, Vizcarra took over from his predecessor, Pedro Pablo Kuczynski, who resigned under pressure amid corruption allegations. In ousting Vizcarra, Congress declared him morally unfit to be president, and lawmakers said he handled the Covid-19 pandemic poorly. Vizcarra was also accused of taking more than $630,000 in bribes in exchange for construction contracts when he was the governor of the small Moquegua department in southern Peru.

> **"Today, the country does not look at the future with hope, but with worry."**
> — Manuel Merino

ADVISOR Q&A

Has Mexico Gotten Through the Worst of Its Recession?

Q **Mexico's economy grew 12 percent in the third quarter, according to national statistics agency INEGI, following a historic decline of 17.1 percent in the second quarter amid strict lockdowns due to the Covid-19 pandemic. What accounts for the expected increase in Mexico's GDP during the third quarter? Is the worst over for Mexico's economy? How well has the Mexican government handled the economic fallout from the pandemic as compared to others in Latin America, and what should it do to help maintain growth?**

A **Pamela Starr, senior advisor to Monarch Global Strategies and professor of international relations and public diplomacy at the University of Southern California:** "It is important not to be distracted by the 'recovery' in the Mexican economy suggested by the strong growth and job creation numbers for the third quarter. These numbers are relative to the second quarter, when a pandemic shutdown rocked the economy, not compared with conditions a year ago. The Mexican economy is still on track to shrink by about 10 percent this year and to recover slowly in the ensuing years. The Mexican recovery will not be 'V-shaped,' but instead appears to be developing into a 'curb' recovery with a strong but incomplete recovery in the third quarter followed by a flattening of growth thereafter. This likely performance in the Mexican economy reflects a number of factors, but one of the most important is the government's refusal to implement a stimulus that might have helped cushion the pandemic's impact on small and medium-sized businesses or the newly unemployed. As a result, Mexico has lost thousands of firms, is expected to see an additional 10 million of its citizens fall into poverty and is on the way to losing a large segment of a new middle class that had developed in recent decades. Unfortunately, there is no indication that the López Obrador government will alter its policy course and thereby mitigate the economic costs of Covid-19."

> **"The Mexican economy is still on track to shrink by about 10 percent this year and to recover slowly in the ensuing years."**
> — Pamela Starr

EDITOR'S NOTE: More commentary on this topic appears in Monday's issue of the daily Latin America Advisor.

NEWS BRIEFS

Argentina to Seek Extended Fund Facility From IMF: Guzmán

Argentina will seek an Extended Fund Facility (EFF) from the International Monetary Fund to replace a failed $57 billion standby loan, Economy Minister Martín Guzmán said Monday, Reuters reported. The EFF is a longer-term program that usually demands more economic reforms than a standby deal. Guzmán said an EFF would allow Argentina to repay the IMF between four and a half years and 10 years after the start of the agreement, adding that he hoped to secure the new deal by April.

Mayor of Mexican Town of Jamapa in Veracruz State Found Murdered

Florisel Ríos, the mayor of the small town of Jamapa in Mexico's Gulf coast state of Veracruz, was found murdered on Wednesday, state Gov. Cuitláhuac García announced, vowing to bring the killers to justice, the Associated Press reported. The incident comes four months after Ríos' police chief, Miguel Castillo, was shown in a video accusing her of ordering officers to kidnap people with the intention of killing them. The video of Castillo, who has been missing since July, was apparently made after his disappearance. He appears in the footage blindfolded and unclothed.

At Least 18 Tankers Expected to Load Oil for Export From Venezuela

At least 18 tankers are expected to load oil to be exported from Venezuela in coming weeks, Reuters reported Wednesday, citing tracking data and internal documents from Venezuelan state oil company PDVSA. In October, the country's oil exports plunged to their lowest levels since the 1940s amid the imposition of U.S. sanctions.

Vizcarra has denied wrongdoing but quickly agreed to leave after Congress voted to remove him from office. "History and the Peruvian people will judge the decisions made," he said Monday.

Argentina's President in Isolation After Official Tests Positive

Argentine President Alberto Fernández and several of his ministers are undergoing preventative isolation after coming in close contact with an official infected with the novel coronavirus, the government said in a statement on Wednesday, Clarín reported. Although the president tested negative for Covid-19, he will remain in isolation, the statement said, adding that his foreign and interior ministers, as well as the minister of women, gender and diversity, are still waiting for their test results. "I took a swap test whose result was negative," Fernández wrote on Twitter after announcing he had been in contact with Gustavo Béliz, the secretary of strategic affairs of the presidency, who had tested positive for Covid-19. "Despite [the results], as we have been recommending, preventative isolation is important to interrupt contagion," he added. Fernández also said he has no symptoms. Argentina is among the country's with the highest rates of Covid-19 cases, with a total reported number of 1.27 million cases and 34,531 confirmed deaths, according to a tally by Johns Hopkins University.

Guatemala Asks U.S. to Allow Citizens to Stay Following Storm

The government of Guatemala on Wednesday asked the United States to allow Guatemalans there to remain on humanitarian grounds, following havoc wreaked by storm Eta in the Central American nation last week, Reuters reported. "The Guatemalan government reiterates the necessity that Guatemalans who are currently in the United States can remain, and will not be deported, under this temporary protection mechanism," said Foreign Minister Pedro Brolo. Temporary protected status, or TPS, allows migrants whose home countries experience a natural disaster, armed conflict or other extraordinary events to provisionally remain in the United States and apply for work permits.

ECONOMIC NEWS

Chilean Central Bank Warns of Risks to Financial System

The Covid-19 pandemic is continuing to pose the most significant risk to Chile's financial system, the country's central bank warned Wednesday in a report, Reuters reported. Amid the pandemic, financial institutions' ability to take action to mitigate the crisis is diminishing, the central bank said, adding that it has already expended 40 percent of its assets through August in order to support liquidity and the country's credit markets, the wire service reported. Low growth that could worsen the economic effects of the pandemic and a dwindling ability of financial institutions to take measures to adapt to the situation are posing risks that could transform "liquidity problems into solvency complications," the central bank said in its Financial Stability Report. "These measures were designed to deal with liquidity problems temporarily," the report added. The central bank also said that concerns have been raised about Chile's sovereign debt rating due to worsening conditions of balance sheets and a "sustained" increase in public debt. Those factors are added to a $29 billion package that the government announced and which includes emergency loans and mortgage deferrals. Some of these government efforts may have "undesirable effects" that include complications involving the evaluation of credit risks and interest rate policy, according to the central bank. In addition, the central bank said "changes to the legal framework" could "render more difficult the functioning of financial markets and the solvency of financial institutions."

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quarterly average of $5.5 billion. Understandably, the pandemic has slowed the pace of divestments and shifted bargaining power to some degree. But I do not expect Petrobras to deviate too far from its five-year $20 billion-$30 billion disposal target. The company is likely to course-correct by pushing back some of its least resilient projects outside of the pre-salt and expanding the assets on offer, particularly within upstream, where it has been less aggressive recently."

A **Vera De Brito de Gyarfas, partner at Mayer Brown:** "Petrobras' Q3 results evidence an improvement in cash flow resulting mainly from a 47 percent increase in the price of crude and a 5 percent increase in production, compared to the previous quarter. Despite Covid-19, Petrobras managed to continue with its divestment plan and especially with investments in R&D, including the implementation of new systems to increase efficiency and profitability. Its tender procedures for goods and services were kept mostly on track. In general, the Q3 results were optimistic, and the company announced that, although it registered losses of $236 million during the last 21 months, it reduced $31.3 billion in debt. Petrobras has continued with its divestment plans despite coronavirus-related obstacles. The Brazilian market continues to be very active and potentially the most interesting in Latin America. On Oct. 1, the Supreme Federal Court rejected a request to suspend the divestment of Petrobras' refineries. On Nov. 4, Petrobras announced it would send out invitation letters to qualified participants to continue with the process of divesting E&P assets in Ceará. It is likely that the negative financial impact of the delay in the process will be mitigated by the increase in production. That surge is a result of the development of pre-salt fields, which are extremely profitable. Petrobras announced that it reduced pre-salt lifting costs by 26 percent, compared with 2019. This pre-salt crude is extremely light crude and is exported to Asia, where the Chinese market's rebound has allowed for continued exports. The trend will most likely continue because new production from additional fields is expected to come online from six different fields."

A **Steven Sandretto, partner at Holland & Knight:** "Certainly, 2020 has been a challenging year for Petrobras, which was hit hard by the Covid-19 pandemic, coupled with the global collapse in oil demand and prices. Due to the pandemic, Petrobras has experienced decreased demand for its fuels and stoppages at some of its production facilities. However, Petrobras acted swiftly to ensure its liquidity. The company sought to significantly cut costs and reduce its capex, and also embarked on an aggressive divestment program to reduce debt and focus on its core business. Although some of those divestments have been delayed, Petrobras continues to have a large pipeline of divestments underway with some expected to close this year. As the Brazilian economy reopens, buyers remain interested in Brazilian assets, and deals continue to close. Despite these challenges, Petrobras recently boosted its production outlook as it recovers from production halts and ramps up its production at offshore oil fields. Significant production increases are a result of Petrobras prioritizing crude production from the pre-salt region. Petrobras also expects continuing good performance from exports, largely due to a resumption in demand from China. During this challenging year, Petrobras was still able to successfully issue $3.25 billion of unsecured notes in May, in a deal that was almost five times oversubscribed. Increased pre-salt production, as well as Petrobras' divestment program, coupled with its cost-cutting measures, have allowed Petrobras to recover quickly from the pandemic and should result in the company being able to weather the coronavirus storm."

LATIN AMERICA ENERGY ADVISOR
is published weekly by the Inter-American Dialogue
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Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Anastasia Chacón González
Reporter & Associate Editor
achacon@thedialogue.org

Latin America Energy Advisor is published weekly, with the exception of some major U.S. holidays, by the Inter-American Dialogue
1155 15th Street NW, Suite 800
Washington, DC 20005 **Phone:** 202-822-9002

www.thedialogue.org

ISSN 2163-7962

Subscription Inquiries are welcomed at
ebrand@thedialogue.org