

Stock Statistics

Ticker	PBR
Exchange	NYSE
Financial Year End	December

Market Price *	\$20.94
Market Cap (\$ bln) *	97.04
52-Week Hi / Low	\$78 / \$14
Average Daily Volume	> 30,000,000

* As of previous day close

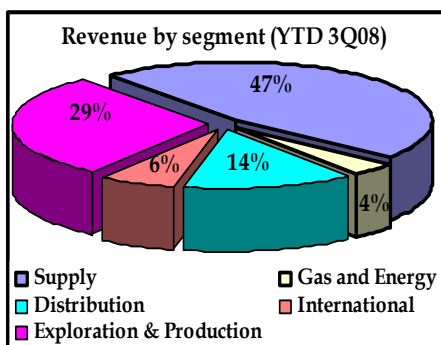


Source: Reuters

Company Description

Petroleo Brasileiro (PBR), also known as PetroBras, is a Brazilian integrated oil and gas company. PBR is engaged in the exploration and production of oil and gas and in the refining, processing, trade and transport of oil and oil products, natural gas and other fluid hydro-carbons. As of end FY07, PBR had 109 production platforms -- 77 fixed and 32 floating; 14,200 productive wells, 70 rigs (43 offshore) and 15 refineries. PBR operates > 23,000 km of pipelines. PBR daily production of oil is 1.9 mln barrels per day (bpd) and 2.3 bln cubic feet of natural gas per day.

PBR operates in Argentina, Bolivia, Colombia, Ecuador, Mexico, Peru, Venezuela, US, Angola and others. Argentina is the most significant, representing ~ 43% of its total international crude oil and natural gas production and 33.3% of its international proved crude oil and natural gas reserves as of 12-31-07.



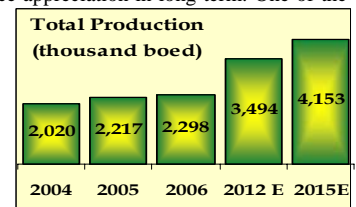
Note: There were 15 ADRs in our 12-01-08 Energy sector report. Those were in order of descending market cap: **BP** UK, **TOT** France, **RDSA** Holland, **E** Italy, **PBR** Brazil, **STO** Norway, **CEO** HK, **REP** Spain, **SSL** South Africa, **PTR** China, **SNP** China, **CGV** France, **PZE** Argentina, **ACGY** UK and **BAK** Brazil.

Investment Recommendation – Buy / 3-5 year target: \$40-\$50

PBR ranked only # 120 (out of 150) in our Energy sector report from December 1st but this is a special situation of sorts (new and significant discoveries) and we explain this in detail below. On July 23, 2008 we increased our under-weight in the Energy sector (and remained under-weight since then) when we added two high-beta names (CHK at 1.21X and PBR at 1.77) and dropped three less volatile names (COP at 1.14X, NBR at 1.32X and E at 1.04X). In my July 23 e-mail, with crude oil already trading 15% off its high at \$124, I wrote the following ... *I think there is a distinct possibility that oil prices may be where they are today 5-10 years from now -- it is not possible to be bullish on the sector with that view.* PBR, CHK, NBR, E and COP have all declined sharply since then down 67%, 70%, 69%, 37% and 40% respectively. Crude Oil has dropped 59% (since July 23) and Natural Gas has dropped 34%. We recently removed our bias towards Natural Gas as the price ratio between crude oil and natural gas collapsed (as expected) from 14X to 8X. PBR expects to deliver a 4% increase in its production growth in Brazil in FY08 and double-digit growth in FY09. PBR is one of the few major integrated oil companies that will be able to show such significant growth going forward. With the collapse in commodities price, the risk-reward is a bit more attractive for the long-term.

Investment Summary

- Strong production growth** - PBR has one of the strongest fundamental investment cases among global oils, which should continue to support its stock price appreciation in long term. One of the key factors is its strong production growth momentum. PBR expects to deliver a 4.1% increase in its production growth in Brazil in FY08 and significant (double-digit) growth in FY09. PBR is also bullish regarding long-term production growth from the pre-salt reservoirs. PBR will start its new operating systems P-51, P-52, P-53, P-54 and Cidade de Niteroi starting in Nov-08 and Jan-09. This will collectively provide 718,000 barrels per day (bpd). PBR has also planned new platforms that are expected to ramp-up in the near future. All of these new platforms are expected to add extra bpd of new production.
- New explorations -- long term growth driver** - PBR had significant and consistent success with oil finds in this year. In Nov-07, PBR found the *Tupi* oil field -- the **third largest oil field in the world** estimated to have ~ 5 – 8 bbl of light oil which is expected to raise Brazil's oil reserves by 62 %. At the beginning of FY08, PBR discovered *Jupiter* another oil field – this discovery was followed by two more massive oil field finds in San Paolo and the Tupi region. The list of its recent discoveries doesn't stop there - in Nov-08, PBR discovered oil in an off-shore well in Campo's basin and then (along with Norway's Statoil-Hydro) found off-shore oil in the Jequitinhonha basin. We expect that these new findings will provide enormous support to PBR's long-term earnings.
- Devaluation boosted 3Q08 results** - During 1H08, when oil prices were peaking, PBR was unable to generate a record breaking profit as oil price and exchange rate moves off-set each other. In fact during 3Q08, instead of getting negatively impacted by lower oil prices, PBR actually benefited by the rising dollar (and Brazilian *Real* devaluation). The 20% devaluation Q/Q helped PBR increase its financial income by R4.4 bln to R10.9 bln. This helped PBR lower expenses while its revenue in Brazilian currency has remained constant. This led to improving margins and cash flow on imported products. PBR management believes the on-going lower oil price environment will not materially impact its future results going forward. The Brazilian Real is currently = US \$0.41



Investment concerns / continued on pages 2, 3 & 4

- PBR stock over-sold on tumbling oil price** - Oil companies' share prices have been falling for the past six months impacted by economic turmoil and sliding crude prices, down more than 65%, since the July peak of \$147. Presently crude oil is traded at \$50.36 per barrel and expected to continue in its downward trend in the near-term. Any significant downward trend in the oil prices may adversely impact the cash flow and earnings estimates of the company.
- Government intervention** – The Brazilian gov't owns > 50% of PBR resulting in a lack of voting rights to shareholders. The gov't appoints most members on the board of directors.
- Currency fluctuation** - exchange rate volatility could have a substantial adverse impact on PBR's financial condition, operations and results because most of its revenues are in the Brazilian currency and a large portion of its liabilities are in foreign currencies.

Peer Benchmarking

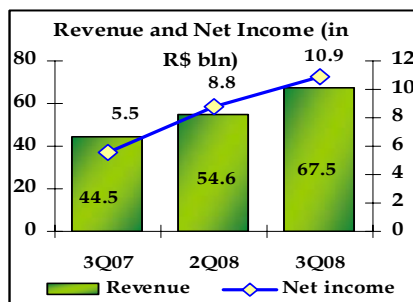
Tick / Mkt Cap	5-Yr. ROE	P / E (ttm)	P / Sales	EV/EBITDA
PBR / \$86B	33.9 %	7.6	0.69	4.6 X
BP / \$152B	22.7 %	5.1	0.38	3.1 X
XOM / \$386B	31.1 %	8.6	0.79	3.9 X
RDSA / \$91B	25.5 %	4.8	0.19	2.1 X

Financial Analysis

Reuters estimates - Reuters estimates FY08 revenue at \$112.2 bln, EBITDA at \$36.1 bln, net income at \$19.5 bln and EPS at **\$4.51**. For FY09, consensus estimates revenue at \$97.2 bln, EBITDA at \$32.6 mln, net income at \$16.6 bln and EPS at **\$3.43**. In FY10, revenue is estimated at \$97.9 bln, EBITDA at \$33.9 bln, net income at \$16.6 bln and EPS at **\$4.00**. Annual capital expenditures are estimated at \$23.2 bln, \$22.1 bln and \$23.3 bln for FY08, FY09 and FY10, respectively.

Note: The estimates in this Reuters section will not always match estimates on the right side, as those are from an independent forecasting service.

Strong revenue and record net income growth - PBR reported 3Q08 and FY08 YTD total revenue of R\$67.5 bln and R\$169.0 bln, reflecting Y/Y growth of 51.7% and 35.0% respectively. The growth has been supported by higher price realizations for crude oil, higher volumes, increased import and foreign exchange impact.



Consolidated net income in 3Q08 reached the record level of R\$10.9 bln, 96% above on the same period in FY07. This result was chiefly driven by increased production, the higher average domestic and export oil product sales price and foreign exchange gains. YTD FY08 total net income also reached a new record reflecting 61% growth versus YTD FY07.

Higher lifting costs - During 3Q08 and YTD FY08, PBR reported a Y/Y increase of 71.5% and 45.4% in its cost of goods sold respectively. The sharp increases were caused by higher lifting costs and production taxes. For 3Q08 and YTD FY08, lifting costs in Brazil without government participation was US\$10.2 per bbl and US\$9.6 per bbl respectively, up 33% and 30% respectively from last year's US\$7.65 per bbl and US\$7.40 per bbl respectively. Total lifting costs inclusive of the government were US\$30.27 per bbl for 3Q08, 50% higher Y/Y, reflecting higher taxes caused by a 70% increase in the average Brazilian oil price and the higher tax rate on the Roncador and Espadarte fields. For 3Q08, International lifting costs increased by 23% Y/Y.

Margins impacted during 3Q08 - The increase in revenue during 3Q08 was mostly offset by increasing COGS, adversely impacting total gross profit margins of the company. PBR reported gross profit margins of 30.7% in 3Q08 versus 38.7% and 38.9% in 3Q07 and 2Q08 respectively. YTD FY08 gross profit margins were 35.0% vs. 39.7% in YTD FY07. EBITDA margin in 3Q08 declined to 23.2% (the lowest level since 4Q02) compared to 29.4% and 33.2% in 3Q07 and 2Q08 respectively. EBITDA was impacted by the increase in gov't take and import costs, as well as the liquidation of inventories acquired at a higher cost in 2Q08.

Balance sheet - At the end of 3Q08, PBR showed R\$10.8 bln cash and cash equivalents on its balance sheet. Total debt at the end of the latest quarter was R\$48.3 bln, up 15% versus R\$41.9 at the end of 2Q08. Net debt at PBR rose by 21% versus 2Q08 due to the depreciation of the Real and increased funding for the SPEs impacting its level of indebtedness -- Net Debt: EBITDA, which increased to 0.59X in 3Q08 versus 0.48X in 2Q08.

Lower Free Cash Flow - PBR total FCF declined in 3Q08 to R\$494 mln impacted by higher capital expenditures. In 3Q08, total investment amounted to R\$34.05 bln, up 11% versus the Q3 2007 total.

Short term loan - PBR's R\$2 bln short term loan from Caixa raised concern in local press regarding the liquidity at PBR. We expect the authorization from the federal government will help PBR to reinforce its working capital needs and capital expenditure program.

Financial Summary

	FY2007 A	FY2008 E	FY2009 E	FY2010 E
Summary Income Statement				
Revenue	87,735	100,957	116,171	133,678
Gross Profit	35,618	41,100	47,293	54,420
EBITDA	26,074	30,146	34,689	39,916
Interest Expense	2,190	2,486	2,730	3,105
Pre-tax Income	19,064	22,315	25,723	29,562
Net Income	13,138	14,459	16,600	19,020
EPS	\$2.99	\$3.30	\$3.78	\$4.34

Summary Balance Sheet

Cash and equivalents	7,254	6,991	6,991	6,991
Long-term Debt	17,245	20,738	20,738	20,738
Total Debt	21,895	28,204	35,137	43,151
Net Debt	14,641	21,213	28,146	36,160
Shareholders Equity	65,179	75,448	87,333	101,110
Total Assets	129,715	150,532	174,535	202,017

Summary Cash Flow

Cash from Operations	22,664	16,005	18,905	21,610
Capex	(20,978)	(24,851)	(28,418)	(32,626)
Capex, net	(20,978)	(19,617)	(22,352)	(25,612)
Free Cash Flow	1,686	(3,612)	(3,447)	(4,002)
Cash Dividends	4,003	4,299	4,826	5,352

Key Ratios

Revenue Growth Y/Y	21.3%	15.1%	15.1%	15.1%
EPS Growth Y/Y	2.4%	10.4%	14.5%	14.8%
Gross Margin	40.6%	40.7%	40.7%	40.7%
EBITDA Margin	29.7%	29.9%	29.9%	29.9%
Debt/EBITDA	0.84x	0.94x	1.01x	1.08x
EBITDA/Interest exp.	11.91x	12.13x	12.71x	12.86x

US\$ million, except EPS

NM: Not Meaningful

Significant Developments

11/26/08 **No intention to buy Repsol stake** - PBR denied published reports that it was poised to take a stake in Repsol (Spain).

11/20/08 **New discoveries** - PBR has completed the drilling of two new wells in the pre-salt layer off the coast of Espirito Santo and proved a discovery of light oil. 30 degrees API, in the area called Parque das Baleias.

10/31/08 **Strategic deal** - PBR has signed a 32-year oil exploration and production deal with Cuba's Companhia Cubana de Petroleo.

10/31/08 **Credit financing** - Brazilian central bank granted PBR, the authority to contract BRL 8 bln (\$3.88 bln) in credit for funding its investment plans.

10/31/08 **Transfer of rights** - State run oil co. PetroEcuador gave final authorization to PBR to formally transfer 40% of its rights in Ecuador to Japan's Teikoku oil co.

10/30/08 **Delay in fleet expansion plans** - PBR and its Transpetro logistics unit will delay expansion of the company's fleet. Deliveries of ships and platforms already contracted as well as tenders planned for later this year will be delayed by at least 12 months.

10/19/08 **Reorganization** - PBR's board of directors has approved the proposal for the incorporation of its wholly owned subsidiary 17 de Maio participacoes S.A.

10/15/08 **Oil discovery** - PBR announces that an oil discovery has been made in Block 15/06, in deep Angolan waters.

10/08/08 **2nd light oil discovery** - PBR discovered light oil in Santos Basin South Pole.

Standpoint Research 155-Variable Model / Quantitative Analysis with Fundamental & Subjective Overlay

This recommendation was generated from the December 1, 2008 **Energy-150** report. Please refer to the "Legend" sheet in our Excel reports for the color code and description of all 155 variables used in our model. The 155-variable scoring is summarized in the 32 categories below (from roe through peg). The number in each of the cells, is the rank out of 150 stocks from the December 1, 2008 report in the respective category. The seven cells to the right of the peg cell are coded and for internal use. A weak score on P/S (ps) can be offset by a strong score in Net Profit Margin (npm). A weak score on return on equity (roe) can be offset by a strong score on price-to-book (pbk). A weak score on technical indicators (especially at the extremes), is looked at positively if it is combined with strong scores on fundamentals and valuation.

rank	ticker	roe	roa	roc	ebitda	npm	acct	eps m	rev gr	eps gr	beta	debt	stab gr
120 / 150	PBR	56	58	96	101	95	105	124	55	135	135	49	85

div I	pbk	base	rel-ma	inside	safe	pcf I	pcf II	fcf	div II	rel str	pr mo	ps	rel ps	off hi-lo
121	61	56	24	56	36	27	130	94	48	110	31	89	114	31

pred	pertix	perhis	blend	peg	deducts	t val	t fund	t prop	t misc	t tech	t score
102	68	120	80	141	6262	2153	2171	789	984	165	43.59%

PBR does not score well on our 155-variable computer model. That being said, this is a special situation (new explorations) and a few of the marks on their color-coded profile above can be disregarded. At the time we ran our model, there was no estimate for 2009 EPS, so there was no PEG ratio (peg) for PBR. PetroBras has a very high beta of 1.77X and the model weighs that negatively. That being said, with the market trading closer to its low than to its high, high-beta may be a positive for long-term investors who can take additional short-term paper losses if market declines continue. PBR is an ADR, so there is no Earnings Purity (acct) figure for them and that is another mark that dragged PBR's ranking down. There are a few other marks I have decided to overlook here – this is one of the few companies that will double production over the next ten years, and that overshadows the negatives most of which are a function of the industry as opposed to stock specific.

In late November, PBR drew from Banco do Brasil for financing, borrowing 751 mln reais (\$323 mln). The loan was in addition to the 2 bln reais that PBR borrowed from state-owned discount bank Caixa Economica Federal last month to pay taxes. Chief of Staff Dilma Rousseff said PBR is not in financial trouble and the company borrowed money from Caixa Economica because it had a cash-flow problem. **This is a volatile stock** and recommended only for those looking to reduce an under-weight in the sector. There may be additional 20% downside risk here if the market re-tests its lows and/or crude oil and natural gas prices decline further. PBR has already lost 75% off its high. We need crude oil and natural gas prices to bounce 30% from here over the next 3-5 years in order to realize good returns in PBR shares. The stock should be held for at least three years or \$40 whichever comes first. **Note: I am basing the \$5.00 (2012) EPS estimate and \$40+ target on an average natural gas price of \$7.50-\$8.50 and crude oil average price per barrel of \$65-\$75, both are conservative forecasts below consensus.** PBR recently denied published reports that it was poised to take a stake in Spanish oil company Repsol. Local newspaper Gazeta Mercantil recently reported that PBR was among the possible suitors for a 30% stake in Repsol currently held by several Spanish companies. REP mkt cap is \$22B.

In late November, PBR discovered significant recoverable oil reserves of 1.5 bln -2.0 bln barrels in fields first discovered last year in Brazil's coastal waters. The new find is in a so-called pre-salt field in the Espirito Santos Basin and is likely to add to speculation about the overall size of Brazil's oil and gas reserves. PetroBras has distanced itself from statements made by government officials who said the entire formation might contain **more than 100 bln** barrels of oil and natural gas equivalent. If true, this would be enough to put Brazil ahead of Russia and Kuwait in the league table of oil-producing nations. Brazil has proven reserves of ~ 14.4 bln barrels of oil and natural gas. Petrobras suggested that the formation may contain more oil and natural gas than previously thought. It said the "excellent" results of two new wells sunk to the north and south of a test well operating since September would lead it "to intensify studies in order to accelerate production from the pre-salt formation in Espirito Santo".

PBR Q3 results released three weeks ago, were not well-received and shares have under-performed since that news. The firm is leveraged and this is a double-edged sword. It helps when commodities prices are elevated and back-fires when prices collapse. The situation at PBR may get a bit worse before things get better. I would not jump in with both feet unless you are looking to reduce an under-weight in the sector and have a long-term time horizon. Foreign exchange volatility helped results and was responsible for much of the difference between actual and expected results. Expenses and net debt were both significantly higher and operational cash flows were negative. **PBR is relying on leverage to fund rising capital expenditures** and the stock market has not accepted this favorably. Oil prices will have to recover and expenses must come down before these shares go back in favor.

PBR 3Q net profit rose 97% to a new quarterly record on higher domestic fuel prices and a weaker Brazilian currency. PBR posted a third-quarter net profit of 10.9 billion Brazilian reais (\$4.9 billion), up from BRL 5.53 billion in the year-ago quarter. PBR attributed the rise in third-quarter net profit to higher domestic gasoline and oil prices, as well as higher international oil prices and **gains from the US\$ appreciation against the Brazilian real.** The company's third-quarter net profit was the highest quarterly profit ever recorded by PBR, while revenues were BRL 67.4 bln, up 52% versus the third quarter of 2007.

We currently are under-weight Energy and have been since Crude Oil prices topped \$100 (on the way up) in Q4, 2007. We have 10 open positions out of 94. That is a 10.64% weight versus 14.08% in the S&P-500. We are long **ESV** (drilling); **ACI** (Coal); **CGV** France and **RES** (Equipment & Services); **DVN**, **XEC**, **PTR** China and **CHK** (Exploration & Production); **PBR** Brazil (Integrated), and **UNG** which is a Natural Gas ETF. 80% of the stocks in this sector are down by at least 50% (off their 52-week high), and our open positions have done no better. We do not (at Standpoint Research) believe in taking big sector bets and that is why we have kept open positions in the sector instead of closing them out even though it was clear the sector was going to take a big hit after commodities prices began to roll-over in Q3 '08. We have removed our recommendation to over-weight stocks levered to Nat Gas versus Crude. **There were three pages of notes, tables and recommendations in our Energy sector report from 12/01/08. I would advise reading those notes, as they complement this report.**

As I wrote several months ago when oil prices were still above \$120 - *in my opinion the spike to \$145 was not justified and it will end just as most historical commodities price spikes have ended. That being said,* I didn't see this collapse to \$50 occurring. I went into 2008 expecting oil prices to trade in the \$65-\$80 range. I recall an OPEC Minister saying oil above \$80 was not justified when we crossed \$100 in Mar-08 and others I follow said the same. OPEC was not able to stop the price rise above \$120 and they weren't able to stop the decline below \$80 either. I think they may be more effective stabilizing the price at current levels at their next meeting.

Continued on next page ...

Weekly Investment Research: Petroleo Brasileiro Brazil (PBR)

In mid-November the Paris-based International Energy Agency released its *World Energy Outlook* for 2008. The document of nearly 600 pages contains estimates for future supply, demand, and price estimates. This year's outlook also included an eagerly-awaited study of 800 of the world's largest oil fields. The price of oil has collapsed from ~ \$150 to ~ \$50 in less than five months. The global recession is impacting demand and there are other factors pressuring oil prices downwards. As we have seen historically in financial markets, there is over-reaction to good news and bad news and this may be a case of the latter.

In a *Fortune* magazine article I read last week (and am quoting from here), the writer mentioned that **the IEA study makes clear that the long-term supply and demand picture for oil continues to favor higher prices**. The report estimates that energy demand will grow 1.6% per year on average through 2030, for a total increase of 45%. To meet that demand, daily oil production will need to rise from today's level of 85 mln barrels to (significantly) more than 100 mln barrels. The study found high and rising depletion rates at existing oil fields that will make it increasingly hard for new supplies to keep pace. So, the IEA says, **the world needs to invest some \$26 trillion through 2030 in infra-structure and exploration**.

"Given what we know, just to stay flat in global oil production we'd have to add the equivalent of four Saudi Arabias between now and 2030," said Matt Simmons, chairman of Houston energy investment bank Simmons & Co. International. Simmons is also the author of *Twilight in the Desert*, the 2005 book that argues that oil-rich Saudi Arabia's petroleum production might have peaked. "It's a very, very scary study. It's hard to argue with the data and it's ghastly what the data says." **Over the next seven years**, the IEA predicts that the price of oil will average \$100 a barrel, and rise to more than \$110 by 2030. "The era of cheap oil is over," Nobuo Tanaka, IEA executive director told reporters at a press conference in London. If Tanaka is right, the vicious sell-off in the equity markets over the past couple of months makes this a good entry point for investors looking to grab oil-industry bargains.

In our (Standpoint Research) opinion, the IEA forecast seems reasonable, but these are volatile commodities and just as people were burned in Q2 2008 trying to pick a top at \$100, \$110, \$120 and \$130, people were burned in Q4 2008 trying to pick a bottom at \$90, \$80, \$70 and \$60. Who is to say we won't break \$50 and \$40? **Below are some comps in the industry for PBR**. See prior page for our current open recommendations in the sector.

			ROE	NET	EPS	REL	P/E	PRICE	PRICE:	E'PRISE
	SHARE	MKT	5 YR	PROFIT	5 YR HST	STR	FWD	TO	CASH	VAL TO
COMPANY NAME	PRICE	CAP	AVG	MARGIN	GR RATE	#	4 QT	BOOK	FLOW	EBITDA
EXXON US XOM	74.31	385966	31.1%	9.2%	25.0%	73	10.8	3.0	6.5	3.67
BP UK BP	43.57	135986	22.7%	7.3%	15.0%	54	7.6	1.3	3.5	2.95
TOTAL FRANCE TOT	47.16	111788	30.4%	8.0%	19.0%	49	7.3	1.6	3.6	1.98
RY DUTCH HOLL RDS	48.00	85096	25.5%	3.9%	-	52	6.3	1.1	2.6	1.96
ENI ITALY E	40.72	81549	25.2%	11.0%	19.0%	48	7.7	1.4	2.9	1.58
PETROBRAS BRAZ PBR	17.88	78440	33.9%	9.1%	18.0%	18	-	0.9	4.7	4.49
STATOILHY NWY STO	14.89	47479	31.8%	7.5%	20.0%	26	6.4	1.3	2.6	1.24
REPSOL SPAIN REP	17.57	21451	17.5%	5.4%	9.0%	32	7.3	0.7	2.2	2.55
PET & CHEM CHINA SNP	59.48	9981	19.2%	0.2%	11.0%	18	-	1.2	1.5	1.30

End of Report

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