Q2 2009 Earnings Call

Company Participants

- Almir Guilherme Barbassa, CFO, IR Officer
- Eduardo Alessandro Molinari, Coordinator, Strategy and Portfolio Management, E&P
- Theodore Helms, Director IR
- Unidentified Speaker, Company Representative

Other Participants

- Arjun Murti, Analyst
- Frank McGann, Analyst
- Kate Lucas, Analyst
- Paul Cheng, Analyst
- Paula Kovarsky, Analyst
- Ricardo Cavanagh, Analyst
- Robert Kessler, Analyst
- Sergio Torres, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Petrobras Conference Call to Discuss the Second Quarter 2009 Results. (Operator Instructions) 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 Second Quarter 2009 Results. We have a simultaneous webcast on the Internet that could be accessed at the site, www.petrobras.com.br/ir/english.

Before proceeding, I'd like to draw your attention to slide two.

We may make forward-looking statements which are identified by the use of the word "will," "expect," and "similar," that are based on the beliefs and assumptions of Petrobras Management and 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 related 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 Second Quarter Results.

This quarter is notable for the absence of extraordinary items and for the reduction in costs, particularly from inventories which were formed during when prices were lower. The quarter also demonstrate the stability of our operating earnings as a result of our domestic pricing policy.

Let's go to slide three please.

During the Second Quarter, oil and gas production in Brazil was up 6% year-over-year and 1% sequentially. Year-over-year growth would have been higher except that we have had a -- to shutting 40,000 barrels of oil equivalent of gas capacity because of limited domestic demand. We continue to maintain our target for average daily production in Brazil of 2.050 million barrels per day in 2009. But note that this includes a range of plus or minus 2.5%.

This year, we have experienced a number of minor operational issues and delays that reduced our expected average for the first seven months of the year. Such issues are to be expected given the complexity of our operations.

We set our targets to reflect our production challenge. But even planning for contingencies, our target range is a more appropriate reflection of the reality of our business.

Next slide please.

In the pre-salt, we continue to accelerate our activities, particularly in the BMS-9 and BMS-11. We now have six rigs on location in the Santos Basin cluster. Three are drilling new wells in Iracema, Tupi Nordeste and Abare.

Two are performing drill stem tests in Guara and Iara. The purpose of these tests is to provide additional information about the productivity of wells and the quality of the oil.

Finally, we have a rig work on the replacement of the Christmas tree of the extended well test.

By the end of this year, we expect the arrival of Petrorig II and the SSV Victoria.

In 2010, five new built rigs that we're contracting 2005 should arrive. These will be supplemented by the arrival of the Transocean's Cajun Express which we recently contracted.

For the remainder of the year, we expect to perform additional drill stem test, as well as new appraisal wells that form part of our evaluation plans for the pre-salt cluster.

We continue to move forward on the bid for the eight standard FPSO hulls to be built in Brazil and hope to have a contract for these hulls signed by year-end.

Additionally, we are nearing the end of the bidding process for two new Pilots that I scheduled to begin production in 2013 and 2014 and possible earlier.

It's well worth noting that we possess the first cargo from Tupi. We found the quality of oil excellent, with low sulfur and high yields of middle distillates.

Next slide please.

We turn now to some key operating data that determined our quarterly results.

In this slide, you will see the average price of Brent increased from $44 to $59 per barrel. The light-heavy differential decreased during this period which is reflected in the differential between our crude oil and Brent. Together, these factors contribute to a substantial improvement in our upstream segment's margin and income.

Next please.

The increase in that price of oil and the strengthening of the real caused a small increase in lifting costs. Lifting costs expressed in US dollars. And without government take, increased by almost $1 per barrel.

Reflecting the influence of the exchange rate on lifting costs, lifting costs were slightly lower when expressed in reais.

Production taxes increased during the period, giving their linkage to international oil price. Production taxes increased by nearly $4 per barrel, while Brent increased some $15 per barrel; the net results was an improvement in our margin.

We continue our policy of adjusting gasoline, diesel and LPG only in the long term when we believe a new international price level has been established. The consequence is a smoothing of our operating income as well as price stability to the Brazilian market consumer.

From the First Quarter of last year until June, we were recovering the difference between international market price and domestic market price. With the reduction of gasoline and diesel prices in Brazil in June 10th combined with the higher international price, we are now close to parity between the two markets.

The markets for derivatives and natural gas rebounded in the Second Quarter versus the First Quarter, although it is still down year-over-year.

To highlight some of the principal movements of our main products, diesel recovered in line with GDP growth.

The first half of last year also saw considerable consumption of diesel for thermo-electric generation.

Gasoline consumption was lower as a result of increasing competition with ethanol.

Fuel oil continued to decline as industry consumers switched to natural gas, which is now abundant and are[ph] cheaply less expensive.

Natural gas sales increased. But are still weak because of the lack of demand for thermo-electric power.

Next.

We continue to upgrade our refineries to improve our margin and our trade balance. Comparing the first six months of 2009 with 2008, we reduced fuel oil production by 51,000 barrels per day, while increasing the output of diesel by 33,000 barrels per day. This enables us to capture the margin between these two products.

Additionally, while refinery through put in Brazil was down 30,000 barrels per day due to a program the refinery maintenance, two-thirds of the reduction of feedstock, two-thirds of reduction in feedstock, was imported light oil, which represents a savings of approximately $13 per barrel more than the domestic crude we exported during the first half of the year.

Higher oil production, improvement in our refinery system. And reduced demand are reflected in our trade balance. The difference between barrels of oil and oil product exported and imported continues to improve with a surplus of 184,000 barrels per day in the first half of 2009 versus a surplus of only 27,000 barrels per day in the first half of 2008.

The commercial trade balance declined from a deficit[ph] of $567 million in the first semester of last year to a surplus of $1.3 billion in this semester.

Let's now turn -- turn now to financial results.

Net revenue increased as a result of higher volume and higher price for our export and for those products in Brazil that adjust each two weeks to international price.

Cost of goods sold decreased as a result of inventory average and because we were able to process more domestic oil and fuel into the middle distillates demanded by Brazilian markets.

Operating expense were reduced from the prior quarter by a decline in freight costs, lower operating expense classified as "Others", as well as reduced write-offs for dry holes, no inventory reductions. And no other impairments. The net result was an increase in operating income by 31%.

Similar to the First Quarter, improving operating income was partially offset by larger financial expenses related to continued appreciation of the real against the dollar.

The quarter-over-quarter net financial results increased from a negative BRL849 million to a negative BRL2.4 billion. The increase in minority interest expense from BRL342 million to BRL1.9 billion is also largely result of real appreciation, as is a portion of the BRL744 million increase in equity investments.

The net debt affect for our financial results affected by the appreciation of the real reduced the net income by BRL2.4 billion during the period. This reduction largely offset the increase of net income from positive financial results due to the appreciation of the real against the dollar, during the second half of last year.

Also affecting the financial results was a quarter-over-quarter increase in financial expense of BRL285 million as a result of our commercial hedge in the Second Quarter of 2009. This loss was largely offset by the benefit of a reduction in cost of goods sold which had the effect of increasing operating income.

With the deduction for interest on capital in the Second Quarter of 2009, our tax expense decreased by BRL645 million. Foreign tax benefit also reduced our tax bill during the quarter.

Despite the higher financial expense and minority interest expense, net income increased 33% over the period.

Next please.

Operating income for our Brazilian Exploration Production segment more than doubled from the prior quarter led by higher price and volumes. As mentioned earlier, low demand for natural gas caused approximately 40,000 barrels of oil equivalent of natural gas to be shut in, reducing revenue potential and increasing per-unit lifting costs. As we saw earlier, costs were higher as a result of higher production taxes.

Next.

Operating income for our Brazilian Downstream segment remained strong, as revenues increased on higher volume and price, while cost of goods sold were favorably impacted by cost averaging. Refining through put was down slightly due to programmed refinery maintenance. The percentage of domestic goods processed decreased slightly from 80% to 79%.

Next.

Our Gas and Energy segment recorded the operating income of BRL576 million despite limited thermo-electric generation of electricity. The gain was largely a result of growing capacity based on greater supply of natural gas and completed infrastructure.

As capacity grows, the Gas and Energy segment has more opportunity for revenues from our purchased sales. The completion of the infrastructure also eliminated the contractual penalties, which adversely impacted earnings in the past.

The positive income[ph] marks a turning point between the Gas and the Energy segment, which now has the infrastructure and the supply of gas to give it the operational flexibility to generate income. This year will mark the peak of the investment cycle for the Gas and Energy; as a result, investment should fall by half next year.

The improvement in the International segment was due largely to absence of extraordinary items that hurt the First Quarter earnings. Growing production in Nigeria is offsetting declining production elsewhere.

Our share of Agbami Production is now 20,000 barrels per day. Akpo is producing since last March. We expect production from these two projects to contribute to 60,000 barrels of oil per day by year-end to our production and will contribute an average of 40,000 barrels per day to 2009 production.

Next.

Capital spending increased to BRL32.5 billion during the first semester of 2009, up 56% for the first semester of 2008. Approximately 50% of our spending was for domestic E&P. And the remainder for our integrated operation. Current spending is roughly equal to our EBITDA of BRL31 billion during the semester, although it is now below our free cash flow.

Capital expenditure during the first half of the year were based largely on existing projects and contracts. And we have not seen substantial cost reduction for expenditure related to these contracts.

For new projects, we are seeing some reduction in price. But still too early to quantify.

What is more apparent in the greater is the great availability of equipment and supplies at price below those of last year. Ultra deep-water rigs are a good example of these. This increase in availability has led to some increasing CapEx above[ph] what was planned. We are closely monitoring event[ph] investment spending. And if necessary, we'll revise our CapEx budget accordingly.

Next, please.

During the quarter, we were active in various markets to finance the project gap between cash generation CapEx. Since our conference call announcing First Quarter results, we have announced a $10 billion loan from the Chinese Development Bank for ten years.

We recently concluded our loan with BNDES, which was fully dispersed on July 31st.

Finally, in July, we reopened -- in June, we reopened our Global Notes due in 2019 to capture another $1.25 billion. In the reopening, we lowered our cost of borrowing from eight and one eight % rate to -- we received in February, to six and seven eight %. Proceeds will be used to reduce commercial bank bridge loans.

We have now tapped the capital market for $2.5 billion of the planned $6 billion that we intend to issue during 2009 and 2010.

Although we have contracted or have obtained, commitment for more than $31 billion since the beginning of the year. And have to fund the difference between our projected cash flow if Brent were to average $66 per barrel during the next five years. And our planned CapEx of $174 billion for the period of 2009 and 2013 business plan.

Next, please.

Total debt expressed in reais declined slightly during the quarter. But net debt increased as we drew down cash balance to fund CapEx and dividends payment.

Our debt, when expressed in dollar, increased partially as a result of additional borrowings and partially because from converging our reais denominated debt into US dollars. Our net debt to net blue[ph] capital ended the quarter at 28%, still profitably[ph] between our target range of 25% to 35%.

Thank you. With that, let me stop and answer any questions you may have.

Questions And Answers

Operator

Thank you. (Operator Instructions) Our first question comes from Robert Kessler from Simmons & Company.

Q - Robert Kessler {BIO 15093691 <GO>}

Hello, good day.

I had a -- I wanted to see if you could provide some commentary around the pre-salt framework. I guess where we stand now and the next steps from here.

As I understand it, the committee has now put forward before the President some three proposals. And the next step is for him to then in turn propose one of those to Congress. Is that correct? And if so, could you give us your indication on timing for when that proposal to Congress will take place? And any additional commentary you might have around your preference among the three proposals.

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

These are proposals that are under the responsibility of the government and that established committee to suggest alternatives.

We are -- although the President of Petrobras is part of this committee, we as a company, we are not taking part on it and we don't know more than is in the newspaper. So I prefer not to comment on these issues.

Q - Robert Kessler {BIO 15093691 <GO>}

Okay. Can I take a different line of questioning then on your pre-salt development plans or early stages thereof, as you look at the next two FPSOs going into sanction here with Iara and Guara at 120,000 barrels a day of capacity, would you envision that increased capacity from -- I think, the earlier number was 100,000 -- is the 120,000 now indicative of what you would expect for the next eight? Or what are your thoughts more broadly about the optimum size of these units as you sanction them going forward?

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

Okay, I'm going to ask Molinari, our colleague from E&P, if he can add some information on that.

A - Eduardo Alessandro Molinari {BIO 21023582 <GO>}

Yes, Iara and Guara is just a formation test. We are doing the test with the drilling rigs, it's very short period.

Q - Robert Kessler {BIO 15093691 <GO>}

As you fully develop the Pre-salt, what is the optimum size of your FPSOs? Is 100,000 barrels a day the right number? Is 120,000 a good number in your thinking today?

A - Eduardo Alessandro Molinari {BIO 21023582 <GO>}

I was talking about these two formation tests. Then we will have Guara net pilot system with 120,000 barrels per day, starting production in 2013.

Then we'll have eight FPSOs until -- from 2015 and 2016 to start production in this period. And these FPSOs will have a capacity of 150,000 barrels per day.

Q - Robert Kessler {BIO 15093691 <GO>}

Okay.

Do you expect those to be relatively fully utilized? I guess I'm thinking of examples in the Campos Basin, where you had a number of modules to a given field or area. And then the utilization of those -- that top-side facility is something less than 100%. Thinking, for example, let's say, Marlim Sul where you've got Modules 1, 2 and 3 with capacity now 430,000 barrels a day, with another module in 2011. But I think you're target there for Marlim Sul, in terms of total output, is around 288 for 2013, which implies a fairly low utilization of the top-side facilities.

Now recognized they're spread fairly broadly geographically. But as you think about these eight new FPSOs with a capacity of 150,000 each, should we expect a fairly high utilization of that 150,000 or something lower?

A - Eduardo Alessandro Molinari {BIO 21023582 <GO>}

Yes. The FPSOs, we produce at the peak, this 150,000 barrels per day. This is the expected production. But of course, we will have a plateau and then a decline as we have in any other field. Okay. So this full capacity will be for a certain field that we don't know yet. It will depend on the other tests that we are going to do.

The pilot system of Tupi, that we are going to evaluate and the reservoir[ph] and have more data. But the peak production will be in this range, 150,000 for a certain period.

Operator

Thank you.

Our next question comes from Paula Kovarsky from Itau Securities.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Hello. Good morning, everyone, I actually have three questions.

First question is on CapEx. And actually what I was trying to understand is the breakdown of CapEx spending. In the strategic plan, E&P accounts for roughly 60% of the spendings and it was around 45% this quarter. So I'd like to understand if this CapEx is supposed to increase in the second half of the year?

And most importantly, if you could give us a little bit of color on how is it being spent between exploration and development production, since some of what we hear is that some of the suppliers claim that the contracting process is kind of slow and there's not been so much CapEx in production and development. So I would like to understand a little bit how those things are working.

Second question relates to expenses. Indeed, the Company posted a significant improvement in operating expenses and I would like to get to understand how recurring those improvements are. And what shall we expect for the second half of the year?

Then, third question relates to the Gas and Energy unit. I was just trying to understand, in a quarter where gas sales are still kind of low, given the stallment of the industrial production here in Brazil and where sales into thermal plants, into electricity, are all so low, the Company posts its best results. So I'd like to understand, how's the profitability of those, both Gas and Energy sales? And how should we look at this unit going forward?

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

Let's start by the last one. Let me have some help on this question, Paula.

A - Unidentified Speaker

Good afternoon.

Basically, our gross profit that brings all the results on the quarter. And we have about BRL2 million in the Gas segment of growing profits. And BRL300 million in the Energy sectors.

And what happened, basically, is that we have exchange rate effect impacting both segments, in Gas and in Energy. And also, in Energy sector, what happens that our energy costs to purchase energy was very low, because of the spot price that we buy to sell our power purchase[ph] agreements.

Also, natural gas, we have a growing volume that also helps to bring more profits in relation with the last quarter. We see month-by-month, basically, we see a growing volume in industrial sectors and we by see until the end of the year, we hope to be the same level of profitability. We don't see any more trouble ahead.

The one point is that the operator said that there will not be any other thermo-generator in the year. And that is a problem but we already knew about that. And what we're trying to develop is to optimize our avenues from power purchase[ph] agreements and taking opportunity of the low cost of energy. And also, we hope that with the growing volume of the industrial market in the gas segment, we believe we're going to be a quite best position in the latter of the year than we had in the last year.

Q - Paula Kovarsky {BIO 15363001 <GO>}

But what do you do with the gas that is not being burned into the thermo plants? I mean, does that go as a loss to the E&P division? How does that work?

A - Unidentified Speaker

What we're trying to do is to make some auctions of short selling gas. Like a one-month-agreement of contracts and with a discount price. And -- but we're not burning gas because of the market, that's an important thing to say. I think that E&P could say a little bit about his point.

What we meant is that we management our supply and our logistics trying to cope with demand, like take less gas from Bolivia, our oil camps, our gas camps, that are not associated, we shut it down. And we bring less G&L. So we are very flexible for the supply side and we can keep with the low demand.

But I think the worse pathway[ph], the First Quarter was really bad about the demand and now we see a growing demand in the Natural Gas business.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Okay.

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

Okay, regarding the CapEx and percentage of the different segments, I guess the best way to view this is to look at our five-year business plan.

We have from $1.74 billion of the total investment in five-year, we have $1.04 billion for the E&P. And if you take one year or one quarter or six months, sometimes you have a different composition on the distribution of these CapEx. But on the long run, the plan in the five-year business plan, shall prevail.

Q - Paula Kovarsky {BIO 15363001 <GO>}

So you don't see any particular trend in the quarter? For instance, when talking about investments in exploration and development and production, they're kind of following the originally planned trends; is that correct?

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

Sometimes they can speed up. And sometimes depends on the moment.

Now, for example, we are planning to receive six -- we have six rigs in the Santos Basin Pre-salt. And we are going to receive another two and another six next year. So you see the expenditure[ph] in this area is going to increase.

I don't know if I fully answered you.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Yes. Then, just could you comment on the BRL4 billion investment in the international area on the quarter.

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

Four billion --.

Q - Paula Kovarsky {BIO 15363001 <GO>}

BRL4 billion.

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

BRL4 billion in the international.

Q - Paula Kovarsky {BIO 15363001 <GO>}

In the semester, sorry.

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

Okay, that's why we dispersed the acquisition of the distribution in Chile, we bought from Exxon, in this semester, as well as the second half of the Pasadena Refinery. Only these two items comprises for nearly $1 billion. And the rest is the normal activity.

Okay?

Operator

Thank you. (Operator Instructions) Our next question comes from Arjun Murti from Goldman Sachs.

Q - Arjun Murti

Thank you. Thanks for the update on the drilling plans.

I was wondering if you could provide an update on when you may give more information on the various reserves on the blocks. You've given an initial estimate for Tupi and Iara. After you're drilling the additional wells on the Tupi block and after you're done drilling those additional wells on BMS-9, might you give a further update on reserves then? And I guess if you don't do it then, when might you be providing additional details on that?

Thank you.

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

Arjun, I'm sorry to say. But probably, we are not of much help to you in this case. I don't know if Molinari can give you more information. But we cannot anticipate this kind of news.

Molinari is saying that he cannot add as well.

Q - Arjun Murti

Can you comment on whether Iracema is viewed as being an extension of Iara? Or if that's a distinct structure, or if it's part of Tupi, that well?

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

Which one you mean?

Q - Arjun Murti

The Iracema well in the northern portion of BMS-11.

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

Molinari, please.

A - Eduardo Alessandro Molinari {BIO 21023582 <GO>}

Iara, we are testing now. Right now preparing now for the formation test. And it will take more than 20 days to finish these tests. But we have already amounts of the volume in Iara which is 3 billion to 4 billion barrels of oil equivalent. So it's just a continuation of the work to there, to load better the reservoir.

Q - Arjun Murti

Do you see Iracema as a separate structure or part of either Tupi or Iara or the entire thing?

A - Eduardo Alessandro Molinari {BIO 21023582 <GO>}

It's the same way as BMS-11.

Q - Arjun Murti

Yes.

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

I don't know if it's the same structure, probably not.

Q - Arjun Murti

Then, if you'll just bear with me with just one final question. Has the Tupi extended-well test or any additional information that you've gotten, give you any encouragement in terms of what types of flow rate you can expect from individual wells in the pre-salt, as well as what kind of reserve recoveries you might have?

I think an earlier question was noticing that the FPSOs actually seem like they're going to be a little larger than originally thought. Is that a function because you think the wells can flow at higher rates? Or can you provide any comments along those lines?

Thank you very much.

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

Yes. Well the extended well test of Tupi, before it stopped production was producing 14,000 barrels per day, as planned. You know that we are limited to the amount of gas we can flare, which is 500,000 cubic meters a day. To know now the productivity of the wells in the pre-salt, we needed to evaluate further to study with the data from the pilot system of Tupi, because in that pilot system, we will not have constraints regarding production.

In Espirito Santo, we have one pre-salt well. We reduced some production from other pre-salt wells in the P-34 platform. So we could increase the production from Espirito Santo, 738 to 18,000 barrels per day. That's the production today. And so we will need to evaluate further there with the pilot system to see the productivity of the well for the permanent systems.

Operator

Thank you.

Our next question comes from Frank McGann from Merrill Lynch.

Q - Frank McGann {BIO 1499014 <GO>}

Hello. Good afternoon.

Just a little bit more information maybe on the refining side in terms of the upgrading projects. You've had a long series of projects that you've been doing for a number of -- and I believe you have a couple more years of the key part of the upgrading process.

But how much more diesel do you think you'll be able to produce, say in 2010 than this year. And again in 2011? How much more capacity will we have on the diesel side?

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

Frank, I guess you are asking two difficult questions. Our colleagues from refining, they don't have this answer.

A - Theodore Helms {BIO 15433381 <GO>}

Frank, we'll try to get that and send it to you. And so, we'll work on that.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. Great. Thanks.

A - Theodore Helms {BIO 15433381 <GO>}

Just for that, we'll let you have another question.

Q - Frank McGann {BIO 1499014 <GO>}

I'm fine.

Operator

Thank you.

Our next question comes from Ricardo Cavanagh from Raymond James.

Q - Ricardo Cavanagh {BIO 1702523 <GO>}

Yes, hello, everybody. My question is regarding lifting costs.

How do you see them evolving in the coming few quarters, if possible?

A - Eduardo Alessandro Molinari {BIO 21023582 <GO>}

The lifting cost, we had a reduction in reais, lifting cost in reais, from the First Quarter to the Second Quarter of 2009. And with the platforms that came on stream this year, five platforms, we expected that the lifting costs will reduce in the near future as production increases in those platforms.

Q - Ricardo Cavanagh {BIO 1702523 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Paul Cheng from Barclays Capital.

Please go ahead.

Q - Paul Cheng {BIO 1494607 <GO>}

Hello, guys, two quick questions.

First, Almir, looking at the 2009 capital spending plan, I think your budget is $28.6 billion with the exchange rate is changing. And also I think that the unit cost in some of the circles[ph] are also changing. Any update in terms of how that number is going to look for this year? And also, any update for the 2010 number?

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

Paul, we did not change our expected CapEx for the remaining of the year, except by the exchange rate. Because if you divide a BRL60.5 or BRL60.4 billion by 1.85, that is the current exchange rate, you will get more than $30 billion.

Q - Paul Cheng {BIO 1494607 <GO>}

Or making it up in other ways then, how much of the BRL60 billion or $28.6 billion, that's your original Cap, how much of them is US dollar denominated? And how much is real denominated?

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

It's about 60-40.

Q - Paul Cheng {BIO 1494607 <GO>}

60-40, BRL60 or $60?

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

BRL60, $40. As you know, we are increasing our national content and many of these investments that is not in the E&P, we can do it with a large national content. So 60-40, I believe, is a fairly number.

Q - Paul Cheng {BIO 1494607 <GO>}

Okay.

And second question, that in the Second Quarter 2009, do you have an under lift or over lift in the quarter? And also, I think in the First Quarter, you have a pretty large under lift. By the end of the Second Quarter, are you now, from an inventory standpoint, abundance or that you are still under lift?

A - Theodore Helms {BIO 15433381 <GO>}

Actually, Paul, we're sorry, "under lift"? I don't think we're familiar with the term.

Q - Paul Cheng {BIO 1494607 <GO>}

It means that your sales volume is lower than your actual production. Because sometimes that due to the timing of the loading into the FPSO or to the VLCC[ph] to sell, sometimes that sales volume may be lower than your production and maybe sometimes it's higher.

It looked like that in the First Quarter, that you may have an under lift. And wondering, Second Quarter, do you have an under lift or over lift? And by the end of the Second Quarter, are you balancing your inventory level or that you still have some catch-up to do?

A - Theodore Helms {BIO 15433381 <GO>}

I think you've asked a very technical question that we have to go back and try to find the answer for. But I don't think anybody in this room knows the answer to the question right now.

Is that right?

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

Maybe I can provide some clue on this, because our total inventory at the beginning of the year were lower than at the end of the semester. So we grew our inventories during this 2009.

Q - Paul Cheng {BIO 1494607 <GO>}

You've increased your inventory or you cut down -- ?

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

Yes.

Q - Paul Cheng {BIO 1494607 <GO>}

You increased?

A - Theodore Helms {BIO 15433381 <GO>}

We increased, right, increased.

Q - Paul Cheng {BIO 1494607 <GO>}

That means that you probably have an under lift.

So Ted, if you don't mind, you can send me an e-mail back or give me a call and let me know then how much is the still under lift.

A - Theodore Helms {BIO 15433381 <GO>}

Sure --.

Q - Paul Cheng {BIO 1494607 <GO>}

And that if I could have a sneak in a another one[ph]. Do you have any inventory gain or trading gain in the supply results for the Second Quarter?

A - Theodore Helms {BIO 15433381 <GO>}

You're actually referring to actual -- where we would recognize a gain -- yes, I don't think, no.

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

No. There were no gains on the Second Quarter or loss. This was only the First Quarter.

Operator

Thank you.

(Operator Instructions)

Our next question comes from Sergio Torres from JPMorgan.

Q - Sergio Torres {BIO 7078415 <GO>}

Good afternoon, everybody.

One question regarding your exports of crude oil. I wonder if you started shipping oil to China already. And if you could share with us how does that commitment is working for the first year? Is it take-or-pay arrangement, or is it right of first refusal?

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

We did not start. We have in place some contracts that was signed before we were in China last May. And signed for the new supply agreement. But the new supply agreement is a kind of -- is a market terms agreement, the right -- kind of right of first refusal. We offer them a volume of oil at market price. If they agree, then okay, they will take it. If not, we'll sell for anyone else that will pay the price we are asking. And this is the basic rule of this supply contract.

Q - Sergio Torres {BIO 7078415 <GO>}

Okay. Great, thank you, Almir.

And a follow-up, if I may, is if you could share with us the outlook for your international refining operations in the US, Argentina and Japan?

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

Let me ask for the help of the International colleagues.

A - Unidentified Speaker

Good afternoon, Mr. Torres.

In Argentina, we have some investments to obtain, the new environmental regulation in our refineries.

In the United States, we're working to Pasadena Refinery a process more of heavy oil.

And in Japan, we're working to increase the total charge to unit.

And that's all.

Q - Sergio Torres {BIO 7078415 <GO>}

Okay. Thank you.

Operator

Our next question will come from Kate Lucas from Collins Stewart.

Please go ahead.

Q - Kate Lucas

Good afternoon, gentlemen. thank you.

I have a question on your Downstream segment. In your slide 14, you show a favorable price effect on revenues between the First Quarter and the Second Quarter. And yet between the two quarters, your average oil product realization prices actually came down slightly. So can you comment on some of the non-oil products related revenues in the quarter? Maybe petrochemicals or other related revenues that would be driving that favorable price affect. Then, how we'd think about those types of revenues and that impact going forward?

A - Theodore Helms {BIO 15433381 <GO>}

Just to clarify, Kate. I think you're looking at the price effect on revenues, which is a positive number in the segment. Then you're looking at the PMR and the realization which actually looks like it's come down during the period.

Is that what you're talking about?

Q - Kate Lucas

Right, your average domestic market oil price products came in a little bit.

A - Theodore Helms {BIO 15433381 <GO>}

Right.

Q - Kate Lucas

And so, there seems to be something unrelated to the oil products, perhaps petrochemicals or some other revenues.

A - Theodore Helms {BIO 15433381 <GO>}

It could also be just -- remember also, it could also be exports, because this only refers to domestic pricing.

I'll ask our Avashta[ph] guys if you can think of any other reason why the Downstream -- or maybe our accounting would have an explanation.

I think it probably relates to the fact that the PMR only includes domestic sales, whereas the Avashta[ph] does include international sales, particularly of products they export.

I don't know if that --.

Q - Kate Lucas

So the slide 14 refers to Global Downstream, not just Domestic Downstream?

A - Theodore Helms {BIO 15433381 <GO>}

Yes, slide 14 -- well, the Downstream segment of Petrobras, however, that includes export revenues.

Q - Kate Lucas

Okay. Thank you.

Operator

Our next question comes as a follow-up from Paul Cheng from Barclays Capital.

Please go ahead.

Q - Paul Cheng {BIO 1494607 <GO>}

Hello, again. Two questions, actually. One is wondering, Almir, can you give us an update about the investigation of the government on the Company, on the tax, where we are in the process? If you can just give me an update on that.

And secondly, what is your July and August % in oil production so far? Even at the low end of your target for 2009, you would suggest the second half 2009, your assuming oil production will need to be close to about 2.040 million barrels per day versus the Second Quarter of 1.964 or June of 1.927. And doesn't seem like you have any really major new projects, maybe just one more that come on stream for the remaining of the year, is that still, maybe stretching here?

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

Okay, Paul, I have Molinari to comment, the second question to you.

A - Eduardo Alessandro Molinari {BIO 21023582 <GO>}

Okay, we have July a production of 1.938 million barrels per day. We have started production of five platforms this year. So all of them is in the process of increasing production.

We have P-51 that started production January 24. The first semester have a production -- average production of 45,000 barrels per day. Now, in the first days of August until 12, we have a production of 78,000 barrels per day.

Then we have Cidade de Vitoria[ph] that started production February 26. It produces 30,000 barrels per day in the first half of 2009; the production now is 45,000 barrels per day.

We have P-53 that started production November last year. And in the first half contributed with 63,000 barrels per day of production. And now it's producing 94,000 barrels per day.

So we will not have a new platform. They are all up and already started, we will build off first half of production.

And besides that, we have the two FPSOs that are not operated by Petrobras, which is FPSO Frade is operated by Chevron. They started production 20th or so for June. And it's -- the production is very low at the moment. But we'll hump up towards the end of the year.

And also, Parque das Conchas -- Petrobras has 30% in Frade. And Parque das Conchas is operated by Shell. Petrobras has 35% working interest and started production recently, July 12. And it's a very small production at the moment but will pick up -- hump up the production towards the end of the year.

So the second half, the production will grow basically with these platforms installed in the first half.

Q - Paul Cheng {BIO 1494607 <GO>}

Thank you.

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

Okay, Paul, regarding the congressional investigation commission regarding the tax process, last week there were a hearing of the head of the Brazilian IRS and the Congress. And he said that really the law was not clear enough regarding the procedure that Petrobras adopted. And there were no problem.

The idea of the no problem that it was not so clear, because the intention of the law was to hedge the companies, the Brazilian corporates, that owns assets designated in dollars. And with the exchange rate variation, they can have a gain or loss depending on this variation. And the law came to protect this company against payments of taxes in moments that they were not realizing the income they were earning or losing, depending on the variation of the exchange rate.

So the procedure that Petrobras adopted was in line with the intention of the law. And so the head of this commission accepted that the answer was enough. And considered, as a normal procedure, the procedure that Petrobras has adopted.

We don't expect to have any other investigation or further demands on this subject. The other subjects were not yet passed, were not yet exempt in the Congress. But the tax procedure, we are considering as solid. And with no problems for Petrobras.

Q - Paul Cheng {BIO 1494607 <GO>}

Right. And Almir, talk about the other corruption investigation. When's that going to be having the hearing in the Congress? Or how that procedure is going to be -- or how that being perceived?

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

Regarding the other subjects?

Q - Paul Cheng {BIO 1494607 <GO>}

Yes.

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

Yes, I guess today or tomorrow there'll be a new one. Today, this afternoon, yes, the Congress is working. And they are hearing the BNAP, the Brazilian National Petroleum Agency, people. And next week and on, they'll be inviting Petrobras employees to tell about the other subjects.

Q - Paul Cheng {BIO 1494607 <GO>}

So that means the investigation is going to be continued for a while, maybe not tax. But on different subjects.

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

Yes, yes, the commission will be for working for maybe three, four, six months, maybe.

Q - Paul Cheng {BIO 1494607 <GO>}

I see. Okay --.

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

Depends on the complexity of what they are finding, or what they are waiting to get.

Operator

Thank you, ladies and gentlemen. this concludes the question-and-answer session for today's conference.

At this time, I'd like Mr. Barbassa to proceed with 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 that we had this time.

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 the IR website, or by dialing plus 1-412-317-0088, the code is 432073 and then the pound sign. Enter one to start the playback. This will last through August 26.

This concludes Petrobras' conference call for today. Thank you very much for your participation. You may now disconnect your lines.