Brazil: Energy Sector Making Up for Lost Time

Over the last year, Brazil's government has instituted aggressive reforms to liberalize its energy sector after years of heavy-handed state-led management, which kept investors locked out and sizable resources locked down. However, if results from two recent auctions in the massive offshore Pre-Salt are any indication, companies once scared to spend in the notoriously politically volatile South American country have had a drastic change of heart.

2ND PRE-SALT BID ROUND

AREA	WINNERS	SIGNING BONUS (R$)
Sudoeste de Tartaruga Verde	No Bids	—
Sul de Gato do Mato	TOTAL	100 Million
Entorno de Sapinho	BR PETROBRAS, Repsol Sinopec Brasil	200 Million
Norte de Carcara	Statoil, Petrogal, ExxonMobil	3 Billion

A host of heavyweights, including Brazil's own Petrobras, ExxonMobil and Royal Dutch Shell, spent 6.15 billion Brazilian reais ($1.87 billion) in fixed-figure bonuses at the 2nd and 3rd ever Pre-Salt auctions on October 27th. Oil and Gas Secretary Marcio Felix said results exceeded expectations. "Between the three rounds [two Pre-Salt and September's non-Pre-Salt 14th Round] we expected revenues of 8.7 billion reais," he said, "but we took in nearly 10 billion, or about 15% more."

Furthermore, in accordance with the production-sharing model utilized in the Pre-Salt as per Brazilian law, firms also pledged huge shares of "profit oil," often multiples of contractually required minimums. According to oil regulator ANP, after investment costs are covered, production revenue beyond that is split, with companies giving the state a percentage, or so-called "profit oil." While it is difficult to quantify how much money this might generate given the complex nature and long timelines of hydrocarbon projects, as well as other variables like oil prices, the amounts are enormous.

"We haven't had time to evaluate yet, but these pledges represent dozens of billions of additional dollars in future state revenue," ANP Director Decio Oddone said at a post-auction press conference. In a later statement, Brazil's President Michel Temer estimated work in the awarded areas would generate some $130 billion in royalties and other government-take over the life of the projects. He further claimed up to 500,000 new jobs would be generated in a country still battling recession.

Six of eight available areas received bids, an outcome officials said they were comfortable with. Highlighting several big wins, at the northern part of the Carcara field, Norway's Statoil won alongside Portugal's Petrogal and Exxon, offering a high 67.12% profit oil share. Statoil already works in Carcara's south, where post-auction it announced a nearly $2 billion deal with Exxon to farm-in half of its 66% stake there.

In the Peroba area, state-owned Petrobras alongside Chinese state-run CNOOC and UK major BP won with another high profit oil offer of 76.96%. However, it fought off fierce competition, besting the likes of Statoil, Exxon, Shell and even Middle Eastern newcomer to Brazil, Qatar Petroleum.

At Alto do Cabo Frio Central, Petrobras and partner BP came out on top, offering a 75.86% profit oil share. Meanwhile, at Entorno de Sapinhoa, Petrobras, Spain's Repsol and Shell won out with 80%. That consortium also works at Sapinhoa, which the newly awarded area surrounds; Sapinhoa is Brazil's second-most productive field according to ANP, with output of over 325,000 barrels of oil equivalent per day.

WORLD CLASS RESOURCES

At Rio's Offshore Technology Conference (OTC), which took place just prior to the auctions, executives waxed about the heft of Brazil's crown jewel. One Repsol executive even speculated that if developed to full potential, the Pre-Salt could be the "third biggest oil province in the world," putting Brazil on a very short-list of countries after Saudi Arabia and Venezuela. That companies were so willing to grant the state big slices of the pie also speaks to just how prolific the Pre-Salt -- which is larger in area than some small countries

3rd PRE-SALT BID ROUND		
AREA	WINNERS	SIGNING BONUS (R$)
Pau Brasil	**No Bids**	—
Peroba	BR PETROBRAS, CNODC, bp	2 Billion
Alto de Cabo Frio Oeste	Shell, CNOOC, قطر للبترول Qatar Petroleum	350 Million
Alto de Cabo Frio Central	BR PETROBRAS, bp	500 Million

-- truly is, even when compared to other promising markets in Latin America.

In oil upstart Guyana, which has attracted attention from Exxon despite not yet having a working petroleum law, simply put, the resource base is not nearly the same scale. Its Stabroek Block, covering huge offshore acreage as home to the Liza prospect, holds an estimated 2.25 to 2.75 billion barrels of oil equivalent, a figure that incorporates natural gas volumes. For contrast, ANP says northern Carcara holds 2.2 billion barrels of oil alone, and that's only for the portion of the field that was up for grabs. Likewise, combined oil volumes for just two exploratory prospects in the 3rd auction, Peroba and Pau Brasil -- which ultimately went unawarded -- were estimated at 9.4 billion barrels.

Mexico meanwhile, for all its recent success ushering in a new deepwater era on its side of the Gulf of Mexico, just doesn't have Brazil's productivity. At OTC, officials from PPSA, the Brazilian government's Pre-Salt project manager, noted the formation's wells rank as some of "the most productive in the world." ANP statistics show numerous Pre-Salt wells yielding over 20,000 b/d of oil, with a few even producing over 30,000 b/d. Even at a price of $50 per barrel, that means a single well at Sapinhoa that happens to produce 30,445 b/d would generate over half a billion dollars of gross revenues on a yearly basis. Given such elevated figures, no wonder Petrobras says its Pre-Salt lifting costs are less than $7 per barrel.

MORE IMPROVEMENTS ON THE WAY

Even if vindicated in light of auction successes, officials say they will not rest on their laurels. Indeed, they spoke of reforms to be unveiled in coming weeks and months, hoping to make investments even more attractive.

After the auctions, Marcio Felix noted that the recently renewed REPETRO oil tax relief program was being toyed with in Brazil's legislature, which may even make it permanent. He also said within weeks or even days, policymakers would adjust waivers for local content to make what in the past had been rigid industrial policy a bit more flexible.

Perhaps most notably, officials intend to offer on a permanent, rolling basis starting next year, every area leftover from all past bid rounds, excluding Pre-Salt blocks, under the assumption that through negotiation the right terms can be found. Officials claim this will create a new dynamic, especially for Brazil's long-neglected continental size onshore.

Speaking in Rio in the weeks before the auctions, ANP director Decio Oddone was cognizant of what the world's energy future holds. "We are in a transition towards a low carbon economy," Oddone said, painting the urgency of getting Brazil's multi-year auction calendar through 2019 rolling, "There will be oil left in the ground but I hope it's not ours." Later, after Brazil's 14th Bid Round, Oddone lamented how the auction's star, the offshore Campos Basin, had not seen any bids for 10 long years. Next year's presidential elections certainly represent a big question mark for energy policy. However, if Brazil can continue pulling off feats similar to its latest auctions during future bid rounds, it should be in a solid position to make up for lost time.

The Institute of the Americas recognizes and greatly appreciates the contributions by Anthony Venezia in preparing this report.

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