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Petrobras Is Headed Into A Perfect Storm

Sep. 29, 2014 7:52 AM ET59 comments
by: Richard Berger

Summary

- Already repeatedly unable to meet production and financial goals, the falling price of crude and weak product markets both at home and abroad continue to plague this SuperMajor.
- Scandal, bribes, kickbacks, inefficiencies and government policy of this captive national oil company are boiling forth faster than they can be headlined.
- Brazil's elections are swinging strongly towards socialist Marina Silva. She has indicated an intention to curb Petrobras, decrease focus and reliance on oil and gas and redirect national treasure elsewhere.

Author Update Jan. 20, 2015, 3:26 AM

Three months have passed since I released this article warning of 5 key factors combining to present a major body blow to Petrobras. Since that time, oil prices have collapsed due to a predicted growing glut led by shale oil and the ramp-up of Canadian tar sands along with production increases by Iraq and Libya. The growing kickback/payoff scandal has expanded to multi country prosecutorial investigations and the arrest of several senior company officers and implication of Brazil's governing party officials. Corporate governance is struggling to re-organize and establish accountability. Certified audited finanical reports required by regulatory bodies and some of the senior debt are still unobtainable due to the expanding investigations, shattered oil prices, weak $BRL/USD exchange rates, and stalled Brazilian economy. All these have contributed to a downgrade in the outlook of the company credit ratings and effectively frozen Petrobras out of international credit markets for new capital to fund planned projects. Just this past week, Moody's warned it is reviewing for possible downgrade the six senior debt instruments of Brazilian rated vessels which are wholly dependent on contract income from Petrobras to service the note payments.

Share prices have dropped almost 50% but still have virtually no potential for good news to lift them significantly in the coming year while many of the storm factors will continue to threaten more significant downside potential. The steep share decline has eased the asymmetric downside potential but still leaves significant risk of further erosion balancing most of any potential sustainable upside. Those who believe all of the downside is now priced into shares are deluding themselves. I strongly believe oil may yet shock down as low as $30/bbl in the next 6 months and will show high volatility over a $40 to $60 range for all of 2015 and likely well beyond that. While these factors are largely priced in now, others significant downside threats remain from the avalanche of legal suits by creditors and shareholders seeking to establish priority on PBR funds should it find massive parts of its huge debt load accelerated due to failure to obtain the required certified audit results required by the rapidly approaching April deadline or by sequestration of funds by legal action in any of the numerous lawsuits moving ahead. The increasingly adverse political regulatory environment has already served up a law barring the company from doing business with any entity implicated in the expanding investigations. This factor will be further exacerbated as Brazil's weakening currency, lowered credit outlook, diminished revenue stream from its 30% stake in PBR all deepen work against the need for the narrowly re-elected Dilma government to meet the growing demand it fullfill its promises of massive new capital investment in public education and medicine while also increasing direct support for the poor and middle class. These contradictory demands for government capital contributions while cost of debt service is rising and funds are drying up will stress the ruling government to crisis levels by year end. Given the need to choose between continuing sovereign support of PBR's debt and capital needs weighed against public pressure, its clear which side of the scales will tip towards. This is a force of political nature that PBR can not win. Almost perfect conditions will be needed for PBR to weather 2015 without significant further price erosion which could probe as low as sub $4 per share at times (but with $6.00 a more likely long term base). Those perfect conditions are not likely nor even on the high side of even odds given the tempests still brewing. Already the toxic effects of Petrobras's fall from grace are expanding to threaten survival of a secondary tier of companies that depend entirely on PBR contract work for their economic survival. The curtailment of a large part of PBR capital spending coupled with the other factors weakening the already stagnating domestic economy will only likely increase pressure on the government to divert yet more resources from PRB. This in turn will amplify a downward spiral in performance goals and results for the company in a year already certain to see major curtailments simply due to the oil price drop.

I have prepared a full Update article to further expand on the discussion of these issues. I suggest investors in PBR, Brazil equities in general, and global Exploration and Production service sector suppliers read it for an expanded discussion of the snowballing problems they need to be aware of in a rapidly changing environment.

Analysts currently touting Petrobras (NYSE:PBR) are simply wrong. Whether it be recent buy calls from Mike Koza or Ken Kam, or any of the 8 of 13 analysts regularly rating PBR who rank it buy or better, they all prove once again that a little knowledge is a dangerous thing. The headwinds facing Petrobras in the near term are gathering into a perfect storm.

Five key factors are converging that will stall upward prospects for Petrobras performance for the next several years. Each of these has negative impact on the strategy, bottom line, market confidence, and share price for this national oil company. Most notable is that each of these headwinds is largely an external factor beyond the ability of Petrobras to control, manage, or even influence. Such situations are the stuff of which investment disasters are made.

The growing world glut of petroleum from shale oil and tar sands is already suppressing crude prices and will be a further drag on them at an accelerating pace as the US becomes a net energy exporter. The milestone of US achievement of energy independence and conversion from importer to exporter creates a double impact. It increases global supplies directly and also frees previously US purchased foreign supplies for sale on the open global market. Investors need to understand the history of oil pricing and the emerging trends in supply, demand, and price. After topping in the week of May 2, 2011, peak prices posted for WTI Cushing have declined in maximum top for each of the subsequent years as the excess supply outpaces rising demand. Since the demand/price peak of 2014, prices have plummeted from a June 20th $107.26 to the current week close of $93.55. The year over year decline from $108 to this $94 range represents a 13% annual decline. This downtrend is expected to continue and accelerate. Similar trends hold for all major markets, including Brent and Saudi light. The falling peaks and rising bottoms for the past four years indicate that we are soon to reach a significant price trend break. Increasing supply side gut, declining cartel price influences, and chronic weak global economic results portend this to be a major break to the down direction.

Scandals involving $100s of billions in kickbacks, overcharges, and special deals between Petrobras management and key suppliers and contractors have emerged that threaten to rock the company to its core. It will take years, if not decades, for the company to recover from this malfeasance by cleaning house, developing new outside relationships, imposing reliable corporate governance safeguards, and restoring investor confidence. Some pundits are speculating that a new government replacing current President Dilma will be more favorable to business and thus Petrobras stands to gain. This outlook is generally true for Brazil business where poll leading Marina Silva is expected to rein in government controls and loosen restrictions and clear out structural inefficiencies. However Silva, a green party candidate, is particularly hostile to Petrobras and is emphasizing a program to encourage accelerated development of green energy: solar and hydro. She is also likely to curtail capital funding in Petrobras and may even divest a significant portion of the government ownership of this national oil company. All things considered, paint Petrobras troubled. Silva is hardly likely to reward Petrobras for teaming up with the rival PT party of current president Dilma Rousseff. Far to the contrary, political punishment and retribution beyond even the restitution and governance restructuring are sure to come.

The already strong and strengthening $USD versus the Brazilian $BRL depresses PBR results when translated to the $USD that most investors use for financial results and will put pressure on the company's cost to raise capital and service existing $USD delimited debt. This trend is not expected to be reversed with the election of Silva. Indeed, the $BRL has been in almost freefall since the election forecasts have shifted from current President Dilma Rousseff to the green party challenger Marina Silva. The new administration can be expected to move fast to make good on its platform of improving schools, medical care, and basic living for all Brazilians (a promise made but not kept by the incumbent party). This will mean a weakening of the nation's current account short term as capital investment soars immediately for infrastructure programs while economic results improve only later.

Petrobras' rapidly increasing capital outlays while production levels stagnate and targeted performance goals are consistently revised downward while still failing to be met year after year is something to frighten even the most optimistic investor. Forbes' rank of the world's largest oil companies places Petrobras at #13. While acknowledging the difficulties PBR faces in developing its primary reserves in the pre-salt ultra deep water offshore, Forbes ignores the multiyear spanning track record of ever increasing capital expenditures with no increase in net production and constant failure to meet milestone goals for production and financial metrics even while frequently revising these goals downward.

(source: forbes.com)

13. Petrobras

2013: 2.5 million BOE per day (oil + natural gas equivalents).
2003: ~1.5 million BOE per day (rank: n/a)
View of the state owned Petrobras headquartrers in Rio de Janeiro. Despite enormous discoveries, Brazil has found its deepwater developments to be technically challenging and complicated by bureaucracy. Nevertheless, expect Petrobras to past huge growth in production volumes over the next decade. *Data courtesy WoodMackenzie.*

The company's own summary of financial results for the past 4 years show the disastrous record of declining income even in the face of rising capital expenditures and rapidly ballooning debt load. You really have to ask why you would want to pay for the right to be part of this unless you are a very long-term investor. The record of downward revisions quarter after quarter and year after year makes future forecasts a mockery. The likely curtailment of support in capital expenditures and government backed lending can be expected to further set back the ever elusive gains promised.

Consolidated Financial Results
US$ Billion

	2010	2011	2012	2013
Net Income	19.18	20.10	11.03	11.09
Capex and Investments	45.08	43.16	42.95	48.09
EBITDA	32.62	37.30	27.63	29.42
Net debt	36.70	54.90	72.34	94.57
Shareholder's Equity	185.40	177.11	169.04	149.12
Net Debt / Net Capitalization	17%	24%	30%	39%
Net Debt / EBITDA	1.12	1.47	2.62	3.21

(source: investidorpetrobras.com.br)

Potential mitigations to weather the storm are virtually non-existent. The near term catalyst for this Perfect Storm is the October 5th national elections and October 26th run-off that is expected to follow. Even if Dilma Rousseff and her PT party should manage to pull off a win, the reprieve would be at best temporary. Too many ill winds have gathered and are condensing into the storm. A Dilma win would mean further erosion of the Real currency, continuing decline of the Brazilian economy, and a sharp retreat of the Brazilian Ibovesta index which has rallied in recent days in parallel with Silva's growing certainty of victory over Rousseff. Further, the scandal trials, redirection of government capital from loans commitments and participatory capital invest in its 30% of Petrobras, and lack of effective management in achieving its goals will all continue to plague Petrobras and even accelerate against it. The election catalyst has become a lose/lose for PBR regardless of the direction the winds blow.

Technical patterns indicate the present steep down channel is likely to continue at the loss of $5.00 per month, testing the $14.00 support within a week to 10 days. Support at $14.00 could result in a cyclic return in the trading channel to the $15.00 range before closing out the end of October in the $9.25 to $11.50 range. Prices as low as the March $10.20 level may be realized by the end of October if Silva defeats Rousseff with a decisive mandate.

(source: modified by author after yahoo.com)

Conclusions and Recommendations:

Petrobras faces a series of independent factors which will each have significant negative impacts on performance for the next 2 to 5 years. The trigger point for a massive investor market reaction in the face of these is likely to be the Brazil Presidential election results of October 5th and the expected run-off of October 26th.

Investors should avoid entering a long position in the shares between now and the final election results. A short of PBR at existing prices has excellent asymmetric profit potential with share price expectations showing little upside expectation from the current $16.46 and potential to test the March 17, 2014 lows of $10.20 and even fall lower as the perfect storm I describe here develops. One cautionary note: PBR shares may pop to the upside for a short term after the election in a general Ibovesta Market Index rally spurred by the change in government. Expect PBR to turn down once the celebratory parties end. Therefore, use contracts of 90 days or more to allow time for the dust to settle.

Existing investors should sell or use options to hedge their position while continuing to hold long term. Those willing to speculate on the likely election results and the effects on Petrobras pricing should consider establishing a position through buying current at the money puts or a more neutral strangle strategy with contract expirations several months beyond the election. More complex strategies such as a short Iron Condor or short Iron Butterfly are also worth consideration for speculators.

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Comments (59)

Richard Berger
Premium Marketplace
Author's reply » Three months have passed since I released this article warning of 5 key factors combining to present a major body blow to Petrobras. Since that time, oil prices have collapsed due to a predicted growing glut led by shale oil and the ramp-up of Canadian tar sands along with production increases by Iraq and Libya. The growing kickback/payoff scandal has expanded to multi country prosecutorial investigations and the arrest of several senior company officers and implication of Brazil's governing party officials. Corporate governance is struggling to re-organize and establish accountability. Certified audited finanical reports required by regulatory bodies and some of the senior debt are still unobtainable due to the expanding investigations, shattered oil prices, weak $BRL/USD exchange rates, and stalled Brazilian economy. All these have contributed to a downgrade in the outlook of the company credit ratings and effectively frozen Petrobras out of international credit markets for new capital to fund planned projects. Just this past week, Moody's warned it is reviewing for possible downgrade the six senior debt instruments of Brazilian rated vessels which are wholly dependent on contract income from Petrobras to service the note payments.

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I have prepared a full Update article for immediate release to further expand on the discussion of these issues. I suggest investors in PBR, Brazil equities in general, and global Exploration and Production service sector suppliers read it for an expanded discussion of the snowballing problems they need to be aware of in a rapidly changing environment.

20 Jan 2015, 03:26 AM

GrowthGeek

Great call in late September Richard--you nailed it. $8 is now looking too high to me as well. This could go as low as $5 within months.

01 Dec 2014, 02:56 PM

Richard Berger
Premium Marketplace
Author's reply » Thanks for noticing :)

Well, we'll wait and see. I actually sold some 12/17/2014 $7 cash covered puts for $0.80 a week ago. I hope I don't end up owning it, but if I do, my net $6.20 basis should make money eventually.

Richard

01 Dec 2014, 03:14 PM

Richard Berger
Premium Marketplace
Author's reply » Events for Petrobras continue to unfold exactly along the lines I laid out here back in September:

1. The $Real continues a sharp decline.

2. The elections are over and no benefit to PBR

3. The scandals have widened with more arrests and more prosecutors both here in Brazil and now also in the US.

4. PBR has been unable to file their quarterly financials due to failure to secure an public auditor opinion.

5. The failure to file financials now has placed PBR in jeopardy of technical default on some of its Bonds

6. The company just cut their outlook for production growth by another 20% for 2014.

7. Shares continue to decline on the lines I have suggested.

Be very wary of trying to pick a bottom in this ticker. The bottom could still be much lower. Avoid is the best strategy for now.

17 Nov 2014, 11:07 AM

GrowthGeek
I might be tempted to buy some at $8, but I concur with just about everything you have said. PBR has to be about the worst big company stock over the past 6 years.

17 Nov 2014, 11:41 AM

Richard Berger
Premium Marketplace
Author's reply » Thanks for sharing your thoughts.

$8 may be a little on the high side to feel comfortable. Here's an alternate suggestion I've just been looking at today ...

Look at the 1/17/2015 $8.00 Put trading at $0.25 premium right now on this 61 day contract. This creates an effective basis of $7.75 for you if the shares are put(a $1.87 discount from current retail, 19.44% sale priced below today's market).

If they are not put, your absolute gain is 3.23% for just 61 days, an annualized yield on your covering cash of 19.3%.

I think using the Cash Covered Put writing to lower market risk (3.23% in this case) while providing a very attractive yield rate on your idle cash could be attractive. I'm scraping around for some idle cash myself right now. :)

Richard

17 Nov 2014, 11:58 AM

Richard Berger
Premium Marketplace
Author's reply » Thanks for joining our discussion.

I feel confident that PBR will survive for now. It is, afterall, a national oil company in partnership with the government. The company has hired 2 private investigative firms to probe and report on the corruption in an attempt to satisfy the auditors. That action will either get PwC to sign off on the quarterly report (with or without a qualified opinion) or at least sufficient for the company to shop another public accounting firm that will provide an acceptable report.

The re-election of Dilma Rouseff will keep Petrobras as a government oil company probably, at least for a few years. I believe the election of Silva or Neves very well may have resulted in the government divesting its interests in PBR both for the want of cash and to divorce themselves from scandal and future manipulation allegations. With Dilma remaining at the helm, that tar is stuck and will be much less an issue for the near term.

My thesis remains intact and confirmed by events as they are unfolding. This is not an attractive nor acceptable investment for the present or next year at least in my own personal view. For those who have shares and are caught in the downward spiral, if your investment horizon is long term (multiple years) then I would ride it out. If you need the liquidity of your PBR investment within the next 24 months then wait for the occasional small rallies and sell into those for an orderly retreat.

Richard.

10 Nov 2014, 04:26 PM

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originofquake
Richard please think about what the facts are telling you?

The sec has caused the nov. Call options to have the most volume. Do you think, one that the sec will delay the earnings report? Two why , who is buying? Every option up tp $20 is exploding , volume very high.

I don't know how to read the signs.

Does pbr get delisted?

What can we ,the U.S. Do about a Brazilian company?

Unknowns are always bad for a stock. It would be insane to invest in pbr in this situation.

10 Nov 2014, 02:03 PM

Richard Berger
Premium Marketplace
Author's reply » Loan default is not a likely issue. For now, PBR's interest cover ratio is quite good and its debt ratio is below industry average. Also, it is considered a State Owned Oil Company and the implied (not explicit) full faith and credit of the Brazilian gov't are behind it. Certainly it would be politically impossible for any Brazil Government to allow Petrobras to fail, regardless of the ruling party's view of the company.

All that said, on the other hand Bloomberg reports that PBR's auditors, PriceWaterhouseCoopers "... informed the state-run oil producer this month that it wouldn't sign off on quarterly results and would have to alert U.S. authorities if appropriate action wasn't taken...". This could put PBR in technical default on many of its loan covenants.

The scandals already directly implicate PBR's most senior level management, with one former director having admitted guilt and turned State's evidence against the company, vendors, and the highest members of the National Government of Brazil. Paulo Roberto Costa, former director, has personally admitted to receiving $627,000 (USD) in bribes related to the PBR purchase of a Pasadena,Tx Refinery and has turned over $25 million of deposits from his Swiss bank accounts to the government of Brazil. This is just the tip of the iceberg.

By law, prosecutors are forbidden from investigating Brazil's elected officials and senior most ministers. The tangential exposures of other related investigations are sure to bring out direct evidence against many of those however, including ultimately President Rouseff even I believe from my readings (I am not a citizen here folks nor even a taxpayer except property tax, so have no dog of my own in the fight).

The ongoing corruption, lowering of reserve estimates related to both technical engineering issues and revised economics that always go with falling oil prices, and the scaled back timing of development plans all are going to continue to impact PBR's ability and cost of raising more money for forward activities. Politics being what it is, the re-elected PT ruling party and President Rouseff have put off any thoughts of raising the Gasoline price for now. Falling global prices are quickly bringing the global price of gasoline into line with that of Brazil anyway and the government hopes by foot-dragging on the question that the markets will moot it. Regardless of government action, these global fall in prices will limit or completely eliminate PBRs ability to raise domestic prices anyway.

Expect a dreary path for the company's shares with occassional misguided enthusiasm in attempts to rally that prove to be dead cat bounces. There is no good news in this one's future for the coming year and more.

Richard

03 Nov 2014, 11:14 PM

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originofquake

Richard burger your the only guy that knew how bad this company is mismanaged. You were spot on and your prediction of $9.25 May see a lower low. Someone mentioned bankruptcy? Loan default? Good by.

03 Nov 2014, 10:10 PM

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originofquake

Richard Berger you are absolutely , on target. If pbr hits a low of $ 9.25 as you predict you will have my respect.

An amazing Pisa.

03 Nov 2014, 12:38 PM

> **Richard Berger**
> **Premium Marketplace**
> Author’s reply » Thanks for noticing. :)
>
> Richard
>
> 03 Nov 2014, 02:21 PM

Richard Berger
Premium Marketplace
Author’s reply » A brief update on the 1st round of the elections:

Dilma Rousseff and Aecio Neves advance to the runoff election on October 26th, while Marina Silva was eliminated. Neves is the govenor of the State of Minas Gerais and a known pro-business leader, experienced politician and has an agenda to deregulate and divest the gov't holding in private industry (aka: Petrobras).

The picture going forward is thus slightly brighter for Petrobras in that it will not face the prospect of an open hostile policies of Silva. However, all of the other headwinds will remain. Divestiture of a significant portion of the government interest in PBR could significantly damage its credit rating, making it more difficult to raise capital and more expensive to service the cost of borrowing.

I therefore remain very bearish on PBR although a temporary uptic is quite likely pending the 10/26 election finals.

06 Oct 2014, 10:49 AM

Richard Berger
Premium Marketplace
Author's reply » My interpretation of Marina Silva's position is from an interview in Globo quoting her senior campaign staffer as saying she is in favor of easing over regulation and interference in Brazilian businesses to allow greater efficiency and improved economic performance but she would deal with Petrobras to shrink its capital expenditure plans (READ: slower development, less "growth", more production decline) and limit any price rises in fuels to minimize the impact on the poor.

No, Silva is not a benefit to PBR, just less of a drag than Dilma who would be forced to deal more harshly with PBR in the wake of the scandals and to win back voter support by implementing the education and medical programs Silva promises and Rousseff has failed to provide in the past. I won't go into all my arguments yet again, they are in the article. Your simple viewpoint is exactly that .. simple. I will refrain from saying more. We shall agree to disagree. Thanks for your viewpoint.

Richard

01 Oct 2014, 12:00 AM

Richard Berger
Premium Marketplace
Author's reply » The election is narrowing for round 1, a 3 way race that still looks certain to be a Dilma Rousseff 1 / Marina Silva 2 finish. This triggers an automatic runoff (if neither gets 50% +1 .. and they will not with all the minor candidates) on 10/26 in which Silva remains the strong favorite. However, as you said and I have been repeatedly saying .. Dilma will be bad for PBR and the Brazil economy, Silva will be bad for PBR and maybe somewhat better for the economy. Neither will have much effect on the dollar exchange rate for the next few years. Bottom line... PBR can be expected to suffer regardless for a few years at a minimum.

Richard

30 Sep 2014, 08:50 PM

Worst Investor Everest
Richard Berger. I disagree with you in that Marina Silva will be bad for PBR. She will be great, as she will allow for PBR to raise prices on fuel, making PBR more profitable. If Marina Silva were up in the polls, PBR would be souring right now.

However, Dilma will sure be bad for PBR, as she will continue to force PBR to sell fuel at a low price, making their profits decline and their debt rises.

Marina Silva = higher fuel prices = higher profits for PBR = Buy

Dilma Rousseff = lower fuel prices = lower profits for PBR = Sell

Thats the way the market sees it, and also me.

30 Sep 2014, 11:51 PM

Worst Investor Everest

The problem is now the election is going to be tight, with Dilma ahead of it. The Bear market is not ending with Dilma Rousseff staying in power. The only reason for PBR to rally from $10 to $20 was the possibility that Dilma could lose. Setting that aside, the stock should go back to the old level and even lower, below $10. And we could even touch that level next month.

Long term, fundamentals should continue to deteriorate along with stock prices, do to prolong recession in Brazil and Dilma forcing PBR to sell gas and gasoline prices at a huge discount, making profits decline. And taxing it as much as possible.

PBR is Dilma's piggy back, at the expense of shareholders.

Still a lot to drop before we get to extreme oversold levels. I'm waiting for the $8 level for a small bounce.

Long term is over. No hope.

30 Sep 2014, 08:12 PM

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beta07

Dear "Worst Investor Everest", thank you for your comment, sounds like you can see things into the future, I wonder if you are a fortune teller?

30 Sep 2014, 10:47 PM

ElCidCampeador

Until PBR is a net exporter of crude, lower oil prices actually HELP the company - as their balance sheet has been trashed by the forced import of refined products to meet domestic shortfall.

30 Sep 2014, 08:01 PM

Richard Berger
Premium Marketplace

Author's reply » 1. The increase this past quarter came and the expense of 4 years of efforts and 4 years of additional capital expenditures that saw *decreasing* production over that term. over $R160 billion has been invested to achieve that increase which came with a lag of 4 years from implementation of the capital program that brought it about. Further, that increase is less than 1/3 what the plan/milestone/benchmark was planned to be by this time even after the initial forecasts had been repeatedly pared back. Yet further, management has already pared back their forecast for increases for this year and next year 4 times in the past 12 months and will have to do so more no doubt. This is all assuming that the capital expenditure and development plans remain on the current schedule. That is not going to happen since the capital available is being curtailed both by currency exchange rates and the plans of the government to re-focus its capital priorities away from Petrobras participation and into immediate programs dealing with education and medical in order to curb the growing populist unrest that has seen hundreds of thousands take to the streets of Brazil repeatedly over the past year. No, PBR is certainly NOT going to follow or achieve its expansion plans during the next 5 years and the outlook beyond that is totally uncertain. Yes, we will continue to see the prior 4 years expenditures bear some added fruit as they come online for the next several months, but not enough to make up for the shortfalls in the over optomistic forecasts and coming curtailments.

Richard

30 Sep 2014, 04:43 PM

Richard Berger
Premium Marketplace
Author's reply » In fact, even 2014 has been a disaster for PBR's overall production. If you look at their own figures for total 2014 BOPE (including oil, gas, and ng liquids) the production has fallen a total of about 1% so far this year even after the increases in pre-salt that are the result of 4 years of intense (and continuing) capital expenditures. See the final bottom line of

http://bit.ly/1wV5tY9

Yes, the company has spent over $R40 billion this year and over $R250 billion the past 5 years and achieved a net loss of production which continues in overall decline even today. Cups and Balls friends, cups and balls.

30 Sep 2014, 05:00 PM

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beta07
An quarterly production increase of 2.7% is considered small? 2.7%/quarter if sustainable, can translates over 10% a year! Their plan is to increase pre-salt production from current 20% to over 50% over next 4 years, this is significant amount of increase. Of course crude price fluctuates and it dropped quite a bit in the last 3 months, so this probably will offset any potential revenue growth in terms of cash flow. E&P activity always involve heavy capital expenditure, but once paid, it generates production income over a very long period of time. Obviously PBR is shifting their focus developing the pre-salt where higher payoff potential than put money else where.

30 Sep 2014, 04:29 PM

VincentCh
Wonderful to see comments based on facts.

01 Oct 2014, 10:40 AM

Richard Berger
Premium Marketplace
Author's reply » Alas, most of that production level was achieved 4 years ago and has been almost flat since then while capital expenditures continue at the pace of over $40 billion annually just to keep pace with decline on the earlier production.

The initial production rates and total ultimate recovery per well is impressive but they decline rate is steep also and the workover and maintenance downtime is high also. Read all the details and not just the highlights that management wants to draw your attention to. As I said before, the old cups and balls trick of misdirection so you are looking at one thing while things that matter are happening in another place is what life is all about. You have to seek out what matters to explain *results*.

Richard.

30 Sep 2014, 01:51 PM

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beta07
"...that production level was achieved 4 years ago and has been almost flat since then..."

Petrobras website shows figure different what you said:

"...From 2010 to 2014, the average daily production from the reservoirs grew tenfold, from an average of 42,000 barrels per day in 2010, to 411,000 barrels per day in 2014 (through May).
"

http://bit.ly/1wV3HpU

Full text from Petrobras website:

Pre-Salt

We have surpassed the 500,000-barrel-of-oil per day mark in the pre-salt, a level reached a mere eight years after the first discovery was made there. The pre-salt province comprises large accumulations of excellent quality, high commercial value light oil. A reality that puts us in a strategic position to meet the great global demand for energy over the coming decades.

The cumulative production of the pre-salt province now exceeds 360 million barrels of oil equivalent. From 2010 to 2014, the average daily production from the reservoirs grew tenfold, from an average of 42,000 barrels per day in 2010, to 411,000 barrels per day in 2014 (through May). This currently represents approximately 20 percent of our total production, and in 2018 it is expected to reach 52 percent of the Company's oil production.

Additionally, from last quarterly reports:

Oil production in Brazil increased by 2.7% from July http://bit.ly/1wV5tY9

Petrobras announces that its consolidated oil and natural gas production in Brazil and abroad reached 2,759 thousand barrels of oil equivalent per day (boed), rising 2.2% from a reported production of 2,699 thousand boed in July.

Petrobras's domestic oil production increased by 2.7% from 2,049 thousand barrels per day (bpd) in July to 2,105 thousand bpd in August. Regarding the total oil production operated by Petrobras domestically, which includes the share operated by the company for its partners, a production of 2,232 thousand bpd was reported in August. This represents a 3.7% rise from July's production of 2,152 thousand bpd.

30 Sep 2014, 02:18 PM

Richard Berger
Premium Marketplace
Author's reply » Yes, exactly, but you need context of the past four years and the COSTS associated with achieving that small incremental increase. As I recall, production actually fell until the past 18 months and has now only achieved these small increases relative to the huge capital expenditures for the same period. You quote numbers in a vacuum without comparison and trends. Now go back and get the same figures for the past 4 years. Then add in the capital costs of leases, exploration, development, and capitalized infrastructure costs and see how much they have had to invest to achieve the tiny increases in production the past few years. Its not encouraging.

Richard

30 Sep 2014, 03:35 PM

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beta07
Important achievements (source: Petrobras website)

We arrived to 500 000 barrels per day in the pre-salt province just eight years after the first discovery in the region occurred in 2006, and counting only 25 producing wells. The comparison with the production history of the Company itself gives the dimension of this result: it took 31 years to reach the milestone of 500 000 barrels per day, which occurred in 1984, with the contribution of 4,108 producing wells. Compared to the Campos Basin, 21 years were needed to achieve this same level, with the contribution of 411 producing wells. 's excellent performance in the Brazilian pre-salt is also highlighted by comparison with other major producing provinces in the world. In the American portion of the Gulf of Mexico, for example, took 20 years from discovery to produce 500 000 barrels a day. In the North Sea, the plateau was reached in ten years. drilled wells We subsalt time dwindling, without giving up the best global practices for operational safety. The average time to drill wells in the pre-salt fields Sapinhoá Lula and spent 126 days in 2010 to 60 days in 2013, a reduction of 55%. Another important achievement was the range of 100% exploration success in the pre-salt in 2013, ie, found oil at all perforations made in that province. In addition, the wells already installed on subsalt have shown productivity well above the world average, reaching an average of 28 thousand barrels per day in the Pre-Salt Pole of the Santos Basin.

30 Sep 2014, 01:13 PM

Apollo11

If crude price continue drop below a $88 a barrel, Dilma's fixed price policy for domestic fuel would a 'put" for PBR which will be good for PBR bottom line, provided that its currency remains stable.

30 Sep 2014, 11:42 AM

Capt Jack Daniels

How does PBR do the next day after a 10% drop

they drop anothe 5%.

30 Sep 2014, 09:35 AM

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beta07

Looks like a panic selling, investors are scared of Dilma and scared of Silva too. Share price now is more reflection of panic on uncertainty, which total disconnect from company's fundamentals value.

30 Sep 2014, 09:54 AM

Richard Berger
Premium Marketplace

Author's reply » The current deep drops are a combination of knee jerk reactions to short term events which really have little meaning and to technical trading which is very much in line with the trading ranges indicated on the chart I presented.

You have hit the nail on the head, PBR loses regardless of who is elected. The only remaining question is if it loses a lot or a hell of a lot. For now, it is probably a big ahead of itself in the plunge.

Richard

30 Sep 2014, 10:19 AM

Hallgente

I'm long PBR at the mo' (out of the money Credit Put spread) so a little move above where it is suites me fine. Got another 18 days to go so not wedded to the long term prospects of PBR. With regard to its current stock price, on the basis everything that the market knows about the company is already in its price, I think only surprises are going to move it one way or t'other. Yesterdays move was I believe currency related/election news, so that's now in the price. Overall, the company has a boat load of reserves in the the ground, it's sorting itself out governance-wise and the longer term prospect for the price of a barrel of oil is higher than where it is now, so 'good' news for a seller of the commodity. Long term PBR is probably a good bet. If you saw the Rosneft CEO talking about their recent Arctic find with their partner XOM, longer term price for a barrel of oil at +$140 is hoped for (Brent (ish) pricing I presume). And I wonder if the exchange rate REAL/USD helps the company since a lot of its sales will be in USD but its costs in local Reis...? Perhaps someone on the board has a view?

30 Sep 2014, 06:38 AM

Richard Berger
Premium Marketplace
Author's reply » Your long term picture is reasonable. My outlook is specifically for the next few years. Tha is why I qualified my short advice to all execpt very long term investors.

As to the exchange rates helping them, you make an interesting point.

However, the change in USD/BRL exchange rate has zero effect on the USD denominated oil sales and debt service and other things that are are already in $dollars since there is no exchange taking place on those.

Richard

30 Sep 2014, 07:50 AM

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zerosum2
PBR owns over 2000 fueling stations, those are processed gasoline and diesel, and I suppose those sales in local R$ currency. Also employee wages and benefits are paid in R$. So those factors probably somewhat off-set each other. Overall a lower exchange rate R$ vs USD probably is negative for PBR, unless they increase using domestic suppliers. A lower Euro is positive for PBR as major platform suppliers are based in Europe.

30 Sep 2014, 10:50 AM

Richard Berger
Premium Marketplace
Author's reply » I've had no skin in the PBR game for many years. I prefer almost any of the other supermajors in direct comparison and use my investment money to target UGP and selected Utilities as my energy related play for the Brazilian focus.

There was no blood in the water when I wrote this article. Even after today, down is the direction PBR will be headed overall going forward. It was submitted about 4pm Saturday afternoon. PBR is simply a bad choice within a sector that is going to under perform for the next few years. You heard it here first.

Richard

30 Sep 2014, 02:05 AM

Richard Berger
Premium Marketplace
Author’s reply » Investing on the come in a company that has repeatedly failed to meet future projections and goals and in fact has pared those projections back year after year is an act of desperation when there are so many quality companies without such baggage. Tied up with the rest of the issues I have mentioned, expect the package to continue to under-perform for the next few years.

30 Sep 2014, 01:40 AM

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zerosum2
Sounds like former investor in PBR who is getting tired and tired again and has completely lost confidence and patience. Past is past, future is much more important than the past. Contrarian wisdom say buy when there is blood in the street, even its your own blood.

30 Sep 2014, 01:58 AM

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zerosum2
PBR's delays and set backs were bad for existing investors riding on multi-year down trend, but great opportunity for new investors establishing position now. As those old bad "news" has driven PBR prices to multi-year low and well below its enterprise book value. New investors establishing a position now can get extremely good bargain of share price as its political turmoil in Brazil provides such opportunity gift. Even though PRB's experienced project delays and revenue stagnation for the last few years, its E&P part still showing positive growth in cash flow. The main drag on the company is not capital expenditures but on importing fuel selling at loss (thanks to Dilma pricing control) and cost overrun building the refineries (thanks to Dilma for endorsing government corruption). Now those two refineries which had experienced delays for years expected complete soon, one actually as soon as November 2014. Once online, PBR can dramatically or even reverse the requirement for imported fuel, therefore the money losing part of PBR should disappear, or even adding profits. It would be catalyst for PBR share price once two new refineries becomes operational.

30 Sep 2014, 01:36 AM

GrowthGeek
I feel awful for PBR investors today as this stock has truly been a turd over the past 5 years. Just when it looked to be gaining some mojo--kaboom again. 5 yr Stock chart of a ball falling down a cliff and occasionally going up when hitting a rock but then continuing its plummet.

29 Sep 2014, 05:11 PM

Richard Berger
Premium Marketplace
Author's reply » Petrobras had two things to attract investors.

1. Very large reserves at reasonably low full cycle finding and development costs.

2. A 30% participatory ownership by the Brazilian government.

1. The program to develop those reserves has been constantly set back, failing to meet goals and milestones. This in turn has resulted in reduction in the scope and speed of the plans and delay of the development of the reserves, a failure to convert potential value into tangible cashflow.

2. A Silva administration is expected to pare back the already reduced development plans extremely deeply. This means further delay in cash flow and lowering of ultimate value via discounted cash flow pushed out many years down the discount curve.

Thus, the 2 attractions of Petrobras will be drags for the early years of a Silva administration. Piled on top of that is a weakened currency exchange to service debt and obtain new debt. Then we toss in a major house cleaning and restructuring of corporate governance to address the all to real scandals and corruption that have been exposed (as well as probably far more to come).

Now, tell me what is attractive *today* about Petrobras?

Richard

29 Sep 2014, 05:39 PM

Capt Jack Daniels
It's absolutely ridiculous that an oil play can wake up the next day and be down over 10% at some point no foreign money will flow into such a dump of a country as Brazil.

29 Sep 2014, 04:01 PM

VincentCh
strangely enough YTD net flow (up to Sep 18th) into Bovespa from oustide Brazil is the higher ever recorded at R$21bn

http://bit.ly/1qVlh7Q

01 Oct 2014, 10:35 AM

Richard Berger
Premium Marketplace

Author’s reply » That is very interesting news indeed. Thanks for sharing it with us.

Richard

01 Oct 2014, 10:48 AM

Richard Berger
Premium Marketplace
Author’s reply » You are correct that the 2nd round is key. So long as Rousseff does not capture the magic 50% +1, there will be an Oct 26 runoff (as I pointed out in my article) and Silva is overwhelmingly favored to win that head to head contest with Rousseff. The current drop in the Brazil markets is indeed an opportunity, but not a good one for PBR. PBR may bounce a bit with the markets when they recover post election but a Silva administration will mean less support for adding to the PBR debt, slower capital investment by the company (with slower development of reserves), additional and deeper lowering of future growth projections, etc etc. But, its all there in the article already.

Richard

29 Sep 2014, 02:04 PM

VincentCh
No anymore, last week and this week polls show Dilma back at top.

01 Oct 2014, 10:29 AM

Zvx
You know what the truth is?

The whole election thing is a joke and it has nothing to do with the fundamentals. It's just a way they lower the entering price. After Dilma wins(there will be second round so it's on 10/26, not 10/3), Brazil will still soar up. So the drop is a great chance to enter. Or maybe later, a little closer to the election, the stupidity will lower the price even more.

29 Sep 2014, 12:58 PM

Worst Investor Everest
It has to do with fundamentals in the fact that Dilma will continue to force PBR to sell fuel at a loss to them, keeping fuel prices low. While Silva may let them to raise fuel prices. A big difference in the buttom line.

29 Sep 2014, 02:08 PM

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crl1603
i feel the main problem for pbr is it's high debt, hard to get out from that millstone.

29 Sep 2014, 12:50 PM

Richard Berger
Premium Marketplace
Author's reply » Debt is a very large issue for PBR. It is large, it is growing, it is being lowered in rating (thus driving up costs), much of it is denominated in USD which the exchange rate is driving up service costs on, and they are likely about to lose the perception of the faith and credit of the Brazil Gov't backing it ultimately.

There is not much you can say good about the debt or its outlook.

Richard

29 Sep 2014, 02:00 PM

Richard Berger
Premium Marketplace
Author's reply » Thanks for your interest. You need to pay closer attention ... I explained in the article that while Dilma Rousseff has been (and is) bad for business in general, Silva's more pro business policies will not carry over to Petrobras specifically and in fact her specifics target to harm Petrobras. I suggest you take the time to actually read the my article. You may disagree with my premises but they still have been proffered and thus there is nothing contradictory to my thesis in them. Further, as both a retired O&G COO and living now in Brazil, I have a bit of a handle on internals of PBR, the micro and macro environments they are operating in here and on the elections and what the potential results mean. I also did suggest in the article that for the next 30 to 60 days you might expect PBR to move in concert with the broader Brazilian markets as it is dragged along with them before the dust finally settles post elections and the actual effects on PBR begin to be realized.

Richard

29 Sep 2014, 12:04 PM

Bob10101
It soundsl like you have the candidates confused. Rousseff is widening her lead and she was the incumbent known to be bad for big business- http://bit.ly/1rnrvDq

29 Sep 2014, 11:28 AM

delano59
That's exxon lying about the oil potential of the 6,500 foot well in the Kara sea drilled entirely into igneous basaltic rock, no sedimentary layers, no halite ,pure salt,known as louann salt like the salt that provides very large oil discoveries in the Gulf of Mexico ,and the southeast coast of Brazil.

29 Sep 2014, 10:05 AM

Capt Jack Daniels

Avoid PBR at all costs... one of the worst company's out there with the Brazilain government being the controlling super shareholder bossman.

29 Sep 2014, 10:02 AM

johnsmith1620

I agree totally. Just lining the pockets of corrupt politicians.

30 Sep 2014, 10:47 AM

johnsmith1620

It is so sad to see what is arguably the richest country in the world in terms of natural resources, drained grey and dry by the insatiable appetites of its greedy politicians and corrupt police force. I look forward to the day when Brazilian laborers stand up and fight them to at least give them a living wage and tolerable workweek. In the meantime, investing in Brazil as an outsider is much more likely than not to just continue to line the pockets of these already rich and dirty politicos. I would not invest a single dollar Petrobras even if it had a huge upside around the bend, just on moral principle alone.

30 Sep 2014, 10:48 AM

delano59

Nothing new, same old, same old.

This oil company is different because of the pre salt oil discoveries. All oil formation ,small swimming things that were on the equator in the living zone lived and died and settled to the bottom of the salt water ocean.

Who cares about the geology, pbr will prosper if oil drops to

$75 dollars per barrel and methane to $3 per mm whatever.

All of the "fracking" shale companies will go bankrupt, and guess who will remain with there individual well producing 30,000 barrels per day?

Petrobras, pbr.

Son with there 6,500 foot deep well in the Kara sea is a dry hole.

My research shows they drilled just 70 miles from the middle of a mid-ocean ridge above sea level.

Accountants know that the cost , break even for fracking shale is above $75 for oil ,and $4.04 for methane.

There is no future for the "frackers."

29 Sep 2014, 10:00 AM

Richard Berger
Premium Marketplace
Author's reply » As to shale oil, in the long run I agree with you. The very glut they create will drive down prices to where further development is not economic. High decline rates for shale oil will then shock prices up, spur another round, recycle the supply/demand economics, etc. A world based on shale oil production is one with huge price volatility. PBR is not going away but is going to have a few lean and learner years as it gets its house back in order and adjusts to a 30% owner (the gov't of Brazil) that is hostile to it and no longer backing the bonds they desperately need for development of the pre-salt and other projects. For now, Sell or hunker down for a long term ride.

Richard

29 Sep 2014, 10:10 AM

Nihilum
There was a 'glut' in the 1980s. It was something like 20% oversupply.

Today, the supposed global oversupply is approximately 2%.

20 Jan 2015, 09:43 AM

Richard Berger
Premium Marketplace
Author's reply » The glut as Canadian Tar Sands comes fully online, Iraq and Libya continue to ramp up, Shale Oil and tite sands development projects come online globally, and natural gas continues to offset oil usage is far more than 2%. The saudis alone have more than a 2% swing production capacity in excess of global demand. I concede that I have not done my own empirical calculation of the total glut currently but it is more on the order of 7% to 10%. I also do not recall a 20% glut in the 80's, you'd have to offer me some references to review for a number anywhere close to that.

Richard

20 Jan 2015, 09:53 AM