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From the 2004 Pdvsa balance sheet (for the SEC) to the 2006 budget

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Between May and June Pdvsa published two documents of vital importance for understanding the current situation of the oil industry: the 2004 financial statements audited under the parameters of the SEC and the Pdvsa budget for the current fiscal year (2006). In the first case, despite the tardiness of its publication, the report contains important elements that are worth commenting on, especially in relation to investment and expenses. And the 2006 budget is the key to understanding why at **Ecoanalítica** we think that the possible issue of bonds by Pdvsa is anything but necessary.

The “new Pdvsa” came into being with the recall referendum

According to the Ministry of Energy and Oil, in 2004 Pdvsa significantly increased its revenue after a 32% increase in the price of the Venezuelan crude basket in that year from the 2003 average. Costs and expenses followed the same trend. Sales rose 39% from 2003, while costs increased 28% in the same period. However, at the same time, the so-called "social expenditure" – flagship of the new philosophy of the oil industry – rocketed from US\$249 million in 2003 to US\$1.24 billion, almost 400%. According to the Ministry, this figure has to be increased by US\$4.32 billion for investment in social

development, made up of US\$2.32 billion for social programs and US\$2.00 billion for Fondespa. In other words, the industry's social expenditure totaled US\$5.56 billion, 49.2% of net profit in 2004. It should be recalled that Pdvsa also financed the start of the "missions" in the heat of the campaign for the recall referendum.

Pdvsa is not making productive investments

In stark contrast to the social contributions, industry investment in raising production, improving processes and increasing the value added activities (especially refining) totaled only US\$2.99 billion. This amount is only 53.8% of the Pdvsa contribution to the social programs and funds set up by the national government.

You don't have to be an oil export to realize that if the industry does not make significant investments to increase production levels and the product mix, its financial capacity could be compromised in the future. In recent years, despite the drastic changes made by Pdvsa in the wake of the 2002-2003 strike, only the high oil prices have kept the financial results at acceptable levels.

To guarantee that these results are sustained over time, it is important to increase production to prepare for a drop in oil prices. However, in the last two years, oil production has been at a standstill and investment levels are below previous years. In 2004, the volume of crude and product exports fell to 2.49 million barrels a day, down 16.1% since 1997. However, for 2006 the government is assuming an export volume of 2.54 million b/d, up only 2.5% in two years and 14% below the production of nine years ago.

Rather than looking at the past, we should look to the future

It is interesting to analyze the figures in the oil industry budget for this year. First we start from the premise, as with the national budget, that the Pdvsa budget is based on an average price for the Venezuelan crude basket of US\$26.0 per barrel, assuming that the volume of crudes and products for export is 2.55 million barrels a day, where crudes represent 77.5% (1.97 million b/d).

A deficit that doesn't exist

Based on these parameters, this year Pdvsa will have total revenue (current and capital) of around VEB60.5 trillion (US\$28.15 billion) while total budgeted expenditure will be VEB66.2 trillion (US\$30.78 billion), giving Pdvsa a financial deficit of VEB5.7 trillion (US\$2.63 billion).

Weekly Report

For many analysts, the presence of this deficit explains why Pdvsa may soon issue new debt to cover the shortfall and guarantee needed investments, along with social spending. However in reality there is no deficit and we will show why this is so.

Calculating the budget with a more realistic price produces an extremely high surplus

This year, the Venezuelan oil basket has averaged US\$56.9, which is US\$30.9 above the budgeted value. At **Ecoanalítica** we conservatively assume that the Venezuelan basket will average US\$54.3 per barrel, and we maintain the government estimate of export production.

Recalculating the budget, total revenue is now VEB119.2 trillion (US\$55.44 billion) while expenses are unchanged, based on the principle that a change in the price does not generate great changes in the industry's expense structure. Consequently, Pdvsa now has a surplus of VEB53.1 trillion (US\$24.68 billion).

PDVSA BUDGET (Trillion VEB)		
	Budget 2006 US\$ 26,0 per barrel	Ecoanalítica US\$ 54,3 per barrel
I. Current Account		
Current Revenue	59,0	117,8
- Operating Income	58,8	117,5
- Others Income	0,2	0,2
Current Expenditure	45,8	45,8
- Operating Expenditure	20,7	20,7
- Non Operating Expenditure	25,1	25,1
Economic Balance: Saving	13,3	72,0
II. Current Capital		
Capital Resources	14,8	73,5
Capital Expenditure	20,4	20,4
Financial Balance: (Deficit)	(5,6)	53,1
III. Financial Account		
Financials Resources	8,9	(49,3)
Financials Applications	8,9	(49,3)

Source: MF and Ecoanalítica

Pdvsa could put through an aggressive investment program

In line with these results, Pdvsa clearly has sufficient resources to meet three simultaneous priorities of the national government. First, implement a medium-term investment plan to increase current production to the levels needed to achieve the 2006-2011 Investment Plan which signals a production rise to slightly over 5 million b/d. Second, contribute surplus funds to the fiscal management of the public sector (remember that this is the surplus is after discounting the industry's fiscal contribution), and, third, cover the so-called "social expenditure."¹

The bad news is that this is unlikely to happen

Given the fiscal voracity of the Chávez administration and the very unorthodox handling of the industry accounts, the most likely scenario is that most of the Pdvsa surplus will be used to finance public expenditure in any of its variants and that investments in the industry will take a back seat. In fact, the Ministry has said that Pdvsa investment this year would be around US\$3.50 billion. The dramatic aspect of this amount is that it represents only 14% of the total financial results of the industry.

With such a comfortable surplus projected, why is Pdvsa issuing more debt and delaying its payments to local suppliers?

With these results, it makes no sense for Pdvsa to borrow, even on favorable financial conditions. To issue debt for a not insignificant amount (US\$3.50 billion) in the context of a large financial surplus is not an optimal financial decision.

Ecoanalítica knows that several its oil clients are not receiving their payments on time due to presumed cash flow problems. We do not understand the reason for these delays but, with oil at US\$56.83 it is definitely not a cash flow problem.

¹ At Ecoanalítica our opinion is that Pdvsa should not be involved in social expenditure which the responsibility of the central government which receives the fiscal revenue from the company.

Economic Tips

Expenditure soars 70%. According to the Central Bank in April central government expenditure escalated 70% in nominal terms from the same month last year, in contrast total revenue increased only 12.2% in the same period. In April the fiscal accounts recorded a deficit of VEB1.3 trillion. The non-oil fiscal result turned a deficit of VEB2.3 trillion into a deficit of VEB5.2 trillion just in April.

Bad precedent. In the first four months of the year, public expenditure grew 51% but total revenue grew only 16%. In other words, the Government is spending more than it receives. In the January-April period the government accumulated a non-oil deficit of VEB17.2 trillion. In the four-month period, government expenditure execution was 30.9%. An unprecedented figure because in the past less than 20% of total expenditure was consumed in the first four months. If this trend continues, the budget could have an execution of 45% in the first half of the year.

BALANCE FISCAL DEL GOBIERNO CENTRAL	Ene-Abr 06	Ene-Abr 05	Nominal	Real
	Bs. Millardos			
Total Revenue	33.077	25.440	30,0%	15,8%
Non-Oil Revenue	16.329	10.338	58,0%	40,7%
Oil Revenue	16.125	11.521	40,0%	24,7%
Centrl Bank Earnings	624	3.582	-82,6%	-84,5%
Total Expenditure	33.512	19.769	69,5%	51,0%
Primary Expenditure	31.505	17.180	83,4%	63,3%
Interest Payments	2.007	2.590		
Domestic Debt	1.238	1.742		
Foreing Debt	770	848		
Quasifiscal Expenditure	-	-		
Fiscal Balance	(435)	5.671		
Primary Balance	1.572	8.261		
Non Oil Balance	(17.183)	(9.431)		
Debt Amortization	4.243	1.873		
Financing Requirements	4.678	(3.798)		
Foreing Debt	130	48		
Domestic Debt	-	3.876		
Tresury Bonds	-	3.521		
Tresury Debt	-	355		
Others	4.548	(7.722)		

Source: BCV y Ecoanalítica

Weekly Report

The Assembly should Confirmed. Venezuela bought more Argentine bonds for US\$242.6 million. With this latest operation Venezuela has acquired a total of US\$2.80 billion in Argentine debt bonds (Boden12 and Boden15).

Chávez speaks. President Chávez said that the monetary reform was being prepared. "The financial system will undergo changes to make our currency strong again." However, he did not reveal what the changes would be or when they would happen, but said they are under study and could be announced in the medium term.

Not until 2008. According to Central Bank director Maza Zavala the monetary reform would require the National Assembly to pass a law that sets out precise conditions for prices and transactions. A six-month vacatio legis would then be needed to set up a new structure, so the reform could not be implemented until the second half of next year or the first half of 2008.

The government wants to audit the Central Bank. President Chávez ordered Finance Minister Nelson Merentes to coordinate the selection of an audit firm to prepare the audit of the accounts and balances of the Central Bank for 2004 and 2005. In our opinion, this decision is related to the administration's request for more foreign exchange profits and the Bank's refusal to hand them over.

No change on unemployment. According to INE figures, unemployment dropped to 10.2% in May, down 2.4% percentage points since May 2005. The rate was unchanged compared with April. INE reported that the formal sector had grown 1.7% percentage points from 53.2% in May last year to 54.9% at the end of last month. The informal sector covers 45.1% of the employed population.

Stronger Ministry of Labor. The Ministry of Labor changed its name to the Ministry of Labor and Social Security, concentrating a series of areas that had been dispersed among various state bodies. The revamped department will be responsible for operating the new social security system which the government could be designing.

Costa Rica joins. High levels of government could be studying the possibility that Banes purchase Costa Rican bonds to help to the Central American nation with investment projects. Costa Rican membership of Petrocaribe with a view to buying oil at preferential prices could also be under consideration. Banes is expected to grant financing to Guatemala and Paraguay.

Oil Tips

Basket down again. The Venezuelan oil price fell to US\$59.75 a barrel last week. This year the Venezuelan basket has averaged US\$56.87.

Production down. According to OPEC, Venezuelan oil production fell 9,500 barrels a day in May to 2.58 million b/d in line with the fall of 105,100 b/d in all the cartel in that month. The number of active rigs in Venezuela was unchanged at 82.

Citgo wants to sell. Citgol said it was considering the sale of its interest in the Colonial and Explorer oil pipelines. JP Morgan is acting as financial adviser. The company is implementing a program to sell its "non-strategic" assets. Some weeks ago Citgo announced that it would be selling the two asphalt refineries (Paulsboro and Savannah) which form its subsidiary Citgo Asphalt, along with its interest in Lyondell-Citgo, a strategic alliance with Lyondell Chemical in which Citgo holds 41% of the equity. If these three operations go ahead, Citgo will be left with the Lake Charles, Lemont and Corpus Christi refineries. On his recent trip to Panama, President Chávez raised the possibility of selling all of Citgo.

Oil agreement with Ecuador falls through. The crude refining agreement between Petroecuador and Pdvsa was not signed because there were ambiguities in the document. No new date was set. The resignation of the president of Petroecuador last week was another factor that contributed to postponing the signing.

Sectoral Tips

EDC launches share issue. Electricidad de Caracas (EDC) announced the launch of a public share offering which is expected to raise around US\$15 million for investments and reduction of liabilities. The issue will be equivalent to 80.78 million new shares, with a nominal value of VEB100. The aim is also to expand the current shareholder base of over 43,000 by another 5,000.

A good opportunity. At *Ecoanalítica* we see this issue as a good opportunity to invest in the capital market. AES was obliged to acquire almost all the equity of EDC, so the shares are not very liquid, which has affected levels of capitalization. Going to the market will not only provide the company with fresh money for investments but also expand the liquidity of the shares and the capital market in general. The issue

represents 2.5% of total capital, which would take the proportion of paper in the hands of local investors to between 16% and 17%.

More could be on the way. We do not rule out more issues in the medium term, everything will depend on the results of this first experiment and on company plans. To guarantee future issues, the first has to be very attractive so our recommendation to our clients is to seriously consider this investment opportunity.

Outsourcing growing. The consulting firm Accenture forecasts that in the next four years the outsourcing activities will grow 10%, and investment in these services will total US\$220 million by 2009, a 48% increase from US\$148 million at the end of 2004.

Trade booming. The Central Bank reported that in the first quarter, commercial sales grew 34.3% from first quarter 2005. Wholesale sales rose 35.9% and retail sales 33.6% in the same period. The leading sectors are: machinery and equipment, construction and hardware, food and beverages, and textile products and footwear.

Manufacturing lags. Unlike the commerce sector, the volume of production of private manufacturing grew only 8.2% in the first four months compared with the same period last year, on Central Bank figures. Manufacturing was seriously affected by the real appreciation of the exchange rate. The sectors with the best performance were: metals (51%), machinery and equipment (41%), and clothing (24%). The only three sectors that fared badly were: wood (-24%), chemical products (-2%) and vehicles (-2%).

CAF president reelected. Enrique Garcia was reelected as president & CEO of the Andean Development Corporation (CAF) for a new five-year term. The unanimous confirmation of Garcia took place in the extraordinary meeting of the CAF board held this week.

Political Tips

Julio Borges could be the man. Data from the latest Greenberg Quinlan Rosner Research (GQRR) poll shows that if a primary election were held now the winner would be Julio Borges of the Primero Justicia party with 43%, followed by Zulia Governor Rosales with 27% and Petkoff with 5%. The poll, taken in the first week of May, is based on 1,511 interviews and has a 2.5% margin of error.

Weekly Report

Turnout guaranteed. 70% of those polled said they were willing to vote in opposition primary elections while 24% said they were not. On the presidential elections in December, 64% said they would definitely vote, divided between 74% Chávez supporters and 48% opposition supporters.

More important results. 79% of those polled rate the performance of the missions as excellent/good; 73% approve the presence of Cuban medics. The main concerns are: crime (57%), unemployment (47%) and corruption (20%).

17 million. Sandra Oblitas, president of the Civil Registry and Electoral Commission of the Electoral Council (CNE), said that the projections given by INE, taking into account the error that a projection based on the 2001 census could have, suggest that there should be 17 million Venezuelans aged over 18 in December and the CNE expects the voting roll to reach this figure.

Electronic voting list dropped. The CNE directors decided not to use the electronic voting lists in the December 3 presidential election but confirmed the use of the Smartmatic voting machines "on similar conditions" to those approved for last year's National Assembly elections. The other condition "confirmed" by the directors is the guarantee that the totalization certificates for each voting center will be printed before authorizing electronic transmission of the results.

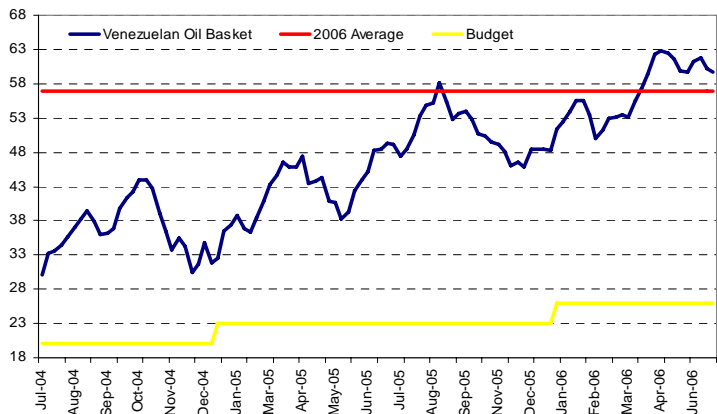
Fingerprint machines in suspense. The decision to scrap the electronic voting lists does not necessarily mean that the fingerprint machines will be eliminated. The decision on the use of the biometric comparison equipment in the voting centers will be taken in the first week of July.

Change at Defense. President Chávez promoted General Raúl Baduel to general in chief of the Republic and named him Minister of Defense to replace General Orlando Maniglia.

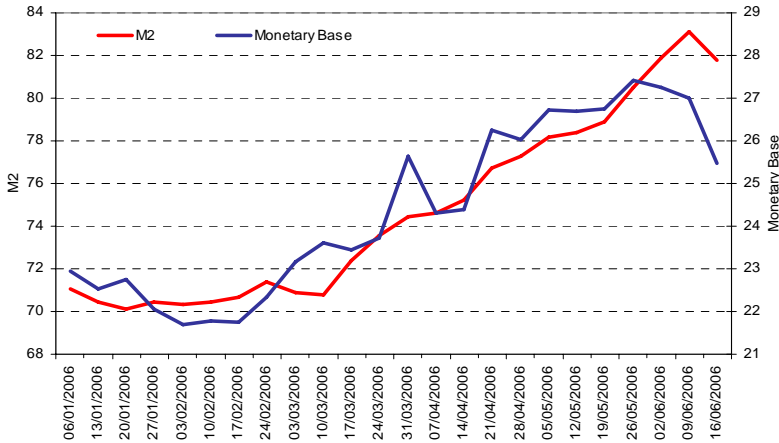
Primaries in limbo. Súmate announced that it could no longer be responsible for organizing the primary elections for the national unity candidate on August 6. The NGO gave technical and organizational reasons. However, in recent weeks, the opposition presidential hopefuls had failed to reach agreement on the method for choosing the unitary candidate, which could also have influenced Súmate's decision. At ***Ecoanalítica*** we think that the most likely outcome is that the main contenders (Borges, Petkoff and Rosales) will select the opposition candidate by consensus through an agreement.

ECONOMIC OVERVIEW

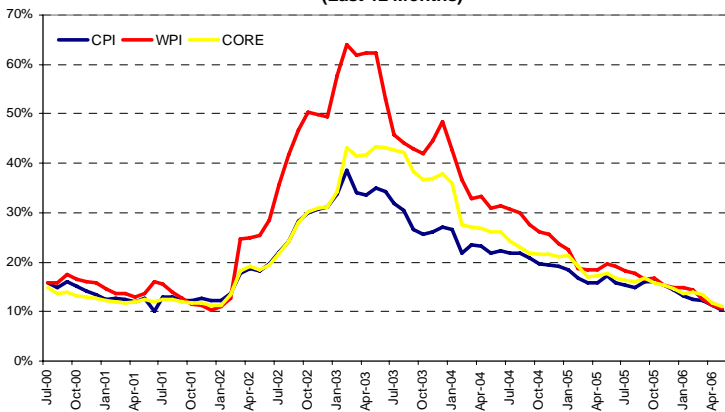
Oil Price
(Venezuelan Basket US\$/pb)



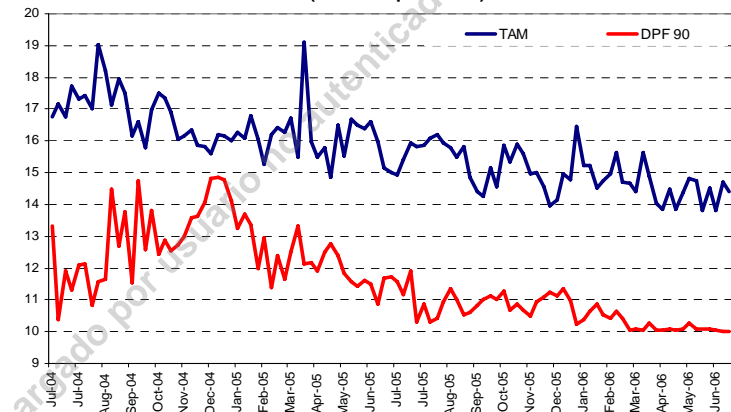
Monetary Base & M2
(VEB Billions)



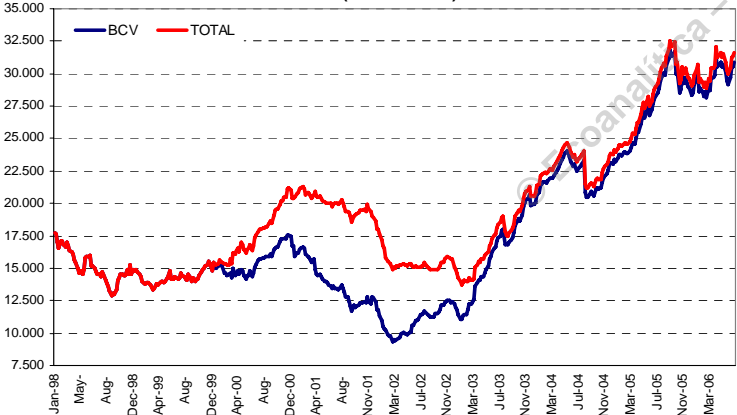
Inflation
(Last 12 Months)



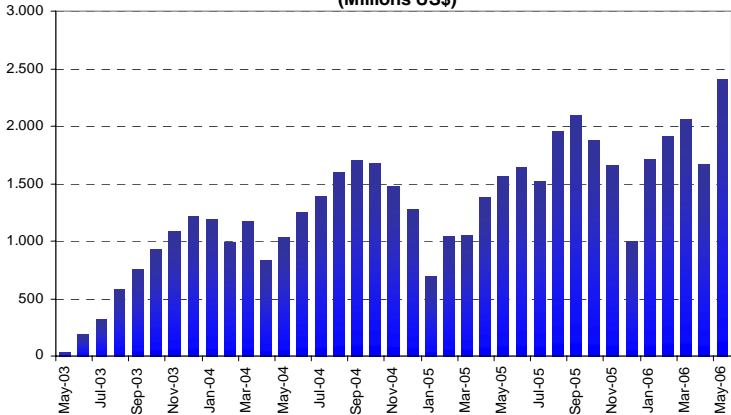
Interest Rate
(Six Principal Banks)



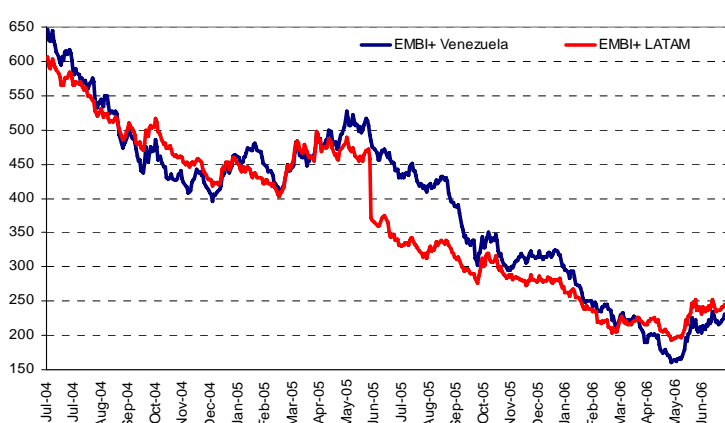
Fx Reserves
(Millions US\$)



Disbursement
(Millions US\$)



EMBI



Central Government
(VEB Billions)

