Q4 2004 Earnings Call

Company Participants

- Raul Adalberto De Campos, Investor Relations Executive Manager

Other Participants

- Frank Mcgann, Analyst
- Guiar Sagimo, Analyst
- Lucrecia Tam, Analyst
- Marc Mccarthy, Analyst
- Michael Schwabe, Analyst
- Patricia Vazquez, Analyst
- Paul Cheng, Analyst
- Scott Piper, Analyst
- Sergio Tamashiro, Analyst
- Unidentified Corporate Representative
- Unidentified Speaker

Presentation

Operator

Ladies and gentlemen. thank you for standing by and welcome to the Petrobras conference call to discuss their Fourth Quarter 2004 fiscal year results. At this time, all lines are in a listen-only mode. Later, there will be a question and answer session and instructions will be given at that time. Should you require assistance during the call, please press star zero. As a reminder, this conference is being recorded.

Today, with us, at Petrobras, Rio de Janeiro, we have Mr. JosÃ© SÃ©rgio Gabrielli de Azevedo, CFO and IR director and his staff.

At this time, I would like to turn the call over to Mr. Raul Adalberto de Campos, Investor Relations Executive Manager of Petrobras who has some additional comments. Please go ahead, Mr. Raul.

Raul Adalberto De Campos {BIO 17251399 <GO>}

Good morning, ladies and gentlemen and welcome to our conference call to discuss Fourth Quarter and 2004 fiscal year results. We have a simultaneous Webcast on the Internet that could be accessed at the site www.petrobras.com.br/ri/english. Additionally, on the Webcast registration screen you may download and print the presentation and download the financial market report. Also, you can send your questions to us by Internet, clicking on the icon 'question to host' at any time during this event.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities and Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Petrobras' management and on information currently available to the company. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on the circumstances that may or may not occur in the future. Investors should understand the general economic conditions, industry conditions and other operating factors could also affect the future results of Petrobras and could cause the results to differ materially from those expressed in such forward-looking statements.

Finally, let me mention that this conference call will discuss Petrobras' results prepared in accordance with Brazilian GAAP. At this moment we are unable to discuss any issues related to U.S. GAAP results. The conference call will be conducted by our CFO and Investor Relations Director, JosÃ© SÃ©rgio Gabrielli de Azevedo. He will comment on the company's operating and financial highlights and the main events during this quarter and year. Afterwards, he will be available to answer any questions you may have. Mr. Gabrielli, you may begin, please.

Jose Sergio Gabrielli de Azevedo: Good afternoon, everybody. I will start by trying to give you some overview of some important environmental conditions for the action of Petrobras last year comparing to 2003. As you can see on table on page 2, we had industrial production rose last year of 8.3%, comparing to 0.3% in 2003.

The wage will increase by 2.3 compared to -4.3 in '03. The unemployment rate also declined from 10.9 to 9.6. Those numbers are an expression of the recovery of the Brazilian economy. The increase of our growth in the Brazilian markets and this had a very important impact on our numbers. The Brazilian GDP growth rate was 5.1%, actually in the press today there are some idea that it was 5.2%, compared to 0.5% in 2003.

And then the consumer price index and general price index average showed a reduction on the inflation ratio in the consumer price index in spite of the increase in the general price index average. The result of all those numbers is that the Brazilian economy was very strong in 2004 compared to 2003. And, the impact on our company, you can see on page 3.

On page three we will show the market in Brazil for Petrobras increased by 6% in all products and the total market for Petrobras increased by 4%, including the international operations. We have increased in all different products. Diesel increased by 9%. Gasoline 6%. LPG by 4% and we have a general increase in sales in the Brazilian market.

It is important to highlight the excellent behavior of the natural gas market. We had an increase of 19% of the sales of natural gas in Brazil in '04 compared to '03. In our strategic plan, we have an average growth rate for the market for gas into 2010 of 14%. This was very important because the total domestic market is very important for the revenues of Petrobras because we sell most of our products to Brazil.

At the same time we had some difficulties in our production. As you know, the declining rate on offshore fields is between 7 and 10% a year and we have our own 83% of our average national production on offshore fields. However, in spite of this declining rate, our reduction in production was only around 2%, 2-3% during the year. This reduction was the result, the main result of the delays that we had in P-43 and P-48. P-43 started production at the end of the year and did not contribute for the annual production.

We had also some problems in the FPSO Marlim Sul that increased production during the Third Quarter but we had problems with sea push [ph], problems in the floor of the sea and we had to cut production by around 40,000 bbl a day and we are going to recover this in 2005.

Not only we had this production problem but also, as you know, the spread between middle distillates and heavy oil and heavy products increased during '04 as the spread between heavy oil and light oil.

For us, it was a better economic position to import more light crude oil to blend with our heavy crude oil and process in Brazil to sell the middle distillates that are necessary for the Brazilian market. As you can see in the Second Quarter of '04, the proportion of domestic [ph] crude as part of the total feedstock process was 73%, the lowest in the series that we are considering. This is a result of trying to get the margin for refined products in relation to the oil that we use in our refineries.

But our refineries also are producing almost to full capacity. We had a factor [ph] utilization of 89% in our refineries and we increased the primary process; increased the; the production of the throughput of our refineries during the year.

As you can see in this graph, this is trying to demonstrate what happened in the spread between light oil and heavy oil during 2004. As you can see, the difference between WTI price and MAYA [ph] price reached at the end of '04 something like $19 per barrel. But it is a very clear tendency for increasing the gap of the two types of oils and this affects also our own oil that's a heavy oil.

These are shown in this graph page seven, where you can see that the average sale price of our oil was in the Fourth Quarter for '04, of $35.11 per barrel while the Brent price was $44.02. There was a spread between Brent price and our own oil increased during the year 2004 as also was the case with the OPEC baskt [ph]. Why didn't it spread force [ph] as a result of that?

Compare now the average realization price of our oil products in the Brazilian market with the international price, we have here the green line is a Brent price, the blue line is the average realization price of the products that we sell in the Brazilian market, in reals converted to the dollar by the current exchange rate. The red line is a composite index where we have the U.S. price average weighted by the volumes that we sell in Brazil as if we could buy immediately the U.S. price in Brazilian market.

As you can see, during 2004 we kept a balanced relation between our average realization price in Brazil with the Brent price, sometimes reducing margin, sometimes increasing margin and that's below the U.S. price during all year to the end of the year. This has an impact on the results of the supply side of the business. Petrobras is an integrated company. But in the supply side of the company we have this impact.

On the Third Quarter for '03 our operating profit was almost zero and we increased our operating profit from the supply side of the business, the segment of supply from 0 to 1.4 billion real. Here we are trying to show the different impacts of the different values, the variables that affect these results. The first column shows the effect of prices on the net income. We had an increasing price at the end of the quarter that increased our net income by 1.2 billion reals. However, as we have a seasonal impact on the Brazilian market in the Fourth Quarter we had a reduction on the volumes that we sold in the Brazilian market and this had an impact of 2.7 billion reals as a reduction on the net income as a result of the reduction on the volume that we sold in Brazil.

The impact of the oil price went down, had an impact on cost of goods sold into the Fourth Quarter that gave us again, increased our operating profits by 1.1 billion reals. The volumes; less volume means less cost of goods sold and we had operating expense around 365 in such a way that we had an increase in the operating profit from the supply side from '03 to '04. This result has to be compared to the exploration/production segment of the business.

In the Third Quarter of '03 we had a very large operating profit and this number also was very big in '04. Also we had an impact on imports. As I mentioned before, we tried to import more light crude oil to blend with our heavy crude oil to process it to use as feedstock in our refineries. As you can see, we increased the import of oil from 319,000 bbl a day in 2003 to 450,000 bbl a day in 2004. At the same time we kept the same level of oil products, imports of oil products and we increased the export of oil products from 213,000 bbl a day to 228,000 bbl a day at the same time that we had a reduction in the export of crude oil from 233 to 181,000 bbl a day in 2004.

We had an increase in lifting cost. Our lifting cost reached 4.69 without the government participation, 12.43 with government participation. This increase in lifting costs are a result of a steady production. We have an increase in operation expense and other expense as a result of the increase in costs in the services providers of the industry that is a general factor affecting all the industry in the world scale [ph]. We had higher expenses, wages, an increase in the workforce and also we had an increase in the governmental participation as a result of the increased international price.

And, as we have some part of our lifting cost that are in reals, the appreciation of the real against the dollar increased the dollar-denominated lifting costs.

As you can see here we have the main factors that affect the increase in higher lifting costs and the first one the most important is the third party services, the second one is the increasing labor force and wages, the third one, as I mentioned before, was the currency appreciation. We had the lower production and we had the materials and public service and other costs.

Also we had an increase in our refining costs. We had an increase in refining costs as a result of higher expenses with wages and increasing the workforce, the same thing that we have in the exploration/production. We had a higher allowance for programmed stoppages and we had also remedial maintenance stoppages in other refineries. The total number also is a result of more complex oil refineries as a result of the beginning of operations of four new coking units in our refineries -- three Hydro treating, hot [ph] ADT [ph].

On the net profits. As you can see, we have almost the same net profits in 2003 and 2004, 17.8 billion reals. Although we had an increase in income as a result of volumes and price, we had 12.5 billion reals of increase in income and the cost of goods sold also increased 10.2 which gives us an increase of something like 2.2 billion reals comparing income and cost of goods sold. However, financial expenses and monetary variations and the exchange rate variation had a reduction, we had a loss of 3.7, 3.8 billion reals in 2004 compared to 2003. That was very important to explain why our operating; our net profits is almost the same comparing the two years.

We had also some SG&A increase. As you can see, we had a 34% increase in SG&A. This is basically a result of increasing sales expense due; as a result of oil products volume and also we had increased the sea freights. The cost of transportation increased very much in all of our activities and this affects very much the SG&A.

We had also an increase in sales and administration expenses and telecommunication, data processing, IT expenses because we are upgrading our systems, controlling systems, in the company. We had also, as I mentioned, the impact of the cost of transportation on E&P and on the supply side also of the business.

Not only we have good results in the exploration/production. But also we changed from a loss period to a gain period in the gas and energy segment of the business. We moved from 1.8 billion reals lost in 2003 to 0.874 billion reals of operating profit in 2004. The main reason for that is that the provisions that we had for losses in the thermalesque [ph] plants are not considered anymore as a result of the arbitration process that are going on right now and the acquisition that we had last year.

But also, we had, as I mentioned, an increase in the market for natural gas and also we had a more greater net income from commercialization of energy in Brazil.

As you can see, we had a 2.1 billion reals provision in 2003 but is not provisioned in '04. We had 19% growth in natural gas volume. We had a 25% increase in the energy commercialization revenue.

Here we are trying show how what the behavior of our cash balance. As you can see, we moved from the Fourth Quarter of '02 to the Fourth Quarter of '03, we increased our cash by something around 13 billion reals. This gave us in the beginning of 2004 a very strong cash balance position. During 2004, we had a reduction of 6 billion reals of our cash balance.

In proportion, we have an increase in cash balance of U.S. denominated abroad, offshore a Brazil or in Brazil but with foreign exchange corrections. This is important to mention because we had a different behavior of the exchange rate in Brazil in 2003 compared to 2004. In 2003 we had a depreciation of the dollar, an appreciation of the real of something like 18% and this was a uniform behavior during the year.

In 2004 during the First Quarter we had a depreciation of the real. In the Second Quarter we had an appreciation of the real in such a way that during the average of the year we had an appreciation of 8% in reals comparing to dollars. This has an impact on the revenues that you can get from the use of our cash balance.

As you can see in the next slide, page 19, we tried to reconcile the net financial expenses in '03 with the net financial expenses in '04. In '03 we had a positive net financial expense of 1.3 which means we had gains of 1.3 billion reals and now we had losses of 2.4 billion reals. The main reason for that was the operations with the PEPSA Argentina hedge concept that we have in Argentina. We have 30,000 bbl a day contract with a fixed price and the difference between the current price and the fixed price is a loss for us which gave us a loss of 807 million reals in 2004.

Also, it was important to mention the effect of the small appreciation of the peso in Argentina in relation to the dollar and the net debt of the subsidiaries in Argentina. And also, it is important to mention the effect of a small appreciation of the real in 2004 in Brazil compared to 2003. All these three variables are responsible for something like almost 2 billion reals of difference between the net financial expenses and revenues in 2004 compared to 2003.

If you look at our cash generation, our EBITA, we had a 36 billion reals EBITDA. We had an increase in EBITDA and we've had a small reduction on the margin in 2004. If you go to page 21, we are trying to highlight some of the cash flow highlights. As I mentioned before, we have a reduction of cash balance by 6 billion reals in 2004 in comparison to an increase in our cash balance by 13 billion reals in 2003. The difference between the two is something like 19 billion reals.

These 19 billion reals were used to amortize our debt. Last year we paid 3.5 billion reals of debt. We reduced our debt by 3.5 billion, in comparison to 2003, when we had an increase of 7.5, which means that we had a reduction of our debt by 11 billion reals during 2003. Also, it is important that we had an increase in our inventories. We increased by 6.2 billion reals our inventories and as a result of that we had a reduction in our cash balance. We also had an investment; we increased our investment by 3.4 billion reals. We invested last 21.7 billion reals compared to 18.3 billion reals in 2006 (ph$). We also paid dividends by 5.4 billion reals in 2004.

As I mentioned before, we had an investment of 21.8 billion reals, 57% in exploration/production, more than last year, not only in absolute terms but also in relative terms. And we had a reduction in relative terms of supply investments and we had an increase in our distribution. We acquired control of ashitee [ph] in Brazil, which is a geo LPG distributor in Brazil. This was important also to the impact on our results.

On page 23, we can see that our leverage ratio is going down. Now it is at 36% and our short term debt on top of that is 16%. We had a reduction on our gross debt and we kept the net debt to the same level, around $35 billion. Our cash, as I mentioned, went down from 25 billion reals to something like 19 billion reals.

On the next slide, page 25 is our yield curve that shows a decrease in cost of debt in Petrobras. During 2003 we had a loss of issuance of debt. In '04 we had a reduction on this issuance and we didn't need really to increase the demand for new resource and we are very opportunistic now on the debt market. We want to minimize our costs to reduce the costs of our debt and to increase the length, the maturity of our debt and at these yield curves on the secondary market of our bonds shows that the market is following this situation. We reduced our costs, we increase the length of our yield curve but we are far from what we view our benchmark, which is the current measures bond.

Also in this table we have some financial ratios that are good financial ratios. We have a net debt on EBITDA of 0.9 in 2004. We had a coverage ratio of 8.5 (inaudible) down in interest. We have 1.08 net debt on top of proved reserves and we have a capital structure (inaudible) on total liabilities of 56%, compared to 61% in 2003. And our total debt on proven reserves we have 1.8 billion reals per barrel in our reserves.

In relation to the future we have a very good position compared to many; several other oil companies. We have an internal replacement ratio of 170%. This is very good compared to many important, big oil companies in the world right now. We've moved our proven reserves from 12.6 billion bbl of oil equivalent under BOE criteria in 2003 to 13.02 billion bbl of oil equivalent in 2004 in spite of the increasing production of 0.6 billion BOE during the year of 2004.

We had new areas incorporated into the Golfinho, Baleia Azul, Baleia Ana, Baleia Bicuda fields, Piranema and Lagosta. We had also started production field construction Ring Fence [ph], Espadarte and we had re-evaluation of existing fields in 2003 in such a way that we could increase our reserves by organic growth.

On our onshore production, we had a growth rate of 2.2% per year. Our onshore production is important because it is lighter; we have a lighter oil in our onshore production than in our offshore production and we could keep 251,000 bbl a day of the onshore production in 2004 with the reserve ratio; proven reserves of 1.2 billion BOE in 2004. To increase the production, these less CapEx than the onshore. The less; the investment is smaller in those fields compared to the offshore fields and also we could overcome the decline rate and keep the production growing.

We are planning to increase our production by 14%, increasing average production at the end of 2005 to 1.7 million bbl a day. This is going to be possible because we have already producing around 60,000 bbl a day in Caratinga P-43. We have P-48 already starting production and we think that we can reach the peak of production during 2005 in March '05. We are expecting to have P-50 with 180,000 bbl a day in the Third Quarter of '05 and Jubarte phase one with P-34 in the Fourth Quarter of â€˜07. We are going to reach a production average of 1.7 thousand barrels per day in 2005.

Also we have a very good exploratory portfolio. We have concession areas now from the south of Brazil, far south of Brazil in Pelotas Bay bazing [ph] into the north of Brazil in the mouth of the Amazon River, including Amada [ph]. And we have a diversified and very prolific concession areas and we have a very good exploratory success ratio.

We have also, on page 30, we have also important projects to improve the quality of our diesel and to allow us to process more of our heavy oil producing lighter products which means that we have very good process petrols in 2005.

Thank you, again go now to the question and answers.

Questions And Answers

Operator

Thank you. The floor is now open for questions. If you do have a question, please press star, then one on your touchtone phone. If at any point your question has been answered, if you would like to remove yourself from the queue, you may do so by pressing the pound key. We do ask that you please pick up your handset to minimize any background noise. Once again, if you do have a question, please press star, then one on your touchtone phone at this time. Please hold while we poll for questions.

Thank you. Our first question is coming from Frank McGann of Merrill Lynch.

Q - Frank Mcgann {BIO 1499014 <GO>}

Hi. Good afternoon. I just have three quick questions. First, on CapEx, I was just wondering if you could provide some details on your spending and the breakdown of spending in 2005 between E&P and the other key areas. Also, given the higher level that you've been indicating for this year, does that indicate that you're spending through 2010 is going to be higher than you had previously indicated?

Secondly, just in terms of taxes and the issue that's come up today in the press about the ruling that went against you in the case relating to the leases on the platforms. Perhaps you could just provide an update on that so we can see what your actions are going to be from here. And then, thirdly, on the petrochemicals side I was wondering what the current status is of your plans to decide whether to increase your stake in Braschem and or the other key pieces for your future petrochemical strategy.

Jose Sergio Gabrielli de Azevedo: Hi, Frank. On the third part, we are going to make our decision on the call in the moment that we have to make the decision. We are not going to anticipate our decision.

The ruling related to leasing on platforms. For sure we have a ruling decision against us but we have two more administrative recourse that we can use and we are going to use in the administrative area and also we are very much confident that we go; if we lose in the administrative area we are going to the judicial system.

On the CapEx, we didn't release in the past year to year the investments through 2010. Up to now we are keeping the target for $53.6 billion through 2010. We are in the process of revision of our business plan for 2005 and by May we are going to release the results. If we change, we are going to announce. I don't know if; I'm sure that the decision on 2005 is not immediately reflected in the impact on 2010.

We announced that we are going to invest in 2005 around $30 billion, 29.6 billion reals. 22 billion reals from our own sources. The funds are going to come from our operating activities. 7 billion reals would come from third parties. 15.9 billion reals we are going to invest in E&P in Brazil. That's the breakdown that I have right now.

We are approaching a exchange rate of 3.01 reals per dollar, not 4.65 in these numbers and also we are not projecting any big change in the types of projects that we have in the Fourth Quarter. The increasing amount reflects very much the increase in costs and some adjustments on the delay of some of our projects.

Okay. Thank you, very much.

Operator

Thank you. Our next question is from (inaudible) of Credit Suisse First Boston.

Q - Unidentified Speaker

Hey. Good morning. Three questions. One is related to the conversion of the (inaudible) units that you are bringing into your refining part. We have this new coke unit that should improve your ability to convert fuel oil into diesel. I would like to know what is the gain in terms of refining margins for the company. How much more refining margin on a per bbl basis you can make through these new conversion units?

The second question, still on the refining side, I'm trying to understand your strategy on the international front, to get some quotes in the press yesterday that the company was still looking for opportunities in the U.S. for no [ph] leasing, refining capacity, eventually in partnership with Fedaveso [ph], I would like to understand better this development, how are you thinking about that.

And the third thing is still on the pension fund discussion. I understand that there is a decision that needs to be made until the end of March. Are you considering the possibility of injecting cash into the fund as part of the solution for that?

Jose Sergio Gabrielli de Azevedo: Well, I'm going to talk on the pension fund first, then international and then on the refining margin. On the pension fund we; I tried to emphasize that there are two different things. One is the impact of the pension fund, unfunded pension fund in the Petrobras accounting balance and the impact on the petros [ph], the pension fund itself outside of Petrobras. We need to solve the deficit problem in the pension fund in the petros which is a foundation that's not Petrobras, is an independent foundation. This we need to have a solution the moment until March 31st. But this can be postponed.

The solution, if there is no negotiation, if there is no adjustment on this part of the deficit must be 50% for the participants and 50% for the company. However, this does not imply cash movement for the entirety of the deficit immediately. This has to be covered along all the productive life of all the employees, which is something around 14 years. Give me 14 years.

But this is one solution. One solution implies a change in the pension fund from the fund benefit to a fund contribution, pension fund. If we reach this agreement, this can be a rather different solution. I don't think that we are going to have any type of cash movement from Petrobras to petros in the amount of the deficit right now.

On relation to international strategy for refining, we know that the differential between heavy oil and light oil tends to increase and for us that we plan to increase our production for heavy oil, including increasing our exports of heavy oil. It is very important for us to know that we are going to be a big producer of the heavy oil which means we are not going be price broker of heavy oil but we have impact on the pricing consistent in international market of heavy oil. In such a way that is very important for us to add value to our product in the international market. One way to do that is to increase our capacity to use our oil in the international markets.

I don't think that right now it's good for us to buy a refinery that we have capacity to prices heavy oil because the price of the refinery we have already discounted of this differential between the heavy oil and the light oil. However, to increase the capacity of conversion internationally and to allow us to access new capacity in the heavy oil area is important for our strategy. That is the point that we are trying to make. This doesn't mean that we are necessarily going to buy a refinery in the United States but we are going to look for possibilities to increase the capacity for conversion worldwide.

On the relation to the margin, we are not going to answer this, Emerson. I have two years fighting with you and some analysts to try to say that the margins are not going to be disclosed in the way that you want.

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. Several quick questions. On the P-50, can you tell me when you expect that that's going to start up?

Jose Sergio Gabrielli de Azevedo: The P-50 we are planning to have a production as to the first oil by the Third Quarter of '05.

Okay. Because I thought â€” so when do you expect that going to peak?

Jose Sergio Gabrielli de Azevedo: Peak. Between six and twelve months after this.

So some time, then, in 2006. Because on the top it seems like you suggest that it's peaking at the Third Quarter 2005 so I was a bit confused. And then the P-43, that has already started up. So you're looking at, you say, December 2005 so I thought you're saying that it's peaking at December 2005 for the P-43.

Jose Sergio Gabrielli de Azevedo: No, P-43 is already producing 65 -- 60,000 barrels a day and is going to reach a peak period in 2005. And also we are expected to have a peak of production in 2005 but P-50 though is going to have a peak in 2006.

Okay. That's great. And also the capacity, you are talking about 180,000 bbl a day. I thought previously that that was more like in the 145, 150. Have we changed the scope of the project?

Jose Sergio Gabrielli de Azevedo: Which project?

On the P-50.

Q - Unidentified Corporate Representative

The capacity of the P-50 is 180,000 barrels of per day but we have a 90 [ph] % and the rest so EBS [ph] 10%, this is the capacity.

Q - Paul Cheng {BIO 1494607 <GO>}

I know. But I'm saying that the gross capacity, I think previously was talking more like 145, 150,000 bbl per day, instead of what you show saying that the capacity is 180,000 bbl per day so the question is that have we changed the scope or that my number previously just wrong.

Jose Sergio Gabrielli de Azevedo: We never changed the capacity. The capacity is 180.

Okay. That's fine.

Jose Sergio Gabrielli de Azevedo: Okay [ph] 50.

Okay. And when I'm looking at your realization, because of the heavy nature of your oil. So sequentially from the Third Quarter that actually is down, based on the data that you provide. So why the government participation will actually be up sequentially from the Third Quarter? I thought that will be a % of your revenue and if your revenue on a per bbl basis is down, why that should be up?

Jose Sergio Gabrielli de Azevedo: Yes, I think that on our government participation we have an international Brent price actually. Very linked to the Brent price. But into the Fourth Quarter, the Brent price increased 5.9% from the third to the Fourth Quarter so we had this increase in the Brent price.

So your government participation is actually not based on your own realization, it is based on an international benchmark.

Jose Sergio Gabrielli de Azevedo: Yes. So correctional.

And in the Fourth Quarter, the effective tax rate I think is not in the 21% or so. I think your normalized tax rate is more like in the 34, 36%. Is that in addition to, say, the reversal of the tax cut that we're going to see in Argentina? Is that also related to the interest on capital that you just declared and that you just retroactive that have the tax benefit in the Fourth Quarter?

Jose Sergio Gabrielli de Azevedo: You mentioned the tax on the other expense; what is the account that you are mentioning?

I'm saying that if we looked at your effective tax rate in the Fourth Quarter, that is lower than what is your nominal tax rate. I think your effective tax rate is about 21% or so in the Fourth Quarter and I know that you have made an adjustment related to your â€" in a tax credit that you claim about 189 million reals related to the Argentina operation because you're going to restructure it and fully consolidate all the operation there so in addition to that it seems like your effective tax rate is still low.

So my question is is that primarily due to the impact or the tax benefit you received from declaring the interest on capital just in February which will retroactively back to get the credit; tax benefit in the Fourth Quarter or that there is other items in there that we should be aware?

Jose Sergio Gabrielli de Azevedo: I would say that I don't know the exact numbers but I would say that our interest on capital has a very important impact on our tax that we pay. We have a tax benefit when we use the interest on our own capital. I don't know exactly the numbers but for sure this is important impact on our tax expense.

Two final questions.

Jose Sergio Gabrielli de Azevedo: Reduction of our tax expense.

Sure. I understand. Two final questions if I could. One, can you give us a number say the planned and unplanned outage? What is the production loss in the Fourth Quarter that you can cite, including plan and unplanned outage and then finally that when we look at the financial income I'm not sure I fully understand why that in the Fourth Quarter we have a pretty large loss despite you have 19 billion reals in the cash position.

Jose Sergio Gabrielli de Azevedo: The financial loss that we had in the Fourth Quarter ...

Financial income. For the financial income, that line item.

Jose Sergio Gabrielli de Azevedo: Pardon?

For the financial income. That line item. When you report your results, you have financial income, you have financial expense, you have monetary gain or loss and just wanted to look at the financial income which typically is your interest income or the bond income that you receive from the holding of the government bond. With 19 billion reals in your portfolio in cash, I know that how that is going to adjust on because of the different exchange rate and all that but it is still a little bit difficult to see why that we were actually instead of having an income, would have a loss in that particular line item. So maybe you can help me to understand maybe better.

Jose Sergio Gabrielli de Azevedo: Yes. The financial results we have on page, on slide number â€" let me try to get that here. On slide number 19 we tried to show some of the consideration between the financial positive results in 2003 with the loss that we have in 2004. One thing is that the exchange rate has different areas, different factors. In 2003 we have an appreciation of the real against the dollar of 18%. In '04 the appreciation was only 8%. There's a big 10% difference.

However, our cash balance in 2003 was greater than our cash balance in 2004. But this is one line of the balance only because this shows that we have a cash balance that is smaller in 2003 in dollars. And in real ...

I'm sorry. Can I interrupt for one second? Can we look at the comparison between the third to the Fourth Quarter.

Jose Sergio Gabrielli de Azevedo: Yes? Third and fourth?

Yes. The Third Quarter to the Fourth Quarter sequentially from the September to the December quarter on your financial income.

Jose Sergio Gabrielli de Azevedo: You are talking on our release to the market. Let me try to get the table here.

That we see from your financial income from the third to the Fourth Quarter from a income of 11 million to a loss of 561 million reals. So I'm trying to understand that while your cash balance is actually higher from the third to the Fourth Quarter so I'm trying to understand that what may have caused close to a 600 million real reversal or a change from the third to the Fourth Quarter.

Jose Sergio Gabrielli de Azevedo: Oh. Our cash balance in the Fourth Quarter is greater because we have a greater volumes sold in Brazil and prices are very; were higher then in the Third Quarter. Which means that we have a cash generation. Our revenue was greater in the Fourth Quarter in relation to the Third Quarter.

Right so ...

Jose Sergio Gabrielli de Azevedo: Also we had a great expense also. It's true, it's true.

Okay. Maybe I will take it off line. I'm trying to understand that with the cash balance position is higher, why that the financial income which including primarily I think is the interest income orders were actually swing negatively from the third to the Fourth Quarter.

Jose Sergio Gabrielli de Azevedo: We had also some losses in the hedging contract in Argentina that had an impact on our cash balance.

Can you tell us how big that hedging loss is in the Fourth Quarter?

Jose Sergio Gabrielli de Azevedo: Yes. This was in the Fourth Quarter because we mentioned here a loss during the year of 807 million reals?

So that (inaudible) in the Fourth Quarter?

Jose Sergio Gabrielli de Azevedo: That's not all in the Fourth Quarter. Was spread not equally. But in the Fourth Quarter probably it was very big because the oil prices peaked, I think, around November.

Okay. But you don't have an exact amount. Okay that's fine. Can you tell us what is the planned and unplanned outage we saw in lost production in the Fourth Quarter?

Jose Sergio Gabrielli de Azevedo: Production in the Fourth Quarter?

The lost production relating ...

Jose Sergio Gabrielli de Azevedo: Lost production in the Fourth Quarter ...

Related to maintenance program as where some planned outage in the Fourth Quarter.

Q - Unidentified Speaker

The production in the Fourth Quarter was almost the same as the Third Quarter. We had some stops in terms of (inaudible). This is the reason why we decreased it 1% but today we are producing more, we are producing today 1506 [ph] thousand barrels per day and increasing to 1600 in the next day.

Q - Paul Cheng {BIO 1494607 <GO>}

Okay. Very good. Thank you.

Operator

Thank you. Our next question is coming from Guiar Sagimo [ph] of JP Morgan.

Q - Guiar Sagimo

Hello. I'm just trying to get to grips with the capital expenditure question that was raised earlier. And on the numbers that you disclosed then on your exchange rate, it looks as if the E&P CapEx would be up to something like $5.3 billion this year. I was just thinking about; I was just hoping to get a clarification on which projects are dragging the CapEx up, whether it is project related or underlying cost related because I would have thought that most of Baracuda Caratinga would have been capitalized in 2004 and given the advanced stage of P-50 that most of that CapEx would have already been incurred. So, in other words, is this project related or underlying cost pressure?

And secondly do you believe that it's a particularly heavy year for E&P CapEx and that CapEx E&P would be expected to fall in 2006?

Jose Sergio Gabrielli de Azevedo: Despite the fact that we didn't disclose our year-to-year investment plans in our strategic plan, we knew that 2005 was a year that we had a very big CapEx project in the strategic plan. Usually we have in the two first years of the strategic plan more investment than in the end of the period but on the particular projects I would ask Mr. Marcuzzi [ph] to give you the details.

Q - Unidentified Speaker

Okay. We are investing, as Mr. Gabrielli mentioned this year 15.9 billion reals in E&P in Brazil. Considering the exchange rate of three reals per dollar, it's equivalent to $5.3 billion. The main project that we are investing this year are P-50 in Albacore West, Jubarte phase one, P-34 to come in line by December of this year and during this year we are also investing in the big projects to come in line from 2006 on mainly P-52 one, Marlin Sul, P-52 in Roncador and 54 in Roncador as well.

In 2006, we are as well starting the production of light oil in Spirit sum [ph] so we have the wells to be connected to gofir [ph] one a new excess shelf for next year and gofir two as well. So this is are the main project so in dollars we are planning to close this year investing $5.3 billion, the last two years we invested 4.6.

Q - Guiar Sagimo

Thank you.

Jose Sergio Gabrielli de Azevedo: Yes. Also we have some charges that are come on stream right now. That we have a dispatch [ph] that is going to start in 2005 that when it is starting in 2005 -- and this, if you take 3 reals per dollar for the investments of 30 billion reals, this is going to be more or less what we are planning in the 53.6 billion portfolio.

Okay. On the remaining part that does not go into E&P, are there any particular large-scale investment projects in the downstream of other areas that you would highlight or mention the 2005 that we should know of?

Jose Sergio Gabrielli de Azevedo: I don't recall right now any big projects; only refrac [ph].

Thank you, very much. Just one final question, a financial question. It's on page number 19 of your Brazilian GAAP report you're referring to a big movement in the working capital in the Fourth Quarter referring to other adjustments and it's 4.9 billion positive and it doesn't specificy what it is and it is clearly not; seemingly not related to inventory or suppliers so I was wondering if you could specify or give some details as to why that occurred?

Jose Sergio Gabrielli de Azevedo: Yes. 807 (inaudible) if we can give you answer or; I would ask I would just send you the answer.

That's perfect. Thank you, very much.

Operator

Thank you. Our next question is coming from Marc McCarthy of Bear Stearns.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Hi, guys. It's Marc McCarthy from Bear Stearns. I have a few questions. Jose I asked you last quarter about the level of imports, level of inventory build, the average cost on the balance sheet. I'll come back to the same question. Maybe if; I don't know if Filippio [ph] is there, we can touch upon the question of how much storage capacity do you have and where are we at to; where I am going with the question is ultimately what is the level of imports next year?

That's basically what I am trying to draw from this and what sort of a reversal on that working capital position will we see in light of the fact that your Brazilian prices are far higher than the purchase price for those inventories. That's the first question and then the second question I'm hoping for Marcusa [ph] to tell me some update about the ES-132 and the RJS-409 auctions. When are they likely to occur and may that push us out of 2006 assuming a 14 month lead time for startup.

And then the last question is related to other income. As we look at the Fourth Quarter other income and you may have said this in your comments earlier, I missed it, there seems to be a sizeable credit in the (audio gap) for other income. And I hope that's clear. I don't know if you're able to comment on what that credit was. Something in the order of 700 million reals. Thanks very much.

Jose Sergio Gabrielli de Azevedo: Again, I am going to ask, Alita [ph] to give you the answer on inventory and inventory capacity and imports on 2005.

Q - Unidentified Speaker

Hello, Marc. We have inventories. We are working with the same number of days in terms of oil available to oil refineries. If you look at our operational inventories, they are not higher than we had last year. You have to consider that our sales increasing about 143,000 bbl per day. It means we had the same number of days in terms of inventories of good oil that we had last year.

Just to give you some idea, in our refinery we are from 4.5 million that we have in our operational stocks we have in our refineries about 1.2. We could go up to 2 million, 2.5 million in our refineries. We have some stocks now at turnoust [ph] we could double or triple our stocks in terminals [ph]. And we have the stocks in our ships coming from the production areas and we have stocks in our production platforms as well. You have to consider that whenever we have a new production unit we have an increase in inventory, as well, because the way we are getting oil from these platforms we are using 1 million barrels of excess to get the crude oil from this production system. It means as long as we are increasing the number of production platforms we are increasing stocks of crude oil, as well.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Right. But if we look at the last nine months you've only had two units installed and yet apparently every quarter you've built in oil inventories of about 100,000 barrels a day each quarter, no? According to the numbers that are included in the release.

Jose Sergio Gabrielli de Azevedo: If you look at the average of 2003 and the average of 2004, we had the same number of days of crude oil stocks ...

But I'm just looking at the last nine months.

Jose Sergio Gabrielli de Azevedo: Okay. I can have a look in more details in monthly to give you a better idea. We can talk later about that and can discuss. But I mean we have spare capacity if you would like to build stocks but it's not our policy to build stocks. We are working with very low stocks in our refineries, I would say 3 to four days of crude oil stocks in the refineries.

So why do we end the year with a 6 billion reals build in inventories?

Jose Sergio Gabrielli de Azevedo: Remember, we had a price impact also. We're including price.

Right. No. And I recognize that. But both on the volume side and on your working capital side we see this build in inventories.

Jose Sergio Gabrielli de Azevedo: I would say that the build in stock â€" it is according to our increasing sales as well.

Q - Unidentified Speaker

Marc, it's Marcusa speaking. Regarding Spirit sample 132, we are calling now is Spirit sample 132 and we plan to sign the contract to construct; to implement the new SPSO [ph], to sign a contract next month so we are expecting to have the first oil by the third or Fourth Quarter of 2006. The same can be applied to RJS 409 in Espadarte so our plan is to start the production until the end of 2006 as well.

Jose Sergio Gabrielli de Azevedo: Marc, can you repeat the last question on the other incomes because I could not understand exactly what you meant.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Sure. On the income statement you have a line called 'other income' or 'other expenses' or just other. It traditionally has been averaging about 1 billion reals negative. The fourth -

Hello?

Jose Sergio Gabrielli de Azevedo: I didn't get your; we had some problems in the connection.

I'm sorry. On your income statement you have a line item called 'other operating expenses or other expenses.' Traditionally is around a billion reals negative and this quarter dropped significantly and I'm curious as to what was the offsetting number. Now, you do break that number out divisionally, actually and; but on your divisional numbers or where you break it out you have another item there as well and that seems to be where the credit was. My number says 673 million reals.

Jose Sergio Gabrielli de Azevedo: Yes. It seems to me now; I understand it. It seems to me we are going off the provision for participation; profit participation. Before that we had these numbers in other lines in the last quarter. By mistake we didn't put it on the correct line and now we are correcting this but I don't know if you have the correct version or not for the release to the market.

Okay. So the second and other losses were too high and you've reversed some of those?

Jose Sergio Gabrielli de Azevedo: Yes; We changed lines. We moved lines from one was classified as other expenses and now it's the fixed line.

Can you tell me which line it is now?

Jose Sergio Gabrielli de Azevedo: It's now in; It's pre-cost [ph] profit participation.

Oh, it's profit sharing?

Jose Sergio Gabrielli de Azevedo: Yes, profit sharing. But you see I don't have the numbers with me. Let me see what I'm talking about.

You had a profit sharing number of 783 million.

Jose Sergio Gabrielli de Azevedo: Yes. Yes.

So if that was reported on an apples to apples basis then in fact the EBITDA would be a different number? Is that correct?

Jose Sergio Gabrielli de Azevedo: No, there is no impact because it was already considered in the other line. Now it's only split in a line that is clear.

On our demonstration of results by segments we moved this number from other operational revenues to employee participation.

Right. So you moved it out of the calculation of EBITDA to below the earnings before tax number?

Jose Sergio Gabrielli de Azevedo: Yes.

So year over the year the numbers were not necessarily comparable? Or were they excluded last year as well?

Jose Sergio Gabrielli de Azevedo: Last year it was excluded also. It seems it was the same thing. There is no change in the accounting procedures.

All right. I'm still a little confused. Maybe we can come back to it after the call.

Jose Sergio Gabrielli de Azevedo: Okay. I will talk to you.

Thanks.

Operator

Thank you. Our next question is coming from Scott Piper [ph] of Morgan Stanley.

Q - Scott Piper {BIO 1962169 <GO>}

My question has been answered. Thank you.

Operator

Thank you. Our next question is coming from Sergio Tamashiro of BBVA Securities.

Q - Sergio Tamashiro {BIO 2274485 <GO>}

Hi. Good afternoon. My question is still regarding the other expense. I though you mentioned that was regarding this reversion in profit sharing but I could see almost an equivalent increase in SG&A but you said that it went to the profit sharing line so could you explain why the SG&A line increased?

Jose Sergio Gabrielli de Azevedo: SG&A increased, we explained, we are trying to identify the different variables that affect; let me see here where; on slide number 15 we have increased in sales expense due to more oil volumes sold in the period and high expense related to sea freights. We have a transportation cost increase and we have an increase in sales cost as a result of volumes, that we sold more. Also, we had some impact on telecommunication, data processing and software that we put the SAP R3 [ph] is arranging the software [ph].

So can we consider this Fourth Quarter 1.4 billion reals in SG&A as the current items or ...

Jose Sergio Gabrielli de Azevedo: We had an additional cost in the Fourth Quarter that are not going to be recurrent in the -â€" or the other calls and plus [ph]; We have an adjustment, for example, we have our wage adjustment occurred in the Fourth Quarter only.

And how much would be this current order expense? 145 or hopefully 1 billion, how would be the current expense.

Jose Sergio Gabrielli de Azevedo: I don't have the number right now. Anyone [ph] has the number there. The recurrent SG&A without the exception of the; no recurrent. The accounting people are saying that they are going to be constant but not; and in this way they are going to be recurrent but they are not going to increase. That is the idea that we have.

But can we consider for this quarter 906 or is that too much conservative?

Jose Sergio Gabrielli de Azevedo: I think that's after the information is going to be this number. I don't think that's too much conservative right now.

Okay. And regarding those (inaudible) high lifting costs, you already mentioned in press release that was due to those maintenance costs, recovery etc and higher than expected increase in this qualitative bergani [ph] agreement, therefore it seems pretty much be all recurrent items and you gave previous guidance for long term that long term lifting costs could go to $3 per barrel in 2010 but looking just at short term, can we expect this maintenance in lifting costs and also refining costs or what would be the bias?

Jose Sergio Gabrielli de Azevedo: On our long term on the lifting costs of $3 a barrel we are also considering in the long run price of oil is $23 a barrel. And this is the price of oil is more than that probably because the cost add to that now as you can see the month right now. Long time high price implies taking down back on the price of the service providers.

Q - Unidentified Speaker

Serge, this is Marcos [ph] speaking. It is important to mention as well that the biggest profit from line P-51, 2, 3. And 4, for example will produce with a low lifting cost and to give you a flavor of that, Marlin Sul for example, produced 500,000 barrels of oil per day with our leasing cost below $2.5 dollars per barrel so it's important to mention that the big systems will increase the productivity.

Q - Sergio Tamashiro {BIO 2274485 <GO>}

But how about this First Quarter with the start of the P-43 and P-48. So can we expect lifting costs below $4?

Q - Unidentified Corporate Representative

In the Fourth Quarter it is important to mention that the exchange rate comparing to the Third Quarter decreased 6.4%. So we have an increase in the lifting cost in dollars per barrel. Another point is the start of production of P-43, we added costs without production so we increased the lifting cost as well. Another point is increasing the work force and the wage. So we have an increase of the lifting cost. For example, excluding the exchange rate effect, the lifting cost increases in reals per barrel 9% and not 16.4% in dollars per barrel so we had this effect in the Fourth Quarter.

Q - Sergio Tamashiro {BIO 2274485 <GO>}

But looking for the First Quarter '05 so we might expect a decrease due to the start of P-43 and P-48.

Q - Unidentified Speaker

Yes, of course it depends on the exchange rate level, Okay?

Q - Sergio Tamashiro {BIO 2274485 <GO>}

Okay. And my last question regarding still this CapEx for 2005. You mentioned this 29.6 billion reals for 2005. Do you consider anything for this call for the Braschem or if you exercise the call, we have to increase this CapEx, the cash CapEx.

Jose Sergio Gabrielli de Azevedo: As I mentioned before, we are going to announce our position in the moment of the call, not before.

Okay. But therefore this 29.6 does not include anything.

Jose Sergio Gabrielli de Azevedo: Probably not.

Okay. Thank.

Operator

Our next question is coming from Lucrecia Tam of Deutsche Bank.

Q - Lucrecia Tam {BIO 1495775 <GO>}

Yes. Hi. Good morning. My question refers again to the other operational expenses. And I see that compared to 2003, I think the major change relates to not provisioning for losses with the thermo electric, I know that you are currently in dispute or trying to get to an agreement. And I wanted to know to what level we could expect in terms of charges to the income statement should not be successful.

Jose Sergio Gabrielli de Azevedo: On the thermo electric plants we are not provisioning any loss but we have to consider each may have a loss as an operating expense for us if we don't reach an agreement. And if we don't reach a solution as soon as we expect to.

Right now we have a negotiation process with the two thermoelectric plants that are in the beginning of the process. I don't if that is your answer. I don't know if that all details your question.

I just wanted to know what sort of operating expenses you would expect in 2005 should you not reach an agreement.

Jose Sergio Gabrielli de Azevedo: I would say that it would be something about the same route as last year, 11.4 billion reals.

Okay.

Jose Sergio Gabrielli de Azevedo: Less than that because last year we had a lot of boats [ph].

Right.

Jose Sergio Gabrielli de Azevedo: And now we don't.

Right. We adjusted for that. Thank you.

Jose Sergio Gabrielli de Azevedo: Thank you. Our next question is coming from Patricia Vazquez [ph] of Energy Intelligence.

Q - Patricia Vazquez

Yes I have three questions. The first one is would it be correct to say that your priority for this year would be in the upstream to increase your domestic output and in the downstream to increase the capacity of your refineries to process your heavy crude? The second question is ...

Jose Sergio Gabrielli de Azevedo: You are correct.

Okay. The second question is there were several announcements made about Petrobras expanding its operations in Venezuela. I was wondering if given these priorities you just mentioned if you could comment on what role that extension in the messo [ph] will play and also whether Petrobras would be interested in participating in some of the LNG projects it was invited to participate in there in the Marsco Sucre [ph] and the Val Tena [ph] platforms.

And the third question is if you could comment on the tax fine that Brazilian authorities have imposed on Petrobras apparently, the $3 billion?

Jose Sergio Gabrielli de Azevedo: Well start from the tax fine. The tax fine was some months ago. Last year, actually. We are trying to get a review; revision of the decision using all the administrative possibilities that we have. The last decision that we had was four in favor of Petrobras, four against Petrobras and we had the chairman of the board decide against Petrobras. But it's not final, we have two more levels on the administrative sphere, on the administrative structure before we go to the judge which means that for us that it is not probable that we are going to be really fined as it is the desire of the representatives of the IR; Internal Revenue Service.

On the Venezuela case we have several teams that are working different areas between Petrobras and Petovesa [ph]. We are discussing with Petovesa refinery projects in Brazil, exploration on offshore in Venezuela. Technological exchange on heavy oil and petrochemicals, alcohol, actually we have several different groups that are working together and trying to reach common grounds for discussion and this is going to continue at least in the next six months. We don't have any complete project right now.

I'm sorry just a little of that question. Would the LNG project be of interest to Petrobras? I mean considering you don't have much experience.

Jose Sergio Gabrielli de Azevedo: LNG? I don't know of any LNG projects right now.

Okay, well part of the announcement was that Petrobras had been invited to participate in two flagship products in Venezuela. Marsco sucre and Val Tena platform. That's what I was referring to.

Jose Sergio Gabrielli de Azevedo: As I mentioned, we have several teams that are working right now but we don't have complete projects in any of them.

Okay. All right. Thank you.

Operator

Okay. Your next question is coming from Marc McCarthy of Bear Stearns.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Hi, guys. Just one follow-up. It occurred to me I didn't get a clear sense as to what; your imports this year were 450,000 bbl. Assuming some more throughput growth next year and some more; I think that's really what the focus is, the domestic market can grow more, you'll import product to meet that.

I'm really just kind of interested to understand in light of the 1.7 million bbl a day of production and probably refining throughput just over that, what your import level will be. The other question I had was if you can, actually on the back of Patricia's comments, to what; Has there been any change in terms of Petrobras Energia's involvement in the Mexican multiple service contract projects? How are; Are they being involved and might they be involved directly in some of these new joint ventures in Venezuela given their existing exposure there?

Jose Sergio Gabrielli de Azevedo: I am afraid that I cannot answer this question because you are requiring details that are not available right now because we are in the beginning of this discussion on the type of project that we are going to do and we don't have a clear idea of what the best way or what we have to do that, if Petrobras and Petrobras Energia (inaudible) company is going to be the operator of the project.

In relation to the imports, we are predicting a smaller number of imports for 2005. We think that we are going to import less than we imported in 2004.

Talking; I clearly hope it's less. But are we to 300,000 bbl a day ...

Jose Sergio Gabrielli de Azevedo: Yes, around there.

Or closer to 400,000 bbl a day.

Jose Sergio Gabrielli de Azevedo: Closer to 300.

Okay. And the change in the multiple service contracts is not a new piece of information. You won these awards last year. Has there been some subcontracting work by or plans for some subcontracting work for Petrobras Energia to handle those contracts?

Jose Sergio Gabrielli de Azevedo: We know that Petrobras Energia has good expertise in handling onshore gas facilities and we are using this expertise.

Okay. But are they funding, basically, the multiple service contract development?

Jose Sergio Gabrielli de Azevedo: Yes, I think they are (inaudible). I think they are hired as operators of the projects.

So you have subcontracted the contract to them? I guess my question is more along the lines of given the unusual relationships you've had between the two companies, how do you structure that between the two companies? Does the cash flow go to them?

Jose Sergio Gabrielli de Azevedo: No, no. The contract is Petrobras but we have a relation with them a service contract with them that we pay for the contract for the service.

And they earn a management fee for that?

Jose Sergio Gabrielli de Azevedo: Yes. It's an arms-length relationship. The Argentina law requires that.

Okay. So they are, in a sense, going to operate the life of the contract. It's their responsibility to staff the project?

Jose Sergio Gabrielli de Azevedo: It's an operational contract like any other contract. (inaudible)

So Petrobras is the owner of the contract.

Jose Sergio Gabrielli de Azevedo: We own 67% right now.

I'm just trying to understand the allocation of CapEx. So it's their responsibility to make the spending.

Jose Sergio Gabrielli de Azevedo: Well, the CapEx is Petrobras.

But more specifically, Petrobras Energia.

Jose Sergio Gabrielli de Azevedo: They are billing on the operational expense. What we pay them is our OpEx, not CapEx.

Okay. Okay. Thanks very much.

Jose Sergio Gabrielli de Azevedo: Okay.

Operator

Our next question is coming from Michael Schwabe of Artha Capital.

Q - Michael Schwabe {BIO 4802007 <GO>}

Two quick questions. First, really a clarification. I'm just wondering if you could, I guess repeat what the production targets are for '05 and how that changed from maybe the last time you had a conference call three months ago, really trying to figure out whether the delays have made a big difference and to whether the P-50 is going to make up for any portion of that and the second question is I think relating to big picture items, the cost increases, both CapEx related and SG&A related. You mentioned some of the items that are driving those cost increases, including wages and I guess third party services and so on.

And I'm just wondering, given that inflation in Brazil is mid single digits and I'm wondering why the increases are so high and what maybe you could give us some examples; I mean, I understand that steel prices and tube prices and some other things have gone up quite a bit and the effects rates have some influence but generally speaking wages and so on shouldn't really be going up by double digits. I was just wondering if you can give us some examples of the items that are driving up the costs.

Jose Sergio Gabrielli de Azevedo: The wages are going up as a relation to the taft [ph]. We had 12% including wages. It was 15% last year as a result of the previous inflation, not the future inflation. That's the reason why we had this increase in wage costs. But also we had an increase in the number of workers, the global force increased in Petrobras. We hired 3.3200 (ph$) new employees in 2003.

We have also the costs of transportation. We have freight costs going up in all areas that we operate right now.

In relation to production, our targets for 2005 on average is 1.7 million bbl a day and we think that we can reach (audio gap) December 1.85 million bbl a day.

Is that any different from your previous guidance?

Jose Sergio Gabrielli de Azevedo: We have done in the dates (inaudible) an increased number of 1.78 million barrels a day.

Okay so 1.78 becomes 1.7.

Jose Sergio Gabrielli de Azevedo: Yes.

And does the year end number change? The 1.85?

Jose Sergio Gabrielli de Azevedo: Yes, it is 1.85 which means that '06 is going to be more than what we were expecting.

I'm sorry. So the 1.85 which you currently expect for December is higher than what your previous expectation was for December '05?

Jose Sergio Gabrielli de Azevedo: Yes, what it means; in '06 probably we are going to have more than we expect before but we didn't release the number.

Okay. Thank you.

Operator

Ladies and gentlemen. there are no further questions at this time. Mr. Gabrielli, please proceed with your closing remarks.

Jose Sergio Gabrielli de Azevedo: Okay, we'd like to thank you everybody and say that we had a very good year in 2004 and we hope that we are going to have a more even better year in 2005. Thank you.

Ladies and gentlemen. your host is making today's conference available for replay starting one hour from now. You may access it from the IR Website or you may access this Website by dialing U.S. 1-973-341-3080, lasting through March 8. That number, again, is U.S. 1-973-341-3080. At the voice prompt enter the access code 5770069. This concludes Petrobras conference call for today. Thank you, very much for your participation. You may now disconnect.