



JARDIM BOTÂNICO INVESTIMENTOS

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INVESTMENT CASE – QGEP

Queiroz Galvão Exploração e Produção (QGEP) is an independent oil and gas exploration and production company which started its activities in 1996. It was the only private Brazilian company in the E&P sector qualified by ANP in 2007 and 2008 bidding rounds as an “A” operator (a classification which allows the company to operate in deep and ultra-deep waters). The company has a diversified portfolio comprised of 15 exploratory blocks distributed in 9 different sedimentary basins, including reservoirs in the deep-water pre-salt area, located in Santos, Jequitinhonha and Camamu basins.

One of the highlights of our investment case in QGEP is the fact that the company has producing assets at the offshore natural gas field of Manati, in the state of Bahia. The natural gas produced is sold at a pre-established and inflation-adjusted price which provides a very predictable (and not correlated to oil prices) cash flow. In practice, it creates a floor to the company’s valuation, helping us to establish a safety margin for this investment. Moreover, QGEP has a solid net cash position (just over R\$800 million), more than enough to cover its investment plan for the next 2 years.

QGEP’s second most important asset is the oil field of Atlanta. It is adding to the company proven and probable reserves (called 2P) almost 60 million barrels of oil equivalent (boe) – practically the same size of 2P reserves QGEP has in Manati. In Atlanta, QGEP is the consortium operator with a 30% stake, and the expectation is that the first oil will come in the end of 2015 or at the beginning of 2016.

Next, there is the Carcará prospect, also located in Santos Basin. There is still no official estimate of the size

or the probable production of this field, but it is known to contain high quality, light oil. It is speculated that the field may contain as much as 1 billion boe (considered a giant field) and QGEP, which has a stake of 10% in this consortium, would be entitled to 100Mboe. Delineation and appraisal wells are being drilled and the first oil is expected for end of 2018 or beginning of 2019. Until then, we can monitor the evolution of this asset through the drilling results of those wells and its productivity tests – as an example of what happened in Atlanta.

Finally, there are the other blocks where QGEP is still on the early state of exploratory work. In fact, in two of them the company has already made discoveries and has plans to progress and define a development plan for the fields. In the other blocks, we appreciate the fact that QGEP has a diversified portfolio of assets, with blocks in several different basins, which reduces the geological risk. These other blocks bring an interesting optionality to this investment case.

At current market prices, QGEP3 is trading virtually at Manati’s value plus its cash position, which gives us a decent margin of safety in this investment. In our assessment, just by adding a conservative valuation for Atlanta and Carcará we get a 30% upside potential for the stock. As a valuation exercise, considering a more optimistic figure for reserves, a higher valuation (US\$/bbl) for the same two fields and maintaining the expected CAPEX plan for the next 2 years, we find that this upside potential could be as high as 80%. This sensitivity analysis with these three scenarios gives us

a good idea of how the risk vs. reward balance is attractive in this investment case.

We do have, however, two concerns when building this position for our funds: (i) to buy the stock only when it is

trading close to this floor valuation; and (ii) limit the stock's allocation in the portfolio in view of the risk embedded in this kind of activity (oil exploration and production).

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