

# Petróleo Brasileiro S.A (Petrobras)

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## Executive Summary

Ticker Symbol: PBR

Sector: Commodities/Oil & Gas

Price Target: \$26.00

Current Price: \$13.37

Recommendation: Buy

Investment Thesis:

PBR's strong cash generation and solid fundamentals, with the company dominating every sector of the O&G industry in Brazil, makes the company discounted to its fair-value price even when pricing in short-term capex expenses and the "Brazil-Risk".

## Company Overview

Business Description:

Petrobras, or Petróleo Brasileiro S.A., is Brazil's largest energy company and a global leader in offshore oil production, especially in deepwater and ultra-deepwater fields, where they have some of the most advance exploration technology in the world. It is majoritarily-owned by the Brazilian government, though it operates with a publicly traded structure in NY and in São Paulo. The company focuses on exploration, production, refining, and distribution, primarily within Brazil, where it has a vertical monopoly over the entire production process.

Management/oportunities:

The CEO of the company is appointed by the president of Brazil and the board has the Brazilian Bank of Development as its largest shareholder. This is cause for concern for many because the company was frequently used as a political tool in the past. Recently, congress passed a law that allowed the management to arbitrarily define the price of gas sold in the country, meaning that if the price of oil rises and the government wants to keep its popularity, gas will still be sold for cheap, affecting 73% of the company's FCF generation.

Management has been focusing on repaying their substantial debt of 26B dollars that came from the construction of new drilling sites and refineries. This has been done successfully and their debt is the lowest since 2008. This, however, has not undermined its Capex spendings, with 6B spending in the first half of 2024

Production of oil has grown modestly at 2% YoY driven by a ramp up in production in the Santos and Campus basins, with 12 new wells in total. Volume of refined products, however, has decreased 3%. Overall production went from 2.64 to 2.7 Million Barrels of oil a day YoY.

% Of oil extracted from the Pre-Salt level has reached an all time high and speaks to the company's commitment in exploration technology and in harnessing this layer of exploration in which they dominate the market

Management has also been focusing on the payment of dividends, with the company having an average dividend yield of 10.6% in the past 5 years.

The way the company operates, it pays most of its costs in BRL, including COGS and SG&A, and has its revenue tied to the price of oil in USD. This allows for the company to have a better profit margin than its competitors.

The company serves as the main vehicle for international investors to invest in Brazil/have exposure to the country. As Brazilian markets become more attractive to international investors in the coming years, influx of money going into PBR will increase and so will the stock price

The company suffered a non-cash expense of \$5.7 Billion due to changes in exchange rates and adherence to a tax transition with the Brazilian government. None of this affected the cash flow

## Industry Overview and Competitive Positioning

Although it is common thought that oil consumption has gone down since the world started to shift towards green energy, this figure is not true. From 2010 to 2023 oil consumption has gone from 86mb/d to 100mb/d, even with the strong subsidies to green energy and marketing campaigns focusing on renewables towards the end of the 2010s and early 20s (namely the inflation reduction act and the market's push for ESG investing).

Petrobras is responsible for more than 60% of Brazilian oil exports in a yearly basis and holds not only the most amount of oil fields in the country, with a proven reserve of 10.9 Barrels of Oil, but has the infrastructure presence and logistics to outcompete any other big oil company that tries to dispute their dominance in the Brazilian oil industry. With such a big barrier to entry, Petrobras is king in this bracket and region

## Financial Analysis

### Income Statement Highlights:

- **Revenue** for First 6 months of 2023 x First 6 months of 2024: 47,235M x 49,750M. Driven by lower oil prices during the semester

- **EBITDA** Q2 2023 x Q2 2024: 25,392M x 21,754, driven by higher operational costs and lower revenue

- **Net Income** Q2 2023 x Q2 2024: \$5,859M x -\$325M was severely affected by the \$5.7B accounting adjustment regarding exchange rates and new tax adherence. Without it it would be \$3,945B

### Balance Sheet Overview:

- **Current Ratio:** 0.89

- **Debt to Equity Ratio:** 88%, with a 6.5% average interest rate and 11 years to maturity on average

- Lowest financial debt since 3Q08, at \$26.3B

#### Cash Flow Analysis:

- **Cash Provided by operating activities:** 1H2023 x 1H2024: \$19,989M v \$18,473M

- **Free Cash Flow:** 6M 2023 x 6M 2024: \$14,637M x \$12,695M (\*see “valuation” point 3 for more),

- **FCF in the TTM** = \$29,145M

- **Analysts’ expectation for FCF in FY 2025:** \$13,890M, driven by higher operational expenses and capital expenditures in order to improve its Pre-Salt infrastructure, development in virgin wells and energy transition initiatives. A lower price of the oil barrel \$75-\$79 will also hurt their top line

#### **Valuation:**

- **EV/FCF analysis:** PBR: 6.46 /// XOM: 15 /// SHEL: 7.66 /// CVX: 15.40

Method Used: Reverse DCF valuation

- Assuming it’s FCF in the TTM of 29,145 Billion USD, a 0% FCF growth over the next 10 years, a terminal growth rate of 1.5% (in line with the US’s GDP growth) and an extremely conservative discount rate of 17% per year (average of market being 10%), the stock should be trading at \$27.10

- Using its current share price and assuming the same stats for WACC, and TGR but applying next year’s expected FCF of \$13,890M, we arrive that the share price should be trading at around \$12.87, a slight decline compared to today’s price of \$13.37, which could be a cause for concern

- Using these conservative assumptions, the company is currently valued in a FCF decline of around -15% CAGR for the next 10 years, which, considering everything stated above, including the opportunities the company has and their risks, seems like a overreaction by the market

#### **Risks**

- If the brazilian government either uses the company as a populist mechanism to please brazilian voters by decreasing the price of gas (and thus PBR’s margins) or is involved in any kind of scandal in the next few years, the company will lose confidence from international investors and have a margin compression, hurting both FCF and influx of money into the stock

- If the price of oil decreases, the margin of the company will be hurt. Considering the company’s ability to generate cash and its BRL-USD cost-revenue advantage, this can be offset and will hurt PBR’s competitors more than they will PBR. Since BRL price is usually inversely proportional to Oil’s, the company’s cost in USD will also go down as the revenue declines with lower oil prices.

- If investments in Capex in order to keep up with the cutting edge oil exploration technology are higher than expected, cash generation will be hurt in the short-medium term

## Conclusion

### **BUY.**

Considering PBR's gigantic MOAT in the Brazilian Oil sector with an incredible dominance in every field of the industry (downstream, midstream and upstream), its quasi-monopoly allows for the company to have a robust cash generation and reward shareholders through generous dividends. Even with high capex expenses projected for the near future, the reverse DCF projects a positive upside and this is supported by comparing the company to its peers' fundamentals. Finally, the company's cost advantage caused by currency contributes for the company to be a great buy even with looming risks on the horizon

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### Sources:

- PBR's Investor Relations Website
- US Energy information administration (EIA)
- Trade.gov
- Yahoo finance
- Y Charts
- Marketscreener
- Morgan Stanley