BANCTRUST & CO.

Venezuela Economics

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Chevron's strong start and the outlook for the Venezuelan oil sector

- **An understandable sense of urgency is visible after the licence to Chevron.**
- **Chevron's management has been cautious, but operations are being resumed quickly.**
- **We expect an increase of 100k bpd from Chevron's joint ventures in 2023; risks tilted to the upside.**
- **Despite potential positive spillovers, we remain sceptical of PdVSA's capacity to lift oil output.**

The licence to Chevron and the sense of urgency… The permission given to Chevron to resume operations in Venezuela last November, for a period of 6 months, has triggered a rapid resumption of oil-related activities by the American company in the country. The temporal and extremely fragile character of the licence, as its renewal is conditioned by progress in political negotiations, has incorporated a sense of urgency in Chevron's activities that might bring about a faster-than-expected short-term recovery. However, the same considerations also increase the risks of making large investments in Venezuela. The sense of urgency is shared by the Venezuelan regime, which desperately needs to raise its oil revenues to stabilise the economy and avoid a new hyperinflationary period before the 2024 elections.

It is important to note that the new contracts signed between Chevron and national authorities, soon after the issuance of the licence, introduce significant uncertainty to the outlook. The lack of details about the arrangements is troublesome, due to the legal ambiguities associated with the broad possibilities allowed by the Anti-Blockade Law and the limitations established by the Hydrocarbons Law and the Constitution. In principle, the government cannot yield control of existing joint ventures to any private company, neither domestic nor foreign. Nevertheless, the Anti-Blockade Law provides legal arguments that could be used to justify emergency-like arrangements, aimed at mitigating the impact of sanctions.

Chevron's conservative tone… In late October 2022, Chevron's CEO Michael Wirth commented in a Bloomberg interview that the increase of the company's oil production in Venezuela, as well as the investment that the company would make in the country, would take "months and years". That day, Wirth argued that, if sanctions were to be "removed or modified", the recovery would not be "instantaneous" because they had to "refurbish fields and equipment, and also because they depend on suppliers, service providers, and mobilising production factors". Similarly, in early December, just days after the licence was issued, Wirth emphasised that it was unlikely that the company invested "in a drilling campaign that grows production in the next six months". Wirth added that there was "a lot of work that had to be done to allow the firm to move in that direction".

Even though we share Wirth's cautious outlook, we estimate that the pace of recovery would be significantly different among the joint projects in which Chevron participates. Table 1 below shows the four mixed companies with Chevron's respective participation, their production levels (potential and observed), as well as our projection for this year. As it can be seen, **the expected increase in oil production in 2023 (100k bpd) is mainly concentrated in the Petropiar joint venture, located in the Orinoco Oil Belt**. This extra heavy project would be the most benefited, in the short term, by a normalisation in the supply of inputs for production, especially diluents.

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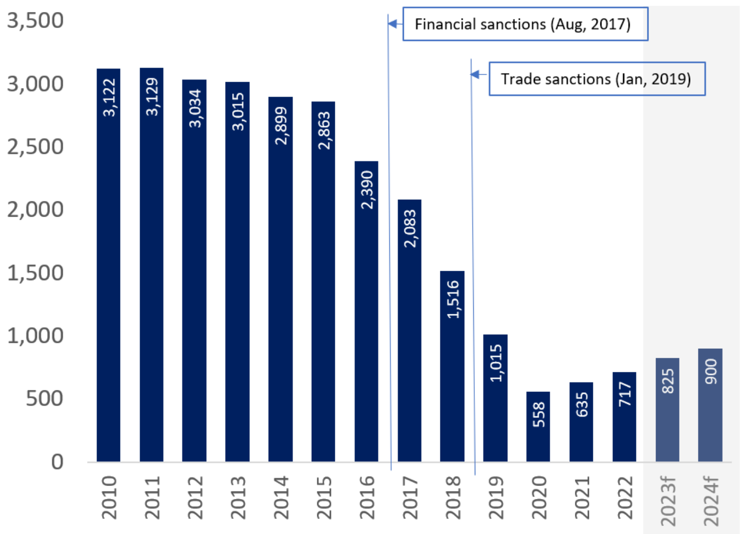
Table 1. Chevron's operations in Venezuela

Joint-venture	Chevron's participation	Prod.Potential (bpd)	Prod. 2022 (bpd)	Proj.2023 (bpd)
Petroboscan	39%	80	15	45
Petropiar	30%	190	50	110
Petroindependencia	34%	60	15	20
Petroindependiente	25%	60	0	5

Sources: BancTrust & Co. estimates based on PdVSA.

Chevron's rapid impact… Since the issuance of the licence, a total of four cargoes have been already sent to the United States. Clearly, the first shipments were likely composed of existing inventories, but even this action is expected to have contributed to alleviate local bottlenecks that affected the production process at the national level. The composition of the oil already sent reaffirms our expectations. From the 740k barrels loaded in the first two tankers, 520k were heavy crude coming from the Jose port in the eastern region of the country, near the Petropiar project in the Orinoco Oil Belt; the rest (220k or 30% of the total) came from the Petroboscan field, in the western region of Venezuela. Under the assumption that no more cargoes are sent in January, the oil sent would already imply an increase of ~30kbpd in oil exports during the month. In upcoming months, the sustained increase in production and exports would be determined by the capacity of Chevron to reactivate and expand output at the Petropiar and Petroboscan fields. As indicated above, Petropiar would lead the recovery, as it would now receive a timely and smooth supply of diluents to be imported by Chevron itself.

Chart 1. Oil production (in kbpd): Baseline scenario under current sanctions regime



Sources: BancTrust & Co. based on PdVSA and OPEC.

Potential spillovers on the rest of the industry… We consider that risks to our baseline projection of Venezuelan oil output are tilted to the upside, mainly due to the spillover effects that can be expected from Chevron's reactivation in the rest of the sector (i.e., the use of its own condensates frees diluents for the rest of companies, the untangling of storage and operational problems in crude upgraders in the Oil Belt, adequate maintenance of shared infrastructure like ports, maritime channels, roads). The upside risks are also related to the favourable impact that ongoing changes in the management of the joint ventures, despite Chevron's minority interest, could have in productivity[1]. This decision, which could be criticised from a legal point of view, might actually be a wise

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one, considering the lack of human capital in the country after one of the worst diasporas in world history. Despite these potential positive considerations, the elevated uncertainty about the state of the fields, the structural electricity bottleneck, and the limited financial capacity of PdVSA to make the necessary investments to increase output, force us to adopt a relatively conservative view.

Will other international oil companies join Chevron? Probably yes. In fact, there is already a cargo programmed for this month to be sent to the Italian ENI, a company that, along with the Spanish Repsol, received an authorisation to import Venezuelan crude even before Chevron in 2022. The so-called oil-for-debt swap was suddenly suspended last year by the Venezuelan regime, but the arrangement could gain relevance again if there is an improvement in the terms with PdVSA, and/or the companies commit to expand domestic production. Furthermore, in recent days the firm ConocoPhillips, whose oil fields were illegally expropriated during the government of Hugo Chávez, revealed its interest in loading, transporting, and selling Venezuelan crude abroad in order to get paid liabilities amounting to cUSD10bn. Recall that ConocoPhillips won in 2019 an arbitration award by the International Centre for Settlement of Investment Disputes (ICSID) for a total of USD8.75bn, a compensation that was upheld by a US Court in August 2022. It is important to note, though, that not all companies that have shown interest in Venezuela are looking to get paid for debts outstanding. In early January, for example, Colombian Ecopetrol formally requested the US government to issue a licence to negotiate with PdVSA the sale of Venezuelan natural gas to Colombia.

As a bottom line, **our 2023-2024 outlook for the Venezuelan oil sector is heavily influenced by our scepticism regarding the capacity of PdVSA to lift production in the current environment**. The stagnation of oil output around 600-700 bpd confirmed our expectations presented way back in 2021 about the oil production capacity under sanctions and limited investment possibilities (see "Venezuelan Oil Sector Not Attractive Anymore", Venezuela Economics Report, 6 August 2021). In the absence of a resumption in the uptrend of international oil prices and/or a broader lifting of external restrictions, it is hard to foresee the government attaining even the more moderate of the production goals announced in the last two years (1.0mn bpd).

[1] In December 2022, Martin Philipsen, an employee of Chevron with a large experience in the oil sector and notorious credentials, was named Petropiar's general manager.

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