

ESG Radar | 3R Petroleum (RRRP3) and PetroReconcavo (RECV3)

Engaged with the ESG matter, while there are headwinds facing the sector

How are the companies positioned against the changing energy landscape?



In this report, we take the opportunity to revisit 3R Petroleum's position when it comes to the ESG agenda, while also analyzing how PetroReconcavo screens from an ESG perspective. In our view, both companies appear to be engaged with this matter, with highlight to 3R's business plan supported by ESG standards, while for PetroReconcavo we see the company still in the beginning of this journey. On the flipside, we note both companies lack a sustainability report, which limits ours and investor analysis. Despite that, we positively acknowledge the companies' efforts in improving ESG data disclosure, with highlight to 3R's efforts posted in the last earnings releases, while we see the world's transition to low carbon economy as a challenge given the industry's high typical greenhouse gas (GHG) emissions intensity.

(E) An increasing pressure to mitigate climate change. In our view, O&G is a sensitive sector from an ESG perspective, and the Environmental pillar is the most important front. While the race to net zero intensifies within companies in this sector, it increases the pressure to disclose how they plan to mitigate climate change, and we see room for improvement for both 3R and PetroReconcavo when it comes to **(i)** ESG data disclosure; **(ii)** a clear strategy plan in order to address the global push for decarbonization; and **(iii)** carbon reduction targets ahead.

(S) All eyes on safety and the impacts around. In the S front, we note two key topics: **(i)** Community relations, as the O&G sector can have a significant positive impact on the economic life of surrounding communities, but there are also substantial risks for those communities; and **(ii)** Health & Safety, given companies' inherently risk exposure.

(G) Building solids corporate governance structures. Both companies have its shares listed in B3's Novo Mercado segment, and we welcome the presence of a senior and highly experienced management in both. When it comes to its Board of Directors, we note PetroReconcavo lacks an independent majority (43%) and 3R counts with 50% independent members¹, while regarding diversity in leadership, they count with only 1 woman in each Board, and no female director in the Board of Executive Officers, which lead us to see a clear room for improvement ahead.

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Company	Ticker	Is the company listed?	Is the company in Novo Mercado?	Does it have an ESG Report?	Does it have a Materiality Matrix?	% of women (Board of Directors)	% of women (Board of Executive Officers)	% independent members (Board of Directors)	ESG MSCI Rating
3R Petroleum	RRRP3	✓	✓	✗	✗	20%	0%	50%	<div> <div>CCC</div> <div>B</div> <div>BB</div> <div>BBB</div> <div>A</div> <div>AA</div> <div>AAA</div> </div>
PetroReconcavo	RECV3	✓	✓	✗	✗	14%	0%	43%	Not Available

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ESG | RRRP3

A business plan supported by ESG standards, but a still long road ahead

Last year, we analyzed 3R Petroleum's position when it comes to the ESG agenda. Now, we are taking the opportunity to review company's advances during this period. In our view, 3R continues to seem engaged with this matter, with its business plan supported by ESG standards, however, we note that the company still doesn't have a sustainability report, which limits ours and investor analysis regarding its ESG initiatives. Despite that, we positively acknowledge 3R's efforts posted in the last earnings releases, while we see the world's transition to low carbon economy as a challenge given the industry's high typical GHG emissions intensity.

(E) All eyes in the company's plan to mitigate climate change. In our view, O&G is a sensitive sector from an ESG perspective, and the Environmental pillar is the most important front. O&G companies' operations could significantly impact surrounding ecosystems or existing land use practices, in addition to boost greenhouse gas (GHG) emissions, implying a challenge when it comes to mitigate climate change.

(i) Carbon Emissions

The race to net zero intensifies within companies in the Oil & Gas sector, which increases the pressure to disclose how they plan to mitigate climate change. Aggressive carbon reduction targets and investments in renewable energy are among the key measures taken by companies, since climate change is a longer-term trend that is likely to influence any decisions, these institutions make in the short term.

According to MSCI, 3R Petroleum appears to lack a clear decarbonization strategy and targets. Also, we note that the company has not yet implemented a long-term carbon reduction target, which we see as an increasingly important step to be taken.

When it comes to climate change commitment, 3R is working on a project, expected to post a great progress during this year, aiming to generate 70% of the energy needed for operation of the Macau Cluster, the most important asset of 3R - responsible for +80% of company's revenue. In this project, energy will be generated through small thermoelectric generators supplied by natural gas produced in the operation of Macau, thus reducing the gas burnt in flares or emitted into the atmosphere. To this end, the company is already working on the reactivation of the three wind turbines at the complex (3 WTGs with 0.6 MW of installed capacity each), inherited from Petrobras, which will shortly be responsible for generating renewable energy to a third (30%) of the power consumed on local operations.

While we welcome 3R's investments in sustainable energy, we see room for improvement in efforts to reduce GHG emissions, as the race to net zero intensifies within companies in the O&G sector and all eyes are on world's transition to a low carbon economy.

(ii) Biodiversity & Land Use

Oil and gas production involve significant disturbances to land (in the case of onshore drilling) or marine ecosystems (in the case of offshore drilling), while negative externalities include high freshwater consumption and oil spills. Also, in the case of an accident, companies may face lost market access or heavy fines and litigation.

That said, while evidence suggests that 3R Petroleum has some land reclamation policies, MSCI states that the company appears to trail better-performing peers in conducting biodiversity impact assessment prior to commencing new operations, which evidence the room for improvement going forward.

ESG | RRRP3

A business plan supported by ESG standards, but a still long road ahead

(S) Safety and regional development as the main highlight. In the S front, we highlight two key topics, as detailed below.

(i) Community relations

The Oil & Gas exploration and production industry can have a significant positive impact on the economic life of surrounding communities, but there are also substantial risks for those communities such as potential land degradation, or their rights to access water and food. Thus, companies' relationship with communities require a multidisciplinary assessment to establish an assertive community approach. In our view, such relation is a long-term process, based on dialogue, transparency and consistency between its positioning and the planned actions.

That said, we positively recognize the start-up of 3R's operations in Bahia, in July/21, which stimulates the pick-up of economic activity in traditional oil producing municipalities, in addition to boost job creation. Also, we welcome the company's development of social projects with local communities, with highlight to Zero Hunger, Sports Incentive and Disease Prevention programs, as per disclosure in 3R's last earnings release. Finally, it's worth mentioning that according to the company, they are focused on improving ESG disclosure, which embraces better information when it comes to 3R social impact generated, expected to be further addressed in the next quarter release.

(ii) Health & Safety

Oil and gas exploration and production is a higher risk occupation than refining. Hence, companies with more assets in exploration and production have higher risk exposure in occupation than the ones focused on refining. On the other hand, over the years and after significant accidents around the world, safety standards have increased in the sector leading to a lower externality vs. other industries. When it comes to 3R, according to MSCI, the company has a group-wide health and safety policy, in line with best practices, which led 3R to post an absence of accidents, in addition to the maintenance of strict protocol against Covid-19. However, we missed a detailed disclosure on H&S performance, which limits our analysis.

(G) Creation of new committees; Building a solid corporate governance structure

3R has its shares (RRRP3) listed in Novo Mercado segment, the highest standard of corporate governance in B3. The company's Board of Directors is composed by 6 members, with 3 independent ones¹ (50%) and when it comes to diversity, 3R's Board has only 1 woman (Ms. Paula Kovarsky), while the company lacks female members in the Board of Executive Officers (see page 06 for the full composition).

On the positive side, we note that 3R's Board that has an independent majority in key committees, which may help the Board to provide strong oversight of risk management and internal controls. Also, the company has recently announced new committees, as per People and Remuneration Committee, Financial Committee and ESG Committee, in order to assist and report to the Board of Directors, which evidences the company's compromise in building a solid corporate governance structure, aligned with the best market practices, which we see as an important milestone achieved. On the other hand, 3R is controlled by a private equity firm, which means that, sooner or later, they will look to divest it, what brings an uncertainty of what 3R's Corporate Governance will look like in the future. Finally, it's worth mentioning that, according to the company, they have been strengthening the principles of corporate transparency, equity, accountability and responsibility and expect to advance its projects within the ESG theme during this year, which is further evidenced by the third party hired to help the company to address this agenda.

ESG | RRRP3

MSCI ESG Rating

MSCI ESG Ratings: 3R has a **BBB** rating by MSCI ESG Ratings. On a global perspective, the **BBB** rating places **RRRP3** among the 25% companies with this rating under MSCI ACWI Index constituents within Oil & Gas Exploration & Production (16 companies).

Figure 01: MSCI Distribution for the O&G Exploration & Production companies

MSCI ACWI Index constituents within Oil & Gas Exploration & Production (16 companies)

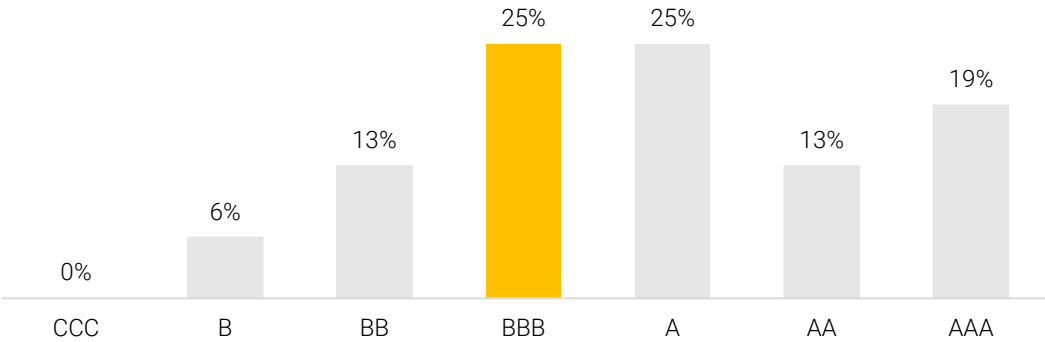


Figure 03: ESG MSCI Rating for 3R - Weights

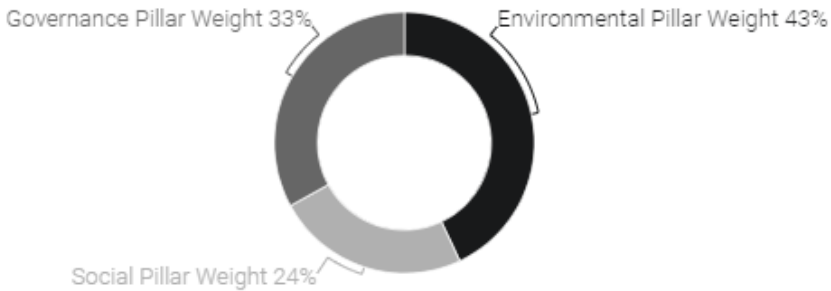
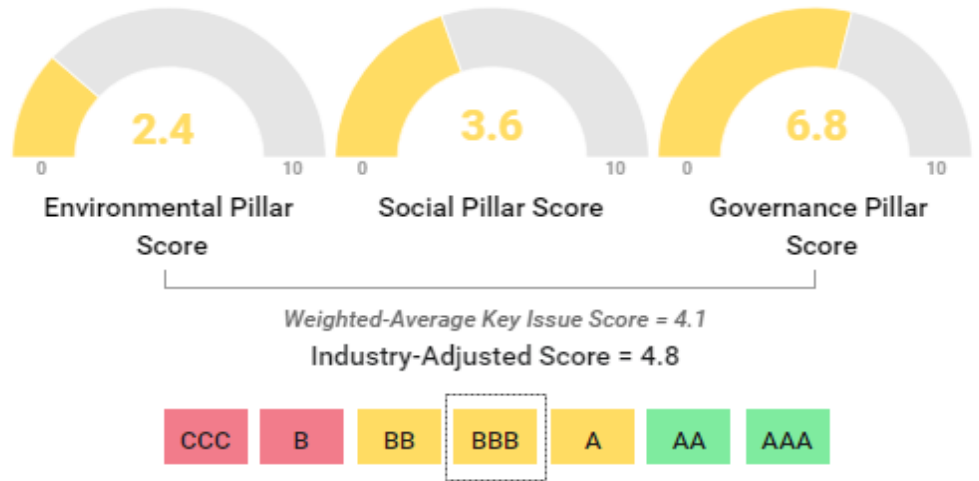


Figure 02: ESG MSCI Rating for 3R – Scores



ESG | RRRP3

Management and Board of Directors

Figure 04: 3R's Board of Executive Officers

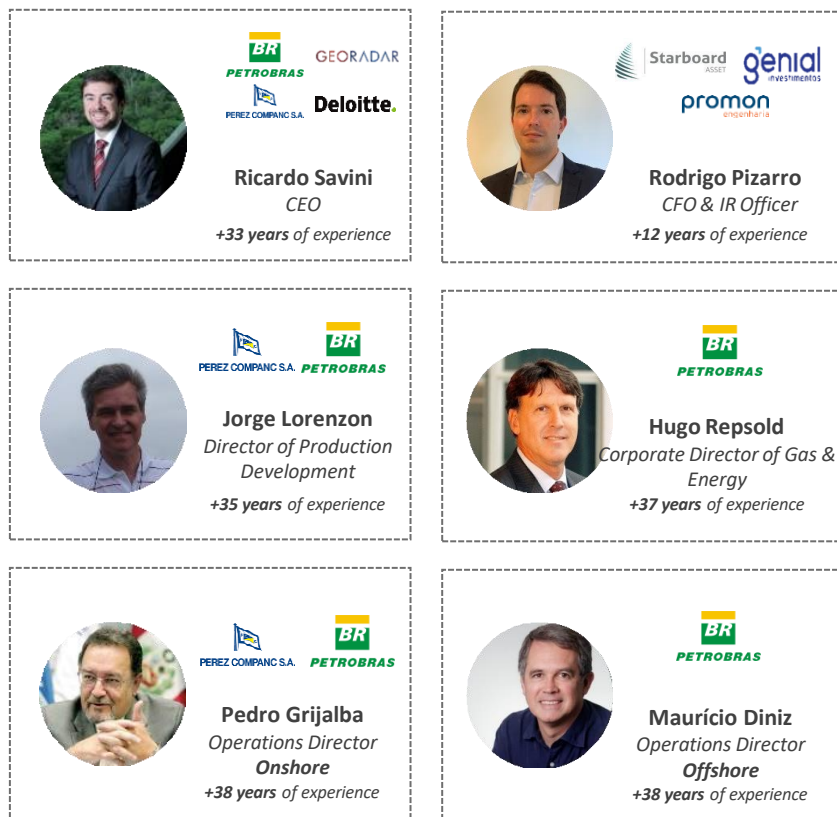
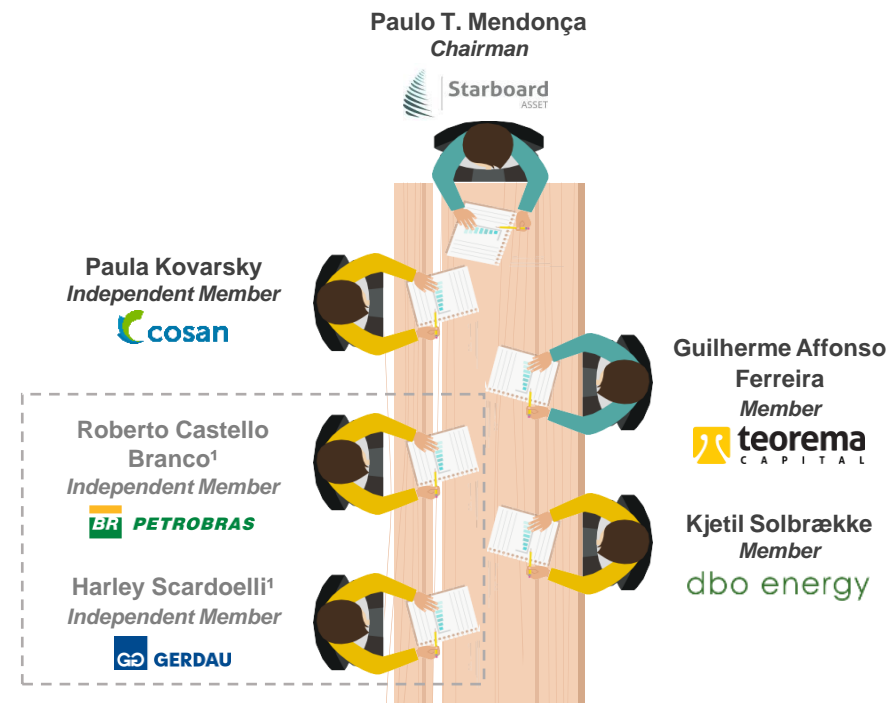


Figure 05: 3R's Board of Directors



Source: 3R and XP Research. Notes: (1) The appointment of new Board members Mr. Castello Branco and Mr. Scardoelli (the latter replacing Mr. Lafuente) has yet to be approved in the Annual and Extraordinary General Meeting held on April 29th, 2022. A media note ([link](#)) suggests Mr. Castello Branco will later be appointed as Chairman.

ESG | RECV3

Still in the beginning of ESG agenda's development

Given PetroReconcavo's relatively recent IPO (mid-2021), it was expected the company to lack some data within the ESG agenda, as the company is still in the beginning of its ESG journey. Even though, we acknowledge PetroReconcavo's initial efforts, as the company recognizes the challenges within the O&G sector as momentum builds behind efforts to promote energy transition. On the **E** pillar, we see RECV's long and good track record operating as a competitive advantage vs. most of its peers, while we missed data disclosure and a clear strategy plan in order to mitigate climate change. When it comes to the **S** front, we welcome the company's integrated model, as well its social programs, while on **G**, PetroReconcavo has its shares listed on B3's Novo Mercado segment, and we highlight the company's experienced management and board, though we note the Board lacks an independent majority and has room for improvement when it comes to diversity.

(E) The pillar with greater room for improvement. O&G is a sensitive sector from an ESG perspective, and the E front is the most important one. In our view, PetroReconcavo's long and good track record operating is a competitive advantage vs. most of its peers, while we missed data disclosure and a clear strategy plan in order to address the increasing pressure to protect the environment. As we see the winds of change howling in the O&G sector and meeting ESG standards swiftly becoming an urgent mandate for these companies, we note it's worth to keep an eye on RECV's exposure to carbon risk.

(S) Social programs as the main highlight. In this pillar, we note three key topics: **(i)** Community relations: PetroReconcavo recognizes its responsibility with the communities surrounding, being committed with the sustainable local development, providing economic, social and environmental benefits to all stakeholders in the regions in which it operates; **(ii)** Health & Safety: company's integrated model allows PetroReconcavo to reduce third party services, while also ensuring its own workforce and equipment to operate, which in our view help the company to mitigate potential risks related to Health & Safety, though we reinforce that PetroReconcavo's business has inherently operational risks of accidents; and **(iii)** Social programs: the company's social activities are focused on childhood and youth, with actions in art, education, sports and music.

***Ciranda Viva Recôncavo:** Created in 2014 in partnership with AVSI Brasil, the program works with the communities of the municipality of Catu-BA, aiming to help communities to develop in a sustainable way, rescuing and valuing their culture and identity.*

***Ciranda Educativa:** The project promotes the values of environmental education and food security for children aged 4 to 6 years, who participate in garden cultivation activities, reading workshops and also joint efforts for nutritional assessment, involving parents and guardians.*

***Ciranda Esportiva:** Created in 2017 and supported by Ferbasa, this initiative encourages the practice of sports as a tool for development – the project currently benefits around 100 young people between 7 and 17 years old, students from public schools in the region.*

(G) An experienced management and board. PetroReconcavo has its shares (RECV3) listed on Novo Mercado, the highest standard of corporate governance in B3, while having as its main shareholders **(i)** PetroSantander (33.2%), an American O&G company, **(ii)** Opportunity (25.7%), one of the largest investment funds in Brazil; and **(iii)** Perbras (5.0%), a service provider for the O&G industry in Brazil. We positively acknowledge PetroReconcavo's experienced management and board, though we note the Board lacks an independent majority (3 out of 7 members, 43%) and has room for improvement when it comes to diversity, as it counts with only 1 woman (out of 7 members), while no female director in the Board of Executive Officers (see page 08 for the full composition).

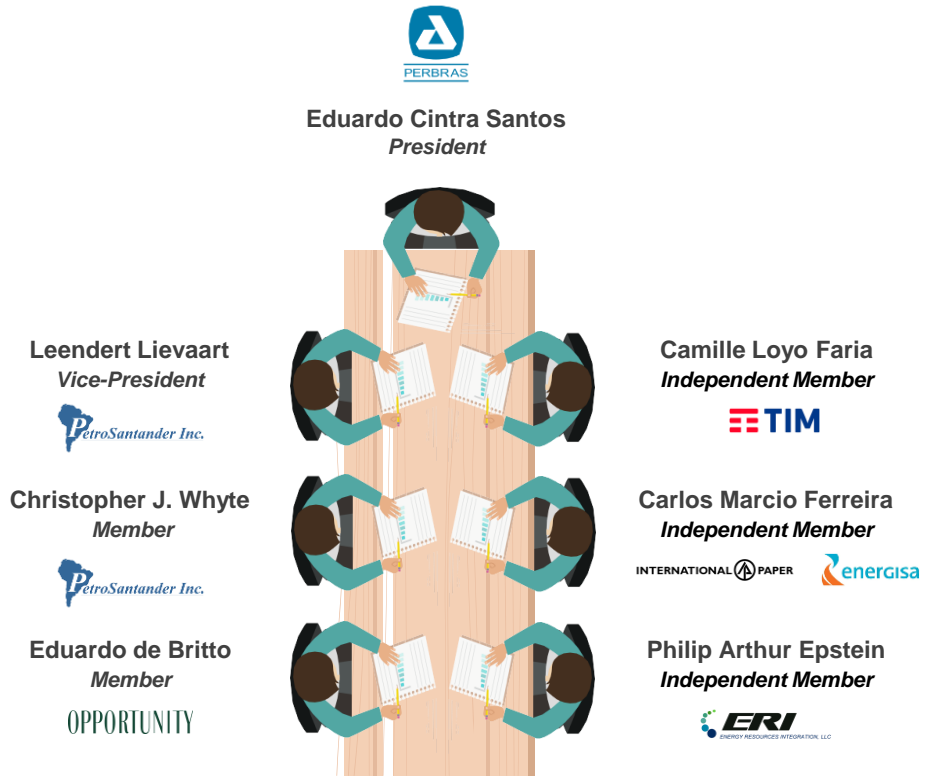
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Management and Board of Directors

Figure 06: PetroReconcavo's Board of Executive Officers



Figure 07: PetroReconcavo's Board of Directors



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