

Brazilian Wave

February 2015 Issue: 42

A nation fighting to overcome crisis

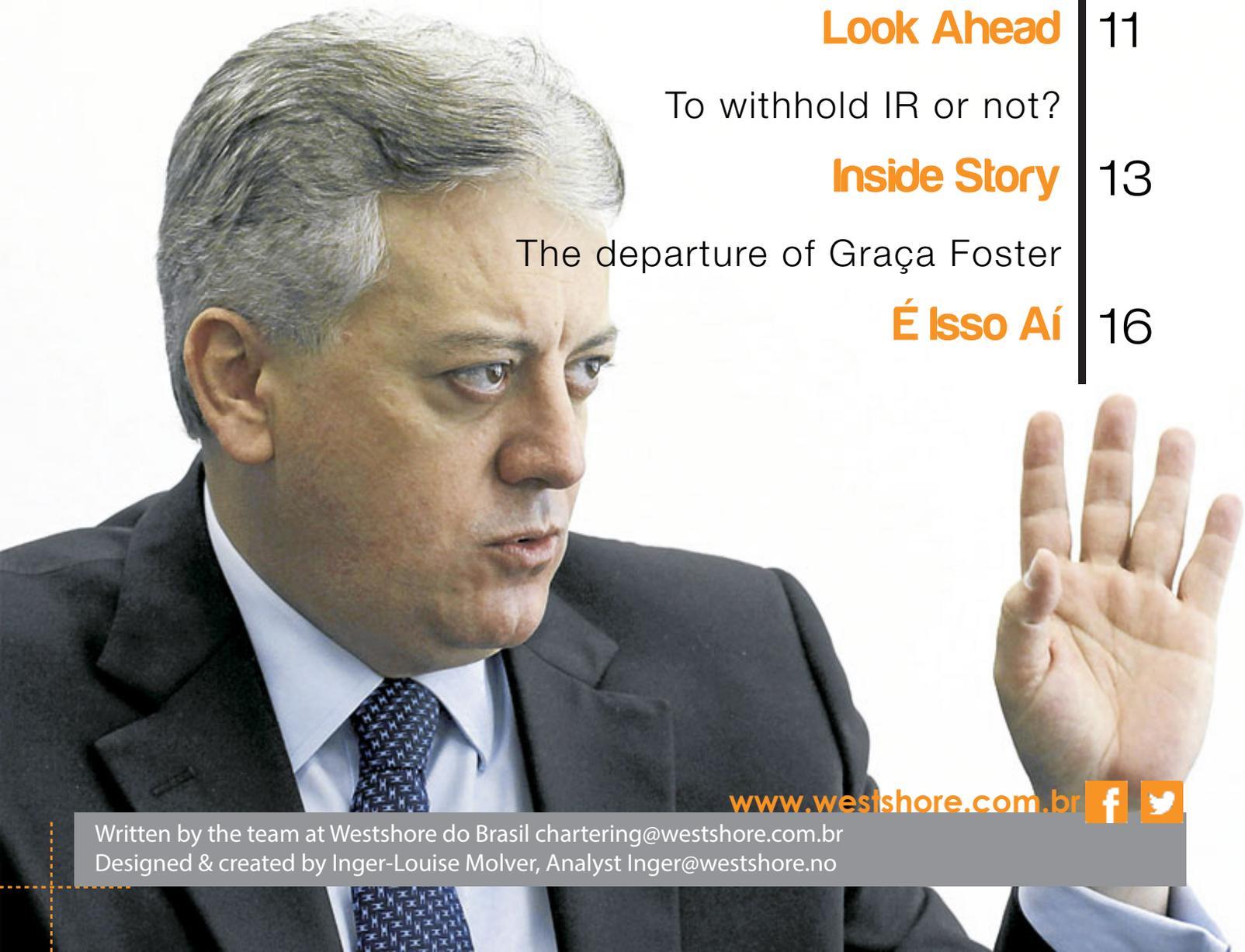
How the scandals are rocking the offshore industry



WESTSHORE

DO BRASIL

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ECO TUG - Newly arrived LH 5000 “ECO MORA” is prompt available Guanabara Bay. The purpose built line handler is 55 tonnes BP Astern and 60 tonnes BP ahead.

DEEPSEA SUPPLY - AHTS Sea Leopard has been fixed to Statoil for cargo and tanker lifting assistance 20 days firm plus options. The vessel will be available a few days in Guanabara Bay before commencing next charter.

FARSTAD - AHTS Far Sea has been fixed to Transocean to assist on a rig move in Guanabara Bay 3 days firm earlier this month. At time of writing the vessel is prompt available Guanabara Bay.

OCEANPACT - OSRV Celia is prompt available in Guanabara Bay, with OR equipment installed.

CHOUEST - Brazilian built and flagged AHTS Elizabeth C remains in direct continuation from previous charter with Shell to assist on various jobs related to works on FPSO Espirito Santo.

ECO TUG - OSRV Eco Octo has been extended with Shell for 2 moths firm plus options. OSRV Eco Orion is available Guanabara Bay subject end of planned maintenance.

LABORDE - Brazilian built and flagged LAB 151 has been fixed to Allseas to support the operations of

pipelayer vessel Lorelay, more news can be found in our Drilling and Production section.

BRAVANTE - Bravante IX, DP2 PSV 5th sister ship delivered to Bravante in the US is set to sail to Brazil early March.

STARNAV - DP2 PSV Starnav Aquarius upgrades and maintenance have been concluded. At time of writing the vessel is available Guanabara Bay subject clearance.

SIEM - The four AHTS vessels Siem Diamond, Pearl, Sapphire and Emerald will soon reach the end of their firm period on their Petrobras charters. Siem Diamond has already completed hers and begun demobilizing out of Brazil.

SOLSTAD - AHTS Normand Borg remains in Brazil after its contract with Petrobras finished its firm period. The vessel can work in Brazil subject to clearance.

BOURBON - Brazilian built and flagged AHTS Geoniso Barroso is expected to arrive back to Brazil later this month to commence work with Petrobras after having worked in West Africa.

FARSTAD - Brazilian built and flagged 192 ton of bollard pull AHTS BOS Turquesa is available in the Brazilian spot market after her successful long term operation with Petrobras.



Petrobras Tenders Update

What's going on with the OSV requirements?



In a turbulent oil market when Oil Companies are revisiting projects and resizing its OSVs fleet, added by an unprecedented corruption scandal hitting the Brazilian oil company, it's no surprise Petrobras OSV tenders have been dragging in the market. So what is the current situation with the tenders?

In addition to the economic uncertainties, the tenders presently out have been generating some noise as they all involve different list of receivers list. This is Petrobras' new criteria for inviting Parties to bid (full CRCC register, BAD evaluation and PEOTRAM) as described in our December 2014 edition (headline news) and was implemented for some tenders but not for all. While some owners with tonnage available are still protesting to be included in the receivers list, tenders have been constantly updated with new documents, procedures and type of vessels.

One of the main changes is the need for bidders (Brazilian Shipping Company and Foreign Owner) to go through an economic-financial evaluation. This involves the compliance to one of three options: Corporate guarantee, parent company guarantee or insurance guarantee. For the first two options, Companies should comply with a minimum net worth, net financial leverage (<65%), liquidity, and for that purpose financial statements should be made available for Petrobras and all other bidders. For the insurance guarantee option, the company should provide a guarantee over a small percentage of the contract value (0.85% to 1.4%) by a Brazilian insurer. Cost for the insurance will depend on the risk analysis of each company, but its cost should be taken into consideration on the day rate.

Meanwhile the following OSV tenders are presently out:

AHTS 18000/21000

The tender for large AHTS has been around since November 2013. It has been cancelled three times already allegedly for different reasons and now reissued including four categories for the AHTS 18000 (including ROV) and one for AHTS 21000. Contract period offered is two plus two years and delivery goes from April up to March 2016.

The argument being that a batch of large AHTS that were on charter to Petrobras for day rates even lower than the ones offered in the previous tender for that OSV type did not have its contract extended. The situation can be dramatic taking into consideration vessels are being redelivered and becoming idle (including Brazilian flag vessels) while foreign ones are likely being demobilized back to the North Sea. Rumours saythat Petrobras intends to reduce its large AHTS fleet by 50% is not helping market mood either.

PSV 1500

After a tender issued in April 2014 was cancelled

due to budget reasons, another tender is out for small foreign flagged PSVs for delivery up to 120 days after contract award. Rates are expected to go down as competition will increase.

PSV 3000/4500

Given the likely availability of Brazilian PSVs in the Brazilian market, a tender for mid-size and large Brazilian flag PSVs was issued in December 2014. Four different mid-size and one large PSV are required for delivery up to 120 days after charter award. Contract period is either two or four years, depending on the type. The tender includes the extension of vessels already under contract but it is expected that some companies will offer foreign tonnage under REB, using the benefit from the law for using its existing and/or under construction Brazilian tonnage.

LH 2500

Tender issued in December 2014 for Brazilian flag line handlers to be delivered within 120 days after four years charter award. Vessel is required to have 20t bollard pull and capacity for four passengers among other requirements, being meant for handling offloading connecting line between FPSO and tankers.





Diamond Rigs In a Row

Following the departure of SS Ocean Worker and SS Ocean Concord in January, the SS rig Ocean Winner has ceased operating a month before its March contract expiration with Petrobras, and is now waiting for a buyer before it leaves Brazil for scrapping. The rig is now offshore Santana Island in Macaé. Meanwhile, the SS rig Ocean Clipper has recently arrived in Macaé after operating for Petrobras in Colombia, and will continue operating for the major oil company in Brazilian waters at least until December 2015.

Pacific Drillship Taking Off

After three years on contract with Petrobras, Pacific Mistral concluded its operations beginning of February and is expected to depart Brazil by the end of this month, destination still to be confirmed. While the company preferred the rig to stay, the recent event at Petrobras made it difficult to obtain a contract renewal approval. After the departure of this ultra-deepwater drillship, Pacific Drilling will have no units operating in Brazil at present.



New Flotel in the Area

The brand new semi-sub accommodation vessel Posh Xanadu arrived in February in Guanabara Bay, towed from a Chinese shipyard by 150 TBP AHT Salveritas, which is owned by the same group. Posh Xanadu offers accommodation for 750 people and will operate in Campos Basin on a one year contract with Petrobras, plus an option for another year. Its sister flotel Posh Arcadia will be delivered in March 2015 by the same shipyard.

First Steps of BC-10 Phase 3

Allseas, in connection with Subsea7, will soon start the offshore phase 3 in Parque das Conchas (BC-10) for Shell, located in Campos Basin. The pipelaying vessel Lorelay owned by Allseas arrived in Rio de Janeiro this month and will be responsible for the installation of about 40 km of rigid pipelines. According to Allseas, Lorelay has been optimized to operate in unlimited water depths, to perform associated work such as the installation of risers and subsea protection frames, and is the first pipelay vessel to operate on full dynamic positioning. Subsea7 will also take part in the project through the installation of jumpers, umbilicals and associated subsea structures. The project has a total duration of approximately two years.

Premier seeks rig

Premier Oil has issued a RFI (Request for Information) for a drilling rig able to operate at a water depth of three thousand meters for one plus one year option for two blocks acquired in the 11th round, the CE-M-665 and CE-M-717. Diamond, Seadrill, Transocean, Pacific Drilling, Ensco, Ocean Rig and Maersk are some of the owners competing and there is no information if any Brazilian company has been invited. The campaign is for two firm wells with operations starting between 2017 and 2018.

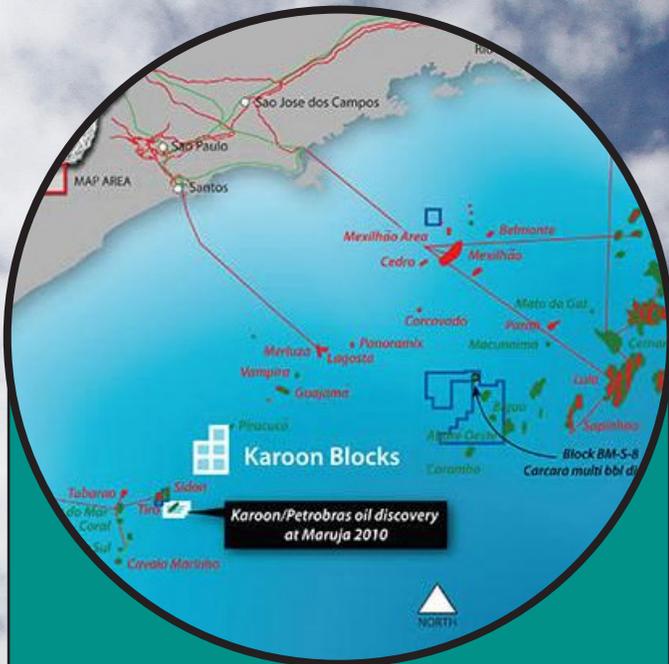


It's Sold

PetroRio (HRT's new name) is set to become one of the biggest independent oil producers in Brazil after the acquisition of Shell's 80% stake in the Bijupirá and Salema fields in Campos basin for a total value of USD 150 mio which includes the FPSO Fluminense. The conclusion of negotiations still depends on approval of the National Agency of Petroleum (ANP) and the Administrative Council for Economic Defense (Cade). Petrobras retains the remaining 20%.



 **PETRORIO**



Success at Kangaroo-2

Australian Karoon has concluded second drilling in the Kangaroo-2 located in Santos Basin and confirmed an oil column of 250 meters. Five oil samples were taken and one has been identified with 27% of porosity and 39 degree API. Karoon previously estimated the Kangaroo discovery could hold 135 million barrels of contingent resources, with further upside to be assessed after the appraisal program. Following the completion of its appraisal operations at Kangaroo-2, the company will turn its attention to the Kangaroo West-1 exploration well which will evaluate a salt-flank prospect on the western side of the Kangaroo salt structure.



Cuts at Statoil

Norwegian Statoil has declared cuts on costs and investments due to falling oil price. The company promised to protect dividend payments and said it is prepared for a long period of low oil prices, however it is proceeding with projects already sanctioned, said Chief Executive Eldar Sætre. With oil prices falling by more than half since June last year, BP and Chevron have also cut costs, delayed or cancelled projects and reduced the proceeds from shareholders to save money.



The new face of Petrobras

In an official statement Aldemir Bendine has been confirmed as the new Petrobras chief executive with Ivan Monteiro named finance chief. Both come from Banco do Brasil's board, where they were the president and the vice-president of finance respectively. Negative rumors in the market have resulted in a drop in share value due to growing disbelief in the new management of Petrobras. With strong connections to the PT (Worker's Party), Bendine received bad reviews in the international market, which saw his appointment as a kind of shield to potential new scandals in the Company. For him the challenges will be even greater, since there are some pending charges against him from his time at Banco do Brasil. For the remaining positions at the board of directors, the criteria followed the desire of the market, since technical names were chosen to fill the seats. The only issue is that the four other directors were announced as interim, so there may still be some changes at the table.

Libra's first appraisal well concluded

Petrobras has drilled and tested the first appraisal well in the Libra block known as NW1 and located in the pre-salt of Santos basin. The well was drilled by Schahin drillship

Cerrado reaching a total depth of 5,734 meters and the results have confirmed the presence of an oil column of around 951 feet (290 meters) and high quality reservoirs.

Explosion at FPSO Cidade de São Mateus

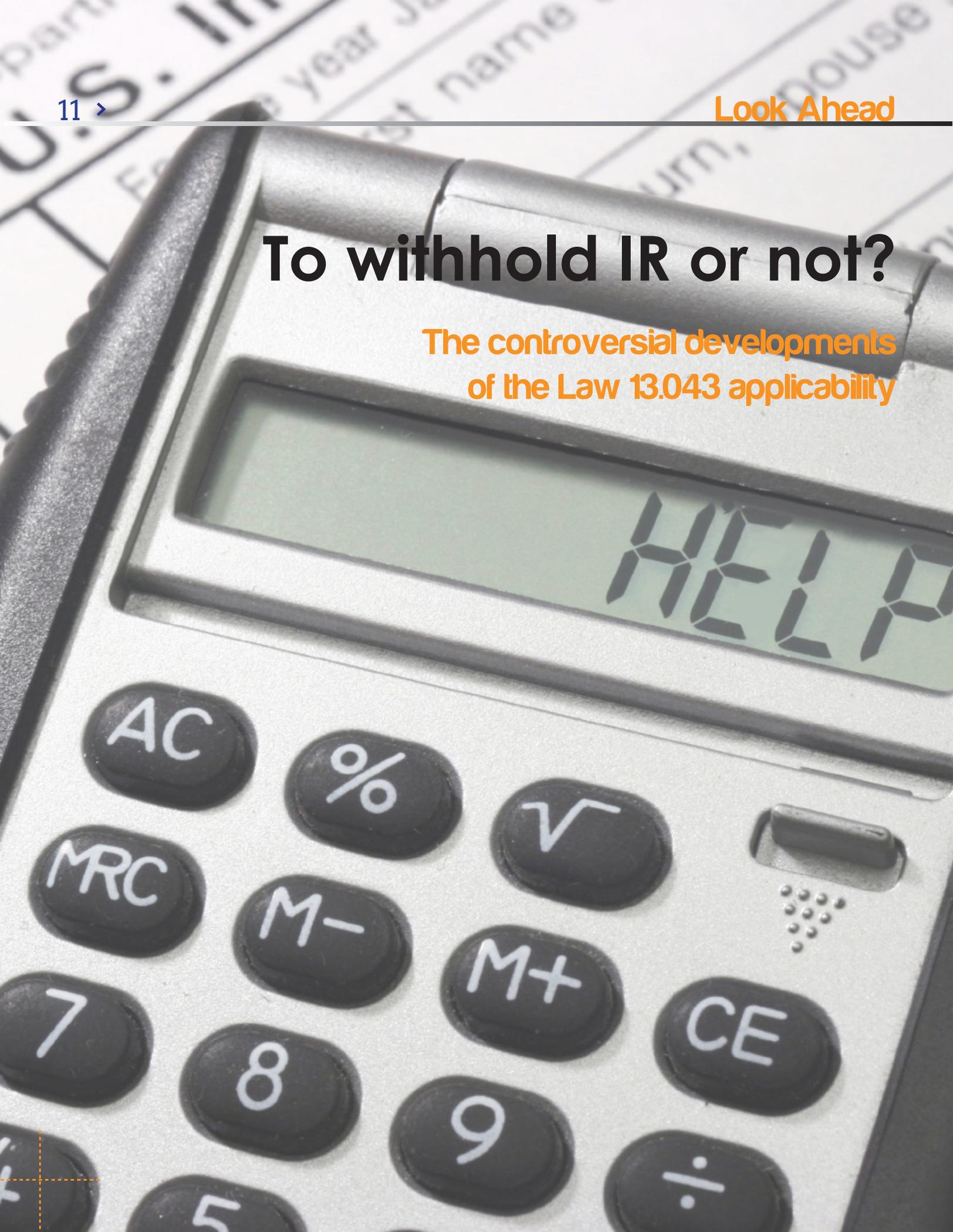
The FPSO Cidade de São Mateus owned by BW Offshore and chartered by Petrobras to produce in the Camarupim field, in Espírito Santo basin, suffered an explosion caused by a gas leak in one of the machinery spaces (pumps house) leaving at least five dead workers, ten injured and four missing at time of writing. A total of 32 workers were rescued from the platform by lifeboat to Vitoria, capital of Espírito Santo state. The Brazilian Navy will open an Inquiry to clarify the causes and responsibilities for what happened on the platform. The deadline for completion of the investigation is 90 days.

Time is running out

After being postponed several times, Petrobras is planning on releasing its much-awaited audited third-quarter financial results by March. The state oil company failed in its unaudited accounts to report any write-downs associated with a historical corruption scandal that has shaken the company. Petrobras has until the end of June to report the results or risk falling foul of some debt covenants. However according to the market, the new chief executive Aldemir Bendine is now pushing for an end of March date for release of the audited results.

To withhold IR or not?

The controversial developments
of the Law 13.043 applicability



Further to the introduction we made in the December issue of Brazilian Wave regarding the federal law 13.043 announced three months ago, some new developments linked to ongoing OSV contracts with Petrobras has shaken the market.

To recap, article 106 of this law has amended the law number 9481/1997, which determines the IR (income tax) payable over products and services by limiting the charter split amount in OSV contracts, as well as rigs, drillships, etc. As of November 14th, the charter portion of any OSV split contract must be limited to up to 65% of the contract value, while the services portion represents the remaining share of the rate. Any ongoing or new contract with a larger portion of charter shall pay IR over the exceeding amount.

Additionally, the law stated that this share limitation “would only apply to parties linked to each other, this ‘link’ being defined as the foreign shipowner having the Brazilian services provider (the EBN) as a partner, directly or indirectly, in an ownership partnership of the vessels chartered”. This definition, as broad as it is, immediately generated many interpretations and doubts. Is the side agreement signed between EBN and foreign owner going to be interpreted as a link by the IRS (Receita Federal), enough to justify the law applicability? How will Petrobras deal with the ongoing and new contracts withholding taxation, in order to be in accordance with the law?

The answer to the last question came in January, when EBNs and foreign owners started receiving notifications from Petrobras, which requested a formal letter stating whether the EBN and the vessel owner are linked or not, including a letter draft sent by Petrobras to make things easier. That letter had to be sent back promptly to avoid such exceeding taxation or the RMs (charter hire proformas) not getting issued and approved, in case both parties are not partners. Having that signed and sent to Petrobras, still several companies not linked to each other started seeing their contracts having the

charter portion getting taxes withheld over the 35% share determined in the law. The strange thing is that, not even the math done is clear enough at this point, which is not exactly 15% or 25% of income tax over 35% of the daily rate. Furthermore, is Petrobras only making a provision just in case? Or is it already paying the actual tax, making it more difficult for shipowners to get it back afterwards? When will this excessive taxation cease?

Meanwhile, in the new Petrobras tenders (see Headline News article for more details), which are aiming for PSV 1500, 3000, 4500 and AHTS 18000 and 21000, the oil major is not taking a position or imposing limitations of charter or services split portions taking this law in consideration, nor asking for any letter stating that the EBN and the foreign shipowner are partners in assets ownership or not. So, given the recent cases of incorrect withholding taxation, is Petrobras also going to exceed the limits in advance in these new contracts, or will it clearly invite owners to follow the law before the tenders are closed, by giving them a chance to avoid stressful situations throughout the contract period?

Although there is always room for different interpretations and it is already causing a lot of headache for shipowners, in the long run we see it as a remote possibility of one interpreting that the holder of the charter contract and the holder of services contract, by only having these contracts related to the same vessel, being considered as “partners” or linked to each other, according to the definition in the new law. Therefore, sooner or later, improper withheld tax will come back to the owners’ pockets. However, in regard to the new tenders, the only hope is that owners which bid not taking this limitation into consideration (if applicable) end up ranking better and being favored when qualified, so then start seeking rate adjustment after being hired to compensate the losses with the “excessive” taxation. Let’s wait and see...



Checkmate unavoidable: The Queen has been deposed

With an unprecedented collapse on Petrobras' ability to honor its costs, debts and a historically low company value, aside from the silent threat of prosecution in the U.S. due to non-compliance with SEC's rules, the real-life chess game for Brazil's (once) most prestigious company seems to have arrived to an end. Or has it?

Not in Brazil's recent history, including the impeachment of former President Fernando Collor, has such a volume of bad news hit Brazil. 1992's confiscation of bank savings of Brazilians combined with unexplained expenses on the refurbishment of the president's residential garden and the payment of a car with funds of suspicious origin triggered the end of a government. It all seems comical compared to the early findings of corruption in Petrobras claiming over 500 million Reais has been deviated from the company over 10 years to political parties. Moreover some 88 billion Reais accounts for the potential overvaluation of Petrobras' assets which costs have been inflated to generate corruption cash.

The scandal has significantly impacted the company value, worth currently some 130 billion Reais, with a net debt of over 240 billion Reais. Investors however are not only impacted by news coming from Brasilia. The market is also concerned with the combination of factors that further muddies the water over the state-giant situation: Petrobras investment in 2014 up to Q3 of over 60 billion Reais, an 18% raise in company debt in the same period equivalent to some 40 billion Reais. That means Petrobras is not able to generate cash to finance its projects, having to run after the market to capitalize. And now who wants to lend? Besides, approximately 70% of such debt is in USD. Albeit the oil price being a commodity also ballasted in USD, it is known to investors that the company is not able to pass such readjustment to its public, as the local prices are controlled by its main shareholder, the Brazilian government.

Not being able to sustain personal trusted friend career-

employee Graça Foster as chair of Petrobras, and unable to source a market reliable name to replace her, the government embosses Banco do Brasil president Aldemir Bendine as Petrobras chairman, a name perceived as an unquestionable follower of "Brasilia desires". For the investor, that means an inability to change the current scenario, the undesired path of Petrobras assisting control on inflation at the cost of its lower cash generation, the potential admission of further deviation and bleeding of company cash into corruption.

The problem with this scenario is the unavoidable comparisons with former administration. For info: from 1995 until end 2002, Petrobras share value multiplied by 6, while the Ibovespa (São Paulo exchange) by 3. That is, Petrobras doubled the average Brazilian stock exchange market. From 2002 until 2013 (presidents Lula and Dilma) Petrobras value multiplied by 5, while Ibovespa grew the same. And in January 2015 Petrobras value is back to nearly... 1995!

Despite this Petrobras seems to have been chosen as the "sponsor" of Brasilia, in the broadest sense. Finance Minister Levy announced a package of restriction measures from taxes being raised to unemployment benefits being cut, while hydroelectric power plants are not able to generate the demanded energy - having costs raised by some 40% due to thermal generation replacement. So it's not only Petrobras that is supposed to keep incentives to local content policy, but will even more so not be able to cash in by raising the cost of diesel and gas. Yes, the people are out on the streets again complaining against bus tariffs which were also

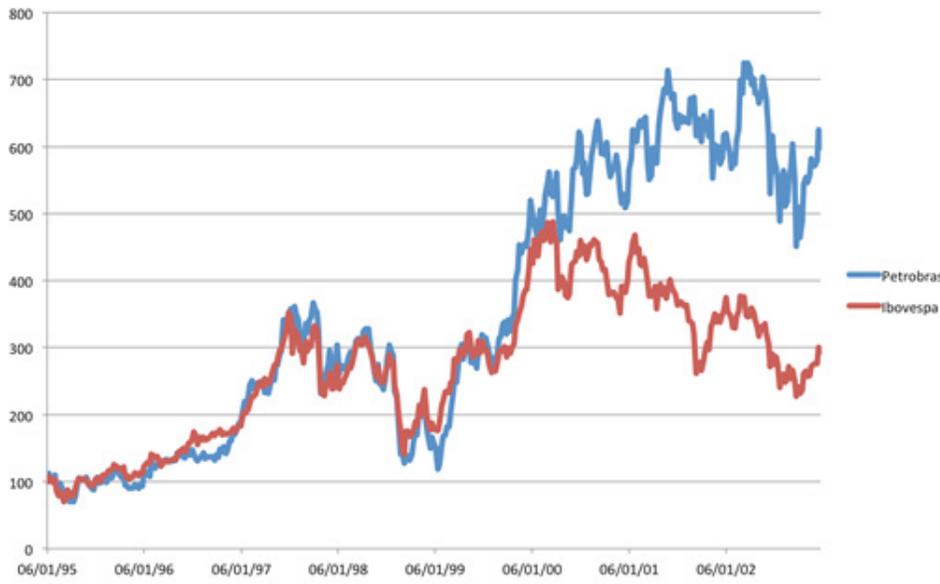
raised due to higher petrol costs!

To complete this tale, the government decided to raise its PT party against its main ally PMDB. This lost the election for president of the chamber in Congress, resulting in several decisions not desired nor supported by the president getting voted and approved. Total political disaster.

Petrobras contractors, whether involved in the scandals or not, have several payments outstanding. That includes several offshore shipping companies. The market rumours are that Petrobras is holding

payments on purpose. Those companies involved in the corruption scandal are in a delicate situation. Unemployment has reached cities like Macaé, Rio and São Paulo, not to mention the cities polarized by refineries or shipyards, such as Fortaleza, São Luiz, Itaboraí...

Workers have closed the Rio-Niteroi Bridge in protest on Feb 10th and the big news seems to be a national riot being called for March 15th demanding impeachment. Dark times coming after carnival, while the queen is isolated - in Avenida Chile or in the Alvorada, reader's choice.



Indexed Petrobras Valuation versus Ibovespa (São Paulo Stock Exchange) - from 1995 until 2002



Indexed Petrobras Valuation versus Ibovespa (São Paulo Stock Exchange) - from 2003 until 2013





2 015 promises to be good for those who enjoy long weekends off to travel and for those who like spending extra time with family and friends. For example in São Paulo there will be 11 public holidays. It will be a year of many breaks and upcoming news.

The “Cidade Maravilhosa” will be celebrating its 450th birthday on March 1st and for this reason some of the traditional carnival groups will be performing a tribute to the city.

The carioca city will also host the events-test for the 2016 Olympics. The opening ceremony is scheduled for August 5th 2016, but the tickets for both the Olympics and Paralympics will go on sale this year setting the excited tone for what’s to come.

Rio is set to rock out in 2015 with the return of one of the world’s biggest rock events – Rock in Rio 2015. The festival has confirmed acts such as Queens of the Stone Age, System of a Down and Slipknot. Rock in Rio was first held in 1985 in Rio shooting Brazil to the forefront of major music shows in the globe breaking attendance records to this day.

The first batch of tickets for the festival have already sold out but those who still want to go have the chance to purchase tickets in April when a second wave of tickets goes on sale online (www.rockinrio.com).

While its might be easy for people to complain and expect a year of difficulties, others are working to adapt structures and make improvements. 2014 was a year of several challenges and 2015 could well be the same, nevertheless we are all part of the change so let’s collectively think positively, do our part and air for a better year in all aspects.