

Q2 2012 Earnings Call

Company Participants

- Almir Guilherme Barbassa, CFO & IR Director
- Gustavo Amaral, VP Upstream
- Lucas Mello, IR Manager
- Maria das Gracas Silva Foster, President & CEO
- Unidentified Speaker, Unknown

Other Participants

- Auro Rozenbaum, Analyst
- Caio Carvalhal, Analyst
- Lilyanna Yang, Analyst
- Marcus Sequeira, Analyst
- Paula Kovarsky, Analyst
- Pedro Medeiros, Analyst
- Unidentified Participant, Analyst
- Vincente Falanga, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Petrobras' call with analysts and investors to present the Second Quarter 2012 results. (Operator Instructions) Present today are Ms. Gracas Foster, President and CEO of Petrobras; Mr. Almir Guilherme Barbassa, Petrobras CFO and Investor Relations Officer; Mr. Jose Miranda Formigli, Chief Upstream Officer; Mr. Jose Carlos Cosenza, Chief Downstream Officer; Mr. Jose Alcides Santoro, Chief Gas & Power Officer and their staff. Before we start, Mr. Lucas Mello, Investor Relations Manager of Petrobras has some additional comments. You may proceed, Mr. Mello.

Lucas Mello {BIO 17682021 <GO>}

Good morning, everybody. I would like to apologize for the delay. We had some technical problems but we hope that this has now been fixed. So we would like to start with our call for Petrobras and the results of the Second Quarter, which is broadcast live over the Internet. And you have our site, www.petrobras.com.br/ri/english. You may follow this call in English. So www.petrobras.com.br/ri/english.

And before proceeding, we may make forward-looking statements based on beliefs and assumption of Petrobras' management. The results will be both in reais and dollars in accordance with the IFRS. However, this conference call will discuss Petrobras' results in reais only.

I would like to give the floor to Ms. Foster now and she will talk about the results of Petrobras and then we will reply to the questions.

Maria das Gracas Silva Foster {BIO 15034303 <GO>}

Ladies and gentlemen. analysts, investors. Good morning. We would like to start our presentation bringing some focus to the results of the Second Quarter. The highlights was the approval of the Business and Management Plan of \$236.5 billion related to projects under implementation and \$27.8 billion projects under evaluation, subjected to adequate return and financeability.

In June and July, on June 25, we had a price increase of diesel and gasoline, 10% for diesel and 8% increase of gasoline. Also very important was in June we booked domestic refining throughput record with 2.01 million barrels per day, advances in contracting and the development of the local industry.

And we felt many technological problems and a new technical partner defined for Atlantico Sul Shipyard. And contracts for construction of 12 drilling rigs by Sete Brasil, six at Brasfels and six at Jurong Aracruz shipyards. And we have also the construction and integration of the first topsides of the eight FPSOs of the pre-salt and four foreign-built drilling rigs which will arrive -- arrived in Brazil in this period.

I'd also like to -- it is true that at the end of this period, in 2012, well, we have increased the number of drilling rigs. On the right we have a picture of our deck mating conclusion of the P-55 in the Rio Grande Shipyard. It was a very successful operation, showing the maturity of the shipyards in Brazil. This was an unprecedented operation involving a structure of 17,000 tonnes, the lifting of 17,000 tonnes, an operation recognized as the largest operation of this nature in Brazil.

Regarding the results of the Second Quarter 2012, Petrobras had a loss of BRL1.3 billion in the Second Quarter of 2012 versus a net income of BRL9.2 billion in the First Quarter of 2012. The exchange variations influenced this. These factors are less likely to occur jointly and with the same intensity in subsequent quarters. So we would like to highlight here the exchange devaluation which had an impact on debt and cost for our Company.

We also had a very significant point in the Second Quarter, sub-commercial wells, because of exploratory activities which happened in the years from 2011 to 2012. And those activities were mainly in new exploratory frontiers. 40,000 barrels were classified as dry but mostly sub-commercial. We had a drop of output. And this was expected by ourselves. And they came especially from the work which we are doing regarding scheduled maintenance, particularly for recovering the Campos Basin.

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The greatest loss is the non-deduction and price differentials in oil products sold in the dollar [ph] is also a factor and there were two adjustments of price on June 25 and June 16. And a significant import of LNG due to higher natural gas demands and power generation. We also had losses because of the drop of the Brent price. And here in Brazil we work with more expensive products [ph] in reais. But this sum of factors led to this situation.

This devaluation of the real, this started in September of 2011. And we have intensified -- and have identified in the Second Quarter of 2012. And this depreciation of the real brought to us some disadvantages, particularly regarding the Company's costs. For example, extraction cost and oil imports, oil products, the high demand for fuel consumption have led us to have to increase imports. We also had a net financial income negative of BRL6.4b.

And recently we have seen in the last few weeks, at least in the last 30 days, a containment of the less possible [ph] drop of the real. Well it will improve the [ph] price of fuel, it will have positive impact in this ongoing quarter. But we've not sold [ph] in the First Quarter. April, May. And June, there is not the full effect of the adjustments of the fuel price of gasoline and fuel oil. I will show you a reduction of the spreads at the end of June.

As I have mentioned before, we had a reduction of the production in the Second Quarter of 2012 when compared to the First Quarter of 2012. This drop was managed by ourselves. But a drop in the cost [ph] of two elements, which in its totality we manage by ourselves.

We must recover the operating efficiency. And we have to be very disciplined regarding our scheduled maintenance and stoppages. It is necessary to stop to guarantee an increase of production, which will occur above all in the Fourth Quarter of 2012 in a very sustainable way. We -- so we still have our targets through 2012. And additionally, in a very positive way, we hope to increase our production 180,000 barrels a day.

Then the next few slides we will see our numbers and the physical complement of these projects. The Anchieta. And we have carried out our planning and following our initial schedule, which was June 2012 in Baleia Azul. And we have the evaluation which we now have. We have two ports planned. We already have 9 wells. Out of 10 we already have 9 for the liftings [ph]. We will be making the connections according to our plan, gradually increasing the production of oil.

Now, to Bauna & Piracaba, which will come into operation in October 2012. According to the original schedule, October 2012 is being maintained. We still have some difficulties to overcome to have everything ready and ready for operation. Bauna & Piracaba FPSO Itajai and Anchieta will in August and October therefore. And there will be some additional 180,000 barrels a day.

Extraction costs, lifting costs, we have several expenses, particularly in the recovery of operating efficiency. This is part of the business plan of the Company and we have been

very successful and very stringent in fulfilling the obligations of this plan, of the priorities [ph]. And we have had -- so it is necessary to do what is necessary to do with them, not only -- we have also some people [ph] left. So we increased exploratory activities, dry wells.

We wrote off -- well here we have a line of 40,000 -- a write-off of 41 dry or sub-commercial wells. In 2012, 16; in the First Quarter of 2011, 27 wells. And now in the Second Quarter of 2011, we are talking about 31 wells written off. These activities of new frontiers imply lower success ratio than pre-salts over the last few years, higher logistic costs and consequently higher expenses related to dry commercial wells.

So 41 wells -- dry wells. By type, we have 21 dry, 8 sub-commercial, nine cancelled projects, two abandoned and one due to mechanical accident. By area, 13 in post-salt, 15 onshore, two in pre-salt. And these two wells in the pre-salt don't change our rate of success. The wells operated by Petrobras, last year we had 94% of success. The post-salt and onshore rates, this success rate was 59%.

Oil and oil products, we had a growth of 6% in oil products in the comparison of this quarter with same quarter of last year. We had a degree of growth due to the increase in fleet and lower prices also of ethanol and imports of oil products when necessary to meet the needs of growing [ph] demand in Brazil.

We had the incentive of diesel, increase in diesel volumes. Incremental volumes were supplied by imports, especially diesel. They reduced downstream margins. We had less oil to export and relatively more national [ph] oil. And all of this led to an improvement of this earning. But we still maintained a negative trade balance.

Higher thermal demand, LNG imports, refineries have had a lot of operating efficiency and have kept in line. We have had in the generation of electric energy, thermal and natural, an average generation, especially in April, of 5,000 megawatts. And thus we have had to go from an import of 700,000 liters [ph] to an imports of 9 million cubic meters of LNG. And the price that we paid for it in Brazil in the Second Quarter was \$15.45, whilst last year at the same period we had a generation -- less generation and also the price, the spot market was \$8.95 in the spot market. So the price is approximately twice as much.

As of the international production, our production has been in line with all the events that we had in the First Quarter. I would like to highlight the Cascade production ramp-up in the US which should be reaching a peak in September of 2012. Also lower sales volume in Nigeria due to lower participation in the Akpo field as a result of the termination of the recovery of the past costs.

We had lower commodity prices in the Second Quarter of 2012 that resulted in a higher impairment of inventories, both in the US and in Japan, totaling a little over BRL500 million per day [ph]. And also cost reduction in our result due to the provision related to the agreement of the Pasadena Refinery.

Now I'd like to give the floor to Mr. Barbassa who will continue this presentation, giving us the financial results and highlights.

Almir Guilherme Barbassa {BIO 1921476 <GO>}

Good morning, to all. We have here on slide 18 our operating income comparing the Second Quarter of 2012 with the First Quarter of 2012. We see a substantial reduction in our operating income. We see an increase in sales revenues due to a higher domestic demand, 4% up. We also had a foreign exchange depreciation effect. We had to use our formal inventories, particularly in the end of the First Quarter and higher costs than those used in the First Quarter of the year.

In addition, operating costs will pay for feedstock, other [ph] services, equipment, all necessary to our operations. The costs were higher given the dollar appreciation. The cost grew significantly. And with that we have a negative impact in our operating income. Something else that was quite analyzed was the effect of the dry holes and those commercial wells that were written off.

We lowered our operating income from BRL11.771 billion to BRL5.282b. And there was also the increase of cost due to higher sales volume on domestic market. Sales from inventories required a higher cost and the foreign exchange effect.

Net income, as you can see on the following slide, was also impacted. The effect was mainly due to the exchange variation and the dollar appreciation since we have quite an exposure to this currency. However, in the long term we have hedged our operations.

We have done a reduction of our operating income. And our financial expense is BRL6.4 billion due to the foreign exchange depreciation on our debt. As you can see, taxes also impacted our results and that's included in our financial results, a part that is in the hands of the minority shareholders of Petrobras. And that -- all of that together, the operating income, financial results, equity income, all taxes and minority interest led to a net income of negative BRL1.3 billion for the Second Quarter of 2012.

On the following slide we see a comparison of the E&P segment, the year-over-year comparison Second Quarter of -- actually the Second Quarter of 2012 compared to the First Quarter of 2012. We see our operational results and we see higher operational costs that somewhat impacted the operating income for this period. Higher domestic oil prices due to the depreciation of the real, lower level of domestic oil production as well as the higher maintenance cost and well interventions partially offset by lower government stake.

We also had increase in geology, geophysics and dry wells and commercial wells expenses. So we had operating expenses linked to those dry wells and sub-commercial wells. So as we can see, the operating results fell from BRL18 billion to BRL16.172b.

In the Downstream segment, we already had a loss in the First Quarter and that result was worsened. We can see basically higher sales prices only at the end the quarter. Lower oil

and oil product exports, domestic oil production channels to supply to Brazilian the domestic market.

We had to import more products. And that entails more tariff, taxes, etc. That worsened the situation. We had a loss BRL7.1 billion in our operating income, which was negative. And it went down a little bit further to BRL9.968b. And also higher level of acquisition costs, internal transfer prices and sales of inventories acquired at higher costs, all of that led to this worsening in the downstream operating income results.

Now let's talk about the domestic output of oil products. We had excellent results in our oil products output. Increase in oil products output due to a higher throughput as a result of higher operational availability and higher utilization in conversion and quality units where operating costs per segment had an excellent performance. And we can see the throughput and utilization factor and refining costs.

Moving on, let's look at our debt. Our debt level grew. But when we look at the net debt over net capitalization, which is the top curve, it grew from 24% to 28%. But in the numerator of this fraction [ph] we had the net debt of the Company, which grew because of the foreign -- because of the exchange depreciation. The denominator, however, did not grow. So this net increase is not going to affect the shareholder's value.

We had an increase in the numerator of the fraction because of exchange variation. Therefore the net-debt-over-EBITDA ratio grew from 1.61 to 2.46. And here this was due to the net debt that grew because of the exchange variation, as explained. And here the denominator. And we have a cash volume here (inaudible), we ended up with an effect on the operating profit. The RSO [ph] dropped. So we can see the impact of the net debt over EBITDA and net debt over net capitalization. But again the reasons were explained.

The Second Quarter of 2012 had weaker results. But they do not reflect expectations for the remaining quarters. Our divestment plans continue as targeted. We intend to maintain our debt indicators, leverage indicators at the leverage limits established on the 2012 to '16 Business and Management Plan.

I will give the floor back to Maria das Gracias to talk about our investments.

Maria das Gracias Silva Foster {BIO 15034303 <GO>}

Thank you, Barbassa. As for our investments in the second half of 2012, we will have a realization in reals which is higher in dollars compared to the first half. BRL38.7 billion to be invested in the second -- in the first half of 2012.

How we are going to invest that amount of money? We have decided to not delay our projects. We have to have absolute capital discipline. We actually intend to have a higher CapEx than what was initially intended. But that requires a lot of devotion and commitment by our financial team.

For Exploration & Production, E&P, we grew by 7% the investments for this quarter. But the investments have to be followed by even more discipline. The projects in our portfolio are being accelerated in terms of their completion.

Ladies and gentlemen. as my final message to you in this webcast, I have to tell you that we are disclosing our quarterly results particularly because our net income was negative. We sustained a financial loss in the Second Quarter. Traditionally in Petrobras the CEO of the Company would not come for teleconference for the quarterly results. But I am here today, together with my officers and my staff, to explain this negative result.

I have my word and my attitude to support me and to tell you that I am fully convinced that we will all change the expected results in the next quarters and in the coming years. I believe, I am convinced that one of the factors that negatively influenced the net income in this result, well there were many factors. But they are less likely to happen again jointly. And most of all I believe in the Company that I am leading. I believe in the strength of our people.

We have qualified people. We know how to work. We know how to operate. We have invested along our history billions dollars in our development and we know what we are doing. Our results are absolutely true and legitimate.

This year we've had frequent new discoveries. We are working strongly towards capital discipline, towards the completion of projects. We are dedicated to improving the profitability of our Company and to boost the production of oil and gas and to give expected results to our shareholders.

Thank you very much for listening.

Questions And Answers

Operator

We can now start the Q&A session. We will start with the questions in Portuguese. And then a session of questions in English. Each analyst or investor will be allowed two questions only. Please ask your two questions together; you will be answered. (Operator Instructions) Our first question comes from Marcus Sequeira, from Deutsche Bank. You may proceed.

Q - Marcus Sequeira {BIO 4622700 <GO>}

Good morning. Thank you for the call. I have two questions. The first is related to the diesel price. The last price increase of diesel, although was positive, you had announced another price increase a little bit before. I would like to understand, how is that decision made?

We know that you are committed to quality and you also have business plan focusing on quality. But we also understand that there is a political element there. So the last diesel

price increase was due to what? Did the government finally understand the need to adjust the prices or was it due to a low inflation rates that gives you more space to increase the price? Can we expect other price increases until the end of the year given the differences in parity with the domestic prices?

A - Maria das Gracas Silva Foster {BIO 15034303 <GO>}

Good morning, Marcus. Petrobras increased the price. But what we have done is systematically talk with and show our stakeholders the relevance of passing on the price increases to consumers. This has been done systematically over the past few years. This is the true demonstration of a need that we have to pass on our cost increases. Our Board members recommended that we follow some guidelines. And this is what we did.

In the last Board meetings of last week we presented the outlook for 2012. And again we saw that there is a mismatch between international prices and domestic prices. And once again we talked about the effect on the cash of the Company. But definitely the price increase was led by Petrobras. I don't know what the government was thinking about it. It was a decision made by Petrobras.

Q - Marcus Sequeira {BIO 4622700 <GO>}

Thank you. My second question has to do with your debt level. How much do you intend to fund during the year? The operating profit marks an inflection point. But I would like to know if that will impact the Company's will to have more funding activities.

A - Almir Guilherme Barbassa {BIO 1921476 <GO>}

Marcus, we intend to fund around \$3b [ph] a year. Most of it has been raised this year. But it won't happen necessarily every year. We are working with a considerable cash surplus. We have to adapt to market movements. I don't think that any of these elements will impact our ability to raise funds. The results of this quarter will not impact our fundraising ability more than what happened in the First Quarter.

Our plan shows that the Company will be producing a positive cash flow already considering the investments until 2016. We are working currently with funds already raised. The Company is very healthy financially and we have a very strong and positive outlook and the expectation of a growing production and exploration. So I do not think that our fund raising capability will be impacted just because of the results of this quarter.

Q - Marcus Sequeira {BIO 4622700 <GO>}

Thank you very much.

Operator

Our next question comes from Caio Carvalhal from JP Morgan.

Q - Caio Carvalhal {BIO 16605563 <GO>}

Good morning. My first question has to do with write-off with the dry wells. I would like to know why did the Company decide to do this? Have you got any plan regarding the period that this should be done 2009/2012? So what was your reason for a decision to write-off so many in this quarter instead of doing it more gradually?

And also, there was plans to focus more in the Fourth Quarter. So my question is to whether in the Fourth Quarter of 2012 there might be an increase of this number, or do you think that this is the heaviest posting or largest posting, or do you think now it will ease off?

Then also my other question regarding your debt, the two indicators on slide 23, debt/equity, the net debt over EBITDA. What about the second half of the strategic plan, the current one? '14, '15 or up to 2016, what is going to happen?

A - Unidentified Speaker

Good morning. Well first of all, what about our flexibility regarding writing off dry wells in 2012? This has to do with the evaluation plans. As you have a well which dries up and then you have plans for drilling new ones, you don't write off the dry one immediately. They are written off according to their profitability, their economic activity or not. Some can be recovered, some not.

Now in the Second Quarter of 2012 there was a, let's say, atypical focus of wells that were left over from the past and had dried up. And Petrobras has a greater number of drilling rigs on new frontiers according to what has been published. And although the new wells have more expensive logistic costs. So individually these costs are higher.

Your second question has to do with the production for the end of this year. Although we have not given you detail of our throughput, the results of the Second Quarter have been atypical. We do not consider that this means in the Fourth Quarter of 2012 we will have a higher number.

Well there is a question of sensitivity. We are very sensitive towards the flexibility. Unfortunately one well has been already written off. They had to be written off and were written off and this is important for our accounting reasons and we have fulfilled our obligation.

Well in view of the devaluation of the real, this is a variable which accompanies the economy from a structural point of view and the more appreciated real creates a buffer for the future for leverage. But besides that, in the next two years we have a scheduled investment for the Company. So this must be done. Growth will ensue.

And finally. But not last at least, the question of price parity is important. So these elements will be realized within the proposed leverage.

Operator

Our next question comes from Paula Kovarsky, Itau BBA. You may proceed.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Good morning. I have two questions; perhaps a follow-up of the previous questions. First of all, the dry wells. I understand that there has been a concentration of projects which were considered non-economic. And this means obviously that there was some blocks were given back to the regulator. I would like to understand whether it is reasonable to think whether the number of blocks to be given back should have a higher average from now on since we have four years with no auction and so we would just have some concessions coming to the end of the exploration phase or new phase of evaluation.

And let's say there is nothing new coming along. So it might be reasonable to admit that the level of dry wells should increase. It is clear the BRL2.7m [ph] will not recur, let's say, in this quarter. But I would like to understand what is a reasonable level of dry wells that we could think of from now on. Therefore consider the average of previous years might be a little bit conservative assumption because of -- due to the lack of auctions.

The second, regarding the question of debt, you all said in the previous call and a presentation of the results that there would be a further initiative to try and release cash because of some of the things that you were going to try and do to try and support or to finance an investment plan. I'd like to understand whether in this quarter if there is some benefit from these initiatives and if you managed to -- will you manage to do something by the end of the year so to release this indebtedness load because you're very close to the investment grade. So what are you thinking about? Will you be able to reduce the CapEx during the year? So what are you thinking about in terms of indebtedness until the end of 2012?

A - Unidentified Speaker

Well as regards your questions, first of all the dry wells. In fact, the write-off of the wells with the conclusion of the drilling of some new wells, this has nothing to do with the fact that we are not having new auctions. This was work which was completely within our plan and in our exploratory portfolio. And opportunities within the (inaudible) peaks were mapped out according to the exploratory success which we have had before outside of the plateau to result well above the average of the industry. The barrel will probably reach \$2 [ph]. But we have a volume of wells and we have told you that economically it did not support a good throughput plan so the solution was to give them back.

A high number of rigs also in some of the basins of Santos and others and one in Amazonas, we had a mechanical problem which left -- led to the abandonment of this well. This is why we had a concentration in the Second Quarter.

And you have mentioned from the level that we should have ahead of us, we will have the same level as the one we should have during 2011. No more at the level of the Second Quarter.

Q - Paula Kovarsky {BIO 15363001 <GO>}

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Let me say, if I can invert the question a little bit. So it's reasonable not to think that this return of dry wells is not that it involved more capital. So following everything which has been said regarding the new investment plan. And clearly a greater degree of objectivity on the exploratory campaign where much greater success. So would it be reasonable to think that this is a reflection of a greater objectivity of the Company of focusing on the areas that have a greater probability of gearing short term and perhaps changing the former position -- impression that we had was that you'd abandoned the wells at the last minute. Is it reasonable to think like that? Does that make sense to you?

A - Unidentified Speaker

Well first of all, we will follow writing off the wells according to accounting standards. The possibility of developing production, greater production, short and medium term, is what we will do. Today we will focus on the increase in a sustainable way. If it allows us to have a greater probability of success with wells we will do this.

Well we also have a bad -- un-success. But also the impact this will have on our results and with the same priority. So a company that invests as we are investing and which is recovering confidence in production maintenance to be able to take a leap forward as from the end of next year, we have to maintain this production in a sustainable way. And managing the dry wells is also part of this strategy and planning exists of the new frontiers. This number written off is in our accounting standards and has a very important effect on the net results of the Company and in our success plans. So we will step up our actions.

Thank you, Paula.

Well regarding the debt, Paula, the investments -- the divestments have been made and we hope to be successful by the end of the year. It's not only a question of divestments. There is also the optimization of our invested capital and I have here two cases of our working capital. We have two examples here.

We have deposited in collaterals. Today we are giving guarantee and in August we will have BRL5 billion which will have a positive effect. And besides these cases we have here -- we've kept an Eletrobras system, a subsidiary of ours, which exceeds BRL2b. We are trying hard to solve this case. And as from September 1 we will be giving guarantees to Eletrobras so we can allow this volume of working capital employed will be well done.

Q - Paula Kovarsky {BIO 15363001 <GO>}

And anything about the total expectation of investments for this year or has this not been altered?

A - Unidentified Speaker

Our expectation is the same.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Bloomberg Transcript

Thank you.

Operator

Next question comes from Auro Rozenbaum from Bradesco.

Q - Auro Rozenbaum {BIO 1702415 <GO>}

Good morning. I would like to go back again to the dry and sub-commercial wells that were written off. You gave some explanations and you said that everything was done according to the regular policies of the Company, etc. So what will you observe typically effect [ph]? It's a potential increase of the write-offs of dry wells and your sub-commercial wells in the Second Quarter.

A - Unidentified Speaker

When we look at the CapEx of the Company some years ago, there was also significant increase in that element. It was quite justified by the amount of new discoveries. So everything seems to be according to the campaign [ph] of the Company. And considering the information that we have and the explanations that we received, it seems fair to assume that we are now going to follow to another well for dries written off to follow the increase of E&P activity.

And more than that, we should expect an increase in the costs of the exploratory activities given the new frontiers and also the depth and complexity challenges that were bluffed [ph] to Petrobras by the pre-salt.

Q - Auro Rozenbaum {BIO 1702415 <GO>}

There was one point that is still not clear to me. Whether we reached a new level of well write-offs, do you think that this is a fair statement that we reached a new level of write-off of wells?

A - Unidentified Speaker

Well Auro, it is not true that we reached a level that we will be perpetuated or that will be repeated after the Second Quarter of 2012. For sure we can manage the portfolios that we have ahead of us in such a way that we won't have, as highlighted by CEO Gracas in her previous answer, a higher risk associated with the wells that are being drilled. The idea is still minimize the amount of wells that are being written off or that were written off in this past quarter.

Now as for wells drilled in previous quarters, as we have said, this quarter had a concentration of dry wells and sub-commercial wells. But this is not expected to be repeated in the coming quarters. So we are in a good position to manage our write-offs so that we won't have an accumulation in one given quarter as it happened in the Second Quarter.

Q - Auro Rozenbaum {BIO 1702415 <GO>}

Is there any way? Have you considered any way of helping analysts analyze their portfolio of the Company and help analysts have the ability to predict this kind of event.

A - Unidentified Speaker

Well Auro, I do not know any company that will give the analysts details about their portfolio of wells that have been drilled and that are being drilled -- that are being drilled and that will be drilled. We already give more detail than the rest of the industry. We're indicating which were the wells that were written off, as was the case this quarter.

Now you can do your research and you can read everything that is public information in our results. Historically our yield is high. It will remain high when we have room to manage what's coming ahead so as to avoid. And we don't expect to have such a concentration of write-offs of wells in the coming quarters.

Q - Auro Rozenbaum {BIO 1702415 <GO>}

And my last quarter -- actually, my last question --.

A - Unidentified Speaker

You have the discovery evaluation plan that you can read.

Q - Auro Rozenbaum {BIO 1702415 <GO>}

My second question is actually I would like to ask you to give us more comments and details on this phenomenon that happened in the Second Quarter in the area of gas and energy. It is divided in two parts, higher need to import gas and the increase in prices. I understand that part of the energy was bought. And I'd like you to elaborate on that. What can we expect for the next quarter?

A - Unidentified Speaker

In the Second Quarter of 2012 we had an increase in the spot prices compared to the previous quarter and year on year was higher. We had to buy LNG at spot prices to supply two thermoelectric power plants. And the prices of LNG increased a lot because of the need of Japan to buy a lot of LNG. So to compare the price of the past quarter and of the same quarter of last year, we see that the price increases were atypical.

We have to import more. We have to import a lot more LNG and that led us to have to spend more than BRL600 million additional to what we have spent in the same quarter of last year. But now prices are stabilizing. LNG is being sold at, I think, \$13. And the energy prices are varying too. And we have to -- we have to consider the new market conditions. We are now selling more than 960 megawatts. All of these factors we suffered in the second half are being attenuated in the -- for the coming quarters.

For the Third Quarter and the Fourth Quarter of 2012, we expect demand for lower energy generation.

Q - Auro Rozenbaum {BIO 1702415 <GO>}

The figures [ph], what can we do to reduce our exposure to the energy market?

A - Unidentified Speaker

We have worked strongly with the electricity industry asking the generators to give us what we can expect, how much energy we can expect 30 days before. So we are working with the regulatory agency as well. And the goal is to have lower exposure. We have a commitment of electric generation. But we need more predictability by the energy industry. This is done with the national electricity operator and with the council for the monitoring of the electrical system.

Q - Auro Rozenbaum {BIO 1702415 <GO>}

Thank you.

Operator

Next question comes from (inaudible) from Execution [ph].

Q - Unidentified Participant

Good morning. My first question is I'd like to understand what is leading to an increase in the depreciation for barrel of oil produced mathematically [ph]? We had an increase of BRL3 per barrel to BRL16 -- around BRL16 per barrel. What's leading to this?

My second question has to do with the balance sheet. A lot of people have asked about it. Many answers have been given. But unfortunately we feel a little bit uncomfortable because in the past we used to hear that production is going to grow. But in practice it didn't. We would like to understand whether that production is going to be weaker or stronger in the future. Well we don't really know what's going to happen. What can the management of the Company do to give us a little safe margin in the balance sheet in terms of what we can expect?

A - Maria das Gracas Silva Foster {BIO 15034303 <GO>}

Before I give the floor to Barbassa, I would like to make a comment. I'd like to talk again about the dry holes and the exploratory policy of the Company. In the foreseeable future, for the nine wells that this contains [ph] that is underway as part of our business plan, we have a very strict follow-up with a [ph] well. We evaluate the movement of each drilling rig. Our oil production will accelerate as set forth in our business plan.

So just to mention a plan B, because that's plan A. But we have -- when you're in an exploratory campaign, you have to deal with the dry holes; it's part of our business. But at the moment we also have a dry well. At the moment we calculate that the well is dry. We have to manage that and we are managing these dry holes and sub-commercial wells. Since December of last year and January of this year we've seen a higher number of dry holes.

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We've got indication that we have to work in a more focused area in managing these dry wells. So the write-offs that we are going to have in the next quarter respectively [ph] already defined. But from then on, in the Fourth Quarter of this year and for next year, we have to be managing these dry holes and sub-commercial wells so that the impact was lower.

We also have the PROEF Operating Efficiency Improvement Program. The PROEF is going to be launched in September, I believe in the first week of September. And it is a clear indication that we will make this kind of strict follow-up a lot more detailed. We will be informing you step by step. We want to get money on the table and put it in the result of the Company.

Our management wants to have more predictability and we have to figure out how many dry wells we can support in our business and management plan. And again, I mentioned the PROEF Operating Efficiency Improvement Program that will increase the profitability of the Company and reduce our operating expenses.

Q - Unidentified Participant

I would like to have a follow-up question. How are you accounting for the dry wells, the dry holes? In my view the cash flow has been used, the investment has been made. A dry hole, it's just an indication that something that has already been done so now we account [ph]. I see this as a set [ph] business. But also good business because you're taking risks to find things that in the long run will increase the market cap of the Company.

So I have a management question. Some things are under control by you. Some things, however, seem to be under control and sometimes they're not. Where will this Operating Efficiency Improvement Program indicate the management's actions?

A - Maria das Gracas Silva Foster {BIO 15034303 <GO>}

Absolutely it is a program that will indicate clearly where we're looking for higher efficiency. Not just the PROEF. But other efficiency programs as well. But we will indicate how we can optimize costs and how we can work step-by-step. We have it in E&P, Energy and Gas the downstream, the distribution company, a number of segments where we can work better; we can use new interfaces to develop the businesses of these segments.

This efficiency program is quite interesting. We are working on it to make it very clear in material where we want to get and how to get there over the years because it's not something that is done overnight. And this is management. Purely and simply it is management.

Gustavo?

A - Gustavo Amaral {BIO 15909055 <GO>}

Just to clarify about a possible venture that will not give any yield. As for the dry holes and sub-commercial wells, it's not that we have a dry well and we are going to neglect it in a

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given quarter. No. If we find a dry well in a certain quarter we will take it with management. Attributable [ph] prices that will decide whether I'm going to write that well off now or later. These are the kind of management decisions.

Well I thought that this has been clear. But this has been made clear. But if not, thank you Barbassa for the clarification.

Am I to be starting to drill the well next month and I'll know by the end of the year that it is dry. We have to be managing the new wells that we have in our exploratory campaign. Our policies have been strictly followed by our Company.

Operator

Our next question comes from Pedro Medeiros from Citigroup.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Thank you. Good morning. In fact I have two questions. The first is for (inaudible). Your first slide you showed the complete process of the operation. So tell us about the guidance for October 2013. There is a clear chance that this unit will be installed. Will it be finished beforehand, that meeting? This has happened. So do you think that this will advance in time.

The second question, there are some confirmations here. One of them still regarding the write-off of projects in the dry wells. In the projects that have been cancelled, was there any crossover with the investment plan?

And on the assets. So what is going to be invested in Brazil and also the investment plans, a recent visit of the President of Venezuela to Brazil. So it was -- they talked about and the project of a refinery and I would like to know how this plan is developing.

And in this quarter vis-a-vis the negative results, we have had no dividends paid out. Is there any forecast of this -- the dividend payout will be handed out or will we have a rule regarding the payout and so the payout of dividends would be much less much? Thank you.

A - Unidentified Speaker

Well first of all deck mating of the P-55 was practically concluded in the Rio Grande. We feel that the deck mating, well, we still several loading of modules which are being put ahead and on schedule. So according to schedule. So that's forecasts of the first oil next year. September 2013 continues to hold but will not be brought forward. That is the reality.

Regarding the write-off of the wells, there is no relationship between investment and the write-off. There is no tie. There's no correlation. Okay?

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Well I was in Brasilia at the meeting of the Mercosul and I was able to talk to the President of PDVSA and they maintained the position of an interest of a stake, to have a stake in the refinery. And they have until November of this year to define what their share would be. And they have to make feasible their guarantees of PDVSA. And there is nothing to do here. It is their issue. So at the right time they will solve this issue and decide the amount and they will present us with what has to be done to complete the project. So they will participate in the PDVSA Refinery.

Regarding the dividend policy of the Company, it has not been altered and will not have any alterations. We will continue to pay out at least 20% of the adjusted net income. And anyway, there has been no -- and a percentage of the market cap. The Board has approved this criteria. At the moment, 3% of the market cap and 20% [ph] of the adjusted net income.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Thank you.

Operator

Lilyanna Yang from UBS.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Thank you for this opportunity. My first question would be the PROEF program in Campos. Could you elaborate on that? You mentioned 5 billion in costs. 1 million has already been scheduled. And the net present value of 1.6, more than \$3b [ph]. So could you tell us what is expenditure and how is this measured?

And another thing I'd like to ask is about the due diligence process which you carried out to be comfortable with the signature of the drilling rigs. So the AIS, EAS and the Judong [ph].

And the refinement, my third question, all of the refining in slide six, what is the fuel price which will be to reasonable for gasoline and the timing? Could you say what you have included because of the increase of domestic prices?

A - Unidentified Speaker

Well first of all, the PROEF program has already started. We have expenditures programmed of \$5.6b. \$1 billion before operating costs, 9.6. And this amount -- of this amount, almost \$1,200 million were already planned for and this is already in the planned CapEx. So what we are doing now is to work on the optimization of the costs through the program of cost optimization. So this cost projection will have to be done -- will have to improve 70% to come back to the historic level.

This growth in efficiency can be seen in the growth of output, the production of oil and included in our business plan for the next few years up to 2016, including using the

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potential of the assets that will be used in this program. The greatest part of these costs are associated with marine installations and others and 26% are specific to maintenance and safety. So as from next year this activity also will be intense.

You asked how you estimate the expenditures. Well we consider the same form of the investment of Petrobras in terms of minimum rates of BBL. And remember, 1.6 is associated to the fact that even if nothing were done in terms of PROEF, which is improbable, when we consider that this number should drop even more, is that we have a number of \$3.3 million of net present value.

You talked about a checklist. So what increases the probability of our projects? We have already tried to anticipate possible problems. This is a correct measure and some actions have been taken. So steps have been taken to act in the yards, ship yards. And positive actions and improve our proposals and anticipate problems.

So when you have technological partners, who are they? You have to have objective criteria. It doesn't matter if they're Japanese or Korean, you have to have completely objective criteria, contracts signed, binding clauses regarding this technological partnership. There must be a demonstration and there must be direct ties with the IBAMA and the Secretariat of the Environment as well, showing us what they have done also outside of Brazil.

So what is important? That all this be done because otherwise we are the ones who will not be delivering and so on and so forth. It is a step-by-step process of objective demonstrations. It's not just to say that we've done this or done that. But to demonstrate that this has already been contracted, that this has already been approved so as to minimize risks. When potential risks are manageable then we will have an action plan to mitigate the risks so as to have a better outcome.

Your other question, well, it depends on many assumptions with the increase of fuel prices. Well the diesel will be imported and naphtha. Well it depends in Petrobras notwithstanding the quality which is a target of ours. Even so, when I -- it is necessary to reduce the work with the inventories if necessary which is a percentage amount that we still have to reach to have parity.

Q - Lilyanna Yang {BIO 14003234 <GO>}

In slide six you don't even have the cost of imports. So what will it be? BRL15 per barrel?

And one last question, I would just like to have your opinion. Is it worthwhile having a partnership of investment for refining with another player perhaps?

A - Unidentified Speaker

Well the question that we are having with partners is that they add value where they know more than we do. They have to bring some kind of an advantage.

We have participated in dozens and thousands of building of wells and expansion of refineries starting from zero. So any partner who brings to us an advantage vis-a-vis better knowledge or more knowledge is welcome. But they must bring some differential so that we can do a better job.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Thank you.

Operator

Our next question comes from Mr. Vincente Falanga [ph] from Santander.

Q - Vincente Falanga

Good morning, to all. Thank you for this call. How do you see the input of gasoline and diesel in the Third Quarter? Reduced with an oscillation of the economy or not?

And the imports I note have negatively impacted the results of Petrobras. So is there any attenuating action in the short term other than looking for parity given that the new capacities will only -- or the refining capacities will only come into play in 2014?

A - Unidentified Speaker

We have been importing a lot. What are we doing to offset that? Our CEO mentioned in the beginning of the presentation that we are trying to improve the quality of our refinement in addition to processing. We have been reaching record levels of quality in our refineries. We have production units that are now allowing us to significantly increase our domestic production so as to offset the imports. These are some of the quality initiatives that we are working on.

Renewing refineries, we will be concentrating on the refining of diesel and use these to offset the imports.

Q - Vincente Falanga

You will see a lot of room to improve productivity or not in search of the marginal increase?

A - Unidentified Speaker

We see opportunities in the new units with additional substantial volumes. The idea is to produce more quality products to offset the imports.

Q - Vincente Falanga

Thank you.

Operator

The next question comes from Mr. (inaudible) from Espirito Santo Corretora.

Q - Unidentified Participant

Good morning, to all. I would like to go back to the balance sheet. There are two things that I would like you to explain more in depth. You talk a lot about exploration expenses that grew a lot. But other expenses also increased. For example, SG&A increased 13% on an already broad base. Legal expenses also increased 37% [ph] vis-a-vis the previous quarter and this is not a small number. So you know there was an increase in exploration expenses. But other expenses also increased in the balance sheet. I would like to understand.

Just like it was asked for other expenses, will these, or why have these expenses increased exceptionally or should this level be expected to be maintained in the next quarters?

Then a question has to do with the financial result. It's negative. But it came out worse negative than I expected. And you mentioned a 7.8% exchange variation while the total exchange variation in the quarter was 10.9%. I would like to understand the methodology that you used.

A - Unidentified Speaker

Osvaldo [ph], I will ask (inaudible) from our accounting department to give you some detail about the SG&A expenses.

As for administrative expenses, they were related particularly to personnel. We hired new staff compared to the First Quarter and also in services to third parties, particularly information technology.

Q - Unidentified Participant

So I understand that this level will be maintained looking forward. Is this a fair statement?

A - Unidentified Speaker

Yes, unless we start seeing the effects, the positive effects of our Operating Efficiency Improvement program which has not been included in the plan yet.

I would like to make a comment, Osvaldo. With regards to the administrative and managerial costs, increases in program [ph] for our operating costs will also consider IT, not personnel. Personnel is not in the scope of the program, at least not in the PROEF program. But all the information technology side of the Company will be optimized. Okay?

Q - Unidentified Participant

Thank you. Hello, again please. Yes. I asked also about the exchange rate variation.

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A - Unidentified Speaker

Oswaldo, could you repeat your question about the exchange variation?

Q - Unidentified Participant

Well I expected an even worse financial result because I was considering the 10.9% exchange variation, which is the official number. But you considered 7.8% exchange variation and I would like to understand what kind of methodology you'd used.

A - Unidentified Speaker

Okay, here's what happened. You're doing your math based on the figure that we showed in the end of the First Quarter, about BRL76b. These BRL76 billion became BRL83 billion -- BRL84 billion in this quarter. Therefore they grew over which we apply the exchange variation.

Not all of these funds are in dollars. A smaller part of it is in local currency in Brazilian reais. And this accounts for debts in other currencies, not just dollar. In some debts we could reduce the exchange variation effect.

Q - Unidentified Participant

Thank you. Understood.

Operator

We are now closing the Q&A session. I will now give the floor to Ms. Maria da Graca Silva Foster for a final comment. Please proceed ma'am.

A - Maria das Gracas Silva Foster {BIO 15034303 <GO>}

Well I would like to thank you a lot for your attention, ladies and gentlemen. our investors and analysts and those of you who stayed with us during this webcast.

Again I stress my conviction and the conviction of our top management in the Company. We are convinced that we've got the right actions in place for the short, medium and long run. Our results are real. New discoveries have been a constant and I'm convinced we are able to reverse this negative impact of the quarter and turn it into a positive result so that we can bring to our shareholders all the value generation that you are expecting the moment you invested in Petrobras.

Again, thank you very much.

Operator

Thank you, ladies and gentlemen. Petrobras will be making the audio of this teleconference for replay within one hour. You can access the audio stream on the following website, www.petrobras.com.br/ri or using phone 5511 3127 199 and the code

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5511 3127 4999 code 61372593 for the English broadcast. And with this we conclude the Petrobras conference call for today. Thank you very much for your participation. You may now disconnect and have a good day.

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