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**WHAT'S BEHIND PDVSA'S
FIGURES?**

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**In general, there is
nothing surprising in
PDVSA's figures for 2006**

PDVSA released its figures corresponding to 2006. From them one can appreciate the increased fiscal pressure that the industry is being subjected to, a gradual increase in costs, and problems with the domestic market and refining activities. As it stands now, the situation PDVSA is in isn't more serious thanks to the high oil price levels.

A few weeks ago, PDVSA held its Shareholder Assembly where the financial statements for 2006 were approved. The figures presented there, in general, didn't cause any surprises, since they were pretty much following the same line they had when they were released in January this year at the yearly report presentation of the Ministry of Energy and Petroleum (MENPET).

In short, the 2006 results revealed that:

1. PDVSA took in revenues totaling US\$99.27 billion, showing an increase of 19.7% (US\$16.35 billion) compared to earnings in

2005, thanks to crude oil prices increasing. However, costs and expenses for the same period increased by 20.9%.

2. The industry's fiscal contributions settled at US\$27.94 billion, itemized in the following manner: US\$17.51 billion in crude and gas royalties, US\$794 million in extraction taxes, US\$8.32 billion in income taxes, and US\$1.3 billion in dividends.
3. Additionally, PDVSA made social contributions totaling US\$10.16 billion in financing the missions and other programs (US\$3.07 billion), transfers to FONDESPA (US\$229 million) and transfers to FONDEN (US\$6.86 billion). So, total PDVSA contribution to the State last year reached US\$38.10 billion, 69.1% of its national revenues.
4. In contrast, last year's investments totaled US\$ 5.94 billion. However one must point out that this registered an increase of 53.2% compared to 2005.
5. Net profits during 2006 were at US\$5.45 billion compared to the US\$6.48 billion taken in 2005, which is to say, US\$1.03 billion less or a drop of 15.9%.

The domestic market is beginning to be a pain in the neck for PDVSA

An analysis of the domestic results reveals that out of total profits earned only US\$1.98 billion came from the domestic market. This figure, in the midst of a 19.6% increase in the Venezuelan oil basket price, marked a significant drop of 65.7% compared to US\$5.78 billion in domestic profits earned in 2005. This means that in 2006, domestic profits represented 36.4% of the total while in 2005 domestic profits represented 89.2% of the total. In one year, PDVSA's domestic operations profits dropped by almost 53 percentage points.

On the other hand, when measured in terms of domestic revenues, between 2005 and 2006 they increased by US\$45.70 billion to US\$55.27 billion, with PDVSA domestic net earnings last year only representing 3.6% compared to the 12.7% of the previous year.

Internal costs increase significantly

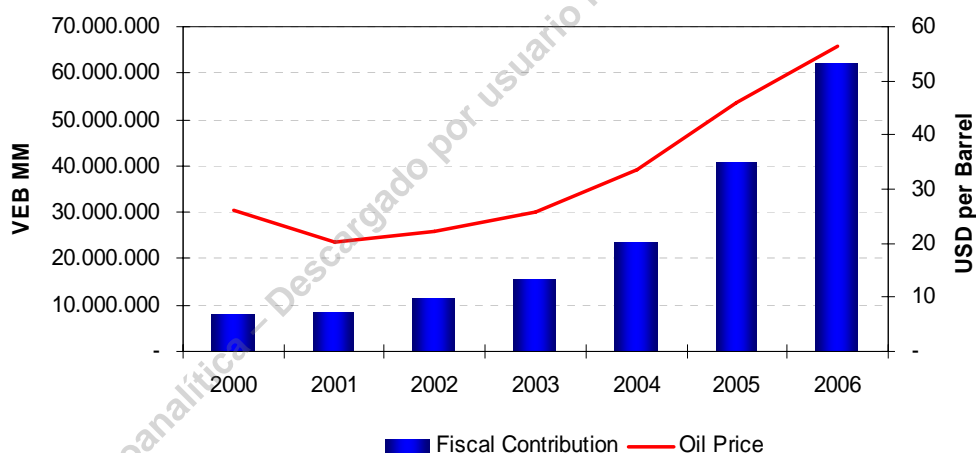
A significant portion of the drop in domestic net profits is due to the sustained increase of internal costs. According to the figures released by the MENPET, operational expenses associated to the company's

core activities were at US\$8.10 billion, followed by expenses related to crude oil and by-product purchases which totaled US\$5.0 billion. In total, costs and expenses increased from US\$14.54 billion to US\$18.29 billion, a 25.8% increase.

Along with increased fiscal pressure

Along with domestic costs, one has to add the increase that domestic payments registered in royalties and other taxes that went from US\$13.32 billion to US\$18.44 billion between 2005 and 2006; and social development spending, which practically doubled, going from US\$6.91 billion in 2005 to US\$13.78 billion in 2006.

PDVSA's Fiscal Contribution



Sources: Bloomberg, Ministerio de Finanzas and Ecoanalítica

A very curious fact was pointed out by PDVSA's own president, Rafael Ramírez, in the message he delivered before the shareholders when he pointed out that US\$1.51 billion was saved in 2006, and that it was generated by the transformation of the operative agreements into mixed companies with majority shareholdings going to CVP. So, it stands to reason that if PDVSA hadn't gone through with the migration process, then the company's domestic profits would have been virtually nil.

External costs also increased

In 2006, not only did internal costs increase, but the same also happened in external subsidiaries. Costs and expenses in 2005 surpassed US\$51.78 billion and reached US\$ 61.90 billion in 2006, spurred on mainly by the total amount of crude oil and by-product purchases which reached US\$53.70 billion and consumed more than 83% of the subsidiaries' total revenues last year.

However, the amount paid in purchase of crude oil and by-products, US\$19.90 billion (37%), corresponded to the acquisition of Venezuelan oil and by-products. In the final balance, PDVSA international subsidiaries registered net profits of US\$3.07 billion, 55% over domestic net profits, and a number which represented 4.8% of their revenue. This was made possible because of what the subsidiaries paid in income tax which was US\$1.66 billion, considerably more than the US\$668 million they paid in 2005, but an amount which barely represented 2.5% of total revenues.

External subsidiaries with low social expense

PDVSA subsidiaries only spent US\$116 million in financing and they only used US\$3.0 million in social development, compared to the US\$13.78 billion that PDVSA contributed; and they received the benefits resulting from the CITGO's stake sales operation in Lyondell-CITGO which was added up to US\$1.43 billion.

The balance can't hide production problems

PDVSA continues to point out that production in 2006 averaged 3.25 million barrels of crude oil a day (2.33 million barrels directly from the company, 357,000 barrels from mixed companies and old operative agreements, and 563,000 barrels from Orinoco Oil Belt associations and risk sharing agreements). However, these figures continue to mix up different types of crude oil and even include gas operations.

Furthermore, the increase in purchases of crude oil and by-products shows that PDVSA is not substantially increasing production. It's important to point out that PDVSA has a vast network of refineries outside Venezuela which maximum capacity, according to experts, is around 4.0 million barrels a day. The upgrading system in Venezuela is made up of seven CITGO refineries in the United States, eight in Europe, and one on the Virgin Islands. Since our oil industry is not working at maximum capacity, PDVSA has increased its purchases of crude oil and by-products from abroad.

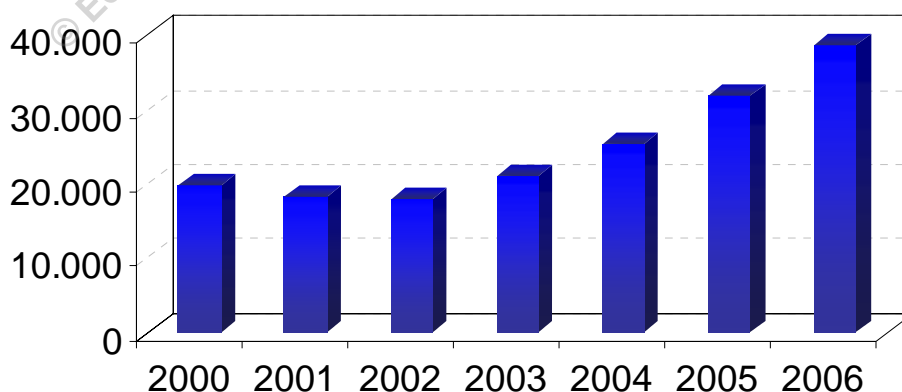
In fact, with regard to refining, PDVSA reported that in 2006, 1,022,000 barrels of oil were processed a day in Venezuela, 205,000 b/d from the refinery Isla (rented in Curazao); and 1,420,000 b/d from refineries property of international subsidiaries, giving a total of 2,647,000 barrels processed.

The purchase of crude oil went up 21%

PDVSA spending with respect to acquiring crude oil and products increased by 21.2% last year, closing at US\$38.78 billion. PDVSA incurs this expense in order to fulfill supply agreements with its refineries outside Venezuela. If PDVSA were producing at maximum capacity, the placement of oil on international markets would not translate to added expenses for the company.

The amount of the company's total purchases has been increasing since 2003. In that year, purchases reached US\$21.02 billion, the following year they were at US\$25.4 billion, in 2005 they were at US\$32.00 billion, and in 2006 they reached US\$38.78 billion. Between 2003 and 2006, crude oil purchases increased by 84.5%, despite the fact that PDVSA reports production increasing from 2.78 million b/d in 2003 (according to PDVSA) to 3.25 million b/d in 2006.

**PDVSA Purchases of crude oil and products
US\$ Millions**



Sources: PDVSA's Financial Statements

The challenge is to increase production

At *Ecoanalítica* we don't understand the logic by which the Government is running PDVSA. If what this Government wants is to maximize oil profits in order to spread the wealth around and generate well being, it doesn't make any sense why it doesn't use the necessary resources in order to significantly increase the industry's production capacities and make an effort to reduce costs.

However, what we have seen is that expenses and costs have significantly increased as well as the purchasing of crude oil abroad in order to compensate for production deficiencies. Add to this the problems facing the domestic market due to substantial gasoline subsidies and an increase in the number of vehicles circulating. One would think that the correct thing to do would be to increase investment in order to increase production and thereby increase revenues that will be able to finance the Government's economic and social policies. Not to do so would be a very shortsighted and limited attitude to take that sooner or later will collapse. Venezuelans should take a look at what happened to Mexico and not make the same mistakes that led to their state-run oil industry, PEMEX, to collapse.

Economic Tips

The economy will grow by 8%. Minister of Finance, Rodrigo Cabeza, announced that by the end of the year, in December 2007, it's very likely that the growth rate of the economy will be at 8%.

2008 budget. The Budget law project for the 2008 Fiscal Year will be submitted before the national Assembly (AN) this coming October 16th by the Minister of Finance, Rodrigo Cabeza. The Budget will be submitted in current bolivars and in *bolívares fuertes* (strong bolivars). Budgeted spending for 2008 is estimated to be around VEB160 trillion.

Public spending dropped during the first semester. According to the Central Bank of Venezuela (BCV), during the first semester of the year, Government spending was at VEB57.6 trillion, which represents a drop of 9% compared to the first semester of 2006. For the first half of the year, the Government closes with a deficit of VEB3.0 trillion and the drop in assets in the Treasury reached VEB5.9 trillion. This period also

highlights the 19% drop in real terms of oil revenues due to the accumulation of resources in another National Treasury Office account (in US-dollars).

FISCAL BALANCE CENTRAL GOVERNMENT (VEB Billions)	June 2007	June 2006	Nominal Variation	January-June 2007	January-June 2006	Real Variation	Nominal Variation
Total Revenue	7.406.017	11.722.347	-37%	54.640	48.891	12%	-6%
Non-Oil Revenue	5.006.002	3.943.104	27%	30.297	23.167	31%	10%
Oil Revenue	2.400.015	7.779.243	-69%	24.272	25.101	-3%	-19%
Central Bank Earnings	-	-	-	71	624	-89%	-90%
Total Expenditure	9.089.842	9.113.671	0%	57.617	53.149	8%	-9%
Primary Expenditure	8.445.360	8.547.402	-1%	53.734	48.792	10%	-8%
Interest Payments	644.482	566.269	14%	3.883	4.358	-11%	-25%
Domestic Debt	368.172	304.737	21%	1.645	1.690	-3%	-18%
Foreign Debt	276.310	261.532	6%	2.239	2.667	-16%	-30%
Fiscal Balance	-1.683.825	2.608.676		-2.977	-4.258	-30%	
Primary Balance	-1.039.343	3.174.945		906	100	809%	
Non Oil Balance	-4.083.840	-5.170.567		-27.320	-29.983	-9%	
Debt Amortization	551.964	631.446		7.562	5.395	40%	
Net Monetary Injection	4.359.493	5.540.481	-21%	31.019	32.710	-5%	-20%
Financing Requirements	2.235.789	-1.977.230		10.539	9.653	9%	
Foreign Debt	4.031	23.265		21	154	-86%	
Domestic Debt	1	0		1.624	0	100%	
Treasury Bonds	0	0		1.624	0	100%	
Treasury Debt	1	0		0	0	100%	
Others	2.231.757	-2.000.495		8.894	9.498	0	

Sources: BCV and Ecoanalítica

Budget spending at 55%. Preliminary figures coming out of the Ministry of Finance show that by middle August the budget was at VEB130 trillion, and of this amount 60% (VEB78 trillion) had already been allocated and 55% had been spent, with more than VEB71 trillion having been laid out. Most of the funds that have been used have gone to fulfill labor agreements with central and decentralized public administration workers and to carryout revenue sharing payments.

SENIAT tax collection drops. During the period between January and August, the SENIAT collected VEB38.2 trillion, which represents a drop of 4.5% in real terms compared to the same period in 2006. The drop was most noticeable with regard to income tax collection which fell 16.4%. This was due mainly to the fact that now mixed oil companies make their income tax payments directly to PDVSA. On the other hand, tax collection in August reached VEB5.0 trillion; barely 1.7% more in real terms compared to the same month last year.

NATIONAL TAX COLLECTION (VEB Billions)		AUGUST		
	2007	2006	Var %	Real Var %
TOTAL	4.991	4.234	17,9%	1,7%
Income TAX	1.629	1.286	26,7%	9,3%
Tax	1.484	1.402	5,8%	-8,7%
Customs	1.687	1.399	20,6%	4,0%
Others Incomes	191	146	30,3%	12,4%
Debit Tax	0	0	0,0%	0,0%

NATIONAL TAX COLLECTION (VEB Billions)		JANUARY- AUGUST		
	2007	2006	Var %	Real Var %
TOTAL	38.194	33.623	13,6%	-4,5%
Income TAX	13.188	13.254	-0,5%	-16,4%
Tax	12.445	10.484	18,7%	-0,2%
Customs	11.391	8.579	32,8%	11,6%
Others Incomes	1.169	984	18,9%	-0,1%
Debit Tax	0	324	0,0%	0,0%

Sources: SENIAT and Ecoanalitica

The BCV corrects. Last week, the BCV decided to resume liquidity injection operations into the financial system. This means that institutions will once again be able to receive resources from the Central Bank and turn over bonds as collaterals. This procedure had been suspended and only authorities were in charge of the operations of loan assistance, which are carried out through advance payments, discount and rediscount.

Government prepares VEB8 trillion in bond issues. Minister of Finance, Rodrigo Cabeza, announced that in the coming weeks the Government will issue into the stock market around VEB8.0 trillion in domestic public debt bonds as one of the measures designed to drain the liquidity in the public hands. This measure, according to the Minister, is part of the economic strategies established by the Administration.

More controls concerning the use of CADIVI allotments. CADIVI signed an information exchange agreement with the Banking Superintendence Office (SUDEBAN) and the National Office for Identification and Immigration (ONIDEX) aimed at strengthening the mechanisms that will allow authorities to verify if the purchases made abroad with credit cards approved by CADIVI are in fact being made by the legitimate owner of the card and during a trip abroad.

CADIVI authorizations increase. CADIVI authorized US\$2.46 billion for credit cards between January and September 10 this year, according to reports published by this entity on its web page. That amount was qualified as “worrisome” by Manuel Barroso, president of CADIVI. Authorizations equaled US\$1.02 billion in July, August and 10 days of September; US\$641 million during the first quarter and US\$882 million in the second quarter.

Money for socialist companies. The Government has earmarked VEB7.6 trillion that will come out of the FONDEN in order to finance the iron and steel industrial complex this year, but official estimates report that investments to all socialist companies between now and 2013 will reach VEB26 trillion, close to US\$12.0 billion.

Missions with priority. According to figures coming from the Ministry of Finance, so far this year, more than VEB20 trillion has been given to missions and communities. Of that amount, VEB6 trillion has been for communal councils and the rest for the other plans.

No variation in Poverty. The president of the National Statistics Institute (INE), Elías Eljuri, reported that poverty measured by unsatisfied basic needs affected 23.4% of households at the close of the first semester this year. This result reflects zero variation compared to the close of the second semester of last year. He continued to say that extreme poverty measured by the same parameters closed around 8% during the first semester of 2007, which means that in six months it dropped around one percentage point, according to the official figures presented. The president of the INE also pointed out that Venezuelan nominal income averaged VEB1.3 million a month at the close of the first half of the year. Eljuri said that real average income was at US\$230.

BCV makes changes in GDP and inflation. The BCV is performing analyses in order to widen statistics, and along those lines, the Bank is considering to calculate a regional GDP. The goods and services basket is also being reviewed in order to estimate the consumer price index. The new basket will consist of 347 items and include DVD players and purchases for pets, among other things.

Public sector collective bargaining agreement being reviewed. The Ministry of Labor and Social Security has almost finished reviewing the public sector collective bargaining agreement, after which it will be sent to the National Budget Office (ONAPRE), the organization that is in charge of determining the cost that the agreement conditions that the government administrative workers are demanding will have. It's estimated that the new labor agreement will be signed before the end of the year.

IV Economic Census postponed. A presidential decree that has postponed carrying out the stages of the IV Economic Census by six months has been published in the *Gaceta Oficial*. It concerns decree No. 5.587, which consists of three articles found in the *Gaceta Oficial* No. 38.768, dated Thursday, September 13, 2007.

Greenspan talks about Venezuela. The former president of the U.S. Federal Reserve, Alan Greenspan, accused Venezuelan President, Hugo Chávez, of “seizing and politicizing” his country’s oil industry and compared him to the Zimbabwean leader, Robert Mugabe, in his memoirs published this week.

OIL TIPS

The sky’s the limit. At this week’s close, the average price per barrel of Venezuelan oil was at US\$71.16, up US\$2.89 from the price reached the previous week which averaged US\$68.27 per barrel, according to figures released by the MENPET. This is the first time this year that the average price per barrel of Venezuelan oil tops the US\$70 mark. The cumulative yearly average price of Venezuelan oil being exported for the year was at US\$58.84, almost US\$2.00 more than the average registered in 2006 (US\$56.45).

PDVSA expects record revenues. PDVSA board of directors calculate that the company will take in consolidated revenues that will top US\$100.00 billion this year, surpassing the US\$ 99.27 billion it registered in its accounts in 2006.

Exxon demands arbitration. The U.S. oil company, Exxon Mobil, requested international arbitration in order to settle a dispute it has with the Venezuelan Government concerning compensation payments for the nationalization of the project it was developing in the Orinoco Oil Belt. The International Centre for Settlement of Investment Disputes (ICSID) received the petition submitted by the oil company this past September 6, according to a Securities and Exchange Commission (SEC) report.

Another mixed company. The *Corporación Venezolana del Petróleo* (CVP) and Harvest Vinccler signed a contract for the conversion of the mixed company Petrodelta in which PDVSA has a 60% stake and its partner 40%.

And China too. PDVSA and China National Petroleum Corp. will invest more than US\$10.00 billion in a heavy crude oil company in the Orinoco Oil Belt in Venezuela.

Lukoil asks for guarantees. OAO Lukoil, the biggest private producer of crude oil in Russia, needs for Venezuela to guarantee that costs won't go up while the company develops heavy crude oil reserves in the Orinoco Oil Belt region. Venezuela is counting on Lukoil and other non-US companies to develop the Orinoco Oil Belt region, an area that is supposed to contain more than one trillion barrels of oil.

PDVSA to change accounts. President Hugo Chávez ordered PDVSA to convert its US-dollar investment accounts to euros and Asian currencies in order to reduce risk. This decision could contribute to weakening the US-dollar now that the U.S. Federal Reserve is preparing to lower interest rates this week, pointed out Philip Wee, an economist for DBS Bank in Singapore, to Bloomberg.

BUSINESS SECTOR TIPS

60% of non-oil exports go to the United States. During the first quarter of 2007, Venezuelan non-oil exports were at US\$3.50 billion, of which US\$2.10 billion were sales going to the United States. This amount represents 60% of total exports. Meanwhile, Italy, Colombia, Mexico, and Holland are among the five countries that Venezuela does most its commercial business with.

Growing trade with Mexico and Colombia. Venezuelan trade with Colombia and Mexico has maintained a steady rate of growth this year, despite Venezuela having left CAN and the G3.

The market must be segmented. According to an expert in marketing, Al Ries, the two problems that affect the marketing of brand names in markets like Venezuela are that these markets are small in terms of population and are subject to import controls. An effective marketing rule that has been established is to be very clear about the market that the product is being aimed at, and to focus on it.

New modification in the agriculture portfolio. The agriculture loan portfolio will suffer a modification for the months of "August, September, October, and December, which should be calculated based on the average balance reflected as gross loan portfolio at December 31, 2005 and at December 31, 2006" in the national banking system, announced the Ministry of Agriculture and Land through a press release. According to the new resolution, the December 31, 2005 gross portfolio of VEB37.98 trillion should be averaged out with the December 31, 2006 portfolio.

Public bank law. The Minister of Finance, Rodrigo Cabeza, announced that a new law to regulate National Banking Sector (public bank) operations will be created. Its intention, according to Cabeza, is that in the medium term, the public banking sector becomes the most important financial intermediary for the people.

State-run banks integrating. On the one hand, a single technological platform will be established which in the long term will be called Bantotal, of Uruguayan origin. On the other hand, credit granting requirements will be unified, since it has been noticed that the institutions all have different credit requirements.

More competition in telecommunications. The National Commission for Telecommunications, CONATEL, received the documentation pertaining to the Cell Phone service Spectrum Public Tender with regard to the 1.700 to 2.100 MHz band frequency blocks. The tender was announced last July. The three leading domestic operators, Movilnet, Movistar and Digitel, all submitted their bids. On October 8, all pre-qualified bids will be published and on October 22 the results will be announced.

Movilnet is the leader. Currently, Movilnet controls 43% of the cell phone market in the country after having increased its subscribers by around one million between May and August, according to the company's president, Jackeline Farías. According to Farías, Movistar controls 41.7% and Digitel, 15.3% of the market. Movilnet expects to sell six million cell phones during 2007 and increase the number of units sold during 2006 by one million.

Shopping center boom. During the first semester of the year, shopping centers have been experiencing a 30% increase in cash flow compared to the same period last year. However, clothing and footwear stores have been experiencing even greater economic activity, since to date they are reporting an average increase of 45% compared to 2006. Fast food vendors have increased by 33%, while movie theaters have increased by 30%, recreation 40%, and department stores by 36%. Given that the last quarter of the year is the one with the highest volume of economic activity, growth in sales in bolivars is estimated to be over 45% compared to last year.

And more is coming. It's estimated that between 2006 and 2008, 3000 new business will enter the market, which will make a total of 19,000 stores. According to Moreno, this represents an increase of 16% in square meters of construction. He pointed out that the average investment cost for a square meter of space in a shopping center is VEB80,000 to VEB150,000, and the average space for shops is between 6 to 55 square meters. Six new shopping centers that are under construction are about to open in Caracas. Inaugurations are set for the end of the year and during the first semester of 2008.

Hardware stores expanding. The national hardware store sector reports a growth of 18% to 20% during the first semester compared to the same period last year and according to estimates gathered by the sector's union organizations. This positive tendency could extend itself into the second semester of 2007.

TAM initiates operations. The airline TAM, the largest in Brazil, announced that it will begin operating on September 28 with one flight a day to Caracas. It will offer executive and economy class service.

Political Tips

Chávez comes in ninth. The President of Argentina, Néstor Kirchner, with 71% approval, and the Presidents of Colombia and Mexico, Álvaro Uribe and Felipe Calderón, tied with 66% approval, are the most qualified leaders in America, while Venezuelan President, Hugo Chávez came in ninth place with 50% approval, according to a survey carried out by the Mexican pollster Consulta Mitofsky.

Popularity doesn't have anything to do with ideology. One must keep in mind that President Chávez has been in power for almost nine years, unlike Kirchner and Calderón. Additionally, the results show that popularity doesn't have anything to do with the Left and the Right and that there is no defined pattern which controls it, since leaders that have very different styles reflect degrees of approval that are also different.

The CNE proposes a date. CNE president, Tibisay Lucena, once again stressed that an exact date had yet to be set for the referendum concerning the constitutional reform proposal, and that it would all depend on when the National Assembly approves it. However, she announced that the CNE has suggested "the first Sunday in December in order to maintain the tradition followed with other electoral processes."

Won't limit names used. The Commission for Civil and Electoral Registry of the CNE waived the prohibition of registering children whose parents wish to give their children names that exposes them to ridicule; are extravagant; difficult to pronounce; include familiar variants and colloquialisms; or generate doubts concerning the gender of the child.

The National Assembly will not set the legal age at 16. Following the opposition's request, the president of the National Assembly, Cilia Flores, announced that the legislative body would not establish the age when a child becomes a legal adult at 16, though the AN will promote that they should be allowed to vote.

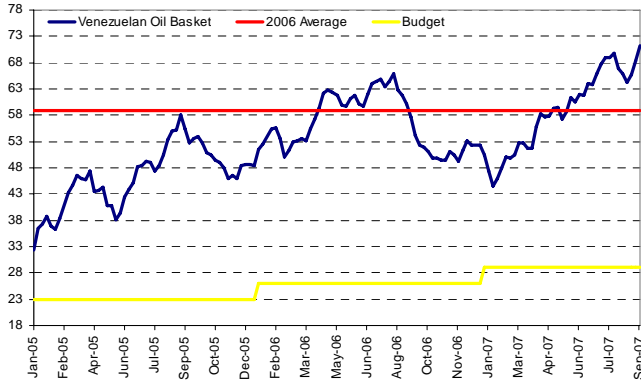
Other Tips

New time zone starting on September 24. The Minister of Education, Adán Chávez, ratified that the new time zone will go into effect one week after classes start, or on September 24, because due to technical reasons, the measure couldn't be put into effect on the very day classes started. He also stated that the class day continues to begin at 7 in the morning.

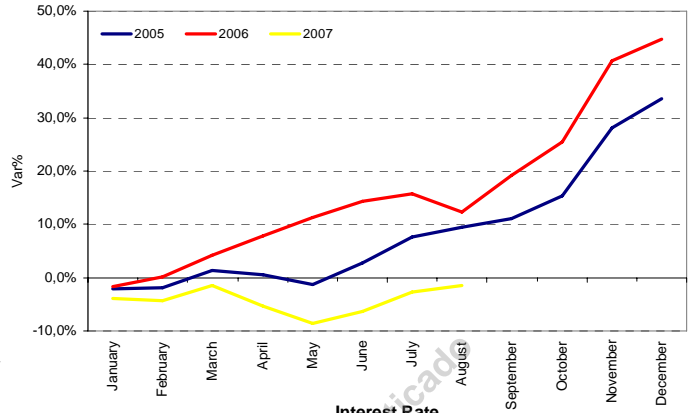
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ECONOMIC OVERVIEW

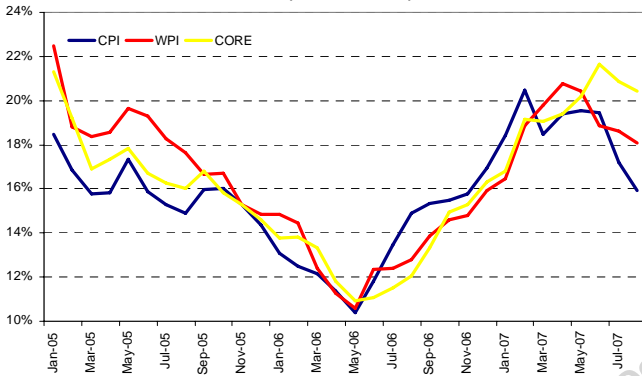
Oil Price
(Venezuelan Basket US\$/pb)



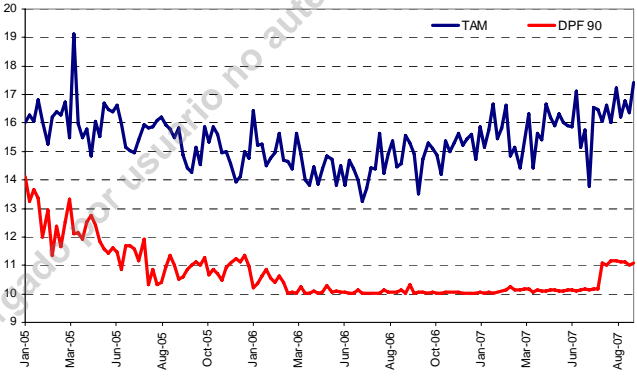
Real Expansion (M2)



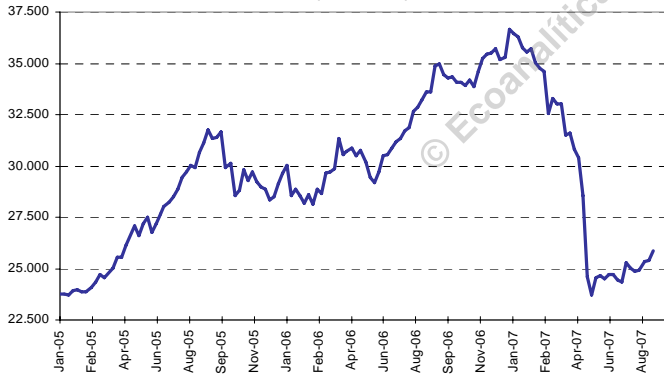
Inflation
(Last 12 Months)



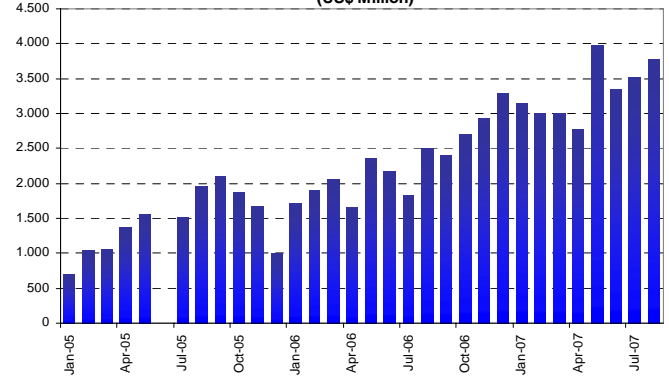
Interest Rate
(Six Principal Banks)



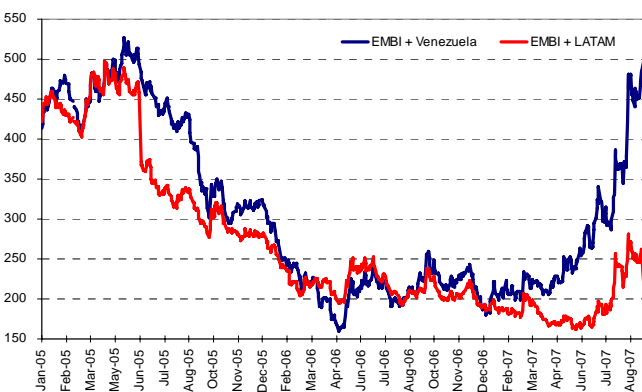
Fx Reserves - BCV
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

