Q2 2003 Earnings Call

Company Participants

- Jose Sergio Gabrielli, CFO & Director, IR
- Luciana Rashid, Executive Manager, IR

Other Participants

- Emerson Light, Analyst
- Frank Mcgann, Analyst
- Katie Blacklock, Analyst
- Marc Mccarthy, Analyst
- Marcello Misquita, Analyst
- Paul Cheng, Analyst
- Unidentified Speaker

Presentation

Operator

Ladies and gentlemen. thank you for standing by and welcome to the Petrobras conference call to discuss the Second Quarter results. Today with us at Petrobras head office, we have Mr. Jose Sergio Gabrielli, CFO and IR Director. And his staff. At this time, I would like to turn the conference over to Luciana Rashid, Investor Relations Executive Manager of Petrobras, who has some additional comments. Please go-ahead, Mrs. Luciana.

Luciana Rashid

Good morning, ladies and gentlemen. Welcome to our conference call to discuss Second Quarter 2003 results. We have a simultaneous webcast on the internet that can be accessed at www.Petrobras.com.br, English version, where you can also download the slide presentation and the financial reports. Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from those anticipated in any forward-looking comments or as a result of macro economic conditions, market risks and other factors.

Finally, let me mention that this conference call will discuss financial results prepared in accordance with Brazilian GAAP. At this moment, we are unable to discuss any questions related to U.S. GAAP results.

The conference call will be conducted by our CFO and Investor Relations Director, Jose Sergio Gabrielli de Azevedo. He will comment on the Company's operating and financial highlights and (inaudible) events during the Second Quarter of 2003. Afterwards, he will be available to answer any questions you may have.

Mr. Gabrielli, you may begin.

Jose Sergio Gabrielli {BIO 5474235 <GO>}

Good morning, all of you. First of all, I would like to comment a little bit on our average realization price. As most of you know, we have -- we operate basically on the Brazilian markets and we have an impact on exchange rates on our numbers.

The first graph that you see on this slide shows our average realization price in Brazil measured in U.S. Dollars, which is our blue line. That shows that in the first semester of '03, we have an increase in our average realization price of 80% in Reals compared to the first semester of 2002. Comparing this Second Quarter of 2003 with the First Quarter of 2003, we have a reduction [ph] on our domestic prices of 13% that we are compensating by an appreciation of Real of 14.23 [ph] % resulting in an increase in average realization price of 5.97% in the Second Quarter of 2003.

I think you can see in this first graph also, we compare our average realization price with an index number of the U.S. prices in the markets with the (inaudible) rates of our volumes of our production, which is the red line. And you can see that we are in the Second Quarter of 2003, online with international U.S. markets behavior of the price for oil products.

The next slide, in the next slide, we show the net revenue results comparing the First Quarter of 2002 and the First Quarter of 2003, the first half, first semester of the two years. (inaudible) shows we increased our net (inaudible) from 2.9 billion Reals to 9.372 [ph] billion Reals from last year's (inaudible) and this slide price shows some of the driving forces for these results. First, we have been increasing our production from 1,896 barrels -- million barrels to 1.2 -- 2,146 million [ph] barrels per day. This increase in production gave us a result, part of the (inaudible) for the increasing revenues. We increased our net revenues of 18.472 billion Reals and this increase in revenue was mainly a result of the increase in average realization price in Reals even though we had a reduction on the total volume of sales of 6% in these two periods.

The second column of this graph shows behavior of the costs of products sold. We have an increase now cost of product sold basically as a result of increased (inaudible) that was linked to increasing price, linked to new brackets for calculation of the participation [ph] rates as a result of more productive fuel (inaudible) and the price of rent. That is the base number for calculation of the approximation [ph], (inaudible) approximation. We have also some increase in some material costs, some products we buy for our production.

The third column, which shows some increase in our operating expenses, are basically the result of some provisions as we have made for mark to the market of some sort (inaudible) that we brought for future use in our thermal (inaudible) plants that are now without clear destination. This increased our operating expenses of one billion Reals. We have also .4 billion Reals, increasing our health plan and .15 billion Reals as a result of our stock purchases [ph] of our operational -- operations.

Our lift in cost per barrel weakened 3% in Dollars but expressed in Reals, they reflect the 32% devaluation. The cost per barrel increased 60% in Reals as a result of production gains as I mentioned already and our operational expenses are not recurrent expenses because it is -- what is some provisions for this did not (inaudible).

The third column shows some impact on our financial expenses of the actual rate fluctuations. We increased our net financial expenditures and reduced our financial income from an exchange rate (inaudible) and increased that amount of Reals necessary to cover interest expenditures. We had higher costs, then they pay more tax and we have (inaudible) corporation of the Petrobras Energia that added only 360.361 [ph] billion Reals to our net profit [ph] which shows that the incorporation of the numbers of Petrobras Energia has a very small impact on our net profit.

The next slide compares the First Quarter of 2003 and the First Quarter -- First Quarter of 2003 and the Second Quarter of 2003 even though in the graph, you have relations with the first half of 2002 and the first half of 2003. This shows that the main driving force was behavior of the revenues, the average price, our average realization price went down in the First Quarter -- in the Second Quarter of the year and we reduced most of the price of our products and this had an important impact on our revenues. We also have an impact on the appreciation of Reals on our financial expenses and our (inaudible) variations and the contribution also of Petrobras Energia was completely concentrated in the Second Quarter of this year.

Next one please. These numbers, they show that we have a reduction on net operating income from the second -- from the First Quarter to the Second Quarter of the year. We have a reduction of 5% our net operating income. We have a reduction of 15 [ph] % our gross profit, 22% in operating profit [ph], 31% in net profit [ph]. Our EBITDA [ph] reduced by 15%, even though we have an increase in sales (inaudible) market of one %, an increase in our international market sales of 44% and a total volume -- sales volume of 12% which means that most of the results are impacted by the reduction on our average realization price.

Next one please. The next slide shows the capital structure. We have an increase in our total debt from 50,137 billion [ph] reals to 54,242 [ph] billion Reals from March to June of 2003 even though our leverage ratio, our net debt to net capitalization ratio, remains at 45% as a result of an increase in our cash balance from 15,211 billion Reals to 16,322 billion Reals. Our short-term debt -- proportion of our total debt increased a little bit from 19% to 21% as a result of the incorporation of the Petrobras Energia in our numbers and as a result of long-term debt that was maturing due [ph] in this period and became short-term debt.

The next slide shows the net revenue evolution from the First Quarter to the Second Quarter of this year. As you can see, the most important variable in the impact on the net revenue evolution was that Petrobras Energia's net revenue impact on our numbers. It's important to mention that this number reflects the fact that we are concentrating numbers from December to May in one month in May of this year. We are -- this is not recording [ph] type of number because from now on, (inaudible) on a moving basis, the numbers of Petrobras Energia.

In relation to our domestic [ph] sales volume growth, we have very small change and the most important change was in our average price, realization price change. Our net revenues declined by 9% as a result of a reduction from our domestic [ph] realization price. The aviation fuel reduced by 31%, NAFTA 43%, fuel oil [ph] 18%, gasoline 7% and diesel 6%. We had a general reduction on our average realization price of our oil products in this second semester.

We had a small increase in domestic sales volume, 1.3% despite 18% rise in natural gas sales volume, five % increase in LPG and we remain at the same level of (inaudible) sales volume.

We had a lower U.S. Dollar revenues from international and here it is due to 15% appreciation of the Reals, 10% drop in crude oil export volume compensated by 2.2% rise in oil products export volume.

The next slide tries to show a little bit how our cost of goods sold evolved in these two semesters. The most important thing, the two most important thing is the (inaudible) effect in the international segment of our operations because we have appreciation of the Real and this reduced our cost of goods sold.

The second thing important is -- to mention is the incorporation of the Petrobras Energia on the cost of goods sold has increased our cost of goods sold by 1.447 [ph] billion reals.

The third thing that's important to mention is the impact on oil -- of oil and oil products imports. It's important to mention that we (inaudible) change the Second Quarter of this year as a result of a realization of crude oil and oil product inventories imported in the First Quarter at higher prices due to the Iraq war. Brent [ph] February was 32.67%, in March was 30.54, in April 24.85 [ph], in May 25.72. As inventory realization occurred in the Second Quarter at an average cost, this negatively impacted the cost of goods sold 1.371 billion Reals despite international crude oil decreased in the period. As we have a use of the average cost from our inventories in the Second Quarter, this (inaudible) cost was above what the real numbers for the Second Quarter and this increased our cost of goods sold.

As a result, we moved 12.48 billion Reals to 13.132 [ph] billion Reals from the First Quarter to the Second Quarter when we increased also our production from 1.8 -- let me see here quickly -- one million 826 million barrels to 2 million 022 thousand [ph] barrels per day.

The next slide please is trying to summarize some of the impact of the losses on financial exposures of the thermal (inaudible) plants. In fourth [ph] quarter of 2002, we made a provision for losses of 724 million Reals. That was increased by 708 million Reals in the First Quarter of 2003. During the First Quarter of 2003, we had an appropriation of 372 million Reals of losses related to the thermal (inaudible) plants. In the Second Quarter of 2003, we had an appropriation of 412 million Reals of losses in the Second Quarter of 2003. At the end of the Second Quarter of 2003, the balance of provision for financial exposure was 648 million Reals.

Now in the Second Quarter of this year, we're making a new provision to adjustments to the market value of gas driven turbine generators. As I mentioned before, we have 8 turbines that were bought in the past and they are arising [ph] and they have no clear destination right now.

The next one please. Given some of the results by segment, we can see that our E&P operations, we have a clear change in the operating revenue. The cost of goods sold was reduced mainly as a result of a lower government [ph] participation in Reals and due to a 4% reduction in production of crude oil NGL and appreciation of Reals. Reduction of rent, which are the calculation days for the (inaudible) income tax [ph]. Also income tax decreased [ph] as a result of lower (inaudible) gross profit. As you can see we have a reduction in operating revenues but also we have a reduction on our cost of production -- cost of goods sold actually.

The next slide shows some other results and the supply results were impacted by stable [ph] prices and high inventory costs. (inaudible) energy was positively impacted by sales increase of 18% but negatively impacted by a higher rate [ph] of (inaudible) and gas which is more expensive in the sales mix. The net earnings reflect the thermal gas turbine provision. This division has shown a drop in gross profit due to a stable sales volume and pass-through of Petrobras realization price. The main impact in the international area results is Petrobras Energia consolidation of the Second Quarter, incorporating results from December 2002 to May 2003.

Our net debt, we can see that in the First Quarter of 2003, our net debt was 34.926 billion Reals. The incorporation of Petrobras Energia increased our debt by 5.803 billion Reals. Our prepayment of exports that resulted in the issuance of debt in the international markets of 2,154 [ph] billion reals and at the end, we increased our cash balance, our net debt from 34926 [ph] to 37924. As I mentioned before, this increase in net debt actually kept our leverage ratio at the same level, 45% comparing the First Quarter and the Second Quarter of this year.

Next one please. This slide tries to show some of the sources and uses of our revenues. We start the semester, we start the Second Quarter with a cash balance of 15.211 billion Reals. We generate -- we had a net cash (inaudible) generated by our operating activities of 5.6 billion Reals and we have a CAPEX -- our CAPEX was 4.6 billion Reals invested [ph] in this period, which means that we have a cash generated by operating activities greater than our CAPEX expense [ph]. At the end of reviewing our cash balance increase from 15 [ph] billion [ph] Reals to 16.3 -- 16.3 billion Reals.

Considering the value added by the Company relating to personnel -- payments to personnel payment of interest and payments to financial institutions and suppliers and paying payments to government entities and shareholders, we can compare the first half of 2002, the second half of (inaudible) and first half of 2003 and we can see that as a result of an international situation, the change in the international situation, the change in the exchange rate in Brazil, the change in perception of Brazilian risk [ph], we have a reduction in our financial institutions that suppliers share in our value added from 23 [ph] % to 6 [ph] % in the second half of 2003 and to almost 0% in the first half of 2003.

We have an increase in (inaudible) entities from 62% that went down to 52 in the first -- Second Quarter of 2002 and went up to 69 [ph] % in the First Quarter of 2003. The shareholders, which are basically the net profit [ph] we have generate, we have 9% of the value added in 2000 -- in the first half of 2002, 33% in the second half of 2002 and 25% in the first half of 2003.

And now I will open the question-and-answer session. Thank you.

Questions And Answers

Operator

Frank McGann of Merrill Lynch.

Q - Frank Mcgann {BIO 1499014 <GO>}

Hi. Good afternoon. Just a quick question. One, do you know what the turbine write-off -- did you write off the full value of the turbines? Is there still a chance you could sell those either to other players in Brazil or outside of Brazil. And then secondly, in financial incomes, specifically interest income, do you know how much the -- which was negative in the quarter, do you know what the write-down was in U.S. Dollar based securities that led to that being a negative number?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

First, the turbine (inaudible) we write off I think around the half of the value of the turbines and we can sell and if the market is becoming better, probably the loss is going to be less than we provisioned. We can, for sure, we can, if we find buyers, we can sell them.

In relation to the interest, I am going to give to the people from the accounting department to answer the question. As I understood, he is asking about the impact of the interest on the exchange.

Can you repeat the question?

Q - Frank Mcgann {BIO 1499014 <GO>}

Yes, it is related -- strengthening of the Real forced the value or forced a write-down of the value in Real terms of some of your U.S. Dollar linked securities according to what I understand. And that is what led to interest income being negative in the quarter and I am just wondering how much that write-down was?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

I think we don't have the question and the answer right now but we can give you a qualitative answer, which is the appreciation of Reals has different impacts on our numbers. First on our foreign exchange revenues, we have a reduction on our Reals revenues because the exchange rate is lower. On the other hand, it is good for us that we paid less [ph] interest on our debt but on the other hand, we earned less Reals from our investments in U.S. Dollars and we earned less Reals in our real investment in the sense of actual investments, overseas and our financial investments also because we earned less Reals per Dollar. The net impact on appreciation is something around, I would say 720 million Reals for the total results of all of the impacts of the exchange rate appreciation on our numbers.

Q - Frank Mcgann {BIO 1499014 <GO>}

Okay. Great. If I could follow up that maybe with just one other one, just in terms of discussions with Bolivia in terms of the prices of gas and other issues related to gas transportation and such, could you just comment on what the status of those negotiations are, what you think the outcome will be and over what time frame you expect to see the results of the negotiations concluded?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

As far as I know, we had some meetings with the Bolivians and they asked for some time to consider our proposals and I think something around one month, they are asking for some time to make their views on our proposals.

Q - Frank Mcgann {BIO 1499014 <GO>}

Okay, thank you very much.

Operator

Thank you. Our next question is coming from Paul Cheng of Lehman Brothers.

Q - Paul Cheng {BIO 1494607 <GO>}

Good afternoon, gentlemen. A few questions. First on the thermal (inaudible) business, do you foresee any potential or possible future write-down from the (inaudible) in any way or do think you have already marked down to value to what you see or are likely going to be further write-offs?

Secondly, on the listing [ph] cause [ph] without a government participation sequentially (inaudible) to about $3.33 per boe from the First Quarter level to 85. Is it just purely because Reals is appreciating against the U.S. Dollar in the Second Quarter or that any other things that relate to that?

The third question is do you have any rule of thumb, what if (inaudible) say every Dollar change in the foreign exchange between Reals to the U.S. Dollar, the net impact to your results -- to your net income?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Good afternoon, Cheng. We are trying to make decision on the thermal (inaudible) plans to make them -- to access all the losses we can have. As I mentioned in my presentation, we made provisions in the Fourth Quarter of 2002, the First Quarter and the Second Quarter. Now, we are marking to the market the value of the turbines and we think we can give different uses for the turbines and then, we can not -- we hope we are not going to realize all the losses that we are provisioned for.

Q - Paul Cheng {BIO 1494607 <GO>}

(inaudible) what is the current book value on the turbine, on your books after the write-down?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

The number was -- how much was the value of the turbines on our books?

Q - Paul Cheng {BIO 1494607 <GO>}

Yes.

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Where we are -- provisioned 330 [ph] million Reals for them and the market value was 384 million Reals -- at the value [ph] of the market, which means that we expense -- 330 million Reals of provision for losses and the value of the market is 384 million Reals.

The lifting costs, I think on our lifting costs as I mentioned, affected by the reduction in [ph] production that we had in the Second Quarter, in P 35 [ph] and P 19 [ph] and also, we have an impact on the appreciation of Reals which is very important for our numbers.

The third question is the net impact on our financials -- financial results as foreign exchange movements. This is a hard question to answer because the impact is different in each moment because we have the positive impact when you have appreciation of Reals and negative impact when we have appreciation in Reals in some of our lines of our statements and this first semester, I would say the appreciation of Reals had a positive impact on our numbers. We're estimating something around 700 [ph] million Reals impact of the exchange rate appreciation.

Q - Paul Cheng {BIO 1494607 <GO>}

Okay. That is fine. Is it possible you can tell us what is the total U.S. Dollar denominated financial instrument -- financial arm [ph] that you own and financial liability that you have?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

I am going to give the floor to the people from the accounting department. (inaudible)

(inaudible) showing that we have 11 billion Reals of cash resources in Brazil -- well, let me again. We have 11 billion reals of cash -- how can I translate this? (inaudible) Financial implications [ph] (inaudible) financial implications. We have 11 billion Reals and we have outside Brazil, 3.2 [ph] billion Reals.

Q - Paul Cheng {BIO 1494607 <GO>}

How about on the liability side?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

On the liability -- let me ask them here to (inaudible) numbers. On the liability side, we have on the longer run, we have a 28.7 billion Reals, 23.7 U.S. Dollar denominated, 1.3 Yen [ph], .9 Euros, 2.6 [ph] in Reals.

Q - Paul Cheng {BIO 1494607 <GO>}

Thank you.

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Okay.

Operator

Thank you. Our next question is coming from Katie Blacklock [ph] of Thames River Capital.

Q - Katie Blacklock {BIO 17145068 <GO>}

Hello. I have a question on the domestic E&P division and specifically, the quarter on quarter decline in net operating revenues. From what I can see, the First Quarter net operating revenues are about 17.2 billion Reals. In the Second Quarter, they fell to 8.6 or 8.7 billion Reals so a fall of about 50% quarter on quarter. In dollar terms, that is actually a fall of about only 40% but still from what I can see, not explained by the 4% fall in volumes and the 15% fall in the oil realization price. So can you give me a little bit more detail as to why net operating revenues fell to the extent that they did in the quarter, please?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Firstly, the main driving force for this sector in our lifting costs is reduction in production [ph] and reduction in exchange rate. But anyway, I'm going to give the floor to (inaudible) who is our Executive Manager of E&P.

Q - Unidentified Speaker

(inaudible) Basically in the Second Quarter, we had some stoppage in (inaudible) platforms located in (inaudible) and as well, the exchange rate declining from about 10

[ph] % as our revenues are related to the Dollar, we had a decline in our profits. This is the main reason, all it is. But the current (inaudible) in July, for example we achieved (inaudible) 1.55 [ph] in August we achieved -- we are achieving to be 1.58 [ph] so we think we are going to recover and have a nice profit.

Q - Katie Blacklock {BIO 17145068 <GO>}

If I could, perhaps ask the same question a slightly different way because I still don't feel that the FX move and the fall in volumes fully explains that decline. If we look at the volumes in the quarter and the average realization price you explicitly state in the press release, we've got volumes of 1,512 per day. So over the quarter. And then a price of 25 21 [ph] which gives me revenues of about $3.5 billion. So in order to get to the 2.9 billion that you're talking about from E&P, I would have to assume that the contribution from the gas division was in fact negative so I still cannot get my numbers to add up based on the information you are providing in the press release.

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

You mentioned gas, the joint production of gas? I could not get your comments.

Q - Katie Blacklock {BIO 17145068 <GO>}

If I am looking at revenues from oil in the quarter, then I am looking at the volumes times by the price essentially in order to get the revenues (inaudible) for the quarter from -- specifically from the oil division. If I do that, I end up with a revenue figure of around $3.5 billion and yet, for the entire E&P division in the quarter, you only generated $2.9 billion. So either there is a mistake somewhere in terms of the average realization price or the volumes or in my calculation or else, the gas division actually gave a negative contribution in order to get to the 2.9 billion that you are stating for the Second Quarter E&P net operating revenues?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

It seems we had some adjustment on our (inaudible) numbers. Let me give you another person to explain this.

Q - Unidentified Speaker

Yes, besides these effects that (inaudible) was explaining, there was an adjustment in net revenue for about 1.5 billion as a result of an elimination that was done in the previous quarter amount between E&P [ph] and the downstream that this effect was corrected this quarter and this effect (inaudible) in the net revenue against cost of goods sold there in the gross margin, there wasn't effect [ph] on the total. Yes? I don't know if I explain.

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

It seems that we have a (inaudible) surprise mechanism that was adjusted in the First Quarter in relation to the Second Quarter but the average result is the same. The problem is the difference between the segments.

Q - Katie Blacklock {BIO 17145068 <GO>}

Okay, thank you.

Operator

Our next question is coming from Emerson Light [ph] of Credit Suisse First Boston.

Q - Emerson Light

Hi. Good afternoon everyone. Two questions. One is related to the tax reform in Brazil. We recently had this agreement within the -- with the governors [ph] in order to address roughly 25% of the CID [ph] collections to the government -- state government and my understanding of this issue is really moves forward and eventually the government decides to increase the CID tax from 50 [ph] cents or so, (inaudible) this will eventually lead to the give up of that idea of using this CID as a cushion for prices even [ph] domestic market which obviously has negative implications for the pricing environment going forward specifically as it relates to Petrobras. So I would like to hear what is your opinion, what is your thoughts about this issue?

The second question is related to gas pipelines in off [ph] regions of the country. We heard last week from the Secretary of Oil and Gas that now the Amazon [ph] government is bringing back the idea of building on their pipeline from (inaudible) down through (inaudible) and also from (inaudible) down to (inaudible) and I would like to understand what would be the involvement of Petrobras in these gas pipelines as I don't see a major investment (inaudible) being directed to these specific projects?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

In relation to the first question Emerson, the distribution of CID between the further evolvement [ph] (inaudible) a problem of the government. This I think is not going to affect the idea of using the CID as a cushion to minimize -- to smooth the impact of the variation of international pricing to the domestic market. The idea is that actual refinery prices is going to be following in a (inaudible) international price. As we are doing that, as we showed in the first slide of this presentation. And basically the government is going to divide it and I don't know, I cannot comment on that, the revenues from CID with the state [ph], I do not see why the idea of the cushion would be changed.

Actually the Minister of Finance has mentioned this, that the CID is important to play this role in the Brazilian economy which is to be a kind of (inaudible) to protect the Brazilian economy from the international variation of price and exchange rate variations. In relation to the gas pipeline, I have no big comments. I read in the papers this idea and we know that we have changed our relative importance in the gas and energy sector from thermal active [ph] plants to increase the gas pipeline network in Brazil. We're finishing a financial package with the Japanese J. B. [ph] and 10 other Europeans and Japanese banks to finance the network, the gas pipeline network, in Northeast and Southeast Brazil, which is a project of $1 billion.

And we think that's important to identify and to upgrade our gas pipelines. In the North of Brazil, we are considering the pipelines from--it will go to [ph] total value. And in (inaudible) we are considering and if we can solve the financial problems and environmental problems that we have, then we are going to have.

Specifically on the CID issue, obviously if you have 26 other governors to share the CID whenever you have to reduce the CIDE, you have 25 or 26 people to complain about that. So it's a much more higher political burden. That's why I think it jeopardizes a little bit the idea of, this idea of using a cushion. (inaudible) difficulties, yes but inflation, everybody is against inflation right? Gas is a very open clear and very visible price in Brazilian markets.

Q - Emerson Light

Okay, thank you.

Operator

Marc McCarthy of Bear Stearns.

Q - Marc Mccarthy {BIO 1542384 <GO>}

I would like to go back to the identification of this restatement of revenues between divisions. And also to clarify, the number that was shown in the press release, the $25.21 cents price realization that just applies to exports or third party sales? So my question is really, in relation to the inventory buildup in the First Quarter as of March, you had a very large buildup of oil that was not actually sold to the refinery. And now it seems in the Second Quarter, they passed from the upstream business to the downstream business. But you didn't actually record or maybe you can clarify all this.

The other question that was asked, do you see a significant drop in domestic upstream revenues, suggesting as though the oil was produced and not sold or maybe you have some other accounting related divisional restatement? I'm kind of curious if your First Quarter has been, in effect, restated vs. the second?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

I'm going to give the people from the accounting department but probably they are going to answer your question more completely in the site [ph] later on because the numbers I don't think that we have right now. But what again I want to mention is that we have run into a problem because we did that inventories [ph] in the First Quarter, buying oil at international going [ph] price that was above the price we have the Second Quarter. When we realized we used the covers [ph] that (inaudible) inventories which means that on average, cost was above the price of--in the Second Quarter. In the upstream and downstream relationship, these would appear as an increasing cost but I don't know if you have any comments, the people here.

Q - Marc Mccarthy {BIO 1542384 <GO>}

If the price of crude dropped in the middle of March and you didn't drop your prices until the end of April.

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Yes, our refining products. These are supply side--supply segments, the crude oil went down from 35 -- I mentioned the numbers, let me see if I can find how to here.

Q - Marc Mccarthy {BIO 1542384 <GO>}

You can call it $10.

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Yes, in the Second Quarter compared to the first one but if you do that [ph] the inventories [ph] would be prices [ph] higher priced. You have 32.67 in February, 30.5 for in March, 24.85 in April, 25.17 [ph] in May. These are the going price and reducing inventories in February and March, (inaudible) inventories reduced [ph] price and we [ph] use it in the Second Quarter.

Q - Marc Mccarthy {BIO 1542384 <GO>}

No, my only point is your nonsensitive product, your fuel oil and the bulk of your product prices that are fully deregulated and changing on a regular basis, didn't really change materially until the end of April?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Yes.

Q - Marc Mccarthy {BIO 1542384 <GO>}

You should have had plenty of time for this higher priced oil to flow through the system.

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Yes, I've been saying that in the Second Quarter, we reduced all our refining products. We reduced aviation fuel, we reduced the gasoline, we reduced 31% in fuel oil, 42% master [ph], 18% fuel oil and gasoline seven % and diesel six % in the Second Quarter. At the moment, that we are reducing the cost of our products that we sold our domestic [ph] market, we are realizing in the in the intersegment [ph] transfer [ph] from our inventories to the supply side with higher prices that we got [ph] in the First Quarter quarter.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Okay, I'm sure there is an explanation. Who was the person the answered the question earlier?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Alvis [ph]

Q - Marc Mccarthy {BIO 1542384 <GO>}

Alvis?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Alvis, he is from our accounting department. The problem that happened in the previous quarter was an adjustment between upstream and downstream areas. And the adjustment was in the fourth [ph] quarter an increase in the net revenue of E&P [ph] against a decrease in the net revenue off downstream. The same adjustment happened between the cost -- between E&P and downstream in terms of cost of goods sold, then the net result in gross margin was 0. Yes, we had problems just in terms of (inaudible) between net revenue and cost of goods sold. We don't have any effect in terms of gross margin, okay?

Q - Marc Mccarthy {BIO 1542384 <GO>}

And so would you say that this was restated on more of a first-half basis and this is why in a sense we see revenues per unit being too low in the Second Quarter and being too high in the first?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Yes, exactly.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Would you say that this is going to continue into the future or this was just related to the inventory build [ph]?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

No, it was a (inaudible) problem.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Okay, thanks a lot.

Operator

Marcello Misquita [ph] of UBS.

Q - Marcello Misquita

Hi. The question is related to (inaudible) the first one is now that the deal has been approved, I would like to know if you have a deadline for the announcement of (inaudible) official view on the synergies and what really you intend to do about acquisition? The second thing is if this issue of having consolidated numbers from them until only May, if that is going to an ongoing feature, or going forward you will always be able to consolidate the numbers correctly, the whole three months [ph] into your three months [ph]?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

In relation to the deadline, I do not have a deadline. We're continuing our work to try to evaluate the best (inaudible) that we have to get the synergies and the best way to manage our assets in Argentina. But we don't have a deadline, a precise deadline to make a decision on that.

In relation to the accounting procedure, we are trying -- I had a meeting with the people from my accounting department. We are trying to catch up [ph] the difference in time [ph] that they are complaining that are very difficult because of operational difficulties. But I hope that we can improve the process that we have for information from Argentina to Brazil. (inaudible) get the same time horizon for Argentina and Brazil. But for now on in this short period of time, it's difficult (inaudible) transition time now.

Q - Marcello Misquita

Also, do you have any news on the Haliburton [ph] dispute, any timing details?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

On the Haliburton, what we have is that the project is following the normal schedule. We had a meeting with them that showed that the new schedule is being followed closely and the platform is (inaudible) already (inaudible) in Singapore. The one in Brazil is also doing all right. We have more than 75% of the construction already done and we hope that we're going to start production by the beginning of 2005. We continue our meetings with Haliburton and KBR [ph] and all the lenders of the project and everything is going on as scheduled.

Q - Marcello Misquita

Okay. And finally if not a question, just a suggestion. I think by many of the questions including ourselves, we are very confused by the equity income line and we are very confused about the breakdown of the costs, especially the lifting costs and the other costs that you have out of the cost of goods sold. So if you could open this line and send any more detailed presentation or press release or something, I think it would certainly help us and I believe other analysts because I think we keeping asking this here, will be very long and we want to go much further, probably needs a bit more detailed printed stuff. Thanks a lot Gabrielli.

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Okay Marcello. We are going to try to include our disclosure of the numbers and we are going to put on our website more detailed information of those two lines. I know that is very difficult but we have to consider also that from details, we cannot disclosure [ph].

Q - Marcello Misquita

Okay.

Operator

Sir, does that answer your question?

Q - Marcello Misquita

Yes. Thank you.

Operator

Thank you. We do have a follow up question coming from Frank McGann of Merrill Lynch.

F McGann. Okay yes, just two things. One in terms of depreciation, depreciation came in a little bit higher than I was looking for. I was wondering if -- what the rate you would expect in the third and Fourth Quarters would be and what the actual cause was besides (inaudible) to the higher depreciation charge?

Secondly, in terms of production, I believe that you continue to go with the 1.59 million barrel per day oil production target for the domestic market, which is looking fairly aggressive at this point based on what we've seen so far this year. But I know you can ramp up production over the next three or four months and essentially, still make that. In what areas do you expect to see higher production so that you will be able to continue or be able to meet your own target of 1.59 billion barrels per day in Brazil?

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Hi Frank. Depreciation, I think we had a point [ph] problem now because of the (inaudible) -- we have a 3 month (inaudible) one month only [ph] and six [ph] months actually and that was Brazilian one month [ph] (inaudible) this I think was a kind of month [ph] for all type of impact that we had on depreciation. I don't see any major change in depreciation procedures, different situation in our assets [ph] that can lead to any change in the future for our depreciation numbers.

In relation to production, we had problems with the P 19 and P 35 in June. In July, we have increased our production already. We think we can increase production in (inaudible) Brazil (inaudible) can produce 1.-- 155,000 barrels per day. Marlene [ph] 500,000 barrels per day and (inaudible) 90,000 [ph] barrels per day and we are maintaining our target for domestic production.

Q - Frank Mcgann {BIO 1499014 <GO>}

Okay great. Thanks.

Operator

Thank you, ladies and gentlemen. Unfortunately, due to time constraints, we are out of time for questions. I would like to turn the floor back over to Mr. Gabrielli for any closing statements.

A - Jose Sergio Gabrielli {BIO 5474235 <GO>}

Well, thank you, all of you. I hope we can answer most of your questions. We are planning to keep our commitment to have a very clear commitment to transferring and disclosure of our numbers and we hope that we can improve even more what you already are doing. Good afternoon.