



We believe Petrobras has a very high chance of meeting its funding gap through 2017 without relying on direct government support

We have revised our base-case cash flow forecasts and now assume lower capex (from USD27bn to USD25bn in 2015 and from USD22bn to USD19bn onwards), 2.0% CAGR of domestic E&P production (vs. 4.0%) and domestic fuel prices increasing by 6% p.a. with no restrictions (vs. 5% p.a. with a 10% premium cap over international prices). We also assume higher working capital uses in 2016 (USD5.0bn vs. USD0.8bn previously), as we believe the company might have to significantly reduce its accounts payable in light of its higher perceived credit risk. We have also reduced our minimum cash position assumption to USD5bn from USD10bn and now assume USD10bn of asset sales in 2016 and USD3bn in 2017 (vs. USD3bn in 2015 and USD5bn in 2016). As a result, we expect the company to end 2015 with USD18bn in cash (compared to the company's USD20bn guidance) and 2016 with USD5bn (minimum cash position), after raising USD5bn of new debt (or rolling over about 90% of its bank debt maturities next year). We forecast a cash burn of USD10bn (mainly due to working capital uses) and USD10bn of asset sales in 2016, assuming Brent of USD50/bbl and USDBRL of 4.2. In 2017, we forecast a cash burn of USD6bn (stable working capital) and USD3bn of asset sales. Since the company won't have any excess cash, it will have to raise USD14bn to pay down its debt maturities (USD11bn) and fund the negative free cash flow (USD3bn). The cumulative funding gap for 2017 would then be USD19bn.

We strongly believe that the company can raise USD19bn through 2017, assuming USD13bn of asset sales and Brent of USD50/bbl. In fact, because all of the company's 2017 bonds (the 3.25%, the 3.5% and the floaters) are due either in January or February of that year, the funding gap to repay these bonds is actually lower; probably around USD14-15bn, while the funding gap to repay the '16s is lower than USD4bn. Even if we assume a Brent price of USD40/bbl, the cumulative funding gap to repay the '16s and '17s would still be manageable, at less than USD5bn and about USD15-16bn, respectively. We believe the company has the ability and motivation to issue secured debt to meet its funding gap for a number of years.

The motivation to issue secured debt comes from the large size of the company's funding needs and the high yields of its long-dated bonds (above 9%). The ability comes from existing lax covenants on bond indentures, the most restrictive of which limit the incurrence of liens at 15% of consolidated total assets, but exclude any liens granted in respect of debt owed to Brazilian public entities (including the state-owned banks) or incurred for equipment financing (capex). We believe the company can export at least USD20bn in aggregate in the next 10 years (assuming Brent at USD40/bbl, no E&P production growth and domestic demand growing at 3% p.a. from 2017 onwards) and perhaps it can issue USD10bn or more of debt backed by these future flows (which is well below the approximate USD35bn cap on lien incurrence imposed by the bonds' negative pledge language). But most importantly, we believe the large Brazilian banks (primarily the state-owned ones) have an incentive to rollover their maturities and concede new credit to Petrobras through secured instruments in order to obtain the stamp of secured creditors.

The funding gap starts to creep up in 2018 if the oil price doesn't rebound
We forecast a cumulative funding gap of about USD31-36bn (including USD23bn of bank debt maturities) to repay the 2018 bonds due in 1Q18 and USD67-81bn (including USD38bn of bank debt maturities) to repay the 2019 bonds, assuming Brent of USD40-50/bbl, USD13bn of asset sales and USD19bn of capex. Raising more than USD60bn of debt in the next four years is no small feat, even if the government instructs its state-owned banks to pick the tab on this. The main hurdle to Brazilian state-owned banks would be the little room they have for additional lending due to regulatory constraints, as