

# [Petroleum and investment grade rating](https://assignbuster.com/petroleum-and-investment-grade-rating/)

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Petrolera Zuata, Petrozuata C. A. case study“ La Apertura” (The Opening) • Target: Orinoco Belt heavy/extra heavy oil accumulation (biggest known in the world) • Key Strategy: Opening Venezuelan oil sector to foreign oil companies • How: Profit sharing agreements, operating service agreements, strategic joint-venture associations • Ownership: PDVSA or subsidiaries contribute10 years), fixed interest rates, fewer more flexible covenants, larger amounts. – Cons: fund must be raised in a lump sum.

Excess funds create a drag on earnings (negative carry) • Rule 144A market (private placement market): – Pros: Like public bonds + speed, underwritten within six months – Cons: only qualified investors can invest in them Conditions needed: hot markets and investment grade rating What kind of debt to choose? • The sponsors should use 144A (private bonds) to fund the deal because of the important advantages and the significant disadvantages which can arise by using the other debt kinds. Rule 144A has big advantage of time – Markets seem to be going in the right direction (Hot markets) – What else is needed?... (on the next slide: Investment grade) Investment Grade Rating • Agencies look at 3 main factors: sponsors’ creditworthiness, project’s economics and Venezuela’s sovereign risk. • Problem: Venezuela’s rating: S&P “ B” Moody’s “ Ba2” • Petrozuata is strictly connected with country’s risks because it is controlled by PDVSA which is Venezuela’s state oil company and operates in Venezuela • If Venezuela defaults on its debt Petrozuata will default too unless… Conoco Inc. is a subsidiary of DuPont which operates worldwide and has investment grade rating • Investing in Petrozuata is indirectly investing in DuPont • If you invest in Petrozuata your real investment is also in Venezuela and DuPont • Petrozuata project has a very good structure and business projections • Same comparables with other oil companies operating in other countries and having investment rate grading • Ras Laffan example of oil company having higher rating than the country in which it operates(Qatar) In order to obtain investment grading it is very important to have DuPont in the deal • If rating agencies consider the fact that Petrozuata will repay its debt although Maraven defaults on its part of debt because DuPont wants to mantain its good reputation it might obtain an investment grading • If Venezuela is strictly linked to Petrozuata and has a “ B” then Petrozuata should have at least a “ B” rating plus a considerable bonus because the risk is diversified into DuPont • Project’s base case DSCR would probably have to exceed 1. 0X • Break-even point low enough so the project can cover all operating and financing costs if oil prices fall substantially Is it a good deal? • We would invest in project bonds as they will likely yield a higher return compared to the 21% cost of equity. Factors that need to be considered: • Hierarchy of payments is good (referred to “ Cash Waterfall”) • Balance Sheet and Income statement suggest PDVSA and DuPont are supposed to be solid companies • Oil prices are not that volatile; fluctuating but arresting around a price between $20 and $25 per barrel (suggested nominal break-even price in 2008 $8. 3 per barrel) • Lower operating costs withrespectto competitors (cash operating cost around $3. 19 against industry median at $8. 55) • More than enough heavy crude oil reserves to sustain the planned production according DeGolyer & MacNoughton (U. S. based oil consulting firm) • Project’s design in accordance with good industry practice; complying with Venezuelan and International environmental laws as stated by Stone & Webster Overseas Consultants, a U. S. ngineering and consulting firm What should Conoco take into account? • • • • True problem is not very favorable businessenvironmentTheoretically, if all contracts are respected and hierarchy of payments holds, the only entities bearing risks are PDVSA and DuPont with their capital investment Banks and whoever invests in project bonds according to the hierarchy of payments should be a safe investor Uncertainty in government’s future actions could be very harmful.

Remember that in January 1976 the Venezuelan government nationalized the domestic oil industry and the compensation package was only 20% of market value!!! (according to foreign oil companies). Lending to Petrozuata is indirectly investing in Venezuela’s business environment and doing business with the government as PDVSA is 100% government owned, which has a non-investment grading by rating agencies • What should Conoco do? Take carefully in consideration what has been mentioned • Make an in depth analysis on Venezuela’s macroeconomic issues • Try to revise the “ Off take agreement” to be sure of having the right to buy the 104, 000 BPCD at the pre-fixed price • If benefits exceed these further costs then consider equity investment • Otherwise the best move would be to take some other entity in the deal to diversify risks even more • Personally, we would be very cautious with investing equity capital as Conoco.