Q1 2009 Earnings Call

Company Participants

- Almir Guilherme Barbassa, CFO, IR Officer
- Theodore Helms, Director
- Unidentified Speaker, Unknown

Other Participants

- Frank McGann, Analyst
- Gustavo Gattass, Analyst
- Robert Kessler, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Ladies and gentlemen. thank you for standing by. Welcome to the Petrobras conference call to discuss the First Quarter 2009 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. Theodore Helms, Investor Relations Executive Manager of Petrobras, who has some additional comments. Please go ahead, Mr. Helms.

Theodore Helms {BIO 15433381 <GO>}

Good afternoon, ladies and gentlemen. Welcome to our conference call to discuss First Quarter of 2009 results. We have a simultaneous Webcast on the Internet that can be accessed at the site www.petrobras.com.br/ir/English.

Before proceeding, I'd like to draw your attention to slide 2. We may make forward-looking statements, which are identified by the use of the words will, expects. And similar words, that are based on the beliefs and assumptions of Petrobras management about information currently available to the company.

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 relating to US 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. And he will be available to answer any questions you may have. Mr. Barbassa, you may begin.

Almir Guilherme Barbassa {BIO 1921476 <GO>}

Good afternoon, ladies and gentlemen. Thank you for joining our conference call to discuss First Quarter results. Earnings were very strong as a result of growing production, stable prices for our key products in Brazil. And lower costs. Even with low oil prices and record CapEx in the fields, our cash balance increased, while our net debt to net capital remained unchanged at 26%.

On the cover of each website, we picture the most significant developments since our last conference call. On this cover is a picture of the value (inaudible) better known as the platform that is performing the expanded well cast out to P.

With the first oil in May 1, we were able to start production only 36 months after announcing the discovery of this vast new frontier. This oil and gas production in Brazil drives our business, business plan. And our cash flow. Let me begin with the production update. During the First Quarter, production in Brazil is up 7% year-over-year. It would have been higher, except that we shut-in 87,000 barrels of oil equivalent per day of natural gas because of reduced domestic demand.

On May 5th, we set a record for oil production in Brazil of 2,059,000 barrels per day, which is above our production targets for the year of 2,050,000 barrels per day. Growth in annual production was generated by P52 and P54 and the startups of the P51, P53. And Cidade de Niteroi.

As you can see, the three new units contributed an average of 99,000 barrels per day during the First Quarter. As they (inaudible) on their full capacity, they will help us reach our production targets for this year and next.

Soon to be installed in 2009 are Frade and Parque das Conchas, operated by Chevron and Shell, respectively. Our share is 30% and 35%. Both Frade and Parque das Conchas were the result of fair amounts of Frade obtained by Petrobras in 1998 in what we call (inaudible). In the future, more of our projects will be with partners or the consortiums that we forming to share exploration risk during the past license round to begins production.

The first production from our complete wells in the (inaudible) began with the extended well cast (inaudible) on May 1. The best will last for a period of 15 months and we will provide the valuable information about the (inaudible) and the optimal way we struck oil from the (inaudible). While the platform capacity is 30,000 barrels per day, we do not expect to produce more than 14,000 barrels per day due to limits on the amount of gas we make there.

You can see in this slide some of the challenges we face in producing oil in such extreme conditions. Fortunately, we have many years developing the know how, the asset base, the penetration and technology to meet these challenges.

We still need more time before we can announce the initial results. But we can say now that we have not encountered anything that is expected or too pricey. We continue to remain as optimistic as ever about the economic liability of this (inaudible).

New discoveries for Petrobras are not limited to the (inaudible). We continue on to find a number of other new fuels (inaudible) with least exploration. These findings, with their future development, are not yet incorporated in production targets. But will give us many opportunities in the years to come. We are confident that the Brazil coast is highly prospective and will continue to yield discoveries as we explore new frontiers.

During the First Quarter of 2008, the price of oil continuously declined. The average price range fell from $54 per barrel to $44, while the price of our own crude fell from $37 to $32 per barrel.

Some unusual factors affected the price of Brazilian crude in the First Quarter, such as the relationship of WTI to Brent and, also, how we calculate the value of our crude for internal pricing. This had little impact on our overall results, as the lower price of our crude oil is captured in higher margin for our downstream segment.

We are already seeing a substantial reduction in the Second Quarter to date between Brent and the price of our domestic crude oil. We are also (inaudible) the price of (inaudible), which has averaged $52 per barrel during the Second Quarter to date.

The decline in the price of oil (inaudible) positive effect on the lifting cost. The lifting cost is expressed in US dollars and, without government take, declined by 5%. These results could have been better.

But for the full operating cost of the three new units we recently installed, that were only reduced 25% of the capacity. Additionally, the (inaudible) of GAAP measurement (inaudible) increased our per unit cost for production.

Production costs declined substantially in the field, given their linkage to international oil price. Lifting costs, including government take, declined 19% quarter-over-quarter and the (inaudible) declined by 53% since the peak in the Second Quarter of 2008.

The trade balance between barrels oil and oil products exported and imported continues to improve. These are (inaudible) of 100,000 barrels per day in the First Quarter of '09. (inaudible) of 7,000 barrels per day in the First Quarter of '08.

Over the same period, the commercial trade balance declined (inaudible) $5 million (inaudible) $150 million, growing export of crude oil because of increased production and declined in these imports due to reduced demand, were the principal cause of (inaudible).

Our prices for gasoline, diesel and LPG did not change during the First Quarter, which is consistent with our (inaudible) of pricing of international (inaudible) the long term.

As a result, the average realization price of product sold in Brazil declined only slightly. We continue to monitor the market carefully, as oil and the oil product market remain lower priced. And future price uncertainty. For example, the price of gasoline in the (inaudible) has increased 17% in the last (inaudible), while crude oil increased 15% during the same period.

The market for oil products in Brazil decreased by 6% in the First Quarter of 2009 versus the First Quarter of 2008. Diesel declined by 6% year-over-year. Of that decline, more than half was a result of (inaudible) utilizing diesel in the First Quarter of '08 for thermal electric power.

In the first part of '09, there was no such consumption. The increased use of biodiesel also reduced demand. Gasoline consumption wasn't changed by the (inaudible) fueled cars. (inaudible) and larger automobiles need (inaudible) economic weakness. Jet fuel remained constant (inaudible) added. Fuel oil demand was flat, switching from natural gas (inaudible) reduced industrial demand.

The (inaudible) market consumption (inaudible) part of the economic downturn, declining by 9%. Natural gas fell much more, decreasing by 29% year-over-year. A large part of the decline was caused by winter, the need of thermal power during the First Quarter of '09 due to (inaudible) hydroelectric power. The remainder of the decline was a result of (inaudible) for natural gas.

Operating expenses, operating income, more than doubled quarter-over-quarter. Net revenue declined as a result of lower international oil price. But our pricing (inaudible) in Brazil (inaudible) the decline. Lower prices for our imports and lower production costs and government take substantially reduced the cost of goods, leading to higher gross income.

Operating expenses were reduced primarily by a decline in (inaudible) cost in G&A. The cost cutting (inaudible) that we have (inaudible) since the Third Quarter of last year. As a result of this movement and the (inaudible) of no recurring (inaudible) that occurred during the First Quarter, operating income increased 117%.

In the First Quarter, our operating income was reduced by a number of nonrecurring items, offset by (inaudible) financial results, by March interest. And lower income tax. In the First Quarter, the absence of (inaudible) items led to higher operating income. It was offset by negative financial results, by March interest. And higher taxes. The end result was relatively flat. Net income was over (inaudible).

Net financial results declined from a positive BRL2.4 billion to a negative BEL849 million. Most of the decline occurred as a result of the exchange effect and monetary valuation of the assets and liabilities in US dollars.

I'll discuss (inaudible) position for assets of (inaudible) subsidiary, (inaudible) foreign exchange gain, when the real did not really devalue against the US dollar.

As a result of this sharp devaluation of reals during the Fourth Quarter of 2008, monetary exchange variation led to positive (inaudible) of BRL2.2 billion in the First Quarter of 2009.

The real's strengthening slightly leads to an exchange and monetary (inaudible) of BRL415 million. Also, that financial result was a quarter-over-quarter reduction financial income of BRL620 million from a commercial hedge in the Fourth Quarter of 2008.

The last (inaudible) consolidation (inaudible) by 735 real from the prior quarter, primarily from reduced monetary exchange losses (inaudible). Included within the log of the First Quarter is a provision of BRL341 million related to the acquisition of the Pasadena refinery.

Minority interest decreased from a positive BRL1.9 billion to a negative BRL342 million, a difference of BRL2.3 billion. This interest is large attributed to the absence of debt related to foreign exchange losses in the First Quarter consolidated subsidiaries. It's a minority interest, primarily, SPCs established for project finance.

As a result of our higher operating income. And without the deduction for interest on (inaudible) in the Fourth Quarter of 2008, our tax expense increased by BRL1.1 billion.

While operating income more than doubled from the Fourth Quarter of 2008 to the First Quarter of 2009, after accounting for the effects of the exchange rate and higher tax, net income was down 6%.

Net income for the production and exploration segment was down sharply as a result of a decline in price. Volume production increased, sales declined slightly, as we started our new platform.

Lower demand for gas (inaudible) 87,000 barrels of (inaudible) per day of natural gas to be (inaudible), reducing revenue potential and increasing per unit lifting cost. Costs were favorably affected by a lower lifting cost, especially when considering production taxes.

Net income for our Brazilian (inaudible) segment was up sharply, as revenues decreased only slightly, while costs of products (inaudible) from our E&P division and internationally continued to decline.

Capacity utilization increased from 88% to 91%, in the absence of refinery shutdowns. The percentage of domestic crude (inaudible) increased from 78% to 80%, as our refineries were adapted (inaudible) with higher activity levels and because of reduced demand in prices for diesel. Maybe it's more economical to run domestic crude, which generally yields less diesel.

Oil and gas in the energy segment showed a small net loss, despite substantially reduced sales of natural gas and less thermal generation. Natural gas use declined by 13.3 million cubic meters per day, while electric generation was reduced from 2,094 megawatts to 651 megawatts quarter-to-quarter, with adequate supply of imported natural gas and continued development of our gas infrastructure. The segment did not pay the contractor (inaudible) result in the past.

The national operator of the fuels (inaudible) simply ordered Petrobras to dispatch 2.3 gigawatts of thermal electric generated power to compensate for the drought in the south of Brazil, combined with an option mechanism we have put in place for such (inaudible).

If our sales are short, then sales, we expect to substantially increase our sales of domestic production this quarter.

Improvement in the international segment was due largely to the absence of extraordinary items that hurt the Fourth Quarter. And growing production in Nigeria is offsetting declines in production elsewhere. Our share of Agbami production is now 20,000 barrels per day. Akpo will be starting up shortly.

We expect production from these two projects to be contributing 60,000 barrels of oil per day by year end. And will contribute an average of 40,000 barrels to 2009 production.

(inaudible) standing increased 41% between the First Quarter of 2008 and the First Quarter of 2009. (inaudible) 50% of our standing was for domestic E&P and the remainder of our integrated operations.

Our capital expenditures were funded largely from cash flow, (inaudible) EBITDA of BRL13.4 billion in the quarter. In the First Quarter of last year, when the price of (inaudible) averaged $97 per barrel, EBITDA totaled BRL14.4 billion against BRL10.2 billion in capital expenditure.

During the quarter, we were accessing various markets to finance (inaudible) financial between cash integration and CapEx. Borrowing increased by BRL5.6 billion, while cash balance grew BRL19.5 billion -- increased to BRL19.5 billion.

Access to capital continued to improve. In February, we initialed $1.5 billion of 20-year bonds and had traded up in price to now (inaudible) 6.75% versus (inaudible) to maturity difference of a little more than 8%.

The US (inaudible) bank recently issued a preliminary commitment to (inaudible) $2 billion of US (inaudible) in financing. We continue with our discussion with other export agents and development banks and are comfortable that we can raise the capital. We continue with our business (inaudible). Thank you. With that, let me stop and answer any questions that you may have.

Questions And Answers

Operator

(Operator Instructions) Your first question comes from the line of Frank McGann with Bank of America.

Q - Frank McGann {BIO 1499014 <GO>}

Good afternoon. And thank you for the presentation. Two questions I have, really. One is on costs and the cost trends going forward and your efforts to get reductions from suppliers and in other ways reduce costs in your business. Maybe you could explain how much you think can pull out over the next year and what kinds of trends you're seeing in your negotiations now.

Then, secondly, in terms of a potential equity offering, which has been talked about a lot lately, I was wondering if you could perhaps go -- if you were to decide to issue equity, when do you think you might need to do that and under what conditions would you likely do that?

And if that's going to be done in conjunction with the government contributing some pretty solid areas to Petrobras, what is the process for the valuation of that and, also, for minority shareholder involvement in the approval of that?

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

Okay, Frank, thank you for the questions. Regarding costs, we are following the markets. We have received many proposals, already showing cost reduction. We are also working in making our project in the simplest way, using more of a standard in the market than our tailor-made project. And we are doing many other -- taking many other initiatives to reduce costs, including G&A costs in the company. And we've sought some reduction already in the quarter.

But we expect to have more along the year, mainly in the CapEx, because the CapEx we are spending now is -- most of them -- based on contracts that we signed one year ago or some time ago, or more than that.

So the reflex of the cost reduction, we are getting many contracts now that are going to reflect in the future. But the main point of your question, how much we expect -- how much we are seeing, we are not -- we don't have yet a conclusion on that, because we did not consolidate -- we did not need an analysis on that.

We don't have yet the information to come to this conclusion. I hope by the end of the Second Quarter, we will be better equipped for that. But yes, we have seen some reduction. But let's wait some time more to say something in terms of percentages.

Regarding the stock (inaudible), we don't have any plan to do this. Of course, it all depends on the oil prices and the costs of our CapEx. If oil prices catch up, yes, we will produce what we will need in EBITDA to face most of what we expend in capital expenditure.

What we can tell is that we don't intend to be in a leverage beyond 35%. But when we may reach that, really, I don't have a clue. It would be a guess if I say anything.

As you know, we based our financial business plan in an oil grant of $27. We are seeing much better prices. And this will be producing more cash than we were expecting.

So instead of having only '09 and most of 2010 already financed, probably we will be entering 2011. So this gives us a lot of comfort. But we will be following our leverage. We don't want to have our investment grade under stress.

And just covering a little bit of the case of (inaudible) by the government, this year, of course, (inaudible), that it's not dependent on Petrobras. It is a decision of the government if they are going to do or not, the controller.

And if they do, the Brazilian corporate law provides for the opportunity for the minority shareholder to accompany the controller. They will have the opportunity to buy the proportionate share of the stock of the company they hold in the process.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. But they would be able to -- just to clarify. Would they be able to -- how would the areas be valued? Do you know that the government might contribute?

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

Sorry. Can you repeat that, Frank?

Q - Frank McGann {BIO 1499014 <GO>}

Yes. If the government were to contribute areas to Petrobras, how would those be valued in order to get a price that shareholders would then be able to buy shares at?

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

It is according to the corporate law, Brazilian corporate law. This value share will be attributed by an independent engineering company that looks at the valuations and this report of valuation shall be approved by the minority shareholder, with (inaudible) of the controller on these (inaudible).

So there might be an independent evaluation approved by a minority shareholder. So the Brazilian corporate law is a very well equipped law. It covers very well this kind of situation.

Q - Frank McGann {BIO 1499014 <GO>}

Great. Thank you very much.

Operator

Your next question comes from the line of Robert Kessler with Simmons & Company. Robert Kessler: Good day. I wanted to see if you could update us with respect to the incremental 28 rigs that you are planning to order for drilling in the pre-salt.

There was some news coming out of the course of the quarter on that and I just wanted to hear you directly speak to what your plans are there.

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

Okay. The rigs we have announced that we are going to lease or to buy beyond the ones we have are already ordered and we have ordered, last year, 12 to be delivered in 2012.

We have another 28 to be delivered from '13 to '17 that have not been ordered yet. We intend to do it along this year and probably in three or four months, they will be coming to market. And we are not planning to place an order on 28 at once. We are discussing a strategy to do this. But most probably, we are going to buy tranches. We will take five, six, seven or eight of each type.

Q - Robert Kessler {BIO 15093691 <GO>}

And can you confirm whether your strategy has changed with regard to whether these will be constructed in Brazil or perhaps in Asia instead?

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

No, no change in this area. They have to be built in Brazil.

Q - Robert Kessler {BIO 15093691 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from the line of Gustavo Gattass with UBS Pactual.

Q - Gustavo Gattass {BIO 1702868 <GO>}

A couple of questions. The first one, in your presentation, you mentioned the discoveries (inaudible) as one of the pro-salt objectives.

I was just wondering if you guys could actually give us some kind of update on that, especially in light of the comments that Director Shirla [ph] had made that (inaudible) had turned out to be disappointing.

If you could give us any idea of how you guys are actually feeling about that finding. The second thing that I just wanted to check has to do with the utilization of Brazilian oil in your refineries. It actually rose about 80%.

I just wanted to check with you guys. Is that the result of the upgrades that you have been doing or was that actually a strategy that is more related to the products weight that you wanted to get out of the refineries?

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

Gustavo, the second question, maybe I will have Judep [ph] to help us.

But I can tell you were are adding new coker units in the old refineries. We have every year, every year since six years ago, we started building new capacity to process more of the domestic crude. And this is to give us more capacity to process the crude oil we produce in Brazil.

A - Unidentified Speaker

(inaudible; microphone inaccessible)

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

Okay. So let's go through the -

Q - Gustavo Gattass {BIO 1702868 <GO>}

Sorry, apologies. But it is very low. From what I understood, you use more domestic oil because you didn't need to produce as much as diesel. Is that the case? I just sort of wasn't able to hear what he was saying.

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

He was away from the microphone.

A - Unidentified Speaker

(inaudible; microphone inaccessible)

Q - Gustavo Gattass {BIO 1702868 <GO>}

Okay, perfect.

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

Okay. So let's go through (inaudible) is a big area. It is a new exploratory frontier. It was acquired, I believe, the fourth big round of the national agency and (inaudible) 180,000 square kilometers. So we did adjust the (inaudible) there. The result was not as we expected. But anyway, it (inaudible) formation above the geology of that area. So we are expanding on the results we have to date through a second well in the area.

Q - Gustavo Gattass {BIO 1702868 <GO>}

Okay, perfect. Thank you.

Operator

Your next question comes from the line of Prem Delko [ph] with Orange Capital.

Q - Unidentified Participant

Thanks for taking my questions. I actually have two questions. One is I want to hear your thoughts on the recent developments on the oil price, particularly the role of China and the news that the Chinese government is somewhat retreating on letting the oil sellers go on the free market and there will be subsidies and those sort of things.

Do you think that that has a major impact on the oil price? Is that something you're looking at and, generally, what are your thoughts on the recent development of the oil price with regards to China?

And the second question is also about China. I don't know, I've read a few news articles about you talking to Chinese potential investors, in a sense, doing deals like that for oil or those sort of things.

Can you clarify if you have conversations, if there are also deals that you could do. And how does that compare to what you can get on the capital markets? Can you talk a little bit about that? Thanks.

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

Okay. Regarding to the last part of your question, what I can say is that we have no conclusion on any negotiation with Chinese. So I cannot tell much to you in this regard. Regarding prices, (inaudible) help us in any way.

A - Unidentified Speaker

(inaudible)

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

It seems that what China is doing there does not have a direct relation with our Brazil market and with what we do.

Q - Unidentified Participant

Okay. Thank you. Operator: Thank you, ladies and gentlemen. There are no questions at this time. Mr. Barbassa, please proceed with your closing remarks.

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

Thank you for being here. I hope the next quarter we can have as good results as we had this time and hope that international economies will catch up to help oil price (inaudible) very good. Thank you, bye-bye.

Operator

(Operator Instructions) This concludes Petrobras' conference call for today. Thank you very much for your participation. You may now disconnect.