

Brazilian Wave

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FINDING MARKET BALANCE

Still too many
vessels in Brazil?

SWITCHING FLAG

Better to do the blocking than be
blocked.... if only it was that simple

Contents

4	Finding a Balance
8	Petrobras' E&P Saga
10	Tanker insight – Crude oil offtakes
12	Porto do Açu
16	Switching to Brazilian Flag
19	E Isso Ai



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WEEKLY MARKET UPDATE

IN THIS REPORT YOU WILL FIND:

- VESSELS NEWS
- PETROBRAS NEWS
- CHARTERERS' UPDATE
- DID YOU KNOW?
- HIGHLIGHT & LOWLIGHT
- VESSELS AVAILABILITY LIST

Report written, designed and created by the Westshore do Brasil Team. Images are merely illustrative and were taken from the internet.



Picture : Ove Daniel
Taken from Skandi Isman

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Westshore do Brasil

FINDING A BALANCE

Still too many vessels, or has market balance finally been achieved?

The total offshore fleet operating out of Brazil from January to April this year showed little change, staying at around 424 vessels with little fluctuation. One could be forgiven for thinking this meant the exodus of vessels leaving the region as a result of early termination was drawing to a close. Between early termination of vessels from predominantly Petrobras, options periods not being taken up and blocking by local tonnage – some 75 vessels have come off hire since the start of 2016. Most of these vessels have either left Brazil or gone into layup. So what led to the net stability of the fleet size despite the continuing blocking and termination? The answer is new deliveries and the growing trend of ‘REB-ing’ foreign flagged tonnage.

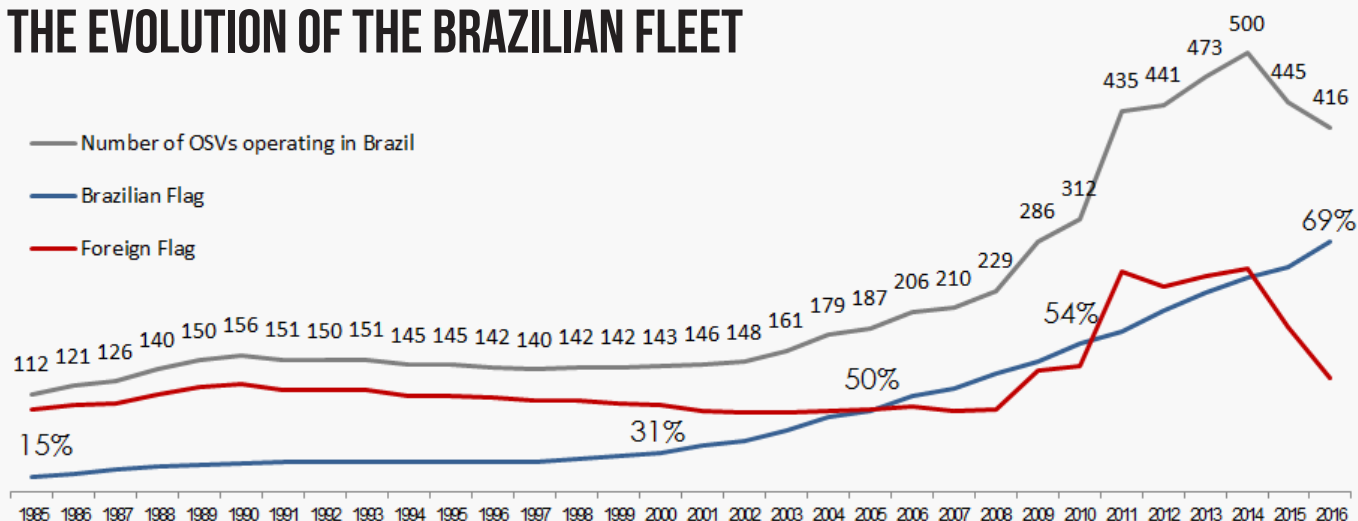
Mid to large PSVs and AHTS left Brazil at an average rate of 4.5 vessels per month but this was offset against additions of new vessels

(both new deliveries and foreign vessels reflagged to the Brazilian Special Register). In May however, the fleet size did drop notably, down to 416 vessels, and we anticipate a further reduction of over the next coming months.

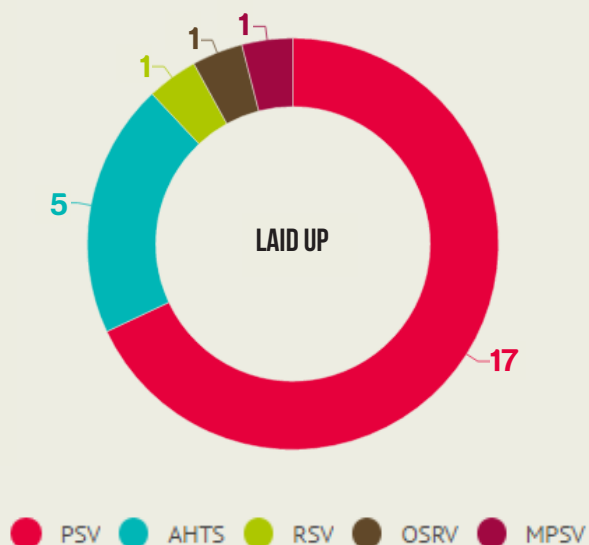
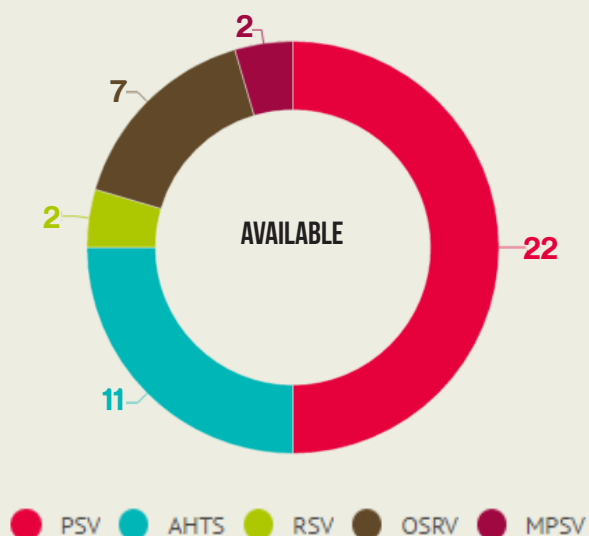
Local content policies and clearer “circularization and blocking” rules implemented by the regulatory agencies over the last decade triggered the Brazilian/foreign ratio to be about the same (around 50% each), until the demand abruptly declined in 2015, causing the big drop shown in the graph below, especially on the foreign flagged side. This may look positive from the Brazilian industry point of view, full employment of local tonnage. However, even after several months blocking circularizations, about 25 Brazilian vessels are in lay-up and 44 vessels are currently unemployed (most are Brazilian vessels). The following graphs show the breakdown of types of these vessels.

cont...

THE EVOLUTION OF THE BRAZILIAN FLEET



VESSEL AVAILABILITY



Worse before it gets better

By December 2016, we expect more than 70 other contracts in Brazil to be ended (conclusion of the firm period of the contract), of which 35 are PSVs and 19 AHTS, Brazilian and foreign. Some of these contracts may be renewed for the optional period, however we expect that most of the vessels will indeed become available, which will keep the availability levels high and the daily rates low.

Petrobras currently has ongoing tenders to hire PSV 4500, OSRV 750, RSV and SDSV. Unfortunately, we expect that those bids may not hire a volume of vessels enough to “clean the market up”. Meanwhile, about 20 vessels of several types and sizes are currently in direct negotiations with Petrobras and the conclusion of this process can take a while and push the results of the bids forward, especially the ones related to PSVs and OSRVs.

ONGOING PETROBRAS TENDERS



PSV 4500 (Rebid) April 2015

Status - Awaiting board approval
24 vessels qualified (BR or REB)
730 days firm



OSRV 750, PSV 1500 & 3000

Status - Direct negotiations due to blockings
Over 20 Brazilian or REB vessels
Expected by Q4 2016
Duration - up to one year



RSV Tender (June 2015)

Status - Commercial negotiations
14 vessels offered (4 disqualified)
Expected Q3/Q4 2016
730 or 1095 days firm



OSRV Tender (Nov 2015)

Status - Awaiting technical qualification
27 vessels offered (13 BR, 14 Foreign)
Expected Q3/Q4 2016
430, 1095 or 1460 days



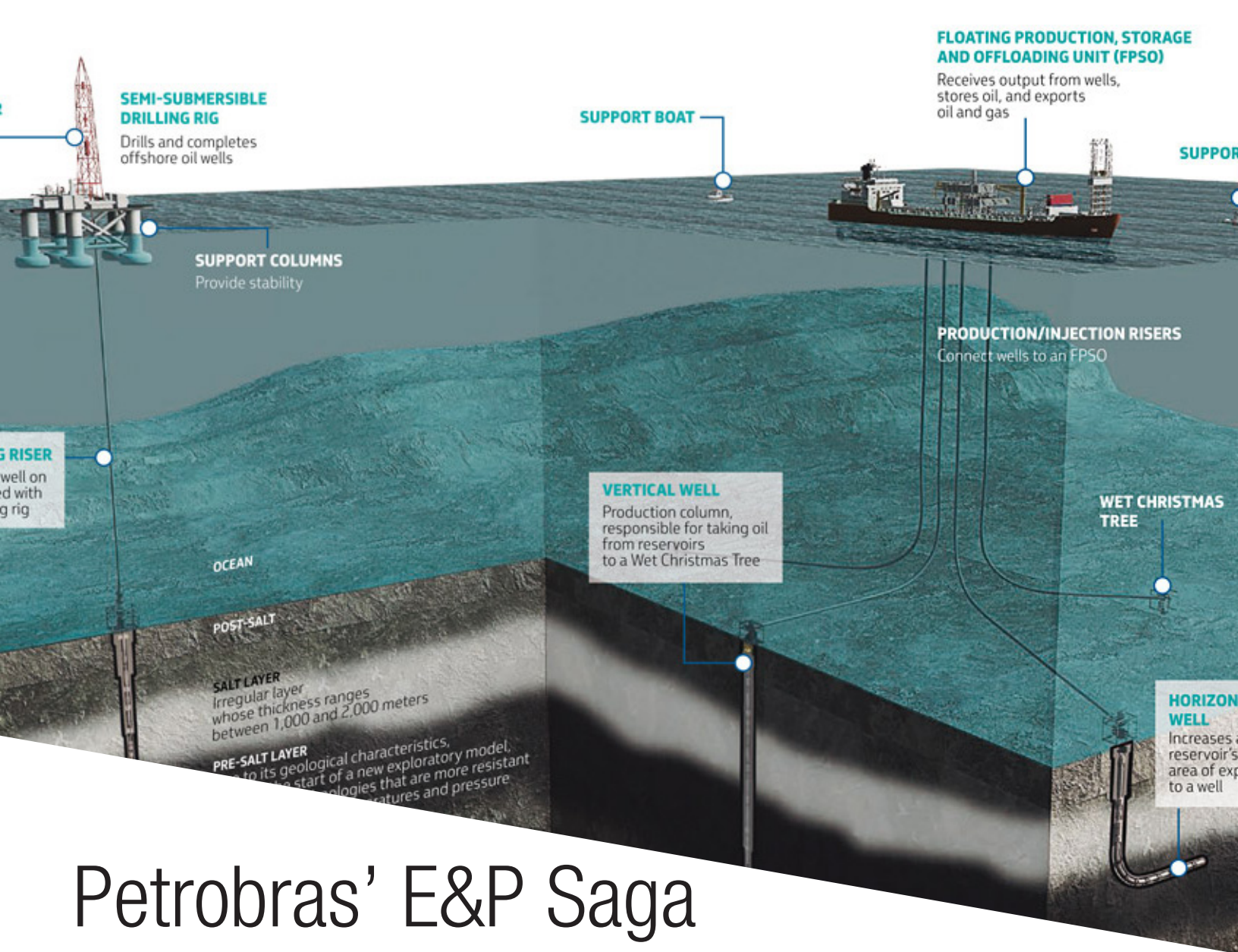
SDSV Tender (June 2016)

Status - Open for proposals
Proposals deadline - June 30th 2016
Expected Q1/Q2 2017
730 or 1095 days firm

New demand?

In regard to new demands from other oil companies, unfortunately the two relevant campaigns that were scheduled for 2016 were recently postponed. Queiroz Galvão Oleo e Gás delayed its Long Duration Test in Atlanta field from Q3/2016 to Q1/2017, after the refitting period of Teekay's FPSO Petrojarl got delayed as well. The company is still set to hire at least one OSRV for this operation. Meanwhile, Karoon's operation in Santos basin (2+2 wells) was recently postponed for the second time from Q3/2016 to Q1/2017. The company will require six OSVs to proceed with the campaign. Allseas and Saipem will hire up to five large PSVs, but those will mostly operate throughout 2017. Next year, Total, PremierOil, BP and other oil majors are planning to start drilling campaigns in their Equatorial Margin blocks; nonetheless, most of them are behind schedule due to delays with licenses and seismic campaigns, as well as budgeting difficulties. Spot market remains hard to depend on, due to vessels' low utilization rate. Taking into consideration the last three months, 58 firm days were hired in the average of 8.3 fixtures per month, which represents the average of 7 days firm per fixture.

The supply/demand ratio has never been as unpredictable as this. The picture changes every month, so charterers and ship owners should be closely monitoring developments. Knowing the market, the rate levels and ideal approach for a particular client, has never been more critical.



Petrobras' E&P Saga

THE CURRENT EXPLORATION AND PRODUCTION POSITION OF BRAZIL'S OIL MAJOR.

RIGS CHARTERED BY PETROBRAS

Company	Drillship	Semi Submersible
Atlantica (BassDrill)	0	1
Diamond Offshore (Brasdrill)	0	2
EnSCO	0	2
EtESCO	1	0
Ocean Rig	2	0
Odebrecht	4	2
Paragon	1	0
Queiroz Galvão O&G	3	5
Schahin	1	0
Seadrill	2	2
Transocean	2	2
Ventura	1	1
Petrobras owned	0	4
TOTAL	17	21

DRILLING RISE

Links the well to the seabed with the drilling rig

The first quarter of 2016 saw Petrobras forced to write off losses of BRL 1.246 billion.

Spending cutbacks have consequently been ramped up a notch and amongst other measures it is currently renegotiating the contract with Sete Brasil over the new drilling rigs.

Petrobras is working to slash its current fleet by 50% and rumor has it that 2016 will close with Petrobras having around 30 units on contract. In our January edition of Brazilian Wave we discussed the 30% reduction in drilling rigs offshore Brazil since 2012. This comes partly as a result no new oil field auctions over the past five years and a heavily reduced pace of environmental licensing. The consequence of this added to the woes of the global downturn in the oil industry has resulted in low exploratory activity and also means more drilling rigs will leave the country during the course of 2016. Petrobras ended 2015 with 46

drilling rigs under contract and from December to June 2016, has released eight further units, namely: Olinda Star, Deepwater Navigator, Paragon MSS2, Dave Beard, Aban Abraham, Sevan Driller, Ensco 6003 and Ensco 6004. The only way to enter the pre-salt is via projects led by Petrobras, according to the rules of the Share Agreement designed to ensure that the country maintains control over such resources.



The first quarter of 2016 saw costs of BRL 1.1 bn resulting from expenses attributable to idle rigs.



So if no other operator has access to these areas as operator, and Petrobras is under pressure to cut spending, rigs will be lying idle. The first quarter of 2016 saw costs of BRL 1.1

billion resulting from expenses attributable to idle rigs. The new Brazilian Interim Government can speed up discussions, reducing costs of exploration and production and increasing the attractiveness of Brazilian fields. It's reported that the average investment costs (CAPEX) and operating (OPEX) on E&P projects around the world have dropped 25% and 13.5%, respectively, according to IHS. In 2014, the pre-salt project and large areas of post-salt were economically viable at a cost of USD 55 per barrel. Estimations for this year's oil industry investments, which includes Petrobras and the private sector, are projected at being in the range of USD 20 to USD 25 billion. The return of investments however, will largely depend on the regulatory change and investors' change of mind. The future of the energy sector is to eliminate Petrobras' compulsory participation in every project allowing so it can focus on its core business, E&P. In the current climate flexibility and the ability to focus on core competence is key, this monopoly is not working.



CRUDE OIL OFFTAKES

AS WE DISCUSS LATER IN THIS EDITION OF BRAZILIAN WAVE THERE ARE SEVERAL NEW INSTALLATIONS AT PORTO DO AÇU, WE ADDRESS THE OFFTAKES CURRENTLY IN PRACTICE.

AN OVERVIEW LISTED BY PRODUCERS FOLLOWS:

- Petrobras, being the major player, has traditionally transferred its production from more than 30 FPSOs to their shore terminals in a very complex program involving multiple types of vessels (owned and chartered) and various uses such as supplying refineries, blending and storage for onward exports;

- BG/Shell participates in 5 FPSOs located at the Santos Basin from where shuttle tankers receive the oil that is then taken to Uruguay – La Paloma anchorage – for transshipment into the export bound Suezmaxes. This pattern will change once the new Oil Terminal (T-Oil) at Porto do Açú becomes operational and Suezmax tankers will receive the oil from the shuttle tankers improving significantly the turnaround and costs involved;

- Shell operates 2 FPSOs, namely Fluminense and Espírito Santo both at the Campos Basin, from where the cargoes are loaded directly into export bound vessels, usually Suezmaxes;

- Repsol has 2 FPSOs operated by Petrobras, one at the Santos and the other at Campos Basin. Repsol has chartered 2 Suezmax shuttle DPs to transship the cargoes in La Paloma like Shell. A third FPSO is expected to be added, at the Santos Basin;

- Chevron has 2 FPSOs, one operated by Petrobras and one by Chevron – Chevron Frade - both in Campos from where all export cargoes are loaded directly into the ships;



Daniel Buckley
Westshore
Tanker Broker

- GALP currently participates in fields with a total of 5 FPSOs under Petrobras' operation whom is also in charge of the exports;

- Statoil operates the FPSO Peregrino at the field of same name located in Campos together with Sinochem utilizing 11 Aframax tankers loading directly for their exports with about 4 shipments per month;

- Petrório has the FPSO Polvo operating at the Campos basin loading directly into their export ships;

- OG Par is expected to resume operations next month at its FPSO OSX 3 in Campos;

- Finally, Queiroz Galvão is expected to commence operations with the FPSO Petrojarl I at the Camamu basin in the state of Bahia;

The Porto do Açú operation is expected to be used firstly by Shell given its position as Prumo's partner following the deal with BG. Initially, the Oil Terminal will be commissioned to receive Suezmax ships and later, upon necessary dredging services, will receive VLCCs. This alternative should work out quite well in as much as the shuttle trips will be shorter, more flexible in terms of timing related to the export vessel and cost effective compared with La Paloma implying backtracking if sailing to the USA, Caribs or Europe. An exception will be shipments heading to the Far East. Another feature will be safety, being inside a protected area allowing the transshipment operations even in bad weather periods.



An aerial photograph of a detailed architectural model of a port. In the foreground, a large body of water contains several miniature ships, including two large tankers with orange and blue hulls on the left, and a smaller blue ship on the right. A long pier extends into the water. The background shows a miniature cityscape with various buildings and a green area. A dark rectangular box with white text is overlaid in the upper center of the image.

Porto do Açu

Strategically placed close to the pre-salt areas, Porto do Açu is gearing up to become Brazil's next oil and gas hub.

WRITTEN BY JOANA RODRIGUES

The three new terminals inaugurated at the Porto do Açu complex on 7th June, in the North of Rio de Janeiro state, brought cheer to the oil industry. In addition to generating direct and indirect employment, the complex attracts new business to Brazil.

The Oil Terminal (T-Oil), operated through a partnership between BG/Shell and Oiltanking is designed for oil transshipment operations (ship-to-ship) which was previously performed offshore. In addition to the T-Oil, the Açu Port Maritime Fuel Terminal (Tecma) and the Multicargas Terminal (T-MULT) were inaugurated. In all, the three areas received R\$ 1.5 billion (USD 435 million) in investment funding. Despite the success of the opening, the Porto do Açu still has issues pending before operations can fully commence. A number of non-conformities were presented by its main customer. Like any new business, the Açu needs adjustments and will undergo a learning curve to gain market share.

HISTORY

Launched at the end of 2006 by Eike Batista, the construction of the Porto do Açu began in October 2007. The EBX Group project was the largest investment in port infrastructure of the Americas.

When the empire of the former billionaire collapsed, the EIG Global Energy Partners LLC took control of its most valuable project: a Brazilian port startup as ambitious and sophisticated as it was risky and thirsty for capital.



PICTURE OVERLEAF - MODEL OF PORTO DO AÇU ONCE WORK IS COMPLETED

1. PHOTO TAKEN BY AGENCIA NACIONAL TRANSPORTES TERRESTRES JULY 2015

2. PHOTO TAKEN BY AGENCIA NACIONAL TRANSPORTES TERRESTRES AUGUST 2015





Two years later, the investment of R\$ 1.5 billion is beginning to bear fruit. The Porto do Açu, occupying an area larger than Manhattan located in São João da Barra (RJ), signed contracts with companies such as BG Group and Votorantim Metais SA. The Açu success story stands out in a country hit by falling commodity prices and a recession that will be the worst in 25 years. These days the port is managed by Prumo Logística, which is controlled by EIG.

ONE OF THE LARGEST LOGISTICS PROJECTS IN THE COUNTRY

Covering an area of 90 square kilometers and strategically located in the Northern part of the state of Rio de Janeiro, Porto do Açu is approximately 150 km from the Campos Basin, where almost 80% of Brazil's oil is produced. Currently in operation, the port has 17 km of docks and is up to 23m deep, with capacity for up to 47 vessels simultaneously, including large vessels such as Capesize and Very Large Crude Carriers (VLCCs), which

can carry up to 320 thousand tons of cargo. The most modern concepts of industrial port, the Porto do Açu will feature an industrial district and a yard for storage and cargo handling. These areas, together with the port, will form the Industrial Complex of Porto do Açu, where offshore industries will be installed, metal mechanic, tank farm for liquid bulk, shipyards, base for oil treatment, thermoelectric, logistics yard, naval repair terminal, among others.

Expectation is that the new terminal will move and store about 609.000 tons of general cargo, 27.000 tons of dry bulk and 243.000 cubic meters of liquid bulk cargo per year. The terminal will also be intended for maintenance and repair of vessels. The site will cover about 575 thousand square meters. No doubt the Porto do Açu is an impressive project, not only for its size but for its potential. But there is no doubt that the project has huge potential, some people say that Açu will be the 'hub' logistics for the development of the pre-salt.



SWITCHING TO THE BRAZILIAN FLAG

Blocking by locally flagged vessels has led many to consider switching flags. Better to do the blocking then be blocked right? Well, if only it was that simple...

ALEXANDRE VILELA

Managing Director
Westshore do Brasil



Much has been said about the need for flexible Brazilian regulation. The market is undergoing a period of record low demand for vessels, foreign flagged tonnage is being cancelled but no one is safe.

THE PROBLEM

Foreign flagged vessels are being blocked because, unlike before when the market was up, there's not enough demand to absorb all the Brazilian flagged tonnage. So when a foreign flagged vessel reaches a point where it could theoretically be blocked – during annual renewal of certification for example, it can and is being blocked by a local vessel. Even though that local vessel is lower in technical specification (within certain parameters) and even though that local vessel will command a higher day rate. Even if the charterer has a preference for the foreign flagged vessel it originally selected during the tender process – the locally flagged vessel can block the foreign one and take the contract. What we see now is that the drop in demand for offshore vessels as a whole has meant that whereas before there were no available locally flagged vessels to do any blocking, now one single Brazilian flagged vessel is enough to block several foreign flagged ones.

THE SOLUTION (OR A SOLUTION AT LEAST)

Current legislation allows a Brazilian

ship owner to replace a foreign flag with a Brazilian flag provided it meets certain criteria. The number of vessels that have been re-flagged to Brazilian since beginning 2016 has already passed 10. The current legislation was intended to make this re-flagging to the Brazilian Special Register as simple as possible. In practice however this is not exactly proving to be the case. Initially the procedure moved relatively quickly. The first vessels choosing to switch the Brazilian flag were inspected and in receipt of the necessary documentation relatively quickly and smoothly. After the inspection process the documentation would follow to the maritime Court in order to be processed and the full registration of the vessel finalized.

More recently however the Marine Authority stopped issuing the certificate until the maritime Court would provide the actual registry for the vessel. The problem here is that the issuance of the final certificate by the maritime Court usually takes 60 days or more. Consequently that means that for a foreign flag vessel to be operating under Brazilian flag, the process takes over 90 days.

The fallout problem is then two-fold: for the owners it means only bidding on contracts with a flexible start date, or else start the REB process in speculation and in advance. For the operators that means not counting on vessels which are offered under Brazilian flag but are as yet under foreign flag, unless the mobilization can



1. Mandrião
2. Bravante V
3. Monty Orr Tide

accommodate such re-flagging period. Charterers are skeptical. Some are afraid of blockage disturbing their award of the best choice, flag aside. For example in the most recent OSRV750 tender Petrobras stated that for vessels to be considered Brazilian flag they should already be under Brazilian flag at the time they are offered – not undergoing re-flagging. Simple and straight forward, allowing foreign flag vessels to be offered on the tender rules second to the local flag. Conversely Shell Brasil recently closed its bid for a MPSV. Here owners were invited to offer both local and foreign flagged tonnage. Shell considered both local and foreign flag options and further the ability of the owners to reflagging the vessel to REB while under the charter should a blocking be presented and not possible to being addressed. On the extreme Total issued a competitive

tender for multiple vessels including OSRV and PSVs for their Equatorial margin operations. Total was more conservative during the tender phases, demonstrating their intent to run no risk of blocking and give a strict preference to local flag. Operators are however more and more alert towards the fairness of blocking. In a recent case a multi-purpose vessel had its blocking revoked for not attending the charter in full. Owners seem to be more aware of how to defend their interest without compromising their relationship with the operators and authorities. So the blocking conundrum has not disappeared, but owners and charterers are increasingly focusing on ways to circumvent problems associated with it. All that needs to happen now is for regulation to keep up with the intentions of the industry.

Westshore chairs offshore conference

One of the largest gatherings of oil and gas companies took place in Rio last month. The Offshore Vessel Connect conference and exhibition brought together companies from several areas of expertise within the offshore vessel world.

Some of the highlights were Shell, discussing what they were looking for with regards to vessel needs in the Colombian upstream market. Technip talked about the challenges of being a foreign owner operating Brazilian flagged vessels. And ABENAV evaluated the impact of Operation Lava Jato (Car Wash) on the offshore market.

Our Managing Director, Alexandre Vilela was invited to chair the conference. Westshore was also invited to deliver a presentation about the current offshore market situation in Brazil. The presentation covered the evolution of the Brazilian fleet, upcoming demands and the current average daily rate for various types of vessels. Westshore broker Paula Quirino, delivered the presentation to a most appreciative audience.

Brazil is going through difficult times and Petrobras is becoming increasingly involved in several scandals under Operation Car Wash, it's the deepest political crisis in decades. But despite this Westshore do Brasil was able to show that there are still opportunities and hope in the Brazilian offshore market. The conference also brought forward valuable insight as to how companies operating within the offshore industry were reacting and coping with the crisis.

