

Q2 2016 Earnings Call

Company Participants

- Isabela Mesquita Carneiro da Rocha
- Ivan de Souza Monteiro
- Jorge Celestino Ramos
- Roberto Moro
- Solange da Silva Guedes

Other Participants

- André Natal
- Bruno Montanari
- Caio Carvalhal
- Christian Audi
- Diego Mendes
- Felipe dos Santos
- Lilyanna Yang
- Luana Siegfried
- Luiz Felipe Carvalho
- Luiz Felipe Guanaís
- Pedro Medeiros

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to Petrobras Conference Call with Analysts and Investors for the Presentation Concerning the Second Quarter of 2016 Results. We would like to inform you that participants will only be listening to the conference call during the company's presentation, which will be conducted in Portuguese with simultaneous translation into English. Following the presentation, the Q&A session will begin when further instructions will be provided.

Present here with us today are Mr. Ivan de Souza Monteiro, Petrobras' CFO and Investor Relations Officer; Mrs. Solange da Silva Guedes, Chief Exploration and Production Officer; Mr. Jorge Celestino Ramos, Chief Refining and Natural Gas Officer; Mr. Hugo Repsold Júnior, Chief Human Resources, HSE and Services Officer; Mr. Roberto Moro, Chief Technology and Production Development Officer; Mr. João Adalberto Elek Junior, Chief Governance, Risk and Compliance Officer; Mr. Nelson Luiz Costa Silva, Chief Strategy, Organization and Management System 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 number two, which contain a notice to shareholders and investors. The words believe, expect and similar ones related to projections and targets are mere forecasts based on the expectations of executives regarding the future of Petrobras.

To begin, we will hear Mrs. Isabela Carneiro da Rocha, Executive Manager of Investor Relations, who will start the presentation related to the second quarter 2016 results. After that, we will then answer the questions from participants. Mrs. Isabela, you may take the floor.

Good morning or good afternoon, everyone. I would like to thank you all for participating. And I would like to start by presenting our second quarter results, highlighting a change in terms of elaborating more of each business segment, so as to help you to understand and model the company better related to transparency. These improvements took into account the quarter results breakdown for a segment, with more information and better results per segment, and also the results for Brazil and abroad in addition to data related to imports of products, sales volume, downstream and distribution. And also the tables - the Excel tables, the spreadsheets are available on the website for Investor Relations.

To start the presentation, we will start by highlighting the exchange rate environment in the first quarter, was BRL 3.51, lower than in the first quarter, but yet higher when we compared the same period of the year before. In terms of Brent, there was an increase in the second quarter vis-à-vis the first quarter amounting to \$46 per barrel on average and lower when compared to the first year or the year before.

Now, looking at the gross result, we start with BRL 22.2 billion increase. And the main factors that impacted this increase was mainly the higher production of oil and gas, 7% higher from Petrobras. And as a consequence, there was a 14% increase in the number of exports of crude oil and oil products associated to lower costs of import of gas or LNG because of higher domestic production and higher demand. And by the same token, there was a reduction in the sales of gasoline, even though the total sales increased reductions in gasoline and also power because of lower power generation; and increased expenses with production taxes and imports because of imports and the price of Brent when compared to the first quarter.

In terms of operating results, it was BRL 7.2 billion. There was a 12% reduction vis-à-vis the first quarter of the year, mainly due to some non-recurring expenses, and expenses with the new voluntary incentive plan. That was BRL 1.2 billion. Also, impairment from Comperj due to the reevaluation of this project, BRL 1.2 million higher expenses and exploratory blocks due to low economies. And we are down-sizing, and it's an evolution of BRL 2.2 million in higher SG&A expenses, amounting to BRL 200 million with consulting services.

Now, looking at the financial result, there was a 30% reduction in finance expenses due to the U.S. dollar appreciation vis-à-vis euro. And today our highest net exposure is in dollar terms vis-à-vis euro and therefore, there was a significant reduction in finance expenses. When we compare this to the first half of the year before, the depreciation brought about increases in finance expenses. Well, net result, we saw a reversal in growth losses, I mean, in terms of last half year BRL 370 million. And this was due to lower expenses and better net financial results, which more than offset this drop in operating results.

Now, going onto the next slide, we have EBITDA and adjusted EBITDA, BRL 20.3 billion. And comparing it to the previous quarter, there was a 4% reduction. And if we exclude some non- - some special items, like contingencies, indebtedness, which brought about - increases the EBITDA margin at around 28%, which is in keeping with the last results.

Now, speaking about operating cash results, there was a 27% increase, BRL 21.9 billion. This was the amount for the second quarter. Now, investments, looking at cash view, we have a CapEx view, BRL 11.8 billion (sic) [BRL 11.2 billion] (06:49), which was down when compared to the previous quarter and the same period of the year before. There was - E&P, there was also - it was also stable, and that results in a free cash flow, which was very positive. It was BRL 10.8 billion. There was a 3.5 times increases with the previous quarter, and this was in the case for the fifth quarter in a row. This is a very important aspect, because it reduces leverage of the company and this also brings about reductions in CapEx and better results.

Now, we will take a look at the debt level. There was an important move towards the reduction of our debt position that was BRL 397 billion, accounting for a 19% reduction or BRL 9.5 billion, once compared to December of 2015. In matched terms, there was also a 15% reduction, reaching BRL 372 billion.

But now, if we look at the dollar amount, there was also a reduction when comparing the second quarter 2015. In this quarter, there was a reduction of 7.5%, and in our net debt in - denominated in dollars at the end of the second quarter was \$103.6 billion.

So, net debt over EBITDA adjusted for the last 12 months as we usually report on is 4.5% this quarter, but I would like to remind you that it used to be 5.3% by December of 2015. Now in terms of leverage, we went from 60% in December 2015 - or 58% in the first quarter to 55% in the second quarter, meaning a drop of 5% in leverage terms.

Now, I would like to refer to our debt management. We're trying to elongate the debt. Our average term is 7.3 years, with an average cost of 3.6% (sic) [6.3%] (09:02). And in terms of offering of bonds and buyback of notes from June until May, we issued \$6.6 billion, and we bought back \$6.3 billion. And the management was in July. It's not reflected in this chart, but there was an equivalent operation, amounting to BRL 3 million.

Now, next, I have a summary of everything that has been explained thus far. We talked about the behavior of our results reaching BRL 876 million. I would like to emphasize that this line of investment is different from the previous view that we showed in the previous slide. Now, when we look at the half year comparison, and if we compare half year with another half year, we look at the same numbers when it comes to investments.

In operating terms, I have here increasing production for oil and gas. There was an 8% increase in crude oil production. It was 2,133 barrels a day because of stoppages in the first quarter and the ramp up of systems like Lula Alto and also FPSO Maricá gas production that experienced an increase of 5% because of reductions in imports of LNG. In terms of production, there was increase in higher production because of the Nigeria field and a 9% increase due to the ramp up of a field in the Gulf of Mexico, (11:05). If we look at the half year comparison, here we have all of the stoppages that occurred in the first quarter as we saw it in the results from the previous quarter.

Now, in the next slide, we look at the pre-salt production. And speaking about pre-salt, we announced the fact that we reached 1.06 million barrels per day. And so we surpassed 1 million barrels per day just for pre-salt. This production increase in pre-salt was due to the lifting cost which is below \$8 per barrel. We also enter Lula Auto field and the Cidade de Maricá early this year, in February and July 8 in the third quarter. We started up Lula Central, FPSO Cidade de Saquarema. And in the third quarter, we will start up FPSO Cidade de Caraguatatuba in the field of Lapa.

Now, speaking about lifting cost. Lifting cost, even though it had a 5% increase in dollar terms, it was down by 5% in BRL. And if you exclude the exchange rate variation, that there was an effect on lifting cost, because we had lower lifting costs. In terms of lifting costs abroad, there was a slight reduction due to lower expenses in Argentina, with the sale of a few fields that occurred in the first quarter.

Next, we look at oil product output in Brazil. This production - or this output was down by 8%. Feedstock processed was stable by 1.709 million (13:08) barrels a day, refining 84%. And yield was very high for oil products, such as diesel, gasoline and jet fuel. So, there was 5% decrease in terms of oil products. In there, a half-year comparison processed feedstock were very much balanced or stable.

Now, looking at oil products, it was BRL 2.109 million. There was an increase of 3% in the sales of oil products. And - but I would like to highlight higher demand. The demand for gasoline remained stable in the country. And there was replacement of products by third party, that's why the increase was not significant. And in terms of diesel, the demand for diesel in the country increased, but there were also placements by third parties and that's why, we increased a little bit our sales of diesel. Now, when we compare the half year, there was a drop in NAFTA demand. Diesel demand also was down by 5%, but gasoline was stable. Therefore, from the first quarter to the second quarter, there was an improvement in the diesel market with a slight increase.

Now, looking at the next slide. So, our balance sheet for liquids was good, because we became net exporters. We exported (sic) [imported] (14:40) 359,000 barrels a day between crude oil and oil products. And we exported 515,000 barrels a day. It is also important to highlight that this stems from growth of oil production in Brazil and the increase of domestic oil in processed feedstock. And this also reflects lower needs to import crude oil. And also, there is less oil to export, so our balance - or trade balance was positive. There was a surplus of 156,000 barrels a day, which offset the deficit that we had in our trade balance in the past.

Now, looking at refining cost, refining cost increased 8% in dollar terms, when you look at first quarter and second quarter, in BRL, it was down by 2%. This also impacts refining costs and personnel costs which is - which accounts for about 60% of the total cost. When you compare the half year periods, there was an increase in reals, in BRL, because of the collective bargaining agreement that occurred last year. And abroad, we look at refining costs, and there was no cost increase half year, comparing both half year periods.

Now, next slide gives us a general and administrative expenses overview. There was an increase of 7% about BRL 200 million. And this was due to consulting expenses that were paid this second quarter.

Next, we take a quick view for all of our business units in the second quarter. Downstream had significant results, and it was different when compared to other companies. And this result is significant, especially for refining and marketing or Downstream. So, BRL 10.3 billion was the result for Downstream in the first quarter. It was less impacted when you compare to the previous quarter, because of expenses, with allowance for loan losses and others. And now E&P BRL 2.9 billion was better than the previous quarter, because of increases in the oil prices, and increases in production.

Now, Gas & Power BRL 900 million. And here what mattered most was the impact of LNG and also electricity cost. Distribution, the result was BRL 300 million, which was better than the previous quarter. We - I would like to highlight that there were lower impairment in terms of distribution, even though there was a reduction on sales volumes of gasoline, jet fuel and other fuel oils.

Here, we also highlight better results abroad. We had a good margin in Paraguay because of the best - a better mix of products sold. Now, fuel, it was down at a loss. So, in the second quarter we have BRL 7.2 billion of operating income.

The next slide, we have the same view for the half year and because of the low price of oil in the first quarter, we have differences in our downstream and the impact of downstream in the first half year of BRL 15.3 billion.

Now, looking at our cash flow in 2016, operating generation expected of \$26.7 billion. Operating cash flow of this chart is denominated in U.S. dollars. The trend here is that, with improvements in Brent prices, so the result may improve further. Judicial guarantees amounted to \$4.5 billion. This is a conservative position. The result in the first quarter, which has been already posted in terms of judicial guarantees was \$355 million, but this is a conservative view for this year's cash position.

In terms of dividends, interest and amortization, was \$20.7 billion. And this relates to the buyback rollover. So, buyback is \$9.3 billion. And dividend investment, our best number was \$17.5 billion. We still maintain our divestment goal of \$7.3 billion, rollover \$10.3 billion, \$14.6 billion divestments, \$10.3 billion rollover, borrowing is \$1.2 billion (sic) [\$1.8 billion] (19:39) and the final cash position is \$27.3 billion. Our liquidity position is such, and this stems from a better operating management and the divestments that have occurred, therefore, we do believe in this chart as being a significant result.

And with that, I conclude my presentation. And I think, now, we are ready to take your questions. Once again, I would like to highlight that questions will be asked either in Portuguese or English and the officers will respond. We'll answer the questions in Portuguese with simultaneous translation into English. Thank you very much.

We will now begin our Q&A session.

Q&A

Operator

I would like to ask participants to ask at the most, two questions and please ask them one after the other. We kindly ask you not to use the speaker phone. Questions made in English will be heard in the original language by all participants and answered by the executives in Portuguese with simultaneous translation into English.

Mr. Luiz Carvalho from UBS has the first question.

Q - Luiz Felipe Carvalho {BIO 18040760 <GO>}

Good afternoon and thank you. I have two questions. First, I would like to hear from Ivan a little bit about the regulatory cost. I've had some conversations with the industry, both upstream and downstream, and we've seen a big disposition in terms of changes on the regulatory front both for pre-salt, local oil, and oil and gas. So, how is the company communicating with the regulators concerning changes in regulatory measures? I just want to understand better, what is the current status of Petrobras communications with the government, whether there is any improvement in the relationship, or whether we can anticipate changes?

And the second question is that I want to understand whether there is any initial understanding in terms of the basic assumptions related to who should pay whom, who should collect from whom, and whether you could give me some timing expectation?

And my last question, well, Nelson probably talked about it, but if Nelson can give me an overview of what could be expected of your next business plan? What can we expect in general, in terms of leverage, asset sales, pricing policy, please elaborate more on this regard?

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

Good afternoon, and thank you for your question. Now, speaking about regulatory aspects, the company is clearly defining the regulatory issue to make it easier for us to make interactions and to promote sales of assets. We are communicating more clearly with our stakeholders. Things are stable, and we want the regulatory measures to allow us to make decisions in the best possible environment, I think this is really important because if that does not occur investors will ask for higher remuneration rates just to cover for additional risks. And that happens when you don't have a stable regulation environment. But I'll give the floor to Solange, because you mentioned four topics or five topics. And I'm unsure of that she can probably elaborate more better on these topics than myself.

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

We are - maybe, I think, in terms of your perception related to the regulatory environment, that's due to a very strong effort of the company in terms of communicating with the regulatory agencies or the government trying to solve issues like you've mentioned REPAR 2 (24:37), which is something that is being mentioned by everyone all of our - all of the industry's investment decisions consider the hypothesis of a non-existence of REPAR 2 (24:52) anymore. So, this is what is being considered now by the association. We, from the industry, are talking to the government and communicating them about our adjustment issues, so that we can initiate some tender offerings or some other kind of model that is also very competitive for next year. All of these are very important regulatory aspects like Ivan mentioned and they may bring about further investments or also increase the degree of confidence of current investments.

You also talk about the transfer of rights. We will repeat the same practice or the same answer that we mentioned in our last meeting, and I said that both ourselves and the other part, we are finalizing or concluding our evaluations that we'll then produce the technical and economic report that will follow. But then, you also asked us about the basic assumptions that may have been discussed. Well, yes, we did talk about it. We talk about our vision with the public prosecutor's office and the government, but we are now evaluating different opinions on both sides in each area. We use these assumptions in the most robust possible way, in order to address the issues with their consulting representation.

Q - Luiz Felipe Carvalho {BIO 18040760 <GO>}

Do you have any idea of timing? Could you expect something coming in still this year or next year?

A - Operator

No. This is a very innovative process. It's a contract negotiation, which are very large magnitude and also very complex. Therefore, it's difficult for me to give you any idea of timeline.

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

It's Ivan again. Officer Nelson is now leading an important meeting, but tomorrow, all of the officers will be together in the third phase of the review of the plan. So, he is not here at the moment, but we will gather that all information, related to the main metrics of the company, can be discussed after the conclusion of this work, because tomorrow we will have another meeting. Thank you very much.

Operator

Christian Audi from Santander has a question.

Q - Christian Audi {BIO 1825501 <GO>}

My question has to do with CapEx. Very, very positive progress in terms of lowering CapEx, for incentive purposes. So, we would like to better understand the levels that were posted in the second quarter around BRL 11 billion. So, is this the new level that we might consider for the next two quarters or not? Is there any trend that might take place in the second half of the year? And secondly, could you elaborate more, on what leads to this drop or reduction and the (28:30) process for E&P? So, that would help us with our vision for the future.

My second question is more now related to the sale or disposal of assets, NTS to Brookfield. What about the sale of these assets? Are you waiting for any regulatory process to have the process concluded? And I wonder if you can confirm about CapEx and disposal of assets? So, are you going to go back to this, or unless you find a partner to the project.

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

Christian, thank you. Ivan speaking. I'm going to talk a little bit about CapEx. In the flow projection, we had and announced in the budget which is higher than what we are actually performing. We believe there is a slight recovery in the second half of the year, vis-à-vis the first half of the year performance, but clearly, we'll be performing investment-wise below the CapEx initially expected. And because we're concentrating and focusing most CapEx in production – Solange is going to make some comments.

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

Christian, good morning, Solange speaking. Most of the difference that you mentioned or that we post this year, like Ivan said, we have an outlook to improve the numbers in the budget in the second half of the year. And perhaps, there is a significant share that might not be recovered this year and this is most precisely related to the performance of contracted projects, mid- to long-term projects, which will not have a significant impact in 2016, and I would say that there won't be any impact in our output for 2017 either. So we are considering, if CapEx – well, there is this perception of an impact in production, but it doesn't happen actually precisely because our short-term output is very much related to the availability of critical resources and those are fully available in order to deliver.

Christian, coming back to the point about the sale of assets, the discussion with Brookfield is okay. We don't have any problem; any regulatory issue that prevent us from moving forward in our discussions. All operators are usually submitted to regulatory authorities, but there is no impediment. We only have natural conversations of big and complex deals. As to your question about Comperj, Jorge Celestino is going to answer your question.

A - Jorge Celestino Ramos {BIO 6004746 <GO>}

Christian, good afternoon. For Comperj, what we're doing is the following. In the business plan and based on diesel demand, in our portfolio, this project doesn't make so much sense. However, we keep on pursuing that and talking to partners. In order to look for a partner to go on this venture, that's precisely what we're doing right now.

Q - Christian Audi {BIO 1825501 <GO>}

Thank you. My last follow-up question is on going back to the strategic plan, do you already have an outlook of when you expect to announce the plan or not?

A - Operator

The answer is, yes. We'll be announcing this plan within the schedule set by CEO Parente and this will happen in September.

Q - Christian Audi {BIO 1825501 <GO>}

Thank you.

A - Operator

Thank you, Christian.

Bruno Montanari from Morgan Stanley has a question.

Q - Bruno Montanari {BIO 15389931 <GO>}

Thank you for taking my question. Good afternoon. First of all, I'd like to congratulate the team for making our lives easier with a new release and the new charts and tables. Thank you. The first question is to Ivan, about the bonus buyback strategy to improve the debt profile. In your cash position, I saw the numbers, but Ivan, how much would the company they willing to do or to further

reduce payments for 2019, what about the equation extend the debt versus increasing the debt service on a temporary basis.

Secondly, Solange, the production pace is very interesting, the ramp-up of these new units. Do you have a range about the numbers for production in December this year? And, Solange, you've been working expensively to renew the rigs contract. Do you think you will achieve the ideal number or should we still decrease the fleet, particularly for deep waters, and in a number of positive scenario, what is do you need to see in order to add more rig to Petrobras' fleet. Thank you.

A - Operator

Bruno, thank you very much for your questions. The operation precisely, has the goal that you mentioned, but we concentrate maturities, we had increasing maturity from 2015 to 2020. I have to admit we're very happy with our first response of the market vis-à-vis the first operation. Demand was greater than \$20 million, we contracted \$6.75 million and because the performance of the bond was excellent. We had a new operation of \$3 million. If you check the curve, it is very positive, very strongly, particularly, over the last 45 days.

At the end of the day, you improve and enhance the scenario of Brazil as a whole, the country, the economy, and Petrobras. So by and large, we believe that we had the right amount, according to our expectation and the outlook in the future, we'll be watching closely new opportunities. I have to tell you that we've had a lot of spontaneous offerings now in terms of ideas and new possible operations, but whenever we make decisions, we disclose it to the market and we are very happy with what we achieved so far. We don't intend to go for new operations right now, but we'll be careful and keep an eye on new opportunities.

Solange is going to add to the comment.

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

Thank you, Bruno. As we said before in the first quarter and now in the second quarter, according to our schedule, our output has increased just as we had previously announced, very strongly particularly in Q2. We are working very close to the downstream and upstream areas involving several aspects of our operations and to maximize the company's results. So, we've been concentrating our schedule maintenance in the first quarter. And now, with the new events of the second quarter, I would say that - I wouldn't give you a range, Bruno, but may be some periods and a couple of days in which we will be around 2.3 million barrels per day by year end. But we don't have any significant stoppages and all systems will be interconnected.

In terms of rig contracts, we did and we are strongly focusing to optimize our expenses with this kind of service.

We have idle resources due to the reduction of the business plan and successive optimization of well construction. It's something very well - the response is very good from our project team and we have an ideal approach. And like you said, what we actually have to do is to go for incremental reductions of our expenditure in terms of the number of rigs available in the fleet, per thousand meters (37:40) and also by daily rate.

So, we are doing this and, as we speak, the performance is very positive, conditions are very positive for the kind of work. In terms of additional rigs to the fleet, this depends on how our strategies will be in the business plan. We don't feel any immediate need to add any rigs to the fleet, but it will depend on announcements in September related to the business plan.

Q - Bruno Montanari {BIO 15389931 <GO>}

Perfect. Thank you.

A - Operator

Thank you, Bruno.

Diego Mendes from Itaú BBA has a question.

Q - Diego Mendes {BIO 16313486 <GO>}

Good morning. I also have two questions. The first question has to do with the refining facility. Maintenance involves 85% and then the faster rate was higher. Considering the domestic market, there was also a difference. Could you give us some color about the behavior going forward? And also in the same question, we can see an increased percentage of domestic oil processed at the refineries possibly due to pre-salt production which has better oil. What about going forward? Those growth of production comes from pre-salt in the industry. Do you believe we will have 100% domestic oil at refineries or is there any constraint? Not technological, but in terms of equipment, in order not to use 100% of our oil.

The second question is about production. There is a middle table that was showed in the presentation to journalist, showing the number of wells already connected to each one of the platforms of pre-salt installed this year. Could you tell us the maximum of each one of the platforms, the maximum number of wells to get to the estimated data ramp-up? Thank you.

A - Operator

Thank you. Celestino is going to answer the question and then Solange will answer.

A - Jorge Celestino Ramos {BIO 6004746 <GO>}

Good afternoon, Diego. With regards to the utilization factor of the refining facility, our planning model runs fully integrated, naturally considering constraints for maintenance coverage of our assets, both refining and other assets, and also, economic assets and factors. So, the higher profitability of the complex and this takes into account imports of crude oil, imports of oil products, exports of crude oil and exports of oil products. So, this is the look and feel of the refineries running this model and with the best economic value possible.

So, if you look at the utilization factor, comparing previous years with the current year, this was below not only due to stoppages at refineries, but also out of market regions because the market is smaller particularly the diesel market and diesel is the product that provides the higher profitability to refinery.

\$15 per barrel oil, so once we deplete the capacity of the diesel market, you begin to have auctions to export crude oil and import some oil products. So, we have more stoppages, it is true. If you compare January 2016 to July 2016 and the same period 2015, we had REPLAN, generous stoppage, and lower feedstock at (42:06). We also had stoppages there and also at (42:08). But on a global basis, the concept stoppage was not as strong as the problems and the economic factor. So, that's the first point.

The second point, about 100% domestic oil - the answer is probably not, due to the hardware at refineries that's the first point. So, you always need more lighter (42:40) oil to have adequate conditions in our refineries, but also for lubricant production in the industry for REDUC that are to lubricant structures, trains and we will always have some imports of this type of crude oil to be used in the refining complex.

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

Diego, Solange speaking. Good afternoon. With regards to your question about wells. We have different productivities, we don't have a fixed number for each one of the plants. I don't have information right now of these wells, but by and large, and as we discussed previously with all of

you when we explained what we did in order to reduce our investments with a long-term impact for our new plants, we shared before with you that we are in a process of two pumps, an average four to eight wells in the platform depending on where they are.

It does not apply to all platforms, but five or six wells becomes our forecast for the first wave and the remaining wells of the project have a gap of ramp-up process and will come later on in a second wave that might even happen a year later. We don't have a basic rule for each one of these units, Diego.

Q - Diego Mendes {BIO 16313486 <GO>}

Okay. Just a follow-up question about a drop in CapEx this year. Is this mostly related to this change in the well interconnection strategy or due to any delay in the construction of the platforms that will start up after 2017?

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

Well, this year, we are reporting results of the first quarter of 2016 and it was not affected yet by the strategy. What I mentioned about a first and second waves, this is within the framework of that discussion, the previous announcement of the business plan 2015-2019 when it had a strong investment reduction for E&P without the impact on production. That was the explanation of the apparent result explaining why you reduce CapEx from 2015-2019 without lowering production in 2020. This is not related to investments in the first half of 2016.

Q - Diego Mendes {BIO 16313486 <GO>}

Okay. Great. Thank you very much.

Operator

Luana Siegfried from Raymond James has a question.

Q - Luana Siegfried

Good afternoon. Thank you for taking my question and for the conference call. I have a very brief question about the sales volume, sale of all your products in Brazil. This volume is lagging behind levels of 2012 and 2014 where we had a peak. I would like to better understand to what extent in terms of barrels per day Petrobras will be comfortable with the future and possible increased demand of all your products in Brazil?

A - Operator

Thank you, Luana. Celestino is going to answer your question.

A - Jorge Celestino Ramos {BIO 6004746 <GO>}

Luana, good afternoon. We have been running our facilities with utilization factors of 84% and 85% or 2 million or 2.5 million barrels or 1.9 million or 2 million. For the second half, usually in the second half, the numbers are stronger. Our projections do not show that the market will have a dramatic drop or affect our operations. It is our understanding that we even have a trend for the second half of the year, a trend to improve the fuel market. So, we are pretty comfortable with our operation. We are very competitive both share and price wise. So, that's not a concern or something that is not on our radar based on the projections we currently have.

Q - Luana Siegfried

Just adding to my question, what about the other way around? I understand economic scenario is still idle, but if we assume improvement in the economy and improved oil product use, what will -

how would you feel comfortable 2.5 million barrels or there's higher (48:08) or what about oil products?

A - Operator

This market is very dynamic. We already had 2.5 million barrels, 2.6 million barrels. So, we do have assets, not only refinery, but logistics assets in Brazil that have already supported these levels in the market. In this horizon or in our analysis 2017, 2021, for the next business plan, we'll be discussing this again, 2017 onwards. But there are no big changes that may have an impact on facilities, at least according to what we have already planned, the complex maintenance or improvement in a couple of assets. So, we don't understand - or we don't believe that market changes may really affect our refining and logistics activities.

Q - Luana Siegfried

Okay. Great. Thank you very much.

A - Operator

Thank you.

Mr. Caio Carvalhal from Brasil Plural has the next question.

Q - Caio Carvalhal {BIO 16605563 <GO>}

Good afternoon, everyone. In fact I would like to go back to something that has been mentioned before related to changes in regulatory aspects. And in particular, I think that something is very critical for the entire industry and Petrobras, which has to do with the gas regulatory framework. And the pipeline of Saudi for Sudeste and for Brookfield there is nothing pending in that regard in the sales process. But about that topic, I would like to ask two things. What about the other asset in the logistics chain of Petrobras and NGL and TPP, the thermological power plant.

What I understand is that the company does not want to get into further divestment while you wait for the regulatory process. But there are some issues that are very important, because they can also impact not only the approval by the regulatory agencies, but also the appreciation of assets. Does the company take that into consideration? I know there is also a matter of time because of the balance sheet. So, the sooner the sale starts, the better, but there is also the issue of having a more stable and robust regulatory framework because the regulatory framework could also happen even before the divestment.

How do you understand these regulatory framework issues and I know also that there are issues related to timing. In the IBT conference a few weeks ago, there is a debate brought about anxieties in the market. I think it will not have a definition (51:14) I know, but whether you have some idea of timing, when that will be tendered or what would be the impact that that would have in the government in terms of defining the regulatory framework?

And the second question addressed to Solange speaking about production and comparing it with your last half-year, and I was quite concerned with the production in the past, but in the second quarter, the things were like a one-off situation when compared to what happen in the first quarter of this year, and when we monitor production in 2016, it's pretty much in keeping with the guidance.

Can you give us an idea related to production or E&P in 2017, many foreign analysts were questioning the production in Brazil, because it pointed to significant growth in production from Brazil in 2017. I know that your strategic plan is still underway and you may not have any specific answer to give me, but what about the systems that are coming in, can we expect a one-digit

growth or a high digit growth for 2017 or whether we believe that this will be a stabilization year, looking for further growth in the future?

A - Operator

Good afternoon. Thank you. Thank you, Caio. Your question was very good, and I think we have a very good example to give you, just to put away your fear. I mean, we do not sell anything, without looking at the value of the asset. The company moderates and we have been doing that. We moderate competitiveness in all of our processes and as you said it correctly, several of these markets, Petrobras is the single operating company and certainly, there is a debate about the regulation and the company has been very forward in terms of that process. We - I'll give the floor to my colleague, who will talk a little bit more about the regulatory framework.

I would like to talk about the process of the BR Distribuidora, with the market was not very welcoming not even abroad or domestically. And then we started publically thinking about selling minority stake, but the proposal that we received from BR Distribuidora, were not in keeping with what we wanted, it didn't reach the level that we were looking for. So, now we are discussing a share control of BR. But timing will not pressure the loss of market cap we have to be very careful especially when it comes to any divestment in Petrobras and we did some operations and that's why we are operating in such a way not to put pressure in the company. We do not want to sell any asset at a value that is not aligned with the current value and that should not affect our evaluation process.

Now, I'll give the floor to Jorge.

A - Jorge Celestino Ramos {BIO 6004746 <GO>}

In terms of the gas regulatory framework, this has to do with the South pipeline. I think we talked about changes that have to be done to the regulatory framework. So, there is a government, there are the agencies for the industry. This is a topic that has to be discussed in depth. It's not an easy task to do it, it's not an easy topic, and I noted that that during our presentation at IBT, but Petrobras will play a crucial role in discussing those models, given the fact that most assets belong to Petrobras.

We understand that the model where you look for divestment and the search for partnerships for our partners maybe it's not aligned with the way that the thing was modeled. But we need to offer probably look at other agents, are there other agents in the market not only for gas molecules, but are there other stakeholders looking for participation in this area, do they - are they looking for stake in this area? Well, what about the government's stake in terms of taxes and everything else. I think the debate is very serious. Now about timing for that model - do you have anything to say?

A - Operator

Thank you. Caio, I was pleased to hear your reference to the fact that you recognize the enormous efforts that we are undertaking. As we said before, that result was a one-off result and we do have still a good outlook in terms of reaching our target. So that's why we speak out of a very sound base. We indeed have to go through the first cycle, which is strategic planning in terms of the restructuring. And we will work on it and report our numbers in September.

But there is another concept that has to be well understood in our evaluation and that is about the E&P segment. Because this segment focuses on the results that are set-up much before it's cultivated. I mean, any change in investments today does not have an immediate impact now in 2016 or even in 2017. These investments have long-term returns. The business structure, it's hard to maneuver quickly, because it's a different industry. And so after all, we made important adjustments last year, in 2015, and we are now evaluating the impact for 2017. And all of the major decisions of 2017 already aligned, I mean, they've been taken - and this is what we have to do, especially when you make some very strong adjustments as we did in 2016.

But, Caio, we do not review all the final numbers, because there are still some decisions being made. And so, we will probably - we will tell you more by the end of September when we meet again.

Q - Caio Carvalho {BIO 16605563 <GO>}

Thank you very much.

Operator

Mr. André Natal from Credit Suisse has the next question.

Q - André Natal

Good afternoon, and thank you very much. Thank you for answering our questions. My first question has to do with the market share you're alluding, given the current Brent prices in Mexico and this is for downstream and also the entry of third parties and the inputs (59:30). You've been able to maneuver well in terms of third-party participation and you're operating at a lower utilization level and eventually you may at the same time lose share. So my question is, how far this can go or maybe this could reopen a debate about lower prices or maybe lower prices not to stimulate such a delicate position in volumetric terms. This is my first question.

The second question may be address to direct to Jorge Celestino, he has to do about the Comperj te Petrobras (1:00:19) you did some, you already did something in 2014 and now BRL 5.3 billion and one of the generating factors of that write-off in addition to some others related to cost of capital, et cetera, have to do with the postponement of the project to 2023. So given the fact that this already happened, so currently, we do not expect to do conduct a major margin review. We were taken by surprise, when you had another write-off or another sale of that project. What generated that write-off, is that probably related to costs of OPGM or cost of CapEx to build the refinery? And maybe that's what - you have a BPL of zero, even negative. Is that true or - and if that is true, if you do not see any good value to the project, so my question is what other business model you want to use, given the fact that the project is posting negative productivity close to zero. And the next question addressed to Solange, if you can tell me a bit about the new platforms for 2017?

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

Thank you. This is Ivan. Okay, two questions addressed to Officer Jorge and the others to Roberto.

A - Jorge Celestino Ramos {BIO 6004746 <GO>}

Good afternoon, André. In terms of paid off of market share and profitability with impacting utilization, and a factor of the refinery, I would say that we've been conducting constant analysis. And our projections are not representing any cause of concern. We are very comfortable with the situation and the profitability of the integrated operation of Petrobras. We were able to bring about the profitable levels. We've also been able to increase the stake of domestic oil in the entire oil basket, therefore, I would say that in the horizon of our planning, this has not bothered us. We are very comfortable with that operation. Please.

Q - André Natal

I just want to understand what is the criteria you look at when you make your judgment, whether you look at a comfortable processing level - I mean or 50%, which is - may not be feasible. What is the criteria taken into account for that decision?

A - Jorge Celestino Ramos {BIO 6004746 <GO>}

In fact, Andre, our model is the one that brings the best possible margins to the company. Petrobras is an integrated company. And as such, it tries to integrate its markets to its assets and

crude oil production. And this has to make the best economic sense to the company and its shareholders. Therefore, we do not have a physical metric or using a certain factor.

If we find in 50%, the best profitable margin, then 60%, that's what we would do, so our business model aims at achieving the best profitability ability possible to the company. So, this is what we've been using.

In terms of impairment of Comperj, our reading of this – or our projections or our forecast indicates that the long-term demand changes and so do long-term margins. All of our forecasts and our project portfolio indicates that we have – we would have to postpone or delay that undertaking. And to that end, we did the impairment of the asset. But we are still looking for partners, because there are opportunities. And this project can make sense to some partner, therefore, we're still looking for prospective partners.

A - Roberto Moro {BIO 6874823 <GO>}

In terms of transfer rights, as of last year, we've been working to improve the execution plan of the project. We encountered a very poor landscape in 2015. And therefore, we made improvements to our execution plan, we made contractual adjustments, or even we chose the buyback of shares. There are some instances where some of – when some of the contracts were non-performing, and so we review the contracts. We are now receiving equipment from this new content. We were able to escalate the phases of projects from one phase to integration. And it is – everything is within the margins that we allocated for the projects.

Q - André Natal

Thank you.

A - Operator

Thank you, André.

Mr. Felipe Guanais from Bradesco has the next question.

Q - Luiz Felipe Guanais {BIO 19933939 <GO>}

Good afternoon, everyone. I would just like to talk about the distributing company. In the North of the country, do you think that this would be an impediment for other investments and whether you could talk about increases in trade receivables? So, my question is about how do you see the impact of this in a large client?

A - Operator

Felipe, we had a hard time understanding your question. But I'll try to answer the best possible way. Any obligation agreed by in the past, our contracts foresees it. Any time there is any change in stake control, we have to be accommodating to accommodate for that change. And this – because this could be a factor of debt acceleration. So, any operations that implies in changes of control or stake holding – and I don't think that this will occur, but this could also decelerate the debt. The debt consists of two components, one component has been contracted which is the contract for debt and there is another contract that has been continuously be varied in terms of its payment.

Q - Luiz Felipe Guanais {BIO 19933939 <GO>}

Thank you.

Operator

Felipe Santos from JPMorgan has a question.

Q - Felipe dos Santos {BIO 16391255 <GO>}

Good afternoon. My question is to Solange. Solange, is there any constraint in the well productivity at pre-salt? Is this the maximum level you assume you will get? And what is the ideal limit you're working with within this possibility range?

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

Felipe, Solange speaking. Good afternoon. Well, productivity or yield takes two aspects into account, first, the reservoir from which the output comes, in terms of the right capacity or the volume to be flown (1:09:40) at a high speed. And the second question has to do with a well engineering. You have to design a well and that's a very complex engineering work.

So, I would say that up to now, our capacity to put together engineering and our best reservoir, our projection is that we might have 50,000 barrels per well. These are very special circumstances in which we need to put together high yield and also the right materials, diameters, facilities which enable us to resist environmental factors and promote the right outflow with the right speed.

Q - Felipe dos Santos {BIO 16391255 <GO>}

Thank you. So up to 50,000 barrels per well, is this the average or the standard? And if you reach such a high level, 35 million per day, if you get to 50,000 barrels per well, which is so high, do you already work with the assumption of having higher platforms compared to what you currently have?

Felipe, I would just like to highlight that the statement that I made is basically, due to the capacity - the production capacity of our reservoir. So, if you consider the same engineering of Campos Basin pre-salt, for instance, we wouldn't have this result. So, a highlight again that these opportunities are not found everywhere, including pre-salt it may vary a lot from a case-by-case basis. And that's why, I mentioned before the number of parts to be implemented, but only in exceptional areas.

I wouldn't say larger units, but maybe fewer wells in the unit, maybe that will be more profitable in our cost effectiveness. But if we analyze it well, I would say that we would be working with fewer wells and having mid-size systems, managed systems working fast for production purposes, but we're very mindful that we are specifically talking about one well.

Perfect. Thank you.

A - Operator

Thank you. Felipe.

Lilyanna Yang from HSBC has a question.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Thank you for taking my question. I have a couple of questions. The first question is about the business plan and the transfer of rights. Wouldn't it make sense to revise the production plan for the barrels with a transfer of rights regime? If I understood it correctly, possibly, Petrobras is not going to build before those starts to significant contribute in the cash flow, according to the current plan in three production platforms and the transfer of rights expected for next year.

The second question has to do with a local content. Could you quantify the penalties related to ANP? And what about the number of plans that have already been audited? Could you give us some color about interpretation about what is compliance, local content? To what extent can you - can have waivers to prevent penalties?

And my third question is about disposal of assets. You had this announced for Carcará. And it was not, if I'm not mistaken, in the original plan of BRL 50 million. So, what about the outlook of sales of assets after the announcement for Carcará, in terms of achieving the goal, or exceeding the goal, or any delay? Or wouldn't that make a lot of difference for investors, and the idea would be considering 2016 at CapEx for the sale of assets?

A - Operator

Good afternoon. The transfer of rights, we're still at a preliminary conversation stage. You mentioned many complex possibilities, but we don't have a final statement to say right now.

As to the local content, what the company has to share right now is that after so many processes, many audits have already taken place for exploratory blocks. 2005, 2007 and all the waivers filed by Petrobras at the ANP applied to all cases. And we have no response or further comment on it.

As to the investment plan, you particularly focused on Carcará?

You're right. It has always been part of our plan. It was never announced, but it was included in our investment plan in 2015. And we are working with this asset in this process for a while. There are several projects that are underway. And it was part of it, and we were successful in this investment and is still part of our goal announced by our CFO.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Perfect. Just to clarify about the barrels of the transfer of rights. If we only focus on the operation and the transfer of rights without taking into account the final price. What about the flexibility of the startup of (01:16:10). Is it really flexible?

A - Operator

Lilyanna, these discussions are only getting started. They are too preliminary. We are only considering the contractual aspects to address the discussion. We don't have anything else to share.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Okay. Thank you.

Operator

Pedro Medeiros from Citigroup has a question.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Thank you. Good morning, everyone. Congratulations on the results. I have a couple of questions. First question, is about the earnings of the second quarter and with the gradual comparison and the realization of price of the domestic REO in E&P. Could you comment more about it? We saw a lot of improvement in the difference of the realization price in domestic oil. Is this related to the scenario and volatility of oil prices, or would it be something more structural, with different prices, spread prices, realization prices, due to the interaction and the level of use by different refineries in the country or the increase in the quality - average quality of oil, and increased share of pre-salt?

Second question, Ivan, could you elaborate more about the stage and restrictions to conclude the deal with Chinese banks to release the credit agreement involving \$10 million that you announced in the cash as a potential balance?

And my third question is, Solange, could you give us more color about the possibility of having disposal of assets upstream domestically that might be equivalent in order of magnitude with the sale of Carcará field?

And my last question about Carcará. I don't know if you can disclose it, but I would like to understand if this access price of \$1.5 million to \$2.5 billion announced in the press release, is this a binary range depending on contingencies, or chances are the deal will be at an intermediate level? Thank you.

A - Operator

Pedro, thank you. Jorge Celestino is going to answer the first question. And I'll come back for the Chinese question. And Solange is going to talk about Carcará.

A - Jorge Celestino Ramos {BIO 6004746 <GO>}

When it comes to the realization of price for oil prices, basically, it is Brent. Brent in the third quarter – or in the second quarter was much higher compared to the first quarter. Think about the average numbers. January at \$33; \$39, March; \$42 in April; \$47 in June and in May; and \$48 in June. So, the difference is basically Brent.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Jorge, just as a follow-on comment, my question is more related to the difference with Brent price, because in 2013, 2014 and 2015, the average was pretty flat, \$11 difference on the realization price. And both in Q1 and Q2, it was between \$5 to \$7. Is this a new level, the new range, or is that a conjuncture that was affecting the result this quarter?

A - Jorge Celestino Ramos {BIO 6004746 <GO>}

Well, there is an effect, if you consider lighter oils on the list. When you use lighter oils – and by the way, in Brazil, if we consider to increase the share of domestic oil and this is lighter oil, at the end of the day, there is also an impact on spread.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Perfect. Thank you.

A - Operator

So, probably, we will have lower spread, lower than the average of the last three years going forward.

Well, not really, it will depend on what we have in the refineries. And it would also depend on the market conditions and also on Brent. Basically, that's it.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Thank you. Great. Thank you.

A - Operator

Pedro, with regards to the negotiation, we have three discussions underway with the Chinese banks. The China Development Bank, about \$10 million, another with \$1 billion, and an additional \$1 billion in another negotiation, and also \$2 billion in another operation. All these deals are properly underway.

With the China Development Bank it is a challenge, actually. We have two contracts in effect, \$10 million in 2009 and \$5 million in 2015. For 2016, the contract has exports volume and the discussion

with the China Development Bank is precisely about how we're going to create the necessary conditions. So, the commercial or volume of exports really meet our expectation.

Q - Pedro Medeiros {BIO 16187063 <GO>}

The format?

A - Operator

Well, we have information on REO prices in the market. And we offer this oil to the three companies. And one company leads the Chinese consortium. If the proposal is accepted, we offer the oil. And if it refuses we sell by the market price. We are having intense negotiations with this model in order to have better performance compared to what happened in the contract of 2009. That's why we haven't reached an agreement yet. For the next two banks, one had disbursement, and the other, we are still working to make it happen in the second half of the year. About Carcará, Solange is going to answer your question.

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

Good afternoon, Pedro. Our evaluation about Carcará, and perhaps other assets of the same size highlights something that we frequently share, in the sense that particularly for downstream, or better speaking, upstream, these numbers spawned from a very well qualified assessment of our portfolio. And when we see in our portfolio an opportunity to improve the company performance by optimizing our operations and considering improved cash flow then we select this divestment asset,

We might have all kinds of opportunities, but we really focus - is on the improvement of our portfolio in general. With regards to the range of BRL 1.5 billion to BRL 2.5 billion, particularly for the sale of Carcará, this is related to some events. The sale has an amount related to it, and conditions are related to events that will happen in the future. And we don't have a specific deadline or date.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Perfect. Thank you, very much.

A - Operator

Thank you, Pedro.

This concludes the question-and-answer session. Thank you very much. We give the floor back to Ivan de Souza Monteiro for the final remarks.

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

Thank you all for joining us today. And the IR department will be here to take any additional questions you may have. Thank you ladies and gentlemen.

Operator

Our audio facility will be available at www.petrobras.com.br/ir. This concludes today's conference call. Thank you very much for joining us. You may disconnect your lines. Have a good day.

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