



PETROBRAS

**Fourth Quarter and Year-end 2002
Conference Call Transcript**

February 20, 2003

OPERATOR: This is the Petrobras conference with the Global Consulting Group on Thursday, February 20, 2003, at 10:00 a.m. central time. Ladies and gentlemen, thank you for standing by and welcome to the Petrobras Conference Call. At this time, all lines are in a listen-only mode. Later, there will be a question and answer session. Instructions will be given at that time. If you should require any assistance during the call, please press star zero. As a reminder, this conference is being recorded. At this time, I would like to turn the conference over to Isabel Vieira from the Global Consulting Group. Please go ahead.

ISABEL VIEIRA: Good morning, ladies and gentlemen. Welcome to Petrobras's Conference Call to discuss fourth quarter and year-end 2002 results. Before proceeding, let me mention that forwarding-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from those anticipated in any forward-looking comments, as a result of macro-economic conditions, market risks, and other factors. Finally, let me mention that this conference call will discuss Petrobras's results prepared in accordance with Brazilian GAAP. At this moment, Petrobras's executives are unable to discuss any questions related to U.S. GAAP results. With us today in Rio de Janeiro is Mr. Jose Sergio Gabrielli de Azevedo, CFO and Investor Relations Director. He will comment on the company's fourth quarter and year-end 2002 results. After that, he and his team will be available to answer any questions you may have. Mr. Gabrielli, you may begin.

SERGIO GABRIELLI: Thank you. Good morning, ladies and gentlemen. It's a pleasure to join you and have the opportunity to participate in these webcasts to present the 2002 results for Petrobras. Before I present the results, we would like to make some comments on the macro-economic and price scenarios of the last two years, which influence our results. In spite of constant volatility during these last two years, influenced by international political tension, the average price of Brent crude in 2002 increased only 2.2% in relation to 2001, reaching 24.99 per barrel. Our domestic average realization price in reais was 95.61 reais per barrel in the quarter, or 20.2% above the third quarter, 2.6 percentage points more than the valuation in the foreign exchange rate between the two quarters. On an annual basis, the average realization price in reais increased 7.2%, from 70.13 per barrel to 71.21 per barrel, thus recovering part of the foreign exchange rate variation for 2002, 24%, an increase in the average price of Brent crude up 2.3%. Brent crude in reais increased from 57.48 per barrel to 72.97 per barrel, a gain of 26.9.

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As a consequence of the price adjustments of November and December, the average realization price in the fourth quarter increased 20.2%. With sales volume in the domestic market remaining constant, note 16.5% growth of the net operating revenue of the controlling company for the period reflects the lower exports of petroleum and derivatives brought about by a cutback in total production of 4.5%.

However, consolidated and net operational revenue for Petrobras in the fourth quarter declined 2% in relation to the previous quarter. Principally, as a result of sales by international subsidiaries, which, when converted into reais, reflected the effects of the 9% appreciation of the real in relation to the U.S. dollar, on an end of quarter two, end of quarter basis.

The biggest effect is shown in the supply segments, which integrated the trading activities of PIFCo, Brasoil and Petrobras America.

Plus gross profit was in line with the third quarter, as a result of the appreciation of the real, by the end of the quarter, and its effect on the cost of goods sold of foreign subsidiaries, in spite of:

- an increase in the provisions for well abandonment of 443 million reais, as a result of a review of estimated costs for fuel abandonment.
- an increase in participation of a government's stake.

Operating income was affected, however, by the following expense items:

- Provision of 828 million reais for non-reimbursables contractual contingency capacity payments to the Eletrobolt and Macaé Merchant thermoelectric plants.
- Provision of 724 million reais to cover financial exposure resulting from contracts with thermoelectric power plants equivalent to 51% of the maximum expected loss for 2003.
- In the fourth quarter, 190 million reais, 512 million per year, right off the wells identified as dry or subcommercial.
- Provision of 398 million reais to cover contingencies resulting from INSS, the social security system in Brazil, notification that attribute joint in several responsibilities to Petrobras for INSS payments not made by company service providers between 1997 and 2001. To avoid recurrence of these liabilities, preventative changes are being made in the internal control systems of the company.
- Regulation of the petroleum and alcohol accounts, which resulted in the reduction of the outstanding balance of 105 million reais.

Quarter over quarter, net income increased 23% basically as a result of the net financial income, including monetary adjustments of 1.4 billion reais against net expenses of 3.1 billion reais in the third quarter.

Its net worth that by the methodology used by Petrobras, the provision for loss to cover financial exposure in thermo electrical plants affected directly our concept of EBITDA.

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Net income in 2002 was 898 million reais, 18% less than in 2001, reflecting the 11% increase in total production, 12% in Brazil, and the partial pass-through of the foreign currency devaluation effect of oil product price in the domestic market.

Our net operating revenue increased 20% compared with 2001, due to:

- increase in 11% in oil and LPG production, in turn helping to boost crude oil export volumes by 138%.
- So 7.2% increase in the average realization price, in spite of not having fully upset the devaluation of the real against the dollar and the increase in prices in the international market, and
- the gain from this translation into reais generated by company activities abroad.

Notwithstanding, the 20% increase in net operating revenue growth profit reported an increase of only 10% in the year 2002, due to the increase in cost of goods sold reflecting:

- the 66% share which is impacted by foreign exchange rate devaluation.
- Higher costs of imported oil and oil products, higher costs relating to government participation or government stake, which fully consider international prices.
- Higher costs in relation to government participation resulting from production growth from fields with high productivity.

Our operating income, before financial income and expenses and monetary adjustments, fell 2% in relation to 2001, influenced by an increase in PASEP, COFINS and city tax, expenses applied to service of 353 million reais in addition to the other factors, which have already been discussed.

In relation to 2001, 2002 net income before tax was also affected negatively by:

- an increase of 2.103 billion in net financial expense for fiscal year 2002, as compared to 2001, largely due to the 52.3 end of year devaluation of the real against the dollar.
- The decrease of 1.427 billion in non-operating revenue in 2002, as compared with 2001, due to one off event in 2001, such as profits on the sales of platforms involving sales and leaseback operations, receipt of insurance claims following the loss of the P36, and sale of our UK assets, among others.

The decline in net income was partially compensated by:

- the foreign exchange translation effect on the overseas controlled companies net shareholders equity amounting to 1.284 billion reais,
- Savings on income tax and social contribution on profits of 701 million reais for the fiscal year due to the provision of interest on capital amounting to 2.220 billion in 2002.

In terms of segmented reports, it's noteworthy that E&P results reflect the increase in production and the variation in international prices, while results for the supplies segment are influenced by the uncoupling of prices in the international and domestic markets.

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The domestic production of oil and LNG in 2002 repeats the excellent growth over the past few years, with an increase of 12.3%, largely due to the startup and completion of the P38, P40 systems in the Marlim Sul field, six new production wells at P36 and P37 platforms in the Marlim field, two new wells in the Espadarte field, the FPSO Brazil located in the Roncador field, and the FPSO ceiling in Espiritu Santos, all these fields located in the Campos Basin.

Domestic production of natural gas grew 9%, notably as gas associated with oil production.

Disregarding the effect of the Pecom acquisition, the 19% lower production of oil and LPG, 8% lower production of natural gas, resulted from the divestiture of overseas assets, the sharp reduction in demand for gas in Argentina, the limitation on Bolivian gas production due to the reduced demand for this gas in Brazil, and lower production from the Colombian and the U.S. fields. It's good to remember that it is not consolidated yet. Even in Brazil, they are GAAP.

In spite of the positive effect of the real depreciation in the fourth quarter, the 6.2 increase in domestic lifting costs, excluding government participation, reflects:

- preventative stoppages for maintenance and the listing of the P34 platform, which increased its six unit costs per barrel produced, eliminating the effect of the average real devaluation, and
- the increase in labor cost resulting from an annual salary negotiation in September, payment of 13th salary and holidays, are very typical seasonal increasing costs in Brazilian companies.

Lifting costs using U.S. dollars without government participation in Brazil fell 8% due to the growth of 12% in total oil and gas production, and to the effect of the average 24% devaluation in reais, and roughly 60% of the total costs that is denominated in local currency.

In 2002, lifting costs, including government participation, grew 7% in Brazil, due to an increase in 37% in the unit cost of this charge, resulting from increased production from new fields, and additionally impacted by the 2.2% higher than 2001 average realization price, benchmarked to Brent crude and to the effects of foreign exchange devaluation. International extraction costs were 19% lower than in the preceding year, principally due to the divestiture of high operating costs assumed in the U.S. and the U.K., which were partially offset by high operating costs in Colombia.

The 4% reduction in Brazilian refining costs was due to the foreign exchange rate translation gains on the local currency cost, and low expense for the catalyzers and chemical input.

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In line with the performance of the last two years, Petrobras increased oil export by 138%, when compared with the same period in 2001.

The increase is due to greater output, combined with favorable conditions for Brent crude oil prices in the international markets, in the light of falling Venezuelan output and the uncertainties surrounding the Middle Eastern conflicts.

Oil imports declined in 2002 by 18%, due to the increase in domestic production. The 34% decline in imported oil product volume during this same period reflected Brazilian economic deceleration, price increases, and the consequent stagnation of domestic consumption. As a result, net imports fell by 76%.

The increase in domestic production was instrumental in achieving the 60% jump in oil and oil product exports in 2002 over the preceding year. At the same time, imports posted a 24% reduction, up 1.352 billion U.S. dollars.

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Over the last two years, there was a substantial reduction in the relative importers of short-term debt, which represented 43% of the total debt in December 2000 and 19% by the end of 2002. This reflects the successful effort of the company in extending its debt profile.

On the other hand, the increase in net debt for 2002 was due to:

- the increase in total debt due to the impact of the sharp devaluation of the real on the portion of the company that denominates in foreign currency of about 90% and new issues of approximately 8 billion reais--\$2.3 billion.
- The reduction in the cash position to cover the acquisition of Perez Companc, Petrolera Perez Companc and Petrolera Santa Fe, for a total acquisition cost of 2.9 billion reais, the major increase investment in reais from 9.9 billion to 18.8 billion, as well as the partial indexing of financial investments to the dollar.

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As of November 30, consolidated figures, including Perez Companc results, as stated in Brazilian GAAP, indicates an increase in leverage ratios, maintaining the ratio between the long and short term debt.

Pecom, however, has a significant reserves in production capacity. In spite of the economic difficulties in Argentina, the account reported a net income of 64 million reais from October 1st until November 2002.

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Additionally, the adoption of the accounting practices SFAS 143 on the BR GAAP statement, we generate a positive impact on the shareholder equity due to the international standards used for recognizing costs for the abandonment of wells and of dismantling of related areas, previously accrued using these historical costs of future value, and therefore, a larger amount than the net present value than will now be entered. The amount of the provision that monthly goes to the income statement will continue to the entry of the costs. In accordance with this new methodology, these costs now will be significantly lower than the ones previously accrued. The provision calculated by the NPV is lower than the provision calculated by the historical costs. Now, we are opening our Q&A section, and we are open to questions. Thank you.

OPERATOR: Thank you. Ladies and gentlemen, we will now begin the question and answer session. If you have a question or a comment, please press the star key followed by the one key on your touchtone phone now. If, at any time, you would like to remove yourself from the questioning queue, please press star two. Please limit your questions to two at a time. Again, to ask your question, please press the star key, followed by the one key on your touchtone phone now. Our first question comes from Carlos De Leon, Deutsche Bank.

CARLOS DE LEON: Hi, this is Carlos De Leon. I'm from Deutsche Bank. Just two questions. Firstly, regarding total lifting costs including the government participation portion, which were up quite significantly during the quarter, compared with the same period last year. Was the increase driven entirely by higher royalty payments and special participation tax, or are there other significant items included as well? And my second question is regarding the two platforms. I wonder if you could comment on the delays in the bidding for construction work on P51 and P52, and specifically, when is the company expecting the bidding now to take place, and will this have an impact on the plant operational startup dates?

MR. GABRIELLI: Good afternoon, Carlos. Well, in relation to total lifting costs, it's true that the government's participation increased. One reason was that the way in which the government calculates this contribution takes care of the whole changing in the international price of oil, and we paid these without the complete pass-through of this change international price to the domestic price, which means that participation is going to increase. There is no different items that are calculated right now. The main driven force is the exchange rate and the price of oil internationally. In relation to the platforms, the company has announced that in two weeks—I think, next week, we are defining new terms of the bidding and the process is going to go on, and as far as it is decided to now, we expect no effects on the beginning of the operation in 2006.

CARLOS DE LEON: Thanks very much.

OPERATOR: Our next question comes from Emerson Leite with CS First Boston.

EMERSON LEITE: Hi, Sergio, just some sort of questions. First, could you comment on the potential talks that Petrobras did with PDVSA to make a joint venture in a new refinery in the Pernambuco states in the northeast region in Brazil?

MR. GABRIELLI: Well, we listen a lot about that, but we have no comments on this particular thing.

EMERSON LEITE: Okay. Well, a second question is, I mean, considering your proximity to some of the senior officials within the new administration, the Lula administration, do you think--in terms of this pricing structure and the potential use of the CIDE as a cushion, do you think the new administration is really prepared to partially give up CIDE tax collection in favor of Petrobras's revenues?

MR. GABRIELLI: Not in favor of Petrobras's revenue, but to minimize the impact of the price of oil into the domestic prices. The government wants to reduce the impact on price, and I think that's not in favor of Petrobras, that's to minimize the impact on domestic price.

EMERSON LEITE: Okay, and one third question. Could you comment on the status of the appraisal of the discoveries recently announced in the company's Campos Basin?

MR. GABRIELLI: I know that we have tests that the technical people is working, that our team is trying to define what is the best situation, and the tests and the idea on what's happening, what's going on.

EMERSON LEITE: Okay, thank you very much.

OPERATOR: Thank you. Our next question comes from Christian Audi with Morgan Stanley.

CHRISTIAN AUDI: Yes, hi. A couple of questions. First, just clarification on the reserve replacement ratio, which you published the new one being 320%. I was just curious how much of that was attributed to new discoveries versus how much of it was attributed to new discoveries as opposed to how much of that is re-tabulation of probable reserves.

MR. GABRIELLI: We have 500 million barrels of new discoveries, and that's the main reason why we have these very high rate of reserve replacements. But I'm going to pass this to [unintelligible].

MALE VOICE: In fact, we incorporated last year 1.94 billion barrels of oil equivalent. That's considering only the new discoveries from [unintelligible] and the [unintelligible] fields in Campus Basin and this 60 blocks. We got 500 million barrels.

CHRISTIAN AUDI: In the case of the revaluation of these reserves, was this due to higher oil prices?

MALE VOICE: No. In fact, it is oil, the API gravity is a little bit lower, but we expected that the area would be feasible to be produced.

CHRISTIAN AUDI: Okay. And the second question is with respect to pricing mechanism. As you look at the strategic plan that you plan to unfold shortly, is one of the items being discussed a potential change on the commercial strategy Petrobras uses to dictate its pricing policy?

MR. GABRIELLI: No. I think that we are going to keep the commercial price to adjust the costs and to adjust the domestic price to the domestic market, which is the common behavior of all companies everywhere. We are not planning to change this policy at this moment.

CHRISTIAN AUDI: Okay, thanks.

OPERATOR: As a reminder, if you would like to ask a question, please press the star key, followed by the one key on your touchtone phone now. If at any time you would like to remove yourself from the questioning queue, please press star two. Our next question comes from Ron Smith, Citigroup Asset Management.

RON SMITH: Yes, gentlemen. If we could go back and address the question on the platforms P51 and P52. Can you give us any idea what requirements you're looking to change in these new regulations you'll be coming out with soon?

MR. GABRIELLI: Well, our technical team is working right now on these. I think, next week, we are going to publish the results of this. I have no comments on that moment.

RON SMITH: Okay, thank you.

OPERATOR: Again, if you'd like to ask a question, please press the star key, followed by the one key on your touchtone phone. Our next question comes from Rodrigo Goes with Bear Sterns.

RODRIGO GOES: Good afternoon. Just a quick question back on the pricing mechanism. Prior to February, you had been adjusting prices to international levels at the beginning of each month. In February, we didn't see that. Is it fair to assume that, given that you're going to remain committed to that policy, should we see a price change at the beginning of March? Thank you.

MR. GABRIELLI: No. Some prices haven't been changed since last month. But changing prices depends on the domestic market, and we are going to make changes probably as soon as possible.

RODRIGO GOES: Okay, thank you very much.

OPERATOR: Again, if you would like to ask a question, please press the star key, followed by the one key on your touchtone phone. Our next question comes from Marcus Sequeira with Merrill Lynch.

MARCUS SEQUEIRA: Hi, good afternoon. Just one question on your capex estimates for this year for the consolidated company.

MR. GABRIELLI: We have 16 billion reais for this year for investment, but we are under revision of our strategic plan. This may be changed or not, depending on the conclusion of this process, that we hope that we are going to finish up at the end of the month of March.

MARCUS SEQUEIRA: Okay, thank you.

OPERATOR: Once again, if you would like to ask a question, please press the star key, followed by the one key on your touchtone phone. Our next question comes from Brian Singer with Goldman Sachs.

BRIAN SINGER: Hi, good afternoon. A follow-up on that question, just with regard to the strategic plan review. Could you provide any timeline for that and maybe give some thoughts after a couple months as CFO, or a month as CFO, what your initial thoughts are, now that you're more knowledgeable?

MR. GABRIELLI: Good afternoon, Brian. I think by the end of March we are finishing this revision of the strategic plan, and then we can talk about numbers.

BRIAN SINGER: Okay, thank you.

OPERATOR: Again, if you would like to ask a question, please press the star key, followed by the one key on your touchtone phone now. Our next question comes from Angus Robertson with Morley Fund Management.

ANGUS ROBERTSON: Hi, good afternoon. Could you give us any indication of production and operating targets for 2003?

MR. GABRIELLI: In the next days, we are finishing our plan and then we can have a clearer view of what's going to happen with our production.

ANGUS ROBERTSON: Thank you.

OPERATOR: Okay, again, if there are any more questions, please press the star key, followed by the one key on your touchtone phone now. Our next question comes from Emerson Leite with CS First Boston.

EMERSON LEITE: Just a follow-up question. From the previous administration, I think we understood that project financing was not anymore under consideration, given the reduced attractiveness of the financing package, and it seems now that you are in talks again with some Japanese financial institutions, looking for new financing under the project financing structure. Could you comment on that?

MR. GABRIELLI: Yes, we have some discussion with the Japanese institutions, but we nothing concluded yet. We hope that with our new strategic plan we can define in a little better way what we are going to do with the project finance, but we have conversations with the Japanese right now.

EMERSON LEITE: And the amount in consideration is how much?

MR. GABRIELLI: It's something around \$2.4 billion for the next few years.

EMERSON LEITE: And is that related to any particular project?

MR. GABRIELLI: Yes, we are discussing the different types of projects that we can go to define the structure of finance with them. We have not defined clearly what kind of project we have. We are discussing a different set of projects.

EMERSON LEITE: And coming back to the thermo power plants and to the contingent liabilities that you have with those [unintelligible] plans, did you get any new PPAs to those plans in order to reduce your exposure to this liability?

MR. GABRIELLI: Well, we are getting every day new PPAs.

EMERSON LEITE: So we should assume that liability is every day getting lower and lower?

MR. GABRIELLI: I'm going to pass this to my colleague, [unintelligible], to talk about that.

MALE VOICE: Yes, I am very strongly [unintelligible] on commercialization to get PPAs on the market. Where I have been successful on getting the new PPAs, and we expect that the average at the end of the year, we'll have better results than what's in the provision.

EMERSON LEITE: But do you have any estimates on how much that \$1.8 billion potential maximum liability is reduced now?

MR. GABRIELLI: \$1.8 billion, no, billion reais.

EMERSON LEITE: But was the net present value of the potential maximum exposure to thermo power plants?

MALE VOICE: Right now, we're working on facing the uncertainties off the next years, we're working now on the 2003 position. So we'll have some uncertainty about what will happen on the Brazilian electrical sector for the next years. So we are concentrating our force on selling PPAs and getting PPAs for 2003 and 2004 to reduce the position this year. But for 2005 and up, we're expecting that the changes on the electrical system regulations, we'll make a better approach for the near future. So I don't want to get PPAs at the moment for long term. We are concentrating on 2003 up to the beginning of 2005.

EMERSON LEITE: Okay. And one final question. Could you comment on the status of the negotiations with the Bolivian government regarding reducing the price of natural gas imported from that country?

MR. GABRIELLI: Yes, we are going to ask [unintelligible].

MALE VOICE: We are consulting this morning to have a meeting with Bolivian guys here in the Petrobras building, as continued work to come to a good conclusion to Bolivia and to Brazil and Petrobras. And there was negotiations began in last year in April, and I think that we'll continue for three to four months. Okay?

EMERSON LEITE: Okay, thanks a lot.

OPERATOR: Again, if you would like to ask a question, please press the star key, followed by the one key on your touchtone phone now. Mr. Gabrielli, there are no more questions at this time. You may proceed with your closing statement.

MR. GABRIELLI: I appreciate your questions and seeing that the company is willing to keep the best relations as we can with all the investors and analysts, and we hope that we can meet very often to explain the results of the company. Thank you very much.

OPERATOR: Ladies and gentlemen, your host is making today's conference available for replay starting one hour from now and lasting through March 6. You may access the replay by dialing 1-800-858-5309. That number again is 1-800-858-5309. At the voice prompt, enter the access code 40469, followed by the pass code 97898. International participants may access the replay as well by dialing 334-323-7226 and entering the same access code and pass code. The replay will be available approximately one hour from now. That does conclude our Petrobras conference for today. Thank you very much for your participation. You may now disconnect.

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