

Q2 2017 Earnings Call

Company Participants

- Hugo Repsold, Head-Human Resources, HSE and Services Director
- Isabela Mesquita Carneiro da Rocha, Investor Relations Executive Manager
- Ivan de Souza Monteiro, Chief Financial & Investor Relations Officer
- Nelson Luiz Costa Silva, Chief Strategy & Organization Officer
- Solange da Silva Guedes, Chief Exploration & Production Officer

Other Participants

- André Hachem, Analyst
- André Natal, Analyst
- Bruno Montanari, Analyst
- Christian Audi, Analyst
- Julia Ozenda, Analyst
- Osmar Cesar Camilo, Analyst
- Pedro Medeiros, Analyst
- Rodolfo de Angele, Analyst
- Vicente Falanga Neto, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen. Welcome to Petrobras Conference Call and Webcast with Analysts and Investors for the presentation of information relative to the results of the Second Quarter of 2017. We would like to inform you that participants will be in listen-only mode, with simultaneous translation into English. After the presentation, we will have a question-and-answer session when further instructions will be provided.

Today with us, we have Mr. Ivan de Souza Monteiro, CFO and Investor Relations Officer; Ms. Solange da Silva Guedes, Chief Exploration and Production Officer; Mr. Roberto Moro, Development and Technology Director; Mr. Hugo Repsold Jr., Chief Human Resources; Mr. João Adalberto Elek Jr., Chief Governance and Compliance Executive Officer; Mr. Nelson Luiz Costa Silva, Chief Strategy, Organization and Management System Officer; Mr. (1:06), Industrial Executive Officer, representing the Chief Refining and Natural Gas Officer; and other executives of the company.

I would like to remind you that this meeting is being recorded, and please be mindful of slide 2 which contains notice to shareholders and investors. The words believe, expect,

and similar ones related to projections and targets are mere assumptions based on the expectations of the company management regarding the future of Petrobras.

In order to start, we will listen to the Executive Investor Relations Manager, Mrs. Isabela Carneiro da Rocha, who will make a presentation about the results of the second quarter 2017. Afterwards, we will have a question-and-answer session. Mrs. Rocha, you may begin.

Isabela Mesquita Carneiro da Rocha {BIO 19730664 <GO>}

Good afternoon. I would like to thank you for joining us in this conference call to discuss Petrobras second quarter 2017 results.

Please go to slide 3, where we highlight the main achievements for the quarter. We'll start as always with safety result with an important reduction in TRI, Total Recordable Injury per million man hours, which reached 1.11 in the second quarter. Net income totaled BRL 4.8 billion in the first six months of 2017, reversing the loss of the first half of 2016. Operating income was BRL 29.3 billion, up 91% from first half 2016.

Adjusted EBITDA increased 6% to BRL 44.3 billion year-to-date, 33% margin in the quarter. The result was BRL 19.1 billion with a 29% adjusted EBITDA margin. Free cash flow remained positive for the ninth month in a row, totaling BRL 9.4 billion in the quarter and BRL 22.7 billion year-to-date. Net debt decreased both in reals and dollars. Liability management enabled an increase of average duration of debt to 7.88 years and a reduction of average cost of debt to 6.1%. Net debt over adjusted EBITDA ratio continued a downward trend and is now at 3.23.

On slide 4, we see our operating performance. Production increased to 2.79 million barrels of oil equivalent per day, of which 2.67 million in Brazil, up 6% from first half of 2016. In June, we had a record in operated pre-salt production of 1.686 million barrels of oil equivalent per day.

There was a 7% decline in the sale of oil products due to a market retraction for these products. We maintained a net exporting position with a balance of 401,000 bpd. Oil exports reached 548,000 barrels per day with higher prices.

In terms of efficiency and costs, we reduced manageable operating expenses by 12% and SG&A expenses were down by 6% (sic) [16%]. We reduced head count by 18%. These are the highlights. I will now give you more detail on slide 6, please.

We see the performance of external variables. Brent prices fell in the quarter to \$50 a barrel and the Brazilian real depreciated in the second quarter. For the six months, we see higher Brent price and an appreciation of the Brazilian real.

On slide 7. Gross income declined in the quarter due to lower diesel and gasoline margins due to lower prices of these products and due to higher expenses related to oil and natural gas imports and lower oil exports volume. In the sale of derivatives, there was

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increase of diesel sales, despite a loss in market share for these products, and lower naphtha sales. The sales didn't drop that much.

In the quarter, gross income was higher due to higher export revenues, lower oil and gas import expense due to higher domestic production and increased share of domestic crude oil in the processed feedstock, and this improvement in the quarter happened despite a 7% retraction of sales in the domestic market.

Operating income was higher both in the quarter and year-to-date. Contributing to this was the sale of NTS, the gas pipeline company. On the other hand, expenses increased really due to the payment of NTS tariff. There was the effect of joining the tax-settlement programs, and I will explain this momentarily, and the provision for losses with receivables related to Vitória 10000 Drillship with the Schahin Group.

In the six months comparison, however, we observed even lower workforce expenses, lower expenses related to dry holes in sub-commercial wells, as well as lower rig idleness. And that accounts for an improvement in the operating profit in the quarter.

In terms of the financial results, financial expenses increased due to charges related to the tax-supplement programs, the interest involved here, and increased year-to-date also due to the dollar-euro depreciation. Net income in the quarter totaled BRL 316 million, similar to that of the second quarter 2016. And if we look at the semester, we see a reversal of the prior-year loss.

On slide 8. In the six months comparison, EBITDA increased to BRL 44 billion, with a 6% increase, and the main reasons are here, they were mentioned before, higher export revenues, lower import expenses and lower operating expenses. EBITDA margin remained high at 33% year-to-date. And in the semester view, the reasons for the reduction were explained in the prior slide and so here we just have the summary.

Now I'd like to go to slide 9 to explain in more detail our contingencies and the effect of joining the tax-supplement programs. These are different processes. So let us start with the first one. Contingencies already provisioned amounting to BRL 1.66 billion that were negotiated for payment of 20% in cash and 80% in fiscal loss credits, given the fact that we joined PRT, which is the tax supplement program. As this was already provisioned for in our balance sheet, there was a provision reversal and the impact on our result was minus BRL 264 million.

Another contingency amounting to BRL 6.54 billion, which has to do with the deductible expenses relative to the renegotiation of the pension plan, these were not provisioned for, it was a possible loss, but they were the object of a court decision, which limited deductibles to 20% of the total amount.

With that, the company decided to join PERT and to negotiate payment. 20% is the down-payment and the remaining payable in a 145 monthly installments as of January 2018, As there was no provision for this, the negative impact on our results amounted to close to BRL 6 billion. We had a negative impact on the result, on the other hand, via closing

(9:34) the company's litigations. More details on the accounting treatment of this can be found on page 19, item 5.1 of the RMF.

On slide 10. We see higher operating cash flow and lower CapEx levels, which led to higher free cash flow, which totaled BRL 22.7 billion year-to-date. This amount was more than enough to cover for interests totaling BRL 12.1 billion in this period.

Moving on to slide 11, we highlight expense reductions overall. Increase in the quarter stems basically from the payment of NTS tariff, which triggered an increase in sales expenses. However, general and administrative expenses remains at the same already low level quarter-on-quarter.

In the year-to-date comparison, all expense lines decreased, thus reducing manageable operating expenses as a result of lower workforce, expenses resulting from PIDV, the voluntary separation incentive program, a 2% reduction in our workforce, this in the second quarter of last year and second quarter of this year, and lower SG&A expense.

On slide 12, we disclose costs linked to company's activities, lifting and refining costs. Lifting costs was higher in the second quarter because of more workovers in the wells and more platform maintenance work. However, lifting costs were lower when compared to the first half 2016. This stems from lower expenses related to maintenance, transport and personnel, and from an increasing production in U.S. dollars. The foreign exchange effect explains this increase. Refining costs stabilized in the quarter and increased year-to-date, given a reduction in processed feedstock.

On slide 13, we highlight a reduction of our debt, with net debt falling below the \$90 billion mark, totaling \$89.3 billion. The average cost of debt has been reducing, reaching 6.1%, while average debt duration has been increasing and is now at 7.88 years. Leverage reduced from 55% to 53%.

On slide 14, we show our active liability management and its effect. This year we made securities offerings amounting to US\$8 billion, which we used for prepayment and tender offer amounting to US\$12 billion. And thus, we extended our debt amortization schedule. It is important to highlight that the cost of securities has been reducing in the market. And we now have a number of sources of funds for the company available.

On slide 15, we show the declining trend of the net debt over EBITDA ratio. I'd like to remind it that our goal is to reach 2.5 by the end of 2018.

On slide 16, we have our cash flow estimate based on the same levels of Brent prices and exchange rates of the second quarter. We are projecting an operating cash flow of \$27 billion, this slide is in dollars; judicial guarantees of \$5 billion, although to-date we have spent only \$300 million; interest and amortizations amounting to \$28 billion; including your liability management, we are maintaining quarter-on-quarter investments of \$17 billion; divestments of \$8 billion, these divestments are those already signed, that we are waiting for closing of the deals; borrowings amounting to \$13 billion, here including the debentures offering announced in July. We hope to have \$20 billion in cash by year-end.

Now, moving to operating highlights we present on slide 18. Growth of production in Brazil up 6%, an average decline of 6% in the Campos Basin; and the higher share of the pre-salt, which surpassed 50% of total oil production in Brazil now in June. In June, we achieved daily and monthly records of operated production.

It is important to highlight the new lifting costs in the pre-salt is \$7 per barrel, which we achieved after nine years of production in the pre-salt. I'd like to remind you that, yesterday, the company announced the discovery of a new accumulation in the pre-salt of this Campos Basin in the area of Marlim Sul, which adds to prior discoveries in this region, which is important because these are areas with an installed infrastructure.

On slide 19, I show you the new production units. P-66, which is also (14:43), it is already producing with one producing well and we are planning two new producer wells for this year. The extended well tests in Libra should start operating in the third quarter of 2017 and we also have P-67, the eighth unit in the Lula field. And we have the new platform in the Tartaruga Verde and Mestiça that should start operating by the first quarter of 2018 maximum.

On slide 20, we show a significant increase in net export of oil in year-to-date, given the higher domestic production linked to reduced volume processed in the refinery. In the case of oil products, improvement in net balance is due to a reduction of sales in the domestic market, particularly diesel and gasoline.

In the quarter, net export of oil reduced, given the sale of stocks that happened in the first half of 2017. In addition to an increase in oil imports, we had a import-export swap, trying to tap into market opportunities due to narrowing of the spread of light and medium oils.

On slide 21, we bring you the production of oil products, which is very much in keeping with a lower volume of sales in the domestic market, particularly given the sale of imported oil products in the domestic market. It is important to highlight, on the left, a significant increase in the share of domestic oil in processed feedstock as a result of change in the pre-salt, and we have a better yield of our noble oil products.

Moving to slide 22, we see a balance in the supply and demand of gas. It's important to highlight, an increase in domestic gas, which allowed us to reduce the imports of LNG and natural gas from Bolivia, that reduces the margin in this segment.

On slide 23, we bring you the execution of our business plan, so starting with safety. And as I mentioned, 1.11 TRI, lower than the limit we had for this year and lower than the target established for the year 2018. As for the four pillars of the plan, our gasoline and diesel price policy was reviewed, allowing for more frequent price adjustments, even daily adjustments, as we announced in July. CapEx and OpEx have been lower than planned, and we have started to have higher efficiency in capital allocation. And finally, partnerships and divestments were resumed. We have some processes already announced, including 33 shallow water and onshore fields, distribution assets abroad, and we announced the IPO of BR Distribuidora.

To end on slide 24, we see our governance performance. We informed that we were certified in the Governance Program for State-Owned Companies, a program by B3. B3 is the new name of the Brazilian Stock Exchange. It is also a self-regulating body in the market. And by being certified, we are meeting their requirements of improved governance and requirements such as appointment policy for members of the top management and board of directors, improvement of informations disclosed, clear definition of public policies, among others.

We'd like to thank you for your attention.

Q&A

Operator

Now, we will have the question-and-answer session. Each participant will be allowed two questions and could you please ask your questions in a clear manner and consequently, so that the executives may answer them consecutively as well. Please do not use the speaker phone for your questions. Questions in English will be heard by all participants in the original language and answered in Portuguese by the executives with simultaneous translation.

Our first question comes from André Natal, Credit Suisse.

Q - André Natal

Good morning everyone. Thank you for the question. I have a few questions. The first one about SG&A. When we compare to what happened in the first quarter, we see that G&A had a drop, but selling expenses went up about BRL 1.5 billion. And we see that, included there, we have the payment of the NTS tariff.

But I would like to understand why BRL 1.5 billion was the amount, because we thought it would be a lower tariff for this year, around BRL 1 billion for the whole year. So this BRL 1.5 billion for one quarter seems a little bit too much. And I would like to know if this increase is exclusively related to NTS or whether you have another large item that could explain the difference. And the second question, it seem to us that BRL 1.5 billion was concentrated in energy, so maybe this suggests - I would like to know whether it is related, all of that, to NTS or not?

And the other one is also related to cost, regarding lifting. You have a very interesting achieving in pre-salt below \$7 and on the other hand, on the quarter, we saw lifting go up a little in spite of a production that was quite similar to the previous quarter, that is to say the first quarter of this year. So, what explains this increase in the lifting cost? Is it because of a higher participation of the Campos Basin in this quarter vis-à-vis the first one? And which are the major items that explain the increase in the lifting costs, although pre-salt is lower?

And the third question about CapEx. We saw that year-to-date CapEx for the first half, if we annualize, it is quite lower than the guidance that you have just reaffirmed in this presentation, about \$17 billion for the year. So we would like to understand if this is below physically and financially, but you expect this to go up over the next half year? Or does it have to do with efficiency and what kind of dynamics is coming into play in CapEx so that this is lower, and although you reaffirmed the \$17 billion in your presentation today?

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A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Thank you. Good afternoon. This is Ivan. We talked about selling expenses, and it is concentrated in energy and the payment of the NTS tariff. There could be some other item, and then afterwards the other officers will answer, but the major or the bulk in the payment of the NTS tariff about SG&A, Nelson Silva will answer. And I would like to ask Repsold to talk about the program of employee severance. And about the part related to investment, Solange will answer.

A - Nelson Luiz Costa Silva {BIO 15817718 <GO>}

Good afternoon. What we see here is a result of the efforts that we have been carrying out. It has to do with the evolution process and the ZBB methodology. And it also means that we have been reducing our expenditures. And it has to do also with our plan for voluntary separation and other efforts that we have been making to reduce administrative expenses, mainly the application of ZBB in the activities that generate value and afterward we benchmark to ourselves in order to do this again.

Would you like to...

A - Hugo Repsold {BIO 19059342 <GO>}

Good afternoon, André. Good afternoon, everybody. We have two programs of voluntary separation, with a major reduction in our head count, about 18%, compared to last year. But, overall, now that the programs have already ended and we have just a little bit of the voluntary separation, incentive have been (24:14) left over. But we have 16,300 employees of the 19,400 that had enrolled initially into two programs. So, 16,300. 2,700 gave up and some were suspended. And the balance was very positive according to our expectations and giving a major contribution to this reduction.

Q - André Natal

Hugo, these 16,300, how many were in the second program?

A - Hugo Repsold {BIO 19059342 <GO>}

9,181 and some were suspended. Altogether, it will be 9,300.

A - Solange da Silva Guedes {BIO 16088234 <GO>}

André, good afternoon. First, you were asking about the costs vis-à-vis the slight increase that we had in the second quarter of 2017. And I think it has already been perceived, that is to say the many benefits for the company as a whole, coming from the higher

production of the pre-salt layers impacting, in several ways, upstream and downstream of the company.

And one of the positive impacts is the cost. As we announced, we are operating below \$7 per barrel. And in the second quarter, there was an increase in maintenance stoppages, we had more expenses, 4% higher in fact in maintenance costs. And we also had a slight variation in production, 1%. And this led us to have this small amount related to other aspects.

And also you are asking a question about CapEx. You are asking about the dynamics that come into play once we have restated the figure that we had stated in the last call. And in fact, we do have a perspective. However, as it may not materialize, we are going to seek very intensively to recover this level of investment by the end of this year. And we have already seen some optimizations and I would say that there are - less than 1% of this amount has to do with optimizations that we are doing in terms of the allocation of the CapEx and that could be included in our forecasts.

Nevertheless, we are maintaining these amounts because we are making our best endeavors in order to recover the allocation of these investments over the year of 2017. Thank you very much. Good afternoon.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Good afternoon, André.

Operator

Next question, Vicente Falanga Neto, Bank of America Merrill Lynch.

Q - Vicente Falanga Neto {BIO 18277588 <GO>}

Good afternoon, Isabela, everybody. I had two questions. The first one is about the remarks of (27:42) saying that the important sales of assets will be done in the second half. So, could you tell us what are the assets that Petrobras believes will be sold by the end of the year?

And the second question is still about the sale of assets. Petros made a communiqué saying that it was reviewing the shareholders' agreement with (28:08) So, I would like to know if, in your frame of mind, would it make sense to reunite because of action and listing abroad, and as has been published in the newspapers consistently.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Good afternoon, Vicente. Regarding the second question, the discussion about the review of the shareholders' agreement, this was published in the Material Fact and it is available. And the shareholders talked about this review for (28:46) and this is the only public information that we can mention so far regarding the divestment program.

Our expectation is that, effectively during the second half, we will see a more intensive activity there. And I can say that beside the usual market information that we have disclosed to the market, such as the intention of having the BR Distribuidora IPO, the intention of selling the gas pipelines of the Northeast region and the other assets that were mentioned as not the core business of the company, like biofuels, et cetera.

I think that the whole regulatory operation in the segment of oil and gas, aiming at a higher competitiveness in the next auctions, is highly beneficial for Petrobras. And as soon as these assets are ready according to the new system together with the Court of Account of the Union, they will be brought to the market according to what is established by this system. And we expect, as (30:01) we expect a higher intensity in this area in the second half of the year.

Q - Vicente Falanga Neto {BIO 18277588 <GO>}

Thank you, Ivan.

Operator

Rodolfo de Angele, JPMorgan.

Q - Rodolfo de Angele {BIO 1541593 <GO>}

Good afternoon. I have two questions. Could you please give us more color about the new discoveries that were announced yesterday and giving us more details regarding return and the economics involved? And I would like to note if you have an update about the model of sale?

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Rodolfo, we did not understand your second question.

Q - Rodolfo de Angele {BIO 1541593 <GO>}

Do you have any news about the potential sale model of the GSF assets?

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Good afternoon, Rodolfo. Yesterday, we were very happy when we were able to make that announcement and I think it's very easy for you to understand and perceive how much value this kind of discovery brings to us, because the exploration area of Petrobras does that in our areas that are already in production. So we have in the Campos Basin, we have a reality of large platforms and we have room there to receive more production.

And when we discovered in the Marlim Sul field, a discovery that was made in July, a field that we will be testing in October with 45 meters depth, this is something that is most welcome. And we have already had the effect of this kind of experience in Marlim. Last year, Marlim - because you connect these discoveries to an already existing infrastructure, so you have more room to have more production. And sometimes, it is less productive

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than what we have in the centers maybe because of the high productivity of this discovery.

So we had learned also about a relevant discovery that we had in the Albacora field in the Campos Basin and that is called the Forno area. And we are about to finish the exploratory work in order to determine these fields, and we are expecting to have the EWT in 2019. And my interest yesterday when I made this general evaluation about the performance of the pre-salt in the Campos Basin from Espírito Santo to Rio de Janeiro, it is exactly because they are very competitive areas. So they end up bringing this important result to the company, which is the lifting cost below \$7 per barrel.

And even if we achieve lower volumes than the Santos Basin, they are still very competitive because they will be using an already depreciated investment structure. Objectively, regarding Marlim Sul, Marlim South, we do not have yet a date because we still have to do the appraisal. But 45 meters gives us already a lot of information and says that we have something interesting there.

Solange will be talking about the investments in the refining.

A - Solange da Silva Guedes {BIO 16088234 <GO>}

Good afternoon, everybody. Good afternoon, Rodolfo. We are still discussing the ideal model of how the development of the business model would be for the refining area. So we do not have any news yet to convey to you.

Operator

Next question, Julia Ozenda, UBS.

Q - Julia Ozenda {BIO 21810538 <GO>}

Thank you for the call. I have two quick questions. Still talking about investments. As some time has already elapsed and we have less time to reach the target, do you have a Plan B or something that you can do in order to get to your de-leveraging target?

And the second question is the following: Looking at imports and talking about some trading companies that import oil, they say that they are investing in capacity and that from now on it's going to be structural. So, in your mind, how do you see the import situation? And is there room for you to further reduce in order to use more the capacity of your own refineries?

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Thank you very much. Our target is maintained \$21 billion for 2017-2018. And I would like to remind you that we are already publishing the new teasers and we are already proceeding according to the Court Of Account of the Union. So you may expect more intensity in this activity in the second half. It is correct that we have less time now, but it is

also correct that we already have the learning curve of the first partnership done. So we are going to use the learning that we have achieved in the next processes.

All the knowledge about the due diligence that we did before, we can see very clearly where investors will be focusing in terms of concern regarding assets or companies that they might be acquiring. But the sense of urgency remains.

Regarding Plan B, we monitor our risks and I would like to remind you that, since the new business plan, we have been emphasizing that it is not only about performance, it's about everything that risks the achievement of the target. But, right now, I want to confirm that the company remains seeking \$21 billion as a target for 2017-2018 in the partnership and investment program.

Regarding infrastructure for import, I would like to give the floor to (37:16)

A - Operator

Regarding imports, year-over-year showed a decline and this is basically due to the domestic market and due to imports. As for imports, imports have increased. In July, the company adopted a new policy, a more agile policy. Our work is being developed in terms of the main factors. One of them is predictability. We established mechanisms to identify import firms. And in addition to predictability, we want to have agility in the new policy. More frequent adjustments were authorized by our marketing department and that gives us more agility, and we also have one-time off action.

And the ultimate objective of the company is to have a global. In terms of the first part of FUT, the quality of FUT that we are losing, we still have very high level of our conversion units converting heavy products and more added value products. And as was mentioned before, the increase of the percentage of domestic oil, while that gives us more profitability for our assets because of the sulfur content, because of the profile of the crude oil, it also gives us a logistic advance or advantage because we can process the oil for export. So this would be kind of an overview of the market.

Q - Julia Ozenda {BIO 21810538 <GO>}

And could you explain what FUT is?

A - Operator

FUT is the use of the refineries that was mentioned in the question. It has to do with the distillation of feedstock. That's just distillation. So the most relevant factor that we follow is the factor of utilization as conversion unit, because that's where we convert and that's what gives us a difference of quality FUT. So we can have a lower quality FUT.

Q - Julia Ozenda {BIO 21810538 <GO>}

Thank you very much. A quick follow-up question. Ivan, could you give us some color in terms of the level of interest of potential buyers in your recent talks with them?

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A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Well, I can speak about this, generally speaking, not only about the assets that were made available, but some specific ones that are raising more interest, because we are divesting some non-core activities for the company. And we have seen a lot of interest. We can clearly see the profile of investors that these are investors that no Brazil have an interest in making investments to remain in the country for the long run. These are not opportunistic investors. These are not investors that are concerned about what's going to happen with the Brazilian economy in the next 6 to 12 months. But they are thinking about a timeframe of 15 to 20 years.

Q - Julia Ozenda {BIO 21810538 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Bruno Montanari with Morgan Stanley.

Q - Bruno Montanari {BIO 15389931 <GO>}

Good afternoon. Thank you for the opportunity. First question is - I have two questions to Solange. I'd like to go back to the lifting costs. I'd like to understand what explains this lifting cost below \$7 per barrel. Is it related to efficiency or renegotiation with service providers or a little bit of everything? I'd like to understand the mechanics of that evolution?

And do you think there's more reduction to come or do you believe that this is a sustainable level for the company? And I want to understand, this is a cost that applies to all fields, Lula, Sapinhoá and others, or is it specific to certain fields?

My second question has to do with potential changes in the regulatory environment, particularly related to local content. Assuming that you can migrate to a new regime, even in the old concession, will the company choose this ops to go that way or will you get waivers for possible non-conformities to local content?

And the third question to Ivan. Your efforts to reduce debt has shown results. We see that we are below \$90 billion. But looking at the make-up of the debt, the company has a lot of cash left. So I'd like to know, what is your opinion about the cash, because the cash can be a little costly? Does it make sense to expect a reduction in gross debt along the third quarter? Thank you very much.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Thank you, Bruno. Solange will answer your first two questions.

A - Solange da Silva Guedes {BIO 16088234 <GO>}

This is Solange. Good afternoon, Bruno. As for the first question, you asked me to give you a general assessment of the nature of our cost reduction. Here's what I can tell you.

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First, maximum units (42:50) are performing really well. In the pre-salt oil of the Campos Basin notably, I draw your attention to our P-66 platform. It has been operating with a 97% operating efficiency from day one and this is an important mark and we want to implement that efficiency mark for all units in the Campos Basin. And it is a very important number for our area development of production and we are really paying attention to this number.

Now, overall, you asked whether this would be a general or a one-time off effect. Well, we are working intensely on our offshore logistics costs and this year we are working hard and this is yielding good results in the pre-salt, but it's also yielding structurally in the upstream segment. In other words, we are working to establish new relationships in the way we work with our logistics costs in terms of cargo, personnel, et cetera. And all of this has been yielding generalized effect in our offshore activity notably.

Now, moving to your second point. You asked about local content and how the company and how ANP is dealing with those in the company. So I'd like to underscore this, and I've mentioned this before, I think that it's a very positive and smart approach by the Brazilian National Petroleum Agency, and applying this from the seventh bidding round forward, because they are simplifying the proceeding and quite a lot. That's very positive because it makes it attractive to migrate. We haven't come to a final decision yet, but in our best assessment, it would be positive to migrate all of the content.

Waivers need to be agreed on and this will entail a lot of effort that might not necessarily give us better results than migrating. So, Petrobras trend is to migrate and to acknowledge that this was a very positive decision by ANP.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Bruno, to answer (45:26) your question about cash. I think that we can clearly divide clearly the positioning of the company from the beginning of 2015 and now is, in 2015 we needed to have high liquidity to do with a loss of investment grade of the company and the country, and given that difficulty that the company had back then to disclose the balance sheet until we could develop a methodology that could capture Operation Car Wash effect and something that would be accepted by the regulators, well, this was a great concern back then. We didn't have a balance sheet. We lost investment grade and we knew that this can make liquidity more difficult for the company. So this was the main reason why we maintained very high liquidity back then.

Now, let's come back to today. We are at \$24 billion, \$25 billion for our liquidity, because we're still dealing with a challenging economic environment in Brazil. There are some additional difficulties regarding the geopolitical risks involving North Korea issues and also because the Brent price has been very volatile. But adding to all of that, we continue with discussions with the U.S. We don't know exactly how this will be solved. There was an appellate court recent decision, but this is the main driver because the big good news is that all of this traditional fundability sources for the company are available.

We have announced a number of operations with commercial banks in different geographies showing that the company now has all of the components in place to better

manage our liability. We have commercial banks, development banks on-board. Yesterday, in the press conference, I mentioned the delight that perhaps, in the next 180 days, we have the possibility of going back to operating with BNDES, the Brazilian Development Bank, to slight definitions (47:38) we have with the Chinese Development Bank.

So these are different reasons leading to the current liquidity. But in on our internal discussions with the company's Risk Committee, as soon as we understand that the risks are at adequate level, we'll see a reduction in the gross debt of the company and the use of cash.

Q - Bruno Montanari {BIO 15389931 <GO>}

Excellent. This is very clear. Thank you.

Operator

Our next question from Christian Audi with Santander.

Q - Christian Audi {BIO 1825501 <GO>}

Thank you. Hello, Ivan and the rest of the team. My first question has to do with your pricing policy. You have now implemented this new policy very efficiently. Have you seen an improvement of Petrobras domestic market share vis-à-vis imported products? And what is your target of refineries utilization? What would be your target?

And finally, Ivan, is there any way to shield this new pricing policy, for example, including it in the Bylaws of the company just to avoid further changes that might happen eventually?

And my last question, it's another topic, the transfer of rights. I knew that you were very dedicated to this process. Could you give us an update on it, particularly regarding the potential of Petro getting paid in barrels? Would you need changes in the law in case Petrobras wants to monetize these barrels as quickly as possible? Thank you very much.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Thank you. You asked about the pricing policy and the utilization, Petro versus market share. So I'll give this to (49:48) and then I'll speak about choosing the Bylaws. And Solange will answer your fourth and final question.

A - Operator

Well, the pricing policy was implemented in the beginning of July. It is ongoing. And the expectation to have greater agility in a closer follow-up of variations of Brent prices, adjustments of prices domestically aligned with international markets, all of this will be seen later on because we have imports that have been made and the expectation is that the effect will be seen more in the future.

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It is important to understand to understand that the FUT, the utilization factor of our refineries, is not a goal for the company. It's not a target for the company. Not even reducing imports is understood or imports are seen as negative, exactly because it creates a competitive market. So I would underscore what was said before. FUT is aligned between the first and the second FUT. Again, the factor of utilization of the facilities and the utilization factor of converting units, which are the most profitable ones, well, they remain quite high compared to periods where we had very high processed feedstock.

And similar to what we did this week together with Banco do Brasil, we joined the compliance program from B3 for state-owned companies. And so you can expect that we'll do everything to shield the policies, that we'll ensure profitability, return to shareholders and creation of value to shareholders, or to anyone who buys securities of Petrobras. So, all opportunities that present themselves to the company, the company is taking.

The company said that the future IPO of BR Distribuidora, the company will be a new company in Novo Mercado. Also, joining the compliance program for state-owned companies, we want to be in Level 2 as well in B3. So you can expect all and every initiatives. It might include changing the Bylaws that will be submitted to internal governance, the executive management and the board of directors and the shareholders' agreement. But this is a goal of our management, as has been for a while, i.e., to adopt practices and mechanisms that will, using your expression, shield the company for inadequate interventions that can reduce its profitability.

Now I turn the floor to Director, Solange.

A - Solange da Silva Guedes {BIO 16088234 <GO>}

Christian, there is no new fact to disclose to the market about this renegotiation. Now, what we see is a qualitative appraisal or a very positive evaluation, both of Petrobras and the agencies that represent that contract, in the sense of beginning this renegotiation. And there are advantages for all parties involved, provided we do this carefully and diligently vis-à-vis the opportunities that asset brings. Nevertheless, we have no more information to share with you now.

Q - Christian Audi {BIO 1825501 <GO>}

Solange, just to finalize, the renegotiation with ANP, is it already underway or we are not sitting with them yet?

A - Solange da Silva Guedes {BIO 16088234 <GO>}

No. We are not yet beginning this renegotiation.

Q - Christian Audi {BIO 1825501 <GO>}

Because it seems to me that the alignment that I see between the government - and in fact, it seems to me to be the one of the best that what have seen in the last few years. So

I'm just curious about why the process is not going forward, because this is being discussed since the beginning of this year.

A - Solange da Silva Guedes {BIO 16088234 <GO>}

Yes. I do agree with you. It's also our perception. And in fact, it's a very positive alignment among many other players in the energy institution, not only these two. And this all creates a very positive agenda overall. As Ivan has already said that some topics of this positive agenda bring about a very bullish frame of mind to the industry. But, however - this is the reason why we have a very positive expectation because of what you have just described, but there are other things involved, and we have to be very careful so that we may really have all the elements in our hands before we start the process.

Q - Christian Audi {BIO 1825501 <GO>}

Thank you, Solange and Ivan.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Thank you, Christian.

Operator

André Hachem, Itaú BBA.

Q - André Hachem

Thank you for the question. My first question has to do with the debt amortization schedule. Have you already reached the comfortable level for 2018 and 2019? And could you please tell me about the outlook for new funding? And what about the development of pre-salt? There is a lot of gas associated that should be marketed for the production of gas. In the case gas is not economically interesting, what could happen with that?

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

André, in the evaluation of all of us, we are very comfortable for 2018. But as 2018 is an election year, we believe there are still opportunities and you should expect any announcement from the company in the next few weeks with the same profile, that is to say we have been trying to get the shorter maturities and prepay some installments, and extend to between five and seven years what remains or the outstanding debt of the principal that is to say and regarding commercial banks. So, for 2018 and 2019, mainly 2018, due to the fact that it is an election year in Brazil, you should see some announcements regarding funding.

Petrobras had a major funding operation with lower cost than the cost that we paid in 2014. So we have no plan regarding funding from international markets for this year. We are right now issuing fixed income in the domestic capital market and we are very happy with that. So these are the operations you could expect from our part.

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A - Solange da Silva Guedes {BIO 16088234 <GO>}

Good afternoon, André. Your question is very interesting because it gives me the opportunity to mention a point that is very interesting for all of you who evaluated the pre-salt. This bigger presence of pre-salt in the company has many positive consequences. And, as you said, it reduces our unit costs, unit lifting costs, it delivers more value to the segment due to the reduction in the spread, and (58:21) has already talked about the reduction in logistics cost in our downstream segment, \$300 million (58:32) in the processed feedstock.

And we have already mentioned in our call about the more noble oil products that increases the profitability and the higher participation of gas, we had an increase in the thermoelectric demand of 2017. And we have a consistent and growing presence of gas in our portfolio. And this delivers a higher margin for the Petrobras system as a whole and this is something that we shared with you yesterday.

So, overall, the pre-salt gas as well as the pre-salt liquid is much welcome because it is having a very important impact on the value chain of the company, and this is valid for gas as well. And we do have some specific cases, in which, due to the excessive presence of CO2, the economic evaluation shows that in specific cases, we could have the reinjection of the gas with a high percentage of CO2, because it also could bring about an even more positive effect. This is not the general rule. The general rule is that we are having incrementally or gradually a very positive impact on the pre-salt in the value chains of the company.

Q - André Hachem

Thank you.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Thank you, André.

Operator

Osmar Camilo, Bradesco BBI.

Q - Osmar Cesar Camilo {BIO 17227387 <GO>}

Good afternoon. Thank you for the question. Let me go back to the expenses regarding the use of the gas pipelines. Could we consider the level of this quarter as a reference, as a benchmark, for the next one? And these expenditures, were they contemplated in your manageable gas expenses of late last year? And I would like to have an update about the class action?

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Yes, you could consider the same cost level. This was considered when we drafted the plan for 2017 and this is the level that you can expect for the next few years.

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Regarding the class action, well, there was a decision made by the Court of Appeals that considered that it does not follow the legal requirements, so establishing a reevaluation by the lower court regarding this. So we are waiting for the decision of the lower court and then carry out everything that is necessary to promote the defense of Petrobras interests.

Q - Osmar Cesar Camilo {BIO 17227387 <GO>}

Thank you.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Thank you.

Operator

Pedro Medeiros, Citigroup.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Thank you for the question. Good afternoon. There are three questions. The first one is a little bit complicated and I will split it into three. Could you talk about the evolution of the improvements in the company in terms of manageable expenses and operating costs, regarding what was in the investment plan last year?

And could you please divide your answer into three. The first one, on the administrative expenses side, and I know that we have talked about it, but it was not clear for me, Nelson and Hugo, if the levels reached this quarter could be considered the level that should be expected to be reached according to the plan that was defined, that is to say, when we look at the expenses from now on?

And the second is the unit cost for refining operations, at least in this quarter, it seems to me that there was a major evolution in this unit cost, a drop of 3% in dollars, dropping also in reals, in spite of a lower utilization rate for the system. So are there more opportunities to reduce the cost or should we expect this level to be recurrent?

And lastly, Solange, on the lifting cost side, could you clarify how much you consider as the platform needs in the cost of the pre-salt? Because we have here \$3 to \$4, the estimate per barrel, and I would like to understand the opportunity for reduction of the lifting cost because, in the next two years, you will have a very high level of your own capacity and that is not treated.

And the two other questions that are more macro. The first one, the process of the negotiation of the Petros beneficiaries, do you have something defined according to plan? And the decisions made, could they lead to a change in the overall estimate for your liabilities vis-à-vis the pension plan?

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And in the quarter, we had a return in the provisioning for receivables. Although the figures were small vis-à-vis what happened in the last few years, it seems to me that it is a departure from what happened in the first quarter, because there were credits that were provisioned from last year. So what are the risks of the same? Do you believe that the same could come back? And what are you doing in order to recover the credits, that credit that have already been provisioned?

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A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Pedro, okay, let's start to organize ourselves here to answer all your questions. And in fact, you asked eight questions. So Nelson Silva will be talking about administrative expenses and what we could expect and the performance. And then Nelson and Hugo, please feel free to answer your questions.

A - Nelson Luiz Costa Silva {BIO 15817718 <GO>}

Pedro, as I had said, our cost reduction effort is made by all areas of the company, all fronts. In a nutshell, what I can say is that looking at the figures of the E&P area, we had a reduction that is very much consistent in all areas. When we look at E&P, we are reducing cost of refining, reducing cost in logistics as well.

And overall, these reductions, I think I should mention because it's important, they are more than what we had in our plan. Our plan had a certain estimate and we are achieving an even better result with the involvement of all areas of the company. The whole company is working on that hands-on.

It's not just one year (1:06:00) or another that has an isolated result, but I must say that this culture of cost reduction and really focusing on the activities that really generate value for the company, this is pervasive in the whole company. All the areas contribute. And when we look at the results, we see that the reduction by means of the voluntary separating incentive plan is already bringing a lot of contribution.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

I would like to tell how we are doing. I think your question is very timely, because in the case of the voluntary separation incentive plan, although we have a few cases that have been suspended or that will be finished by the end of the year, this is the level. From now on, the company gets into a normal regime and we will go back to contracting people and selecting people. And we have many processes of internal mobility to adequately adapt this workforce. But the implementation, and what Nelson called the culture that is being pervasive in the company, has been showing other opportunities for reduction.

So we have a lot of work in the supply of goods and services yet. And some results and some bidding processes have been showing that we will be able to continue to reduce cost based on more competitive processes and the participation of more suppliers. And also in terms of our stocks, our inventories, we have been achieving gains that are higher than what we planned. So there are many ways for us to get to the end of this process. So this is an ongoing learning and ongoing improvement in the company.

A - Hugo Repsold {BIO 19059342 <GO>}

Pedro, still on those two important comments. First is that nothing of this is being done in detriment of safety. It is important to underscore that we never stop focusing on safety, safety for our people and our equipment. So we never give up on that.

Secondly, the management system that we currently have in the company is a continuous improvement system. We don't expect that this effort and that these results will be reduced eventually. On the contrary, we will be successful when the management system is working, is implemented, is part of everyone's daily work, and when cost reduction will be a daily thing, a normal thing, and something that will continue. And again, I underscore, we never risk any people or assets.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

And this is Ivan. You made two comments about the Petros and the receivables from the electric system. We're fulfilling all governance sets, both at Petrobras and at the foundation, and we're discussing with PREVIC, the regulator, how to solve that deficit. So I can't say anything about that yet, but we are following governance and the approval of our discussions. This is an extremely important item. It demands a lot of attention from Petrobras Human Resources, but this is being adequately addressed.

As for the electric sector, as you know, we are charging in court the receipt of the credits, products that were provided and are paid for, and we continue with that discussion. As you can see in our market disclosure documents, we are following all of the procedures and the company will use all procedures available to recover these credits, because we supplied the products and we were not paid. So, all and every initiative to receive these credits have been adopted or will be adopted and will continue to be adopted by the company. I now turn the floor to Officer Solange Guedes.

A - Solange da Silva Guedes {BIO 16088234 <GO>}

Good afternoon, Pedro. You made an observation about the impact of chartering in the pre-salt costs. And here's what I can tell you. As I mentioned in answering a prior question, something that we are making strongly on is costs of services rendered for the operation of the vessels and the ships.

We are adopting lower costs - we have now lower costs because we have a higher productivity of the field and so we can keep our units working at their top potential. And this is very positive. The impact of chartering on operating costs can work in many ways. We have many ways of managing these costs, but chartering is something that we don't have a lot of leeway with, compared to other line items of our operating costs. There's not much we can do about it.

Again, I mention and I underscore our performance. Our own units enable us to have higher degree of freedom and they end up delivering some opportunities that chartering cannot give us. One example of this experiment is the operation of P-58 at Parque das Baleias, and it allows us to say that it gives us more flexibility and freedom.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Thank you. I would really like to thank you for all of the answers and congratulations on the results.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

We thank you.

Operator

Thank you very much. We are now closing the question-and-answer session of this webcast and conference call. I now turn the floor to Officer Ivan de Souza Monteiro for his final remarks. Mr. Monteiro, have the floor.

A - Ivan de Souza Monteiro {BIO 16420543 <GO>}

Again, I would like to thank you all for participating in this event. I'd like to say that our Investor Relations department is available for any further questions you might have. Thank you very much.

Operator

Ladies and gentlemen, the audio of this conference call for replay and slide presentation will be available at Petrobras IR website at www.petrobras.com.br/ir.

This concludes today's conference call. Thank you very much for your participation. Please hang up your phones and have a great day and a great weekend.

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