



Petroleós de Venezuela, S.A: Summary Bond Terms

<u>PDVSA Bonds</u>	<u>5%, 2015</u>	<u>5.25%, 2017</u>	<u>8.5%, 2017</u>	<u>9%, 2021</u>
Issuer	Petroleós de Venezuela, S.A.			
Currency	USD			
Issue Date	October 28, 2009	April 12, 2007	October 29, 2010	November 17, 2011
Tenor at Issue	6 Years	10 Years	7 Years	10 Years
Time Remaining Till Maturity	2.49 Years	3.95 Years	4.5 Years	8.55 Years
Duration	2.27	3.81	3.11	5.54
Maturity Date	October 28, 2015	April 12, 2017	November 2, 2017	November 17, 2021
Maturity Type¹	Bullet	Make whole @ 10	Make whole @ 50 / Sinkable	Make whole @ 50 until 11/17/2021/ Sinkable
Coupon	5% p.a semi-annual (April & October)	5.25% p.a. semi-annual (April & October)	8.5% p.a semi-annual (May & November)	9% p.a semi-annual (May & November)
Day Count Basis	30/360	30/360	30/360	30/360
Bond Rating	B2 (Moody's; Dec 2012), B+ (S&P and Fitch; Dec 2012)	B2 (Moody's; Dec 2012), B+ (S&P and Fitch; Dec 2012)	B2 (Moody's; Dec 2012), B+ (S&P and Fitch; Dec 2012)	B2 (Moody's; Dec 2012), B+ (S&P and Fitch; Dec 2012)
Use of Proceeds	General Corporate Purposes	General Corporate Purposes	General Corporate Purposes	Repay / Refinance Debt
Governing Law	Venezuela	New York	New York	New York
Price/Yield Data²	Price: \$91.60 Yield to Maturity: 8.333%	Price: \$86.055 Yield to Maturity: 9.579%	Price: \$97.463 Yield to Maturity: 9.202%	Price: \$94.3 Yield to Maturity: 10.007%
Recommendation	BUY	BUY	BUY	BUY

¹ A Make-whole call is a type of call provision in the bond which will allow PDVSA to pay off the remaining debt early. Bond holders will receive a lump sum payment (will be "made whole") if PDVSA decides to call the bond. This will be done at the price corresponding to the benchmark treasury + specified basis-points (10 basis-points or 50 basis-points).

² As at April 30, 2013



<u>PDVSA Bonds</u>	<u>12.75%, 2022</u>	<u>9.75%, 2035</u>	<u>5.5%, 2037</u>
Issuer	Petroleós de Venezuela, S.A.		
Currency	USD		
Issue Date	February 17, 2011	May 17, 2012	April 12, 2007
Tenor at Issue	11 Years	23 Years	30 Years
Time Remaining Till Maturity	8.80 Years	22.05 Years	23.95 Years
Duration	5.33	8.25	10.71
Maturity Date	February 17, 2022	May 17, 2035	April 12, 2037
Maturity Type	Make whole @ 50 / Sinkable	Sinkable	Make whole @ 10
Coupon	12.75% p.a semi-annual (February & August)	9.75% p.a. semi-annual (May & November)	5.5% p.a semi-annual (April & October)
Day Count Basis	30/360	30/360	30/360
Bond Rating	B2 (Moody's; Dec 2012), B+ (S&P and Fitch; Dec 2012)	B2 (Moody's; Dec 2012), B+ (S&P and Fitch; Dec 2012)	B2 (Moody's; Dec 2012), B+ (S&P and Fitch; Dec 2012)
Use of Proceeds	General Corporate Purposes	General Corporate Purposes	General Corporate Purposes
Governing Law	New York		
Price/Yield Data³	Price: \$112.75 Yield to Maturity: 10.488%	Price: \$93.76 Yield to Maturity: 10.48%	Price: \$66.33 Yield to Maturity: 8.929%
Recommendation	BUY	HOLD	HOLD

³ As at April 30, 2013

About the Issuer

PDVSA was organized in 1975 under the laws of Venezuela, as a corporation to coordinate, monitor and control all operations relating to hydrocarbons. It is wholly owned by the Venezuelan government and is the holding company of a group of oil and gas organizations. The Venezuelan government, through the Ministry of People's Power for Energy & Petroleum, established national petroleum policies and currently regulates and supervises the operations of Petr6leos de Venezuela, S.A. (PDVSA).

PDVSA is the largest vertically integrated oil company in Latin America with daily crude oil production of 2,400 million barrels of oil per day (MMbpd) and the fourth largest vertically integrated oil company in the world (as of 2011). It engages in exploration, development and production (upstream) and sales, marketing, refining, transportation, infrastructure, storage and shipping (downstream) operations in Venezuela, the Caribbean, North America, South America, and Europe. PDVSA sells crude oil mainly to the United States, Canada, the Caribbean, Europe, South America and Asia. It also refines crude oil and other feedstock in Venezuela and abroad into a number of products, including gasoline, diesel, jet fuel, petrochemicals and industrial products, lubricants, waxes, and asphalt. In addition, it is engaged in the exploration and production of gas from offshore sources.

Venezuela, the home of PDVSA, is characterized by its overdependence on the petroleum industry (accounts for approximately 95% of export earnings) and high sensitivity to exogenous shocks. Along with vast petroleum resources, the country owns natural supplies of coal, iron ore and bauxite and facilities to generate hydroelectric power. Currently, Venezuela faces a series of challenges which come in the form of public distrust through the break down in human rights and basic freedoms, divergence of political interests and drug-related violence. In conjunction with this, the country's administration has previously hampered market friendly policies and has sought to further increase the impact of the 21st century socialist revolution through government intervention in the economy with the continued nationalization of firms in select and strategic industries. As a result of the recently held elections, it is evident that Venezuela's political climate is still deemed to be volatile in nature and has the power to influence the wider economy.

Industry Overview

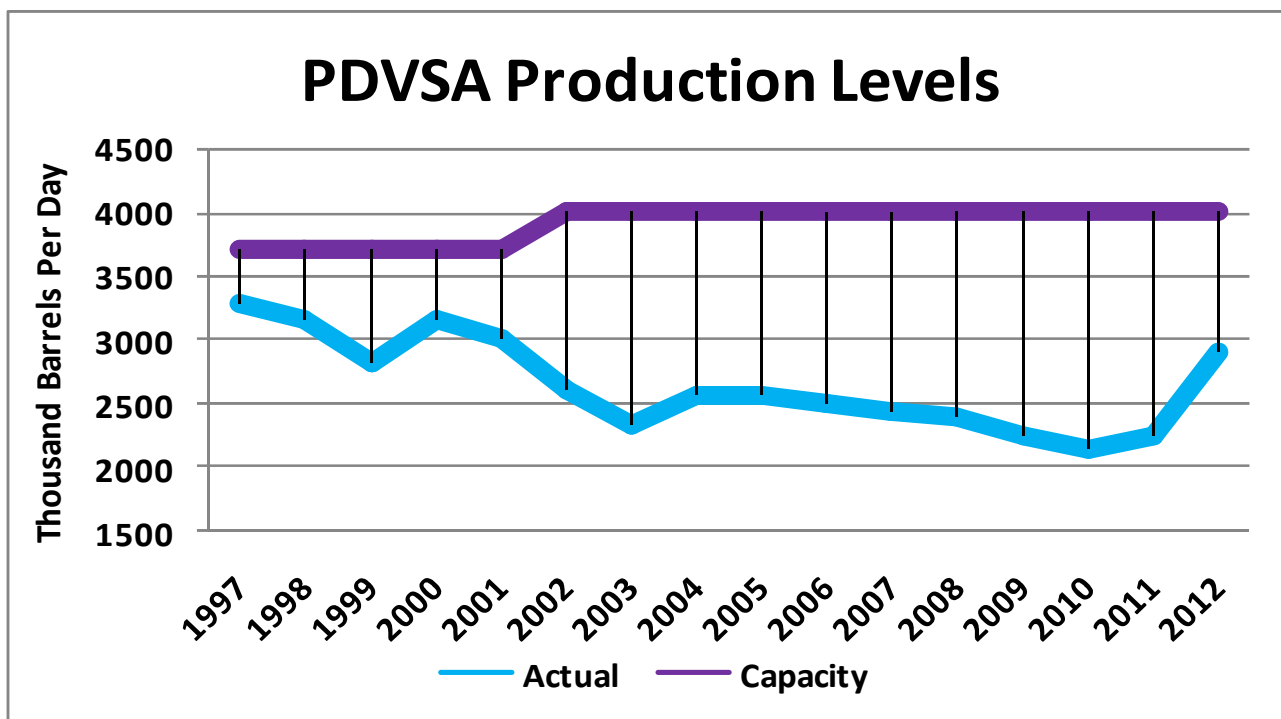
The oil and natural gas industry in Venezuela has been suffering in recent years due to the lack of direction, investment and maintenance from the relevant administrative bodies, as well as the loss of key workers. This mismanagement of the sector has caused Venezuelan petroleum production to decrease by more than 13% since 1997 and approximately 38% below productive capacity as of 2012. Given that the funds from PDVSA have been used to invest in more social programmes than energy initiatives, it is clear that the operations of the industry are not functioning efficiently.

The industry has been put under pressure by way of preferential sales to regional neighbours at below-market prices and attractive financing terms. This, in turn, causes the Venezuelan oil industry to be performing well below potential. On the other hand, there is a great deal of potential for capacity expansion. However, this would require a significant amount of capital investment. Ironically, the one thing the industry needs the most has been previously stifled by the leftist policies of the late Hugo Chavez through hindering the necessary private investment and this is likely to continue with the successful election of his successor, Nicolas Maduro. In 2012, there were a series of accidents and even deaths at state-owned PDVSA refineries across the country which was essentially blamed on the company's overall underinvestment in the oil industry.

Petroleos de Venezuela, S.A Financial Indicators

<u>Petroleos de Venezuela, S.A.</u> <u>Income Statement Summary (US\$M)</u>			
<u>For the Year Ended</u>	<u>31/12/2011</u>	<u>31/12/2010</u>	<u>31/12/2009</u>
Revenue	123,942	94,144	74,996
Cost of Revenue	(39,783)	(36,849)	(27,194)
Gross Profit	84,159	57,295	47,802
Other Expenses	(81,519)	(54,986)	(44,882)
Net Income	2,640	2,309	2,920

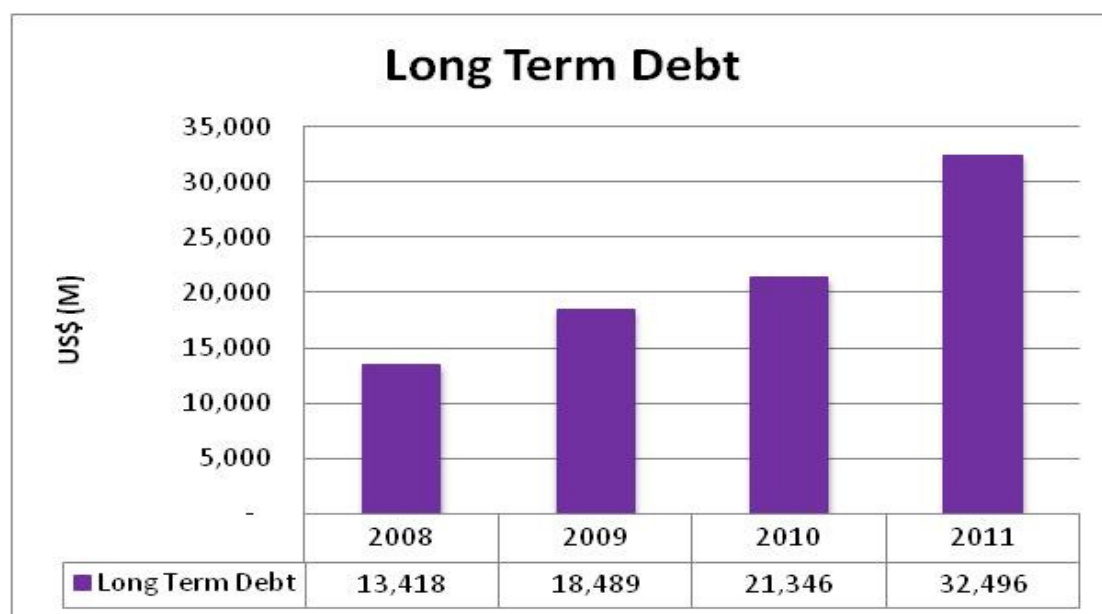
PDVSA has consistently recorded net profits despite its fall off in production up to 2010, after which there was a slight increase in 2011 and 2012. Without fail, the state-owned oil company has been lagging in production well below the current 4 million barrels per day (MMbpd) productive capacity. Its operations have become less efficient due to biased employment policies which facilitated the hiring of Chávez loyalists instead of the most qualified and suitable workers at the state-run oil company. Also eroding PDVSA's revenue potential are the myriad of preferential agreements which Chávez arranged with some Asian, Latin American and Caribbean nations.



Petroleós de Venezuela, S.A Financial Indicators

<u>Petroleós de Venezuela, S.A.</u>			
<u>Summary Statement of Financial Position (US\$M)</u>			
<u>As at</u>	<u>31/12/2011</u>	<u>31/12/2010</u>	<u>31/12/2009</u>
Total Assets	182,154	151,765	149,601
Total Liabilities	108,271	76,451	75,212
Total Shareholders' Equity	73,883	75,314	74,389

Total assets of US\$182.2 billion have consistently increased over the 3-year review period. Total liabilities have also increased and a significant portion of this can be attributed to the increase in the long term debt of the firm.



Source: www.pdvsa.com

Petroleós de Venezuela, S.A Financial Indicators

<u>Petroleós de Venezuela, S.A.</u>			
<u>Summary Statement of Cash Flows (US\$M)</u>			
<u>For the Year Ended</u>	<u>31/12/2011</u>	<u>31/12/2010</u>	<u>31/12/2009</u>
Cash Flow From Operating Activities	12,392	12,643	7,895
Cash Flow From Investing Activities	(13,728)	(13,657)	(15,313)
Cash Flow From Financing Activities	3,929	1,564	9,916
Net Cash Increase	2,593	550	2,498

Positive cash flows from operations indicate that PDVSA has been able to consistently generate sufficient cash flows to maintain and grow its operations, while negative investing cash flows indicate the presence of heavy capital expenditure. Overall, the net cash increase indicates that PDVSA is generating more cash than it uses while still possessing the flexibility to strengthen its operations through expansion or leveraging opportunities.

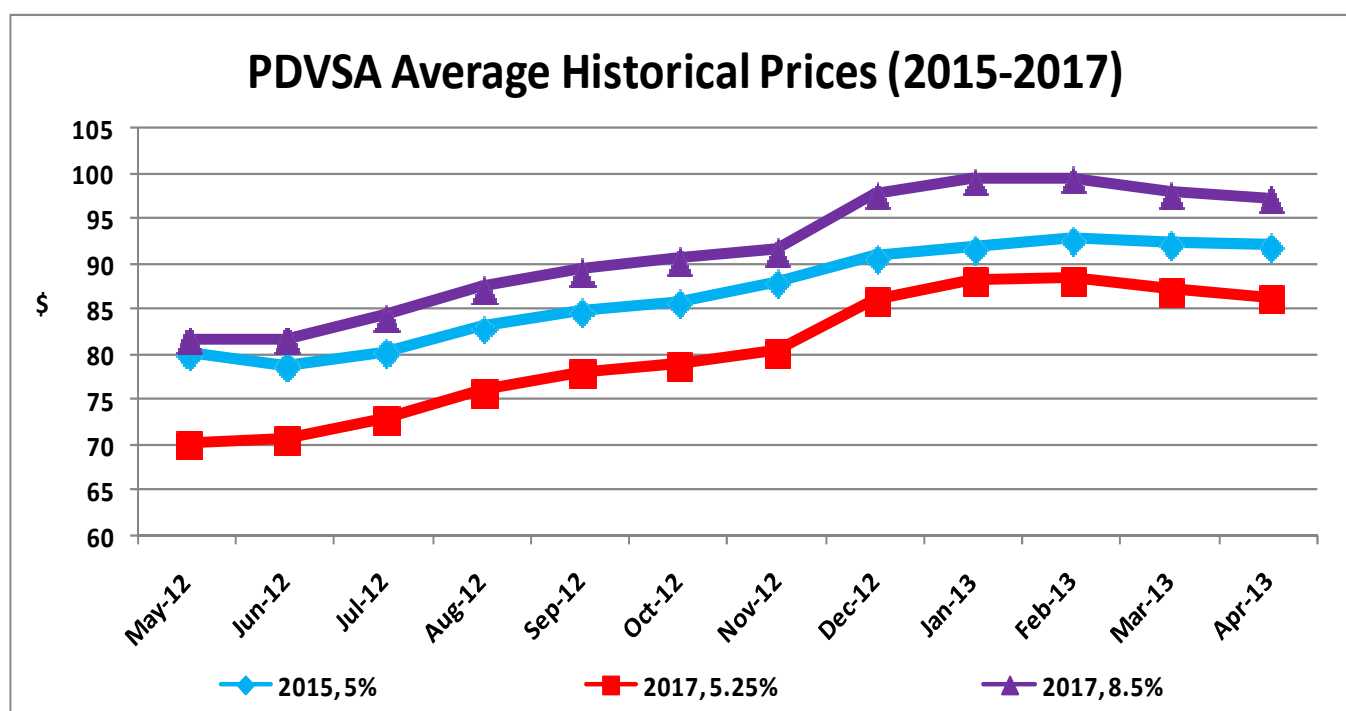
<u>Petroleós de Venezuela, S.A.</u>				
<u>Select Financial Ratios</u>				
<u>Ratios</u>		<u>2011</u>	<u>2010</u>	<u>2009</u>
Liquidity	Current (x)	1.26	1.12	1.16
Leverage	Debt to Equity (%)	47.23	33.13	28.79
	Interest Coverage (x)	21.07	9.48	8.36
Profit	Return on Assets (%)	1.58	1.53	2.08

The liquidity position of PDVSA improved in 2011 over 2010 and shows that PDVSA is capable of paying its obligations should they become due. The debt to equity ratio illustrates that PDVSA has been increasingly financing its growth with debt while the interest coverage ratio shows that the company still has a high and increasing margin of safety as it has the ability to easily pay interest on outstanding debt with the potential to take on opportunities which can magnify its earnings through additional leverage.

The low return on assets is due mainly to the nature of the industry in which PDVSA operates coupled with the company's size and eroded profits as a result of preferential arrangements. This industry (oil

and natural gas) is characterized by high barriers to entry and firms normally requiring large amounts of equity to operate.

PDVSA Bonds - Historical Data⁴

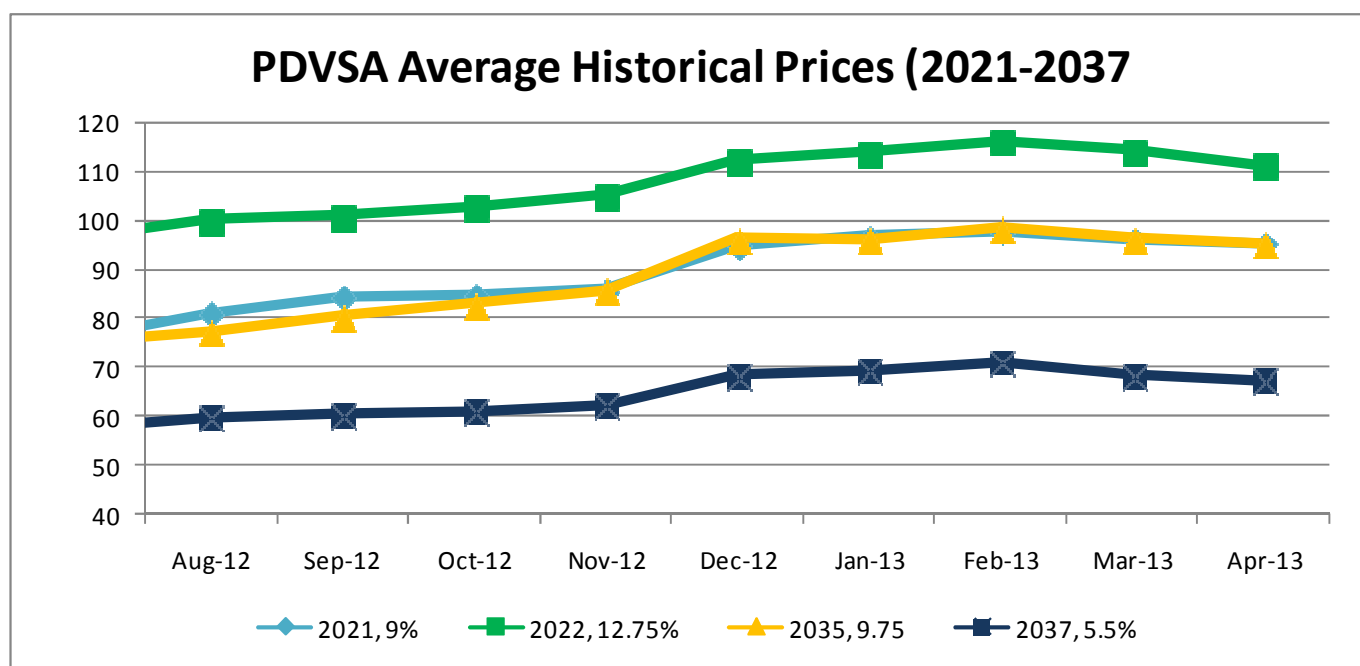


Since the elections following the death of late Venezuelan President, Hugo Chavez, all illustrated PDVSA bonds have been experiencing downward pressure. This may be due to the fact that the new Venezuelan President, Nicolas Maduro may be following in his mentor's path to exercise supervisory control over the affairs of PDVSA and consequently, bondholders see this as increased risk associated with these bonds. Historically speaking, bond investors that have purchased and held both Venezuelan sovereign and corporate bond issues have seen attractive and even super-normal returns compared to other emerging market corporate debt and the long-term outlook suggests that the Venezuelan public sector will maintain its willingness and ability to service its debt. On the shorter end of the PDVSA curve, the 2015 and 2017 bond issues are all deemed as being at attractive entry prices for potential investors. As at April 30, 2013 the 2015 bond issue recorded an ask price/yield of \$91.60/8.333%. At this level,

⁴ Historical Data Retrieved from Bloomberg Terminal on April 30, 2013

potential investors have an opportunity to purchase shorter term PDVSA bonds at a discount with attractive yields exceeding 9%.

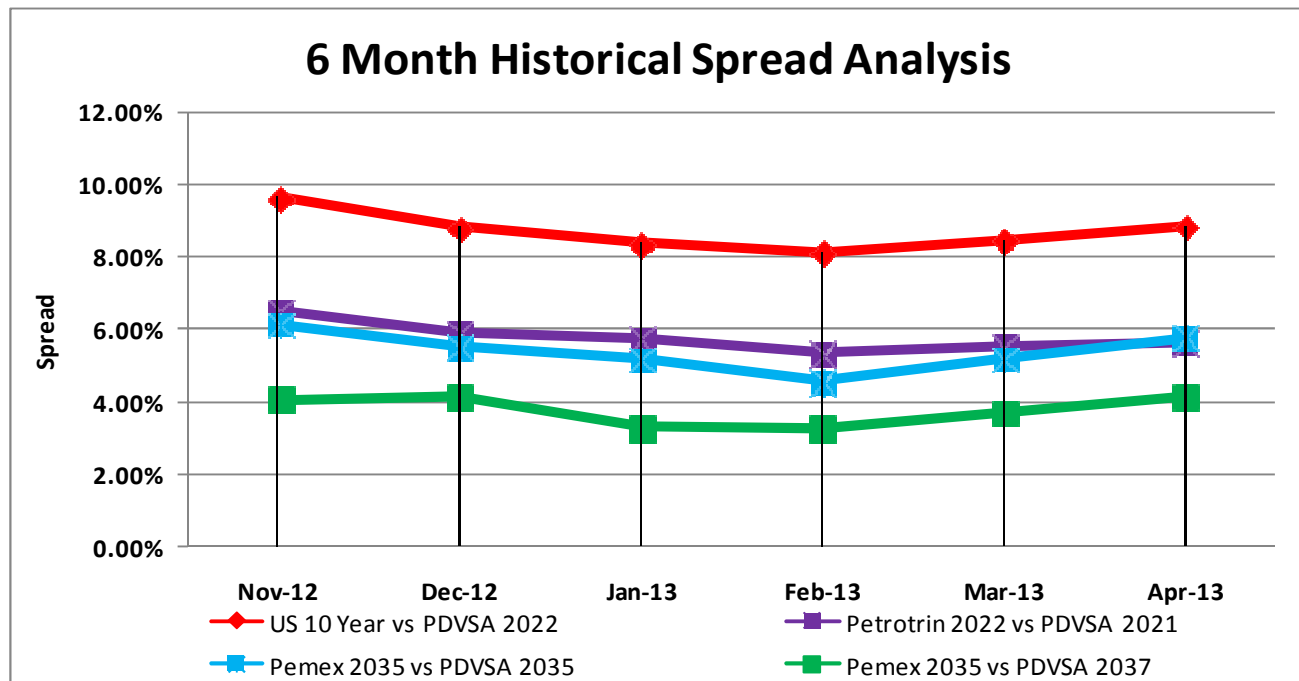
PDVSA Bonds - Historical Data⁵



On the longer end of the curve for PDVSA bonds, there has also been downward pressure on prices which is representative of the related uncertainty surrounding the current political climate in Venezuela at this time. Due to the fact that investors inherently view PDVSA bonds as sovereign debt, the attractive yields ranging from 8% to above 10% currently factor in any socio-political instability present in the economy as a result of the recently held elections. On April 30, 2013 the recorded ask prices/yields on the 2021 and 2022 PDVSA bonds were \$94.30/10.007% and \$112.75/10.488% respectively. At these levels, investors with a healthy risk appetite have an opportunity to realign their portfolios to incorporate some of these fairly attractive returns.

⁵ Historical Data Retrieved from Bloomberg Terminal on April 30, 2013

Spread Analysis



Relative to Caribbean and Latin American corporate benchmarks, Petroleum Company of Trinidad and Tobago (Petrotrin) (Baa1; Moody's and A; S&P) and Petróleos Mexicanos (Pemex) (Baa1; Moody's and BBB; S&P) bonds, the yields on PDVSA bonds (B2; Moody's, B+; S&P and Fitch) are deemed to be representative of the comparative risk which the market factors into holding these bonds.

There is a premium for holding the PDVSA 2021 bond over the Petrotrin 2022 issue (spread of 563 bps) considering that the market factors in a higher risk of default on PDVSA as a result of the difference in rating. Petrotrin currently holds a rating of Baa1 (Moody's) and A (S&P) which is deemed by ratings agencies as investment grade. For the analysis of the bonds on the longer end of the PDVSA curve, there was a comparison done between the Pemex 2035 and PDVSA 2037 issued bonds. From this analysis, it was deduced that there is a premium for holding the PDVSA 2037 bond over the Pemex 2035 (moderate credit risk) as a result of the difference in ratings. The PDVSA 2037 issue is rated as speculative with a high credit risk and has a spread of 415 bps over the Pemex 2035 bond as of April 2013.

For the purpose of this analysis it was also necessary to compare PDVSA bonds to the yields offered on securities with one of the lowest possible risk of default, US Treasury Bonds. The spread of PDVSA 2022 bonds over US 10-Year Treasuries as of April 2013 was 886 bps and proves to be a notable indication of the high premium investors can expect to receive for holding more risky debt. The 10-Year US

Treasuries are backed by the full faith and credit of the U.S. government. Hence, these securities offer lower yields relative to other bonds because they are considered to have one of the lowest levels of default risk.

Risk Factors

1. PDVSA is solely owned by the Bolivarian Republic of Venezuela. Hence, there is a high level of influence of government priorities and programmes on the operations of the company.
2. The volatile nature of international oil prices and other significant economic events has a direct impact on the operations of PDVSA.
3. Business operations and revenue generating capacity are heavily affected by the risk of high levels of inflation and further currency devaluation, following the action taken by the Venezuelan Government in February 2013.
4. PDVSA requires substantial capital expenditures and if production levels are not maintained or improved, the company's ability to service its debt may become impaired.
5. Adverse natural conditions/disasters including, but not limited to, hurricanes, fires and earthquakes frequently impact the country and, as a result, could have an adverse deleterious impact on the company's operations.
6. Political instability and uncertainty due to the reactions from the successful election of Chavez's successor, Nicolas Maduro.
7. Policies imposed by the central government in the future such as the adjusting of any interest rates would have an impact on PDVSA bond prices. Duration analysis measures this interest rate risk and demonstrates the sensitivity of bond prices to a change in interest rates. Based on the duration calculations, for every 100 basis-point (1%) decrease in interest rates it is expected that bond prices will increase by 2.27% (2015) and 3.81%(2017,5.25%), 3.11% (2017, 8.5%), 5.54% (2021), 5.33% (2022), 8.25% (2035), 10.71% (2037) respectively. Considering the fixed-rate nature of PDVSA bonds, if there is any change in market interest rates, investors should see bond

price changes and they need to be cognizant of this fact before making any decision to invest in these securities.

Outlook & Recommendation

Following Hugo Chávez's death in March 2013, there is currently still a level of uncertainty in the market as it relates to Venezuelan and by extension, PDVSA bonds. For investors with a healthy risk appetite, there are extremely attractive opportunities to enter the market with the purchase of both the 2015 and 2017, 5.25% issues which are currently trading well below par and offering a mid yield to maturity of 8.333% and 9.579% respectively as of April 30, 2013. There has been a fall-off in bond prices and it would appear that there is a potential for positive returns (in the form of attractive yields along with capital accumulation) within the market for bond-holders and potential investors.

As it relates to the aforementioned PDVSA bonds, the company's ability to service its debt remains fairly robust and, as such, we recommend the 2015, 2017 (5.25%), 2017 (8.5%), 2021 and 2022 issues as a **BUY** and the 2035 and 2037 issues as a **HOLD**. However, it is clear that a diversified and balanced portfolio is what will bring favourable returns to avid investors in this uncertain global macro-economic climate.

Sources: Bloomberg, CIA World Factbook 2012 & Petróleos de Venezuela, S.A. (PDVSA), Oppenheimer & Co. Inc., United States Energy Information Administration

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