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Week IV September 2008

PDVSA 'S FIRST SEMESTER FIGURES

By:

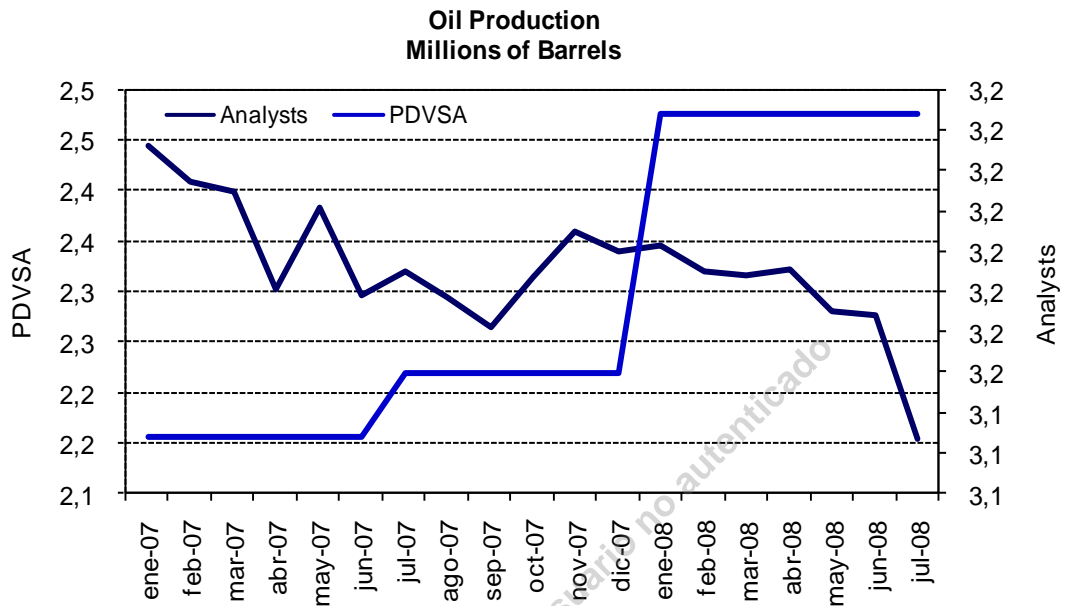
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Michael Penfold

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PDVSA recently released its financial and operational statements for the first semester 2008. Once again, their operational figures haven't been audited by any independent entities, so this takes quite a bit of credibility away from the numbers presented. However, there is still some interesting information that is worth commenting on.

Production is still questionable

The first thing that stands out regarding the Financial Operational Report for the first semester 2008 has to do with production. The figures released show that PDVSA's total oil production during this period was at around 3.4 million b/d, slightly higher than what was registered during the same period last year when it was at 3.3 million b/d. Crude oil exports were at 2.9 million b/d, in other words, 22,000 b/d more than what was registered in the first semester 2007. As is well known, these figures are quite different from what international agencies report regarding oil production, including organization like the OPEC.



Sources: OPEP, IEA, PDVSA and Ecoanalítica

The last quarterly report released by the OPEC regarding the oil market had Venezuelan oil production at 2,343 million b/d at the close of the month of June and global production at 32,104 million b/d for the whole organization. These figures released by the OPEC based on secondary sources are equivalent to 931 b/d less than the official amounts reported by PDVSA. The Energy Information Administration (EIA) of the United States report shows that for the close of the month of June, Venezuelan oil exports to the U.S. decreased in 185 million b/d, comparing to the first semester of 2007. Just five years ago, Venezuela was the leading exporter of oil to the U.S., now it's between fourth and fifth.

Refinery doesn't take off and the domestic market shrinks

Another thing that stands out from the information released by the Financial Operational Report is that PDVSA's internal refinery capacity is dropping. This is something that we have been noticing during the last few years. This is a very important fact. In the current oil market, refining oil has become one of the most profitable activities within the industry. PDVSA, during the first semester of the year, PDVSA has reduced its internal capacity to refine oil by 3.0% compared to the same period last year, a drop of 80,000 b/d. Total sales of domestic hydrocarbons (including natural gas) have dropped by 10,000 b/d compared to the same period last year. So, government policies to slow the automotive industry down and cut back on the sale of vehicles has had limited

success since the drop in domestic fuel consumption is only 1% compared to last year. The domestic market still consumes 936,000 b/d.



The subsidy is about as much as profits

According to PDVSA, the amount of liquid hydrocarbons sold in the domestic market during the first semester 2008 were 572,000 b/d at an average price of US\$ 8.18 per barrel. During the same period, the average export price of the Venezuelan crude oil basket was at US\$ 96.12 per barrel. So, if the gasoline subsidy were to be measured by international oil prices, just in the first semester of this year, it would have been at US\$ 9.16 billion, in other words, almost the same as the total of PDVSA's profits during the same period. These figures lead us to think that sooner, rather than later, PDVSA is seriously going to have to rethink, and review, domestic gasoline prices, especially with regard to the future when oil prices stabilize.

Unclear investment figures

The Financial Operational Report shows that PDVSA's investment in the first semester was at US\$ 6.91 billion, up 85.3% compared to the same period in 2007. If we look at this figure by quarters, it shows that in the first quarter 2008 PDVSA invested US\$ 1.72 billion, while in the second quarter 2008, it invested US\$ 5.19 billion, an increase of 201.1% compared to first quarter investment. Some analysts have pointed out that these figures don't really relate to oil import levels reflected in the Central Bank of Venezuela (BCV) balance of payments figures (US\$ 960 millions).

It's important to point something out here, according to information gathered by Ecoanalítica, PDVSA's purchases made abroad are not registered in the balance of payments given its autonomy when it comes to financial and exchange matters, a practice that we feel is not appropriate and does not follow the procedural guidelines of fiscal and foreign accounts. The oil import figures reflected by the BCV figures correspond to those made by the Corporación Venezolana de Petróleo (CVP).

PDVSA has publically stated that it plans to invest US\$ 15.60 billion this year, which would be a record amount. Given first semester 2008 results, in order for this to be achieved, PDVSA will have to invest between July and December this year US\$ 8.69 billion, or US\$ 1.45 billion a month. The average investment for the first semester 2008 is around US\$ 1.15 billion.

The new PDVSA

These are some of the first semester 2008 financial results which stand out:

1. Costs and spending were up by 44%, where the highest increase (76%) was for the sum of royalties, extraction taxes, and other taxes. In the second column (64%) was operation costs. The reason given for this by PDVSA was higher refinery costs in the international market (CITGO) and the increase of traditional operations and new business.
2. 17% increase in crude oil purchases, mostly for CITGO.
3. Exploration costs were only at US\$ 61 million, up by 17% compared to the first semester 2007.
4. Financing debt remained the same at US\$ 15.75 billion, just 2% less than the levels reached during the first semester 2007.
5. However, accounts to be paid to suppliers increased by 38%, settling at US\$ 7.77 billion. Accounts receivable to be collected by PDVSA are at US\$ 21.55 billion, quite significant, up 92% compared to the same period last year. This increase is associated with PETROCARIBE agreements and other energy agreements with countries in Latin America. According to our calculation, amounts to be collected from those agreements is around US\$ 12.88 billion, in other words, 59.8% of the total for this area.

Weekly Report

| PDVSA's Results US\$ Millions | I-H 2008 | I-H 2007 | Var. % |
|----------------------------------|----------------|----------------|--------------|
| Oil Sells | | | |
| <i>Exports</i> | 70.520 | 41.724 | 69,0 |
| <i>In Venezuela</i> | 1.534 | 1.099 | 39,6 |
| <i>Others</i> | 367 | 41 | 795,1 |
| Total Incomes | 72.421 | 42.864 | 69,0 |
| Costs and Expenses | -49.783 | -34.562 | 44,0 |
| Others Incomes and expenses | 1.087 | 1.006 | 8,1 |
| Total Costs and Expenses | -48.696 | -33.556 | 45,1 |
| Social Development Contributions | -1.824 | -4.123 | -55,8 |
| FONDEN Contributions | -5.850 | -3.120 | 87,5 |
| Taxes | -6.574 | -1.177 | 458,5 |
| Net Profit | 9.477 | 888 | 967,2 |

Sources: PDVSA and Ecoanalítica

More fiscal contributions and less social contribution

The Financial Operational Report shows that PDVSA's contribution to the nation (fiscal, social, and FONDEN) were at US\$ 26.93 billion, up 54.9% compared to the same period last year. In other words, of the company's total revenues (US\$ 72.42 billion), PDVSA earmarked 9.5% to investment, while contributions to the Administration were at 37.2%. Comparing all this to last year's net profits during the first semester 2008 which was at US\$ 9.50 billion, PDVSA earmarked for investment the equivalent of 72.7%, while the contributions to the State represented almost three times the company's profits.

We can't fail to point out that there was a significant change regarding PDVSA's so-called social contribution which dropped by 56%, going from US\$ 4.12 billion during the first semester 2007 to US\$ 1.82 billion during the first semester 2008.

No reason to worry in the short term

Thanks mainly to the high oil prices, and a little to PDVSA's increase in investment, the company continues to post acceptable financial figures. This is why at Ecoanalítica we don't see any immediate danger for the company, at least not in the short term. However, the Administration has to be aware of three things: first, the industry's accounts receivable, the low level of refinery, and the state of the domestic market.

In the long term, PDVSA seems to be following the path of PEMEX

We continue to insist that PDVSA needs to take advantage of the moment it is going through, characterized by increased revenues, to

increase production levels. PDVSA has a number of ambitious projects planned, like increasing production levels to 4.9 million b/d by 2013, of which it would have to extract 2.8 million b/d, 590,000 barrels from the mixed companies, and 280,000 b/d from the four current association working the Orinoco Oil Belt, and increase to 384,000 b/d, the current production of liquids which is at 164,000 b/d. Up until now, there is no sign of any equipment available or projects going on that will achieve these goals.

On the other hand, a figure that has not been released before regarding long term plans, has production capacities increasing to 6.5 million b/d by 2021, a figure which just months ago had been set at 5.8 million b/d. In our opinion these goals are unrealistic, especially if fiscal pressures on the industry remain the same, and PDVSA remains responsible for so many other things besides oil.

Economic Tips

Country-risk down. After the different events occurred in the political and economic arena last week and after having reached its highest level over recent years (1,025 base points for 09/17/08), the country-risk index, EMBI+, started to drop early this week. This indicator was at 827 base points on 09/24/08.

Immune to global environment. President Hugo Chávez said that, since Venezuela only has US\$ 375 million of its reserves in the U.S., the country is protected against the effects of the financial crisis in that country.

Fund with China almost completely committed. The resources in the Fund with China, a financing mechanism created in February with a joint contribution of US\$6.0 billion, have been committed up to 83% for infrastructure projects (housing, agriculture and industry). Since this is a revolving Fund, the Venezuelan and Chinese governments are already preparing a new payment for next months.

Improvement of Venezuela's debt quality is being studied. Moody's reported that it's studying the possibility of increasing rating of Venezuela's sovereign debt, since the country has exhibited a good performance in terms of its debt compliance, as well as a significant improvement in its debt indicators. Moody's expects to increase "b1" rating of Venezuelan bonds issued in foreign currency and "B2" of government debt in foreign currency.

The highest weaknesses. Despite the favorable macroeconomic results, some of the factors with the hardest impact on our debt and that will be studied in depth to increase their rating are domestic political volatility and the high dependence on oil. According to a report released by Moody's, in the case of Venezuela, these factors lead "the possibility of risky events to be ranked as high in Moody's methodology for sovereign bonds."

Interest Rates. The interest rates for the six principal banks of the country dropped 159 bps, to close in 22.32% on September 19th. The long-term deposits also suffered a light fall, passing from 17.11% to 17% during the same week.

International Reserves. With a weekly increase of 4.65%, the international reserves closed, last Friday 19th of September, in US\$ 39,467 millions.

Monetary Liquidity. The monetary liquidity increased in VEF 2,341 millions, to close on September 12th in VEF 164.925 millions, which meant an increase of 1.44% comparing to the previous week closing.

OIL TIPS

Venezuelan oil basket props.. At the close of the third week of September, the price of the Venezuelan oil basket was at US\$ 88.76 per barrel, due to the U.S. financial crisis.

But the average is still high. Despite the decreasing trend exhibited by oil prices over recent weeks, the average price of the Venezuelan oil basket for the year-to-date is at US\$ 103.45 per barrel, substantially over the level estimated for this year.

Sudden increase. But the markets' jitters and the uncertainties concerning the future of the U.S. economy made prices to sharply increase on September 22nd by more than US\$ 25 per barrel, thus registering the largest increase ever posted in a single day. WTI for delivery in October closed at US\$ 120.9, whereas Brent from the North Sea was at US\$ 106.04 per barrel.

They will remain high. Ecuador's Minister of Petroleum, Galo Chiriboga, pointed out that oil prices will remain high over the next months due to the Northern winter and the recent production cut by the OPEC.

Production cutback is being proposed. The Executive is studying the possibility that OPEC holds an extraordinary meeting before next December to discuss a new production cutback that helps stop oil prices from falling.

Crude oil exports drop. According to an operational report released by PDVSA, Venezuela's crude oil and product exports to the U.S. decreased by 10%, with 172,000 b/d less shipped and a total of 1,501,000 b/d in the first half of 2008. Exports to Europe (27%), Africa (31%) and other destinations (21%) also went down. However, Asia, the Caribbean, Central America and South America are among the regions that received the largest quantity of PDVSA oil barrels.

PDVSA payroll inflates. According to PDVSA's financial statements for the first half of 2008, PDVSA's payroll grew 25% as compared to the first semester of 2007 (57,030 employees), so that workforce is now at 71,426 employees. The number of workers in the country increased by 28% to 66,214 in the first half of 2008 and workers abroad decreased by 3%, to 5, 212.

Agreements inked. Las Tuesday, state-run oil companies PDVSA and ENAP formalized agreements with Ecuador to separately develop natural gas in the Gulf of Guayaquil. The Ecuadorean Ministry of Mining and Petroleum pointed out that PDVSA will invest US\$ 40 million and ENAP will contribute US\$ 310 million.

CITGO asks for help. PDVSA's U.S. subsidiary, CITGO, confirmed the request made to the Oil Strategic Reserve, for the delivery of 1 million barrel crude oil for its refinery in Lake Charles, Louisiana.

The U.S. delivers oil. The U.S. Government said it sent 250,000 barrel of crude oil from the Petroleum Strategic Reserve to a refinery owned by CITGO Petroleum Corp., PDVSA's subsidiary.

Gas pipeline "revival" is being studied. Cuba and Venezuela are analyzing the "possible reactivation" of a 189 km gas pipeline joining the southern and northern coasts of the island, which would facilitate oil supply to the Cienfuegos refinery operated jointly by both countries.

The Government signed new agreements. The Government signed agreements to explore liquefied natural gas blocks in the Caribbean with foreign companies, including: U.S.'s Chevron, ENI from Italy, and Russia's Gazprom. Furthermore, the governments of Qatar, Algeria, Portugal and Japan will also be involved in the project, which is intended to increase gas production from 6.3 billion to 11.5 billion cf/d for 2012. According to the Minister for Energy and Petroleum, 57% of the

production will be earmarked for Argentina, Brazil and PETROCARIBE member countries and the remaining 43% will be traded on the international market.

Extended until November. After its publishing in the *Gaceta Oficial* last Thursday, the Organic Law of Rearrangement of the Liquid Hydrocarbon Domestic Market entered into force this week. As a result, representatives of the transportation sector will have until November 16 as a deadline to reach an agreement with the Government; otherwise the expropriation process will start.

Agreement with Italian oil company. The Italian oil company ENI announced an agreement with PDVSA for the development of two areas off-shore Venezuela. This agreement is divided into two phases. First, activities of exploitation and authentication of reserves to be performed by a mixed company in which both PDVSA and ENI will have 20% stake each, with the remaining percentage in hands of other partners. The second stage will be a company between PDVSA (60%) and ENI (10%) that will be responsible for the development activities.

PDVSA, less and less an oil company. The half-year report of the company reflects the expansion of PDVSA over the last months. Concerning food sector and thanks to the creation of PDVAL and the acquisition of Lácteos Los Andes, the company reported sales for up to US\$ 367 million.

BUSINESS SECTOR TIPS

Negotiations go on. The Minister of Energy and Petroleum pointed out that negotiations with Cemex are still on and that the price will be defined based on the book value.

Delinquency increases. According to data presented by Softline Consultores, bank loans that are in arrears (matured or under litigation) have increased over the last months. For August, this kind of loans account for 1.98 of the loan portfolio of the national financial system. The figure, although it's not alarming, represents an increase of 0.7% with respect to August 2007.

New Resolution. Since yesterday universal, commercial, development banks and savings and credit institutions have to calculate interests accrued by deposits in savings accounts based on the average monthly balance of said accounts, as per Resolution 224.08 issued by the Ministry of Finance, published in the *Gaceta Oficial* No. 39,018 dated September 17th. According to this resolution, financial entities, for

this calculation, must take into account the daily balances kept by their clients during the whole month.

First step to produce gas-driven vehicles is completed. The Minister of Light Industries and Trade (MILCO), William Contreras, announced that car assembly plants in Venezuela complied with the regulations issued by MILCO as per which they should notify which will be the new models of vehicles that will function on gas (GNV). Now PDVSA has to certify the components of the GNV system and that manufacturers finally manage to insert them in the production chain. According to MILCO, vehicles with dual system should be marketing for April 1, 2008.

The sector will expand. According to William Contreras, restrictions imposed since this year to the imports of vehicles and parts forced companies that want to survive to start thinking about producing directly in Venezuela. In August, MILCO received 26 proposals to establish vehicle assembly plants in Venezuela.

The first ones. Indeed, according to *El Nacional* newspaper, about ten companies of the automotive sector started to build plants in the country with investments in the order of US\$ 245 million. They include Iveco, which built a plant that allowed it almost to double its daily assembly capacity. The same happened to General Motors, which opened a second assembly plant in Mariara.

Airlines are looking for alternatives. Airlines operating in the country are looking for a way to face the resolution issued by the National Civil Aviation Institute (INAC), according to which international airlines must reduce their frequency of flights to the U.S. from next September 28th. One of the proposals being studied is that Venezuelan and U.S. airlines operate "with shared codes", so that a company could use airplanes and crews from other company. This would help resolve the issue of flight deficit that will be certainly provoked by this measure.

16,000 in one semester. Figures released by the construction sector indicate that 40,000 housing units were built during the first half of the year, of which 16,000 corresponded to the public sector and 24,000 to the private sector. The Minister of Housing, Francisco Sesto, hasn't referred to the construction target for the rest of the year, but he did explain that the country has capacity to build 200,000 housing units per year.

Subsidy increase for rice production. The National Government increased subsidy for rice production sector, from VEF 0.085 to VEF 0.185 for the 2008 winter harvest.

Weekly Report

Milk production boosted. FONAPROLE, Fondo Nacional de Producción de Leche, will Grant 557 credits to matinal producers and a total of 1,200 credits over the rest of the year to increase dairy product production. To this end, Fonaprole has US\$ 300 million from the China-Venezuela agreement and from PDVSA.

More and more foreign exchange for the technology sector. According to figures published by CADIVI as of September 18th, more than US\$ 2,092 have been allocated for the telecommunications and computer sectors corresponding to 16,238 applications, which represents US\$ 350 million more than the amount allocated in the same period last year.

Exports will drop. According to the Asociación Venezolana de Exportaciones (AVEX), this will be a bad year in terms of performance of non-oil exports for the country. Based on its projections, these exports will be at US\$ 2.5 billion, which would reflect a drop of 34% in comparison to last year. Francisco Mendoza, chairman of AVEX, institutional and bureaucratic obstacles existing in the country are the most important causes of this drop.

Political Tips

More purchases from Russia. The director of the Russian corporation Russian Technologies, Serguei Shemezov, informed that Venezuela is currently negotiating the purchase of air-defense systems, armored vehicles for troop transportation and fight bombers from Russia.

Electoral race started. Since today and for the next 58 days, 8,294 candidates to 603 public posts started their electoral campaigns to will voted from 16.9 million of Venezuelan voters.

Government supporters will use the President's assassination attempt as an electoral flag. Darío Vivas, a member of the PSUV national leadership, declared that the campaign of the government party will be based on remembering destabilizing plots by the opposition sector, the most important of the being, of course, President Chávez's assassination and overthrow.

In the meantime, the opposition will focus on the Government's performance. The different opposition campaigns will be focused on demanding that the representatives that are currently in office account for their performance.

Weekly Report

Vivanco expelled. Last week President Chávez ordered José Miguel Vivanco, director of the NGO Human Rights Watch to leave the country. Vivanco came to Venezuela to present the report “*A Decade Under Chávez: Political Intolerance and Lost Opportunities for Advancing Human Rights in Venezuela*,” which denounces the current Venezuelan government. According to the Government, Vivanco violated the “Constitution and the laws of the Bolivarian Republic of Venezuela, attacking the Venezuelan institutions and illegally meddling in our country’s internal affairs.”

Reactions to Nixon Moreno’s asylum. Last week, the Vatican granted diplomatic asylum to Nixon Moreno, the student leader and political scientist, which has been living for more than one year in the Caracas Nunciature headquarters. The Ministry of Justice has still to issue the safe-conduct but the National Assembly already expressed its disagreement with the decision and urged the Vatican to “annul asylum and hand Moreno over to the Venezuelan authorities so he could face the charges issued against him.” The Vatican could resort to international entities if Moreno’s trip is not authorized.

More and more money to win. The electoral campaigns of president Chávez are more and more expensive, increasing by up to 1860% since the first presidential election back in 1998, when US\$ 423,383 was spent. In 2000, for the re-legitimization of the different publicly elected officials, expenses for up to US\$ 2.4 million were reported to the CNE, whereas in the 2006 presidential campaign, the government parties reported expenses for up to US\$ 10.2 million. However, little is known of the figures concerning the presidential recall referendum of 2004, and the financing of the electoral campaign of the last year’s constitutional referendum was completely assumed by CNE.

Judges are still waiting for an answer. Former judges Juan Carlos Apitz, Ana María Ruggeri and Perkins Rocha, who as per the award issued by the IHRC must be reinserted in their positions in the Judicial Power, have been waiting for 26 days now to see the award fulfilled. According to the decision of the IHRC, if they are not reinstated in their positions, they must be compensated for with US\$ 93,000 each.

Other Tips

New Monetary Union. Five of the six countries of the Gulf Cooperation Council (Saudi Arabia, United Arab Emirates, Kuwait, Qatar and Bahrain) agreed on the creation of a monetary unit. While the central bank that will govern these economies

is being established, a monetary council will be created that will work from now on to launch a single currency.

Failed in antidrug activities. According to the list of “Major Drug Transit or Major Illicit Drug Producing Countries for Fiscal Year 2009,” published by the U.S. Government, Venezuela is ranked together with Burma, as the two single countries that “that have failed demonstrably during the previous 12 months to adhere to their obligations under international counternarcotics agreements.”

USA Crisis Tips

AIG helped. Finally, the U.S. Federal Reserve (FED) decided to grant a loan to the American International Group (AIG), the second largest insurance company in the world with assets valued in US\$ 1 trillion, thereby saving it from declaring bankruptcy for an illiquidity crisis. The credit line granted for 24 months and backed by all AIG's assets, offers the company a playing margin to fulfill some of its obligations while it sells part of its business. In exchange, the FED got a stake of 80% in the company's equity.

Emergency transformation. The FED approved the transformation of the two last independent investment banks in the U.S., Morgan Stanley and Goldman Sachs, into commercial banks. The measure authorizes these banks to accept deposits from individuals and to have permanent access to loans granted by the FED through its discount window. As a result, Morgan and Goldman must adjust to the conditions governing commercial banks (as a higher amount in legally required reserves) and they will be directly supervised by the FED.

The world's central banks intervene. Vis-à-vis the lack of liquidity on the market and after undertaking some individual actions, the major central banks in the world (FED, Bank of England, the Bank of Canada, the Bank of Japan, the National Swiss Bank and the European Central Bank) decided to act co-ordinately and offered last week about US\$ 180.0 billion through overnight operations and swap lines with the FED.

Millionaire proposal. The U.S. Treasury Department presented a proposal to rescue the economy, which has still to be approved by the Congress. The proposal mainly consists of using US\$ 700.0 billion to buy mortgage debts, considered the root of the current financial crisis.

Weekly Report

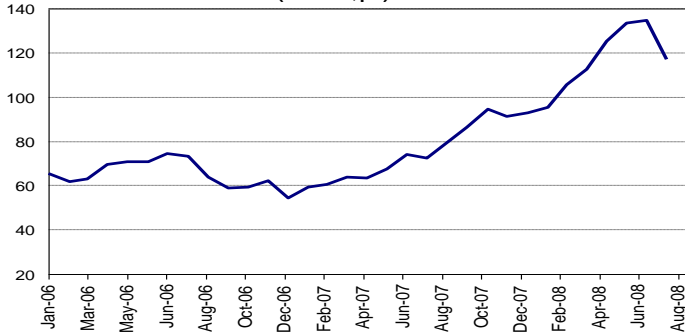
Every kind of assets. Besides of assets related to house or commercial mortgages, the proposal allows for the purchase of every kind of “problematic” or low-quality assets, which may jeopardize the stability of institutions with seat both in the U.S. and out of the country. The government could buy, if necessary, student or car loans, and even whole companies.

Total control. The approval of the Rescue Plan grants broad authority to the Treasury to make decisions without significant restrictions. These decisions, including the appointment of financial agents, hiring of employees, management of assets and implementation of more regulations, cannot be reviewed by any court or federal agency. The Treasury must only report the results to the Congress six months after the commencement of the plan and then every three months.

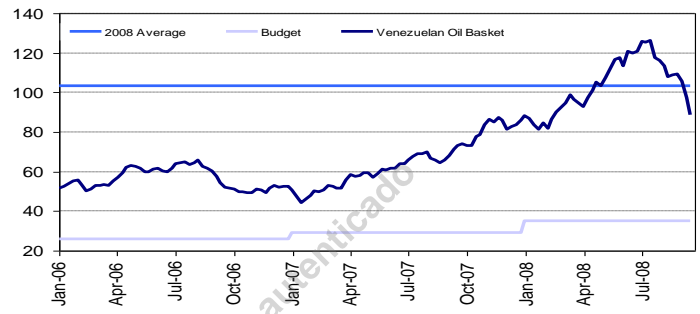
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ECONOMIC OVERVIEW

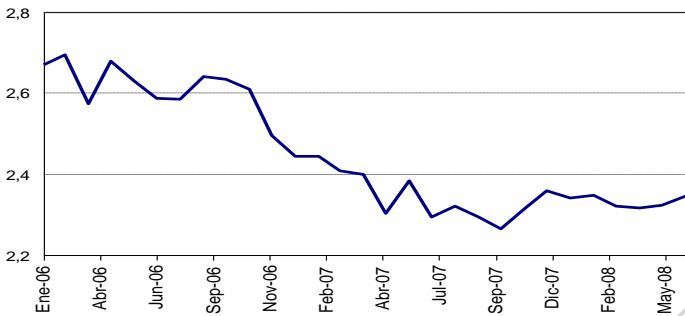
Oil Prices (WTI US\$pb)



Oil Price (Venezuelan Basket US\$/pb)



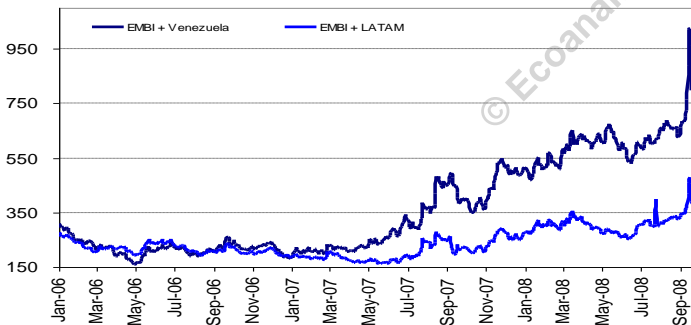
Oil Production MMBD



Fx Reserves - BCV (US\$ Million)



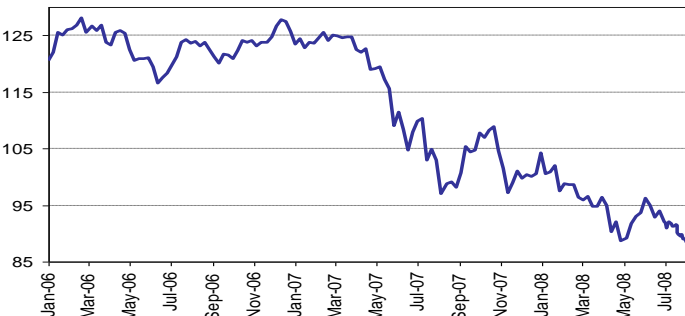
EMBI +



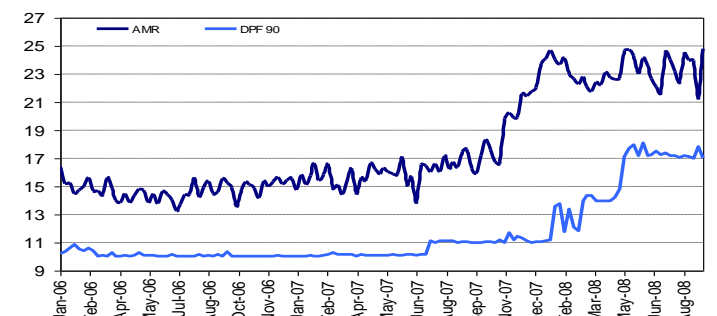
Venezuelan Global 18 Close Price



Venezuelan Global 27 Close Price

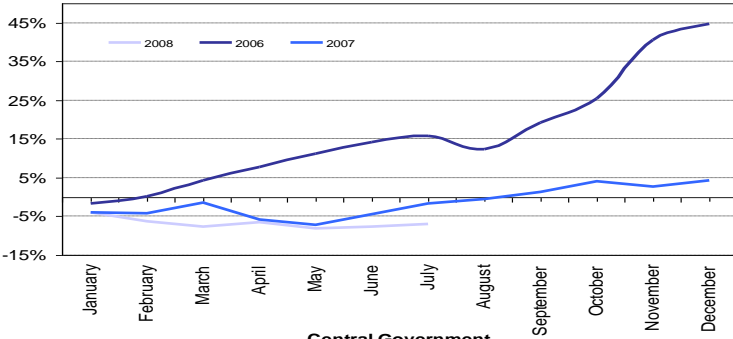


Interest Rate (Six Principal Banks)

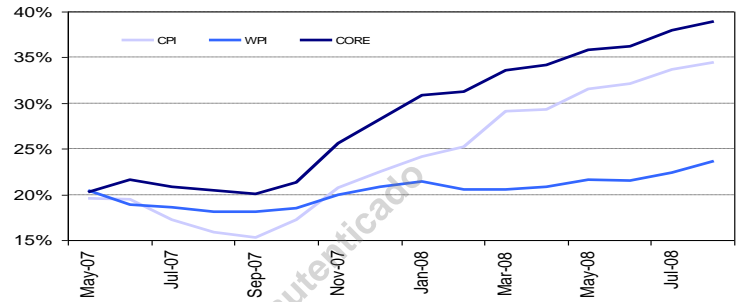


ECONOMIC OVERVIEW

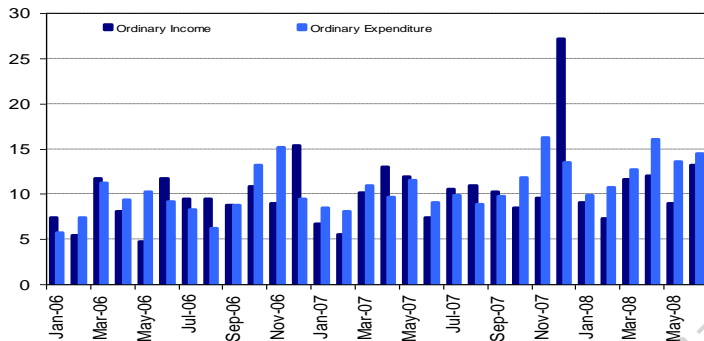
Real Expansion (M2)



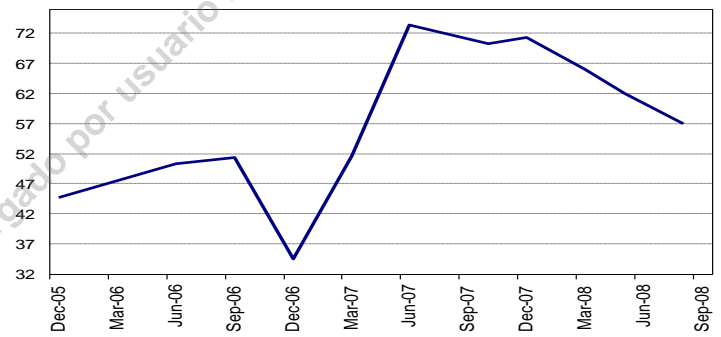
Inflation (Last 12 Months)



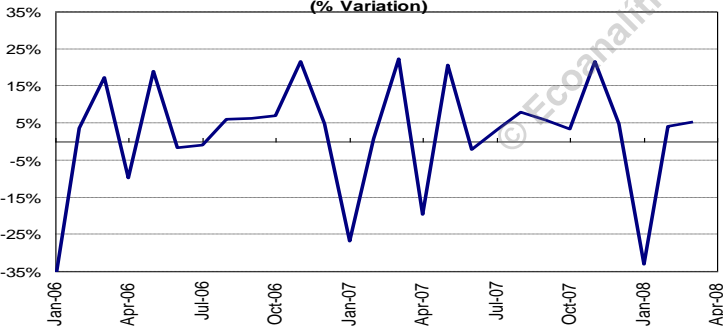
Central Government (VEB Billion)



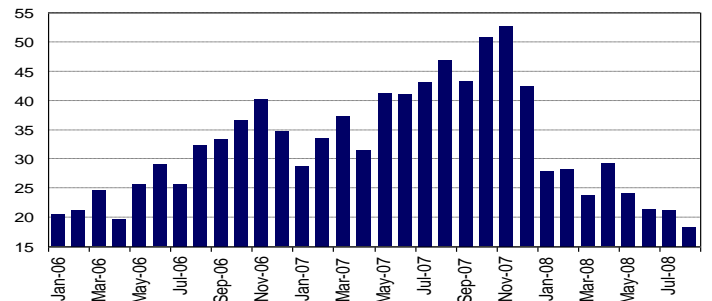
Resources of the State (US \$ MM)



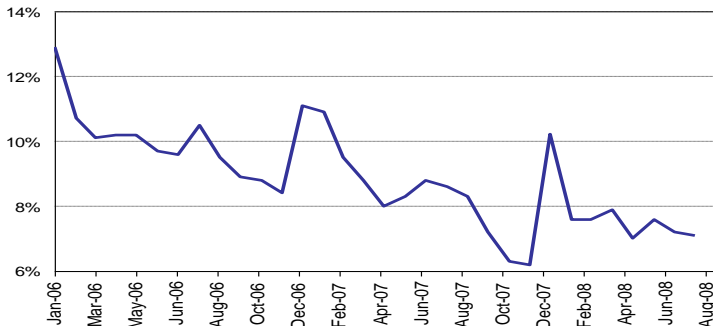
Volume of Sales (% Variation)



Sale of Vehicles (Thousands of Sold Units)



Rate of unemployment (% Variation)



Disbursement (US\$ Million)

