

Opinion **Nick Butler's blog**

The problems with Petrobras

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Nick Butler FEBRUARY 7, 2013

Petrobras is in a mess. The Brazilian state company makes promises year after year, only to disappoint. Worse still, the Brazilian government heaps on the pressure by trying to push up production targets. But it refuses for national political reasons to give the company the means and freedom to deliver.

To start with the good news. [Petrobras keeps discovering huge volumes of oil and gas](#). The Lula field for instance is estimated to hold 8bn bbls of oil, making it a world-class elephant. Offshore Brazil is clearly one of the most prolific new provinces in the world.

That's the end of the good news. The bad news is that Petrobras seems unable to either set or deliver credible development plans for the resources it holds.

- The company's spending is out of control. The last five year plan talked about investment of \$16bn a year. Actual spending in 2012 was \$25bn.
- The company is facing a cash crisis and has become famous for late payment of its bills. The fund set up to help develop local supply chains has not received the money it is owed. The head of the Brazilian Infrastructure Institute has warned that small companies could fail as a result.
- The company is squeezing suppliers. The shares of the Italian company Saipem, which has extensive Brazilian interests, fell sharply last week because Petrobras has squeezed its margins to a ridiculous degree. Saipem itself said that problems in Brazil would cut its 2013 profits by 80 per cent. The result is that many of the industry's best technical suppliers now choose not to work in Brazil.
- Behind all this is the mismanagement of the company by the Brazilian government. Petrobras is used by the government as an instrument of domestic policy.
- The company is not allowed to increase the prices it charges to domestic consumers and loses money as a result. Recent increases in petrol and other product prices have been minimal as the government tries to maintain popular support by keeping prices artificially low.

- At the same time Petrobras is being forced to support local employment even though the local service sector is clearly not ready for the immense complexity involved in deepwater sub salt developments.

The result is that Petrobras is very unlikely to meet its own target of more than doubling production to 5.7mbd by 2020. Plans are well behind schedule. This underperformance is already giving the country a bad name. One industry executive told me that a Brazilian promise was not worth the paper it wasn't written on.

In comparative terms, [Petrobras has fallen behind Ecopetrol](#), the Colombian state company, and is descending to the level of [Pemex, the vast bureaucracy that controls Mexican oil and gas](#). The company has just been given another negative assessment by Moody's. Its workforce is about to start a five-day strike.

Petrobras is not yet big enough to cause a problem for the world market. The old fields continue to produce. But the outlook is a growing concern for western companies whose investments in Brazil as partners with Petrobras represents an important element of their global portfolios. The outlook is also a problem for shareholders in emerging market funds who hold Petrobras stock because of its very size. The company's share price has fallen more than 10 per cent this week following a dreadful earnings report on Tuesday, and has dragged down the whole Brazilian market.

For the moment, the Brazilian government seems indifferent to the problem. There is no appetite to make Petrobras a genuinely private company or to bring in the international industry to manage the development of Brazil's oil and gas resources.

With the greatest respect to the splendid Jim O'Neill on the day he announces his retirement, I have always been sceptical about [the Goldman Sachs theory that the Bric economies](#) would dominate the world over the next half century. The reality of what is happening to Petrobras only reinforces that scepticism.

Update, February 10 2013:

Petrobras says it is not facing a cash crisis and that its cash balance exceeds R\$40bn (US \$20.3bn). The company adds that it has neither delayed payments nor does it have debt with suppliers, service providers and Credit Rights Investment Funds. Petrobras says that its production targets are in alignment with its business and management plan.

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