PETROBRAS INTERNATIONAL FINANCE CO
Form 20-F
June 26, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 20-F
ANNUAL REPORT
PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
for the fiscal year ended December 31, 2006

Commission File Number 1-15106	**Commission File Number: 333-14168**
PETRÓLEO BRASILEIRO S.A. PETROBRAS	**Petrobras International Finance Company**
(Exact name of registrant as specified in its charter)	**(Exact name of registrant as specified in its charter)**
Brazilian Petroleum Corporation PETROBRAS	
(Translation of registrant s name into English)	
The Federative Republic of Brazil	**Cayman Island**
(Jurisdiction of incorporation or organization)	**(Jurisdiction of incorporation or organization)**
Avenida República do Chile, 65 **20031-912 Rio de Janeiro RJ** **Brazil**	**Harbour Place** **103 South Church Street, 4th floor** **P.O. Box 1034GT BWI** **George Town, Grand Cayman** **Cayman Islands**
(Address of principal executive offices)	**(Address of principal executive offices)**

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class:	**Name of each exchange on which registered:**
PETROBRAS Common Shares, without par value* PETROBRAS American Depositary Shares (as evidenced by American Depositary Receipts), each representing 4 Common Shares	New York Stock Exchange
PETROBRAS Preferred Shares, without par value* PETROBRAS American Depositary Shares (as evidenced by American Depositary Receipts), each representing 4 Preferred Shares	New York Stock Exchange

* Not for trading, but only in connection with the registration of American Depositary

Shares, pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

Title of each class:

PifCo U.S.$500,000,000 9.125% Senior Notes due 2007
PifCo U.S.$450,000,000 9.875% Senior Notes due 2008
PifCo U.S.$400,000,000 9.00% Global Step-Up Notes due 2008
PifCo U.S.$600,000,000 9.750% Senior Notes due 2011
PifCo U.S.$750,000,000 9.125% Global Notes due 2013
PifCo U.S.$750,000,000 8.375% Global Notes due 2018
PifCo U.S.$600,000,000 7.75% Global Notes due 2014
PifCo U.S.$899,053,000 6.125% Global Notes due 2016

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by this Annual Report :

At December 31, 2006, there were outstanding:
2,536,673,672 PETROBRAS Common Shares, without par value
1,850,364,698 PETROBRAS Preferred Shares, without par value
300,050,000 PifCo Common Shares

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act.

Yes þ No o

If this report is an annual or transitional report, indicate by check mark if the registrant is not required to file reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes o No þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ [Petrobras] **Accelerated filer** o **Non-accelerated filer þ [PifCo]**

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 o Item 18 þ

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

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FORWARD-LOOKING STATEMENTS

Many statements made in this annual report are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that are not based on historical facts and are not assurances of future results. Many of the forward-looking statements contained in this annual report may be identified by the use of forward-looking words, such as believe, expect, anticipate, should, planned, estimate and potential, among others. We have made forward-looking statements tha address, among other things, our:

- regional marketing and expansion strategy;
- drilling and other exploration activities;
- import and export activities;
- projected and targeted capital expenditures and other costs, commitments and revenues;
- liquidity; and
- development of additional revenue sources.

Because these forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements. These factors include:

- general economic and business conditions, including crude oil and other commodity prices, refining margins and prevailing exchange rates;
- international and Brazilian political, economic and social developments;
- our ability to find, acquire or gain access to additional reserves and to successfully develop our current ones;
- uncertainties inherent in making estimates of our reserves;
- our ability to obtain financing;
- competition;
- technical difficulties in the operation of our equipment and the provision of our services;
- changes in, or failure to comply with, governmental regulations;
- receipt of governmental approvals and licenses;
- military operations, terrorist acts, wars or embargoes;
- the cost and availability of adequate insurance coverage; and
- other factors discussed below under Risk Factors.

These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially from those expressed or forecast in any forward-looking statements as a result of a variety of factors, including those in Risk Factors.

All forward-looking statements are expressly qualified in their entirety by this cautionary statement, and you should not place reliance on any forward-looking statement contained in this annual report.

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The crude oil and natural gas reserve data presented or described in this annual report are only estimates and our actual production, revenues and expenditures with respect to our reserves may materially differ from these estimates.

Unless the context otherwise requires, the terms Petrobras, we, us, and our refer to Petróleo Brasileiro S.A. PETROBRAS and its consolidated subsidiaries and special purpose companies, including Petrobras International Finance Company. The term PifCo refers to Petrobras International Finance Company and its subsidiaries.

CERTAIN TERMS AND CONVENTIONS

A glossary of petroleum industry terms, a table of abbreviations and a conversion table are presented beginning on page 194.

PRESENTATION OF FINANCIAL INFORMATION

In this annual report, references to *real*, *reais* or R$ are to Brazilian *reais* and references to U.S. dollars or U.S are to the United States dollars. Certain figures included in this annual report have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables may not be an exact arithmetic aggregation of the figures that precede them.

Petrobras

The audited consolidated financial statements of Petrobras and our consolidated subsidiaries as of December 31, 2006 and 2005, and for each of the three years in the period ended December 31, 2006, and the accompanying notes, contained in this annual report have been presented in U.S. dollars and prepared in accordance with U.S. generally accepted accounting principles, or U.S. GAAP. See Item 5. Operating and Financial Review and Prospects and Note 2(a) to our audited consolidated financial statements. We also publish financial statements in Brazil in *reais* in accordance with the accounting principles required by Law No. 6404/76, as amended, or Brazilian Corporate Law and the regulations promulgated by the *Comissão de Valores Mobiliários* (Brazilian Securities Commission, or the CVM), or Brazilian GAAP, which differs in significant respects from U.S. GAAP.

Certain prior year amounts for 2005 and 2004 have been reclassified to conform to current year presentation standards. These reclassifications had no impact on our net income.

Our functional currency is the Brazilian *real*. As described more fully in Note 2(a) to our audited consolidated financial statements, the U.S. dollar amounts as of the dates and for the periods presented in our audited consolidated financial statements have been recalculated or translated from the *real* amounts in accordance with the criteria set forth in Statement of Financial Accounting Standards No. 52 of the U.S. Financial Accounting Standards Board, or SFAS 52. U.S. dollar amounts presented in this annual report have been translated from *reais* at the period-end exchange rate for balance sheet items and the average exchange rate prevailing during the period for income statement and cash flow items.

Unless the context otherwise indicates:

- historical data contained in this annual report that were not derived from the consolidated financial statements have been translated from *reais* on a similar basis;

- forward-looking amounts, including estimated future capital expenditures, have all been based on our Petrobras 2015 Strategic Plan, which covers the period from 2004 to 2015, which we refer to as the Petrobras 2015 Strategic Plan, and on our 2007-2011 Business Plan, and have been projected on a constant basis and have been translated from *reais* in 2007 at an estimated average exchange rate of R$2.50 to U.S.$1.00, and future calculations involving an assumed price of crude oil have been calculated using a Brent crude oil price of U.S.$55 per barrel for 2007, and U.S.$40 per barrel for 2008 and U.S.$35 per barrel for 2009 and thereafter, adjusted for our quality and location differences, unless otherwise stated; and estimated future capital expenditures are based on the most recently budgeted amounts, which may not have been adjusted to reflect all factors that could affect such amounts.

PifCo

PifCo s functional currency is the U.S. dollar. Substantially all of PifCo s sales are made in U.S. dollars and all of its debt is denominated in U.S. dollars. Accordingly, PifCo s audited consolidated financial statements as of December 31, 2006 and 2005, and for each of the three years in the period ended December 31, 2006, and the accompanying notes contained in this annual report have been presented in U.S. dollars and prepared in accordance with U.S. GAAP and include PifCo s wholly-owned subsidiaries: Petrobras Europe Limited, Petrobras Finance Limited, Bear Insurance Company Limited BEAR and Petrobras Singapore Private Limited.

RECENT DEVELOPMENTS

PESA Issues Notes

On May 7, 2007, Petrobras Energía S.A. (PESA), a company indirectly controlled by us, issued notes amounting to U.S.$300 million, with a term of 10 years and bearing interest at 5.875% per year. Interest will be paid semi-annually and the principal will be paid in a single installment at maturity. The issuance was made both in the Argentine market and in the international market.

Acquisition of Assets of the Ipiranga Group

On March 18, 2007, Ultrapar Participações S.A. (Ultrapar) acquired, as a commission agent acting on behalf of Braskem S.A. (Braskem) and us, the total share capital of the controlling shares of Refinaria de Petróleo Ipiranga S.A. (RPI), Distribuidora de Produtos de Petróleo Ipiranga S.A. (DPPI) and Companhia Brasileira de Petróleo Ipiranga (CBPI) (together, the Ipiranga Group), including petrochemical, refining and distribution assets. Under the investment agreement, we and Braskem acknowledged and agreed to the terms of the proposed transaction.

After completion of the proposed acquisition, the businesses of the Ipiranga Group will be managed by Ultrapar, Braskem and us. Ultrapar will hold the retail businesses located in the South and Southeast regions of Brazil, and we will hold the retail businesses located in the North, Northeast and Central-West regions of Brazil. Besides these, we will hold a 100% of the share capital of IASA (a subsidiary of the group that produces asphalt). We and Braskem will jointly hold the petrochemical assets, represented by Ipiranga Química S.A. and Ipiranga Petroquímica S.A. (IPQ) and for IPQ s stake in Copesul Companhia Petroquímica do Sul (Copesul), in the proportion of 40% and 60%, respectively. The assets related to refining operations will be equally shared between Ultrapar, Braskem and us.

The Ipiranga transaction is expected to close during the fourth quarter of 2007. The transaction is expected to take place in four phases. In the first phase, Ultrapar acquired RPI, DPPI and CBPI from these entities controlling shareholders for a purchase price of R$2,000.2 million. In the second phase Ultrapar will make a mandatory tender offer for the remaining outstanding voting shares of RPI, DPPI and CBPI, as required under Brazilian law. In the next phase, Ultrapar will issue preferred shares in exchanges for the outstanding preferred shares of RPI, DPPI and CBPI. In the fourth phase Ultrapar will delivery part of the distribution assets to us and total petrochemical assets to us and Braskem.

The total value estimated for the operation is U.S.$4.0 billion and we are expected to pay approximately U.S.$1.3 billion for our interest. The transaction will be subject to the approval of the Brazilian anti-trust authorities (CADE Administrative Board for Economic Defense), the Secretary for Economic Rights and the Secretary for Economic Monitoring.

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Acquisition of Refinery Pasadena Texas

In September 2006, we announced the closing of the acquisition by Petrobras America, Inc., or PAI, our wholly-owned subsidiary in the U.S. Gulf of Mexico, of 50% of Pasadena Refining System Inc. (PRSI), formerly the Crown Refinery in Pasadena, Texas, from Astra Oil Company, a U.S.-based refining and trading company owned by the Belgian group Compagnie Nationale à Portefeuille SA-CNP. The purchase price was approximately U.S.$416 million. PAI and Astra are conducting studies to expand its capacity and install units that will enable it to process heavy oils and deliver high quality products.

Electrical Energy

Petrobras is expected to sign an agreement with the National Electrical Energy Agency (*Agência Nacional de Energia Elétrica*, or ANEEL), in an effort to increase capacity in 24 gas-fired power plants. This agreement is highlighted as a part of our strategy to develop the Brazilian natural gas market as an integrated energy company with a goal of making the gas-fired power business profitable. The actions to be undertaken before 2011 will allow for an additional electrical energy capacity of 4 GW, which are expected to be reached not just through a greater supply of gas, but also through the conversion of plants into those that can support biocombustible operations and through the availability of plants that can process combustible oil. We understand that our actions, along with the actions of other companies, with the contracting for expected demand and the reserve capacity for energy generation, will allow the electrical business greater operational stability.

PRESENTATION OF INFORMATION CONCERNING RESERVES

The estimates of our proved reserves of crude oil and natural gas as of December 31, 2006, included in this annual report have been calculated according to the technical definitions required by the U.S. Securities and Exchange Commission, or the SEC. DeGolyer and MacNaughton provided estimates of most of our net domestic reserves as of December 31, 2006. All reserve estimates involve some degree of uncertainty. See Item 3. Key Information Risk Factors Risks Relating to Our Operations for a description of the risks relating to our reserves and our reserve estimates.

We also file oil and gas reserve estimates with governmental authorities in most of the countries in which we operate. On January 12, 2007, we filed reserve estimates for Brazil with the *Agência Nacional de Petróleo* (the National Petroleum Agency, or the ANP), in accordance with Brazilian rules and regulations, totaling 11.671 billion barrels of crude oil and condensate and 12,492.9 billion cubic feet of natural gas. The reserve estimates we filed with the ANP and those provided herein differ by approximately 30.1%. This difference is due to (1) the ANP requirement that we estimate proved reserves through the technical abandonment of production wells, as opposed to limiting reserve estimates to the life of our concession contracts as required by Rule 4-10 of Regulation S-X and (2) different technical criteria for booking proved reserves, including the use of 3-D seismic data to establish proved reserves in Brazil.

We also file reserve estimates from our international operations with various governmental agencies under the guidelines of the Society of Petroleum Engineers, or SPE. The aggregate reserve estimates from our international operations, under SPE guidelines, amounted to 0.66 billion barrels of crude oil and NGLs and 3,679 billion cubic feet of natural gas, which differs by approximately 44 percent from reserve estimates provided herein because the SPE s different technical guidelines allow for (1) the booking of reserves in Bolivia beyond the life of certain gas sale contracts and (2) the booking of reserves in Nigeria based on 3-D seismic data and certain oil recovery techniques, such as fluid injection, based on analogous fields.

Bolivia and Venezuela implemented new nationalization measures during 2006. The nationalization measures in Bolivia and Venezuela caused a reduction of our reserves in these countries in 2006. The new regulation in Venezuela reduced our reserves as Petróleos de Venezuela S.A. (PDVSA) became the main controller of the companies, created to operate the fields with private companies. Due to new government regulations, our reserves in Bolivia were also reduced. In Nigeria, the consortium in charge of the Akpo field included Total, Petrobras and a Nigerian private company called SAPETRO. The agreement underwritten by these companies established that Total and Petrobras carry the investment cost of the third party and it would be compensated in the

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future with SAPETRO s production/reserves. Throughout 2006, SAPETRO sold its participation to a Chinese oil company and, as part of this agreement, Petrobras and Total were reimbursed for their past carrying investments. In addition, in Nigeria, due to certain farm-in arrangements in the Akpo field, we reduced our expectations for future production. See Item 4. Information on the Company International.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

Selected Financial Data

Petrobras

The following table sets forth our selected consolidated financial data, presented in U.S. dollars and prepared in accordance with U.S. GAAP. The data for each of the five years in the period ended December 31, 2006 has been derived from our audited consolidated financial statements, which were audited by KPMG Auditores Independentes for the year ended December 31, 2006, by Ernst & Young Auditores Independentes S/S for each of the years ended December 31, 2005, 2004 and 2003, and by PricewaterhouseCoopers Auditores Independentes for the year ended December 31, 2002. The information below should be read in conjunction with, and is qualified in its entirety by reference to, our audited consolidated financial statements and the accompanying notes and Item 5. Operating and Financial Review and Prospects.

Certain prior year amounts for 2005 and 2004 have been reclassified to conform to current year presentation standards. These reclassifications had no impact on our net income.

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BALANCE SHEET DATA PETROBRAS

	2006	2005	As of December 31, 2004	2003	2002
			(in millions of U.S. dollars)		
Assets					
Current assets:					
Cash and cash equivalents	$ 12,688	$ 9,871	$ 6,856	$ 8,344	$ 3,301
Accounts receivable, net	6,311	6,184	4,285	2,905	2,267
Inventories	6,573	5,305	4,904	2,947	2,540
Recoverable taxes	2,593	2,087	1,475	917	672
Advances to suppliers	948	652	422	504	794
Other current assets	1,842	1,685	1,484	1,817	748
Total current assets	30,955	25,784	19,426	17,434	10,322
Property, plant and equipment, net	58,897	45,920	37,020	30,805	18,224
Investments in non-consolidated companies and other investments	3,262	1,810	1,862	1,173	334
Other assets:					
Accounts receivables, net	513	642	411	528	369
Advances to suppliers	852	462	580	416	450
Petroleum and Alcohol Account-Receivable from the Brazilian government(1)	368	329	282	239	182
Government securities	479	364	326	283	176
Unrecognized pension obligation					61
Restricted deposits for legal proceedings and guarantees	816	775	699	543	290
Recoverable taxes	1,292	639	536	467	156
Investments PEPSA and PELSA					1,073
Goodwill	243	237	211	183	
Prepaid expenses	244	246	271	190	100
Marketable securities	94	129	313	806	208
Fair value asset of gas hedge		547	635		
Others	665	754	510	545	209
Total other assets	5,566	5,124	4,774	4,200	3,274
Total assets	$ 98,680	$ 78,638	$ 63,082	$ 53,612	$ 32,154
Liabilities and Shareholders equity					
Current liabilities:					
Trade accounts payable	$ 5,418	$ 3,838	$ 3,284	$ 2,261	$ 1,702
Taxes payable	3,357	3,423	2,569	2,305	1,801
Short-term debt	1,293	950	547	1,329	671
Current portion of long-term debt	2,106	1,428	1,199	1,145	727
Current portion of project financings	2,182	2,413	1,313	842	239
Current portion of capital lease obligations	231	239	266	378	349
Dividends and interest on capital payable	3,693	3,068	1,900	1,955	307

Payroll and related charges	1,192	918	618	581	283
Advances from customers	880	609	290	258	119
Employees postretirement benefits obligations Pension	198	206	166	160	89
Other current liabilities	1,236	1,069	1,176	823	976
Total current liabilities	21,786	18,161	13,328	12,037	7,263
Long-term liabilities:					
Long-term debt	10,510	11,503	12,145	11,888	6,987
Project financings	4,192	3,629	4,399	5,066	3,800
Employees postretirement benefits obligations Pension	4,645	3,627	2,915	1,895	1,363
Employees postretirement benefits obligation Health Care	5,433	3,004	2,137	1,580	1,060
Capital lease obligations	824	1,015	1,069	1,242	1,907
Deferred income tax	2,916	2,166	1,558	1,122	259
Gas-fired power liabilities			1,095	1,142	
Deferred Purchase Incentive		144	153		
Provision for abandonment of wells	1,473	842	403	396	
Other liabilities	636	556	497	541	350
Total long-term liabilities	30,629	26,486	26,371	24,872	15,726
Minority interest	1,966	1,074	877	367	(136)

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	2006	2005	As of December 31, 2004	2003	2002
			(in millions of U.S. dollars)		
Shareholders equity					
Shares authorized and issued:					
Preferred share	7,718	4,772	4,772	2,973	2,459
Common share	10,959	6,929	6,929	4,289	3,761
Capital reserve and other comprehensive income	25,622	21,216	10,805	9,074	3,081
Total Shareholders equity	44,299	32,917	22,506	16,336	9,301
Total liabilities and Shareholders equity	$ 98,680	$ 78,638	$ 63,082	$ 53,612	$ 32,154

(1) Prior to July 29, 1998, the Petroleum and Alcohol Account reflected the difference between our actual cost for imported crude oil and oil products and the price set by the Brazilian government, as well as the net effects on us of the administration of certain subsidies and of our fuel alcohol activities. From July 29, 1998 until December 31, 2001, the Petroleum and Alcohol Account was required to be adjusted by the Specific Parcel Price-PPE and certain fuel transportation and other reimbursable costs. As from the

price deregulation on January 2, 2002, the Petroleum and Alcohol Account reflected only the outstanding balance owed to us by the Brazilian government and adjustments resulting from monetary correction and audits to the Account. See Item 4. Information on the Company Regulation of the Oil and Gas Industry in Brazil Price Regulation The Petroleum and Alcohol Account.

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INCOME STATEMENT DATA PETROBRAS

	For the Year Ended December 31,				
	2006	2005 (8)	2004 (8)	2003(8)	2002(8)
	(in millions of U.S. dollars, except for share and per share data)				
Sales of products and services	$ 93,893	$ 74,065	$ 51,954	$ 42,690	$ 32,987
Value-added and other taxes on sales and services	(17,906)	(14,694)	(10,906)	(9,527)	(7,739)
CIDE(1)	(3,640)	(3,047)	(2,620)	(2,249)	(2,636)
Net operating revenues	72,347	56,324	38,428	30,914	22,612
Cost of sales	40,061	29,828	21,279	15,533	11,506
Depreciation, depletion and amortization(2)(3)	3,673	2,926	2,481	1,785	1,930
Exploration, including exploratory dry holes(2)	934	1,009	613	512	435
Selling, general and administrative expenses	4,989	4,474	2,901	2,091	1,741
Other operating expense	1,829	2,008	793	597	222
Total costs and expenses	51,486	40,245	28,067	20,518	15,834
Financial income	1,165	710	956	634	1,142
Financial expense	(1,340)	(1,189)	(1,733)	(1,247)	(774)
Monetary and exchange variation on monetary assets and liabilities, net	75	248	450	509	(2,068)
Employee benefit expense	(1,017)	(994)	(650)	(595)	(451)
Other non-operating income (expense), net(4)	(583)	(262)	(449)	(924)	(1,395)
Income before income taxes, minority interest, extraordinary item and accounting change	19,161	14,592	8,935	8,773	3,232
Income tax (expense) benefit:					
Current	(5,011)	(4,223)	(2,114)	(2,599)	(1,269)
Deferred	(680)	(218)	(117)	(64)	116

Total income tax expense		(5,691)		(4,441)		(2,231)		(2,663)		(1,153)
Minority interests in results of consolidated subsidiaries		(644)		35		(514)		(248)		232
Income before extraordinary item and effect of change in accounting principle		12,826		10,186		6,190		5,862		2,311
Extraordinary gain net of tax				158						
Cumulative effect of change in accounting principle, net of taxes(2)								697		
Net income for the year	$	12,826	$	10,344	$	6,190	$	6,559	$	2,311
Weighted average number of shares Outstanding:(5)										
Common(5)		2,536,673,672		2,536,673,672		2,536,673,672		2,536,673,672		2,536,673,672
Preferred(5)		1,850,364,698		1,849,478,028		1,849,478,028		1,849,478,028		1.807.742.676
Basic and diluted earnings per share:(5)(6)										
Common and Preferred Shares(5)(6)	$	2.92	$	2.36	$	1.41	$	1.50	$	0.53
Common and Preferred ADS(5)(6)	$	11.68	$	9.44	$	5.64	$	6.00	$	2.12
Cash dividends per(5)(7):										
Common and Preferred shares(5)(7)	$	0.84	$	0.68	$	0.42	$	0.37	$	0.29
Common and Preferred ADS(5)(7)	$	3.36	$	2.72	$	1.68	$	1.48	$	1.16

(1) CIDE is an excise tax payable to the Brazilian government, required to be paid by producers, blenders and importers upon sales and purchases of

specified oil and fuel products at a set amount for different products based on the unit of measurement typically used for such products.

(2) In 2002, U.S.$284 million in abandonment costs were recognized as depreciation, depletion and amortization in accordance with SFAS 19. In 2003, as a result of our adoption of SFAS 143 - Accounting for Asset Retirement Obligations, depreciation on the asset retirement obligation was recorded under depreciation, depletion and amortization, while accretion expense was recorded under exploration, including exploratory dry holes. This change resulted in U.S.$43 million in abandonment costs being recognized as exploration, including exploratory dry holes in 2003. The cumulative

effect of adoption is recorded separately.

(3) Includes impairment charge.

(4) Amounts reported include financial charges in respect of the Petroleum and Alcohol Account of U.S.$2 million in 2002.

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(5) On July 22, 2005, our Board of Directors authorized a 4 for 1 stock split. For purposes of comparison, the weighted average number of shares outstanding, net income per share/ADS and cash dividends per share/ADS were restated for periods prior to the stock split, which became effective as of September 1, 2005. See note 10 to our audited consolidated financial statements.

(6) Basic and diluted earnings per share for 2003 reflect our adoption of SFAS 143. That change in accounting principle altered our 2003 basic and diluted earnings per share from U.S.$1.34 (before effect of change in accounting principle) to U.S.$1.50 (after effect of change in accounting

principle). And for 2005, the extraordinary item altered our basic and diluted earnings per share from U.S.$2.32 (before effect of extraordinary item) to U.S.$2.36 (after effect of extraordinary item).

(7) Represents dividends declared in respect of the earnings of each period.

(8) Certain amounts from prior years have been reclassified to conform to the current year s presentation. These reclassifications had no impact on the Company s net income.

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PifCo

The following table sets forth PifCo s selected consolidated financial data, presented in U.S. dollars and prepared in accordance with U.S. GAAP. The data for each of the five years in the period ended December 31, 2006 have been derived from PifCo s audited consolidated financial statements, which were audited by KPMG Auditores Independentes for the year ended December 31, 2006, by Ernst & Young Auditores Independentes S/S for each of the years ended December 31, 2005, 2004 and 2003 and by PricewaterhouseCoopers Auditores Independentes for the year ended December 31, 2002. The information below should be read in conjunction with, and is qualified in its entirety by reference to, PifCo s audited consolidated financial statements and the accompanying notes and Item 5. Operating and Financial Review and Prospects.

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INCOME STATEMENT AND BALANCE SHEET DATA - PifCo

	For the Year Ended December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
	(in millions of U.S. dollars)				
Income Statement Data:					
Sales of crude oil and oil products and Services:					
Related Parties	$ 14,236.5	$ 13,974.4	$ 10,118.4	$ 5,543.0	$ 5,375.5
Others	7,833.3	3,161.7	2,237.2	1,432.5	1,014.7
Lease income(1)					36.1
	$ 22,069.8	$ 17,136.1	$ 12,355.6	$ 6,975.5	$ 6,426.3
Operating Expenses:					
Cost of sales					
Related Parties	(8,122.0)	(7,780.3)	(4,391.3)	(2,851.4)	(2,409.0)
Others	(13,778.5)	(9,203.0)	(7,844.7)	(4,068.7)	(3,962.5)
Lease expense(1)					(24.0)
Selling, general and Administrative expenses					
Related parties	(189.7)	(158.1)	(98.7)	(17.1)	
Others	(17.7)	(7.6)	(1.1)	(1.5)	(1.2)
	(22,107.9)	(17,149.0)	(12,335.8)	(6,938.7)	(6,396.7)
Operating income (loss)	(38.1)	(12.9)	19.8	36.8	29.6
Financial income(2)					
Related Parties	999.2	765.5	568.6	401.7	201.9
Others	286.0	218.5	110.2	41.2	17.7
Total	1,285.2	984.0	678.8	442.9	219.6
Financial expense(3)					
Related Parties	(722.4)	(409.8)	(169.0)	(111.9)	(61.3)
Others	(735.4)	(589.1)	(592.2)	(370.8)	(253.4)
Total	(1,457.8)	(998.9)	(761.2)	(482.7)	(314.7)
Other income, net					
Related Parties			(0.5)		
Others	0.2		4.0		
Net loss	$ (210.5)	$ (27.8)	$ (59.1)	$ (3.0)	$ (65.5)
Balance Sheet Data (end of period):					
Cash and cash equivalents	$ 510.8	$ 230.7	$ 1,107.3	$ 664.2	$ 260.6
Trade accounts receivable					
Related parties	10,658.9	8,681.1	7,788.1	5,064.5	4,837.1
Others	835.4	212.7	153.6	109.4	57.1
Notes receivable					

Related parties	6,354.4	3,909.3	1,936.9	1,726.4	1,631.6
Export Prepayment					
Related parties	532.2	943.9	1,414.7	1,479.4	751.2
Marketable Securities	1,796.9	2,248.6	1,864.8	615.8	96.3
Total assets	21,321.3	16,748.9	14,670.2	10,196.6	8,697.3
Trade accounts payable					
Related parties	1,142.9	950.7	562.1	271.0	292.0
Other	1,122.0	616.1	568.1	349.0	281.1
Notes payable					
Related parties	12,828.5	8,080.3	6,435.0	2,442.8	3,688.2
Short-term financing and current portion of long-term debt	1,205.9	891.1	680.9	1,076.4	367.5
Long-term debt(4)	4,640.1	5,908.4	6,151.8	5,825.3	3,850.4
Total stockholders equity	(24.8)	8.0	35.7	94.8	43.9
Total liabilities and stockholders equity	21,321.3	16,748.9	14,670.2	10,196.6	8,697.3

(1) As a result of PifCo s transfer of PNBV, its leasing subsidiary, to us in January 2003, PifCo had no lease income or lease expense in 2003, 2004, 2005 and 2006.

(2) Financial income represents primarily the imputed interest realized from PifCo s sales of crude oil and oil products to us and intercompany loans to related parties.

(3) Financial expense consists primarily of costs incurred by PifCo in financing its activities in connection with the importation by us of crude oil and oil products.

(4) Includes capital lease obligations of U.S.$601.7 million at December 31, 2002.

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Exchange Rates

Foreign currencies may only be purchased through Brazilian financial institutions authorized to operate in the exchange market and are subject to registration with the Central Bank electronic system. The Central Bank of Brazil allows the *real*/U.S. dollar exchange rate to float freely, and it has intervened occasionally to control unstable movements in foreign exchange rates. We cannot predict whether the Central Bank or the Brazilian government will continue to let the *real* float freely or will intervene in the exchange rate market through a currency band system or otherwise.

The *real* depreciated 52.3% in 2002 against the U.S. dollar, before appreciating 18.2% in 2003 and continuing to appreciate 8.1% in 2004, 11.8% in 2005 and 8.7% in 2006. As of June 21, 2007, the *real* has appreciated to R$1.920 per U.S.$1.00, representing an appreciation of approximately 10.2% in 2007 year-to-date. The *real* may depreciate or appreciate substantially in the future. See Risk Factors Risks Relating to Brazil.

The following table provides information on the selling exchange rate, expressed in *reais* per U.S. dollar (R$/U.S.$), for the periods indicated. The table uses the commercial selling rate prior to March 14, 2005.

	(R$ /U.S.$)			
	High	**Low**	**Average (1)**	**Period End**
Year ended December 31,				
2006	2.371	2.059	2.175	2.138
2005	2.762	2.163	2.435	2.341
2004	3.205	2.654	2.926	2.654
2003	3.662	2.822	3.075	2.889
2002	3.955	2.271	2.924	3.533
Month				
November 2006	2.187	2.135	2.156	2.167
December 2006	2.169	2.138	2.150	2.138
January 2007	2.156	2.125	2.139	2.125
February 2007	2.118	2.077	2.096	2.118
March 2007	2.139	2.050	2.089	2.050
April 2007	2.050	2.023	2.032	2.034
May 2007	2.034	1,929	1.986	1,929
June 2007 (through June 21)	1.964	1.905	1.930	1.920

Source: Central Bank of Brazil

(1) Year-end figures stated for calendar years 2006, 2005, 2004, 2003 and 2002 represent the average of the month-end exchange rates during the relevant period. The figures provided for the months of calendar years 2007 and 2006, as well as for the month of June

up to and including June 21, 2007, represent the average of the exchange rates at the close of trading on each business day during such period.

Brazilian law provides that, whenever there is a serious imbalance in Brazil s balance of payments or serious reasons to foresee such an imbalance, temporary restrictions on remittances from Brazil may be imposed by the Brazilian government. These types of measures may be taken by the Brazilian government in the future, including measures relating to remittances related to our preferred or common shares or American Depositary Shares, or ADSs. See Risk Factors-Risks Relating to Brazil.

Risk Factors

Risks Relating to Our Operations

Substantial or extended declines in the prices of crude oil and oil products may have a material adverse effect on our income.

The majority of our revenue is derived from sales of crude oil and oil products. We do not, and will not, have control over the factors affecting international prices for crude oil and oil products. The average prices of Brent crude, an international benchmark oil, were approximately U.S.$ 65.14 per barrel for 2006, U.S.$54.38 per barrel for 2005 and U.S.$38.21 per barrel for 2004. Changes in crude oil prices typically result in changes in prices for oil products.

Historically, international prices for crude oil and oil products have fluctuated widely as a result of many factors. These factors include:

- global and regional economic and geopolitical developments in crude oil producing regions, particularly in the Middle East;
- the ability of the Organization of Petroleum Exporting Countries (OPEC) to set and maintain crude oil production levels and defend prices;
- global and regional supply and demand for crude oil and oil products;
- competition from other energy sources;
- domestic and foreign government regulations; and
- weather conditions.

Volatility and uncertainty in international prices for crude oil and oil products may continue. Substantial or extended declines in international crude oil prices may have a material adverse effect on our business, results of operations and financial condition, and the value of our proved reserves. In addition, significant decreases in the price of crude oil may cause us to reduce or alter the timing of our capital expenditures, and this could adversely affect our production forecasts in the medium term and our reserve estimates in the future.

Our ability to achieve our long-term growth objectives depends on our ability to discover additional reserves and successfully develop them, and failure to do so could prevent us from achieving our long-term goals for growth in production.

Our ability to achieve our long-term growth objectives is highly dependent upon our ability to discover additional reserves, as well as to successfully develop our current reserves. In addition, our exploration activities expose us to the inherent risks of drilling, including the risk that we will not discover commercially productive crude oil or natural gas reserves. The costs of drilling wells are often uncertain, and numerous factors beyond our control (such as unexpected drilling conditions, equipment failures or accidents, and shortages or delays in the availability of drilling rigs and the delivery of equipment) may cause drilling operations to be curtailed, delayed or cancelled. These risks are heightened when we drill in deep water (between 300 and 1,500 meters water depth) and ultra deep water (more than 1,500 meters). Deep water drilling represented approximately 34 % of the exploratory wells we drilled in 2006, a higher proportion than for many other oil and gas producers.

Unless we conduct successful exploration and development activities or acquire properties containing proved reserves, or both, our proved reserves will decline as reserves are extracted. If we fail to gain access to additional reserves we may not achieve our long-term goals for production growth and our results of operations and financial condition may be adversely affected.

Our crude oil and natural gas reserve estimates involve some degree of uncertainty, which could adversely affect our ability to generate income.

The proved crude oil and natural gas reserves set forth in this annual report are our estimated quantities of crude oil, natural gas and natural gas liquids that geological and engineering data demonstrate with reasonable certainty to be recoverable from known reservoirs under existing economic and operating conditions (i.e., prices and costs as of the date the estimate is made). Our proved developed crude oil and natural gas reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. There are uncertainties in estimating quantities of proved reserves related to prevailing crude oil and natural gas prices applicable to our production, which may lead us to make revisions to our reserve estimates. Downward revisions in our reserve estimates could lead to lower future production, which could have an adverse effect on our results of operations and financial condition.

We are subject to numerous environmental and health regulations that have become more stringent in the recent past and may result in increased liabilities and increased capital expenditures.

Our activities are subject to a wide variety of federal, state and local laws, regulations and permit requirements relating to the protection of human health and the environment, both in Brazil and in other jurisdictions in which we operate. In Brazil, we could be exposed to administrative and criminal sanctions, including warnings, fines and closure orders for non-compliance with these environmental regulations, which, among other things, limit or prohibit emissions or spills of toxic substances produced in connection with our operations. In 2006, we experienced spills totaling 77,402 gallons of crude oil, as compared to 71,141 gallons in 2005 and 140,000 gallons in 2004. As a result of certain of these spills, we were fined by various state and federal environmental agencies, named the defendant in several civil and criminal suits, and remain subject to several investigations and potential civil and criminal liabilities. See Item 8. Financial Information Legal Proceedings. Waste disposal and emissions regulations may require us to clean up or retrofit our facilities at substantial cost and could result in substantial liabilities. The *Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis* (Brazilian Institute of the Environment and Renewable Natural Resources, or IBAMA) routinely inspects our oil platforms in the Campos Basin, and may impose fines, restrictions on operations or other sanctions in connection with its inspections. In addition, we are subject to environmental laws that require us to incur significant costs to cover damage that a project may cause to the environment (*environmental compensation*). These additional costs may have a negative impact on the profitability of the projects we intend to implement or may make such projects economically unfeasible.

As environmental regulations become more stringent, it is probable that our capital expenditures for compliance with environmental regulations and to effect improvements in our health, safety and environmental practices will increase substantially in the future. Because our capital expenditures are subject to approval by the Brazilian government, increased expenditures to comply with environmental regulations could result in reductions in other strategic investments. Any such reduction may have a material adverse effect on our results of operations or financial condition.

We may incur losses and spend time and money defending pending litigations and arbitrations.

We are currently a party to numerous legal proceedings relating to civil, administrative, environmental, labor and tax claims filed against us. These claims involve substantial amounts of money and other remedies. Several individual disputes account for a significant part of the total amount of claims against us. For example, on the grounds that drilling and production platforms may not be classified as sea-going vessels, the Brazilian Revenue Service asserted that overseas remittances for charter payments should be reclassified as lease payment and subject to a withholding tax of 25%. The Revenue Service has filed two tax assessments against us that in the aggregate, on December 31, 2006, amounted to R$3,914 million (approximately U.S.$1,832 million). See Item 8. Financial Information Legal Proceedings.

We may also be subject to labor litigation in connection with recent changes in Brazilian laws relating to retirement benefits affecting our employees.

In the event that claims involving a material amount and for which we have no provisions were to be decided against us, or in the event that the losses estimated turn out to be significantly higher than the provisions made, the aggregate cost of unfavorable decisions could have a material adverse effect on our financial condition and results of operations. In addition, our management may be required to direct its time and attention to defending these claims, which could preclude them from focusing on our core business. Depending on the outcome, certain litigation could result in restrictions on our operations and have a material adverse effect on certain of our businesses.

If the State of Rio de Janeiro enforces a law imposing the Domestic Value-Added Tax (ICMS) on upstream oil activities, our results of operations and financial condition may be adversely affected.

In June 2003, the State of Rio de Janeiro enacted a law, referred to as the Noel Law, imposing ICMS on upstream activities. The constitutionality of the Noel Law is currently being challenged in the Brazilian Supreme Court (*Supremo Tribunal Federal*, or STF) and although the law was approved by the State Legislature, the

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government of the State of Rio de Janeiro has not yet enforced it. Currently, the ICMS for fuels derived from oil is assessed at the point of sale but not at the wellhead level. If the State of Rio de Janeiro enforces the Noel Law, it is unlikely (depending on the grounds of the Supreme Court s decision) that the other states would allow us to use the tax imposed at the wellhead level in Rio de Janeiro as a credit to offset the tax imposed at the sale level. Therefore, we would have to pay ICMS at both levels. We estimate that the amount of ICMS that we would be required to pay to the State of Rio de Janeiro could increase by approximately R$9.4 billion (U.S.$4.3 billion) per year. This increase could have a material adverse effect on our results of operations and financial condition.

Our participation in the domestic power market has generated losses and may not become profitable.

Consistent with the global trend of other major oil and gas companies and to secure demand for our natural gas, we participate in the domestic power market. Despite a number of incentives introduced by the Brazilian government to promote the development of gas-fired power plants, development of such plants has been slow due to the market structure and regulation of the power industry, among other things. We have invested, alone or with other investors, in fifteen (thirteen in operation and two under construction or development) of the 21 existing gas-fired power generation plants. Demand for energy produced by our gas-fired power plants has been lower than we expected, as a consequence of the reduction in electricity demand due to a rationing that took place in Brazil in 2001 and 2002. The resulting excess of electricity generation capacity in Brazil has lowered the prices of energy and the majority of our thermoelectricity generation capacity is not contracted in the short term. Although almost all of our long-term capacity has been sold through the energy auctions promoted by the Brazilian government, we still face certain risks associated with our gas-fired power business. The main risks are:

- The potential mismatch between the contracted price indexation for energy to be sold by gas-fired power companies and the cost of natural gas or other substitute fuel supply; and

- The dependence on the construction of pipelines and other infrastructure to transport and produce natural gas, and the commitment to purchase firm quantities of natural gas to satisfy the requirement of the new regulatory model for power generation in order to sell under long term energy contracts.

As a result of the foregoing, our participation in the domestic power market has generated losses and may not become profitable.

We may not be able to obtain financing for some of our planned investments, and failure to do so could adversely affect our operating results and financial condition.

The Brazilian government maintains control over our budget and establishes limits on our investments and long-term debt. As a state-controlled entity, we must submit our proposed annual budgets to the Ministry of Planning, Budget and Management, the Ministry of Mines and Energy, and the Brazilian Congress for approval. If we cannot obtain financing that does not require Brazilian government approval, we may not be free to make all the investments we envision, including those we have agreed to make to expand and develop our crude oil and natural gas fields. If we are unable to make these investments, our operating results and financial condition may be adversely affected.

Currency fluctuations could have a material adverse effect on our financial condition and results of operations, because most of our revenues are in* reais *and a large portion of our liabilities are in foreign currencies.

The impacts of fluctuations in exchange rates, especially the *real*/U.S. dollar rate, on our operations are varied and may be material. The principal market for our products is Brazil, as over the last three fiscal years over 75% of our revenues have been denominated in *reais*, while some of our operating expenses and capital expenditures and a substantial portion of our indebtedness are, and are expected to continue to be, denominated in or indexed to U.S. dollars and other foreign currencies. In addition, during 2006 we imported U.S.$10.7 billion of crude oil and oil products, the prices of which were all denominated and paid in U.S. dollars. Conversely, a substantial share of our liquid assets are held in U.S. dollar denominated assets, or indexed to the U.S. dollar, but we do not use forwards, swaps and futures contracts to mitigate the impact of changes in currency values on our operations and financial statements because of their limited liquidity and cost.

Our recent financial statements reflect the appreciation of the *real* by 18.2%, 8.1%, 11.8% and 8.7% against the U.S. dollar in 2003, 2004, 2005 and 2006, respectively, as a result of improvement in macro-economic conditions and reduction in the markets perception of political risk in Brazil and global emerging market risk. As of June 21, 2007, the exchange rate of the *real* to the U.S. dollar was R$1.920 per U.S.$1.00, representing an appreciation of approximately 10.2% in 2007 year-to-date. Any reversal of this trend could affect negatively the results of our operations.

We are exposed to increases in prevailing market interest rates, which leaves us vulnerable to increased financing expenses.

In spite of marked improvements in our credit ratings, which have facilitated our access to fixed-interest long-term capital, a substantial portion of our total debt is represented by structured finance, export credits, trade financing and other similar financing methods the funding of which depends on floating rate instruments, and which for contractual, cost or other considerations cannot be prepaid. As of December 31, 2006, approximately 59% U.S.$12,589 million of our total indebtedness consisted of floating rate debt. In light of cost considerations and market analysis, we decided not to enter into derivative contracts or make other arrangements to hedge against the risk of an increase in interest rates. Accordingly, if market interest rates (principally LIBOR) rise, our financing expenses will increase, which could have an adverse effect on our results of operations and financial condition.

We are not insured against business interruption for our Brazilian operations and most of our assets are not insured against war or sabotage.

We do not maintain coverage for business interruptions of any nature for our Brazilian operations, including business interruptions caused by labor action. If, for instance, our workers were to strike, the resulting work stoppages could have an adverse effect on us. In addition, we do not insure most of our assets against war or sabotage. Therefore, an attack or an operational incident causing an interruption of our business could have a material adverse effect on our financial condition or results of operations.

We are subject to substantial risks relating to our international operations, in particular in Latin America and the Middle East.

We operate in a number of different countries, particularly in Latin America, West Africa and the Middle East that can be politically, economically and socially unstable. The results of operations and financial condition of our subsidiaries in these countries may be adversely affected by fluctuations in their local economies, political instability and governmental actions relating to the economy, including:

- the imposition of exchange or price controls;
- the imposition of restrictions on hydrocarbon exports;
- the depreciation of local currencies;
- the nationalization of oil and gas reserves;
- increases in export tax / income tax rates for crude oil and oil products; or
- unilateral (governmental) institutional and contractual changes.

If one or more of the risks described above were to materialize we may not achieve our strategic objectives in these countries or in our international operations as a whole, which may result in a material adverse effect on our results of operations and financial condition.

Of the countries outside of Brazil in which we operate, Argentina is the most significant, representing approximately 44% of our total international crude oil and natural gas production and 35% of our international proved crude oil and natural gas reserves at December 31, 2006. In response to the Argentine peso crisis that began in 2001, the Argentine government has made a number of changes in the regulatory structure of the electricity and gas sectors and has established export tax rates for crude oil, natural gas and oil products. We also have significant operations in Bolivia and Venezuela that represented, respectively, approximately 23% and 11% of our total international production in barrels of oil equivalent and 24% and 9% of our international proved crude oil and natural gas reserves, respectively, at December 31, 2006. Deterioration of the situation in Argentina, Bolivia or Venezuela may have an adverse effect on our results of operations and financial condition.

The nationalization measures taken by the Bolivian and Venezuelan governments may have an adverse effect on our results of operations and financial condition. The Bolivian and Venezuelan governments have recently increased their participation in their respective domestic oil and gas industries, which may generate material losses to us.

We have been operating in Bolivia since 1996. Our consolidated interests related to Bolivia include two refineries, oil and gas reserves, which represented approximately 1.9% of our total reserves at December 31, 2006 and our interest in the Bolivia-Brazil gas pipeline (GTB). We also hold a long-term gas supply agreement, or the GSA, for the purchase of natural gas from the Bolivian state oil company, Yacimientos Petrolíferos Fiscales Bolivianos YPFB. As of December 31, 2006, the book value of Bolivia assets was U.S.$1,173 million. In 2006, the natural gas we imported from Bolivia represented approximately 56% of our total natural gas sales. We supply this natural gas to the Brazilian market, including local distribution companies and gas-fired power plants in which we have an interest. On May 1, 2006, the Bolivian government announced that it would nationalize several industries in the country, including the oil and gas industry. As a result, companies engaged in oil and gas production activities in Bolivia were required to deliver to YPFB all their oil and gas production. The nationalization measures also included a significant increase in the government take (including royalties and direct taxes) for companies engaged in oil and gas production in Bolivia from 18% of total production in 2005 to approximately 82% in 2006, subject to production levels and the price of natural gas, among other variables to take into account. We reviewed our production estimates for Bolivia and reduced our proved reserves in this country from 2.7% of our total reserves in December 31, 2005 to 1.9% of our total reserves in December 31, 2006. After negotiations with the Bolivian government, in May 2007, we reached a sales agreement with YPFB, in which they have agreed to pay, in two installments, U.S.$112 millions for all the outstanding shares of Petrobras Bolivia Refinación S.A., which owns the two refineries in Bolivia. On June 11, 2007 we confirmed the first payment of U.S.$56 million from YPFB. The Bolivian government attempted to increase the gas prices under the agreement but currently has agreed to maintain the prices at the levels originally provided in the agreement, with the exception of prices for gas with a calorific power higher than 8,900 kcal/m3, for which a new price premium formula based on international market prices has yet to be negotiated.

Our interests in Venezuela include oil and gas reserves, which represented approximately 0.7% of our total reserves at December 31, 2006. In April 2005, the Venezuelan Energy and Oil Ministry instructed Petróleos de Venezuela S.A. (PDVSA), the Venezuelan government-controlled company created to operate oil and gas reserves with private companies, to review thirty-two operating agreements signed by PDVSA with oil companies from 1992 through 1997. In addition, PDVSA was instructed to take measures in order to convert all effective operating agreements into state-controlled companies in order to grant the Venezuelan government, through PDVSA, more than 50% ownership of each field, including agreements with our affiliates in connection with the areas of Oritupano Leona, La Concepcion, Acema and Mata. As a result, as of December 31, 2005, we recorded an impairment charge in order to adjust the book value of our Venezuelan assets in the amount of U.S.$134 million. In March 31, 2006, we, PDVSA and Corporación Venezolana del Petróleo S.A. (CVP), entered into memoranda of understanding (MOUs) in order to effect the migration of the operating agreements to partially state-owned companies (mixed companies), whereby the interest of PDVSA in each mixed company would be 60% and the interest of private companies like us would be limited to 40%. In August 2006, the final migrating contracts were executed for Oritupano Leona, Mata, Acema and La Concepción, with effective date of April 1, 2006.

All these measures generate significant uncertainty as to the status and prospects of our investment and operations in Bolivia and Venezuela. We cannot estimate the degree to which these nationalization measures will affect us, and believe they may have a material adverse effect on our results of operations and financial condition. See Item 4. Information on the Company¾International¾ Bolivian Activities and Item 4. Information on the Company¾International¾ Venezuelan Activities.

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Risks Relating to PifCo

PifCo s operations and debt servicing capabilities are dependent on us.

PifCo s financial position and results of operations are directly affected by our decisions. PifCo is a direct wholly-owned subsidiary of Petrobras incorporated in the Cayman Islands as an exempted company with limited liability. PifCo has limited operations consisting principally of the purchase of crude oil and oil products from third parties and the resale of those products to us or to third parties. PifCo also buys crude oil and oil products from us, for sale to third parties and affiliates on a limited basis. PifCo s ability to service and repay its indebtedness is consequently dependent on our own operations.

Financing for PifCo s operations is provided by us as well as third-party credit providers in favor of whom we provide credit support. This support to PifCo s debt obligations is made through standby purchase agreements whereby we agree to repurchase from the holders of PifCo s notes their right to receive payment from PifCo in case PifCo defaults payment.

Our own financial condition or results of operations, or our financial support of PifCo directly affect PifCo s operational results and debt servicing capabilities. For a more detailed description of certain risks that may have a material adverse impact on our financial condition or results of operations and therefore affect PifCo s ability to meet its debt obligations see Risks Relating to Our Operations.

PifCo depends on its ability to pass on its financing costs to us.

PifCo is principally engaged in the purchase of crude oil and oil products for sale to us, as described above. PifCo regularly incurs indebtedness related to such purchases and/or in obtaining financing from us or third-party creditors. All such indebtedness has the benefit of our standby purchase obligation or other support, and PifCo has historically has passed on its financing costs to us by selling crude oil and oil products to us at a premium to compensate for its financing costs. If for any reason we are not permitted to continue these practices, this would have a materially adverse effect on PifCo s business and on its ability to meet its debt obligations in the long term.

Risks Relating to the Relationship between us and the Brazilian Government

The Brazilian government, as our controlling shareholder, may cause us to pursue certain macroeconomic and social objectives that may have an adverse effect on our results of operations and financial condition.

The Brazilian government, as our controlling shareholder, has pursued, and may pursue in the future, certain of its macroeconomic and social objectives through us. Brazilian law requires the Brazilian government to own a majority of our voting stock, and so long as it does, the Brazilian government will have the power to elect a majority of the members of our board of directors and, through them, a majority of the executive officers who are responsible for our day-to-day management. As a result, we may engage in activities that give preference to the objectives of the Brazilian government rather than to our own economic and business objectives. In particular, we continue to assist the Brazilian government to ensure that the supply of crude oil and oil products in Brazil meets Brazilian consumption requirements. Accordingly, we may make investments, incur costs and engage in sales on terms that may have an adverse effect on our results of operations and financial condition.

If the Brazilian government reinstates controls over the prices we can charge for crude oil and oil products, such price controls could affect our financial condition and results of operations.

In the past, the Brazilian government set prices for crude oil and oil products in Brazil, occasionally below prices prevailing in the world oil markets. These prices involved elements of cross-subsidy among different oil products sold in various regions in Brazil. The cumulative impact of this price regulation system on us is recorded as an asset on our balance sheet under the line item Petroleum and Alcohol Account Receivable from the Brazilian government. The balance of the account at December 31, 2006 was U.S.$ 368 million. All price controls for crude oil and oil products ended on January 2, 2002, however, the Brazilian government could decide to reinstate price controls in the future as a result of market instability or other conditions. If this were to occur, our financial condition and results of operations could be adversely affected.

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We do not own any of the crude oil and natural gas reserves in Brazil.

A guaranteed source of crude oil and natural gas reserves is essential to an oil and gas company s sustained production and generation of income. Under Brazilian law, the Brazilian government owns all crude oil and natural gas reserves in Brazil and the concessionaire owns the oil and gas it produces. We possess the exclusive right to develop our reserves pursuant to concession agreements awarded to us by the Brazilian government and we own the goods we produce under the concession agreements, but if the Brazilian government were to restrict or prevent us from exploiting these crude oil and natural gas reserves, our ability to generate income would be adversely affected.

Risks Relating to Brazil

The Brazilian government has historically exercised, and continues to exercise, significant influence over the Brazilian economy. Brazilian political and economic conditions have a direct impact on our business and may have a material adverse effect on our results of operations and financial condition.

The Brazilian government s economic policies may have important effects on Brazilian companies, including us, and on market conditions and prices of Brazilian securities. Our financial condition and results of operations may be adversely affected by the following factors and the Brazilian government s response to these factors:

- devaluations and other exchange rate movements;
- inflation;
- exchange control policies;
- social instability;
- price instability;
- energy shortages;
- interest rates;
- liquidity of domestic capital and lending markets;
- tax policy; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

Uncertainty over whether the Brazilian government will implement changes in policy or regulations that may affect these or other factors in the future may lead to economic uncertainty in Brazil and increase the volatility of the Brazilian securities market and securities issued abroad by Brazilian companies.

Inflation and government measures to curb inflation may contribute significantly to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets and, consequently, may adversely affect the market value of our securities and financial condition.

Our principal market is Brazil, which has, in the past, periodically experienced extremely high rates of inflation. Inflation, along with governmental measures to combat inflation and public speculation about possible future measures, has had significant negative effects on the Brazilian economy. The annual rates of inflation, as measured by the National Consumer Price Index (*Índice Nacional de Preços ao Consumidor Amplo*, or IPCA), have decreased from 2,477.15% in 1993 to 916.46% in 1994 and to 5.97% in 2000. The same index increased to 9.30% in 2003, before decreasing to 3.14% in 2006. Considering the historically high rates of inflation, Brazil may experience higher levels of inflation in the future. The lower levels of inflation experienced since 1995 may not continue. Future governmental actions, including actions to adjust the value of the *real*, could trigger increases in inflation, which may adversely affect our financial condition.

Access to international capital markets for Brazilian companies is influenced by the perception of risk in Brazil and other emerging economies, which may hurt our ability to finance our operations and the trading values of our securities.

International investors generally consider Brazil to be an emerging market. As a result, economic and market conditions in other emerging market countries, especially those in Latin America, influence the market for securities issued by Brazilian companies. As a result of economic problems in various emerging market countries in recent years (such as the Asian financial crisis of 1997, the Russian financial crisis in 1998 and the Argentine financial crisis that began in 2001), investors have viewed investments in emerging markets with heightened caution. These crises produced a significant outflow of U.S. dollars from Brazil, causing Brazilian companies to face higher costs for raising funds, both domestically and abroad, and impeding access to international capital markets. Increased volatility in securities markets in Latin American and in other emerging market countries may have a negative impact on the trading value of our securities. We cannot assure you that international capital markets will remain open to Brazilian companies or that prevailing interest rates in these markets will be advantageous to us.

Risks Relating to our Equity and Debt Securities

The size, volatility, liquidity and/or regulation of the Brazilian securities markets may curb your ability to sell the common or preferred shares underlying our ADSs.

Petrobras shares are the most liquid in the São Paulo Stock Exchange (BOVESPA), but overall, the Brazilian securities markets are smaller, more volatile and less liquid than the major securities markets in the United States (and perhaps other jurisdictions), and may be regulated differently from the way in which U.S. investors are accustomed. Factors that may specifically affect the Brazilian equity markets may limit your ability to sell the common or preferred shares underlying our ADSs at the price and time you desire.

The market for PifCo s notes may not be liquid.

Some of PifCo s notes are not listed on any securities exchange and are not quoted through an automated quotation system. We can make no assurance as to the liquidity of or trading markets for PifCo s notes. We cannot guarantee that the holders of PifCo s notes will be able to sell their notes in the future. If a market for PifCo s notes does not develop, holders of PifCo s notes may not be able to resell the notes for an extended period of time, if at all.

You may be unable to exercise preemptive rights with respect to the common or preferred shares underlying the ADSs.

Holders of ADSs who are residents of the United States may not be able to exercise the preemptive rights relating to the common or preferred shares underlying our ADSs unless a registration statement under the U.S. Securities Act of 1933 is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement with respect to the common or preferred shares relating to these preemptive rights, and therefore we may not file any such registration statement. If a registration statement is not filed and an exemption from registration does not exist, JPMorgan Chase Bank, N.A., as depositary, will attempt to sell the preemptive rights, and you will be entitled to receive the proceeds of the sale. However, the preemptive rights will expire if the depositary cannot sell them. For a more complete description of preemptive rights with respect to the common or preferred shares, see Item 10. Additional Information Memorandum and Articles of Association of Petrobras Preemptive Rights.

You may not be able to sell your ADSs at the time or the price you desire because an active or liquid market for our ADSs may not be sustained.

Our preferred ADSs have been listed on the New York Stock Exchange since February 21, 2001, while our common ADSs have been listed on the New York Stock Exchange since August 7, 2000. We cannot predict whether an active liquid public trading market for our ADSs will be sustained on the New York Stock Exchange, where they

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are currently traded. Active, liquid trading markets generally result in lower price volatility and more efficient execution of buy and sell orders for investors. Liquidity of a securities market is often a function of the volume of the underlying shares that are publicly held by unrelated parties. We do not anticipate that a public market for our common or preferred shares will develop in the United States.

Restrictions on the movement of capital out of Brazil may impair your ability to receive dividends and distributions on, and the proceeds of any sale of, the common or preferred shares underlying the ADSs and may impact our ability to service certain debt obligations, including standby purchase agreements we have entered into in support of PifCo s notes.

The Brazilian government may impose temporary restrictions on the conversion of Brazilian currency into foreign currencies and on the remittance to foreign investors of proceeds from their investments in Brazil. Brazilian law permits the Brazilian government to impose these restrictions whenever there is a serious imbalance in Brazil s balance of payments or there are reasons to foresee a serious imbalance.

The Brazilian government imposed remittance restrictions for approximately six months in 1990. Similar restrictions, if imposed, could impair or prevent the conversion of dividends, distributions, or the proceeds from any sale of common or preferred shares from *reais* into U.S. dollars and the remittance of the U.S. dollars abroad. The Brazilian government could decide to take similar measures in the future. In such a case, the depositary for the ADSs will hold the *reais* it cannot convert for the account of the ADS holders who have not been paid. The depositary will not invest the *reais* and will not be liable for the interest.

In addition, if the Brazilian government were to impose restrictions on our ability to convert *reais* into U.S. dollars, we would not be able to make payment on our dollar-denominated debt obligations. For example, any such restrictions could prevent us from making funds available to PifCo, for payment of its debt obligations, certain of which are supported by us through standby purchase agreements.

If you exchange your ADSs for common or preferred shares, you risk losing the ability to remit foreign currency abroad and forfeiting Brazilian tax advantages.

The Brazilian custodian for our common or preferred shares underlying our ADSs must obtain a certificate of registration from the Central Bank of Brazil to be entitled to remit U.S. dollars abroad for payments of dividends and other distributions relating to our preferred and common shares or upon the disposition of the common or preferred shares. If you decide to exchange your ADSs for the underlying common or preferred shares, you will be entitled to continue to rely, for five Brazilian business days from the date of exchange, on the custodian s certificate of registration. After that period, you may not be able to obtain and remit U.S. dollars abroad upon the disposition of the common or preferred shares, or distributions relating to the common or preferred shares, unless you obtain your own certificate of registration or register under Resolution No. 2,689, of January 26, 2000, of the *Conselho Monetário Nacional* (National Monetary Council), which entitles registered foreign investors to buy and sell on the São Paulo Stock Exchange. In addition, if you do not obtain a certificate of registration or register under Resolution No. 2,689, you may be subject to less favorable tax treatment on gains with respect to the common or preferred shares.

If you attempt to obtain your own certificate of registration, you may incur expenses or suffer delays in the application process, which could delay your ability to receive dividends or distributions relating to the common or preferred shares or the return of your capital in a timely manner. The custodian s certificate of registration or any foreign capital registration obtained by you may be affected by future legislative or regulatory changes and we cannot assure you that additional restrictions applicable to you, the disposition of the underlying common or preferred shares, or the repatriation of the proceeds from the process will not be imposed in the future.

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You may face difficulties in protecting your interests as a shareholder because we are subject to different corporate rules and regulations as a Brazilian company and because holders of our common shares, preferred shares and ADSs have fewer and less well-defined shareholders rights than those traditionally enjoyed by The United States shareholders.

Our corporate affairs are governed by our bylaws and the Brazilian Corporate Law, which differ from the legal principles that would apply if we were incorporated in a jurisdiction in the United States, such as the States of Delaware or New York, or in other jurisdictions outside Brazil. In addition, your rights as an ADS holder, which are derivative of the rights of holders of our common or preferred shares, as the case may be, to protect your interests against actions by our board of directors may be fewer and less well-defined under Brazilian Corporate Law than those under the laws of other jurisdictions.

Although insider trading and price manipulation are considered crimes under Brazilian law, the Brazilian securities markets are not as highly regulated and supervised as the U.S. securities markets or markets in some other jurisdictions. In addition, rules and policies against self-dealing and the preservation of shareholder interests may be less well-defined and enforced in Brazil than in the United States, putting holders of our common shares, preferred shares and ADSs at a potential disadvantage. Corporate disclosure may be less complete or informative than what may be expected of a U.S. public company.

We are a state-controlled company organized under the laws of Brazil and all of our directors and officers reside in Brazil. Substantially all of our assets and those of our directors and officers are located in Brazil. As a result, it may not be possible for you to effect service of process upon us or our directors and officers within the United States or other jurisdictions outside Brazil or to enforce against us or our directors and officers judgments obtained in the United States or other jurisdictions outside Brazil. Because judgments of U.S. courts for civil liabilities based upon the U.S. federal securities laws may only be enforced in Brazil if certain requirements are met, you may face greater difficulties in protecting your interest in actions against us or our directors and officers than would shareholders of a corporation incorporated in a state or other jurisdiction of the United States.

Preferred shares and the ADSs representing preferred shares generally do not give you voting rights.

A portion of our ADSs represent our preferred shares. Under Brazilian law and our bylaws, holders of preferred shares generally do not have the right to vote in meetings of our stockholders. This means, among other things, that holders of ADSs representing preferred shares are not entitled to vote on important corporate transactions or decisions. See Item 10. Additional Information Memorandum and Articles of Incorporation of Petrobras Voting Rights for a discussion of the limited voting rights of our preferred shares.

Enforcement of our obligations under the standby purchase agreement might take longer than expected.

We have entered into a standby purchase agreement in support of PifCo s obligations under its notes and indentures. Our obligation to purchase from the PifCo noteholders any unpaid amounts of principal, interest and other amounts due under the PifCo notes and the indenture applies, subject to certain limitations, irrespective of whether any such amounts are due at the maturity of the PifCo notes or otherwise. See Additional Information PifCo Senior Notes Standby Purchase Agreements and Additional Information PifCo Global Notes Standby Purchase Agreements.

We have been advised by our counsel that the enforcement of the standby purchase agreement in Brazil against us, if necessary, will occur under a form of judicial process that, while similar, has certain procedural differences from those applicable to enforcement of a guarantee and, as a result, the enforcement of the standby purchase agreement may take longer than would otherwise be the case with a guarantee.

If Brazilian law restricts us from paying PifCo in U.S. dollars, PifCo may have insufficient U.S. dollar funds to make payments on its debt obligations and we may not be able to pay our obligations under the standby purchase agreement in U.S. Dollars.

Currently, payments by us to PifCo for the import of oil, the expected source of PifCo s cash resources to pay its obligations under the PifCo notes, will not require approval by or registration with the Central Bank of

Brazil. There may be other regulatory requirements that we will need to comply with in order to make funds available to PifCo. Nonetheless, Central Bank of Brazil may impose prior approval requirements on the remittance of U.S. dollars abroad. If Brazilian law were to impose restrictions, limitations or prohibitions on our ability to convert *reais* into U.S. dollars, PifCo may not have sufficient U.S. dollar funds available to make payment on its debt obligations.

In the case that the PifCo noteholders receive payments in *reais* corresponding to the equivalent U.S. Dollar amounts due under PifCo s notes, it may not be possible to convert these amounts into U.S. Dollars. We will not need any prior or subsequent approval from the Central Bank of Brazil to use funds we hold abroad to comply with our obligations under the standby purchase agreement.

***We would be required to pay judgments of Brazilian courts enforcing our obligations under the standby purchase agreement only in* reais**

If proceedings were brought in Brazil seeking to enforce our obligations in respect of the standby purchase agreement, we would be required to discharge our obligations only in *reais*. Under the Brazilian exchange control limitations, an obligation to pay amounts denominated in a currency other than *reais*, which is payable in Brazil pursuant to a decision of a Brazilian court, may be satisfied in *reais* at the rate of exchange, as determined by the Central Bank of Brazil, in effect on the date of payment.

A finding that we are subject to U.S. bankruptcy laws and that the standby purchase agreement executed by us was a fraudulent conveyance could result in PifCo noteholders losing their legal claim against us.

PifCo s obligation to make payments on the PifCo notes is supported by our obligation under the standby purchase agreement to make payments on PifCo s behalf. We have been advised by our external U.S. counsel that the standby purchase agreement is valid and enforceable in accordance with the laws of the State of New York and the United States. In addition, we have been advised by our general counsel that the laws of Brazil do not prevent the standby purchase agreement from being valid, binding and enforceable against us in accordance with its terms. In the event that U.S. federal fraudulent conveyance or similar laws are applied to the standby purchase agreement, and we, at the time we entered into the standby purchase agreement:

- were or are insolvent or rendered insolvent by reason of our entry into the standby purchase agreement;
- were or are engaged in business or transactions for which the assets remaining with us constituted unreasonably small capital; or
- intended to incur or incurred, or believed or believe that we would incur, debts beyond our ability to pay such debts as they mature; and
- in each case, intended to receive or received less than reasonably equivalent value or fair consideration therefor,

then our obligations under the standby purchase agreement could be avoided, or claims with respect to the standby purchase agreement could be subordinated to the claims of other creditors. Among other things, a legal challenge to the standby purchase agreement on fraudulent conveyance grounds may focus on the benefits, if any, realized by us as a result of PifCo s issuance of these notes. To the extent that the standby purchase agreement is held to be a fraudulent conveyance or unenforceable for any other reason, the holders of the PifCo notes would not have a claim against us under the standby purchase agreement and will solely have a claim against PifCo. We cannot assure you that, after providing for all prior claims, there will be sufficient assets to satisfy the claims of the PifCo noteholders relating to any avoided portion of the standby purchase agreement.

ITEM 4. INFORMATION ON THE COMPANY

History and Development of Petrobras

We are a state-controlled company created pursuant to Law No. 2,004 (effective as of October 3, 1953). A state-controlled company is a Brazilian corporation created by special law, of which a majority of the voting capital must be owned by the Brazilian federal government, a state or a municipality. We are controlled by the Brazilian federal government, but our common and preferred shares are also publicly traded. Our principal executive office is located at Avenida República do Chile, 65, 20031-912 Rio de Janeiro RJ, Brazil and our telephone number is (55-21) 3224-4477.

We were incorporated in 1953 and began operations in Brazil in 1954 as a wholly-owned governmental enterprise responsible for implementing the government s hydrocarbon activities in Brazil. Since our foundation, our legal name has been Petróleo Brasileiro S.A. PETROBRAS. From that time until 1995, we carried out all crude oil and natural gas production and refining activities in Brazil in the name of the government. On November 9, 1995, the Brazilian Constitution was amended to authorize the Brazilian government to contract with any state or privately owned company to carry out the activities related to the upstream and downstream segments of the Brazilian oil and gas sector. This amendment made possible the deregulation of the sector in 1988.

The crude oil and natural gas industry in Brazil has experienced significant reforms since the enactment of Law No. 9,478, or the Oil Law, on August 6, 1997, which established competition in Brazilian markets for crude oil, oil products and natural gas. Effective January 2, 2002, the Brazilian government deregulated prices for crude oil and oil products. See Regulation of the Oil and Gas Industry in Brazil Price Regulation. The gradual transformation of the oil and gas industry since 1997 has led to increased participation by international companies in Brazil across all segments of our business, both as our competitors and as our partners.

Based upon our 2006 consolidated revenues, we are the largest corporation in Brazil and one of the largest oil and gas companies in Latin America. In 2006, we had sales of products and services of U.S.$93,893 million, net operating revenues of U.S.$72,347 million and net income of U.S.$12,826 million.

We engage in a broad range of oil and gas activities, which cover the following segments of our operations:

Exploration and Production Our exploration and production segment encompasses exploration, development and production activities in Brazil.

Supply Our supply segment encompasses refining, logistics, transportation, exportation and the purchase of crude oil, as well as the purchase and sale of oil products and fuel alcohol. In addition, this segment includes the petrochemical and fertilizers division, which includes investments in domestic petrochemical companies and our two domestic fertilizer plants.

Distribution Our distribution segment represents the oil product and fuel alcohol distribution activities conducted by our wholly owned subsidiary, Petrobras Distribuidora S.A. BR in Brazil.

Gas and Power Our gas and power segment encompasses the purchase, sale, transportation and distribution of natural gas produced in or imported into Brazil. In addition, this segment includes our participation in domestic electricity production, including investments in domestic natural gas transportation companies, state owned natural gas distributors and gas-fired power companies.

International Our international segment encompasses Exploration and Production, Supply, Distribution and Gas and Power activities conducted in the following countries: Argentina, Angola, Bolivia, Colombia, Ecuador, Equatorial Guinea, Iran, Libya, Mexico, Mozambique, Nigeria, Paraguay, Peru, the United States, Tanzania, Turkey, Uruguay and Venezuela.

Corporate Our corporate segment includes the financial results and those activities not attributable to other segments, including corporate financial management, overhead related to central administration and other expenses, which include actuarial expenses related to our pension and health care plans for non-active participants.

As a foreign private issuer, we are exempt from many of the corporate governance standards the New York Stock Exchange, or NYSE, applies to U.S. domestic issuers listed on the NYSE. In accordance with Section 303A.11 of the NYSE Listed Company Manual, we have posted a summary of significant differences between the NYSE standards and our corporate governance practice on our website, www.petrobras.com.br.

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Competitive Strengths

Dominant market position in the production, refining and transportation of crude oil, natural gas and oil products in Brazil

Our legacy as Brazil s former sole supplier of crude oil and oil products has provided us with a fully developed operational infrastructure throughout Brazil and a large proved reserve base. Our long history, resources and established presence in Brazil permit us to compete effectively with other market participants and new entrants now that the Brazilian oil and gas industry has been deregulated. We operate most of the development fields in Brazil and substantially all of the country s refining capacity. Our average domestic daily production of crude oil and NGLs increased 5.6% in 2006, increased 12.8% in 2005, and decreased 3.1% in 2004.

Strong reserve base

As of December 31, 2006, we had estimated proved developed and undeveloped crude oil and natural gas reserves of approximately 11.458 billion barrels of oil equivalent in Brazil and abroad, including proportional reserves related to unconsolidated companies in Venezuela in the volume of 78.6 million barrels of oil equivalent. In addition, we have a substantial base of exploration acreage both in Brazil and abroad, which we are exploring by ourselves and with industry partners in order to continue to increase our reserves.

As of December 31, 2006, our worldwide proved reserves to production ratio was 14.5 years.

The majority of our reserves, including recent discoveries, are located in deepwater areas that generally require additional planning, more comprehensive evaluation and added lead time to begin production when compared to onshore production. In accordance with our Business Plan for the period from 2007 to 2011, we have been investing the necessary capital to build the offshore platforms needed to derive income from these reserves. Although our proved reserve life is higher than the industry average, the additional planning required to bring deepwater areas into production also means that our percentage of proved undeveloped reserves may be higher than the industry average.

We believe that our proved reserves will provide us with significant opportunities for sustaining and increasing production growth.

Upstream and downstream technological expertise and international recognition for production and exploration in deep and ultra-deep waters

While developing Brazil s offshore basins over the past 37 years, we have gained expertise in deepwater drilling, development and production techniques and technologies. We are currently in the process of developing technology to permit production from wells at water depths of up to 9,843 feet (3,000 meters).

Our deepwater development and production expertise has allowed us to achieve high production volumes and relatively low lifting costs (excluding royalties, special government participation and rental of areas, which we refer to as government take). Our aggregate average lifting cost for crude oil and natural gas products in Brazil for 2006, excluding government take, increased to U.S.$ 6.59 per barrel of oil equivalent, as compared to U.S.$5.73 per barrel of oil equivalent for 2005. Government take, increased to U.S.$ 11.05 per barrel of oil equivalent for 2006, as compared to U.S.$9.00 per barrel of oil equivalent for 2005. The international price of oil is one of the factors in determining the government take.

Cost efficiencies created by large-scale operations combined with vertical integration among business

As the dominant integrated crude oil and natural gas company in Brazil, we can be cost efficient as a result of:

- the location of over 81% of our proved reserves in large, contiguous and highly productive fields in the offshore Campos Basin, which allows for the concentration of our operational infrastructure, thereby reducing our total costs of exploration, development and production;

- the location of most of our refining capacity in the Southeast region, directly adjacent to the Campos Basin and situated within the country s most heavily populated and industrialized markets; and

- the relative balance between our domestic production of 1,778 Mbpd, our refining throughput of 1,746 Mbpd and our sales to the Brazilian market for hydrocarbon products of 1,697 Mbpd.

We believe that these cost efficiencies created by our integration, our existing infrastructure and our balance allow us to compete effectively with other Brazilian producers and importers of oil products into the Brazilian market.

Strong position in Brazil s growing natural gas markets

We participate in most aspects of the Brazilian natural gas market, but our ability to meet potential demand has been limited by constraints in supply, transportation and distribution infrastructure, which is still under development. The output from gas-fired power plants was lower than in 2005, and as a consequence, the demand for natural gas in Brazil increased only 2.5% in 2006, despite the 9.8% growth in the non-thermoelectric market (mainly in the industrial and vehicular segments) as compared to 11% in 2005. Nonetheless, we still expect a significant growth due to new gas transportation pipelines that will start operations.

Because of the diversity of our natural gas operations, we believe that we are well positioned to take advantage of the opportunity to meet potentially growing energy needs in Brazil through the use of natural gas. We intend to do so through:

- increasing the internal production of both associated and non-associated gas, mainly offshore in the Espírito Santo, Campos and Santos Basins;

- expanding of the natural gas transportation network throughout Brazil;

- prioritizing the acceleration of investment projects in anticipation of the natural gas supply in the southeast region of Brazil;

- increasing participation in the natural gas distribution market through investments in 19 of the 25 natural gas distribution companies in Brazil;

- investments in gas-fired power plants, which serve as sources of demand for our natural gas; and

- seeking greater operational flexibility in our sources, including two LNG projects in the northeastern and southeastern regions, to improve our energy demand management.

Success in attracting international partners in all our activities

As a result of our experience, expertise and extensive infrastructure network in Brazil, we have attracted partners in our exploration, development, refining and power activities such as Repsol-YPF, ExxonMobil, Shell, Chevron, Statoil and Total. Partnering with other companies allows us to share risks, capital commitments and technology in our continuing development and expansion.

We may face significant risks in our ability to take full advantage of these competitive strengths. See Item 3. Key Information Risk Factors.

Strategy

We intend to continue to expand our oil and gas exploration and production activities and pursue strategic investments within and outside of Brazil to further develop our business. We seek to evolve from a dominant integrated oil and gas company in Brazil into an energy industry leader in Latin America and a significant international energy company. In line with our Strategic Plan and to further these goals, we intend to:

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Consolidate and increase competitive advantages in the Brazilian and South American oil and oil products market

Our 2007-2011 Business Plan contemplates capital expenditures of approximately U.S.$40.7 billion in exploration and development activities in Brazil. Through these investments, we plan to implement 15 large-scope projects, among others, aimed at increasing production to 2.374 million bpd by 2011. Our 2007-2011 Business Plan contemplates capital expenditures of approximately U.S.$8.5 billion in exploration and development activities outside of Brazil. These investments will be primarily exploration and development activities in South America. At December 2006, we had exploration, development and production rights in 89.87 million gross and 46.84 million net acres (363,700 gross and 189,500 net square kilometers) outside Brazil.

At the same time that we seek to expand production, we intend to increase proved reserves, focused on deepwater exploration in Brazil. We have net exploration, development and production rights in 33.8 million acres (136,772 square kilometers) in Brazil. We expect to continue to participate selectively with major regional and international oil and gas companies in bidding for new concessions and in developing large offshore fields.

Our domestic production in 2006 supplied approximately 80% of the crude oil feedstock for our refinery operations in Brazil, the same level as in 2005 and 76% in 2004. We expect an increasing percentage of the crude oil feedstock to be supplied by our domestic production, as investments in our refineries permit. Our refineries were originally designed to process light imported crude oil, whereas our current reserves and production increasingly consist of heavier crude oil. We are in the process of improving and adapting our refineries in order to better process our domestic production of heavier crude oil. Because our domestic refining capacity constitutes 98.4% of the Brazilian refining capacity, we supply almost all of the refined product needs of third-party wholesalers, exporters and petrochemical companies, in addition to satisfying our internal consumption requirements with respect to wholesale marketing operations and petrochemical feedstock.

Selectively expand international activities in an integrated manner with our business

In the short term, we expect to expand internationally by using our existing asset base or participating in selective partnerships in core activities where we have a competitive advantage. We consider our core activities to be integrated oil and gas operations throughout South America and deepwater exploration and development off the U.S. Gulf Coast, Colombia and West Africa. We also have exploration interests in Angola, Argentina, Bolivia, Colombia, Ecuador, Peru, Mozambique, Nigeria, Equatorial Guinea, Iran, the Gulf of Mexico, Tanzania, Turkey and Libya.

Develop and lead the domestic natural gas market and act in an integrated manner in the gas and power market in South America

Through our participation in all segments of the natural gas market, both in Brazil and abroad, we seek to meet domestic natural gas demand. We intend to continue to expand our participation in the natural gas market by:

- developing the natural gas industry in an integrated manner with other areas of the Company in the production and consumption chain; and

- taking advantage of opportunities in the power industry in an integrated manner with other natural gas market areas in which our Company already operates.

As a result of our investments and the growing importance of natural gas as a cleaner energy alternative, we anticipate that the proportion of revenues and assets represented by natural gas operations will increase, leading to a greater impact of these activities on our results of operations.

Selectively expand our activities in the petrochemicals market

We intend to expand activities in the petrochemical and fertilizer markets by seeking strategic partnerships and creating synergies with our existing business. Our 2007-2011 Business Plan contemplates investments of approximately U.S.$3.2 billion in petrochemical business. Such investment will be aimed at increasing production of our basic petrochemicals, including polyolefins (polyethylene and polypropylene), acrylic acid and terephtalic acid. We believe that the growth of petrochemical activities will generate synergies with refining activities and we intend to benefit from the expected growth in the petrochemical market in Brazil.

Selectively perform in the renewable energy market

We intend to develop renewable energy alternatives in Brazil. Our priorities for investments in renewable sources of energy are:

- The diesel from the HBIO process. The HBIO technology has been developed by the Petrobras research and development facility as one of the projects of the Petrobras refining technology program. This process involves a catalytic hydroconversion of mixtures of diesel fractions and vegetable oil in an HDT reactor under controlled conditions of high temperature and hydrogen pressure. The triglycerides from vegetable oil are transformed into linear hydrocarbon chains, similar to those that already exist in the diesel coming from petroleum but, without residue generation and with a small propane production; and

- biomass energy.

Overview by Business Segment

Exploration, Development and Production

Summary and Strategy

Our exploration and production segment includes exploration, development and production activities in Brazil and abroad. We began domestic production in 1954 and international production in 1972. As of December 31, 2006, our estimated net proved crude oil and natural gas reserves in Brazil were approximately 10.573 billion barrels of oil equivalent. Crude oil represented 85% and natural gas represented 15% of these reserves. Our proved reserves are located principally in the Campos Basin.

During 2006, our average daily domestic production was 1,778 Mbpd of crude oil and NGLs and 1.660 billion cubic feet of natural gas per day. Our aggregate average lifting costs for crude oil and natural gas in 2006 were U.S.$6.59 per barrel of oil equivalent in Brazil (excluding government take).

We conduct exploration, development and production activities in Brazil through concession contracts. Under the terms of the Oil Law, in 1998 we were granted the concession rights to areas where we were already producing or could demonstrate we could explore or develop within a certain time frame. We refer to these concessions as Round Zero. In a number of concessions, we have joint ventures with foreign partners to explore and develop the concessions. In conjunction with the majority of these arrangements, we received a carried interest for capital expenditures made during the exploration phase, with our partners incurring all capital expenditures until the development of a commercial discovery commences. Since then, we have participated in all the bid rounds for new concession areas in Brazil conducted by the *Agência Nacional de Petróleo* (the National Petroleum Agency, or the ANP).

At December 31, 2006, we held 459 areas, representing 33,796 thousand net acres (136,772 square kilometers). We currently have joint venture agreements for exploration and production in Brazil with 25 foreign and domestic companies. We are also active in exploration and production activities outside Brazil. For a full description of our international activities, see International Exploration and Production.

Our main strategies in exploration, development and production in Brazil are to increase production and reserves by:

- Strengthen our position in deep and ultra-deepwater drilling and operating;

- Operate both onshore and in shallow waters, focusing on profitable opportunities;

- Implement new practices and technologies in order to increase reserve recovery;

Increase exploration and development efforts in new territories to maintain a sustainable reserves to production ratio;

Assure long-term Brazilian self-sufficiency in oil, with production reaching approximately 20% above domestic consumption by 2015;

Optimize the development of our existing proved reserves, especially by expanding light oil production; and

Accelerate the production and supply of natural gas.

Principal Domestic Oil and Gas Producing Regions

Our annual daily production in Brazil has consistently grown over the years. In 1970, we produced 164 Mbpd of crude oil, condensate and natural gas liquids in Brazil. We increased production to 181 Mbpd in 1980, 654 Mbpd in 1990, 1,271 Mbpd in 2000 and 1,778 Mbpd in 2006. In describing our oil and gas producing regions, reservoirs refer to underground formations containing producible oil or gas. Fields are areas that contain one or more reservoirs. Blocks are sections of a sedimentary basin where we carry out oil and gas exploration and production activities under concession contracts.

Our main domestic oil and gas producing regions are:

Campos Basin

The Campos Basin is the largest oil and gas producing region, and covers approximately 28.4 million acres (115 thousand square kilometers). Since exploration activities in this area began in 1968, over 60 hydrocarbon accumulations have been discovered in this region, including eight large oil fields in deepwater and ultra deepwater. We currently have exploration rights to 32 blocks in this Basin, which are grouped into 13 block contracts, with an exploration acreage of 11.1 thousand square kilometers. In terms of proved hydrocarbon reserves and annual production, the Campos Basin is the largest oil basin in Brazil and one of the most prolific oil and gas areas in South America. The annual crude oil production volume in the region increased steadily for the past ten years until 2004, when oil production in the Campos Basin decreased to 1,204 Mbpd from 1,252 Mbpd in 2003. In 2005, oil production in the Campos Basin increased to 1,405 Mbpd and in 2006, increased to 1,468 Mbpd. The Campos Basin s oil production accounted for approximately 83% of Brazilian oil production in 2006.

At December 31, 2006, we produced crude oil from 36 fields in the Campos Basin and its proved crude oil reserves were 7.85 billion barrels, representing 87.3% of our total proved crude oil reserves. In 2006, the crude oil we produced in the Campos Basin had an average API gravity of 23.2 and an average water cut of 1%. We currently have 29 floating production systems, 14 fixed platforms and 4,969 kilometers of pipeline and flexible pipes operating in 36 fields at water depths from 262 to 6,188 feet (80 to 1,886 meters) in the Campos Basin.

Espírito Santo Basin

We have made several discoveries of light oil and natural gas in the Espírito Santo Basin. We currently have exploration rights to 48 blocks in this Basin, which are grouped into 23 block contracts, 13 onshore and 10 offshore, with an exploration acreage of 9.9 thousand square kilometers. During 2006, we produced 77.3 Mboe per day of oil and natural gas in the Espírito Santo Basin (19.7 Mboe onshore and 57.6 Mboe offshore). On February 21, 2006, we began gas production in the Peroá Field.

Santos Basin

The Santos Basin represents one of the most promising exploration areas. In January of 2006, we approved the Master Plan for Development of Natural Gas and Oil Production in the Santos Basin, with a base of exploration and production in the city of Santos, in the state of São Paulo. We currently have exploration rights to 55 blocks in the Santos Basin, which are grouped into 32 block contracts, with an exploration acreage of 41.2 thousand square kilometers. Current production of oil and natural gas is 9.24 Mboe per day in the Coral and Merluza fields.

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Properties

The following table sets forth our developed and undeveloped gross and net acreage by oil region and associated crude oil and natural gas production:

	Production Acreage as of December 31, 2006				Average Oil and Natural Gas Production for the Year Ended December 31,	Average Oil and Natural Gas Production for the Year Ended December 31,
	Developed		**Undeveloped**		**2006(1)(4)**	**2005(1)(4)**
	Gross(2)	**Net(2)**	**Gross(2)**	**Net(2)**		
	(in acres)				**(boe per day) (3)**	
Brazil(1)						
Offshore						
Campos Basin	1,706,226	1,587,370	399,808	388,441	1,594,820	1,530,147
Other offshore	310,358	280,459	690,892	665,193	120,147	64,510
Total offshore	2,016,583	1,867,829	1,090,700	1,053,634	1,714,967	1,594,657
Onshore	1,019,781	1,019,782	138,129	138,129	339,327	363,203
Total Brazil	3,036,364	2,887,611	1,228,829	1,191,763	2,054,294	1,957,860
International						
Onshore	3,634,675	2,334,637	2,306,486	1,507,738	233,915	245,828
Offshore	113,457	31,893	332,816	68,185	9,377	12,909
Total International	3,748,132	2,366,530	2,639,302	1,575,923	243,292	258,737
Total	6,784,496	5,254,141	3,868,131	2,767,686	2,297,586	2,216,597

(1) Over 77% of our production of natural gas was associated gas in 2006 and 2005.

(2) A gross acre is an acre in which a working interest is owned. The number of gross acres is the total number of acres in which a working interest is owned. A net acre is deemed

to exist when the sum of fractional ownership working interests in gross acres equals one. The number of net acres is the sum of the fractional working interests owned in gross acres expressed as whole numbers and fractions thereof.

(3) See Conversion Table for the ratios used to convert cubic feet of natural gas to barrels of oil equivalent.

(4) Includes production from shale oil reserves, natural gas liquids and reinjected gas volumes, which are not included in our proved reserves figures.

The following table sets forth our total gross and net productive wells as of December 31, 2006:

	Productive Wells		
	Oil	**Gas**	**Total**
Gross productive wells			
Brazil	9,058	484	9,542
International	5,873	354	6,227
Total	14,931	838	15,769
Net productive wells			
Brazil	9,046	484	9,530
International	4,237	236	4,473
Total	13,283	720	14,003

Productive wells are those producing or capable of production. A gross well is one in which a working interest is owned. The number of gross wells is the total number of wells in which a working interest is owned. A net well is deemed to exist when the sum of fractional ownership working interests in gross wells equals one. The number of net wells is the sum of the fractional working interests owned in gross wells expressed as whole numbers and fractions thereof.

Deepwater Expertise

We are the leading company in deepwater drilling, with recognized expertise in deepwater exploration, development and production. We have developed expertise over many years and have achieved significant milestones, including the following:

- in January 2003, we drilled the world s second horizontal deepwater multilateral well in the Barracuda-Caratinga field, in Campos Basin, at an water depth of 2,999 feet (914 meters), consisting of two legs for each well;

- on December 31, 2006, we were operating 62 wells at water depths in excess of 3,281 feet (1,000 meters); and

- by December 31, 2006, we had drilled 565 wells at water depths in excess of 3,281 feet (1,000 meters), the deepest well being an exploration well in a water depth of 9,360 feet (2,853 meters).

Because many of Brazil s richest oil fields are located offshore in deep waters, we intend to continue to focus on deepwater production technology to increase our proved reserves and future domestic production. See Item 5. Operating and Financial Review and Prospects Research and Development. Our main exploration and development efforts focus on offshore fields neighboring existing fields and production infrastructure, where higher drilling costs have been offset by higher drilling success ratios and relatively higher production. On a per-well basis, the exploration, development and production costs offshore are generally higher than those onshore. We believe, however, that offshore production is cost-effective, because historically:

- we have been more successful in finding and developing crude oil offshore, as a result of the existence of a larger number and size of oil reservoirs offshore as compared to onshore reservoirs and a greater volume of offshore seismic data collected; and

- we have been able to spread the total costs of exploration, development and production over a large base, given the size and productivity of our offshore reserves. Offshore production has exceeded onshore production by a per barrel production ratio of 6.94:1 in 2006, 5.92:1 in 2005 and 4.96:1 in 2004.

We currently extract hydrocarbons from offshore wells in waters with depths of up to 6,188 feet (1,886 meters), and we have been developing technology to permit production from wells at water depths of up to 9,843 feet (3,000 meters). Set forth below is the distribution, by water depth, of offshore oil production in 2006 and 2005.

OFFSHORE PRODUCTION BY WATER DEPTH

Depth	Percentage in 2006	Percentage in 2005
0-400 meters (0-1,312 feet)	17%	18%
400-1,000 meters (1,312 feet-3,281 feet)	52%	56%
More than 1,000 meters (3,281 feet)	31%	26%

Exploration Activities

Concessions in Brazil

We acquired the right to exploit all exploration, development and production areas in Brazil as a result of the monopoly granted to us by Brazilian Law. When regulatory changes in the Brazilian oil and gas sector began in 1998, our monopoly ended. On August 6, 1998, we signed concession contracts with the ANP for all of the areas we had been using prior to 1998. Those concession contracts covered 397 areas, consisting of 231 production areas, 115 exploration areas and 51 development areas, for a total aggregate area of 113.3 million gross acres (458.5 thousand square kilometers).

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As of December 31, 2006, we had 459 areas, consisting of 247 production areas, 154 exploration areas and 58 development areas, for a total aggregate area of 42.0 million gross acres (170.1 thousand square kilometers). This total area represents 2.7% of the Brazilian sedimentary basins.

Recent discoveries

The exploration highlight of the year was the light oil and natural gas discovery made in the pre-salt section in the ultra-deep waters of the Santos Basin.

In 2006, we declared the commercial feasibility of 27 new oil and gas accumulations 18 offshore and 9 onshore. Some of these areas were classified as new oil and natural gas fields; others were incorporated to adjacent oil and gas fields. Of the 27 areas, 18 are located offshore in the Campos (10), Santos (4) and Espírito Santo (4) basins; and 9 are located in the onshore coastal basins of Potiguar (4), Reconcavo (1) and Espírito Santo (3), and in the Paleozoic Solimões basin (1).

In the Santos Basin, 3 areas operated exclusively by Petrobras were declared commercial and transformed into the oil and natural gas fields of Tambuatá, Pirapitanga and Carapiá. Another area was incorporated into the Mexilhão gas field ring-fence. We also hold a 40% working interests in 2 other areas declared commercial by Shell, as operator, in the northern Santos Basin.

After the commerciality declarations, we consider the light oil and natural gas discovery made in the pre-salt section in the ultra-deep waters of the Santos Basin to be the most important news of the year. In order to reach the light oil and natural gas reservoirs, more than 2,000 meters of salt layers were drilled at a depth of more than 2,000 meters. This discovery is promising for the exploration of the pre-salt section in the deep and ultra-deep waters of the Santos Basin, as well as in the deep and ultra-deep waters of other basins in the Brazilian Margin.

In the offshore Espírito Santo Basin, 2 new fields, the Carapó and Camarupim, were defined, and 2 other areas were incorporated to the ring-fences of the Golfinho and Canapu fields. Onshore, 3 new oilfields were defined: the Saira, Seriema and Tabuiaiá fields.

The declarations of commercial feasibility in the Campos Basin include 10 new areas. Seven of them were classified as the new fields of Maromba, Carataí, Carapicu, Catuá, Caxaréu, Mangangá and Pirambú. Three other were incorporated to the existing ring-fences of the Marlim Leste, Viola and Baleia Azul fields. Another important discovery was made inside the limits of the ring-fence of the Roncador field, in deeper reservoirs than the reservoirs that generally produce such volumes.

Five other declarations of commercial feasibility were made in the north-northeastern onshore basins. Four of them originated the new fields of Tangará (Reconcavo Basin) and Pintassilgo, Patativa and Jaçanã (Potiguar Basin). Another area was incorporated into the ring-fence of the Baixa do Juazeiro Field, and in the Paleozoic Solimões Basin (in the field of Araracanga) was declared commercial.

We had a 48.7% success ratio for our exploration wells during 2006, with 39 wells out of 80 exploratory wells classified as discovery or producing wells.

Auctions of exploration rights

Since 1999, ANP has conducted auctions of exploration rights, which are open to us and qualified companies. We have competed in the public auctions, acquiring a large number of exploration rights, as detailed in the table below. We have also relinquished a considerable number of the exploratory areas in which we were not interested or successful in exploring.

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The following chart summarizes our success in the exploration bidding rounds conducted by the ANP during the last three years:

Event	Exploration	Development	Production	Total
Areas held (December 31, 2003)	54	35	234	323
Areas won on Bid, Round 6	36	0	0	36
Areas obtained through acquisitions (BT-REC-4, BT-POT-9, BT-ES-4, BM-C-14, BM-S-14 and BM-S-22)	6	0	0	6
Joint concession SMI to PJ (4)	0	0	(1)	(1)
New concession (January 15, 2004) (Baleia Franca)	0	1	0	1
New concession (January 15, 2004) (Golfinho)	0	1	0	1
New concession (January 15, 2004) (Mexilhão)	0	1	0	1
New concession (January 19, 2004) (Azulão)	0	1	0	1
New concession (January 19, 2004) (Japim)	0	1	0	1
New concession (August 30, 2004) (Piranema)	0	1	0	1
New concession (December 20, 2004) (Baleia Anã)	0	1	0	1
New concession (December 20, 2004) (Baleia Azul)	0	1	0	1
New concession (December 20, 2004) (Baleia Bicuda)	0	1	0	1
New concession (December 22, 2004) (Salema Branca)	0	1	0	1
Areas held (December 31, 2004)	96	45	233	374
Areas won on Bid, Round 7	39	0	0	39
Areas relinquished (until December 31, 2005) (BM-FZA-1)	(1)	0	0	(1)
New concession (February 1, 2005) (Jandaia)	0	1	0	1
New concession (April 4, 2005) (Anambé)	0	1	0	1
New concession (July 14, 2005) (Acauã)	0	1	0	1
New concession (November 24, 2005) (Inhambu)	0	1	0	1
New concession (December 27, 2005) (Papa-Terra)	0	1	0	1
New concession (December 29, 2005) (Uruguá)	0	1	0	1
New concession (December 29, 2005) (Tambaú)	0	1	0	1
New concession (December 29, 2005) (Canapú)	0	1	0	1
Areas redefined (January 17, 2005) (Rio Joanes)	0	(1)	1	0
Areas redefined (February 1, 2005) (Fazenda Sori)	0	(1)	1	0
Areas redefined (February 25, 2005) (Camaçari)	0	(1)	1	0
Areas redefined (March 3, 2005) (Jandaia)	0	(1)	1	0
Areas redefined (April 1, 2005) (Fazenda Matinha)	0	(1)	1	0
Areas redefined (April 12, 2005) (Quererá)	0	(1)	1	0
Areas redefined (June 18, 2005) (Rio da Serra)	0	(1)	1	0
Areas redefined (August 11, 2005) (Anambé)	0	(1)	1	0

Areas redefined (August 13, 2005) (Fazenda Santa Rosa)	0	(1)	1	0
Areas redefined (November 24, 2005) (Inhambu)	0	(1)	1	0
Joint concession BBI to CHT(5)	0	(1)	0	(1)
Joint concession NPE to DEN (6)	0	(1)	0	(1)
Total areas held (as of December 31, 2005)	**134**	**41**	**243**	**418**
Net area held in thousands of acres (as of December 31, 2005)	**31,727**	**523**	**3,008**	**35,258**
Areas won on Bid Round 8	**21**	**0**	**0**	**21**
Areas relinquished (until December 31, 2006)	**(1)**	**0**	**(4)**	**(5)**
New Concessions	**0**	**25**	**0**	**25**
Areas redefined	**0**	**(8)**	**8**	**0**
Total areas held (as of Dec. 31, 2006)	**154**	**58**	**247**	**459**
Net area held in thousands of acres (as of December 31, 2006)	**29,716**	**1,192**	**2,888**	**33,796**

(1) COG Córrego Grande, CCN Córrego Cedro Grande

(2) CDL Cardeal, MP Massapê

(3) CR Curió, FBL Fazenda Belém

(4) SMI São Miguel, PJ Pajeú

(5) BBI Baleia Bicuda, CHT Cachalote

(6) NPE Norte de Pescada, DEN Dentão Joint Ventures

In Bid Round 8, held December 28, 2006, we acquired 21 new exploration concessions, 14 to be operated in partnership. As the public auction conducted by the ANP was interrupted by a court decision, the exploration contracts were not signed with the ANP, and consequently, the 14 exploration agreements with the partners have not yet been finalized.

As of December 31, 2006, we had 154 exploration agreements and 305 production agreements. In 69 of the 154 exploration agreements, we are exclusively responsible for conducting the exploration activities. Our participation ranges from 20% to 85% in the 85 exploration agreements in partnership, and in 54 of them we are responsible for conducting the exploration activities. As of December 31, 2006, we had partnerships in exploration with 21 foreign and domestic companies.

Drilling Activities

During 2006, we drilled a total of 411 wells, 331 development wells and 80 exploratory wells. Of those wells, 283 development wells and 50 exploratory wells were located onshore and 48 development wells and 30 exploratory wells were located offshore. These numbers refer to the wells we drilled in 2006, but such wells may not have been evaluated or reclassified in 2006.

We plan to expand exploration and development activities in 2007 by:

- drilling approximately 114 new exploratory and approximately 400 new development wells;
- shooting and processing two-dimensional and three-dimensional seismic surveys; and
- constructing onshore and offshore production and support facilities.

The following table sets forth our fleet of drilling rig units. We will use these owned and leased rigs to support future exploration, production and development activities. Most of the offshore rigs are operated in the Campos Basin.

DRILLING UNITS

	2006		**2005**		**2004**	
	Brazil	**International**	**Brazil**	**International**	**Brazil**	**International**
Land rigs for onshore exploration and development	19	22	22	19	19	28
Owned	13	0	13	0	13	0
Leased	6	22	9	19	6	28
Semi-submersible rigs	20	3	17	1	18	0
Owned	4	0	3	0	4	0
Leased	16	3	14	1	14	0
Drill ships	8	1	7	2	7	1
Owned	0	0	0	0	0	0
Leased	8	1	7	2	7	1
Jack-up rigs	6	1	7	1	6	0
Owned	5	0	6	0	6	0
Leased	1	1	1	1	0	0
Moduled rigs for offshore exploration and development	10	0	11	0	11	0
Owned	6	0	9	0	8	0
Leased	4	0	2	0	3	0
Total	63	27	64	23	61	29

Development Activities

Development occurs after completion of exploration and appraisal, and prior to hydrocarbon production, and involves the installation of production facilities including platforms and pipelines. We have an active

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development program in existing fields and in the discovery and recovery of new reserve finds. Since the 1980s, we have concentrated development investments in the deepwater fields located in the Campos Basin, where most of our proved reserves are located. We develop fields in stages of production, which we refer to as modules. As of December 31, 2006, we had a total of 8,412 oil and gas producing wells in Brazil, of which 7,699 were onshore and 713 were offshore.

The following table describes our main production development projects fields in the various basins and their production capacity :

Main Domestic Production Development Projects

Field	Unit Type	Production Unit	Capacity (bpd)	Water Depth (m)	Production Wells	Injection Wells	Start Up (year)	Observation
Albacora Leste (1)	FPSO	P-50	180,000	1,230	17	14	2,006	
Golfinho Module 1	FPSO	Capixaba	100,000	1,300	5	3	2,006	Chartered from SBM
Jubarte Phase I	FPSO	P-34	60,000	1,350	4		2,006	
Espadarte Module 2	FPSO	Cidade do Rio de Janeiro	100,000	1,350	5	4	2,007	Chartered from Modec
Golfinho Module 2	FPSO	Cidade de Vitória	100,000	1,360	5	3	2,007	Chartered from Saipen
Piranema	SS	P-300	30,000	1,090	3	3	2,007	Chartered from Sevan Marine
Roncador Phase II	SS	P-52	180,000	1,800	18	11	2,007	
Roncador Module 2	FPSO	P-54	180,000	1,400	11	6	2,007	
Jabuti	FPSO	Cidade de Niterói	100,000	1,400	8	0	2,008	Chartered from Modec
Marlim Sul Module 2	SS	P-51	180,000	1,255	10	9	2,008	
Frade (2)	FPSO	n/a	100,000	900	12	7	2,009	
Marlim Leste	FPU	P-53	180,000	1,090	14	7	2,009	
Jubarte Phase II	FPSO	P-57	180,000	1,300	15	7	n/a	
Parque das Conchas (3)	n/a	n/a	100,000	1,600	n/a	n/a	2,011	
Roncador Module 3	SS	P-55	180,000	1,795	11	7	n/a	

(1) Petrobras (operator) 90%, YPF 10%.

(2) Petrobras 30%, Chevron (operator) 51.74%, Frade Japão 18.26%.

(3)

Petrobras 35%,
Shell
(operator) 50%,
ONGC 15%.

Abbreviations:
SS = Semisubmersible
FPSO = Floating, Production, Storage and Offloading
FPU = Floating and Production Unit

Some of these fields are being financed through project financings. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Project Finance.

Production Activities

Our domestic crude oil and natural gas production activities involve fields located on Brazil s continental shelf off the coast of nine Brazilian states, of which the Campos Basin is the most important region, and onshore in eight Brazilian states. We are also producing crude oil and natural gas in nine other countries: Angola, Argentina, Bolivia, Colombia, Ecuador, Mexico, Peru, the United States, and Venezuela. See International.

The following table sets forth average daily crude oil and natural gas production, average sales price and average lifting costs for each of 2006, 2005 and 2004:

	For the Year Ended December 31,		
	2006	2005	2004
Crude Oil and NGL Production (in Mbpd)			
Brazil (1)			
Offshore			
Campos Basin	1,468	1,405	1,204
Other	78	36	38
Total offshore	1,546	1,441	1,242
Onshore	232	243	251
Total Brazil	1,778	1,684	1,493
International	130	163	168
Non-consolidated international production (2)	12		
Total crude oil and NGL production	1,920	1,847	1,661
Crude Oil and NGL Average Sales Price (U.S. dollars per Bbl)			
Brazil	$ 54.71	$ 45.42	$ 33.49
International	44.02	34.91	26.51
Natural Gas Production (in Mmcfpd)			
Brazil (3)			
Offshore			
Campos Basin	759	752	645
Other	257	172	184
Total offshore	1,016	924	829
Onshore	644	719	762
Total Brazil	1,660	1,643	1,590
International	595	575	564
Non-consolidated international production (2)	12		
Total natural gas production	2,267	2,218	2,154
Natural Gas Average Sales Price (U.S. dollars per Mcf)			
Brazil (4)	$ 2.61	$ 2.17	$ 1.93
International (5)	2.16	1.64	1.17
Aggregate Average Lifting Costs (oil and natural gas) (U.S. dollars per boe)			
Brazil			

With government take	$ 17.64	$ 14.73	$ 10.72
Without government take	6.59	5.73	4.28
International	3.36	2.90	2.60

(1) Brazilian figures include production from shale oil reserves and natural gas liquids, which are not included in our proved reserves figures.

(2) Equity method companies in Venezuela.

(3) Brazilian figures include reinjected gas volumes, which are not included in our proved reserves figures.

(4) Excludes (1) exploration and production overhead; (2) costs related to intra-company transfers of oil products to our exploration and production division; (3) costs of sales of oil products produced in natural plants overseen by our exploration and production department; and (4) price of oil and gas bought from partners in certain joint

ventures.

(5) Excludes (1) royalties; (2) special government participation; and (3) rental of areas.

Average Brazilian production of crude oil and NGL for 2006 increased 5.6% relative to 2005, reaching 1,778 Mbpd, principally as a result of the start-up of the P-50 platform in April 2006, the FPSO-Capixaba in May 2006 and the P-34 platform in December 2006.

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Reserves

Our estimated worldwide proved reserves of crude oil and natural gas as of December 31, 2006 totaled 11.46 billion barrels of oil equivalent, including:

9.48 billion barrels of crude oil and NGLs; and

11,843.4 billion cubic feet of natural gas.

We calculate reserves based on forecasts of field production, which depend on a number of technical parameters, such as seismic interpretation, geological maps, well tests and economic data. All reserve estimates involve some degree of uncertainty. The uncertainty depends mainly on the amount of reliable geologic and engineering data available at the time of the estimate and the interpretation of this data. Therefore, the estimates are made using the most reliable data at the time of the estimate, in accordance with the best practices in the oil and gas industry.

DeGolyer and MacNaughton, or D&M, reviewed and certified 92% of our domestic proved crude oil, condensate and natural gas reserve estimates as of December 31, 2006. The estimates for the certification were performed in accordance with Rule 4-10 of Regulation S-X of the SEC.

As of December 31, 2006, our domestic proved developed crude oil reserves represented 44% of our total domestic proved developed and undeveloped crude oil reserves. Our domestic proved developed natural gas reserves represented 44% of our total domestic proved developed and undeveloped natural gas reserves. Total domestic proved crude oil reserves increased at an average annual growth rate of 3.3% in the last five years. Natural gas proved reserves increased at an average annual growth rate of 6.5% over the same period.

The following table sets forth our estimated net proved developed and undeveloped reserves and net proved developed reserves of crude oil and natural gas by region as of December 31, 2006, 2005 and 2004:

WORLDWIDE ESTIMATED NET PROVED RESERVES

	Crude Oil (MMbbl)	Brazil Natural Gas(1) (Bcf)	Combined(2) (Mmboe)	Crude Oil (MMbbl)	International Natural Gas(1) (Bcf)	Combined(2) (Mmboe)	Combined Global Proved Reserves (Mmboe)
Net Proved Developed and Undeveloped Reserves:							
Reserves as of December 31, 2004	9,243.4	7,954.3	10,569.1	702.0	3,292.8	1,250.9	11,820.0
Revisions of previous estimates	123.0	842.4	263.4	0.5	(32.6)	(4.97)	258.4
Extensions, discoveries and improved recovery	252.0	996.9	418.2	38.4	38.8	44.9	463.1
Production for the year	(584.5)	(529.8)	(672.8)	(58.8)	(210.9)	(93.9)	(766.7)
Reserves as of December 31, 2005	9,033.9	9,263.8	10,577.8	682.1	3,088.1	1,196.8	11,774.6
Revisions of previous estimates	463.4	322.1	517.2	(15.2)	(459.1)	(91.7)	425.5
Extensions, discoveries and improved recovery	119.7	328.2	174.4	28.1	75.1	40.6	215.0

Sales of reserves in place				(4.5)	0.0	(4.5)	(4.5)
Purchase of reserves in place	0.9	45.8	8.5	8.9	16.0	11.6	20.1
Production for the year	(616.0)	(532.9)	(704.8)	(42.6)	(209.8)	(77.6)	(782.3)
Interest Loss in Venezuela (3)				(174.8)	(93.9)	(190.5)	(190.5)
Transfer to Unconsolidated Companies				(65.7)	(77.3)	(78.6)	(78.6)
Reserves as of December 31, 2006	9,001.9	9,427.0	10,573.1	416.3	2,339.1	806.2	11,379.3
Net Proved Developed Reserves:							
As of December 31, 2004	4,129.8	4,427.6	4,867.7	383.1	2,495.2	799.0	5,666.7
As of December 31, 2005	4,071.7	4,088.8	4,753.2	365.9	2,333.7	754.9	5,508.1
As of December 31, 2006	3,987.7	4,115.4	4,673.6	232.9	1,758.0	525.9	5,199.5
Proved Reserves in Unconsolidated Companies				65.7	77.3	78.6	78.6
Total Proved Reserves as of December 31, 2006 (4)	9,001.9	9,427.0	10,573.1	482.0	2,416.4	884.8	11,457.9

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(1) Natural gas liquids are extracted and recovered at natural gas processing plants downstream from the field. The volumes presented for natural gas reserves are prior to the extraction of natural gas liquids.

(2) See Conversion Table for the ratios used to convert cubic feet of natural gas to barrels of crude oil equivalent. Production of shale oil and associated reserves are not included.

(3) Changes due to contractual changes (Joint Ventures to Unconsolidated Companies).

(4) Total Proved Reserves as of December 31, 2006 equals Reserves as of December 31, 2006 plus Proved Reserves in

Unconsolidated Companies.

The following tables set forth our crude oil and natural gas proved reserves by region, as of December 31, 2006, 2005 and 2004:

CRUDE OIL NET PROVED RESERVES BY REGION

	As of December 31,					
	2006		2005		2004	
	Proved Developed and Undeveloped	Proved Developed	Proved Developed and Undeveloped	Proved Developed	Proved Developed and Undeveloped	Proved Developed
	(MMbbl)					
Brazil						
Offshore						
Campos Basin	7,855.4	3,305.4	7,886.0	3,395.9	8,130.4	3,422.7
Other	373.7	131.8	388.3	101.3	335.4	106.1
Total offshore	8,229.1	3,437.2	8,274.3	3,497.2	8,465.8	3,528.8
Onshore	772.8	550.5	759.6	574.5	777.6	601.0
Total Brazil	9,001.9	3,987.7	9,033.9	4,071.7	9,243.4	4,129.8
International						
Other South America(1)	408.2	252.2	625.8	350.8	678.4	367.0
West Coast of Africa	42.0	7.4	42.6	8.6	11.8	11.8
Gulf of Mexico	31.8	10.0	13.7	6.5	11.8	4.3
Total international	482.0	269.6	682.1	365.9	702.0	383.1
Total	9,483.9	4,257.3	9,716.0	4,437.6	9,945.4	4,512.9

(1) Includes Argentina, Bolivia Colombia, Ecuador, Peru and proportional reserves related to unconsolidated companies in Venezuela.

NATURAL GAS NET PROVED RESERVES BY REGION:

	As of December 31,		
	2006	2005	2004
	Proved	Proved Developed	Proved Developed

	Developed and Undeveloped	Proved Developed	and Undeveloped	Proved Developed	and Undeveloped	Proved Developed
			(Bcf)			
Brazil						
Offshore						
Campos Basin	4,043.1	1,748.0	3,836.5	1,772.3	4,039.3	1,820.4
Other	2,985.7	918.5	2,912.1	720.9	1,337.5	854.0
Total offshore	7,028.8	2,666.5	6,748.6	2,493.2	5,376.8	2,674.4
Onshore	2,398.2	1,448.9	2,515.2	1,595.6	2,577.5	1,753.2
Total Brazil	9,427.0	4,115.4	9,263.8	4,088.8	7,954.3	4,427.6
International						
Other South America(1)	2,241.7	1,688.9	2,951.7	2,270.2	3,162.2	2,456.2
Gulf of Mexico	174.7	112.2	136.5	63.5	130.6	39.0
Total international	2,416.4	1,801.1	3,088.1	2,333.7	3,292.8	2,495.2
Total	11,843.4	5,916.5	12,351.9	6,422.5	11,247.1	6,922.8

(1) Includes Argentina, Bolivia, Colombia, Peru and proportional reserves related to unconsolidated companies in Venezuela.

Please see Supplementary Information on Oil and Gas Producing Activities in our audited consolidated financial statements for further details on our proved reserves.

Refining, Transportation and Marketing

Summary and Strategy

Our refining, transportation and marketing business segment encompasses the refining, transportation and marketing of crude oil, oil products and fuel alcohol, including investments in petrochemicals.

We own and operate 11 refineries in Brazil, with total processing capacity of 1,986 million barrels per day. With the acquisition of the Ipiranga Group, one-third of the Ipiranga Refinery became part of the Petrobras assets. After this acquisition, only one independent refinery in Brazil remains. This refinery has an aggregate installed capacity of approximately 0.03 million barrels per day. Our domestic refining capacity constitutes 98.4% of the Brazilian refining capacity. We built nine of our 11 refineries prior to 1972, and we completed the last refinery (Henrique Lage) in 1980. At that time, we were only producing 200 Mbpd of crude oil in Brazil. Our refineries were built to process light imported crude oil. Subsequent to their completion, we discovered large reserves of heavier crude oil in Brazil. As a result, we are continually upgrading and improving our refineries to process large quantities of heavy crude oil.

We approved initial studies for construction of a new refinery in the Northeast of Brazil. With an estimated investment of U.S.$2.88 billion in the industrial complex of Porto de Suape, in the state of Pernambuco. The refinery will have the capacity to process 200 Mbpd of heavy oil with the start of operations planned for 2011.

We process as much of our domestically produced crude oil as possible through our refineries, and supply the remaining demand within Brazil by importing crude oil (which we also process in our refineries) and oil products. As our own domestic production increases and refinery upgrades enable us to process more throughput efficiently in the next few years, we expect to import proportionately less crude oil and oil products. Until January of 2002, we were the sole supplier of oil products to the Brazilian market. Now that we are no longer the sole supplier of oil products to the Brazilian market, we intend to reevaluate our import strategy and may reduce imports to the extent such reductions improve our profitability. We also export crude oil and oil products, to the extent that our production of oil products exceeds Brazilian demand or our refineries are unable to process the growing domestic crude oil production.

We transport oil products and crude oil to domestic wholesale and export markets through a coordinated network of marketing centers, storage facilities, pipelines and shipping vessels. As the single supplier for almost fifty years of a country that ranks as the 12th largest oil-consuming nation in the world, according to the June 2006 issue of *Statistical Review of the World*, we have developed a large and complex infrastructure. Our refineries are generally located near Brazil s population and industrial centers and near our production areas, which creates logistical efficiencies in our operations.

In accordance with the requirements of the Oil Law, we have placed our shipping assets into a separate subsidiary, Petrobras Transporte S.A., or Transpetro. This subsidiary leases storage and pipeline facilities and provides open access to these assets to all market participants. Our petrochemicals business is now also included in the refining, transportation and marketing segment.

Our main strategies in refining and transportation are to:

- focus on clients and develop our portfolio of goods and services based on their needs;
- expand our processing, transportation and commercialization activities, using bio-energy sources and raw material produced by us;
- diversify our business portfolio, focusing on synergies among assets;
- expand activities in the petrochemical and fertilizer industries, by seeking strategic partnerships and promoting synergies with our other operations;

improve efficiency in all stages of logistic processes by using a variety of transportation systems and focusing on operational excellence, safety standards and high quality services; and

apply state of the art technology in oil processing to promote energy and environmental efficiency.

Our refining, transportation and marketing results are reflected in the Supply segment in our audited consolidated financial statements.

Refining

At December 31, 2006, we had total installed refining capacity in Brazil of 1.986 million barrels per day, which, according to *Petroleum Intelligence Weekly*, made us the 8th largest refiner of oil products in the world among publicly traded companies in 2006. In Brazil, we processed an average of 1.746 million barrels of crude oil per day in 2006, which represents a utilization rate of 88% for the year, calculated over total distillation capacity. This compares with an 85% average utilization rate in 2005 and an 86% average utilization rate in 2004.

Approximately 80% of the crude oil feedstock for our refinery operations in Brazil was supplied by domestic production, as compared to 80% in 2005 and 76% in 2004. We expect an increasing percentage of the crude oil feedstock to be supplied by our relatively lower cost domestic production, as our overall domestic production increases. Because our domestic refining capacity constitutes 98.4% of the Brazilian refining capacity, we supply almost all of the refined product needs of third-party wholesalers, exporters and petrochemical companies, in addition to satisfying our internal consumption requirements with respect to wholesale marketing operations and petrochemical feedstock.

Our refineries are located throughout Brazil, with heavy concentration in the Southeast where demand for domestic products is greatest, due to significant industrial activity and large population centers. Most of our refineries are located near our crude oil pipelines, storage facilities, refined product pipelines and major petrochemical facilities. This configuration facilitates access to crude oil supply and major end-user markets in Brazil.

Refinery Production and Capacity

In Brazil in 2006, we produced a total of 644 million barrels of oil products, or on daily basis 1,764 million barrels per day. Approximately 80% of this crude oil came from Brazilian production. Our average refining costs (consisting of variable costs and excluding depreciation and amortization) in Brazil were U.S.$2.29 per barrel in 2006, U.S.$1.90 per barrel in 2005 and U.S.$1.38 per barrel in 2004. According to our strategic plan, because of the heavier crude characteristic of many Brazilian fields, we have also invested in hydro-treatment facilities to reduce impurities in our refinery s oil products and to facilitate the conversion of heavy crude oil into lighter products. As a result, our refining costs have been increasing because the throughput has remained stable. The majority of our heavy crude conversion capacity is located in our refineries: Landulpho Alves, Duque de Caxias, Paulínia, Presidente Bernardes, Gabriel Passos and Henrique Lage. The following table describes the installed capacity, refining throughput and utilization factor of our refineries for each of 2006, 2005 and 2004:

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REFINING STATISTICS

	2006			2005			2004		
Refineries	**Capacity (Mbpd)**	**Throughput[1] (Mbpd)**	**Utilization[2] (%)**	**Capacity (Mbpd)**	**Throughput[1] (Mbpd)**	**Utilization[2] (%)**	**Capacity (Mbpd)**	**Throughput[1] (Mbpd)**	**Utilization[2] (%)**
Paulínia	365	341	93	365	320	88	365	351	96
Landulpho Alves (8)	323	261	81	332	249	75	323	237	73
Duque de Caxias (8)	242	254	105	275	242	88	242	230	95
Henrique Lage	251	211	84	251	241	96	251	236	94
Alberto Pasqualini(3)	189	114	60	189	116	61	189	103	54
Pres. Getúlio Vargas(4)	189	183	97	189	186	98	189	165	87
Pres. Bernardes	170	163	96	170	157	92	170	154	91
Gabriel Passos	151	136	90	151	131	87	151	132	87
Manaus	46	36	78	46	44	96	46	45	98
Capuava	53	40	76	53	35	66	53	46	87
Fortaleza	7	7	100	6	5	83	6	5	83
Total Brazilian (8)	1,986	1746	88	2,027	1,726	85	1,985	1,704	86
Pasadena (9)	100	91	91						
Gualberto Villarroel(5)	40	24	60	40	25	63	40	22	55
Ricardo Eliçabe(6)	31	30	97	31	26	84	31	30	98
Guillermo Elder Bell(5)	20	16	80	20	16	80	20	16	80
San Lorenzo (6)	50	33	66	38	37	97	38	33	89
Del Norte (7)	26	17	65						
Total International	241	194	81	129	104	81	129	101	78
Total	2,227	1,940	87	2,156	1,830	85	2,114	1,805	85

(1) Throughput does not include slop or any reprocessed feedstock.

(2) Utilization was calculated based on crude oil and NGL only.

(3) We own 70% of this refinery.

(4) Because of improvements to the crude plant of this refinery, its output can now slightly exceed the nameplate capacity originally registered with and acknowledged by the National Petroleum Agency in Brazil in 2003.

(5) Located in Bolivia.

(6) Located in Argentina.

(7) Located in Argentina. Del Norte statistics are not included since we own just 28.5% of that refinery.

(8) Includes NGL Capacity (Mbpd): Landulpho Alves = 9, Duque de Caxias = 33 in 2005.

(9) Located in the United States. We acquired 50% of this refinery in September 2006 and we started

operations in October 2006. We are not including the full year s information, rather the last three months figures only in calculating the average.

We operate our refineries, to the extent possible, to satisfy Brazilian demand. Brazil demands a proportionally high amount of diesel, relative to gasoline, which together represent more than half of our production. Because we operate refineries to maximize the output of diesel fuel for which demand in Brazil is greater than our internal production, we produce volumes of gasoline and fuel oil in excess of Brazilian demand and such excess must be exported.

Brazil s demand for oil products has been relatively constant for the last three years, but we continue to increase our refinery throughput, thereby reducing the amount of products we must import to satisfy demand. We have also increased our exports of refined products. The following table sets forth our domestic production volume for our principal oil products for each of 2006, 2005 and 2004:

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DOMESTIC PRODUCTION VOLUME OF OIL PRODUCTS

	2006 (Mbpd)	%	2005 (Mbpd)	%	2004 (Mbpd)	%
Product						
Diesel	665.8	37.8	660.1	38.0	657.0	38.7
Gasoline	345.3	19.5	324.5	18.7	292.8	17.3
Fuel oil	259.0	14.7	257.8	14.9	279.9	16.5
Naphtha and jet fuel	212.1	12.0	218.5	12.6	220.2	13.0
Other	281.4	16.0	274.3	15.8	245.7	14.5
Total	1,763.6	100.0	1,735.2	100.0	1,695.6	100.0

Refinery Investments and Improvements

In recent years, we have made investments in our refinery assets in order to improve yields of middle and lighter distillates, which typically generate higher margin sales and reduce the need to import such products. Our principal strategy with respect to refinery operations is to maximize throughput of domestic crude oil. Since the heavy domestic crude oil produces a higher proportion of fuel oil for each barrel of crude oil processed, production of fuel oil is expected to remain relatively constant as throughput of additional Brazilian crude oil offsets new investment in conversion capacity and the production of coke which can be converted into middle distillates products.

We plan to invest in refinery projects designed to:

- enhance the value of Brazilian crude oil by increasing capacity to refine greater quantities of heavier crude oil that is produced domestically;
- increase production of oil products demanded by the Brazilian market that we currently must import, such as diesel;
- improve gasoline and diesel quality to comply with stricter environmental regulations currently being implemented; and
- reduce emissions and pollutant streams.

Major Refinery Projects

Included in our Strategic Plan are a number of upgrades to key refineries. Our major investments are generally (1) coker to further break down heavy oil into middle distillates or (2) hydro-treatment units that reduce sulfur to produce products that meet international standards. We believe our hydro-treatment units will make it possible to offer diesel fuel containing a maximum sulfur content of 0.05% (starting in 2009), thus meeting stricter environmental standards being implemented under Brazilian law. The principal refineries and planned investments (2007 2011) are as follows:

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Refinery	Objective
Alberto Pasqualini (REFAP)	Units to upgrade gasoline and diesel quality.
Presidente Getúlio Vargas Refinery (REPAR)	Expansion and metallurgic adaptation of existing distillation unit to increase heavy oil processing, installation of a coker, expansion of existing refinery unit and units to upgrade the quality of diesel and gasoline, and creation of a propylene unit.
Henrique Lage (REVAP)	Metallurgic adaptation of existing distillation unit to increase heavy oil processing, installation of a coker and units to upgrade the quality of diesel and gasoline, and creation of a propylene unit.
Paulínia Refinery (REPLAN)	Expansion and metallurgic adaptation of existing distillation unit to increase heavy oil processing, installation of other coker, and units to upgrade the quality of diesel and gasoline, and creation of a propylene unit.
Landulpho Alves (RLAM)	Expansion and metallurgic adaptation of existing distillation unit to increase heavy oil processing, expansion of existing refinery unit, installation of a coker, and units to upgrade the quality of diesel and gasoline.
Duque de Caxias Refinery (REDUC)	Metallurgic adaptation of existing distillation unit to increase heavy oil processing, expansion of existing refinery unit, installation of a lube oil unit, installation of a coker and units to upgrade the quality of diesel and gasoline.
Gabriel Passos Refinery (REGAP)	Metallurgic adaptation of existing distillation unit to increase heavy oil processing, installation of a coker, unit to upgrade the quality of diesel and gasoline, and creation of a propylene unit.
Presidente Bernardes Refinery (RPBC)	Expansion and metallurgic adaptation of existing distillation unit to increase heavy oil processing, installation of a coker, and units to upgrade the quality of diesel and gasoline.
Capuava Refinery (RECAP)	Units to upgrade the quality of diesel and gasoline.
Isaac Sabbá Refinery (REMAN)	Mild thermal cracking unit and units to upgrade the quality of diesel and gasoline.
	Units to improve the lube oil production.

Lubrificantes e Derivados de Petróleo do Nordeste
(LUBNOR)

In addition to the refineries mentioned above, our 2007-2011 Business Plan envisions investments in the New Abreu Lima refinery, to be installed in Pernambuco, and which is expected to begin operations in 2011.

Imports

During 2006 we continued to import crude oil and oil products because domestic production was not adequate to satisfy Brazilian demand for certain products. In addition, because the bulk of our domestic reserves consist of heavy crude oil, we need to import lighter crude oils to create an adequate mix of oils to satisfy Brazilian demand and to permit refining by our refineries.

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Imported crude oil is transferred into our refineries for storage and processing, with a small percentage being sold to the other two Brazilian refiners, including the recently purchased Ipiranga refinery. Imported oil products are sold to the retail market in Brazil through distributors, including our subsidiary BR.

The average daily volume of our imports of crude oil has increased to 370 Mbpd in 2006, as compared to 352 Mbpd in 2005, because of the increase in the demand in the Brazilian market.

The following table sets forth the percentage of crude oil that we imported during each of 2006, 2005 and 2004 by region.

IMPORTS OF CRUDE OIL BY REGION

	2006	**2005**	**2004**
		Volume (%)	
Region			
Africa	70.6%	67.5%	73.4%
Middle East	27.9	29.4	24.2
Central and South America/Caribbean	1.5	3.1	2.4
Oceania	0.0	0.0	0.0
Europe	0.0	0.0	0.0
Total	100.0%	100.0%	100.0%

In 2006, our total costs of imports of crude oil from all these regions was U.S.$7,007 million, as compared to U.S.$6,035 million in 2005 and U.S.$5,191 million in 2004.

Imports of oil products increased to 118 Mbpd in 2006, as compared to 94 Mbpd in 2005 and 110 Mbpd in 2004 primarily as a result of the increase in domestic consumption. For distillates, the increase in the imported amounts is a result of the increase in the demand from the Brazilian market. For naphtha, the decrease is a result of the increase in the imports by petrochemical companies. The following table sets forth the volume of oil products imported during each of 2006, 2005 and 2004:

IMPORTS OF OIL PRODUCTS

	2006	**2005**	**2004**
		Volume (Mbbl)	
Oil Product			
LPG	9,936	6,268	11,537
Distillates(1)	20,287	16,740	16,879
Naphtha	7,329	8,243	7,231
Others(2)	5,550	3,523	4,487
Total	43,102	34,774	40,134

(1) Includes gasoline, diesel fuel and some intermediate fractions.

(2) Includes Algerian NGLs, fuel oil, Ethanol,

Methanol and
others.

In 2006, total costs of oil product imports, measured on a cost-insurance-and-freight basis, was U.S.$3,692 million, as compared to U.S.$2,108 million in 2005 and U.S.$1,721 million in 2004. For a discussion of import purchase volumes and prices, see Item 5. Operating and Financial Review and Prospects Sales Volumes and Prices Import Purchase Volumes and Prices.

Exports

We also export that portion of oil products processed by our refineries that exceed Brazilian demand. In addition, we export domestic crude oil that we are unable to process efficiently in our refineries because of limited conversion capacity. Our total exports increased to 214 MMbbl in 2006 from 193 MMbbl in 2005 as a result of the increase in production of domestic crude oils and the adjustment in the local demand for quality products. The following table sets forth the volumes of oil products we exported during each of 2006, 2005 and 2004:

EXPORTS OF OIL AND OIL PRODUCTS(1)

	2006	**2005**	**2004**
		(Mbbl)	
Crude Oil	122,279	96,155	66,319
Fuel Oil (including bunker fuel)	61,351	63,896	107,104
Gasoline	16,018	17,240	11,510
Other (2)	12,562	9,716	1,288
Total	212,210	187,007	186,221

(1) The figure includes sales made by PifCo to unaffiliated third parties, including sales of oil and oil products purchased internationally.

(2) Not including fertilizers.

The total value of our crude oil and oil products exports, measured on a free-on-board basis, was U.S$11,989 million in 2006, U.S.$8,938 million in 2005 and U.S.$5,923 million in 2004.

Transportation

The Oil Law requires that a separate company operate and manage the transportation network for crude oil, oil products and natural gas in Brazil, so we created a wholly-owned subsidiary, Petrobras Transporte S.A. Transpetro, in 1998 to build and manage our vessels, pipelines and maritime terminals and handle various other transportation activities. In May 2000, Transpetro also took over the operation of our transportation network and storage terminals to comply with legal requirements. As of October 1, 2001, with the approval from the ANP, these pipelines and terminals were leased to Transpetro, which started to offer its transportation services to us and to third parties. As the owner of the facilities leased to Transpetro, we retain the right of preference for its use, based on the historical level of transportation assessed for each pipeline, formally assigned by the ANP. The excess capacity is made available to third parties on a non-discriminatory basis and under equal terms and conditions.

Prior to the enactment of the Oil Law, we were the only company authorized to ship oil products to and from Brazil and to own and operate Brazilian pipelines. Pursuant to the Oil Law, the ANP now has the power to authorize any company or consortium organized under Brazilian law to transport crude oil, oil products and natural gas for use in the Brazilian market or in connection with import or export activities, and to build facilities for use in any of these activities. The Oil Law has also provided the basis for open competition in the construction and operation of pipeline facilities.

Pipelines and Terminals

We own, operate and maintain an extensive network of crude oil, oil products and natural gas pipelines connecting our terminals to refineries and other points of primary distribution throughout Brazil. On December 31, 2006, our onshore and offshore crude oil and oil products pipelines extended 6,280 miles or 10,104 kilometers in length, our natural gas pipelines aggregated approximately 6,073 miles or 9,771 kilometers in length, including the Brazilian side (1,612 miles or 2,593 kilometers) of the Bolivia-Brazil pipeline, and our flexible pipelines totaled 2,032 miles or 3,269 kilometers in length.

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NATURAL GAS PIPELINES IN BRAZIL

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CRUDE OIL AND OIL PRODUCTS PIPELINES IN BRAZIL

An important project for the offshore loading of crude oil in the Campos Basin is the *Plano Diretor de Escoamento e Tratamento* - PDET (Director s Plan for Draining and Treatment), which consists of a fixed platform (PRA-1) connected to five offshore production platforms through pipelines that will transfer the crude oil of these platforms to a floating, storage and offloading platform (FSO) and two monobuoys, which will in turn facilitate the transfer of the crude oil to shuttle tankers or the export of the crude oil to other countries. The shuttle tankers will transport the oil to the Southeast terminals where it will be pumped to existing onshore pipelines connected to refineries in Rio de Janeiro, Minas Gerais and São Paulo. The PDET project will cost approximately U.S.$1.270 billion and is expected to start its operation in the second half of 2007. This project will permit an increase in the flow of oil produced in the Campos Basin by up to 630 Mbpd. The PRA-1 platform was installed offshore in January 2007 and preparations are being made to connect the platform to the sub-sea pipelines.

Transpetro also operates 44 storage terminals 24 marine terminals and other 20 tankfarms with a nominal aggregate storage capacity of 65.0 million barrels of oil equivalent. At December 31, 2006, tank capacity at these terminals consisted of 35.2 million barrels of crude oil, 27.3 million barrels of oil products and fuel alcohol and 2.5 million barrels of LPG. Transpetro s marine terminals operate an average of 5,000 vessels per year.

Transpetro is currently evaluating alternatives to improve the efficiency of its transportation system, including improvements to the monitoring and control of the pipeline network through the gradual implementation of a supervisory control and data acquisition system, which, when completed, will monitor the pipelines and storage facilities located throughout the country.

Transpetro implemented the first phase of the project and inaugurated a centralized control and operating center in June 2002, in its headquarters in Rio de Janeiro. Currently, there are a national back-up master station and two regional master stations connected through satellite communication. Tank-farms and pump stations are equipped with mini stations connected to the regional master stations. In addition, Transpetro has been investing in the development of a pipeline integrity program (*Programa de Integridade de Dutos)* to ensure the integrity and safety of its pipeline operations.

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Shipping

On December 31, 2006, our fleet consisted of the following 53 vessels (46 owned and 7 bareboat chartered), 32 of which are single hulled and 21 of which are double hulled:

OWNED/BAREBOAT CHARTERED VESSELS

	Number	Capacity (deadweight tonnage in thousands)
Type of Vessel		
Tankers	45	2,592.3
Liquefied petroleum gas tankers	6	40.2
AHTS Anchor Handling Tug Supply	1	2.2
FSO Floating, Storage and Offloading	1	28.9
Total	53	2,663.6

These vessels are currently operated by Transpetro and their activities are mainly concentrated in the Brazilian coastline, South America (Venezuela and Argentina), Mediterranean Sea, Caribbean Sea, Gulf of Mexico, West Africa and the Persian Gulf. The single-hulled ships only operate in areas where environmental legislation permits, including Brazil, Venezuela, Argentina and the West Coast of Africa. The double-hulled ships operate in other international locations in accordance with applicable laws. Our shipping operations support the transportation of crude oil from offshore production systems, our import and export of crude oil and oil products and our coastal trade. In 2006, Transpetro increased shuttle operations in the Campos basin by a chartered bareboat vessel, double-hulled, dynamic-positioned vessel with 1 million barrels capacity. In 2007, two more vessels of the same type and same trade will be incorporated. Our Business Plan calls for investments of U.S.$2.8 billion to renew our fleet, by adding 42 vessels by 2011. The table below sets forth the types of products and quantities of such products we transported during each of the years indicated.

PRODUCTS AND QUANTITIES TRANSPORTED

	2006	2005	2004
		(millions of tons)	
Product			
Crude oil	106.85	92.38	88.4
Oil Products	39.76	40.42	34.0
Fuel Alcohol	0.08	0.04	
Total	146.69	132.84	122.4
Percentage transported by our owned/bareboat chartered fleet	40.3%	43%	45.1%
Coastal transport as a percentage of total tonnage	65%	67%	61.1%

The average monthly-chartered tonnage in 2006 amounted to 8.6 million deadweight tons, as compared to 5.9 million deadweight tons in 2005 and 4.6 million deadweight tons in 2004. The chartered tonnage is continuously adjusted to our needs for overall market supply cost reduction. Our aggregate annual cost for vessel charters was U.S.$1,348.28 million in 2006, U.S.$972.01 million in 2005 and U.S.$701 million in 2004.

Petrochemicals

We conduct our petrochemical activities, with the exception of naphtha sales, through our subsidiary, Petrobras Química S.A., or Petroquisa. Petroquisa is a holding company with interests in nine operational petrochemical companies involved in the production and sale of basic and final petrochemical products and utilities. On December 31, 2006, our ownership percentage of the total capital of these investments ranged from 8.27% to 85.04% and our ownership percentage of the voting capital of these investments ranged from 9.81% to 70.45%. The total book value of these investments was U.S.$924 million on December 31, 2006. Most of such interests are minority voting interests. Our shareholders equity in these companies increased by U.S.$12 million between December 31, 2005 and December 31, 2006.

Shareholders at the Extraordinary General Meeting held on June 1, 2006 approved the incorporation of shares in Petroquisa by us, pursuant to the re-ratification of the Protocol of Merger and Incorporation of the share incorporation transaction executed by the two companies. Our Board of Directors approved the issuance of 886,670 of our preferred shares in connection with the incorporation of shares of Petroquisa by us. We held 99.99% of Petroquisa s shares prior to such incorporation.

To implement the transaction, the exchange ratio for the shares to be used was based on the net equity value of both companies at the base date of December 31, 2005, when 4.496 preferred shares issued by us were attributed to each batch of 1,000 common or preferred shares issued by Petroquisa. As a result, the minority shareholders of Petroquisa became our shareholders.

None of our shareholders had stated their intention to exercise the right withdraw by the legal deadline of July 7, 2006. Five of Petroquisa s shareholders, with a total interest of 1,015,910 shares, exercised the right to withdraw by the established deadline (July 5, 2006) and were reimbursed at the rate of R$153.47 (U.S.$71) per batch of 1,000 shares, using funds provided by Petroquisa, on July 10, 2006. Petrobras then acquired the shares for the same price, thereby transferring ownership.

The basic supply feedstock used in Brazil s petrochemical industry is naphtha. Until 2001, we were the sole supplier of naphtha to Brazil s petrochemical industry. Following regulatory change in 2002, the petrochemical industry began importing naphtha and condensates directly. In 2006, the industry imported approximately 30% of its naphtha needs, and we supplied the remainder from our refining operations.

We currently expect to maintain a presence in the petrochemicals industry principally by participating in projects integrated with our refineries. We expect that our selective investments in petrochemicals will consolidate our involvement in the entire value chain and will help integrate our basic and refining products. Although we have divested certain interests in the petrochemical segment in the past, we plan to increase the current level of investments, as part of our downstream strategy.

On March 31, 2006, the construction of Rio Polímeros S.A (Gas Chemical Complex), located next to our Duque de Caxias Refinery (REDUC) was finalized and the plant became operational, after the conclusion of the pre-operational phase. The complex has a nominal plant capacity of 540,000 tons per year of polyethylene and 79,000 tons per year of propylene produced from ethane and propane extracted from natural gas originated in the Campos Basin. Petroquisa holds a 16.7% interest of the voting and preferred capital in Rio Polímeros. In addition to Petroquisa, the three other investors are BNDESPAR and two leading private Brazilian petrochemical companies, Suzano and Unipar.

Our strategy in the petrochemicals field is to selectively expand our presence in the petrochemicals market. According to our 2007-2011 Business Plan, we will invest approximately U.S.$3.2 billion in capital expenditures in our Brazilian petrochemicals operations. This investment will be aimed at increasing the production of several basic and intermediate petrochemicals, such as ethylene, propylene, benzene, para-xylene, acrylic acid, purified terephthalic acid (PTA) and styrenes, as well as plastic resins, including polyethylene, polypropylene, PET and styrene. These projects will be carried out with other partners.

In addition, our petrochemicals project portfolio includes the construction of a petrochemical complex named COMPERJ. This complex would integrate refinery units and petrochemical facilities to produce petrochemical raw materials such as ethylene, propylene, aromatics and its petrochemical derivatives, such as polyethylene and polypropylene, in order to supply the growing demand for such products in the Brazilian market. We are currently developing the basic project for this petrochemicals complex.

The plant, with an expected capacity to process 150 Mbpd of heavy oil, will produce, in addition to several petrochemicals, some quantities of coke, diesel oil and naphtha. The conversion of heavy oil in petrochemicals is possible due to our innovative proprietary technology, named Petrochemical FCC, developed by us in our R&D Center. The total estimated investment in this plant is U.S.$8.3 billion. The COMPERJ is expected to begin operations in 2012.

On September 16, 2005, Petroquisa and Braskem incorporated Petroquímica Paulínia S.A. PPSA, a joint venture between the two companies, contributing 40% and 60% of the entity s capital, respectively. PPSA s purpose is to implement a polypropylene unit in Paulínia-SP and to use polymer-grade propylene supplied by us as raw material for its operations, with capacity of 300 thousand tons per year and a global investment estimated at U.S.$328 million. The commercial operations are projected to begin in the second quarter of 2008. To date, Petroquisa has invested R$52 million in this project.

On November 28, 2005, Petroquisa, Mossi & Ghisolfi and Citene signed a Memorandum of Understanding in which Mossi & Ghisolfi and Citene agreed to conduct a feasibility study relating to the development of a Purified Terephthalic Acid Plant in Pernambuco. The study showed favorable results. In March of 2006, Petroquisa and Citene signed a new memorandum regarding the creation of a company to implement the project and Mossi & Ghisolfi withdrew from the project. Companhia Petroquímica of Pernambuco-PETROQUÍMICASUAPE will manage the project. The plant will have a production capacity of 640 thousand tons per year. We are projecting that an investment of U.S.$542 million through 2009 will be required for this project, an estimate of the start-up costs of the plant through 2009.

Fertilizers

We continued to modernize our fertilizer production plants and develop new projects to increase nitrogenate production and expand operations in this segment. In 2006, sales of ammonia and urea generated a gross revenue of U.S.$350 million, a 6% increase as compared to 2005.

In 2006, we invested a total of R$92 million in our two fertilizer factories in Bahia and Sergipe to improve their operational reliability, logistics, product quality and Health, Safety and Environment (HSE). The construction of a new warehouse in Sergipe with a capacity of 30 thousand tons of urea nearly doubled the unit s storage capacity and greatly increased its logistical flexibility.

The factories in Bahia and Sergipe sold 213 thousand tons of ammonia in the domestic market in 2006, their fifth consecutive year of continuous growth. We also continued as the leader in the domestic market for urea fertilizer, with sales of 710 thousand tons in 2006. The investments in operational reliability at the Bahia plant led to the highest level of production of this plant 285 thousand tons in the last seven years.

In 2007, we expect to open a new urea granulation unit at the Sergipe factory with an expected production capacity of 600 tons per day. In order to reduce and possibly eliminate our need to import nitrogenated fertilizers, we are also planning the construction of a new industrial plant UFN-3 that uses natural gas as raw material. The unit, which we estimate will cost approximately U.S.$822 million, will have an estimated production capacity of 1 million tons of urea and 760 thousand tons of ammonia per year beginning in 2012.

Distribution

Summary and Strategy

Through Petrobras Distribuidora S.A., or BR, we distribute oil products, biodiesel and fuel alcohol to retail, commercial and industrial customers throughout Brazil. Our operations are supported by tankage capacity of approximately 2.3 million cubic meters, at 127 storage facilities and 104 aviation product depots at airports throughout Brazil.

Our main strategies in distribution and marketing are to:

- become the leader in the Brazilian market for petroleum derivatives and biofuels, maximizing market share and profitability;

position ourselves as the top brand in the eyes of customers by providing excellent products and services; and

coordinate our business in the energy sector with our other activities and ultimately expand the market for derivatives and biofuels.

As of 2005, Liquigás Distribuidora became the official name of our liquefied petroleum gas (*gás liquefeito de petróleo*, or LPG) distribution company, previously called Agip do Brasil S.A. and Sophia do Brasil S.A. Agip do Brasil S.A. was acquired in August 2004 to expand our share in the LPG distribution sector and to consolidate our presence in the distribution market. By the end of 2006, Liquigás Distribuidora held a 21.7% market share and ranked third in the LPG distribution market based on sales volume according to Sindigás (*Sindicato Nacional das Empresas Distribuidoras de Gás Liqüefeito de Petróleo*).

In 2006, we sold 607.8 million barrels of oil products to wholesale customers, with gasoline and diesel fuel representing approximately 41.96% of these sales. Of our total sales in 2006, 171.1 million barrels of oil products were supplied to BR for retail marketing. The following table sets forth our oil product sales to wholesale customers and retail distributors for each of 2006, 2005 and 2004:

OIL PRODUCT SALES

	2006	**2005**	**2004**
		(MMbbl)	
Product			
Diesel	230.9	228.1	224.9
Gasoline	120.0	114.3	104.8
Fuel oil	94.3	77.2	106.1
Naphtha and jet fuel	82.3	79.3	81.5
Others	361.8	343.5	129.1
Total	889.3	842.4	646.4
Customer			
Wholesalers			
Diesel	110.8	105.5	106.6
Gasoline	46.5	43.0	42.9
Others	24.6	25.4	25.6
Total wholesalers	181.9	173.9	175.1
Retail distributors			
BR	159.5	157.8	145.1
Third parties	547.9	510.7	326.2
Total retail distributors	707.4	668.5	471.3
Total customers	889.3	842.4	646.4

Retail

As of December 31, 2006, our sales network in Brazil included 6,554 retail service stations compared to 6,933 as of December 31, 2005, and comprised approximately 18% of the total number of service stations in Brazil, all under the brand name BR. Over 65% of these BR stations are located in the South and Southeast regions of Brazil, where over 57.2% of Brazil s total population of 188 million reside. Of these 6,554 service stations, 5,870 were active stations and BR owned 638. As required under Brazilian law, BR subcontracts the operation of all its service stations to third parties. The other 5,232 service stations were owned and operated by dealers, who use the BR brand name under license with BR facilities as their exclusive suppliers. BR provides technical support, training and advertising for its network of service stations.

In 2006, 355 of our service stations also sold vehicular natural gas, compared to 295 in 2005 and 245 in 2004. The sales from these stations consisted of 19,246 million cubic feet (545 million cubic meters) in 2006, representing 23.7% of Brazilian market share, 17,198 million cubic feet (487 million cubic meters) in 2005, representing 25.1% of Brazilian market share and 15,008 million cubic feet (425 million cubic meters) in 2004, representing 27% of Brazilian market share.

The introduction of biodiesel was one of the BR s accomplishments in 2006. Aligned to its strategy of being consumers favorite brand and adding value to Petrobras, BR Distribuidora delivered the product to 3,740 service stations and 2,380 major consumers across the country, totaling 2,222,000 m^3 of B2. In 2005, BR owned 2 service stations that sold biodiesel, totaling 820 m^3. Through June 2007, biodiesel is expected to be sold at all BR service stations.

The table below sets forth market share (based on volume) for retail sales of different products in Brazil for each of 2006, 2005 and 2004:

BR MARKET SHARE IN DISTRIBUTION

	2006	**2005**	**2004**
Fuel oil	69.4%	64.8%	64.4%
Diesel	31.6%	31.9%	28.6%
Gasoline	25.0%	25.0%	22.1%
Fuel alcohol.	34.0%	32.2%	31.2%
Total	33.6%	33.8%	31.6%

Prices to retailers have generally tended to remain consistent between competing distributors, particularly due to the low margin in the sector. Therefore, competition among distributors continues to be primarily based on product quality, service and image.

During 2006, approximately 26.3% of the retail sales at service stations in Brazil were made through BR-owned or franchised entities. We believe that our market share position has remained strong over the past several years due to the strong brand name recognition of BR, the remodeling of service stations and the addition of lubrication centers and convenience stores.

In 1996, BR created the *De Olho no Combustível* program (Eye on the Fuel program), which is a certification program designed to ensure that the fuels sold to end consumers at service station networks are identical in content to the fuels originating from our refineries. We have already certified 4,778 service stations under this program.

The retail market for gasoline and diesel fuel in Brazil is highly competitive and we expect that prices will be subject to continuing pressure. Accordingly, we intend to build upon the strong brand image that we have established in Brazil to enhance profitability and customer loyalty.

We participate in the retail sector in Argentina, where we currently own 719 retail service stations that operate under the brand names Petrobras (492 stations), Eg3 (190 stations) and San Lorenzo (37 stations). We also have a participation in the retail sector in Bolivia, Colombia, Paraguay and Uruguay, with 26, 47, 131 and 89 retail service stations, respectively.

Commercial and Industrial

We distribute oil products and bio-fuels to commercial and industrial customers through BR. Our major customers are aviation, transportation, industrial and utility companies and government entities, all of which generate relatively stable demand.

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Set forth below are commercial and industrial sales statistics for each of 2006, 2005 and 2004:

COMMERCIAL AND INDUSTRIAL RETAIL SALES BY PRODUCT

	For the Year Ended December 31,		
	2006	2005	2004
		(Mboe)	
Fuel oil	24,195	22,850	24,649
Diesel	77,409	78,241	70,521
Gasoline	37,640	36,690	32,147
Jet fuels	15,245	15,784	15,020
Fuel alcohol	5,858	5,132	4,147
Lubricants	1,498	1,601	1,460
Others	26,605	24,943	22,609
Total	188,450	185,241	170,554

Natural Gas, Power and Renewable Energy

Summary and Strategy

Our natural gas and power activities encompass the purchase, sale and transportation of natural gas produced or imported into Brazil. In addition, this segment includes our domestic electric energy generation and commercialization activities, as well as participation in domestic natural gas transportation companies, state-owned and private natural gas distribution companies and gas-fired power plants. We are also involved in the development of renewable energy, alternative energy and energy efficiency projects with the objective of decreasing carbon emissions resulting from our activities.

Natural gas demand has been growing sharply in the recent past, but decreased rates of growth are expected in the near future due to limitations in supply. The Brazilian government estimated that, in 2006, natural gas consumption represented 9.6% of primary energy use, as compared to 9.3% in 2005 and 8.9% in 2004. We expect that number to be 11% by 2010. A significant portion of this growth will come from industrial users, who, motivated by environmental concerns and fair prices for natural gas, will replace fuel oil with natural gas. Power plant use and vehicular use are also expected to grow. In 2006, industrial and vehicular consumption have grown 6.3% and 19.3%, respectively.

Our main strategies in the natural gas and power segment are to:

- Develop and consolidate the natural gas business in a profitable manner;
- Expand business in South America, especially related to the supply network for the Brazilian market, in order to increase our share in the primary distribution markets;
- Structure our supply system to permit it to continue to be reliable, flexible, and competitive;
- Develop and consolidate the energy business in a profitable manner, expanding our share in generation and co-generation;
- Act in an effective way within the energy segment in order to make the hydrothermal system more efficient and take advantage of business opportunities;
- Take advantage of synergies within the biofuel business so as to expand the market for our products and services, continue leading the domestic production of biodiesel and increase our share in the ethanol business; and

Produce electricity using renewable sources, such as wind power, solar power, small-scale hydropower and biomass (raw materials with biologic origin), and take advantage of cooperation between our businesses and the businesses of our subsidiary, BR.

Our natural gas and power results are described in the Gas and Power segment of our audited consolidated financial statements.

Natural Gas

Pipelines

In 1998, we developed and built the Bolivia-Brazil natural gas pipeline, which has a total capacity of 1,060 MMscfd (30 MMcmd). The pipeline is 1,969 miles (3,150 kilometers) in length, running from Rio Grande in Bolivia to Porto Alegre in Southern Brazil. The Bolivia-Brazil pipeline connects to our domestic pipeline system that transports natural gas from the Campos and Santos Basins. This pipeline was designed to supply gas to some of our power and petrochemical plants.

The Cabiúnas project comprises transportation and processing facilities of natural gas from the offshore oil fields in the Campos Basin of the State of Rio de Janeiro. This project has been operational since the second semester of 2005 and increased the transportation capacity from the previous 290 million cubic feet (8.2 million cubic meters) per day to a total of 519 million cubic feet (14.7 million cubic meters) per day of associated gas, while reducing the volumes of natural gas currently flared on offshore platforms and alleviating existing constraints on oil production from these platforms. In 2006, the average daily volume of natural gas flared on the offshore platforms of the Campos Basin was 118 million cubic feet (3.338 million cubic meters).

We recently evaluated our natural gas production portfolio, studied other opportunities, and decided to launch several natural gas production projects three years ahead of schedule using a new approach to their implementation in Brazil. The analysis also led to the 2006 Gas Production Acceleration Plan (PLANGÁS) involving E&P, Gas and Power and Supply, as well as Engineering, and CENPES and Transpetro. The PLANGÁS aimed to increase our share in the domestic gas market and help us meet growing demand for gas in the Southeastern Region of the country, thus reducing the region s dependence on imported gas. Specifically, the PLANGÁS consists of interdependent projects, including the increase in the gas production of the Campos, Espírito Santo and Santos Basin, the processing and compressing capacity of the Cabiúnas Terminal and adjustments and expansions to the Malha Sudeste and GASENE pipeline Projects, both in different stages of development and in accordance with our 2007-2011 Business Plan. The GASENE Project involves the construction of 1.4 thousand kilometers of pipelines with capacity of 20 million cubic meters per day, connecting the Cabiúnas Terminal in Rio de Janeiro with the city of Catú in Bahia. The work involves the Cabiúnas-Vitória Gas Pipeline (25% completed), the Vitória-Cacimbas Gas Pipeline (95% completed), and the Cacimbas-Catú Gas Pipeline, where work shall begin in late 2007. Total investment in the GASENE Project shall amount to approximately U.S.$2.2 billion. As of December 2006, R$1.205 billion had already been invested.

We are currently developing the Southeast and the Northeast Gas Pipeline Networks (*Malha Sudeste* and *Malha Nordeste*). This project, known as the Malhas Project, will increase our transportation capacity by expanding the existing natural gas infrastructure and delivering natural gas to markets in the Northeast and Southeast regions of Brazil. During 2006, the natural gas pipeline expansion projects of Northeastern Region (Malha NE) were modified due to changes in our natural gas supply strategy. In the past, the Northeastern shortfall of natural gas was met by the importing of Bolivian gas. It was therefore necessary to invest in the logistics of transporting the gas to Pecém, in Ceará State. Due to the uncertainty of the Bolivian gas supply, Petrobras decided to substitute part of the natural gas imported from Bolivia by LNG (Liquid Natural Gas) imported from other regions, through the Pecém LNG Project.

As a result, the total extension of the natural gas pipelines was reduced by approximately 300 kilometers, in stretches in the northeastern region of Brazil. In the end, the extension was approximately 622 miles (1,000 kilometers) long, which is expected to begin operations throughout 2006 and 2007, at a total cost of approximately U.S.$1.0 billion.

The Northern Region gas project consists of building a natural gas shipment system between our production areas in Urucu and the city of Manaus, located in the northern state of Amazonas. This venture consists of three pipelines: a) construction of the Urucu-Coari LPG pipeline (279 km long and 10 inch nominal diameter), b) conversion of the existing pipeline between Urucu and Coari (18 inch nominal diameter), and the c) construction of the Coari-Manaus gas pipeline (383 km long and 20 inch nominal diameter). A total of R$391 million was invested in 2006 to complete 32% of the project.

Local Distribution Companies

We sell natural gas in Brazil to local gas distribution companies. Under Brazilian law, each state has the monopoly over local distribution. Most states have established companies to act as local gas distributors and we have minority interests in some of these companies. We appoint the majority of the technical and commercial directors of all distribution companies in which we hold a minority shareholding stake.

Currently we hold, through our subsidiary PETROBRAS Gás S.A. GASPETRO, 19 minority interests in natural gas distribution companies in 19 states of Brazil. The majority of the companies have started operations. GOIASGAS, a natural gas distribution company, joined the group of operating companies in November 2006, when it started its operations with LNG, supplied by GAS LOCAL. GAS LOCAL began its operations in August of 2006, selling LNG, as a joint venture with Praxair Inc. However, four companies (CEBGÁS, RONGÁS, GASAP and GASMAR) have not yet started their operations. Also, in the state of Espírito Santo, we have the exclusive rights to distribute natural gas through our subsidiary BR.

In 2006, the gas distribution companies that are operating in which we have an interest (ALGÁS, BAHIAGÁS, CEGÁS, CEG-RIO, COMPAGÁS, COPERGÁS, MSGÁS, GASPISA, PBGÁS, POTIGÁS, SCGÁS, SERGÁS, SULGÁS, GOIASGAS and GASMIG) held total assets of R$2,411 million (U.S.$1,128 million) compared with R$2,289 million (U.S.$978 million) in 2005. The assets are mainly an aggregate pipeline extension of 2,654 miles (4,272 kilometers).

Also in 2006, the average volume of gas distribution, of the companies in which we have an interest was 665,632 million cubic feet of natural gas per day, or 18,849 million cubic meters per day, increasing by approximately 1.8% in the last year. The total net operational revenue in 2006 was R$3.939 billion (U.S.$1.842 billion) as compared to R$3.467 billion (U.S.$1.481 billion) in 2005.

The total net income of the companies in which we have an interest reached R$331.0 million (U.S.$154.8 million) last year compared with R$299.0 million (U.S.$127.8 million) in 2005.

In 2006, investments in the companies in which we have an interest reached a total of R$269.6 million (U.S.$126.1 million) compared to R$290.8 million (U.S.$124.2 million) in 2005.

Some of the operating distribution companies in which we have an interest have entered into long-term gas supply contracts with us under which such companies have purchase obligations (in the case of contracts relating to Brazilian gas), and ship-or-pay and gas purchase obligations (in the case of contracts relating to Bolivian gas or with gas-fired power producers).

The following table sets forth our domestic sales of natural gas to affiliated and non-affiliated local distribution companies for each of 2006, 2005 and 2004:

DOMESTIC SALES OF NATURAL GAS TO LOCAL DISTRIBUTION COMPANIES

	Year Ended December 31,		
	2006	**2005**	**2004**
		(in MMscfd)	
Total sales annual average(i)	1,355	1,289	1,164
Annual sales growth(i)	5.2%	11%	19%

(i) The volume of natural gas sold to local distribution companies (thermal and non-thermal). Our internal

consumption
and natural gas
received by
internal transfer
are not included.

Commitments and Sales Contracts

Our investment in the Bolivia-Brazil gas pipeline in 1998 was the result of a 1996 gas supply agreement, or the GSA, for the purchase of natural gas between the Bolivian state oil company, Yacimientos Petrolíferos Fiscales Bolivianos YPFB, and us. The GSA requires us to purchase from YPFB specified quantities of natural gas transported through the pipeline over a 20-year term.

Gas purchase commitments. Under our contracts with YPFB signed in 1998 for the purchase of natural gas, we have agreed to purchase minimum volumes of natural gas from Bolivia at a formula price that varies with the price of fuel oil. We have purchased and paid in 2006, 2005 and 2004, approximately U.S.$1.3 billion, U.S.$799 million and U.S.$544 million, respectively. Such increase resulted from higher prices (which reflected the international prices for fuel oil) and the increase in the imported amounts: 24.44 MM m3/d in 2006, as opposed to 22.96 MM m3/d in 2005 and 19.94 MM m3/d in 2004. During 2002 and 2003 we purchased less than the minimum volumes set under our agreement with YPFB, and therefore we paid a total amount of U.S.$81 million to satisfy our purchase commitment. Set forth below are the minimum volumes we have agreed to under these contracts, together with an estimate of the amounts we are obligated to pay for such minimum volumes:

NATURAL GAS PURCHASE COMMITMENTS

	2007	**2008**	**2009**	**2010**	**2011**
Brent Crude Oil Projection (1)	50	35	30	30	30
Volume Obligation (Mmcmpd)	24	24	24	24	24
Volume Obligation (Mmcfd)	850	850	850	850	850
Estimated Payments (U.S.$million)(2)	1,101	884	758	740	740

(1) Corporate projections announced in June 2006 in the 2007-2011 Business Plan.

(2) Amounts calculated based on current prices set forth under the agreements projected constant to the future. Prices may be adjusted in the future and actual amounts may vary. Of these amounts, 25.3% are related to Petrobras Bolivia.

In connection with the long-term contract to buy gas (The Gas Supply Agreement or GSA) to supply gas-fired power plants and for other uses in Brazil, the Company entered into a contract, with a gas producer that constituted a derivative financial instrument under SFAS 133. This contract, the Natural Gas Price Volatility Reduction Contract (the PVRC), was executed with the purpose of reducing the effects of price volatility under the GSA. The terms of the PVRC include a price collar for the period from October 2002 to December 2019, with us receiving cash payments when the calculated price is above the established ceiling, and us making cash payments when the price is below the established floor, with no cash payments being made when the price is between the ceiling and the floor. As of December 31, 2005, we recorded a derivative asset based on the fair value calculation amounting to U.S.$547 million and a liability of U.S.$144 million, which is deemed a deferred purchase incentive. Due to the new Hydrocarbons Law of Bolivia (See Note 21 to our audited consolidated financial statements), the other party involved in the PVRC contested the contract, alleging among other, *force majeure* and excessive onus. On August 12, 2006, the parties agreed to cancel the PVRC. As a result, on August 14, 2006, we received U.S.$41 million and wrote-off accounts receivable related to the PVRC amounting to U.S.$77 million. We adjusted the fair value asset and liabilities related to the PVRC by recording a financial expense of U.S.$328 million during the first quarter of 2006 as a result of the tax increases in Bolivia. In the second quarter of 2006, we wrote-off the remaining fair value asset of U.S.$94 million as a consequence of the contract cancellation.

Ship-or-pay commitments. In order to support the financing for the Bolivia-Brazil pipeline, we also have entered into unconditional ship-or-pay purchase obligations for the transportation of natural gas with Gás Transboliviano or GTB and Transportadora Brasileira Gasoduto Bolivia-Brasil or TBG, the companies which own and operate the Bolivian and Brazilian portions of the pipeline, respectively. TBG s portion of the pipeline financing is consolidated in our balance sheet. Our volume obligations under the ship-or-pay arrangements are generally designed to meet the gas purchase obligations with respect to our gas purchase contracts with YPFB. The total capacity of 1,060 MMscfd (30 MMcmd) also includes a transportation capacity option of 212 MMscfd (6 MMcmd), valid for a 40-year term. This transportation capacity option was granted to us in consideration for our agreed investment of approximately U.S.$379 million in the Bolivia-Brazil gas pipeline. The total estimated project cost

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was U.S.$1.9 billion. In 2006, 2005 and 2004, Petrobras made total payments of approximately U.S.$483 million, U.S.$532 million and U.S.$348 million, respectively. Of these amounts, approximately U.S.$424.8 million, U.S.$473.5 million and U.S.$302 million corresponded, respectively, to payments made to TBG for the transportation of natural gas. Set forth below are the minimum volumes we have agreed to under the ship-or-pay arrangements, together with an estimate (assuming certain changes in the U.S. Consumer Price Index (CPI)) of the amounts we are obligated to pay for such minimum volumes:

NATURAL GAS SHIP-OR-PAY COMMITMENTS (TBG)

	2007	2008	2009	2010	2011
Volume Commitment (MMcmpd)	30	30	30	30	30
Volume Commitment (MMcfpd)	1,059	1,059	1,059	1,059	1,059
Estimated Payments (U.S.$million)	393.80	393.57	398.21	401.96	404.11

NATURAL GAS SHIP-OR-PAY COMMITMENTS (GTB)

	2007	2008	2009	2010	2011
Volume Commitment (MMcmpd)	30	30	30	30	30
Volume Commitment (MMcfpd)	1,059	1,059	1,059	1,059	1,059
Estimated Payments (U.S.$million)	58.49	58.79	59.08	59.37	59.67

Natural gas sales contracts. In light of these gas purchase and ship-or-pay obligations, we have entered into or negotiated firm gas sale and ship-or-pay sale arrangements to sell natural gas to local gas distribution companies and gas-fired power plants, most of which we operate and in which we own a minority interest.

The arrangements with the gas-fired power plants are made through contracts with the local distribution companies, which in turn enter into back-to-back arrangements with the gas-fired power plants, and a portion of the gas buyer s payments is usually guaranteed to us by the parent companies of the gas-fired power companies or through financial guarantees. Our total sales of natural gas, which includes sales to gas-fired power companies, for 2006, 2005 and 2004, were approximately U.S.$2,879 million, U.S.$2,398 million and U.S.$1,876 million, respectively. The table below sets forth the commitments by local gas distribution companies and by gas-fired power plants for the purchase of volumes of natural gas from us beginning in 2007, together with an estimate of the amounts obligated to be paid for such volumes, including volumes in firm contracts, contracts in renegotiation, and new firm-flexible contracts under negotiation:

NATURAL GAS SALES CONTRACTS

	2007	2008	2009	2010	2011
			(in MMscfd)		
To Local Gas Distribution Companies					
Related parties(1)	500	508	544	549	560
Third parties	640	640	642	645	646
To Power Generation Plants					
Related parties(1)	107	107	107	107	107
Third parties	104	104	259	259	259
Total	1,351	1,359	1,552	1,560	1,573
Estimated Contract Revenues (U.S.$million)(2)(3)	$2,416	$2,663	$3,224	$3,153	$3,093

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(1) For purposes of this table, related parties include all local gas distribution companies and power generation plants in which we have an equity interest and third parties refer to those in which we do not have an equity interest.

(2) Figures show revenues net of taxes. Estimates are based on sales (outside sales) and do not include internal consumption or transfers. Estimated volumes are based on take or pay agreements in our contracts, expected volumes, and contracts under negotiation, not maximum sales.

(3) Prices may be adjusted in the future and actual amounts may vary.

Pricing. On June 1, 2001, the Brazilian government instituted a mechanism which allows a U.S. dollar-indexed component of the natural gas pricing mechanism to be passed through to gas-fired power plants for a period of 12 years, pursuant to *Portaria* No. 176 (a joint regulatory act issued by the Ministry of Mines and Energy and the Ministry of Finance), which was updated by *Portaria* No. 234 issued on July 22, 2002. See Regulations of the Oil and Gas Industry in Brazil Price Regulation Natural Gas. This mechanism has enabled us to sell natural gas to a number of gas-fired power plants that were unwilling to purchase natural gas under the prior gas price regulation because it requires the buyer to take the intra-year exchange rate risk. Under the new formula, exchange rate variations are reflected in gas prices annually, while we will be remunerated at market based interest rates for any resulting delay in gas price adjustments.

Power

Brazil currently has an installed electricity generation capacity of approximately 96,623 MW. More than 96% of this capacity is interconnected to form one single integrated system, with approximately 90% of the electricity supplied to that system coming from hydroelectric sources. As a result of the significant growth in electricity demand, combined with the limited investment in the sector during the last two decades and a high dependency on hydroelectric power (and consequently susceptibility to a prolonged drought), we believe substantial additional generation capacity needs to be developed in Brazil.

New Regulatory Model

A New Regulatory Model for the Brazilian Electric Power Sector (*Novo Modelo Regulatório do Setor Elétrico Brasileiro*), Law No. 10,336, was introduced on March 16, 2004, with the enactment of the New Industry Model Law. Under the new model, assured energy availability may be sold under regulated contracts to public utility companies, as these companies are legally bound to acquire energy as cheaply as possible through auctions or free contracts. Energy availability sold under regulated contracts must be acquired by means of public auctions and energy availability sold under the free market is negotiated freely through bilateral contracts. The new regulatory model also creates incentives for investments in power generation from alternative sources.

The first auction for power plants built recently or under development was held in December of 2005. We participated in the auction and sold 1,391 MW of energy from our gas-fired power plants with the intention of securing long-term contracts. The contracts represented 42% of the energy sold in the auction.

Of the 1,104 MW sold in the October 2006 auction, 48.5% (535 MW) were from gas-fired power plants. Our sales totaled 205 MW, 18.6% of the energy sold in the auction.

Status of Investments

We believe that our participation in the construction and development of gas-fired power plants has strategic benefits for our business because:

- our participation in the power sector helps create a market for natural gas made available through our investments in the natural gas business;

- we are able to build inside the fence co-generation plants close to our refineries and other facilities, which provide us with a reliable and inexpensive source of electricity for use in our own refineries; and

- these co-generation plants also produce steam for use by our refineries and in onshore crude oil recovery enhancement projects. For example, the gas-fired power plant, Termoaçu, which is currently under construction, will generate steam for the Exploration and Production Unit of Rio Grande do Norte and Ceará. The production and consumption of steam reduces the overall costs of generating electricity, making such electricity cost competitive relative to other gas-fired power generation, including new hydroelectric developments.

In addition, we concluded a program for the acquisition of three gas-fired power plants (Eletrobolt, TermoCeará and Macae Merchant), in order to mitigate the losses resulting from contractual obligations previously suffered.

The main purpose of these acquisitions is to reduce our financial exposure in connection with these merchant gas-fired power plants. See Financial Exposure.

Financial Exposure

To encourage the development of some of the gas-fired power plants in which we participate with an equity interest, or to which we sell our natural gas, we have entered into agreements to provide economic support to such gas-fired power plants. Our obligations under these agreements were structured as tolling arrangements whereby we agree to provide each of the inputs to produce electricity and operate the plant, as well as off-take the electricity, remunerating the gas-fired power plant at a price that will service capital (equity and debt).

We have only entered into tolling arrangements with gas-fired power plants in which we have an equity interest. Our power commitments under the tolling agreements are as follows:

POWER OFFTAKE PROJECTED COMMITMENTS

PLANT	2007	2008	2009
		(Average MW)	
FAFEN	138	138	138
TermoBahia	186	186	186
Total NE Tolling Arrangements	**324**	**324**	**324**
Ibiritermo	226	226	226
Total S/SE Tolling Arrangements	**226**	**226**	**226**

In 2007, total generating capacity in respect of which we have tolling commitments, based upon commitments of projects under construction or in operation, is 550 MW.

We expect that the electricity we purchase under the tolling agreements will be partly used for demand in our facilities, estimated to be 282 MW in 2007, 296 MW in 2008, and 310 MW in 2009, allocated between the Northeast and South/Southeast regions of Brazil. UTE FAFEN has a power purchase agreement for the sale of electric power to third parties (distributors /concessionaires). By the end of the fourth quarter of 2005, we sold energy availability in auctions coordinated by the MME, by means of energy agreements of 15 years, starting as of 2008, with increasing volumes, reaching 1391 MW in 2010. Our commercial strategy is to continue the sale of our remaining capacity in public auctions to distributors and the sale to large consumers through power purchase agreements.

On December 28, 2006, we reached an agreement with Companhia Paranaense de Energia (COPEL) to lease the Araucária gas-fired power plant, a plant in the Curitiba Metropolitan Region with 484.5 megawatts of capacity. Our lease agreement with UEG Araucária is effective until December 31, 2007, and may be extended for a period of up to 12 months. We also leased the Bahia I gas-fired power plant on December 28, 2006, a plant with 31.6 megawatts of capacity.

On April 27, 2007, Petrobras signed a contract with Empresa Metropolitana de Águas e Energia SA (EMAE) to lease the Piratininga oil-fired power plant, located in the metropolitan region of São Paulo, the largest energy market in Brazil. Petrobras operates a gas-fired power plant on the same site, Usina Fernando Gasparian. The operation of the gas-fired power plant together with part of the Piratinga oil-fired power plant will allow for 540 megawatts of capacity. In addition, it will be possible to reach a capacity of 200 megawatts from the oil-fired power plant. This arrangement provides greater operational flexibility and increases the total amount of energy that we can supply. The lease is effective until 2024.

Renewable Energy Alternative

Our strategy in energy development is based on renewable energy, energy efficiency and the potential gains in carbon credits due to the prevented emissions promoted by these activities.

Renewable Energy

We aim to become the leader in national biodiesel production and expand our participation in the ethanol business. In order to achieve these objectives, we have developed and intend to invest U.S.$700 million in various initiatives relating to renewable energy sources, as described in our 2007-2011 Business Plan.

We already have one wind power plant with a 1.8 MW capacity in Macau RN, northeast of the country. At first, we intend to use the produced energy for internal consumption. Other projects for wind power plants and small hydropower plants are under study. These projects will expand our use of renewable energy. Our Business Plan in 2006 projected production at 855 million liters (225.87 million gallons) of biodiesel by 2011, as well as export 3.5 billion liters (924.6 million gallons) of ethanol and generate 240 MW of electricity through a renewable source of energy.

Biodiesel

Brazil is an important player in the international biofuels market and has a highly favorable climate and soil for the growing biomass, especially for the oleaginous seed crops.

With this growth and in accordance with our strategy of becoming the national leader in the biodiesel industry as an integrated power company, we began the construction of 3 processing plants in 2006. The facilities in Candeias (BA), Montes Claros (MG) and Quixadá (CE), will produce approximately 57 million liters of biodiesel per year and will start operations by the end of 2007.

As of January 2008, the addition of biodiesel to diesel oil will be mandatory, in the proportion of 2%. For the acquisition of raw materials soy, cotton, castor oil and palm oil and an oleaginous seed called *pinhão manso* in addition to animal fat, we have entered into partnerships with small agricultural businesses, taking advantage of the tax incentives granted to biodiesel producers that generate work and income for family-run agriculture businesses.

Biodiesel decreases the emission of gases that create the greenhouse effect, due to its vegetable origin, sulphur and particulate matter, optimizing the performance of engines. Besides the environmental and social advantages, according to the increase in the use of renewable sources of energy, our product will accelerate the end of the necessity of importing diesel fuel.

Sustainable Development

Our actions relating to the sustainable development of power in 2006 aimed to evaluate the implementation of projects to avoid emissions of greenhouse gases (GHG), throughout the entire Petrobras system to obtain Certified Emission Reductions (CER) according to the Clean Development Mechanism (CDM) and rules of the Kyoto Protocol, as well as to propose sales policies regarding these CERs. We have studied the technical viability and baseline methodologies in order to obtain approval and registration of those projects with the Executive Board of the CDM. We registered the first Petrobras CDM Project in March of 2007. This project represents the use of wind power as a substitute for the generation of power with fossil fuels in the platforms of Aratum, in Rio Grande do Norte. Other projects underway, mainly linked to the downstream area, are aimed at elaborating the CDM Project Design Document, a template on which a company describes its calculations for reduced emissions in accordance with the Kyoto Protocol. They include the generation of power in turbo expanders in several refineries, reduction of N_2O in the fertilizer production area, and the use of heat from gases emitted, among others.

Energy Efficiency

The consolidation of our energy consumption and the enhancement of energy efficiency in our units are the main activities of the Internal Energy Conservation Program.

In 2006, there was a relative reduction in the burning of fossil fuels, saving approximately 1.084 barrels of equivalent oil per day; a volume that resulted in savings of approximately U.S.$20 million and that avoided emissions of approximately 171 thousand tons of CO_2 in 2006.

In addition, the *Programa Nacional de Racionalização do Uso dos Derivados* (the National Oil and Natural Gas Derivates Rationalization Program, or CONPET), a governmental program involved in environmental matters and coordinated by us, facilitated the prevention of about 818 thousand ton of CO_2 emissions into atmosphere in 2006, saving approximately 305 million liters of oil diesel and increasing motor efficiency by 7%.

International

Summary and Strategy

In 2006, approximately 6.8% of our net revenues were generated outside Brazil. We seek to evolve from an integrated oil and gas company in Brazil to a leading energy company in Latin America and a strong international player.

Currently, we plan to focus our non-Brazilian exploration, development and production activities regionally, in areas where we can successfully exploit our competitive advantages, such as deepwater technology. We particularly intend to drill off the west coast of Africa and the Gulf of Mexico and onshore in South America. We recently acquired rights to participate in four exploration blocks offshore Angola. We are also expanding our interests in South America in the downstream segment. During 2006, the following new assets were bought: one lubricant plant, service stations and convenience stores in Colombia; service stations, oil products distribution facilities (asphalt, lubes and aviation products), and one LPG distribution facility in Paraguay; and service stations, oil products distribution facilities (asphalt, lubes, marine and aviation products), and one natural gas distribution company in Uruguay.

We have budgeted U.S.$12.1 billion in capital expenditures for the period from 2007 to 2011 for international investments.

Our main strategies in the international segment are to:

- Assure our leadership as an integrated energy company in Latin America;
- Expand our exploration and production activities in the Gulf of Mexico and Africa;
- Expand our operations in new exploration and production in areas where we may have competitive advantages;
- Expand downstream activities in profitable markets with a high potential for growth;
- Add value to our production of heavy crude;
- Incorporate natural gas reserves and operate in the LNG market; and
- Internationalize and add value to our brand.

Our international results are reflected in the International segment in our audited consolidated financial statements.

Exploration and Production

During 2006, we conducted exploration activities outside Brazil: in Argentina, Bolivia, Colombia, Ecuador, Nigeria, Peru, the United States and Venezuela. In addition, we are currently performing studies to evaluate blocks where we hold interests in Angola, Argentina, Colombia, Mexico, Nigeria, the United States, Iran, Equatorial Guinea, Tanzania, Turkey, Libya, Mozambique and Venezuela. Production activities were conducted in Angola, Argentina, Bolivia, Colombia, Ecuador, Mexico, Peru, the United States, and Venezuela. Collectively, these activities represented 23.9% of our total capital expenditures for crude oil and natural gas exploration and production. Our capital expenditures for international exploration and production were U.S.$2,304 million for 2006, U.S.$1,067 million for 2005 and U.S.$666 million for 2004. The following table provides information about the allocation of such expenditures for each of 2006, 2005 and 2004:

DISTRIBUTION OF CAPITAL EXPENDITURES IN INTERNATIONAL EXPLORATION ACTIVITIES

	2006	2005	2004
Argentina	6.4%	7.2%	3.1%
Bolivia	0.6	4.4	0.2
Colombia	3.6	4.6	3.5
Peru, Ecuador and Venezuela	1.1	0.3	2.4
South America	11.7	16.5	9.2
West Coast of Africa	43.7	47.8	52.0
Gulf of Mexico	31.5	33.9	36.8
Others	13.1	1.8	2.0
Total	100.0%	100.0%	100.0%

Development

Over the past three years, we have participated in the development of a number of fields internationally. These include: five in Colombia (Guando, Rio Ceibas, Yaguara, Santiago and Espinal), three in the United States (GB 200, North Coulomb and Cottonwood), one in Angola (Block 2), two in Nigeria (Akpo and Agbami), many fields in Argentina concentrated in the Neuquen and Austral basins (most importantly in Medanito, Puesto Hernandez, Rio Néuquen, Santa Cruz I and Santa Cruz II), four in Bolivia (San Alberto, San Antonio, Colpa Caranda and Monteagudo), one in Ecuador (Block 18), one in Peru (Lote X) and four in Venezuela (Ortiupano-Leona, Mata, Acema and La Concepción). In 2006, our net production outside Brazil averaged 142.2 thousand barrels per day of crude oil and NGLs and 101.1 thousand barrels of oil equivalent of natural gas per day at an average lifting cost of U.S.$3.36 per barrel. The following table provides information on the allocation of our international development activities for each of 2006, 2005 and 2004.

ALLOCATION OF CAPITAL EXPENDITURES IN INTERNATIONAL DEVELOPMENT ACTIVITIES

	2006	2005	2004
Argentina	26.5%	36.2%	41.9%
Peru	5.8	8.3	10.9
Ecuador	3.6	16.7	7.4
Bolivia	1.3	1.7	1.5
Colombia	2.8	4.6	6.8
Venezuela	1.8	15.9	28.4
South America	41.8	83.4	96.9
West Coast of Africa	41.0	15.0	1.4
Gulf of Mexico	17.2	1.6	1.7

Total	100.0%	100.0%	100.0%

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Argentine Activities

We operate in Argentina mainly through our subsidiary PESA Petrobras Energía S.A. (ADR: PZE), in which we have a 67.2% interest.

As of December 31, 2006, our combined crude oil and natural gas proved reserves in Argentina were approximately 311 million barrels of oil equivalent, approximately 60.5% of which were proved developed reserves and approximately 39.5% of which were proved undeveloped reserves.

PESA s production in Argentina is concentrated in the Neuquén and Austral Basins. PESA holds 670 thousand net acres under production concessions in the Neuquén Basin and 2.456 thousand net acres under production concessions in the Austral Basin. Our gross production acreage in Argentina amounted to 4,807 thousand acres (3,233 thousand net). For the year ended December 31, 2006, combined crude oil and natural gas production in Argentina averaged 107.9 thousand barrels of oil equivalent per day.

In the downstream segment we have refining capacity of 81 thousand barrels per day, distributed in two refineries operating with a throughput rate of 78%. We also have a 28.5% interest in Refinería Del Norte which we operate. We also participate in the retail sector in Argentina, where we currently own 719 retail service stations that operate under the brand names Petrobras (492 stations), Eg3 (190 stations) and San Lorenzo (37 stations).

We also participate, through PESA, in petrochemical businesses, in which we have three plants, Puerto General San Martin, Zarate and Campana in Argentina, where we also have a 40% participation in Petroquímica Cuyo. PESA also owns a petrochemical integrated complex for the production of ethylbenzene, styrene, and polystyrene plant in Brazil, INNOVA, a wholly-owned subsidiary of PESA.

Project MEGA

We own a 34% participation in Compañia MEGA S.A. (representing a total investment of U.S.$80.3 million), a joint venture with Repsol-YPF and Dow Chemical to fractionate natural gas liquids. The company consists of a natural gas processing plant in Loma La Lata (Province of Neuquén), a 600 km long pipeline, a separation plant, port, storage and effluent treatment facilities in Bahía Blanca (Province of Buenos Aires). We are obligated under an off-take contract to take minimum volumes of LPG and natural gasoline, if delivered, at market prices.

Other interests of PESA

In the gas and power sector, we participate, through PESA, as a co-controlling shareholder in TGS, which owns approximately a 7,500 km extension pipeline with current firm contracted transport capacity of 71.6 MMcmd and a gas processing plant located in Bahía Blanca, with a processing capacity of 43 MMcmd.

Regarding our electricity assets in Argentina, we cover the entire production chain, accounting for 6.5% of the country s electricity generation through ownership interests in two generation plants, Pichi Picún Leufú (hydroelectric generation) and Genelba (gas-fired power generation). We also have an indirect interest in Transener, Argentina s largest transmission company and owner of 95% of Argentina s high-tension network. In June 2006, PESA s Board of Directors accepted the terms of the binding offer submitted by Eton Park Capital Management for the acquisition of our 50% equity interest in Citelec and, as part of this offer, our 22.22% interest in Yacylec. In August 2006, Petrobras Energía entered into a stock purchase agreement with EP Primrose Spain S.L. (a company controlled by Eton Park Capital Management) with respect to Eton Park s offer. Under the terms of the stock purchase agreement and the terms of Petrobras Energía s divestment commitment, the consummation of the transaction with Eton Park was subject to the approval by the pertinent regulatory agencies and authorities. On February 9, 2007, the Argentine Antitrust Commission issued a resolution rejecting the sale of Citelec shares to Eton Park Capital Management. In March 2007, Petrobras Energía received an offer from Energía Argentina S.A. (Enarsa) and Electroingeniería S.A. for the purchase of its shares in Citelec and Yacylec, proposing legal, economic and financial conditions identical to those previously agreed with Eton Park Capital Management. As a result of this offer, a letter of agreement was executed subject to approval by the Board of Directors of Petrobras Energía, Enarsa and Electroingeniería. The letter of agreement provides that the offer will be accepted if the rejection of EP Primrose Spain S.L. s proposed transaction becomes final through administrative or legal proceedings or if the agreement entered into with EP Primrose Spain S.L. were terminated for failure to obtain all required governmental authorizations. We also maintain an important presence in the central area of Buenos Aires, an area with more than 2.1 million customers, through Edesur, Argentina s largest energy distribution company by volume.

Bolivian Activities

As of December 31, 2006, our combined crude oil and natural gas proved reserves in Bolivia were approximately 214.7 million barrels of oil equivalent, approximately 96.8% of which were proved developed reserves. We drilled one exploration well in Bolivia in 2006, but we found that it was not commercially feasible. In 2006, we also started drilling a development well in the Sábalo Field, located in the San Antonio block. This operation will continue in 2007. For the year ended December 31, 2006, our combined crude oil and natural gas production in Bolivia averaged 57.0 thousand barrels of oil equivalent per day.

On May 1, 2006, the Bolivian government established by decree that the state-owned YPFB will become a partner in every asset belonging to the oil and gas sector.

With respect to our operations in Exploration and Production, we have a 35% interest in the San Alberto and San Antonio Fields (the other partners are Empresa Petrolera Andina (50%) and Total Bolivia (15%)). During the transition period, we were involved in intense negotiations with YPFB and the Bolivian government, resulting in the signing of new operational contracts with YPFB in October 2006. These new operational contracts provide that (i) all hydrocarbon resources are property of YPFB, (ii) we maintain our status as operator of the oil and gas fields but sales must be made through YPFB, and (iii) we have the right to recover our costs and participate in the profits generated by the production. The contracts became effective in May 2007.

In terms of our two refineries, the decree established the transfer of 50% plus 1 share to YPFB and the remaining 49.9% to be retained by us. However, in May 2007, after intense negotiations with the Bolivian government, we reached an agreement with YPFB, in which we will receive U.S.$112 million for all of our shares of PBR. A transition period of two months has been defined in which the transfer of the operations and the shares have to take place as well as the payment, which is set to be made in two parts.

Since the nationalization measures were first announced by the Bolivian government, we and the Bolivian government have had disagreements in connection with the terms of the GSA. The Bolivian government attempted to increase the gas prices under the agreement but currently has agreed to maintain the prices at the levels originally provided for in the agreement, except for a premium for those volumes with calorific power higher than 8,900 kcal/m3, for which a new price formula has, based on international market prices, yet to be negotiated.

YPFB also became the sole distributor of refined oil and gas products in Bolivia, and we ceased our activities in this area. We continue to own Petrobras Bolívia Distribución, or PDB, a company with a former network of 104 service stations, but which currently retains ownership of only 26 of these stations.

For further information on our Bolivian activities, see Item 3. Key Information Risk Factors Risks Relating to Our Operations¾ The recent nationalization measures taken by the Bolivian and Venezuelan governments may have an adverse effect on our results of operations and financial condition.

Venezuelan Activities

In March 2006, Petrobras Energía S.A. (PESA), Petróleos de Venezuela S.A. (PDVSA), and Corporación Venezolana del Petróleo S.A. (CVP) entered into several Memoranda of Understanding in order to migrate the Operating Services Agreements to majority state-owned companies (*empresas mistas*, or mixed companies), which had the effect of limiting private participation in the oil business in Venezuela. The economic effects of the migration came into force starting April 1, 2006.

As of December 31, 2006, estimated proved oil and gas reserves attributable to PESA s operations in Venezuela amounted to 78.6 million barrels of oil equivalent, accounting for 14.1% of PESA s total reserves. Estimated proved oil and gas reserves attributable to the company s operations in Venezuela are calculated on the basis of the contractual structure in force as of such date. In 2006, we drilled one dry hole exploration well in Venezuela.

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In March 2006, PESA entered into several Memoranda of Understanding (MOUs) in order to migrate the Operating Services Agreements of the Oritupano Leona, La Concepción, Acema and Mata Areas, to majority state-owned companies (mixed companies). As a consequence of the migration process, PESA s role of operator was changed to that of a minority shareholder of the mixed companies. The new operator is the mixed company itself. Pursuant to the abovementioned MOUs, interest of private investors in the mixed companies was limited to 40%, with the Venezuelan Government holding a 60% interest. PESA s direct and indirect interest in the Oritupano-Leona, La Concepción, Acema and Mata areas was set at 22%, 36%, 34.5% and 34.5%, respectively. Before April 1, 2006, PESA s indirect interest in the Oritupano-Leona, La Concepción, Acema and Mata areas was 55%, 90%, 86.2% and 86.2%, respectively.

The MOUs established that CVP will recognize a divisible and transferable credit in favor of the private companies that will compose the partially state-owned companies. PESA was awarded a credit in the amount of U.S.$88.5 million. This credit can be assigned but it will not bear interest and may only be used for future investments in oil and gas exploration, development or production activities in Venezuela.

Compliance with the terms of the MOUs was subject to approval by the relevant authorities, including the National Assembly, as specified below, and PESA s Board of Directors.

The organization of the majority state-owned companies and the terms and conditions governing the performance of primary activities thereby, were indeed approved by the Venezuelan Ministry of Energy and Petroleum and the Venezuelan National Assembly, as well as by PESA s Board of Directors.

Other Activities and relevant facts regarding our operations in Venezuela

In February 2005, as part of the cooperation strategy between Brazil and Venezuela, the two countries signed 14 Memoranda of Understanding (MOUs) designed to develop a series of initiatives and projects to increase assistance and collaboration in the oil and gas sector.

We and PDVSA are the main players in these agreements. To carry out these efforts, we incorporated a separate entity, independent from PESA, called Petrobras Venezuela Inversiones y Servicios S.A. (PEVIS). PEVIS will be entitled to develop all the initiatives, projects and studies supported by the cooperation agreements signed between Brazil and Venezuela, and in addition, PEVIS will serve as a service unit, providing technical expertise and personnel to support projects and/or units where we require this support. PEVIS will also be in charge of finding and developing possible business enterprises located in the local area, in the north of South America and in the Caribbean.

By mid July 2006, PEVIS was formally incorporated and began the process of hiring personnel, mainly from PESA Venezuela. See Item 3. Key Information Risk Factors Risks Relating to Our Operations The recent nationalization measures taken by the Bolivian and Venezuelan governments may have an adverse effect on our results of operations and financial condition for a description of the risks associated with these measures.

During 2006, the Venezuelan projects included:

Carabobo 1

This block is part of the strategy that the Venezuelan government has developed for the exploitation of the vast reserves of extra heavy oil in the Orinoco Belt in the southern part of the country. In this case, the field development is, in principle, tied to a vertically integrated business model that includes the construction of an enhancer complex to produce synthetic crude with better quality as it comes from the extra heavy crude oil, and also the construction of a refinery in the northeast of Brazil (Pernambuco state) to which part of the production from the enhancer complex will be allocated.

During 2006, we, through PEVIS, worked with this model through its different stages. Relating to production, during the second semester of the year, a technical team worked on the reserve estimate and the certification of the Carabobo 1 block. This process officially concluded in December 2006 with a reserve certification by a third party. In 2007, a joint technical group of PDVSA s and our engineers began work on a preliminary development plan for the upstream portion of the integrated project. This group has reviewed numerous

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aspects related to wellbore characteristics and drilling, geology and petrophysics, production strategy, facilities, operation and maintenance and a basic layout and distribution of all facilities planned for the field including delivery and points for the fluids. All this work is considered to be preliminary as the definition of the specific area and its limits to be assigned to the mixed company is yet to be determined by the Ministry of Energy and Petroleum (MENPET).

The analysis of the enhancer complex is on hold until PDVSA presents the results of a conceptual visualization study performed by a Canadian consortium.

The basic engineering of the Pernambuco Refinery was conducted in Brazil. The proposed refinery will be built in the city of Suape, and PDVSA will have a 40% share, that is similar to the share that we will have in the Carabobo field. Construction is expected to start in the second semester of 2007.

Currently, PDVSA and the MENPET are in the process of discussing legal details of the Carabobo 1 area and the contracts for this area and for the Pernambuco Refinery

Mariscal Sucre

The studies to develop four offshore gas fields (Río Caribe, Mejillones, Patao and Dragón) in the northeastern part of Venezuela, in association with PDVSA, were conducted in Brazil. The studies were performed during 2006, and focused on upstream activities. The mid and downstream stages of the project are still in their conceptual stages, with PDVSA responsible for these studies. Although this project is now being carried out in Brazil, PEVIS personnel have been serving as the liaison between Venezuelan and Brazilian officials in order to facilitate this initiative.

Mature Fields

As part of the new business model implemented by PDVSA, the exploitation of developed fields (blocks that have been in operation for several years and in some cases abandoned due to their declining production rate with traditional methods) through incorporated joint ventures (mixed companies) with foreign companies will be projected for several assets in 2007 and 2008.

Due to its geographic location and to particular characteristics that in some ways resemble the fields that PESA operated for ten or more years, PDVSA offered us five fields from its portfolio to be operated by a mixed company between both PDVSA and us.

We and PDVSA studied the fields of Lido, Limon, Nieblas, Adas and La Paz during 2006 in order to create a development strategy for the mixed company. A final project was submitted to our Board of Directors in March 2007. At this point PEVIS was authorized to proceed with the negotiations with PDVSA and MENPET in order to create a mixed company to operate these fields. After our proposal, PDVSA required the payment of an entry bonus, a type of downpayment used in the bid, in order to authorize the creation of the mixed company. The negotiations regarding the amount of this bonus are still in progress and results are expected during the second semester of 2007.

Project PT Moruy

This project is being developed through an incorporated joint venture with Teikoku (PT MORUY II, S.A.), giving equal shares to each company, to explore one offshore block in the Venezuelan Gulf called Moruy II, for the production of non-associated gas. The rights to explore and develop this block were obtained in an open bid organized by MENPET in November 2005. In February 2006, a Gas License was granted to PT MORUY II, S.A. and all the studies officially started.

The license, under the Venezuelan law for gaseous hydrocarbons, entitles the licensee to explore and develop the area if commercial resources of free gas are found. The joint venture has a firm commitment to perform a seismic survey in the area and the drilling of one exploratory well over a period of 30 months.

During 2006, several studies were performed to design the required seismic survey and the process for implementing the survey, which were finished in the third quarter of 2006. In January 2007, the vessel to perform seismic studies arrived in the Moruy II block, and all the necessary permits and licenses were obtained.

The 3D seismic acquisition was performed between January and March 2007, completing the entire scope of the study in accordance with the budget and time allotted, with the required quality and without any environmental incident or any issue raised by the surrounding communities. Currently the interpretation of the seismic data, development of technical studies associated with environmental licenses, and the planning of all the activities related to the drilling of the exploratory well are being conducted as planned.

Other relevant facts during 2007

As an extension of all the activities and milestones accomplished in 2006, in 2007 PEVIS has taken a series of actions to move forward into the development of its projects in Venezuela and also in allocating technical personnel to some of our localities in order to accommodate the human resources demand from several of the corporate ventures in Brazil and abroad.

Ecuadorian Activities

In Ecuador, our subsidiary, Petrobras Energía, or PESA, operates Blocks 18 and 31. As of December 31, 2006, we had interests, through PESA, of 30% and 60% in Blocks 18 and 31, respectively.

Block 18 is located in the Oriente basin of Ecuador, having a significant potential of 28º to 33° API light crude oil reserves. The concession for production activities in Block 18 is for an initial 20-year term from October 2002. Once this term expires, Ecuadorian hydrocarbon laws provides for the possibility of an additional five-year extension period.

Block 18 has 25 productive wells, of which 3 are located at the Pata field and 22 are located at the Palo Azul field. No exploration wells were drilled in Ecuador during 2006. In 2006 drilling of 8 productive wells resulted in a significant increase in production. The oil treatment plant and ducts became operational in December 2006 and currently allow the treatment of 40,000 barrels of dry oil per day and increase gross production that had been limited by the former production facilities.

Block 31 is located in a highly sensitive ecological area of the Amazon jungle in the central part of the eastern border of the upper Amazon basin and covers an area of 494 thousand net acres. Pursuant to the block s production sharing agreement between Petroecuador and PESA, Petroecuador is entitled to a crude oil production share ranging between 12.5% and 18.5%, depending on the field s daily crude oil production and crude oil gravity.

PESA also conducted extensive exploratory work in Block 31, including the drilling of four exploratory wells, which led to the discovery of the Apaika/Nenke, Obe, and Minta fields.

In August 2004, the Ecuadorian Government approved an environmental impact study, but due to limitations imposed by the Ministry of the Environment in Ecuador (MAE) relating to works within Parque Nacional Yasuní, works were temporarily suspended. Petrobras Energía Ecuador, MAE and the Ministry of Energy and Mines of Ecuador are working to agree on a new development plan for Block 31. Based on the proposal submitted by the Company, the new development project associated with the Apaika and Nenke fields will minimize impact on Parque Nacional Yasuní. PESA will use cutting-edge technology in connection with oil production and environmental protection, this certainly being an example of integration between oil production activities and nature.

Regarding the exploitation of Blocks 18 and 31, PESA signed an agreement with OCP (Oleoducto de Crudos Pesados), whereby an oil transportation capacity of 80,000 bbl/d is secured for a 15-year term, starting November 10, 2003.

On January 11, 2007, PESA obtained approval from the Ecuadorian Government, for the sales agreement by which it will transfer 40% of its rights and interest in Blocks 18 and 31 and the corresponding rights and obligations, including in the OCP, to Teikoku Oil Co. As a result of this authorization, the parties are currently in the process of completing the necessary formalities, including the necessary steps towards obtaining amendments to the participation contracts, in order to incorporate Teikoku as a partner in the agreements for Blocks 18 and 31. Once the amendments are finalized, the terms and economic conditions of the Teikoku transaction will go into effect. See International Ecuadorian Activities.

As of December 31, 2006, PESA s crude oil proved reserves in Ecuador were approximately 53.9 million of barrels of oil and its oil production averaged 11.9 thousand barrels per day.

Peruvian Activities

As of December 31, 2006, PESA s combined crude oil and natural gas proved reserves in Peru were approximately 88 million of barrels of oil equivalent and PESA s combined oil and gas production averaged 14.5 thousand barrels per day.

In May 2004, PESA entered into a contract with Repsol Exploración Perú S.A. to perform certain exploration activities jointly in Block 57, which is located in the Ucayali basin. Pursuant to this contract, PESA participates in Block 57 with a 35.15% interest. As of November 2004, PESA entered into an agreement with Occidental for the assignment to Petrobras Energía de Perú S.A. of 30% of the rights in the License Agreement for Hydrocarbon Exploration and Production in Lote 103.

In 2005, PESA entered into license agreements for hydrocarbon exploration and production in Lote 58 and Lote 110 at the Ucayali Basin (adjacent to Camisea) and in Lote 112 at the Marañón Basin. Perupetro has recently awarded Petrobras Energía del Perú S.A Lote 117 located at the Marañón Basin.

In 2006, we drilled 45 wells and performed 219 workovers. In addition, we extended our secondary recovery project, with 6 conversions of producing wells to injectors. As a result, investments for the year totaled approximately U.S.$64 million.

Uruguayan Activities

In December 2004, we entered the Uruguayan market through the acquisition of 55% of the voting shares of Conecta S/A, which is one of the two local natural gas distribution companies operating in Uruguay, for U.S.$3.2 million. The other 45% of the Conecta s voting shares remains with the state-owned Administratión Nacional de Combustibles Alcohol y Portland ANCAP.

Conecta has exclusive rights to supply small to medium-size consumers with a demand of up to 5,000 cmpd, and operates in small cities in Uruguay such as, Paysandu, Ciudad de la Costa y Colonia, selling 57,000 cmpd. Conecta s revenues in 2006 were U.S.$5.6 million.

In June of 2006, we finished the acquisition of 66% of the shares of Gaseba Uruguay Grupo Gaz de France S.A. (Gaseba), a natural gas distribution concession in Montevideo, Uruguay. The company is now changing its name to Distribuidora de Gas de Montevideo Grupo Petrobras. Gaseba has exclusive rights to supply small to medium-size consumers with a demand of up to 5,000 cmpd, and operates in the Montevideo area, selling 133,000 cmpd. Gaseba revenues under our management in 2006 were U.S.$15.1 million.

Also in June of 2006, we completed the acquisition of Shell s fuel and lubricant retail and commercial businesses in Uruguay. The company now controls 89 services stations, and installations for aviation fuel and asphalt, and a marine fuels business. Under our management in 2006, Petrobras Uruguay Distribución SA had U.S.$168.9 million in revenues, selling 199 thousand cubic meters of products.

Paraguayan Activities

In March of 2006, we completed the acquisition of Shell s fuel and lubricant retail and commercial businesses in Paraguay. The Company now controls 131 services stations, with 45 convenience stores, installations for aviation fuel supply and one LPG refueling plant. In 2006, under our management, Petrobras Paraguay Distribución Ltd had U.S.$171 million in revenues, selling 234 thousand cubic meters of products.

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Colombian Activities

In 2006, the National Hydrocarbons Agency and Ecopetrol approved the farm-in contract signed in 2005 with Hocol, which allowed us to acquire concession rights in the Upar, San Jacinto, Rio Paez, Achira and Rio Cabrera blocks.

In 2006, we had interests in ten exploration contracts and seven production contracts in Colombia, including the recently acquired Tibu field, the contract for which was agreed upon with Ecopetrol in December 2006. We are the operating company in twelve of these contracts.

As of December 31, 2006, our combined crude oil and natural gas proved reserves in Colombia were approximately 35.5 million of barrels of oil equivalent and our combined oil and gas production averaged 16.9 thousand barrels per day.

At the end of 2006, we had control over 47 service stations and 17 convenience stores in Colombia, all of which now use our new brand image.

We carried out seismic studies in Block Tayrona, a 22,346km^2 offshore block in the Caribbean Sea of Colombia, in association with Exxon and Ecopetrol. We are the operator of the concession during the exploration phase.

U.S. Gulf of Mexico Activities

Petrobras America, Inc., or PAI, our wholly-owned subsidiary, continues to expand its activities in the Gulf of Mexico s deep and ultra-deep waters either through farm-in agreements (by which PAI, rather than obtaining an interest directly from the relevant government authorities, acquires an interest from a party who has already obtained such interest), or participation in Lease Sales conducted by the United States Minerals Management Service (the U.S. industry regulator). As of December 31, 2006, PAI held interests in 319 offshore blocks in the Gulf of Mexico from shallow to ultra-deep waters and 1 onshore block, 170 of which were operated by our subsidiary.

As a result of its participation in Gulf of Mexico Lease Sale 198 and 200 in 2006, Petrobras was awarded a total of 43 exploration blocks: 37 blocks strengthened its position in deep and ultra-deep oil prospects while 6 blocks create a strong coverage in the westernmost part of the Gulf, where we now hold full control over 10 prospects with good potential for gas.

The average production in the Gulf of Mexico reached only 4.0 thousand barrels of oil equivalent per day (boed), approximately 65% of the target, mainly due to operational matters relating to the ongoing effects of Hurricanes Rita and Katrina, which occurred at the end of 2005.

In August 2006, we announced the acquisition of 25% participation of the Cascade Field and 26.67% participation of the Chinook field from BHP Billiton. PAI also agreed to buy the 15% participation from Hess in the Chinook Field. Since then, PAI has held 50% and 66.67% in Cascade and Chinook, respectively, and is the current operator of the two field developments. In December 2006, PAI announced the approval of the Conceptual Plan for the development of Cascade and Chinook from the United States Minerals Management Service (MMS). The plan includes the deployment of the first Floating, Production, Storage and Offloading (FPSO) facility in the Gulf of Mexico. PAI has proposed the use of six technologies which are new to the U.S. Gulf of Mexico including a disconnectable turret buoy allowing the FPSO to move offsite during hurricanes and severe weather conditions, crude transportation via shuttle tanker, free-standing hybrid risers, underwater electric submersible pumps, torpedo pile vertical loaded anchors and polyester mooring systems.

In September 2006, we announced the closing of the acquisition by PAI of 50% of Pasadena Refining System Inc. (PRSI), formerly the Crown Refinery in Pasadena Texas from Astra Oil Company, a U.S.-based refining and trading company owned by the Belgian group Compagnie Nationale a Portefeuille SA-CNP. The purchase price was approximately U.S.$416 million. PAI and Astra are conducting studies to expand its capacity and install units that will enable it to process heavy oils and deliver high quality products.

In February 2007, we announced that the first well of the Cottonwood Field started production with initial output of 1.1 million cubic meters of gas and 4,000 barrels of light oil (condensate) per day. A second well started production in March, boosting gas production to 2 million cubic meters per day. Together, the two wells will take the field production to about 20,000 barrels of oil equivalent per day. Cottonwood is the biggest Petrobras America field in production, leading PAI production to surpass 25,000 barrels of oil equivalent per day (boed) during 2007, up from the current 4,000 boed. This is the first deepwater field we have developed and put into production abroad as an operator. PAI holds 100% of Cottonwood Field, following the acquisition of 20% from Mariner Energy Inc. in November 2006. This event marks our return, as an operator, to the Gulf of Mexico.

Mexican Activities

In 2003, as part of the bidding launched by Petróleos Mexicanos (PEMEX) for the operation of areas under multiple service contracts, contracts for the Cuervito and Fronterizo blocks were awarded to a joint venture composed of us (45% interest), the Japanese company Teikoku (40%) and the Mexican company Diavaz (15%). There are 12 gas discoveries in this block, which shall be developed with a total expenditure of U.S.$510 million.

In 2006, this operation obtained the process certification, Development, infrastructure and maintenance for activities in non-associate gas fields, according to ISO 14001 and OHSAS 18001.

African Activities

We have interests in four blocks in Nigeria, OML-127, OML-130, OPL-324 and OPL-315. We are partners in the Agbami Field, in the OML127 block, operated by Chevron, which is presently in the development phase, First, oil is estimated to occur in mid 2008, from an FPSO with a production capacity of 250,000 bpd. We also have a participation in the Akpo field, in the OML-130 block, operated by Total, with production scheduled to commence at the end of 2008, also by the means of a FPSO (185,000 bpd), which is now under construction. In 2006, we drilled 6 development wells in the Agbami field and 6 in the Apko field. Agbami and Akpo are both considered to be world class oil fields and we expect our share in their production to correspond to an aggregate of 67,000 bpd at their peak. Two other discoveries are under appraisal on Block OML-130: the Egina and Preowey fields, where we drilled three successful extension wells in 2006. During 2006 we also drilled an exploration well, known as a wildcat dry hole, in the OML-130 Block.

We are the operating company in two other exploration blocks in Nigeria. In OPL-324, with ExxonMobil and Statoil as partners, we drilled one exploration well in 2006, fulfilling the exploration commitment for the second contractual phase, which ends in December 2008. Our participation in Block OPL-315 was acquired in the last Nigerian Bid Round, held in August 2005. The Production Sharing Agreement with NNPC was signed in February 2006. Our partners in this venture are Statoil and Ask Petroleum.

We withdrew from the exploration block OPL-250 and we are the operating company in two other exploration blocks, OPL-324 and OPL-315. In 2006 we drilled one dry hole exploration well in Block 324. Participation in Block OPL-315 was acquired in the last Nigerian Bid Round, held in August 2005 and the first exploration well is expected to be drilled in 2007.

In 2006, in Equatorial Guinea, we had a 50% participation in the drilling of a deepwater well operated by Chevron in Block L, which turned out to be dry. Chevron and Hess terminated operations in Block L, while we and our other partners, Tollow Oil and Sasol, awaited a decision from the government of Equatorial Guinea regarding the request for a three years extension of the current exploration phase concession, with additional seismic coverage as commitment. Our participation in Block L would increase to 67%, and we would be the operator.

On March 12, 2005, we signed an exploration and joint production agreement with Libya s state-owned National Oil Corporation (NOC). This agreement provides for the exploration of four blocks in Area 18, which have an extension of 10,307 square kilometers and are located in the Mediterranean Sea at water depths of 200 to 700 meters. We own a 70% interest in a consortium with Oil Search Limited (OSL) and will be the operating company in the area. Under the agreement, the exploration phase will last five years and may be extended for 25 more years if discoveries are made. We will be required to drill a well and conduct seismic evaluations.

The Angolan branch of our wholly-owned subsidiary, Petrobras International Braspetro B.V., has continued to perform as a non-operating partner in two licenses under petroleum sharing agreements. No exploratory drilling was carried out in Angola during 2006. As of December 31, 2006, our combined crude oil and natural gas proved reserves in Angola were approximately 7.4 million of barrels of oil equivalent. For the year 2006, oil production averaged 5.37 thousand barrels per day.

We recently participated in three bidding rounds promoted by Angolan government in 2006 and acquired interests in 4 exploration blocks offshore Angola: deep water Blocks 15/06, 18/06 and 26, being the operator in the latter two, and shallow water Block 6, also holding the operatorship. Drilling activity in such blocks shall begin not earlier than 2008. Block 18/06 is the remaining area of Block 18, operated by BP. Likewise Block 18/06 which is the remaining area of Block 15/06, operated by Exxon.

In Tanzania, we acquired and processed new seismic data in Blocks 5 and 6, located in the deep and ultra-deep waters of the Mafia Basin. The Production sharing agreement for Block 6 (11,099 km2) was signed in December, which together with Block 5, amounts to 20.3 thousand km^2. We hold 100% of the rights and the operating right to both blocks. Depending on the studies now underway, we may enter a partnership in Block 5 to go to the next phase in securing an exploration license and drilling the first well in that Block.

We acquired a 17% interest in the Zambezi Delta Block in Mozambique, an area of 45,000 km^2 located offshore of Mozambique. The Company is committed to drilling a well in 2007. We are also expecting a seismic study for this year.

In November 2006, we also signed a Memorandum of Understanding with a local state company named Empresa Nacional de Hidrocarbonetos (ENH), in order to jointly undertake E&P studies and biofuel related activities in the country, as well as professional training.

Middle East Activities

In Iran we have a company called Petrobras Middle East B.V. (PEMID) and the principal activity is oil exploration and production. On July 14, 2004, PEMID signed with the National Iranian Oil Company, or NIOC, a Service Contract relating to exploration operation in the TUSAN block in shallow waters of the Persian Gulf, or the Contract Area. The exploration period under the Contract shall be 3.5 years. The operations authorized by NIOC to be carried out by PEMID are mainly related to exploration and appraisal for petroleum by topographical, geological, geophysical and other methods including seismic acquisition, drilling and all other activities normally associated with exploration in the Contract Area. We own a 100% interest in this block. The exploration will be carried out by PEMID, which was organized in October 2004. The first exploration well of the Tusan Block was drilled at the end of 2006. During 2006, we also evaluated other exploration opportunities in the Middle East.

According to the terms of the Contract, during the exploration period a minimum amount of U.S.$32.2 million must be spent and if the Contract enters into optional exploration period, a further minimum amount of U.S.$10.0 million must be spent for exploration operations in the Contract Area. On December 20, 2005, the Company received approval from NIOC to spend up to $U.S.77.8 million. Furthermore, the total expenditures incurred would be recoverable from NIOC only if the exploration operations result in commercial discovery.

Turkey Activities

In Turkey, we have a company called Petrobras Oil & Gas (PO&G) and we formed a partnership with the Turkish National Oil Company, Turkiye Petrolleri Anonim Ortaklig (TPAO) to explore and produce oil in two blocks with significant reserve potential in the Black Sea. The first is named the Kirklarelli block (License 3920), located in the western part of the Turkish portion of the Black Sea at a water depth of 1,200 meters. The second is called the Sinop block (License 3922), located in the central part of the Black Sea at a depth of 2,200 meters underwater. The two Joint Operating Agreements (JOA) were signed on August 17, 2006 and validated by the Turkish government on December 27, 2006. According to our completed technical evaluation, the two blocks that we purchased are the ones that present the best geological possibilities.

At the end of February 2007, we finished our 3D seismic survey commitment for both blocks. Pursuant to our drilling commitment, we are looking for drilling services for the second quarter of 2009. In this regard, we signed a Memorandum of Understanding (MOU) on March 2007, in connection with our drilling commitment.

We were the winner of two of the three blocks offered in the bidding process for deepwater exploration and production in the Black Sea held by the TPAO.

PifCo

PifCo was established on September 24, 1997 as a wholly-owned subsidiary of Braspetro Oil Services Company, or Brasoil, a wholly-owned subsidiary of Petrobras Internacional S.A. (Braspetro), which has since been absorbed by us. PifCo was initially incorporated under the name Brasoil Finance Company, which was changed by special resolution of PifCo s Sole Shareholder to Petrobras International Finance Company on September 25, 1997. On January 14, 2000, the board of directors of Braspetro as well as our board of directors approved the transfer of 100% of PifCo s voting shares from Brasoil to us. Since April 1, 2000, PifCo has been our wholly-owned subsidiary. On May 7, 2007, we replaced the existing Memorandum and Articles of Association in its entirety, with a new amended and restated Memorandum and Articles of Association. PifCo is a tax exempt company incorporated with limited liability under the laws of the Cayman Islands. PifCo s registered office is located at Harbour Place, 103 South Church Street, 4th floor, George Town, Grand Cayman, Cayman Islands, and PifCo s telephone number is 55-21-2240-1258. We are in the process of revising the current Memorandum and Articles of Association to increase the capital stock and to amend the stated purpose of PifCo. See Item 19 for a description of Exhibit 1.2 to this Annual Report.

PifCo Business Overview

PifCo was incorporated in order to facilitate and finance the import of crude oil and oil products by us into Brazil. Accordingly, PifCo s primary function is to act as an intermediary between third-party oil suppliers and us by engaging in crude oil and oil product purchases from international suppliers and reselling crude oil and oil products in U.S. dollars to us on a deferred payment basis, at a price which includes a premium to compensate PifCo for its financing costs. PifCo is generally able to obtain credit to finance purchases on the same terms granted to us, and PifCo buys crude oil and oil products at the same price that suppliers would charge us directly.

As part of our strategy to expand our international operations and facilitate our access to international capital markets, PifCo engages in borrowings in international capital markets supported by us, primarily through standby purchase agreements of the related securities.

In addition, PifCo also engages in a number of activities that are conducted by four wholly-owned subsidiaries:

Petrobras Europe Limited, or PEL, a United Kingdom company that acts as an agent and advisor in connection with our trading activities in Europe, the Middle East, the Far East and North Africa;

Petrobras Finance Limited, or PFL, a Cayman Islands company, that carries out a financing program supported by future sales of fuel oil;

Bear Insurance Company Limited, or BEAR, a company incorporated in Bermuda that contracts insurance for us and our subsidiaries; and

Petrobras Singapore Private Limited, or PSPL, a company incorporated in Singapore to trade crude oil and oil products in connection with our trading activities in Asia. This company initiated its operations in July 2006.

As part of our restructuring of our international business segment, in January 2003, PifCo transferred to us Petrobras Netherlands B.V., or PNBV, a Dutch company engaged in leasing activities of primarily offshore equipment to be used by us for exploration and production of crude oil and natural gas. PNBV became our directly wholly-owned subsidiary, effective as of January 2003.

Beginning in 2004, as part of our restructuring of our offshore subsidiaries in order to centralize trading operations, PifCo has engaged in limited exports of oil and oil products and has begun to store oil and oil products in Asia.

PifCo s Principal Commercial Activities

PifCo s principal activity is the purchase of crude oil and oil products for resale to us and, to a limited extent, third parties. PifCo acquires substantially all of its crude oil and oil products either through purchases on the spot market or short-term supply contracts. PifCo acquires a small portion of its crude oil and oil products through long-term supply contracts. PifCo s crude oil and oil product purchase obligations are, in most instances, guaranteed by us. PifCo sells the products to us at the purchase price it paid, plus a premium, determined in accordance with a formula designed to pass on PifCo s average costs of capital to us.

In addition, PifCo finances its oil trading activities principally from commercial banks, including lines of credit and commercial paper programs, as well as through inter-company loans from us and the issuance of notes in the international capital markets.

The following chart illustrates how PifCo acts as the intermediary between international crude oil suppliers and us.

PifCo purchases crude oil and oil products from international oil suppliers on a free-on-board (F.O.B.) basis under standard terms that traditionally require payment within 30 days from the bill of lading. Before February 2005, we bought crude oil and oil products from PifCo under terms that allowed for payment up to 270 days from the date of the bill of lading. Since February 2005, we began to buy crude oil and oil products from PifCo under terms that allow for payment up to 330 days from the date of the bill of lading. We would typically be unable to meet the 30-day payment term imposed by international suppliers because of the complexity of Brazilian customs and importing regulations. For example, if a shipment to which a bill of lading relates must be delivered to different parts of Brazil, different sets of documents must be delivered to each delivery point. Depending on the unloading ports locations, this process may be completed up to 120 days from the vessel s departure. Because PifCo is not subject to the Brazilian regulations applicable to us, PifCo can pay the international supplier on time without having to produce these different sets of documents. To cover its financing costs, PifCo includes a premium when it sells crude oil and oil products to us.

PifCo s subsidiaries are:

Petrobras Europe Limited (PEL)

In May 2001, PifCo established PEL, a wholly-owned subsidiary incorporated and based in the United Kingdom, to consolidate our trade activities in Europe, the Middle East, the Far East and North Africa. These activities consist of advising on, and negotiating the terms and conditions for, crude oil and oil products supplied to PifCo and us, as well as marketing Brazilian crude oil and crude oil products exported to the geographic areas in which PEL operates. PEL plays an advisory role in connection with these activities and undertakes no direct or additional commercial or financial risk. PEL provides these advisory and marketing services as an independent contractor, pursuant to a services agreement between PEL and us. In exchange, we compensate PEL for all costs incurred in connection with these activities, plus a margin.

Petrobras Finance Limited (PFL)

In December 2001, PifCo established PFL, a wholly-owned subsidiary incorporated and registered in the Cayman Islands. PFL primarily purchases fuel oil from us and sells the products in the international market in order to generate export receivables to cover its obligations to transfer these receivables to a trust under an exports prepayment program. Until June 1, 2006, PFL also purchased bunker fuel from us. The exports prepayment program helps provide PFL with the funding necessary to purchase oil products from us, as described below.

Bear Insurance Company Limited (BEAR)

In January 2003, PifCo received BEAR from Brasoil. This transaction took place as part of the restructuring of our international business segment. BEAR currently serves as an intermediary for us, advising on, and negotiating the terms and conditions of, certain of our insurance policies.

Petrobras Singapore Private Limited (PSPL)

In April 2006, PifCo incorporated a new wholly-owned subsidiary: Petrobras Singapore Private Limited, or PSPL, a company incorporated in Singapore to trade crude oil and oil products in connection with our trading activities in Asia. This company initiated operations on July 1, 2006.

Exports Prepayment Program

We sell and deliver fuel oil and, subject to certain conditions, other oil products (collectively, the Eligible Products) to PFL under two principal agreements: Master Export Contract and the Prepayment Agreement. Until June 1, 2006, bunker fuel was also an Eligible Product under the Agreement, but was excluded from the Program after a Consent Solicitation approved by the investors on May 23, 2006. The PF Export Receivables Master Trust, or the Trust, was formed under the laws of the Cayman Islands to provide PFL with the funding necessary to purchase Eligible Products from Petrobras and resell these products through the arrangements described below.

On May 21, 2003, the Trust issued to PFL U.S.$550 million of Senior Trust Certificates (the Series 2003-A Senior Trust Certificates), maturing on June 1, 2015. On the same date, the Trust issued U.S.$200 million of Senior Trust Certificates (the Series 2003-B Senior Trust Certificates), maturing on June 1, 2013. The Series 2003-A Senior Trust Certificates, along with the Series 2003-B Senior Trust Certificates, represent senior undivided beneficial interests in the property of the Trust (other than certain charitable property held by the Trust).

On the same date, the Trust also issued to PFL U.S.$110 million in Series 2003-A Junior Trust Certificates and U.S.$40 million in Series 2003-B Junior Trust Certificates (collectively, the Series 2003 Junior Trust Certificates. The Series 2003 Junior Trust Certificates represent junior subordinated undivided beneficial interests in the property of the Trust (other than the charitable property).

The series 2003-A Senior Trust Certificates, the 2003-B Senior Trust Certificates and the 2003-A Junior Trust Certificates, the 2003-B Junior Trust Certificates are referred to collectively as series 2003 Trust Certificates.

PFL agreed to transfer the Trustee, in return for the Series 2003 Senior Trust Certificates and Series 2003 Junior Trust Certificates, the right to an additional specified amount of receivables to be generated from PFL s sale of Eligible Products with a value equal to the aggregate amount scheduled to be paid in respect of the Series 2003 Senior Trust Certificates and the Series 2003 Junior Trust Certificates. The value of receivables scheduled to be designated for sale in any quarterly period represents a portion, but not all, of the receivables expected to be generated from the sale of Eligible Products by PFL in such period. The remainder of such receivables remains the property of PFL.

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The timely payment of interest on, and scheduled principal of, the Series 2003-B Senior Trust Certificates is unconditionally and irrevocably guaranteed under a financial guaranty insurance policy issued by MBIA Insurance Corporation. The Series 2003-A Senior Trust Certificates do not have the benefit of any financial guaranty insurance policy.

In addition to the Series 2003 Senior Trust Certificates currently outstanding, additional series of senior trust certificates (which may or may not benefit from a financial guaranty insurance policy) may be issued to PFL from time to time if Petrobras agrees to sell additional Eligible Products to PFL in an amount that is adequate to make all required payments under the additional series of senior trust certificates and certain other conditions are met.

The other Senior Trust Certificates, issued in 2001, were prepaid. PFL prepaid the floating rate Senior Trust Certificates (Series 2001-A2 and 2001-C) on September 1, 2005 and the fixed rate Senior Trust Certificates (Series 2001-A1 and 2001-B) on March 1, 2006, in accordance with the applicable provisions of the governing agreements.

Petrobras Bunker Fuel and Fuel Oil Business

As described above, PFL, a wholly-owned subsidiary of PifCo, purchases fuel oil from us and sells the products in the international market in order to generate export receivables to cover its obligations under the exports prepayment program. Until June 1, 2006, PFL also purchased bunker fuel from us but since then we have been selling bunker fuel in the international market directly and this product is no longer subject to our exports prepayment program.

Bunker fuel is a common term for marine fuels that are burned in the boilers or engines of ships. We produce and export two types of bunker fuel: intermediate fuel oil or marine fuel (for ships main engines and, occasionally, auxiliary engines) and marine diesel fuel or marine gas oil (for auxiliary engines and main engines of military vessels).

Our bunker fuel production in 2006 was 29,629 Mbbl, as compared to 28,000 Mbbl in 2005 and 27,425 Mbbl in 2004. Our total bunker fuel production totaled 141,664 Mbbl for the period from January 1, 2002 to December 31, 2006. We export approximately 80% of the bunker fuel we produce, with the exception of bunker fuel used by our fleet. Bunker fuel that we sell in Brazil to ships owned by non-Brazilian companies is considered an export under Brazilian regulations.

PETROBRAS ANNUAL BUNKER FUEL PRODUCTION

	2006	**2005**	**2004**	**2003**	**2002**
			(Mbbl)		
Export	23,588	22,948	22,452	21,402	23,653
Domestic Consumption	1,614	1,313	1,061	1,048	1,620
Petrobras Fleet	4,427	3,739	3,912	4,291	4,596
Total	29,629	28,000	27,425	26,741	29,869

Fuel oil originates from residual fractions of distillation units at the refinery and from other processes such as de-asphalting. Diluents in the form of lighter cutter stocks are mixed into the residue pool to create the desired viscosity for different types of fuel oil.

Major buyers of our fuel oil include utilities, refineries and traders. Fuel oil is used by industries and utilities to run machinery and generate electricity. Commercial buildings and homes employ fuel oil for heating purposes, and refineries use fuel oil for blending purposes.

Fuel Oil Export Sales

The following table sets forth our fuel oil export sales for the period from 2002 to 2006:

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FUEL OIL EXPORT SALES

	2006	2005	2004	2003	2002
Millions of U.S.$	1,500.1	1,077.6	1,306.1	967.3	697.0
Millions of Barrels	67.3	25.5	47.5	38.4	30.8

Organizational Structure

All of our 22 direct subsidiaries listed below are incorporated under the laws of Brazil, except PifCo, Petrobras International Braspetro B.V. (PIB BV), Braspetro Oil Company (BOC), Braspetro Oil Services Company (Brasoil) and Petrobras Netherlands B.V. (PNBV), which are incorporated abroad. See Exhibit 8.1 for a complete list of our subsidiaries.

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The following diagram sets forth our significant consolidated subsidiaries as of December 31, 2006:

See Exhibit 8.1 for a complete list of our subsidiaries, including their full names, jurisdictions of incorporation and our percentage equity interest.

Property, Plants and Equipment

Petrobras

Under Brazilian law, the Brazilian government owns all crude oil and natural gas reserves within Brazil, and we have certain rights to exploit those reserves pursuant to concessions. The greater part of our property, consisting of refineries and storage, production, manufacturing and transportation facilities, is located in Brazil. Our main owned and leased tangible assets consist of our wells, our platforms, our refining facilities, our pipelines, our vessels and other transportation assets and our power plants. Some of these assets are subject to liens but the value of such encumbered assets is not material. See Item 4. Information on the Company for a description of our reserves, sources of crude oil and natural gas, main tangible assets and material plans for expansion and improvements in our facilities.

PifCo

PifCo does not own or lease any material tangible properties or fixed assets. The majority of PifCo s assets consist of leasehold improvements, computers and furniture. In January 2003, PifCo transferred its subsidiary PNBV to us as part of our restructuring of our subsidiaries according to the areas of business each subsidiary deals in.

Regulation of the Oil and Gas Industry in Brazil

Regulatory Framework

Under Brazilian law, the Brazilian government owns all crude oil and natural gas reserves in Brazil. In addition, Article 1 of Law No. 2,004 of 1953 granted the Brazilian government a monopoly over the research, exploration, production, refining and transportation of crude oil and oil products in Brazil and its continental shelf, subject only to the right of companies engaged in crude oil refining and the distribution of oil products at that time to continue those activities. Under Article 2 of Law No. 2,004, the Brazilian government made us its exclusive agent for purposes of exploiting the Brazilian government s monopoly. In 1988, when it enacted the current Brazilian Constitution, the Brazilian Congress incorporated Article 1 of Law No. 2,004 into the Constitution and included within the scope of the Brazilian government s monopoly the importation and exportation of crude oil and oil products.

Beginning in 1995, the Brazilian government undertook a comprehensive reform of the country s oil and gas regulatory system. On November 9, 1995, the Brazilian Congress amended the Brazilian Constitution to authorize the Brazilian government to contract with any state or privately-owned company to carry out the activities related to the upstream and downstream segments of the Brazilian oil and gas sector. Accordingly, this amendment made it possible to end our government-granted monopoly. The amendment was implemented by the enactment of the Oil Law No. 9,478, which revoked Law No. 2,004.

The Oil Law provided for the establishment of a new regulatory framework, ending our exclusive agency and enabling competition in all aspects of the oil and gas industry in Brazil. As a result of this constitutional amendment and the subsequent and ongoing implementation of the changes under the Oil Law, its amendments and related regulations, we have been operating in an environment of gradual deregulation and increasing competition.

The Oil Law also created an independent regulatory agency, the *Agência Nacional de Petróleo, Gas, e Combustíveis Renováveis* (ANP). The ANP s function is to regulate the oil, natural gas and renewable fuels industry in Brazil. A primary objective of the ANP is to create a competitive environment for oil and gas activities in Brazil that will lead to the lowest price and best services for consumers. Among its principal responsibilities is to regulate concession terms for upstream development and award new exploration concessions. See Item 10. Additional Information Material Contracts Petrobras Concession Agreements with the ANP.

The Oil Law granted us the exclusive right to exploit the crude oil reserves in all fields where we had previously commenced production, in accordance with the concession agreement entered into with the ANP on August 6, 1998. For each concession area, we were granted an exclusivity period of 27 years as of the date the field was declared to be commercially profitable.

The Oil Law also established a procedural framework for us to claim exclusive exploratory rights for a period of up to three years, which was later extended to five years, with respect to areas where we could demonstrate that we had established prospects prior to the enactment of the Oil Law. In order to perfect our claim to explore and develop these areas, we had to demonstrate that we had the required financial capacity to carry out these activities, either alone or through other cooperative arrangements.

Each year we are required to submit our capital expenditures budget for the following fiscal year to the Ministry of Planning, Budget and Management and the Ministry of Mines and Energy. Once reviewed by those offices, the capital expenditures budget is then submitted to the Brazilian Congress for approval. As a result of this process, the total level of our capital expenditures for each fiscal year is regulated, although the specific application of funds is left to our discretion. Since mid-1991, we have obtained substantial amounts of our financing from the international capital markets, mainly through the issuance of commercial paper and short, medium and long-term notes, and have increasingly been able to raise long-term funds for large capital expenditure items such as rigs and platforms.

Our strategic objectives and planning are subject to supervision by the Ministry of Planning, Budget and Management. Our activities are also subject to regulation by the Ministry of Finance and the Ministry of Mines and Energy, among others. In addition, since our common and preferred shares and ADSs are traded on the São Paulo Stock Exchange, the New York Stock Exchange, *Mercados del Valores Latinoamericanos en Euros* (LATIBEX) and Buenos Aires Stock Exchange, respectively, we are also regulated by the *Comissão de Valores Mobiliários* (Brazilian Securities Commission, or the CVM), the Securities and Exchange Commission, *Comisión Nacional del Mercado de Valores CNMV* and *Comisión Nacional de Valores*, or the CNV, as of April 27, 2006.

Brazil is not a member of OPEC, but we have been invited to attend OPEC meetings as an observer. Therefore, neither Brazil nor we are bound by OPEC guidelines. However, to the extent that OPEC influences international crude oil prices, our prices are affected, as our prices are linked to international crude oil prices.

Price Regulation

Since January 2, 2002, pursuant to Law No. 9,990, and as set forth below, the Brazilian government eliminated price controls for crude oil and oil products, except for the natural gas sold for qualifying gas-fired power plants. This led to increased competition and further price adjustments, as other companies were allowed to participate in the Brazilian market and import and export crude oil, oil products and natural gas to and from Brazil.

Prices remain regulated, however, for certain natural gas sales contracts and electricity.

To permit the taxation of all imported crude oil, oil products and natural gas in conjunction with the opening of the market to all participants, the Brazilian government established an excise tax to be applied with respect to the sale and import of crude oil, oil products and natural gas products (*Contribuição de Intervenção no Domínio Econômico*, Contribution for Intervention in the Economic Sector, or CIDE). Until April 30, 2004, the amounts paid as CIDE could be deducted from the payments of the PIS/PASEP and COFINS taxes.

As of May 1, 2004, important changes were made regarding the taxation of oil products sales. The amount paid as CIDE that can be deducted from PIS (*Programa de Integração Social*)/PASEP (Programa de Formação do Patrimônio do Servidor Público) and COFINS (*Contribuição para o Financiamento da Seguridade Social*) was reduced to zero. The PIS/PASEP tax and the COFINS tax previously ad valorem taxes on imported products were converted into specific value taxes, and the CIDE tax was changed to the following rates:

Product	**PIS/PASEP and COFINS rate**	**CIDE**
	(*reais*/m3, except LPG/metric ton)	
Gasoline	R$261.60	280.0
Diesel	148.00	70.0
Jet Fuel	71.20	
LPG	167.70	

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For certain trading transaction, the taxpayer may still opt to pay the PIS/PASEP tax and the COFINS as ad valorem taxes.

Previously, beginning with the implementation of the Oil Law in 1997 and through December 31, 2001, the Brazilian oil and gas sector was significantly deregulated and the Brazilian government changed its price regulation policies. Under these regulations, the Brazilian government:

- introduced a new methodology for determining the price of oil products designed to track prevailing international prices and the *real*/U.S. dollar exchange rate;

- eliminated regulation of the cost at which we could record imported crude oil and oil products in our cost of sales;

- gradually eliminated controls on wholesale prices at which we could sell our oil products, except for diesel, gasoline and LPG;

- effective July 28, 1998, eliminated transportation cost equalization subsidies known as *Frete para Uniformização de Preços* (Freight for the Uniformity of Prices, or FUP), in the case of transportation subsidies for oil products, and *Frete para Uniformização de Preços do Álcool* (Freight for the Uniformity of Prices of Alcohol, or FUPA), in the case of transportation subsidies for fuel alcohol; and

- continued to require that we act as the Brazilian government s administrator for the fuel alcohol program.

Until the passage of the Oil Law 9,478 in 1997, the Brazilian government had the power to regulate all aspects of the pricing of crude oil, oil products, fuel alcohol and other energy sources in Brazil, including natural Gas and Power.

Crude Oil and Refined Oil Products

Pursuant to the Oil Law and subsequent legislation as per Law No. 10,336 dated December 19, 2001, the oil and gas markets in Brazil underwent regulatory change beginning January 2, 2002. As part of this action:

- the Brazilian government no longer set sales prices for crude oil and oil products; and

- the Brazilian government established CIDE, an excise tax payable to the Brazilian government required to be paid by producers, blenders and importers upon sales and purchases of specified oil and fuel products at a set amount for different products based on the unit of measurement typically used for such products.

Previously, until the enactment of the Oil Law, the Brazilian government regulated all aspects of the pricing of crude oil and oil products in Brazil, from the cost of crude oil imported for use in our refineries, to the price of refined oil products charged to the consumer.

Natural Gas

Starting in January 2002, price controls on natural gas prices in Brazil were eliminated. Some contracts that were signed under the old system of price controls are still in force, but new contracts must contain clauses ensuring that prices are freely negotiated amongst the parties.

The Petroleum and Alcohol Account Certification and Settlement As provided in the Oil Law 9,478, the fuel market in Brazil was freed of price controls as of January 1, 2002, permitting other companies to produce and sell on the domestic market and, also, import and export oil and oil products. In addition, as of January 1, 2002, we were no longer required to charge the prices established by the Brazilian government on the sale of oil products, and the realization price is no longer established by a formula adjusted to the international market.

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Considering the price deregulation in the market and current legislation, as of January 1, 2002 the Petroleum and Alcohol Account is no longer used to reimburse expenses related to the supply of oil products and fuel alcohol to us and third parties. The movements in the account for periods after 2002 relate only to (i) payments and adjustments mandated by the Agência Nacional do Petróleo ANP with no impact on the income statement and (ii) adjustments resulting from the audit of the account by the ANP.

The ANP/STN Integrated Audit Committee submitted, on June 23, 2004, its final report certifying and approving the balance of the Petroleum and Alcohol account. The conclusion of this audit process for the Petroleum and Alcohol account establishes the basis for concluding the settlement process between the Brazilian government and us.

As defined in Law No. 10,742 dated October 06, 2003, the settlement of the Petroleum and Alcohol account with the Brazilian government should have been completed by June 30, 2004. We have been working with the Ministry of Mines and Energy MME and Secretary of the National Treasury STN in order to resolve remaining issues necessary to conclude the settlement process.

To facilitate the required settlement, on June 30, 1998, the Brazilian government issued National Treasury Bonds-Series H to us, representing the credit owed to us by the Brazilian government from the Petroleum and Alcohol Account. The bonds were placed with a federal depositary to support the balance of this account.

The National Treasury Bonds-Series H matured on June 30, 2004. As of June 30, 2004, there were 138,791 National Treasure Bonds-Series H outstanding in the amount of U.S.$56 million against the balance of the Petroleum and Alcohol Account was U.S.$241 million. On July 2, 2004, the Brazilian Government made a deposit in an account in our name of U.S.$56 million for payment of the bonds. However, only U.S.$3 million of this amount was made available to us. We do not have access to the remaining U.S.$53 million, which represent a partial guarantee of the balance of the Petroleum and Alcohol Account, according to the determination of the Secretaria do Tesouro Nacional (STN). The legal, valid and binding nature of the account is not affected by any difference between the balance of the account and the value of the outstanding bonds.

The remaining balance of the Petroleum and Alcohol account may be paid as follows: (1) National Treasury Bonds issued at the same amount as the final balance of the Petroleum and Alcohol account; (2) offset of the balance of the Petroleum and Alcohol account, with any other amount we owed to the Brazilian Government, including taxes; or (3) by a combination of the above options.

The following table summarizes the changes in the Petroleum and Alcohol Account for 2006, 2005 and 2004:

	For the Year Ended December 31,		
	2006	**2005**	**2004**
	(in millions of U.S. dollars)		
Opening balance	$ 329	$ 282	$ 239
Reimbursements to Petrobras: transport of oil products			1
Financial income	7	9	4
Results of certification/audit process conducted by the Brazilian government			16
Partial settlement			(3)
Translation gain (loss)(1)	32	38	25
Ending balance	$ 368	$ 329	$ 282

(1) Exchange rate translation gains (losses) are recorded as a component of cumulative

translation
adjustments.

The U.S.$39 million increase in the balance of the Petroleum and Alcohol Account during 2006 was primarily a result of the 10.7% appreciation of the *real* against the U.S. dollar.

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Exploration and Development Regulation

During the time we had a government-granted monopoly in Brazil for oil and gas operations, we had the right to exploit all production, exploration and development areas in Brazil. When government-granted monopoly was terminated, the Brazilian government was allowed to contract with any state or privately owned company for the development of the upstream and downstream segments of the Brazilian oil and gas sector. Before establishing bidding rounds for concessions, the Brazilian government granted us the exclusive right to exploit crude oil reserves where we had previously commenced operations. In 1998, the ANP started to conduct bidding rounds to grant concessions for production, exploration and development areas, and we were required to compete for concessions.

With the effectiveness of the Oil Law and the regulations promulgated by the ANP thereunder, concessionaires are required to pay the government the following:

- signature bonuses;
- rentals for the occupation or retention of areas;
- special participation; and
- royalties.

The minimum signature bonuses are published in the bidding rules for the concessions being auctioned, but the actual amount is based on the amount of the winning bid and must be paid upon the execution of the concession agreement.

Rentals for the occupation and retention of the concession areas are determined for in the related bidding rules and are payable annually. For purposes of calculating rentals, the ANP takes into consideration factors such as the location and size of the relevant concession block, the sedimentary basin and its geological characteristics.

Special participation is an extraordinary charge we, and all other concessionaires, must pay in the event of high production volumes and/or profitability from oil fields, according to criteria established by applicable regulation, and is payable on a quarterly basis for each field from the date on which extraordinary production occurs. This participation rate, whenever it is due, varies between 0% and 40% depending on:

- volume of production; and
- whether the block is onshore or offshore and, if offshore, whether it is shallow or deep water.

Under the Oil Law and applicable regulations, the special participation is calculated based upon quarterly net revenues of each field, which consist of gross revenues calculated using reference prices published by the ANP (reflecting international prices and the exchange rate) less:

- royalties paid;
- investment in exploration;
- operational costs; and
- depreciation adjustments and applicable taxes.

The ANP is also responsible for determining monthly royalties payable with respect to production. Royalties generally correspond to a percentage ranging between 5% and 10% applied to reference prices for oil or natural gas, as established in the relevant bidding guidelines (*edital de licitação*) and concession contract (*contrato de concessão*). Virtually all of our production currently pays the maximum 10% rate. In determining the royalties applicable to a particular concession block, the ANP takes into consideration, among other factors, the geological risks involved and the production levels expected.

The Oil Law also requires concessionaires of onshore fields to pay to the owner of the land a special participation fee that varies between 0.5% and 1.0% of the net operating revenues derived from the production of the field.

Environmental Regulations

All phases of the crude oil and natural gas business present environmental risks and hazards. Our facilities in Brazil are subject to a wide range of federal, state and local laws, regulations and permit requirements relating to the protection of human health and the environment. At the federal level, our offshore activities and those which involve more than one state of the Federation are subject to the regulatory authority of the *Conselho Nacional do Meio Ambiente* (National Council for the Environment) and to the administrative authority of the Brazilian Institute for the Environment and Renewable Natural Resources, or IBAMA, which issues operating or drilling licenses. Maintenance of the licenses requires the submission of reports, including safety and pollution monitoring reports (IOPP) to IBAMA. Onshore environmental, health and safety conditions are controlled at the state rather than federal level. Law No. 6,938 of August 31, 1981, and subsequent regulations and decrees established strict liability for environmental damage, mechanisms for enforcement of environmental standards and licensing requirements for polluting activities.

CONAMA s Resolution No. 23 of 1994 requires us to conduct environmental studies in connection with a number of our activities. We must eliminate, mitigate, or compensate relevant parties for any adverse environmental effects identified through these studies.

On December 27, 2000, Law No. 10,165, modifying Law No. 6,938, created the *Taxa de Controle e Fiscalização Ambiental* (Environmental Control and Inspection Tax, or TCFA). The law empowers IBAMA to collect, on a quarterly basis, certain fees from us and other companies that meet a minimum revenue threshold, are engaged in potentially environmentally damaging activities and/or are exploiting natural resources within Brazil. At present, we do not consider this fee imposed by IBAMA to be material. The *Confederação Nacional da Indústria* (Brazilian Industry Confederation, or CNI) is currently challenging the constitutionality of these fees in the Brazilian Supreme Court (*Supremo Tribunal Federal*, or STF).

Brazilian environmental laws and regulations provide for restrictions and prohibitions on spills and releases or emissions of various hazardous substances produced in association with our operations. Brazilian environmental laws and regulations also govern the operation, maintenance, abandonment and reclamation of wells, refineries, terminals, service stations and other facilities. Compliance with these laws and regulations can require significant expenditures, and violations may result in fines and penalties, some of which may be material. In addition, operations and undertakings that have a significant environmental impact, especially the drilling of new wells and expansion of refineries, require us to apply for environmental impact assessments in accordance with federal and state licensing procedures. In accordance with Brazilian environmental laws, we have proposed the execution of, or we have entered into, environmental commitment agreements with the environmental protection agencies and/or the federal or state public ministries, in which we agree to undertake certain measures in order to complete the environmental licensing for several of our operating facilities.

Under Law No. 9,605 of February 12, 1998, individuals or entities whose conduct or activities cause harm to the environment are subject to criminal and administrative sanctions, as well as any costs to repair the actual damages resulting from such harm. Individuals or legal entities that commit a crime against the environment are subject to penalties and sanctions that range from fines to imprisonment, for individuals, or, suspension or interruption of activities or prohibition to enter into any contracts with governmental bodies for up to ten years for legal entities. The government environmental protection agencies may also impose administrative sanctions on those who do not comply with the environmental laws and regulations, including, among others:

- fines;
- partial or total suspension of activities;
- obligations to fund recovery works and environmental projects;
- forfeiture or restriction of tax incentives or benefits;

closing of the establishments or undertakings; and

forfeiture or suspension of participation in credit lines with official credit establishments.

Under Law No. 9,966 of 2000, entities operating organized ports and port installations and owners or operators of platforms and its support installations must perform independent environmental audits every two years, with a view to evaluating the environmental management and control systems in their units. We are in full compliance with this law.

Law No. 9,985 of July 19, 2000 establishes an environmental compensation of at least 0.5% of the value of a project relating to activities that have a negative environmental impact that cannot be mitigated. This compensation may only be applied in conservation units, as defined by the Sistema Nacional de Unidades de Conservação da Natureza (the National System of Nature Conservation Units, or the SNUC). Environmental agencies are still implementing this law, but they may attempt to apply it in a retroactive manner.

In 2006, we invested approximately U.S.$645 million in environmental projects as compared to approximately U.S.$521 million in 2005. These investments were primarily directed at reducing emissions and wastes resulting from industrial processes, managing water use and effluents, remedying impacted areas, implementing new environmental technologies and upgrading our pipelines.

In March 2006, the Brazilian Congress enacted Law No. 11,284, which, among other things, creates the concept of environmental insurance as an economic policy instrument. Brazilian companies will be required to purchase environmental insurance only once the Brazilian Congress approves a new law to regulate Law No. 11,284 that expressly creates this obligation. We do not know the terms and conditions under which environmental insurance will be contracted in the future and, therefore, we cannot estimate whether the requirement to purchase environmental insurance will have a material adverse effect in our business, financial condition and results of operations.

We are subject to a number of administrative proceedings and civil and criminal claims relating to environmental matters. See Item 8. Financial Information Legal Proceedings Environmental Claims.

Health, Safety and Environmental Initiatives

Initiatives

The protection of human health and the environment is one of our primary concerns, and is essential to our success as an integrated energy company. In order to address and prioritize health, safety and environmental concerns and ensure compliance with environmental regulations, we have:

developed the PEGASO program to upgrade our pipelines and other equipment, implement new technologies, improve our emergency response readiness, reduce emissions and residues and prevent environmental accidents. From April 2000 to December 2006, we spent approximately U.S.$4.081 billion under this program, including the *Programa de Integridade de Dutos* (Pipeline Integrity Program) through which we conduct inspections of, and improvements to, our pipelines. In 2006, we spent approximately U.S.$562 million in connection with the PEGASO program;

proposed the execution of, or entered into, environmental commitment agreements with several environmental protection agencies and/or the federal or state public ministries, in which we agree to undertake certain measures in order to complete the environmental licensing for several of our operating facilities;

integrated our corporate health department into the already existing corporate environment and safety department, thereby facilitating the development of systematic, company-wide procedures to handle concerns related to health, safety and the environment, or HSE;

established our new HSE policy and corporate guidelines, which focus on principles of sustainable development, compliance with legislation and the availability and use of environmental performance indicators;

undertook capital investments to reduce the HSE risk of our operations, including making improvements to our refineries and transportation facilities and developing and implementing oil pollution prevention guidelines;

built nine environmental protection centers and seven advanced bases for oil spill prevention, control and response, established local and regional, onshore and offshore contingency plans involving public services and communities to deal with oil spills, and chartered three dedicated oil spill recovery vessels (OSRVs) fully equipped for oil spill control and fire fighting;

received HSE integrated management certificates for our operating units. As of December 2006, Petrobras owned 34 certificates for its operating units in Brazil and 20 for units abroad. These certificates acknowledge the compliance of our HSE management system with ISO 14001 (environment) and OHSAS 18001 (health and safety) standards. Because some of those certificates cover more than one site, the total number of certified sites is 159 in Brazil and 20 abroad. The *Frota Nacional de Petroleiros* (National Fleet of Vessels) has been fully certified by the IMO International Management Code for Safe Operation of Ships and for Pollution Prevention (ISM Code) since December 1997;

implemented through the Programa de Segurança de Processo (Process Safety Program) standardized, company-wide guidelines for HSE management, for effectively investigating incidents and for strengthening our institutional commitment to HSE through employee training. The HSE Management Manual developed through that program is a day-to-day management tool currently being applied in all of our operating units;

implemented the Excellence in Health, Safety and Environment Project, included in our Strategic Agenda, which, through actions already defined in all of our business and services segments and in our subsidiaries, seeks to ensure that by 2015, we reach the same level of performance as measured by safety, environmental and health indices as the leading oil, Gas and Power companies in the world;

developed an Air Emissions Management System, in conjunction with an international consulting company, for our operations in Brazil and South America. The system gathers information about emissions of sulfur dioxide, nitrogen oxides, carbon monoxide, the main greenhouse gases (carbon dioxide, methane and nitrous oxide), volatile organic compounds (VOCs) and particulate material, allowing us to improve the management of our emissions. We have registered our 2004 Annual Emissions Summary in the Global Greenhouse Gas Register of the World Economic Forum. The report gathers data provided by the Air Emissions Management System and is available for public access through the Forum s website;

established a corporate goal, included in our Balanced Scorecard, for avoiding emissions of greenhouse gases (GHG). Considering the projects included in our 2007-2011 Business Plan,, we aim to cut 18.5 million tons of GHG emissions through 2011, by implementing projects that may also be eligible for the Clean Development Mechanism of the Kyoto Protocol;

participated in negotiations conducted by the Brazilian Ministry of Mines and Energy of new regulations of environmental compensation related to the implementation of new projects;

participated with the Brazilian Ministry of Mines and Energy and IBAMA in a governmental follow-up group created to supervise the implementation of the new planned gas pipelines and oil and gas production projects;

participated regularly in the discussion agenda of the Brazilian Ministry of Mines and Energy and the Ministry of the Environment about environmental issues affecting our business; and participated directly in discussions with the Ministry of the Environment and IBAMA regarding issues that could affect Petrobras business.

In addition, we conduct environmental studies for all new projects as required by Brazilian environmental legislation, and our HSE department evaluates each and every project with a total budget exceeding U.S$25 million to confirm its compliance with all HSE requirements and adoption of the best HSE practices throughout the project s life cycle.

We will continue to evaluate and develop initiatives to address HSE concerns and to reduce our exposure to HSE risks.

Our Executive Board has approved the building of three biodiesel production plants, with a total capacity of 150,000 tons per year. The three plants will demand an investment of about U.S.$90.5 million each and are expected to begin operations in December of 2007.

We have bought 70,000 cubic meters of biodiesel, certified with the social fuel label, to be delivered throughout 2006. Social fuel is fuel manufactured under a government program designed to promote family-run agricultural enterprises.

In 2006, BR purchased an interest in Brazil small hydroelectric plants for a total value of R$74.6 million, to hold a 49% participation. This allowed the distribution of 13 small hydroelectric plants throughout the states of Minas Gerais, Espírito Santo, Rio de Janeiro, Goiás and Mato Grosso do Sul, with an aggregate power potential of 291 MW.

An additional undertaking in this area is our participation in two other small hydroelectric plants through our affiliate, Termoeléctrica Potiguar S.A.: Clean Water and Air. Together, the two allow for 25.4 MW of power potential.

The 15 small hydroelectric plants are linked to PROINFA, the Brazilian Government s Incentive Program of Brazilian Government for Alternative Energy Sources.

Management

We have an HSE Management Committee, which was created by our executive officers to ensure that HSE issues are addressed throughout the company. The committee is composed of executive managers of our different business segments and of directors of our controlled companies, BR Distribuidora and Transpetro. The work of the HSE Management Committee is supported by three permanent subcommittees and by temporary commissions and work groups, each one responsible for a specific HSE issue, such as licensing and environmental compensation, emissions and climate change, operational risk assessment, management of change, new projects and health management.

We have also created an Environmental Committee, which is composed of three members of our Board of Directors. The committee is responsible for, among other things: (1) overseeing and managing environmental and work safety issues affecting us; (2) establishing measurable environmental targets and ensuring compliance; and (3) recommending changes in environmental, health and safety policy, if necessary, to our Board of Directors. The Environmental Committee charter is still subject to approval by our Board of Directors.

Competition

As a result of the regulatory reform of the oil and gas industry in Brazil, we expect to face increasing competition both in our downstream and upstream operations.

In the exploration and production segment, the Brazilian government s auction process for new exploratory areas has enabled multinational and regional oil and gas companies to begin exploring for crude oil in Brazil. If these companies discover crude oil in commercial quantities and are able to develop it economically, we expect that competition with our own production will increase.

In the past, we have faced little competition as a result of the prevailing laws that effectively gave us a monopoly. With the end of this monopoly and regulatory reform, other participants may now explore, produce, transport and distribute oil products in Brazil. As a result, some participants have already begun importing refined oil products, which will compete with oil products from our Brazilian refineries, as well as the oil products we currently import. We now have to compete with global imports at international prices. We expect that this additional competition may affect the prices we can charge for our oil products, which in turn will affect the profit we can make. We estimate that we had a market share of approximately 98.1% in the Brazilian oil production segment in 2006. We do not have meaningful competitors in the oil production segment in Brazil. In the oil exploration segment, we estimate that the exploration activities conducted solely by us represented approximately 72% (number of exploration wells we drilled solely compared to the total number of exploration wells drilled in Brazil in 2006) of the Brazilian oil exploration market in 2006 and the exploration activities conducted by us in conjunction with other partners represented approximately 86% (number of exploration wells we drilled solely and with partners compared to the number of exploration wells drilled in Brazil in 2006) of the oil exploration market in Brazil in 2005. Our main competitors in the oil exploration segment are Agip, Devon, Shell, Maersk, Statoil, Chevron Texaco, Encana, El Paso and BG Group. We also expect continued competition in our distribution segment, where we currently face the most significant competition of any of our business segments. In particular, we face competition from small distributors, many of which have been able, and may continue to be able, to avoid paying sales taxes and mix their gasoline with inexpensive solvents, enabling them to sell gasoline at prices below ours. We had a market share of approximately 42.6% in the Brazilian oil products distribution segment according to Sindicom, a Brazilian industry association of oil and gas distribution companies. Our main competitors in this segment are Shell, Esso and Texaco.

In the natural gas and power segment, we expect competition from new entrants that are acquiring interests in natural gas distribution and gas-fired power generation companies, and existing competitors that are expanding operations in order to consolidate their position in Brazil. We had a market share of approximately 94.3% in the Brazilian natural gas segment based on 2006 volumes sold to the Local Distribution Companies and total natural gas market, according to the *Associação Brasileira das Empresas de Gás Natural* (the Brazilian Society of Natural Gas Companies, or ABEGÁS).

In the international segment, we plan to continue expanding operations, although we expect to face continuing competition in the areas in which we are already active, including the Gulf of Mexico, Africa and the Southern Cone. We have already become a major player in some of the countries in which we have international operations. In Argentina, we estimate that we have a market share of 13.5% for auto fuel and 12.3% for lubricants. In Bolivia, we have a market share of 92% of the oil refining market, 0.3% of the fuel market, and 72% of lubricants.

Insurance

Our insurance programs principally focus on the concentration of risks and the importance and replacement value of assets. Under our risk management policy, risks associated with our principal assets, such as refineries, tankers, our fleet and offshore production and drilling platforms, are insured for their replacement value with third-party Brazilian insurers. Although the policies are issued in Brazil, most of our policies are reinsured abroad with reinsurers rated A- or higher by Standard & Poor s rating agency or B+ or higher by A.M. Best. Substantially all of our international operations are insured or reinsured by our Bermudian subsidiary Bear Insurance Company Limited following exactly the same rating criteria.

Less valuable assets, such as small auxiliary boats, certain storage facilities, and some administrative installations, are self-insured. We do not maintain coverage for business interruption, except for a minority of our international operations. We also do not maintain coverage for our wells for substantially all of our Brazilian operations.

We maintain coverage for operational third-party liability with respect to our onshore and offshore activities, including environmental risks such as oil spills. The insurance policy covers any damage resulting from either our or our affiliates activities, with the exception of our international activities, which have their own insurance and are therefore not included in this policy. In Brazil, our coverage in this policy is of up to U.S.$220 million per accident in the aggregate (fines imposed by government authorities are not covered). In case of an accident, this coverage may not be sufficient to compensate us for losses incurred. Although we do not insure most

of our pipelines, we have insurance against damage or loss resulting from specific incidents, as well as oil pollution from our pipelines. Our fleet and most of our Mobile Offshore Units are entered in Protection and Indemnity Insurance mutuals (P&I Clubs), that provide collective self-insurance to their members against third party liabilities and expenses arising from owning ships or operating ships as principals.

We also maintain coverage for risks associated with transportation, hull and machinery risk and directors and officers (D&O) insurance coverage. All projects and installations under construction are insured in compliance with the terms of the relevant financing agreements, usually through a performance bond in connection with completion of the contract and/or other damage and liability insurance. All projects and installations under construction that have an estimated maximum loss above U.S.$40 million are covered by a construction policy.

The premium for renewing our property risk insurance policy for a 12-month period commencing June 2006 was U.S$34.5 million. This represented an increase of 17% over the preceding 12-month period. The increase was primarily due to an increase in the insured value of our assets, which in the same period, increased by 32%, from U.S.$32.7 billion to U.S$43.2 billion. Since 2001, our risk retention has increased and our deductibles may reach U.S.$40 million in certain cases.

Our facilities are regularly subject to risk surveys undertaken by international risk consultants. The reports and recommendations prepared in these surveys are released to our insurers and underwriters, as well as the actions taken by us to meet these recommendations. All the significant accidents and their causes, as well as the improvements we make to our HSE standards are periodically released to the public.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS .

Management s Discussion and Analysis of Petrobras Financial Condition and Results of Operations

You should read the following discussion of our financial condition and results of operations together with our audited consolidated financial statements and the accompanying notes beginning on page F-1 of this annual report.

Overview

We earn income from:

- domestic sales, which consist of sales of oil products (such as diesel oil, gasoline, jet fuel, naphtha, fuel oil and liquefied petroleum gas), natural gas, electricity and petrochemical products;
- export sales, which consist primarily of sales of crude oil and oil products;
- international sales (excluding export sales), which consist of sales of crude oil, natural gas and oil products that are purchased, produced and refined abroad; and
- other sources, including services, investment income and foreign exchange gains.

Our expenses include:

- costs of sales (which are composed of labor expenses, costs of operating and purchases of crude oil and oil products); maintaining and repairing property, plants and equipment; depreciation and amortization of fixed assets; depletion of oil fields; and costs of exploration;
- selling (which include expenses for transportation and distribution of our products), general and administrative expenses; and
- interest expense, monetary and foreign exchange losses.

Fluctuations in our financial condition and results of operations are driven by a combination of factors, including:

the volume of crude oil, oil products and natural gas we produce and sell;

changes in international prices of crude oil and oil products, which are denominated in U.S. dollars;

related changes in the domestic prices of crude oil and oil products, which are denominated in *reais*;

fluctuations in the r*eal*/U.S. dollar and Argentine peso/U.S. dollar exchange rates;

Brazilian political and economic conditions; and

the amount in taxes and duties that we are required to pay with respect to our operations, by virtue of our status as a Brazilian company and our involvement in the oil and gas industry.

Sales Volumes and Prices

The profitability of our operations in any particular accounting period is related to the sales volume of, and prices for, the crude oil, oil products and natural gas that we sell. Our consolidated net sales in 2006 totaled approximately 1,104,723 million barrels of crude oil equivalent, representing U.S.$72,347 million in net operating revenues, as compared to approximately 1,025,033 million barrels of crude oil equivalent, representing U.S.$56,324 million in net operating revenues, as compared to approximately 989,719 million barrels of crude oil equivalent, representing U.S.$38,428 million in net operating revenues in 2004.

As a vertically integrated company, we process most of our crude oil production in our refineries and sell the refined oil products primarily in the Brazilian domestic market. Therefore, it is oil product prices, rather than crude oil prices, that most directly affect our financial results. Nonetheless, as crude oil production increases, and as exports increase, the increase in crude oil production will have a greater relative importance.

Oil product prices vary over time as the result of many factors, including the price of crude oil. The average prices of Brent crude, an international benchmark oil, were approximately U.S.$65.14 per barrel in 2006, U.S.$54.38 per barrel in 2005 and U.S.$38.21 per barrel for 2004. For December 2006, Brent crude oil prices averaged U.S.$62.33 per barrel. For the first quarter of 2007, although crude oil prices have been showing some volatility, they are also maintaining the level of U.S.$60.00 per barrel.

Domestic Sales Volumes and Prices

During 2006, approximately 69.7% of our net operating revenues were derived from sales of crude oil and oil products in Brazil, as compared to 72.4% in 2005 and 73.2% in 2004. As export volumes of crude oil and oil products have increased, domestic sales as a percentage of net operating revenues have declined.

Our revenues are principally derived from sales in Brazil. The following table sets forth our domestic sales by volume of oil products, natural gas and fuel alcohol for each of 2006, 2005 and 2004:

	For the Year Ended December 31,								
	2006			2005			2004		
	Volume (Mbbl, except as otherwise noted)	Net Average Price (U.S.$) (1)	Net Operating Revenues (U.S.$ in millions)	Volume (Mbbl, except as otherwise noted)	Net Average Price (U.S.$) (1)	Net Operating Revenues (U.S.$ in millions)	Volume (Mbbl, except as otherwise noted)	Net Average Price (U.S.$) (1)	Net Operating Revenues (U.S.$ in millions)
Energy products:									
Automotive gasoline	112,541	73.86	8,312	104,901	$ 60.08	$ 6,302	100,712	$ 41.58	$ 4,188
Diesel	245,159	83.65	20,507	242,831	68.20	16,561	240,237	44.64	10,725
Fuel oil	36,340	47.47	1,725	36,243	40.81	1,479	39,654	28.45	1,128
Liquid petroleum gas	73,382	36.00	2,642	77,891	34.55	2,691	76,982	28.14	2,166
Total energy products	467,422		33,186	461,866		27,033	457,585		18,207
Non-energy products:									
Petrochemical naphtha	60,197	63.31	3,811	57,281	53.49	3,064	57,595	42.28	2,435
Others	96,369	63.09	6,080	80,953	58.35	4,724	77,652	41.96	3,258
Total non-energy products	156,566		9,891	138,234		7,788	135,247		5,693
Fuel alcohol	59	67.80	4	126	23.81	3	455	30.77	14
Natural gas (BOE)	88,839	26.27	2,334	83,090	21.77	1,809	77,310	18.61	1,439
Sub-total	712,886	63.71	45,415	683,316	53.61	36,633	670,597	37.81	25,353
Distribution net sales	204,649	91.46	18,718	201,347	78.53	15,811	182,327	57.36	10,458
Intercompany net sales	(195,903)	69.89	(13,692)	(187,268)	62.22	(11,651)	(164,730)	46.69	(7,692)
Total domestic market	721,632	69.90	50,441	697,395	58.49	40,793	688,194	40.86	28,119
Export net sales	259,630	55.39	14,381	187,008	47.80	8,938	186,221	31.81	5,923

International net sales	73,363	62.72	4,601	64,860	48.41	3,140	83,800	33.89	2,840
Others	50,098	47.87	2,398	75,770	40,09	3,038	31,504	39.17	1,234
Sub-Total	383,091	55.81	21,380	327,638	46.14	15,116	301,525	33.15	9,997
Services			526			415			312
Consolidated net sales	1,104,723		72,347	1,025,033		$ 56,324	989,719		$ 38,428

(1) Net average price calculated by dividing net sales by the volume for the year.

During 2006, we did not announce any increases in our prices for gasoline and diesel in the domestic market.

Export Sales Volumes and Prices

While our principal market is the Brazilian market, as our domestic production of crude oil has increased, we have begun to export greater amounts of crude oil and oil products that exceed Brazilian demand. We also export volumes of domestically produced heavy crude oil that our refineries are unable to process operationally or economically. See Item 4. Information on the Company Refining, Transportation and Marketing. Our export volumes of crude oil and oil products totaled 212,210 million barrels of crude oil equivalent in 2006, as compared to 187,007 million barrels of crude oil equivalent in 2005 and to 186,221 million barrels of crude oil equivalent in 2004. We base our crude oil export prices on international prices, as adjusted to reflect specific market conditions. We determine export prices of our oil products and natural gas by reference to market conditions, as well as direct negotiations with our clients. As a result of an increase in average prices and volume of export sales of crude oil and oil products, the total value of our crude oil and oil product exports (measured on a free-on-board basis) in 2006 was U.S.$14,381 million, as compared to U.S.$8,938 million in 2005 and to U.S.$5,923 million in 2004, representing approximately 19.9% of our net operating revenues in 2006, as compared to 15.9% in 2005 and 15.4% in 2004. See Item 4. Information on the Company Refining, Transportation and Marketing-Exports.

International Volumes and Prices

We produce, refine, transport, distribute and market crude oil and natural gas internationally. Sales from production outside Brazil to sources outside Brazil were U.S.$2,398 million in 2006, U.S.$3,038 million in 2005 and U.S.$2,840 million in 2004, representing approximately 3.3% of our net operating revenues in 2006, as compared to 5.4% of our net operating revenues in 2005 and to 7.4% in 2004. We expect our international sales to continue growing as our international production continues to grow and we increase our refining and distribution capacity abroad. See Item 4. Information on the Company International.

Import Purchase Volumes and Prices

We continue to import lighter crude oil for blending in our own refineries, as well as smaller quantities of diesel, liquefied petroleum gas, naphtha and other oil products, to attend the demand of the Brazilian retail market. We have continuously upgraded our refineries to handle heavier crude oil in order to reduce our purchases of imported crude oil and oil products by refining a greater portion of our heavier crude oil production. The upgrade in our refineries mentioned above has increased the margin between our net operating revenues and cost of goods sold, since it is less expensive to produce crude oil domestically than it is to import crude oil. In 2006, the net margin decreased to 17.7% as compared to 18.4% in 2005, as a result of an increase in imported crude oil to 370 Mbpd in 2006 from 352 Mbpd in 2005. The increase in the importation of lighter crude oils is in line with the strategy of international marketing operations, which make the importing of lighter crude oils rather than middle distillates more feasible.

Prior to December 31, 2001, we were the only company permitted to import oil products to supply the Brazilian market s demand for these products. Now that other parties are permitted by law to import oil products and supply the market, we continue to reevaluate our strategy in order to achieve optimal levels of imports for our profitability. We imported a total of 43.1 million barrels of oil products in 2006, as compared to 34.8 million barrels of oil products in 2005 and to 40.1 million barrels of oil products in 2004. See Item 4. Information on the Company Refining, Transportation and Marketing-Imports.

Effect of Taxes on our Income

General

In addition to taxes paid on behalf of consumers to federal, state and municipal governments, such as the *Imposto sobre Circulação de Mercadorias e Serviços*, or ICMS, we are required to pay three principal charges on our oil production activities in Brazil:

Royalties, which generally correspond to a percentage between 5% and 10% of production, are calculated based on a reference price for crude oil or natural gas, and will thus vary with the international price of crude oil. The ANP also takes into account the geological risks involved, and productivity levels expected, with respect to a particular concession. Virtually all of our crude oil production is currently taxed at the maximum royalty rate.

Special Participation, which applies to our larger, more profitable fields, and ranges from 0% to 40% depending on the volumes of crude oil produced in the fields, the location of the fields (including whether they are onshore or offshore), water depth and number of years that the field has been in production, and the quality of the oil that is produced. In 2006, the tax was charged on 19 of our fields, including Marlim, Albacora, Roncador, Leste do Urucu, Rio Urucu, Canto do Amaro, Marimbá, Marlim Sul, Namorado, Carapeba, Pampo, Albacora Leste, Barracuda, Caratinga, Cherne, Pilar, Fazenda Alegre, Miranga and Carmópolis. The tax is based on net revenues of a field, which consists of gross revenues less royalties paid, investments in exploration, operational costs and depreciation adjustments and applicable taxes. The Special Participation Tax uses as a reference international oil prices converted to *reais* at the current exchange rate.

Retention Bonus, which is a tax payable on those concessions that are available for exploration and production, and is calculated at a rate established by the ANP, taking into consideration factors such as the location and size of the relevant concession block, the sedimentary basin and its geological characteristics.

These charges imposed by the Brazilian government are included in our cost of goods sold. In addition, we are subject to tax on our income at an effective rate of 25% and a social contribution tax at an effective rate of 9%, the standard corporate tax rate in Brazil. See Note 3 to our audited consolidated financial statements.

Potential Change in ICMS Legislation

In June 2003, the State of Rio de Janeiro enacted a law (State Law nº 4.117, dated June, 27th, 2003, also known as Noel Law) imposing the ICMS on upstream activities. The law was regulated by Decree nº 34.761, dated February 3, 2004, which was suspended by Decree nº 34.783 of February 4th, 2004, for an undetermined period of time. Nevertheless, the State of Rio de Janeiro may choose to enforce the law at any time.

The constitutionality of this law is currently being challenged. The claim was filed by the Federal Prosecutor and the Attorney General has given a favorable legal opinion. The Supreme Court provisionally did not suspend the effectiveness of the law.

In accordance with legislation currently in force, the ICMS for fuels derived from oil is assessed at the point of sale but not at the wellhead level. As a result, the tax is mainly collected in the states where the sales of fuels are made. If the State of Rio de Janeiro enforces the new law, it is unlikely that the other states would allow us to use the tax imposed at the wellhead level in Rio de Janeiro as a credit to offset the tax imposed at the sale level. Therefore, we would have to pay ICMS at both levels, unless we are successful in challenging this tax in court. If the Supreme Court decides that this law is constitutional, our ability to challenge the payment of ICMS at both levels will depend on the ground of the Supreme Court s decision.

We estimate the amount of ICMS that we would be required to pay to the State of Rio de Janeiro could increase by approximately R$9.4 billion (U.S.$4.3 billion) per year as a result of this change in legislation. This increase could have a material adverse effect on our results of operations and financial condition.

Financial Income and Expense

We derive financial income from several sources, including interest on cash and cash equivalents. The majority of our cash equivalents are short-term Brazilian government securities, including securities indexed to the U.S. dollar. We also hold U.S. dollar deposits.

Our financial income was U.S.$1,165 million in 2006, U.S.$710 million in 2005 and U.S.$956 million in 2004.

We incur financial expenses from short and long-term debt denominated in U.S. dollars, *reais* and other currencies. Our financial expenses were U.S.$1,340 million in 2006, U.S.$1,189 million in 2005 and U.S.$1,733 million in 2004. In addition, we capitalized U.S.$1,001 million in interest in 2006, as compared to U.S.$612 million in 2005 and to U.S.$267 million in 2004.

Inflation and Exchange Rate Variation

Inflation

Since the introduction of the *real* as the Brazilian currency in July 1994, inflation in Brazil has remained relatively stable, although it increased markedly in 2002. Inflation was 3.8% in 2006, 1.2% in 2005 and 12.1% in 2004, as measured by the IGP-DI, a general price index. Inflation has had, and may continue to have, effects on our financial condition and results of operations. A large percentage of our total costs are in *reais*, and our suppliers and service providers generally attempt to increase their prices to reflect Brazilian inflation. These increases are counteracted by the adjustments that we make to our prices to offset the effects of inflation and an appreciation of the U.S. dollar against the *real*.

Exchange Rate Variation

Since we adopted the *real* as our functional currency in 1998, fluctuations in the value of the *real* against the U.S. dollar, particularly depreciations of the *real* had, in the past, and will continue to have, if they reoccur, multiple effects on our results of operations. Our reporting currency for all periods is the U.S. dollar. We maintain our financial records in *reais*, and translate our statements of operations into U.S. dollars at the average rate for the period. The amounts reported in our statements of operations in any given period will be reduced at the same rate as the *real* has depreciated in relation to the U.S. dollar during that period. During 2006, however, there was an 8.7%

appreciation of the *real* against the U.S. dollar, as compared to an appreciation of 11.8% in 2005, and an 8.1% appreciation in 2004.

Virtually all of our sales are of crude oil or oil products, which generally trade freely in the international markets at prices expressed in U.S. dollars. From July 1998 through the end of 2001, our net operating revenues reflected changes in the U.S. dollar/*real* exchange rate, with a one month delay, because the formula used by the government to set realization prices for crude oil and oil products included adjustments based on exchange rate variations. See Item 4. Information on the Company Regulation of the Oil and Gas Industry in Brazil Price Regulation.

Since January 2, 2002, when prices were deregulated, we have been free to establish prices for our products based on market conditions and have generally been able to maintain parity with international prices. As a result, although substantially all of our revenues are in *reais*, they have been, and continue to be, linked to U.S. dollar-based international prices. When the *real* depreciates against the U.S. dollar, assuming international prices remain constant in U.S. dollars, we may increase the prices for our products in *reais*, in which case our net operating revenues in *reais* increase. An increase in our *reais* net operating revenue, however, is not reflected in our net operating revenue when reported in U.S. dollars, when the *real* depreciates.

Another effect of depreciation is that our operating costs and expenses when expressed in U.S. dollars tend to decline. This happens primarily due to the fact that a substantial portion of our costs and operating expenses is denominated in *reais*. Prior to 2003, our *reais*-denominated costs increased at a rate slower than the depreciation. Accordingly, the effect was to decrease costs of locally supplied products and services when reported in U.S. dollars. The opposite effects occur when the *real* appreciates against the U.S. dollar such as in 2004, 2005 and 2006. In recent periods, the exchange rate variation has had the following additional effects, among others, on our financial condition and results of operations:

- We record the remeasurement effects of our non-*reais* denominated assets and liabilities held in Brazil (e.g., cash, cash equivalents and financial obligations) in our statements of income. Primarily because of our substantial liabilities denominated in foreign currency, we recorded a U.S.$55 million net foreign exchange gain in our 2006 statement of income, as compared to a U.S.$269 million net foreign exchange gain in 2005 and to a U.S.$368 million net foreign exchange gain in 2004. To the extent these variations are not recognized in a transaction (such as the repayment of the debt in the period in which there is a depreciation), the foreign exchange gain is added back for purposes of determining our cash flow.

- Our other assets and liabilities in Brazil, primarily accounts receivable, inventories and property, plant and equipment, cash and cash equivalents and government securities, pension plan liabilities, health care benefits and deferred income taxes, are all translated into U.S. dollars. Therefore, any depreciation (appreciation) of the *real* against the U.S. dollar will be reflected as a reduction (gain) in the U.S. dollar value of those assets and liabilities, charged directly to shareholders equity. These currency translation effects are beyond our control. Accordingly, we recorded a U.S.$3,230 million credit directly to shareholders equity in our statement of changes in shareholders equity for 2006, without affecting net income, to reflect the appreciation of the *real* against the U.S. dollar of approximately 8.7%, as compared to a credit of U.S.$3,107 million in 2005 to reflect the appreciation of 11.8%, as compared to a credit of U.S.$1,911 million in 2004 to reflect the appreciation of 8.1%.

Foreign currency translation adjustments reflecting a depreciation have a significant impact on the balance sheet of a company such as ours, whose assets are primarily denominated in *reais*, but whose liabilities are primarily denominated in foreign currencies. The reductions in our asset values charged to shareholders equity, however, do not necessarily affect our cash flows, since our revenues and cash earnings are to a large degree linked to the U.S. dollar, and a portion of our operating expenses are linked to the *real*.

The exchange rate variation also impacts the amount of retained earnings available for distribution by us when measured in U.S. dollars. Amounts reported as available for distribution in our statutory accounting records prepared in accordance with Brazilian accounting principles decrease or increase when measured in U.S. dollars as the *real* depreciates or appreciates against the U.S. dollar. In addition, the exchange rate variation creates foreign

exchange gains and losses that are included in our results of operations determined in accordance with Brazilian accounting principles and that affect the amount of our unretained earnings available for distribution.

Results of Operations

The differences in our operating results from year to year occur as a result of a combination of factors, including primarily: the volume of crude oil, oil products and natural gas we produce and sell, the price at which we sell our crude oil, oil products and natural gas and the differential between the Brazilian inflation rate and the depreciation or appreciation of the *real* against the U.S. dollar. The table below shows the amount by which each of these variables has changed during the last three years:

	2006	**2005**	**2004**
Crude Oil and NGL Production (Mbpd)			
Brazil	1,778	1,684	1,493
International	130	163	168
Non-consolidated international production(1)	12		
Total Crude Oil and NGL Production	1,920	1,847	1,661
Change in Crude Oil and NGL Production	4.0%	11.2%	(2.4)%
Average Sales Price for Crude (U.S.$ per bbl)			
Brazil	$54.71	$45.42	$33.49
International	$44.02	$34.91	$26.51
Natural Gas Production (Mmcfpd)			
Brazil	1,660	1,644	1,590
International	595	576	564
Non-consolidated international production(1)	12		
Total Natural Gas Production	2,267	2,220	2,154
Change in Natural Gas Production (sold only)	2.2%	3.1%	7.2%
Average Sales Price for Natural Gas (U.S.$ per Mcf)			
Brazil	2.61	2.17	1.93
International	2.16	1.64	1.17
Year End Exchange Rate	2.14	2.34	2.65
Appreciation (Depreciation) during the year(2)	8.7%	11.8%	8.1%
Average Exchange Rate for the year	2.18	2.44	2.93
Appreciation (Depreciation) during the year(3)	10.7%	16.8%	4.8%
Inflation Rate (IGP-DI)	3.8%	1.2%	12.1%

(1) Non-consolidated companies in Venezuela.

(2) Considering year end exchange rate.

(3) Considering average exchange rate for the year.

Results of Operations for the year ended December 31, 2006(2006) compared to the year ended December 31, 2005 (2005).

The comparison between our results of operations for 2006 and for 2005 has been affected by the 10.7% decrease in the average r*eal*/U.S. dollar exchange rate for 2006 as compared to the average r*eal*/U.S. dollar exchange rate for 2005.

The exchange variation resulting from monetary assets and liabilities related to operations of consolidated subsidiaries whose functional currency is not *reais* are not eliminated in the consolidation process and such results are accounted for as cumulative translation adjustments.

Revenues

Net operating revenues increased 28.4% to U.S.$72,347 million for 2006, as compared to U.S.$56,324 million for 2005. This increase was primarily attributable to: an increase in prices of our products, both in the domestic and international markets; an increase in sales volume both in the domestic and international markets; and the 10.7% increase in the value of the r*eal* against the U.S. dollar in 2006, as compared to 2005.

Consolidated sales of products and services increased 26.8% to U.S.$93,893 million for 2006, as compared to U.S.$74,065 million for 2005, primarily due to the increases mentioned immediately above.

Included in sales of products and services are the following amounts that we collected from customers on behalf of the federal or state governments:

- Value-added, PASEP, COFINS and other taxes on sales of products and services and social security contributions. These taxes increased 21.9% to U.S.$17,906 million for 2006, as compared to U.S.$14,694 million for 2005, primarily due to the increase in prices and sales volume of our products and services; and

- CIDE, the per-transaction fee, which increased 19.5% to U.S.$3,640 million for 2006, as compared to U.S.$3,047 million for 2005. This increase was primarily attributable to the increase in sales volume of our products and services and to the 10.7% increase in the value of the r*eal* against the U.S. dollar in 2006, as compared to 2005.

Cost of sales (excluding Depreciation, depletion and amortization)

Cost of sales for 2006 increased 34.3% to U.S.$40,061 million, as compared to U.S.$29,828 million for 2005. This increase was principally a result of:

- a U.S.$3,376 million increase in the cost of imports due to higher prices for the products imported and to the increase in the volume of products imported;

- a U.S.$2,588 million increase in costs associated with a 19.4% increase in our international market sales volumes;

- a U.S.$2,033 million increase in taxes and charges imposed by the Brazilian government totaling U.S.$7,443 million for 2006, as compared to U.S.$5,410 million for 2005, as a result of higher international oil prices and the new interpretation by the ANP prohibiting the deductibility of charges associated with project financing for the Marlim field; including an increase in the special participation charge (an extraordinary charge payable in the event of high production and/or profitability from our fields) of U.S.$3,885 million for 2006, as compared to U.S.$3,016 million for 2005, as a result of higher international oil prices and an increase of U.S.$249 million due to the new interpretation by the ANP mentioned above;

- a U.S.$187 million expense related to gas produced and re-injected in reserves in the Solimões, Campos and Espírito Santo basins;

- a U.S.$156 million increase in costs associated with our international trading activities, due to increases in volume and prices from offshore operations, conducted by PifCo; and

- the 10.7% increase in the value of the *Real* against the U.S. dollar in 2006, as compared to 2005.

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Depreciation, depletion and amortization

We calculate depreciation, depletion and amortization of most of our exploration and production assets on the basis of the units of production method. Depreciation, depletion and amortization expenses increased 25.5% to U.S.$3,673 million for 2006, as compared to U.S.$2,926 million for 2005. This increase was primarily attributable to the following:

- increased capital expenditures related to property, plant and equipment associated with our crude oil and natural gas production; and
- the 10.7% increase in the value of the *Real* against the U.S. dollar in 2006, as compared to 2005.

Exploration, including exploratory dry holes

Exploration costs, including for exploratory dry holes, decreased 7.4% to U.S.$934 million for 2006, as compared to U.S.$1,009 million for 2005. This decrease was primarily attributable to the U.S.$71 million of gains resulting from the revision of estimated costs related to abandonment of wells and to the decrease of U.S.$109 million in expenses related to dry holes. These decreases were partially offset by the 10.7% increase in the value of the *Real* against the U.S. dollar in 2006, as compared to 2005.

Impairment of oil and gas properties

For 2006, we recorded an impairment charge of U.S.$21 million, as compared to an impairment charge of U.S.$156 million for 2005. During 2006, the impairment charge was primarily related to producing properties in Brazil and the most significant amounts were related to our Três Marias, Trilha and Córrego de Pedras fields. During 2005, the impairment charge was primarily related to a loss in some of our investments in Venezuela (U.S.$134 million), due to the tax and legal changes implemented by the Ministry of Energy and Petroleum of Venezuela (MEP) in connection with its nationalization measures. See note 9(c) and 9(e) to our consolidated financial statements for the year ended December 31, 2006.

Selling, general and administrative expenses

Selling, general and administrative expenses increased 11.5% to U.S.$4,989 million for 2006, as compared to U.S.$4,474 million for 2005.

Selling expenses increased 11.8% to U.S.$2,394 million for 2006, as compared to U.S.$2,141 million for 2005. This increase was primarily attributable to the following:

- an increase of approximately U.S.$43 million in expenses related to the increased consumption of materials;
- an increase of approximately U.S.$23 million in personnel expenses due to the increase in our workforce and salaries;
- an increase of approximately U.S.$13 million in expenses mainly associated with transportation costs of oil products, due mainly to an increase in the exports; and
- the 10.7% increase in the value of the *Real* against the U.S. dollar in 2006, as compared to 2005.

General and administrative expenses increased 11.2% to U.S.$2,595 million for 2006, as compared to U.S.$2,333 million for 2005. This increase was primarily attributable to the 10.7% increase in the value of the *Real* against the U.S. dollar in 2006, as compared to 2005.

Research and development expenses

Research and development expenses increased 82.2% to U.S.$727 million for 2006, as compared to U.S.$399 million for 2005. This increase was primarily due to:

- a provision for an ANP research and development investment, related to regulation ANP 05/2005, in the amount of approximately U.S.$249 million;
- additional investments in programs for environmental safety, including deepwater and refining technologies of approximately U.S.$31 million; and
- the 10.7% increase in the value of the *Real* against the U.S. dollar in 2006, as compared to 2005.

Other operating expenses

Other operating expenses decreased 25.6% to a total of U.S.$1,081 million for 2006, as compared to U.S.$1,453 million for 2005.

The most significant charges for 2006 were:

- a U.S.$568 million expense for institutional relations and cultural projects;
- a U.S.$331 million expense for idle capacity from gas-fired power plants;
- a U.S.$75 million expense for losses resulting from legal proceedings and contingencies related to pending lawsuits;
- a U.S.$64 million expense for unscheduled stoppages of plant and equipment; and
- a U.S.$46 million gain related to bonuses received from partners and other results with non-core activities.

The most significant charges for 2005 were:

- a U.S.$457 million expense for gas-fired power plants related to idle capacity and penalties and contingencies;
- a U.S.$397 million expense for institutional relations and cultural projects;
- a U.S.$255 million loss related to the exchange of assets between us and Repsol that occurred in 2001. See Note 10(b) to our consolidated financial statements for the year ended December 31, 2006;
- a U.S.$139 million expense for losses resulting from legal proceedings and contingencies related to pending lawsuits;
- a U.S.$64 million expense for unscheduled stoppages of plant and equipment; and
- a U.S.$61 million expense related to contractual losses from compliance with our ship or pay commitments with respect to our investments in the OCP pipeline in Ecuador.

Equity in results of non-consolidated companies

Equity in results of non-consolidated companies decreased 79.9% for a gain of U.S.$28 million for 2006, as compared to a gain of U.S.$139 million for 2005, primarily as a result of losses in investments in certain affiliated companies of Petrobras Distribuidora S.A., in the amount of U.S.$52 million and in certain affiliated companies of Petrobras S.A., in the amount of U.S.$43 million.

Financial income

We derive financial income from several sources, including interest on cash and cash equivalents. The majority of our cash equivalents are short-term Brazilian government securities, including securities indexed to the U.S. dollar. We also hold U.S. dollar deposits.

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Financial income increased 64.1% to a gain of U.S.$1,165 million for 2006 as compared to U.S.$710 million for 2005. This increase was primarily attributable to an increase in financial interest income from short-term investments, in the amount of U.S.$229 million, in 2006 as a result of increased cash and cash equivalent due to increases in operational cash generation, and an increase in financial income from customers in the amount of U.S$147 million, as compared to 2005. A breakdown of financial income and expenses is disclosed in Note 13 to our consolidated financial statements for the year ended December 31, 2006.

Financial expenses

Financial expenses increased 12.7% to U.S.$1,340 million for 2006, as compared to U.S.$1,189 million for 2005. This increase was primarily attributable to the increase of U.S.$378 million of losses on derivatives instruments principally due to cancellation of gas hedge contract; and U.S.$143 million of losses with repurchased securities. These increases were partially offset by the increase of U.S.$389 million in our capitalized interest as part of the cost of construction and development of crude oil and natural gas production projects. A breakdown of financial income and expenses is disclosed in Note 13 to our consolidated financial statements for the year ended December 31, 2006.

Monetary and exchange variation on monetary assets and liabilities, net

Monetary and exchange variation on monetary assets and liabilities, net generated a gain of U.S.$75 million for 2006, as compared to a gain of U.S.$248 million for 2005. The decrease in monetary and exchange variation on monetary assets and liabilities, net is primarily attributable to the effect of the 8.7% appreciation of the *Real* against the U.S. dollar during 2006, as compared to the 11.8% appreciation of the *Real* against the U.S. dollar during 2005.

Employee benefit expense for retired participants

The employee benefit expense consists of financial costs associated with expected pension and health care costs. Our employee benefit expense increased 2.3% to U.S.$1,017 million for 2006, as compared to U.S.$994 million for 2005. This increase was primarily attributable to the 10.7% increase in the value of the *Real* against the U.S. dollar in 2006, as compared to 2005. This increase was partially offset by the decrease of U.S.$96 million in the employee benefit expense for non-active participants due to the increase in expected return on plan assets regarding the good market performance during 2006.

Other taxes

Other taxes, consisting of miscellaneous value-added, transaction and sales taxes, increased 59.2% to U.S.$594 million for 2006, as compared to U.S.$373 million for 2005. This increase was primarily attributable to:

- an increase of U.S.$54 million in the PASEP/COFINS tax related to the increase in financial income;
- an increase of U.S.$49 million in the CPMF, a tax payable in connection with certain bank account transactions;
- an increase of U.S.$48 million in taxes related to the increase in operations with SPEs, mainly with Companhia Locadora de Equipamentos Petrolíferos CLEP, Nova Transportadora do Sudeste NTS and Nova Transportadora do Nordeste NTN;
- an U.S.$12 million increase in taxes in Colombia and Bolivia, related to foreign remittance accounts and dividends; and
- the 10.7% increase in the value of the *Real* against the U.S. dollar in 2006, as compared to 2005.

Other expenses, net

Other expenses, net are primarily composed of gains and losses recorded on sales of fixed assets and certain other non-recurring charges. Other expenses, net decreased 39.3% to U.S.$17 million for 2006, as compared to U.S.$28 million for 2005, primarily due to the decrease in expenses related to platforms that were not producing.

Income tax (expense) benefit

Income before income taxes, minority interest and extraordinary gain increased 31.3% to U.S.$19,161 million for 2006, as compared to U.S.$14,592 million for 2005. The income tax expense increased 28.1% to U.S.$5,691 million for 2006, as compared to U.S.$4,441 million for 2005, primarily due to the increase in income mentioned above. This increase was partially offset by the additional tax benefits related to the provisioning of interest on shareholders equity that amounted to U.S.$1,012 million for 2006 as compared to tax benefits related to the provisioning of interest on shareholders equity that amounted to U.S.$791 million for 2005. The reconciliation between the tax calculated based upon statutory tax rates to income tax expense and effective rates is disclosed in Note 3 to our consolidated financial statements for the year ended December 31, 2006.

Extraordinary gain, net of taxes

We recorded an extraordinary gain, net of taxes, in the amount of U.S.$158 million due to the Escalators Liquidation Agreement entered into on December 29, 2005, and effective as from January 1, 2006, related to a contingent purchase price adjustment on the exchange of assets between us and Repsol that occurred in 2001. See Note 10 (b) to our consolidated financial statements for the year ended December 31, 2006.

Results of Operations for the year ended December 31, 2005(2005) compared to the year ended December 31, 2004 (2004).

The comparison between our results of operations for 2005 and 2004 has been affected by the 16.8% decrease in the average *Real*/U.S. dollar exchange rate for 2005 as compared to the average *Real*/U.S. dollar exchange rate for 2004. We refer to this ch