



Buy the '17s; Rest of Curve Is Neither Steep Nor Low-priced Enough *

Capex and opex cuts as well as domestic price increases are positive but not enough to significantly mitigate the large funding gap

This week's announcement of capex and opex cuts for 2015 and 2016 and last week's domestic fuel price increases are positive news for Petrobras, but we remain concerned with the company's challenge to roll over USD60bn and USD104bn of debt maturities in the next four and nine years, respectively, and with the company's ability and motivation to subordinate bondholders. We are also not convinced that the company can stop its cash burn with oil below USD55/bbl and USDBRL above 3.8. Further domestic price increases beyond cost inflation might prove difficult to achieve without a significant improvement of Brazil's economy. We also see important challenges for the USD15bn divestment program targeted by the end of 2016.

Revised guidance is poor on disclosure; divestments might prove challenging and not so impactful for deleveraging if majority stakes are sold

Petrobras announced on Monday evening a reduction in the capex and opex excluding raw materials guidance for 2015 and 2016. The capex guidance was reduced by USD3bn and USD8bn, to USD25bn and USD19bn, in 2015 and 2016, respectively, while the opex ex- raw materials was reduced by USD1bn and USD6bn, to USD29bn and USD21bn. The company also reiterated its USD15bn divestment plan by 2016 and kept its 2016 production guidance unchanged. The 30% capex reduction for 2016 was most likely above consensus – we were forecasting USD22bn for that year. The opex reduction is more difficult to reconcile with our estimates and general consensus due to the lack of disclosure on historical figures and whether the new guidance includes any non-recurring items or deconsolidation of assets (that would eventually be sold). We also have questions about future capex levels and the future production curve, in light of the announced capex reduction. Moreover, we see challenges to the USD15bn divestment plan in terms of valuation and timing and believe the company might have to sell majority stakes of non-core assets and/or sell pre-salt reserves at relatively low valuations. The latter could prove quite challenging to be approved by the government due to the risk of strong public and political opposition. It is also important to note that selling control of assets would reduce the company's EBITDA and thus mitigate their deleveraging impact, even if accretive to leverage (above 5x EV to EBITDA).

Upgrading the '17s to Buy; the rest of the curve is neither steep nor low-priced enough

We have revised our forecasts and strongly believe the company can meet its debt maturities through 2017 without resorting to direct support from the government. We thus upgrade Petrobras 3.25% and 3.5% '17s to Buy (from Hold) due to a still attractive yield of about 9.7%, in our view. We maintain our Hold recommendation on the other Petrobras bonds that we cover and initiate coverage of Petrobras 2115 bonds with a Hold recommendation. We are more comfortable with an yield of 9.7% for the '17s than with 10.0%-10.5% for the 2018-2019 maturities, given the company's steep funding gap ramp and the risk of bondholder subordination, combined with relatively high bond prices and more dependence on the oil price and the USDBRL. While the maturities beyond 2019 offer lower bond prices (67 - 82), we don't think yields under 11%

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