

Q2 2006 Earnings Call

Company Participants

- Almir Guilherme Barbassa, CFO, Investor Relations Director
- Raul Adalberto De Campos, Executive Manager, Investor Relations

Other Participants

- Frank McGann, Analyst
- Marc McCarthy, Analyst
- Paul Cheng, Analyst
- Ricardo Cavanagh, Analyst
- Terry Zumela, Analyst
- Unidentified Speaker

Presentation

Operator

Welcome to the Petrobras conference call to discuss the Second Quarter results. (Operator Instructions) As a reminder, this conference is being recorded. Today with us we have Mr. Almir Guilherme Barbassa, CFO and IR officer. And his staff. At this time, I would like to turn the conference over to Mr. Raul Adalberto de Campos, Investor Relations Executive Manager of Petrobras for some additional comments. Please go ahead.

Raul Adalberto De Campos {BIO 17251399 <GO>}

Good morning, or good afternoon, ladies and gentlemen. Welcome to our conference call to discuss 2006 Second Quarter 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, anytime during this event.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities 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 circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Petrobras. And could cause 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 officer, Mr. Almir Guilherme Barbassa. He will comment on the Company's operating and financial highlights and the main events during this quarter. Afterwards he will be available to answer any questions you may have. Mr. Barbassa, please begin.

Good morning. Good afternoon, ladies and gentlemen. It's a pleasure to be here with you and have the opportunity to talk about Petrobras' 2006 Second Quarter results. (inaudible) on the slides on the (inaudible) (NLG) production, we had an increase of (1.6). We were expecting more than that. But unfortunately we had a number -- a larger number of stoppages of platforms for maintenance. And these have caused a small increase in the production.

Next please. Oil prices for exploration and production. The exploration had an increase of 4.5 -- around \$(4.5) per barrel increase. But this was less than the international market had. The differential between light and heavy oil is about \$11.4. And the deals (inaudible) will help the downstream activity. But -- and the reason that light oil increased more than heavy is due to the Middle East crisis and the high demand for light oil products in the United States as well. So E&P had an increase in price. But not proportionally to the light oil.

Next please. (inaudible) lifting costs -- we had a reduction on these costs, highly due to the First Quarter, where we had higher-than-expected costs. When compared with the First Quarter, we had a decrease in dollars and (inaudible).

But if we see the next slide, we realize that including the government participation, the lifting cost is increasing when compared with the First Quarter. And this is mainly due to the government participation. As you can see, since 2002, the government participation increased 185%, when Brent has increased 181. (inaudible) due to the fact that the government participation has increased (inaudible) of production of every new oil field. This is the structure of the government participation. So, in long-term, the government participation (freezes) as a proportion of the -- more than the (technical difficulty) that is used as a reference for calculation of the government participation.

In the refining area, it's important to (inaudible) here the domestic -- (inaudible) the capacity in Brazil, we kept the utilization of 91% for the last four quarters. This is important to us because we are not speaking (inaudible) refinery. But this is the average of four of 11 refineries. And the utilization for domestic crude is kept in the average of 8% (inaudible) important also because as we (inaudible) more oil in the domestic refineries. And we kept the same average of domestic oil (inaudible) more domestic oil (inaudible).

There is refining costs in slide 7. We can see that due to the low cost in the First Quarter, we had an increase of 9%. And this is due to the scheduled stoppage and (inaudible), as well as fixed-rate foreign exchange rate FX. But if you see all this fixed (inaudible) is one high and one low. So we cannot (inaudible) that the next one, the next quarter will be lower than this one. But if we look at this (inaudible), it shows (technical difficulty).

Next one, please. The average utilization price -- we increased it by about \$0.50 (inaudible) Brazil. But, as you can see, from May -- April, May, the price -- the international price of Brent and the price in the United States that is shown in the red line, they have increased more than we have done in Brazil, because these (inaudible) due to the high demand of light product in the United States. And due to the Middle East conflict. We expect that as (inaudible) price will come down. And our average price will be in the long-term average as usually.

Next please. Sales -- we increased our product sales by 2% in the domestic markets. And this was due mainly to higher volume of gasoline we sold, because the mixture of ethanol and gasoline has reduced since March -- last March. So more gasoline -- we have reduced the ethanol component from 25 to 20%. So more gasoline has been sold to the domestic market (inaudible) was sold in the domestic market for the period. And we sold -- we sold more naphtha as well, due to the price formation that this quarter (inaudible) advantages for the domestic buyers of naphtha to buy from Petrobras (inaudible) international markets. An important component of the oil products is diesel.

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And the volume of diesel sold in the Second Quarter was about the same as the First Quarter, due to the (inaudible) demand that was reduced.

Next one please. (inaudible) had an increase due to higher production and higher price. But the cost of cost of goods sold increased more because we have seen the cost -- the lifting costs and the cost of refinement -- refining -- both of them had an increase. So, the increase in cost of goods sold was more than proportional (inaudible). These are (inaudible) percentage in the EBITDA and operating profits. But net income was helped by the (inaudible) of the real. And that gave us some gain on the -- our international investment, as well as the domestic financial investments in (inaudible).

Next one. Operational expenses. Sales are about (inaudible) sales expense about the same. We had an increase in the general and administrative expenses. And this was due to the -- one of the causes was that we hired more than 4000 new employees in the first semester. At the Second Quarter, we had 2000 of them (inaudible) and training. And this was the cost of this training. And the cost of the (inaudible) was charged to the G&A. (inaudible) this was one of the causes of (inaudible) cost increase.

Exploratory costs is (inaudible) exploration activity, we are increasing our exploration activity. So more cost (inaudible) other expenses. We had (inaudible) more amounts in the First Quarter. And the quarter -- the second one we had increases in the communication area. And (inaudible) communication. That was -- the cause of it was a large increase in the (inaudible).

The (inaudible) in the operating profit of E&P, as we mentioned, the price increase of \$4.5 has helped them to increase results. But the increase in production was (absorbed) in the (inaudible), because the new platform that was put on stream in April and May, they proved themselves (inaudible) they produced (inaudible) and then they (inaudible) for another (inaudible) to the land. And in this case, those of them added together, they took more than 700,000 barrels (inaudible). That was large enough to absorb the production increase of 1.6%. Average cost of (inaudible) cost of goods sold, we have (inaudible) and they're facing expenses. As we saw, there is more expense increase. So we had a reduction in the operating profit of the segment. But as a final result, it was larger than the First Quarter.

The supply area, we have the same price effect, as well as volume (inaudible). That was -- it caused some gain. But the average of the cost of goods sold has caused a large decrease in the (inaudible) operating expenses caused a reduction, a substantial reduction, from 3 billion to 2.5 billion reais.

The high cost of E&P, as the E&P sold at a higher price and imported oil as well, (inaudible) that caused the (inaudible) to increase in expense of supply.

As a final figure for the net costs, we had revenues causing -- as well as cost of goods sold and operational expenditures, these are the summary of what we have seen at the beginning. And financial and nonoperational expense, as well as employees participation; this was the main reason of (inaudible) cost increase, what leads us to increase the net cost from 6.7 to almost 7 billion reais in the quarter.

The balance of exports and imports (inaudible) and oil products resulted in (inaudible) of 94,000 barrels of oil per day. We export a net volume of 94,000 barrels of oil per day. And here is the physical balance. The financial balance, when we see all of the liquids, we have posted a result as well. But if we add the gas that we import, the expenditures with gas. So the balance will become negative.

The leverage of the Company keeps coming down (inaudible) expense in the end of June. And we paid part of our debt in July. But this does not reflect we anticipated \$900 million in payment of

debt. But this is not (inaudible). The increase on the short-term debt when compared this to total is due to maturing debts that (inaudible) to mature next year. So there isn't -- and the volume is still under control (inaudible) no problem (inaudible) payment of \$12 billion in 12 months -- 12 billion reais; sorry.

This (inaudible) statement is important to stress here. The cash generation capacity of the Company was able to pay in the (semester) 7.5 billion reais of dividends. And another 2 billion reais in financing. And support the CapEx increase of about (10)%. And even though we kept about the same volume we had at the end of last year.

So, at the end of last year (inaudible) million reais. We (inaudible) 2 billion (inaudible). So the cash generation is very important in the Company. And the result in the semester will not have the dividend payments. So we can expect an increase in the cash balance.

The investments -- we had a 24% increase when compared with the first (inaudible) first half of last year. And the same percentage in the exploration and production, what is the main segment of the Company. We hope we will have a higher realization in the second half of the year -- as usual.

So, that's what we have for the moment. If you have any questions, we are available, myself and my colleagues here, to answer or to (inaudible) that. Thank you, very much.

Questions And Answers

Operator

(Operator Instructions) Frank McGann, Merrill Lynch.

Q - Frank McGann {BIO 1499014 <GO>}

Two questions. One, if you could maybe update us on the outlook for production in the second half of this year, as well as looking into the first half of 2007, in terms of your level of expectations. But also the status of the platforms that are coming on stream, both in the second half of this year and to the first half of next year. And then secondly, just perhaps you could comment on the potential Colombian refinery investment. And what your plans are for that over the next year or two.

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

I will have my colleague from E&P (inaudible) that is going to give you the answer to the first question. But let me answer about the refinery. We are participating in the bidding process in Colombia to acquire part of the refinery (inaudible) that belongs to (El Copetrol). And (inaudible) in line with our strategy to acquire more capacity of refining outside Brazil. And invest in (SSI). And this is going to be the case. (inaudible) is going to have an upgrade (inaudible) to be prepared to process heavy fuels produced in Brazil. And this is our target. We are competing. There are other companies competing for the same acquisition. And we expect by the end of the month we will have announced a final (inaudible). Let me hand over to (inaudible) to give you the information on the production.

Q - Unidentified Speaker

With the platforms P-43 and P-48, we have already reached the capacity. In fact, the P-48 is producing 180,000 barrels per day, more than the nominal capacity. And the P-48 will have another well coming on stream; it is producing 150,000 barrels per day. And will reach 170,000 barrels per day -- okay -- next week. So we are picking up production until the end of this year. Our target is to produce 1,880,000 barrels per day in 2006.

Next year we have two (inaudible) introduction units coming onstream in May, which is (inaudible). And the other two in (inaudible) field, P-52 and P-54, in the second half of 2007. The production target for 2007 is 1,939,000 barrels per day on average.

Operator

Marc McCarthy, Bear Stearns.

Q - Marc Mccarthy {BIO 1542384 <GO>}

I have a few questions. I guess I missed some of your initial comments on the area -- along the line of inventories. I was wondering if you could give us, if you have the number, what the number of barrels in terms of oil and product were at the end of June versus March and December. It certainly seems to me that there's been a considerable buildup, both in terms of the working capital statement, I would imagine, ahead of the seasonal peak in demand. As you look in your ITR, you can see that the numbers are both in oil and product. But largely in oil. And I was wondering if that is also kind of compensating for this pricing shortfall that I believe you mentioned about.

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

The buildup of inventory is due to the change in the accounting process. After May, we were considering as sold product that is (multiple speakers)

Q - Marc Mccarthy {BIO 1542384 <GO>}

On board.

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

(multiple speakers) is on board (inaudible). In June, we changed (inaudible). So, all the oil that is in the -- on board. But is not yet delivered to the clients, is considered part of our stock. So this implies an increase in the oil (inventory) of one month of exports. It's a time (inaudible) days one month, that is a time we spend to reach the consumer, the client.

And there is another effect also. With the established P-50 and (inaudible) (DSO), both of them build up inventories in themselves before delivering the oil to the vessel that is going to transport the oil from -- for other destinations. So these average inventories, they (inaudible) to the total inventory of the Company.

Q - Marc Mccarthy {BIO 1542384 <GO>}

And you think the one month of inventory is related to the sort of \$2.2 billion inventory boost of December?

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

The one month counts for most of that. And there is -- the two (inaudible) will account for 700 to 1 million barrels of oil, of inventories they built on the (inaudible) will account for another (inaudible). But you said that there is an increase of 2.2 billion (multiple speakers)

Q - Marc Mccarthy {BIO 1542384 <GO>}

\$2.2 billion is the inventory increase from June -- the (average) between June and December.

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

Yes. When you see (inaudible) people is helping me here. There is another effect, is the increase in the import price (multiple speakers) as you increase the import price (inventories) adding up in dollars.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Okay. I'll probably follow up with this off-line. The second question, (inaudible) you just mentioned 1.88 million barrels a day in 2006. Is that your sort of exit production for the year?

Q - Unidentified Speaker

That's just the average (technical difficulty)

Q - Marc Mccarthy {BIO 1542384 <GO>}

That's the average production for the year?

Q - Unidentified Speaker

Yes.

Q - Marc Mccarthy {BIO 1542384 <GO>}

So that would suggest that you're going to be well in excess of 1.9 million barrels through the sort of third and Fourth Quarter, to reach an average like that? Is that the sort of expectation?

Q - Unidentified Speaker

We are -- as I mentioned, we are increasing production in the P-43 -- P-48; sorry -- and also picking up production on the P-50 platform, FPSO Capixaba. And (inaudible) field. So we are working with (inaudible) this year.

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

And the P-34 and the (inaudible) that will come onstream by the Fourth Quarter of the year.

Q - Marc Mccarthy {BIO 1542384 <GO>}

So what is your year-end average production? I can't (inaudible) -- given your first-half average of 1.75, to average 1.88 would take -- gosh -- exit the year at more than 2.1 million barrels. Something seems -- that must be your exit production as opposed to your --

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

Marc, the stoppages we have have reduced the average of the first half of the year (multiple speakers)

Q - Marc Mccarthy {BIO 1542384 <GO>}

If you could give me your sort of estimate for second half. If you have a first half of 1.75, how do you get to 1.88?

Q - Unidentified Speaker

That is the projects that are not only the new ones P-34 and also (inaudible) that will give somewhat (inaudible) at the end of this year (inaudible) in December.

Q - Marc Mccarthy {BIO 1542384 <GO>}

P-34 is 60,000 barrels; (inaudible) is 20? Right?

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

(multiple speakers) (inaudible) is only (inaudible); so this will not contribute very much with the (inaudible) for the year. (multiple speakers)

Q - Marc Mccarthy {BIO 1542384 <GO>}

But you won't reach peak production until after the first part of 2007 on any of them. So --

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

P-50 is increasing production. And also (inaudible) is in the (inaudible) phase.

Q - Marc Mccarthy {BIO 1542384 <GO>}

It seems to me that the 1.88 -- it doesn't seem reachable. I guess I'm trying to understand how that number --

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

1.75, as you said, is the first half, isn't it?

Q - Marc Mccarthy {BIO 1542384 <GO>}

Yes.

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

So you are not counting the full contribution of P-50 and the Capixaba FPSO in this average. (multiple speakers) will be contributing in the second half, only if (inaudible) two platform is going to add in the second half almost 280,000 barrels per day.

Q - Marc Mccarthy {BIO 1542384 <GO>}

So you're suggesting a second-half average of around 1.9 to almost 2 million barrels a day? Is that right?

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

(180). The average is (1,808,000). But on the first half we have a concentration of stoppages, planned stoppages, in May and June. We have 34,000 barrels per day. That was the impact in the average for the first half (inaudible) stoppage. So in the second half, we have only three platforms. We have P-20 that this coming onstream again today or tomorrow. And we have three other platforms. But the impact will be very small.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Okay. So -- I guess I'll come back to you with that one also. My last question is more along the lines of Venezuela. There's been quite a bit of talk about you participating in Marisal Sucre and a natural gas project there. I'm curious to hear any thoughts about this. And how this might play into your efforts to secure LNG capacity for the Northeast.

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

This is not new. We are discussing all this participation for (inaudible) part of many discussions we have with Venezuela. And we are (technical difficulty) probability on having participation on the Marisal Sucre, as well as in other oil fields in Venezuela. (inaudible) Marisal Sucre is later to come onstream, much later than we expect to have the LNG installed in Brazil. So in the future it may supply Brazil. But not for the timing we are counting on the LNG. Because it's (inaudible) will come onstream much later than 2008, 2009.

Operator

(Operator Instructions) Paul Cheng, Lehman Brothers.

Q - Paul Cheng {BIO 1494607 <GO>}

I have three (inaudible) simple questions. First, any plan to raise your domestic (quota) prices over the next three to six months to close the gap between your product prices and the international price (inaudible)? Second question, you indicate that in the Second Quarter you have 2000 new employees under training; that's why the G&A expense is higher. How much higher (inaudible) -- how much is that two dozen people training cost (inaudible)? Also that on a full-year basis on average, how many new employees you target to hire over the next several years on average, idea? And finally, talking about the production in Brazil for the oil production, do you have your oil production from last week? What is the current oil production (inaudible)? Thank you.

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

(inaudible) oil production of last week. Well, the average -- I have here the average (inaudible) is 1,746,000 barrels per day.

Q - Paul Cheng {BIO 1494607 <GO>}

Is that (technical difficulty)

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

For the first two weeks of August.

Q - Paul Cheng {BIO 1494607 <GO>}

That's the first two weeks of, (1746)?

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

Yes. But (technical difficulty). This is the first days of August. And we had FPSO we started (multiple speakers) P-20.

Q - Paul Cheng {BIO 1494607 <GO>}

Right. But that's the first two weeks of August is 1746, similar to the Second Quarter average?

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

And what are the other questions?

Q - Paul Cheng {BIO 1494607 <GO>}

The first question -- the other two questions is (multiple speakers) do you have any plan to raise your domestic (inaudible) prices over the next three to six months. So that they would be closing the gap between currently your product size and the international product pricing? And the second question is that for (multiple speakers)

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

I have that. The -- regarding prices, we understand, as I tried to explain in the presentation, that we are in -- we were in our next (inaudible) of pricing in the United States due to the summer and Middle East because of the conflict. And this maybe can revert to the average price we are (inaudible). So, if this is going to be as a peak of price, we shall keep our policies to adjust when prices remain high for longer periods. And we don't see a very clear reason for having at that moment a peak price. So, as we get convinced that price has gone up and is going to maintain higher, we adjust our price.

Q - Paul Cheng {BIO 1494607 <GO>}

Almir, is there any particular criteria or factors, or the indicator you look at to determine whether that this is the time for you to raise the product prices or not? (multiple speakers) just based on the objective view, or the judgment by management (multiple speakers) no indicator from outside we can look at?

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

We don't have a formal (inaudible) how we manage this price. But the general (inaudible) we do not unveil more information there.

Q - Paul Cheng {BIO 1494607 <GO>}

The last question is that for the new employees, you (indicate) 2000 of new employees are under training in the Second Quarter; that's why G&A is up. How much of the increase of the G&A is related to that 2000 new employee training? Also, on average over the next several years, how many new employees do you plan to hire?

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

(multiple speakers). We had an increase on the training area, an increase over the First Quarter of 23 million reais in the Second Quarter. But this year, it is important to say, we hired more than 4000 new employees. And since the beginning of the Second Quarter remained under training the 2000. And in the long term, we intend to increase our working force by 8 to 10,000 new employees up to 2010. We are --

Q - Paul Cheng {BIO 1494607 <GO>}

By how many? I'm sorry; by how many new employees a year?

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

Not a year; the total we are planning to hire up to 2009 is 8 to 10,000. Let's give as an average of 2000 to 3000 a year.

Q - Paul Cheng {BIO 1494607 <GO>}

That is the new hire. That's just the new additions. So, you have (multiple speakers) in order so the number would be somewhat higher, right?

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

No, no. We have to deduct the retirement from that figure. These are new hires.

Q - Paul Cheng {BIO 1494607 <GO>}

This is new hire. Okay. And so that means that the increase in G&A from the first to the Second Quarter is actually not primarily related to that 2000 new hire training, because you say it's only increased by 23 million reais?

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

(multiple speakers) from the first to second.

Q - Paul Cheng {BIO 1494607 <GO>}

So what is the primary reason for the increase from the first to the Second Quarter?

A - Raul Adalberto De Campos {BIO 17251399 <GO>}

Let me run through the whole increase in the general administrative (multiple speakers). There's a general increase in the workforce; that's 38 million. Information services and environmental

management -- that's the SAP -- that's 46 million. You have the 23 million for personnel training. And you have higher consulting costs relative to new exploratory projects of 24 million.

Q - Paul Cheng {BIO 1494607 <GO>}

And all of that is -- other than the training, all the other ones (inaudible)?

A - Raul Adalberto De Campos {BIO 17251399 <GO>}

No, not necessarily. You've got expenditures, for instance, with information services, which is the SAP introduction, which may not be repeatable.

Q - Paul Cheng {BIO 1494607 <GO>}

Raul, (inaudible) possible that I think I also have some difficulty to see how you will be able to meet the full year 2006 production at (inaudible). When you get a chance can you give me a call? Maybe you can give me some additional maybe insight how we would be able to get up to that level.

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

What you will see, what we published, is the (50 and 80) main projects with the capacities coming onstream this year.

Q - Paul Cheng {BIO 1494607 <GO>}

I understand that.

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

We have a lot of projects that (inaudible) producing already.

Q - Paul Cheng {BIO 1494607 <GO>}

I understand that. But if you -- based on the number that (inaudible) second half of the year, your production may be over 2 million barrels per day. And your next year target is actually 1943, or something like that. (multiple speakers)

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

(multiple speakers) 179.

Q - Paul Cheng {BIO 1494607 <GO>}

So you actually -- it's looking for the next year production (inaudible) going to be lower than the second half. Just wanted to make sure that that is what you are targeting.

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

As I mentioned, we have a lot of fields onstream. And we have a decline rate on those fields. We have new fields come onstream, as I mentioned. So the balance of that is what we put as a target for the Company.

Operator

(Terry Zumela), Citigroup.

Q - Terry Zumela

Quick question relating on expenses. If you could revise the increase in expenses; not the administrative. But R&D, taxes; what happened quarter-over-quarter in operating expenses there.

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And if this is recurring. And also, if you confirm that your CapEx plans are really going to be much more concentrated in the second half of the year. And I have a follow -- another one about (inaudible). But if you could answer those two first.

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

(inaudible) can help me on these details. (multiple speakers). Okay. There is one point that has increased G&A expenses is the (inaudible). And the (inaudible) is caused by the E&P rules that require every oil company that produces in Brazil to apply a percentage of the oil production, the oil revenue production, in (inaudible) in Brazil.

And this -- we had some balance on the application on how to calculate this (inaudible) which kind of research could be applied against this obligation. And it took some time to price (inaudible) everything with E&P. And we came to a conclusion at the end of last year. So we start spending more to comply with these obligations (inaudible). And deals will remain at this level for the future, because we are increasing our production. As we increase, more revenue has to be invested in research. And we have to (inaudible) we had in the past in this area.

(multiple speakers)

The (inaudible) expenses. As I showed in the presentation, you can see that the government participation increased in the fields. And as we had more income, more income taxes we paid as well. As well as (inaudible)

Q - Terry Zumela

(technical difficulty)

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

Would you repeat, please?

Q - Terry Zumela

Sure; sorry. I'm actually talking about the taxes in the operating expenses, below exploration assets in your income statement. (multiple speakers). Mr. (inaudible)

(multiple speakers)

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

(It counts for all these) we mentioned.

Q - Terry Zumela

And the CapEx?

A - Raul Adalberto De Campos {BIO 17251399 <GO>}

(multiple speakers) (inaudible) the financial tax expense.

Q - Terry Zumela

Exactly.

A - Raul Adalberto De Campos {BIO 17251399 <GO>}

165 million. That's as the result of the growth in operations and (inaudible) on other revenues; that's 82 million, of which 50 million was due -- was an adjustment for (inaudible) prior periods.

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

The CapEx question -- (which is it)?

Q - Terry Zumela

If it's -- the second half is really going to be much higher than the first half.

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

(inaudible) what we expect. But (inaudible) the E&P was -- usually we have CapEx higher in the second half.

Q - Terry Zumela

What's your current target for the CapEx in the year?

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

(39) billion reais. And we spent a little more than 13 billion. So, we have really a very big challenge.

Q - Terry Zumela

Final question, if I may, about the pension fund. How is the process of negotiating with your employees the changes in the (inaudible) fund -- how many employees have accepted the changes? Has it happened already? You had mentioned that that would be (inaudible) employees accepting the changes. When is this incentive expected to be paid. And how much it would be?

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

We are in the process that will be ending by the end of this month. We are now working the (inaudible) from the employees, because it's really a very complex decision they have to take. And every employee has to have -- has to take this decision to give up one of the (rights). And so they have to evaluate the fully -- for the situation that they are faced. And we are working hard on that explanation. We hope by the end of the month we'll have a very high (inaudible). (multiple speakers). At this moment I don't know how much we have. But, of course, as we get near the end of the period, more and more people will make up their minds. And we are working with lots of expectation that we are going to fulfill our goals. That's really very important for the Company, because it means to have the newer pension plan for the new employees. And to solve a problem that has been recurring, to cause that to in the pension (inaudible) we have today.

Q - Terry Zumela

Great. So if the incentives are -- if the acceptance is as high as we are expecting. And if everything is (inaudible) by the end of this month, the incentives should still be paid in the Third Quarter?

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

(multiple speakers). I don't know that -- the decision of the employees has to be done by the end of the month. And there are some procedures after that to be taken. I believe there is a great chance this incentive is going to be paid in the Third Quarter. But it may -- I'm not sure of that.

Operator

Ricardo Cavanagh, Raymond James.

Q - Ricardo Cavanagh {BIO 1702523 <GO>}

I have a question related to the international division you mentioned previously in the call, the possibility of what (inaudible) you were (inaudible) doing certain businesses in Venezuela, new businesses. And I was wondering, how are you perceiving the new ventures working in Venezuela,

the companies that you previously controlled that now are controlled by Pedevessa, if you perceived the likelihood that Pedevessa would be deciding to invest more money in order to augment production there. And also, you expect to receive any (inaudible) payment in the short-term from Venezuela.

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

We work with this assumption that we are going to either bring that for some time to increase production, or (inaudible) of our understanding. And the new ventures we are developing with Venezuela includes, as you may know, one refinery in Brazil in the Northeast where we are working together. We (stand in) both sides.

Operator

Marc McCarthy, Bear Stearns.

Q - Marc Mccarthy {BIO 1542384 <GO>}

I just had a follow-up about if you could give us an update on Gazini, the bidding process, when a decision will be made. And a timeframe for when the spend would occur. And what I was curious about was what do you foresee as being the sort of exit CapEx in the Fourth Quarter?

A - Raul Adalberto De Campos {BIO 17251399 <GO>}

What do you mean by exit CapEx?

Q - Marc Mccarthy {BIO 1542384 <GO>}

What do you expect the fourth -- you have a seasonal pickup in CapEx through the end of the year; this quarter was 2.8 billion. How do you foresee the Fourth Quarter CapEx evolving into?

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

About Gazini, Marc, we have nothing new. We have no new decision or information about this project.

Q - Marc Mccarthy {BIO 1542384 <GO>}

My understanding -- the bids were submitted and are under the -- your review process in the month of July.

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

Yes. But no conclusion so far. Still under evaluation.

Q - Marc Mccarthy {BIO 1542384 <GO>}

How do you foresee that's going to evolve through the -- when will a decision be made?

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

Let me see if (inaudible) has any new information.

(multiple speakers)

Yes. He is adding that the (inaudible) portion of the Gazini project is under construction. But the (north) and the longest one is still under evaluation; no decision has been taken so far.

Q - Marc Mccarthy {BIO 1542384 <GO>}

So you're talking about the (Catuka Simbas) section (multiple speakers)

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

Yes.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Is it something that you can kind of give us a sense of when a decision will be made?

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

We have no -- not this information at this moment. There is another point you raised --

Q - Marc Mccarthy {BIO 1542384 <GO>}

Fourth-quarter CapEx.

A - Raul Adalberto De Campos {BIO 17251399 <GO>}

Hold on, Marc; I'm getting some data here. Last year -- just to give you some compare on seasonality, okay? Last year, out of the total of 25.7 billion CapEx, 8.8 came in the Fourth Quarter. And in the whole of the first semester, only 11. So well less than half came in the first semester. And then it speeded up into the third and fourth. And that's the seasonality due to accounting bidding processes (inaudible)

Q - Marc Mccarthy {BIO 1542384 <GO>}

So your suggestion is to maintain the same sort of seasonality?

A - Raul Adalberto De Campos {BIO 17251399 <GO>}

No, it's historical. Officially the target -- officially the target today is still 39 billion.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Thanks, Raul.

A - Raul Adalberto De Campos {BIO 17251399 <GO>}

Let me read one quick question which we got from the Internet. I think it was already answered. And it is along these lines. But let me read it to the interested party, (Terrence Murray). (inaudible) investments of Petrobras in the first half of 2006 equaled 13.6 billion, or less than half the expected total for the year of 39 billion? Again, I think (it has) already been answered.

Operator

(Operator Instructions) Thank you, ladies and gentlemen. There are no further questions at this time. Mr. Barbassa, please proceed with your closing remarks.

A - Raul Adalberto De Campos {BIO 17251399 <GO>}

Before Mr. Barbassa makes his closing comments, on the Webcast, slide number 14, there is a mistake. So please disregard that slide. We will correct it on our site when you access the Webcast. Actually, it's already been corrected on the Website. Slide number 14.

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

Thank you, ladies and gentlemen. Thank you, all for being here with us today. I hope the next quarter we can have as good results as we had this time. Hoping to see you next time. Thank you.

Bye bye.

Operator

Thank you. Ladies and gentlemen. your host is making today's conference available for replay, starting one hour from now. You may access this replay at our Website, or by dialing 1-973-341-3080, code 765-6457, lasting through August 22nd. This concludes Petrobras' conference call for today. Thank you, very much for your participation. You may now disconnect.

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