

Q2 2005 Earnings Call

Company Participants

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

Other Participants

- Christian Audi, Analyst
- Emerson Leite, Analyst
- Frank Mcgann, Analyst
- Gustavo Gatass, Analyst
- Marc Mccarthy, Analyst
- Margaret Kalvar, Analyst
- Pierre Sagimaw, Analyst
- Ricardo Fernandez, Analyst
- Unidentified Speaker

Presentation

Operator

Welcome to the Petrobras conference call to discuss the Second Quarter 2005 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. (Operator Instructions) As a reminder, this conference is being recorded.

Today with us we have Mr. Almir Barbassa, CFO and IR director 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 who has some additional comments. Please go ahead, Mr. Raul.

Raul Adalberto De Campos {BIO 17251399 <GO>}

Good morning, ladies and gentlemen. Welcome to our conference call to discuss the Second Quarter 2005 results. We have a simultaneous webcast on the Internet that can be accessed at the site www.Petrobras.com.PR/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 icon 'question to host' at anytime during this event.

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Before proceeding let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act the 1996. The 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 Director, 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, kindly begin.

Almir Guilherme Barbassa {BIO 1921476 <GO>}

Good afternoon, ladies and gentlemen. It's a pleasure to be here with you and have the opportunity to talk about Petrobras' Second Quarter 2005 results. We have a presentation, first the usual disclaimers. Then in slide three we have the evolution of the oil price internationally and the oil prices of the E&P area of Petrobras. All of them follow the same trend of oil price increase. But in the last few quarters we can observe that E&P oil price has a larger gap when compared to international ones. This can be explained by the next slide where we can observe that the spreads between the heavy and light oil is much larger than the spread that we are observing between brand and sales price of Petrobras.

Next slide, please. We can see refining life, how our margins are performing. The refineries that process heavier oil can get larger or better margins. That's why Petrobras is investing heavily in modernizing its primary and making them better prepared to process the national oil, the oil produced in Brazil and increase the margins.

Next, please. We can observe here that the domestic [ph] oil and NGL production has increased 18.4% during the last year. These use a word 'record'. And this was possible because in the Second Quarter of 2004 we installed the FPSO (inaudible). And in the end of last year, beginning of this year we had two other platforms, P-43 and P-48, coming on stream. These made possible the increase of production we realized during the period. The total production gross of Petrobras including gas was about 15% in the period.

Next slide, please. Here we have the balance of imports and exports. And the exports is the star because we increased the exports in the last quarter quite significantly. We were able to export in the last quarter 148,000 barrels a day in excess of the imports, generating a surplus of \$900 million in the quarter. Looking at the imports, we have to increase a little bit in volume the oil products -- the imports of oil products. This was due

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to the increase of demand in domestic markets as well as scheduled stoppages of the refinery in the period.

Next, please. Here we can see how the total demand grew between the first and the Second Quarter of 2005 as well as the volume processed in the domestic refinery has reduced a little bit due to the scheduled stoppage as we have mentioned. This same stoppage has caused a reduction in the processed installed capacity in Brazil. But if you look at domestic crude as a percentage of the total oil processed, it has increased since (inaudible) of last year when two conversion units have been installed and start producing at REPLAN and REPAR refineries.

Next slide. Average realization price. As the graph shows, the international prices are increasing as well as we have our domestic average realization price increasing as well. During the last year, between the Second Quarter of 2004 and Second Quarter of 2005, there was an increase of our average price of 47.5%. In the last quarter it was -- the increase was 10.9. So we are following in the long run the average price of the international market.

Next slide, please. Here are the sales volumes and we can see how the domestic market has increased demand 5% in the last quarter. But the most important increase is the exports, 41%. This made possible the surplus, as we mentioned.

Next one, the operational results have shown a positive trend. We had net revenue increasing by 8.2. And regarding the cost of goods sold, that had an increase as well, we realized an EBITDA of 11,000,000.8 reales in the Second Quarter of 2005 with an increase of 12.6%. This cash generation made possible the Company to keep investing higher and higher volumes of money in the increase of production as we have forecasted in our strategic plan.

Next, please. Looking at the segmentation, we have E&P as our main area of profit realization. As we can see here, the main cause of the increase in the operational profit was the production increase in the period as well as price and reduction of the average lifting cost. And we can see in the next page where the lifting costs have reduced from \$5.95 in the First Quarter of 2005 to \$4.88 in the Second Quarter. And the cause of this reduction was the increasing production and reduction of many different kinds of costs that had happened during the First Quarter and did not repeat in the second one. But as we have a real appreciation in the last quarter, we had an increase in the lifting costs because the translation of the reales into dollars make it more expensive.

Next one, please. Downstream we can see how the increase had happened. (inaudible) one-third of the gain between the First Quarter and the Second Quarter was due to the volume that was sold by the segment and one-third was due to the increase of the volume of the domestic oil that was processed. And another third was due to the reduction of operating costs.

Next one. We have here the domestic refining cost that is increasing and part of this is explained by the refineries that are more complex; that demands more material and

serves contract for the program to stoppage. Due to the stoppage lower volumes processed is what made the unit cost higher. Investment in refining made the cost of processing higher as well. Investing in making the refinery more complex.

Next one, please. We can see here that the E&P and downstream are the areas that contribute more to the operational profit of the Company. And this is explained by the increasing domestic oil production and as well as increasing price.

Next one, please. The foreign exchange rate, as it changes it makes different effects on the financial income. We can see here that between the First Quarter 2004 and the Second Quarter there were -- when there was a depreciation in the reales we have a gain. But between the first and Second Quarter of 2005 there was an appreciation and we lost some money.

Next one, please. Here is how we went from the operational profit to the net profit. And is highlighted in this slide, the monetary and foreign correction on assets and liabilities as well as income and expense -- financial income and expense explain a larger hard. And I have here to say that we had a bad effect on the foreign exchange variation on the period. Because Petrobras as a shareholder has some receivables from its subsidiary outside Brazil. So the magnitude of foreign exchange effect is due to the currency balance between Petrobras and its foreign subsidiary.

Petrobras' balance sheet is in reales. If it lends dollar to a subsidiary according to the Brazilian GAAP the asset is evaluated according to the exchange rate movement. If the real appreciates Petrobras must register a foreign exchange loss. But there is no corresponding gain in the subsidiary because its balance sheet is already in dollars. While the (inaudible) amounts are (inaudible) the loss in reales is not. For example, if Petrobras lends to a subsidiary \$1 billion to buy a platform, it registers in the balance sheet the reales equivalent as an asset. The subsidiary registered the platform as an asset and \$1 billion as a liability.

If there is a real appreciation Petrobras would recognize a loss in its balance sheet while the subsidiary does not do it, there's no affect on the subsidiary. In the consolidation the assets of Petrobras and the ability of the subsidiary all disappear and the loss in Petrobras would remain in the balance sheet. And this is a reality in Petrobras. Petrobras has a receivable that produced about 1 billion reales of loss in the Second Quarter due to the appreciation of the reales. And this explains why we came from \$9.5 billion of operating profit to a net profit of 4.9.

Next, please. The leverage of Petrobras is performing quite well. We are at 32% inside of our target of 25 to 35 and in the period we were able to reduce the net debt beyond the effect of the foreign exchange devaluation. This was due to the cash generation that we can see on the next slide -- was \$18.7 billion. What made it possible to invest \$11 billion and producing a free cash flow of 7.6. We used 3.8 in financing and out of this 3.8 about 2.7 was amortization. So using 1 billion of the cash we had at the beginning of the period we reduced 2.7 in that. So we had a reduction in the net debt at the end of the period. That's it, thank you.

Questions And Answers

Operator

(Operator Instructions) Frank McGann, Merrill Lynch.

Q - Frank McGann {BIO 1499014 <GO>}

Good afternoon. Just a couple questions, not so much related to the quarter. But I was just wondering what the status of the negotiations are with Petrovasa [ph] for the refinery project that is being considered as well as the heavy oil project that's being discussed? And then also maybe you could provide a little bit of color on the Macarea [ph] negotiations as well in Alo Cartia [ph]?

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

We are dealing with this investment in the strategic plan. We are finalizing our deal on it and soon we hope we'll have a strategic plan released. So I hope by then we'll have all the information about it.

Q - Frank McGann {BIO 1499014 <GO>}

If I could follow-up then, maybe if you know -- do you know when the date would be for the strategic plan? And separately, in terms of CapEx, I think year to date you've spent about \$4.3 billion, what you think the full year amount is likely to be? And lifting costs, how much further do you think they can come down as you go into the Third Quarter with full production for both P-43 and P-48?

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

Markus [ph], could you help us please?

Q - Unidentified Speaker

Considering the ramp-up of P-43 and P-48 we are expecting to close the year with a lifting cost of about \$4.7 per BOE depending of course on the exchange rate. But today we are performing around 4.8, 4.9 and we are expecting to decrease to something between 4.5 and 4.7 depending on the exchange rate.

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

Regarding the CapEx, as I said, we have invested 11 billion reales in the first half of the year and the total CapEx for the year is 29. We usually -- Petrobras performs or invests more in the second half than the first. This is traditional for Petrobras and we hope we do the same in this year. So our target keeps the same -- we keep the same target, to reach the 29 billion CapEx in the year.

Q - Frank McGann {BIO 1499014 <GO>}

Thank you, very much.

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Operator

Pierre Sagimaw [ph], JP Morgan.

Q - Pierre Sagimaw

Can you explain what the key raisins and components were behind the sharp rise you saw in minority interest in the Second Quarter?

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

You're speaking of the 1.350 million reales loss of minority interest, right?

Q - Pierre Sagimaw

Correct.

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

That is the -- the main component is 968 million which is really the (inaudible) because of the change in the Brazilian (inaudible) regulation 408, we have to consolidate (inaudible) Brazilian GAAP like it's done in the U.S. GAAP. So many of the special purchase companies we do not have any active interest in. So they have to be consolidated line by line and then their bottom line transfers out to the active shareholders. In the long run, all these benefits of the (inaudible) will resort back to Petrobras. But on a year-by-year basis it has to be allowed for. Do you understand?

Q - Pierre Sagimaw

I think I understand. My understanding was also that this accounting change was implemented from the 1st of January 2005 unless I'm mistaken and this is the big swing between the first and Second Quarter. So I just wonder, is this just an accrual issue or is there something else going on here?

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

No, the big issue is that there's an accounting benefit off of the SPC because they have (inaudible) of liability. As they were expressed in reales their profits went up, okay?

Q - Pierre Sagimaw

Okay.

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

When you convert the dollar liability with the SPC to reales your bottom-line increases.

Q - Pierre Sagimaw

Got you.

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

Now just the SPC's account for 968 million of the 1.35, then there is 198 million (inaudible) which is the Brazil/Bolivia pipeline. There of course we will own 51%, there are other interests that own the other 49. There the results definitely go to all the shareholders. And then we have 128 million which is through PNBV which is Petrobras Holland. So there we are the ultimate beneficiary.

Q - Pierre Sagimaw

Thank you.

Operator

Christian Audi, Morgan Stanley.

Q - Christian Audi {BIO 1825501 <GO>}

I had two questions on the refining front. First, similar to how Markus [ph] gave us a sense of the lifting costs that he plans to get toward the end of the year, could you comment on refining cost expectations by year-end? And secondly, in general terms -- I don't know if Phillipe is around to speak -- given your stock right now and the cost at which your inventories are in your books right now, if you had any comments about his expectations for refining margins for the second half of the year?

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

Okay, I'll need you to help us in this answer.

Q - Unidentified Speaker

Lets start talking about refining cost. As you know, the market in Brazil is seasonal which means that we normally have our maintenance program for the first half of the year. That's why we had I would say less (inaudible) in our refinery during the first half. And of course we had real appreciation was another factor that increased the refining cost. In the first half we had our refining (inaudible) amount (inaudible) barrels per day. At the moment we are above 1,800 which means we don't have more installation maintenance in the second half of the year which means we are considering to have much more I would say utilization, better utilization compared to the second half to which we will drop the refining cost for something below 1.8 yearly average. Christian, please remind me the other questions?

Q - Christian Audi {BIO 1825501 <GO>}

I was just wondering if you could give us a sense as you sit now knowing the inventories that you have and the price or cost at which they came into your books and your review of the second half in terms of refining margins. Light/heavy French [ph] remains very wide, likely not to come down. So with that as a backdrop how you expect your margins to continue to improve or any color there would be very helpful.

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

In terms of the inventories we had a drop at the end of the second half. We are at a very stable level at the moment. We do not expect to have an increase in inventories. In terms of the inventory, there of course there is a delay. Of course we are going to have the effect of higher inventory cost in the Third Quarter. In terms of margins, we have been increasing the national crude processed in our refineries which gives us a better margin. We do expect to have a good margin second half as well.

Q - Christian Audi {BIO 1825501 <GO>}

Okay, thank you.

Operator

Marc McCarthy, Bear Stearns.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Almir, thanks very much for the presentation and the discussion of foreign exchange. I wanted to ask specifically if those receivables are the key contributing factor to this foreign exchange minority interest. If that minority interest is largely driven by these SPC's which largely are driven by the significant receivables that you went through and detailed.

The second question I had was specifically about the eliminations number. I've asked this in the past, it's always a complicated figure. Eliminations spiked significantly, your refining margins were substantial, (inaudible), you did a great job. But to me, this is -- I had this big question about if I figure this out on a per barrel basis, it figures to about \$3.85 a barrel, that in a sense maybe the downstream transfer pricing -- I guess my question is where the elimination is coming from. Because they are so significant, to me it means that the divisions are overstated; either upstream is lower, which I doubt, or downstream is lower, which I believe.

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

Okay, Marc. The receivable I mentioned does not relate to the minorities. It is a receivable from Petrobras in regard to its subsidiaries. It does not relate to SPCs that explain most of the variation of the amount implied in the minority space. Regarding today elimination, I would transfer you to Alvis [ph].

Q - Unidentified Speaker

This is Alvis from accounting department. Increasing the eliminations in the Second Quarter in comparison to the First Quarter is related to increasing the oil price in international markets, because the revenues from B&B to supply area is eliminated in the same period. But the cost of goods sold in the supply area has an effect in these stocks and the inventories. Then we expect that some parts of this effect of inventories of supply area will be realized in the next quarter.

Q - Marc Mccarthy {BIO 1542384 <GO>}

So, in a sense, what you're saying is that the inventory hit in the future will be absorbed, let's say, some proportion of the 1.9 billion reales over the next several quarters as the inventories are consumed?

Q - Unidentified Speaker

Yes, perfect.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Why are they not accrued during the same period, or is related to the fact that the crude that was consumed by downstream in the Second Quarter was related to inventories consumed -- recorded on a, let's say, a FIFO basis?

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

No. Here in Brazil you use the average cost. So the effect is -- some parts of this effect is retained in the inventories. If you use it, the FIFO, of course, you are right, the effect will be different. But here in Brazil we have a specific method to evaluate the inventories. We had an effect retaining the inventories that, as I said before, we expect to realize this effect in the next quarter.

Q - Marc Mccarthy {BIO 1542384 <GO>}

So why wouldn't that have just been reported on your working capital statement as opposed to being incorporated into your divisional income statement? In other words, your inventory changes during the period were very light.

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

We had (inaudible) using two different partners. We reduced our inventories in terms of the volumes. But if you to make an analysis in terms of units, cost, we realize that the cost per unit is higher than the previous quarter. But we need more information than we have published to analyze this kind of effect.

Q - Marc Mccarthy {BIO 1542384 <GO>}

So as a shorthand methodology, we can take that higher cost and either expense it into the Second Quarter or have to expense it into the second half. Either way, it's going to come out of the full-year numbers, out of supply.

Q - Unidentified Speaker

Okay.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Okay, thanks very much.

Operator

(Operator Instructions) Margaret Kalvar, Harding Loevner Management.

Q - Margaret Kalvar {BIO 18450283 <GO>}

I just wondered if you could expand a little bit on the effect of the currency on the revenues realized by the supply segment. Then also, my second question concerns your exports. What are your key export markets? Who are you sending the incremental exports to?

Q - Unidentified Speaker

Regarding the exports, we have been exporting crude oil into the United States, West Coast mostly. We have (inaudible) mostly to West Coast. We have Caribbean, we have Gulf Coast as well. Sometimes the arbitrage is open to Far East. And we have exported some cargoes into China, Singapore. And sometimes Europe. It depends on the advertiser. We are open to export to anywhere in the world.

The first part of your question, if I fully understood, the effect of the foreign exchange on the revenues of the supply, there is no effect except for the exports. As the real appreciates, we receive less reales for every barrel of oil. That's the only effect.

Q - Margaret Kalvar {BIO 18450283 <GO>}

But is the internal transfer price based on dollars? And wouldn't you realize a margin spread domestically if you are pricing domestically in reales?

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

The transfer price from E&P to the supply segment, right, that tends to follow the dollar and the exchange rate.

Q - Margaret Kalvar {BIO 18450283 <GO>}

Okay.

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

Now, the supply selling price, that is based in reales except for the export price, of course, which is readjusted for the currency.

Q - Margaret Kalvar {BIO 18450283 <GO>}

Right, okay.

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

And of course on when supply imports, that also reflects the currency.

Q - Margaret Kalvar {BIO 18450283 <GO>}

Right, right.

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

Any more, Margaret?

Q - Margaret Kalvar {BIO 18450283 <GO>}

No, I guess that's it.

Operator

Emerson Leite, Credit Suisse First Boston.

Q - Emerson Leite {BIO 4003528 <GO>}

Good afternoon, couple questions. First of all, just would like to have a breakdown explanation why the equity income line on the consolidated statement came in negative at almost 500 million reales? Then second, sometime ago earlier in the year, you announced the discovery of potentially substantial light oil reserve in the Santos basin. I would like to know if is there any new development in there or any new information as how relevant is this potential find? Third, what is the schedule for new cracking units in the next, let's say, 12 to 18 months?

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

Okay. Let's start with the next refining unit that we're going to have. First of all, we are going to have some cracking and coking units in (inaudible), okay, at the end of this year. We are increasingly the distillation capacity as well in (inaudible). After that, we are going to have coking units at the end of 2006 in REDUC region there. And then we are going to have coking units 2007, 2008, in REGATI [ph] and REVAP. We're still working on that. But the next ones will be REVAP and REDUC.

Q - Unidentified Speaker

Regarding the discovery in (inaudible); it's specifically in BS 500 block [ph] -- BS 500 and BS 400 as well. We announced that we are discovering BS 500 and in BE 400 it was a prospect called d'esidro [ph]. But we are now carrying out the evaluation plans and we are estimating to have that clear definition (inaudible) by the end of next year.

Q - Emerson Leite {BIO 4003528 <GO>}

Thank you.

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

Emerson, this is Raul. Your first part of the question was on the financial revenues?

Q - Emerson Leite {BIO 4003528 <GO>}

No, it was on the equity income line which was negative -- almost 484 million reales. Just wondering what's the source of this?

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

One moment, Emerson.

Q - Emerson Leite {BIO 4003528 <GO>}

Thank you.

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

Emerson, the 484 million reales we lose in the Second Quarter and it was due to the investment we have a broad. They accounted externally in dollars. But when we translated it into reales, we appreciated the reales, it produced this loss and the main assets we have are in Argentina, Nigeria, as you know, Bolivia -- and we have as well -- but this is due to the investment -- the equity participation in these subsidiaries. Okay?

Q - Emerson Leite {BIO 4003528 <GO>}

Okay, Almir, thank you very much.

Operator

Gustavo Gatass, UBS.

Q - Gustavo Gatass

I have some follow-up questions here. Just first on the lifting cost numbers that Markus gave, I just want to understand. Is \$4.7 an average number for the year or is that a target for year-end?

Q - Unidentified Speaker

Gustavo, I mentioned that the final number for the year depends on the exchange rate. Considering an exchange rate of 2.7 on average for example, we are estimating to close the year between 4.5 and 4.7.

Q - Gustavo Gatass

And does that take into account the fact that probably by the end of the year P-43 is not going to be fully ramped up?

Q - Unidentified Speaker

No, no. This figure represents the average (multiple speakers).

Q - Gustavo Gatass

It is for average, okay.

Q - Unidentified Speaker

Okay.

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Q - Gustavo Gatass

Okay. The second question I had, you guys mentioned in the local meeting the potential one month delay here on P-50 and P-34. I was just wondering, are you going to get any kind of financial compensation from the contractors because of the delay?

Q - Unidentified Speaker

No, regarding P-50 for example, there is not a delay. We are talking about to have the startup in November and we are -- just two months is only the final preparation for the startup. And P-34 is on schedule. We are estimating to have the first (inaudible) by the beginning of next year. So we are estimating this year to close the year with a production level on average of 1.7 million, as we announced to the market. And for next year we are planning to increase 200 barrels or 1.9 on average.

Q - Gustavo Gatass

Okay. So neither of them has any kind of contractual breach then?

Q - Unidentified Speaker

No.

Q - Gustavo Gatass

Okay. And just one last point. Can you give us some kind of guidance on the international production for the rest of the year?

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

Yes, until the rest of the year we don't expect any major changes in the international production. The main -- if you look back on last year's strategic plan you're going to see the main growth areas there are Nigeria and the U.S. Gulf and they're still going to happen towards 2007, 2008.

Q - Gustavo Gatass

But the weakness we saw in Second Quarter then is to stay?

Q - Marc Mccarthy {BIO 1542384 <GO>}

The weakness, no, not the weakness but the stability. That was just a question of workover in some wells.

Q - Gustavo Gatass

Okay, thanks.

Operator

(Operator Instructions) Ricardo Fernandez [ph], ING.

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Q - Ricardo Fernandez {BIO 5573550 <GO>}

I guess a little bit more of a longer term question. As I understand it your refining capacity is being improved dramatically so that you'll be well to produce gasoline diesel products at I guess global standards in terms of quality over the many years -- four or five years, whatever the number is. The question I have is as that quality improves will you begin pricing it in the local market, in the domestic market, i.e. instead of we'll say a 20%, 30% discount to the cost or the price of gasoline in the U.S. obviously excluding taxes and what not? Will that began to grow transferred into the Brazilian market?

Q - Unidentified Speaker

Of course the price of any product depends on the quality of the product. You can see in the last quarter we had an increase in diesel prices in the internal market because of improving quality. (inaudible) of May we launched a 500 ppm gas oil here in the Brazilian market. Of course we are investing a lot in order to improve gasoline quality, in order to match the Brazilian standards that will come in the future and also to be able to explore gasoline to reach any market in the world which we hope to have everything ready by 2009. Okay?

Q - Ricardo Fernandez {BIO 5573550 <GO>}

But the question is as you improve the quality then you will definitely be increasing the price because it's a better quality?

Q - Unidentified Speaker

Of course.

Q - Ricardo Fernandez {BIO 5573550 <GO>}

Despite the fact that for example brand prices or your heavy crude prices could be going down. But it doesn't necessarily mean that the gasoline or derivative product will be declining at the same rate because the quality is improving? Is that a fair statement?

Q - Unidentified Speaker

It's a fair statement. We'll also improve the quality of our (inaudible) cost. It's more valuable, you have to charge more. But we deal with the 500 ppm that will launch 1st of May.

Q - Ricardo Fernandez {BIO 5573550 <GO>}

Okay, that was my question. Thank you.

Operator

Marc McCarthy, Bear Stearns.

Q - Marc Mccarthy {BIO 1542384 <GO>}

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Just two easy questions. Jose, with the expected year-end start of P-50 we're going to run into likely the same situation we faced in the First Quarter, costs and no volume. Are your year-end numbers factoring that in? This is a 180,000 unit that you have I remember about 85% or 90% of. So it should make a dent. Are we going to see a one-off impact in the Fourth Quarter from that? That's the first question.

The second question, Alipio, great to have you on the call again. Third-quarter diesel spike, what sort of level of throughput can you pull through and what sort of product imports should we see into this Third Quarter to meet that sort of seasonal demand that we've always seen in the past? And will you be bringing up the light oil imports to maximize your output?

Q - Unidentified Speaker

We only mentioned the stock up of (inaudible) for November and the lifting cost between 4.5 and 4.7 closing the year. We are considering the costs that we are adding in the last quarter, considering they start up (inaudible). So that's why we are not declining more the lifting cost until the end of this year because we are considering the new costs with P-50 operational.

Marc, in the first half of the year we had our refinery maintenance. We do not expect to have any maintenance in the second half of the year. We are going to be running at full capacity. We have been doing that in the last July we reached our refining record of 18 -- 75,000 barrels per day (inaudible) here in Brazil. In July and August we are quite above 1800 thousand [ph] barrels per day in our refining system. It means we are going to reach the demand processing crude oil here in Brazil. It means we will not see any big increase in imports in the country because we are running at full capacity. We are going to have some maintenance. But it's not the (inaudible) units and some (inaudible) units, okay?

Q - Marc Mccarthy {BIO 1542384 <GO>}

But Alipio, are you reaching this 1875 as a result of bringing in more light crude to be able to maximize your throughput?

Q - Unidentified Speaker

No, no, no, no. Remember, we now have a new, big coking unit in REPLAN [ph] which is our biggest refinery. We have four new hard retreating units. We are able to process more Brazilian crude oil in our refining system. You are going to see us running above 80% of the national crude in our refining system in the second half of the year.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Okay. So as it relates to product imports to meet that sort of final level of demand that we've always seen in the Third Quarter, we shouldn't anticipate --?

Q - Unidentified Speaker

Say it again, please, Marc.

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Q - Marc Mccarthy {BIO 1542384 <GO>}

The diesel imports that we've traditionally seen to sort of top off the market to meet the final spike in demand -- I can certainly understand why it will be down year-over-year. But we should certainly continue to anticipate a spike in product imports?

Q - Unidentified Speaker

Not dramatically, not dramatically. You are not going to see a big change in imports. It's not going to reach high numbers.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Okay. Can I just ask you one follow-up question -- it's an easy one? Where are you pushing all of your gasoline on the export market?

Q - Unidentified Speaker

Well, we are open to sell everywhere in the world. But it's mainly the Caribbean and West Africa.

Q - Marc Mccarthy {BIO 1542384 <GO>}

Thanks.

Operator

Emerson Leite, Credit Suisse First Boston.

Q - Emerson Leite {BIO 4003528 <GO>}

A point on the natural gas side. I was wondering if you could provide an outlook for how much gas we can expect over the next 12 months coming from the new projects -- more concerned about the eventual need of natural gas. We are seeing more and more the talk of potential tightness in the natural gas supply and until at least (inaudible) kicks in. So can you give us an outlook for how much more we can expect in terms of gas production over the next 12 to 18 months? And second, finally, on the drilling contracts, I understand that you have finalized a round of negotiations with some of the main oil service players who operate in Brazil. When is the next significant round of negotiations for drilling contracts?

Q - Unidentified Speaker

Emerson, regarding the natural gas production in Brazil, we have first for example last month we started the production in (inaudible) huge producing 500,000 cubic meters per day. For next year in the First Quarter we estimate to have the first gas in (inaudible) we will be able to produce in by (inaudible) 6 million cubic meters per day. This year in Padua [ph] -- Padua is a facility located in Spiritu Santos [ph]. We are now implementing the first phase of the project and we are able to produce 2.5 million cubic meters per day next month.

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So we have in (inaudible) 500,000 (inaudible) meters per day in (inaudible) next year 6 million cubic meters per day in the First Quarter. Padua, the first phase 2.5 million. This year we have as well P-50. P-50 is an oil project. But we produce associated gas and we can produce -- we can (inaudible) 2.5 million cubic meters per day. And next year we have as well the first phase of (inaudible) development and we can offer to the market 1.5 million cubic meters per day. So in the short-term these are the main gas projects.

Regarding the drilling contract, we are not forecasting negotiations for this year. We are (inaudible) for next year mainly depending on the results of BS 400 and BS 500 (inaudible) so we can have new negotiations next year.

Q - Emerson Leite {BIO 4003528 <GO>}

For this incremental gas production that you mentioned, the transportation infrastructure is already in place so it can absorb this incremental production I would imagine?

Q - Unidentified Speaker

Regarding (inaudible), we are implementing the transportation system to deliver the gas from (inaudible) to (inaudible) and in Spiritu Santos the first phase of (inaudible) -- the first phase, now we are implementing the first phase. The second phase, as Mr. Barbassa mentioned this morning, we are expecting to conclude the strategic plan. But the first phase connecting Spiritu Santos to (inaudible) is -- we are carrying out this phase now.

Q - Emerson Leite {BIO 4003528 <GO>}

Thank you, very much again.

Operator

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

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

Thank you, all for being here. I hope that next quarter we can have as good results as we have now and thank you once again. All right.

Operator

Ladies and gentlemen. your host is making today's conference available for replay starting one hour from now. You may access at IR website this replay by dialing 1-973-341-3080 lasting through August 23rd. That number again is 1-973-341-3080. At the voice prompt enter the access code 631-9887. This concludes Petrobras' conference call for today. Thank you, very much for your participation. You may now disconnect.

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