

Y 2019 Earnings Call

Company Participants

- Andrea Marques de Almeida, Chief Financial and Investor Relations Officer
- Anelise Lara, Chief Refining and Gas Natural Officer
- Carlos Alberto Pereira de Oliveira, Chief Exploration and Production Executive Officer
- Roberto Castello Branco, Chief Executive Officer
- Unidentified Speaker

Other Participants

- Andrew De Luca, Analyst
- Bruno Amorim, Analyst
- Frank McGann, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Petrobras Webcast and Conference Call with Analysts and Investors concerning its Fourth Quarter 2019 Results. We would like to inform you that participants will follow the transmission by Internet and telephone only as listeners. After an introduction a Q&A session will begin and instructions on how to participate will be provided. (Operator Instructions)

Present with us today are Mr. Roberto Castello Branco, Petrobras CEO; Ms. Andrea Almeida, Chief Financial and Investor Relations Officer; Mr. Carlos Alberto Pereira de Oliveira, Chief Exploration and Production Officer; Ms. Anelise Quintae Lara, Chief Refining and Natural Gas Officer; Mr. Rudimar Andreis Lorenzatto, Chief Production Development Officer; Mr. Eberaldo de Almeida, Chief Corporate Affairs Officer; Mr. Nicolas Simone, Chief Digital Transformation and Innovation Officer; Mr. Roberto Furian Ardenghy, Chief Institutional Relations Officer; Mr. Marcelo Zenkner, Chief Governance and Compliance Officer, as well as other Company executives.

We will start by listening to Petrobras' CEO, Mr. Roberto Castello Branco, with the main highlights of the results. The presentation will remain available throughout the webcast and on the Company's Investor Relations website.

Please, Mr. Roberto go ahead.

Roberto Castello Branco {BIO 3193867 <GO>}

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Thank you. It's very pleasant to have the opportunity to exchange the ideas with you. Our (Technical Difficulty) performance was very good. The numbers are very clear, but we are in the oil business. Oil is a business with a long term horizon and so the strategy and the execution of the strategy is a key for us. And our strategy, as you know very well, it's a very simple one based on five pillars, five because it's simple to always to remind the strategic goals.

And second point is the execution. 2019 we delivered what we promised in terms of strategic execution. We went ahead with portfolio management, divesting \$16.3 billion of non-core assets, assets in which we are not the natural owners. On the other hand, we invested \$27.4 billion in our core assets and particularly, we invested in the acquisition of rights to explore and produce oil in ultra-deepwaters, with especially Buzios. Buzios is the largest offshore oil field discovered in the world, is a real world-class asset with significant reserves low cost -- low lifting costs, low risk as Petrobras is the best player in terms of understanding, knowing Buzios.

Petrobras was awarded by the Offshore Technology Conference due to its projects to explore Buzios. So it's an example how deep is our knowledge about these giant oil field. So it's an example how the portfolio can be managed very efficiently with a goal of creating value to shareholders.

And at the same time, jointly with a strong cash flow generation, we're able to reduce debt, we fed about \$24 billion in debt, reducing the -- this reduction combined with a very efficient corporate liability management. Petrobras was awarded as by the Latin Finance with best corporate liability management program.

We economized \$1.2 billion interest. Petrobras had a very heavy interest burden in the past. There was years where Petrobras paid about \$7 billion in interest to its creditors. It's more than is needed to invest in our production system, which is about \$5.5 billion. And this is very important for the future of the Company.

At the same time, we put in place more disciplined capital allocation, very rigorous criteria to approve projects. Our main concept is, projects have to compete for capital, capital is scarce. Funds will be allocated to projects on their own merits, not because we like this project, we dislike that. They have merits. And one of the most important metrics, they have to be resilient at a price of oil as low as \$40 per barrel. So we are -- with this we are on the safe side.

At the same time we are implementing several programs dedicated to increase significantly the rate of return on projects. We're able to reduce the ramp-up period of our platforms, FPSOs, to an average of nine months. We recently -- we employed an innovation, the use of a dry tow to drive our new FPSO, P-70 from China, from the Chinese shipyard to Rio. Instead of taking 100 days, the average in the past, it took only 45 days and time is key for rates of return on projects.

And we are implementing two projects that have the potential to revolutionize the oil industry. One is dedicated to increase significantly the probability of finding oil in an

exploration, to reduce practically to zero the probability of drilling a well and finding no oil.

And the other one is a project to shorten the period between the start of the exploratory phase to the first oil, or the pre-salt we had an average of 3,000 days, our goal is to reduce to 1,000 days. This is being executed. First results are very good. We are very enthusiastic about the future of both projects. That will place our rate of return of -- the rates of return of our products on another plateau.

And we are using -- we are starting to use digital transformation to help us with these projects even with activities in the corporate center using more data analytics, augmented reality, artificial intelligence. We have created a new division that's in charge, working very intensively in producing results in the short term. We are strengthening our high-performance computing capacity by the end of this year to be 10 times -- the capacity would be 10 times the one we had at the end of 2018.

These are several initiatives that are being executed. Last year, we announced the start of implementation of (inaudible). We concluded it, and this year, we are going to execute it to be not only a metric for variable compensation, but it's very important to identify inefficiencies in the various segments of the Company in order to be able to correct, then to eliminate these inefficiencies and to empower people, to feel people -- to make people to feel like entrepreneurs taking -- managing a small business and trying to be successful in their achievements, because they know that they will be compensated by their efforts. So this is the scenario.

In terms of environmental social and governance, I'd like to tell you that we have a strong focus in environment. We have a strong commitment with the decarbonization of our operations. Petrobras is second only to Equinor in terms of emissions per barrel of oil, and we will continue relentless to pursue the reduction of the emission of greenhouse gases. We are advancing in terms of carbon capture. Petrobras is a member of the Oil and Gas Climate Initiative, a non-profit institution of the oil and gas industry dedicated to sustainability in the world.

And in social terms we are focusing our activities in the social area, in the -- to preschool education with various programs dedicated to children between zero to six years of age because these are programs with a very high social rate of return. It's the contribution to Petrobras to reduce poverty in Brazil. Brazil still have many people poor, still have serious problems in terms of education. And education, as you know, is a very powerful weapon to fight poverty and to promote economic development.

And we are very happy to know that our improvement in terms of human rights. The corporate human rights benchmark that's published annually, promoted a significant increase -- significant improvement in the position of Petrobras. We had an index of 17.6 in 2018, now we are classified in 2019 last year with 46.6, much above the average for the structured industry. Mining and oil, it's around 29. So these are very good results.

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In terms of diversity, Petrobras saw Goldman Sachs saying that it's not going to work in IPOs with companies with no women in their boards. We have three. We have two Executive Directors, two excellent Executive Directors. The number of executive managers, women executive manager doubled from five at the beginning of 2019, now have 10. So we are not focusing only on value, on generating value to shareholders. We have also social concerns.

And last, but not least, in terms of safety, Petrobras set another benchmark for the global oil industry. The rate of reported accidents has decreased to 0.76 since a new benchmark for the industry. And we will continue to pursue better results.

But having said that, I'll pass to my colleague, CFO, Andrea Almeida for her comments on the financial performance of the Company.

Andrea Marques de Almeida {BIO 19358739 <GO>}

Thanks, Roberto. Very happy to be here to share with you some results. And I think Roberto already mentioned the most important ones from the year, but I will go into more -- maybe some into more detail.

So regarding the operating cash flow, we were able, in 2019, to reach \$25.6 billion and free cash flow of \$18.4 billion. Our EBITDA and net income had a solid performance of \$32.7 billion and \$10.2 billion, respectively. And we also managed to pay \$2.5 billion to our shareholders.

Our fourth quarter results were positively impacted by external factors such as Brent and exchange rates. Brent price increased by 2% and real depreciation by 4%. One of the greatest achievements of 2019 was the \$24.5 billion reduction of our debt. That reached \$87.1 billion. Important to highlight that this amount includes \$24 billion of the impacts that we got from IFRS 16 implementation.

Our leverage, measured by net debt to EBITDA, reached 2.46 times. Considering the IFRS 16, we know we've moved already, but we still have a big challenge to reach that 2.5 net debt that is the goal for 2020.

Despite the 9.5% drop in Brent prices, our recurring adjusted EBITDA increased 1%, reaching \$34.1 billion in '19, due to lower production costs, lower contingencies and the impacts of IFRS 16 adoption.

In a quarterly basis, our recurring adjusted EBITDA increased by 2%, reaching \$9 billion on the fourth quarter, due to lower production costs, the price appreciation of our oil streams and Brent prices.

The highlights of the EBITDA by business segments is the growth of the E&P and refining segments. In the upstream, we had an increase of 9%, reaching \$8.8 billion, mainly due to

higher production and the recovery in Brent prices. In the downstream segment, we had a strong increase of 68%, with the EBITDA reaching \$1.6 billion in the fourth quarter.

The drawdown of low cost inventories offset the lower margins of diesel, LPG and gas. The gas and energy segment was impacted by the increase of operating expenses despite better margins in natural gas.

The strong cash generation and divestments in the fourth quarter enabled us to acquire some blocks in the ANP auctions, especially the transfer of rights of surplus. We invested around \$18.5 billion in the quarter and managed to prepay \$5.9 billion in debt, including \$5 billion from the China Development Bank

As a result of our efficient liability management, in 2019, we reduced the cost of our debt to 5.9% per year, below 6%, and managed to increase the debt maturity to 10.8 years. In addition, given the availability of \$9 billion in revolving credit lines, our cash management and working capital optimizations, we established a new target for our minimum cash holdings of \$5.5 billion.

We have been extremely active in our liability management activities. And I would like to highlight some important financial transactions that were concluded in '19. The prepayment of \$24.9 billion, including buyback of bonds in banking market and the biggest one was China Development Bank.

Exchange of bonds amounting to \$3.7 billion with the original maturity between 2023 and 2029 for a new one more liquid bond that has a maturity in 2030, with an yield of 5.093%, the lowest since 2013.

We did -- receivable sales of Eletrobras receivables of \$2.1 billion and this was related to a debt that was going to mature in 2025. We issued debentures in the local market of about \$1.7 billion that continue to help us on the liability.

And last, but not least, we received from Latin Finance an award for the best corporate liability management program in 2019 in recognition of two global bond offers in March and the bond repurchase and offer in September 2019.

Our initiatives have contributed to improve our risk perception by the market. From the beginning of '17 and till now there was a compression in our credit spreads by 283 basis points. This is related to the 10-year bond. From April 2019 -- shifting from that to equity from April 2019 to February 2020, we concluded three important follow on offers reaching almost \$10 billion.

The first was the sale of BR Distribuidora shares, reducing our stake to 37.5%. It was the first privatization of a state-owned company done through the capital market. In addition, we had Caixa and BNDES secondary offers that showed the market's confidence in the implementation of our transformation agenda. After these transactions our free float

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increased from 36% to 49.5% and the number of shareholders increased significantly in Petrobras reaching 480,000 investors.

We have been working hard in order to reduce the Company's contingencies. We had important achievements in 2019, with tax and civil contingencies decreasing by \$11 billion. This reduction already includes the monetary effects of \$4.2 billion in the period, showing that our results were even more outstanding.

Now, I would like to update you about changes in our pension fund issues. Petros, that is our pension fund, has been both increasing deficit, and closed 2019 with a deficit of BRL30 billion. During 2019, we implemented important changes in order to improve management and governance. We want to approve a much more effective equalization plan that we will reduce the impact on employees proposing a new long-term defined contribution plan that is called internally PP3.

In the investments line, we continue to focus on developing the pre-salt. We invested \$10.7 billion in 2019 and effectively respecting the target that we set for the year. And if we add the signing bonus, our total invested reached \$27.4 billion.

Our net income reached \$10.2 billion in '19, an increase of 42%, mainly due to the capital gains on the divestments of TAG and BR. If we consider recurring net income, the result was slightly below last year, mainly reflecting the Brent depreciation, which impacted oil margins in 2019.

The quarterly results were impacted by impairment, usually concentrated in the fourth quarter, mainly due to the revision of the assumptions of the new strategic plan. The recurring net income increased by 25% compared to the third quarter. This growth was mainly due to higher oil margins as a result of higher price, lower costs and lower financial expenses.

We are paying \$2.5 billion to our shareholders. In 2020, we have the expectation to be around \$3 billion as already mentioned, on the Petrobras Day. In the future if we reach the total debt of \$60 billion, we expect to increase the payment of dividends to our shareholders. And at this point in time, we will be able to distribute 60% of the difference between operating cash flow and investments.

We have not yet reached the dividend yield of our peers. However, our total shareholder return outpaced our competitors, reaching 33% for the preferred ADRs, and 25% for the common ADRs.

I would like to highlight the tax divestment, which was as well awarded as the best cross border M&A transaction by Latin Finance. And I could not refrain from emphasizing the importance of our portfolio management process. In 2019, we were able to get \$16.3 billion of total divestments, with \$14.7 billion of cash inflows.

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In the fourth quarter of '19, we had some important developments. We signed two operations and we concluded an additional four transactions.

Now, we leave the floor to questions.

Questions And Answers

Operator

Thank you. The Q&A session will now get underway. (Operator Instructions) Our first question comes from Frank McGann, Bank of America.

Q - Frank McGann {BIO 1499014 <GO>}

Hello. Thank you very much. I was wondering two things. One on refining and the sales process that's ongoing now. If you could perhaps update us on what the latest is in terms of timing for the different phases of that process? And secondly, in terms of E&P and production levels for 2020, when do you expect that we'll really begin to see the effects of maintenance? Do you have any guidance you could provide in terms of which months are likely to see the most important levels of maintenance? And what potentials effects we could see in those months?

A - Anelise Lara {BIO 20915362 <GO>}

Hi, Frank. Regarding our divestment in the refining process, we are in the binding phase, means that now the potential buyers, they are evaluating the data information that they received about each refinery to make a binding proposal that we expect to receive by the second quarter of this year. We keep our expectation to have the SPA signed by the end of this year and to have the closing by the end of 2021, according to the antitrust authority, the document that we signed with CADE.

A - Carlos Alberto Pereira de Oliveira {BIO 19164278 <GO>}

Hello, Frank. This is Carlos speaking. About the maintenance effect that we are going to see on the production this year, in last month, generally, we didn't see this effecting yet. We produced about the same thing that we had produced December last year, around 3 million barrels of oil equivalent per day. But now this month, we have started with the stoppage of some platforms and we will start to see this effect. The effect will be mostly seen at the first semester of this year, when we are going to do the two-thirds of our stoppage, the number of the stoppages that we have planned for the year. So mostly, we are going to see the effect during along this first semester and we also see it beginning at this month of February.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. In terms of the number of platforms that are affected, how many are there, and what is the average time that each would come down for maintenance? Obviously, I realize it's different for each one, but the average effects might be for each unit that's affected?

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A - Carlos Alberto Pereira de Oliveira {BIO 19164278 <GO>}

Platforms (Technical Difficulty) stoppage that they arise, and on the average we could think about 15 days as the average figure for the stoppage. And number of platforms it's -- well, we will have 30 stoppages this year and 37 platforms.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Bruno Amorim, Goldman Sachs.

Q - Bruno Amorim {BIO 17243832 <GO>}

Hi. Good morning, everyone. I have just a quick follow-up on oil production in Brazil. Your production reached near 2.4 million barrels per day in the fourth quarter of 2019, while you are guiding for 2.2 million barrels per day in 2020. So I just wanted to understand, to what extent can this guidance be considered conservative? Even in light of the reliability, safety and integrity maintenance activities you intend to perform and asset sales in 2019 as a reference you over delivered on your targets provided in mid last year by roughly 4%. So is it fair to think that your guidance is a conservative forecast or not? Thank you so much.

A - Unidentified Speaker

No. We don't think it's conservative. In fact, what we do is that we have made a extensive analysis of risks and looking what we have faced last year, also the years before, and we decided to include it in our production, because now we are very well just at the beginning of the year, but some things can happen along the year. And when we looked back to the past and see what happens, so we decided that we should include this.

There are things that are generally are disruptive in our analysis of risk of lower prediction. So we have this -- we have considered this 200,000 barrels per day in our figures for the year 2020 and it has to do with the integrity, safety and reliability of our systems. And in this figure we -- if we can split all the factors that had contributed to this 200,000 barrels of equivalent per day less on the production, we could split as 40% that has to do with what we call the SSCC CO2, the cracking corrosion factor based on the CO2 on the -- for the -- it has to do with the inspection and maintenance of the sea pipelines. It's around 40%. 40% has to do with the production stoppage on the pre-salt platforms. And 20% has to do with the production stoppage that we will have on the post-salt platforms. And we also related this 20% to the agreement that we have made with IBAMA and where we have to put some injection water plants on the platforms.

So it's splitted in this fact. But going back and going straight to your question, we still think that the production that we have set for the year 2020 is correct. We will see what is happening during the year. For sure, we had a very good production at the beginning of the year, although, we don't -- we have already sold the Tartaruga Verde, the 50% of the

Tartaruga Verde, and also the assets that we have in Nigeria, but we have to wait. But so far we think that the figure is very good, what you have said.

Q - Bruno Amorim {BIO 17243832 <GO>}

Thank you. And just a very quick follow-up. So, I guess you do maintenance every year, right. So can you please confirm this 200,000 barrels is on top of what you usually do in terms of maintenance, or is it the total maintenance impact you expect for the year, including what you would usually do in, let's say, a normal year?

A - Carlos Alberto Pereira de Oliveira {BIO 19164278 <GO>}

It's also included, is all included. And the target for the year 2020, we included all the maintenance that we have for the year.

Q - Bruno Amorim {BIO 17243832 <GO>}

Okay. And then can you give us an idea of how much is the usual impact of maintenance on production? I understand this year maintenance will impact production to a greater extent than what's the usual number. So usually how does these 200,000 number look like in a regular year let's say?

A - Carlos Alberto Pereira de Oliveira {BIO 19164278 <GO>}

For the year 2020, it's what I mentioned, 40% of the figure 200,000 barrels per day is due to the maintenance of the pre-salt platforms and 20% related to the maintenance of the post-salt platform. So we could consider something like 120,000 barrels of barrels of oil equivalent per day for the year 2020. That's the figure related to the maintenance of the platforms.

Operator

The next question comes from Andrew De Luca, Barclays.

Q - Andrew De Luca {BIO 18025129 <GO>}

Yes. Hi. Thanks for taking my question. I wanted to ask on LME. So there was some interesting color you guys provided on the Portuguese call. You mentioned that you're looking to reduce the cost of funding to about 5% from where you are, a little bit under 6% at the end of the quarter. But at the same time, if we look at the last transactions you've done in the market, there has been reluctance from bondholders to tender bonds just because how comfortable they are with the Company's trajectory.

So if I'm not mistaken, you mentioned on the Portuguese call you're looking at creative ways to reduce your debt and maybe increase these participation rates for future LME transactions. Is there any other color you could provide from the comments that you provided on the Portuguese call and maybe any sense of timing for these transactions? Thank you.

A - Andrea Marques de Almeida {BIO 19358739 <GO>}

So we will have to be creative for the reasons you just mentioned. Now it's hard, nobody wants to sell us back the bonds, that they have a high return and definitely, now we will be issuing lower yield to maturities that's the reality of Petrobras moving forward. So when I say we will have to be creative, is we will have to give investors something different, maybe a more liquid bond and buyback with some cash. We will have to -- or maybe explore a window of time and always giving the bond that is this -- like closer to the maturity that the bondholder has.

It's hard to tell you when those things are going to happen because those things are totally related to the windows of opportunities that we have in the capital markets. What I can tell you is, right now, it has been amazing liquid the market at the beginning of the year. So there is opportunities right now, but I'm not saying we will do something right now. We are just saying that the beginning of the year has been really positive for people issuing new transactions with a very low, I would say, yields compared to the past.

We will explore those opportunities, but it's not just about capital markets. It's about renegotiating the debt we have in the bilaterals, and this is every day work. So we already did some this year and we will keep doing that. So the bilaterals, that we have flexibility to buyback, we will be always negotiating them to increase terms and reduce amount outstanding, reduce the interest on them, and increase the maturities on them. It's going to be our work, I would say, in the next two years, forever may be.

Q - Andrew De Luca {BIO 18025129 <GO>}

Great. Thank you very much.

Operator

The next question comes from Mohammed Gulan [ph], Raymond James.

Q - Unidentified Participant

Hey, guys. Thank you for taking the question this morning. So several of the large global integrated oil and gas companies have recently made pretty ambitious announcements regarding the reduction of carbon emissions, some of them even going as far as targeting net zero emissions. Can you talk about any specific goals you guys might have and can we expect this similar enough from you guys in the foreseeable future?

A - Roberto Castello Branco {BIO 3193867 <GO>}

Hello, Mohammed. Thanks for your question. If you want I can announce now that Petrobras will have zero emissions by 2050. I won't be here, and you won't be there. So I can make any announcement for 2050, but let's go to the real world, let's be frank. First, we are not investing in renewables right now because we are very humble guys. We don't have the competence to thrive in this type of business. It is different from oil. In oil, we are the best, but we are not going to lose money just because European companies are doing so and so. We have 10 commitments to sustainability, zero growth in absolute operating emissions still 2025. I hope I'll be still alive in 2025. Perhaps not as CEO of

Petrobras, but Petrobras will be here. And you'll continue to be in the financial industry. Zero routine flaring by 2030.

And we are committed also to carbon capture. We have a store of carbon capture. Our goal is 40 million tonnes of CO rejection by 2025, and 32% reduction in carbon intensity in the upstream segment by 2025. So there is a list of 10 commitment. You can find it in our presentation for the announcement of the strategic plan. Earlier in the Petrobras Day 2019, we made this presentation at the NYSE and London as well. But that's how we are.

And last but not least, I'd like to tell you that Petrobras in terms of carbon mission by barrel of oil is second only to Equinor in the global oil and gas industry. That's it. And regarding renewables, we are investing in research and development, trying to acquire the competencies for the future. If you go for this business, we will go to win, not to lose.

Q - Unidentified Participant

Okay. Good answer. Thank you. That's all from me.

Operator

Thank you, all. At this time, the Q&A session of Petrobras webcast and conference call is over. Mr. Roberto Castello Branco will now make his final remarks. Please go ahead.

A - Roberto Castello Branco {BIO 3193867 <GO>}

Well, I'd like to thank you for attending our conference call. It's always a good opportunity to exchange idea, to hear your questions, to have the opportunity to be more transparent. Transparency is one of our goals. It's very (inaudible) to the reduction of cost of capital and we'll be very open to your questions at any time. You are very welcome to our offices, or we will organize a visit to one of our operations this year.

And my message is that we are strongly committed to make Petrobras a much better Company. Our goal is to become the best energy company focusing on oil and gas in terms of value creation to shareholders. Thank you for your attendance.

Operator

Thank you. The audio of this conference call for replay will be available on Petrobras' Investor Relations website at www.petrobras.com.br/ir. Thank you very much for your participation and have a great day.

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