PETROBRAS INTERNATIONAL FINANCE CO
Form 20-F
June 28, 2006

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, 2005

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

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, 2005, there were outstanding:
2,536,673,672 PETROBRAS Common Shares, without par value
1,849,478,028 PETROBRAS Preferred Shares, without par value
50,000 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.

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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.

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 204.

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 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, 2005 and 2004, and for each of the three years in the period ended December 31, 2005, 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 Corporation 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.

We are required by Brazilian Corporation Law to change auditors every five years and to select auditors through a bidding process authorized by the Board of Directors. From June 2003 through December 31, 2005, Ernst & Young Auditores Independentes S/S served as our independent auditors and audited our financial statements for each of the years ended December 31, 2005, 2004 and 2003. PricewaterhouseCoopers Auditores Independentes audited our financial statements for each of the years ended December 31, 2002 and 2001. As of January 1, 2006, we hired KPMG Auditores Independentes to serve as our independent auditors.

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 remeasured 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 2005-2015 Strategic Plan and 2006-2010 Business Plan and have been projected on a constant basis and have been translated from *reais* in 2006 at an estimated average exchange rate of R$3.01 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.$45.00 per barrel for 2006, and U.S.$30.00 per barrel for 2007 and U.S.$25.00 per barrel for 2008 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.

We signed a final agreement for the acquisition of Petrobras Energía Participaciones S.A., or PEPSA, and Petrolera Entre Lomas S.A., or PELSA, in October 2002 and the acquisition was approved by Argentine government agencies in May 2003. Our results of operations for 2002 do not include PEPSA and PELSA s results and our results of operations for 2003 only include PEPSA and PELSA s results from June through December of 2003. We acquired Liquigás Distribuidora S.A. (formerly Sophia do Brasil S.A. and Agip do Brasil S.A.) in August 2004. Our results of operations for 2004 only include Liquigás Distribuidora s results from August to December of 2004. See Note 20 to our audited consolidated financial statements for further information about these acquisitions.

We adopted FIN 46 in our financial statements for the year ended December 31, 2003. Our interest in certain project finance special purpose entities and gas-fired power plants were consolidated on a line-by-line basis in the income statement beginning as of January 1, 2004. Although this consolidation affected each line of the income statement, it did not have a significant impact on our net income.

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, 2005 and 2004, and for each of the three years in the period ended December 31, 2005, 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 and Bear Insurance Company Limited BEAR

PRESENTATION OF INFORMATION CONCERNING RESERVES

The estimates of our proved reserves of crude oil and natural gas as of December 31, 2005, 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, 2005. 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 16, 2006, 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 11.36 billion barrels of crude oil and NGLs and 11,206.57 billion cubic feet of natural gas. The reserve estimates we filed with the ANP and those provided herein differ by approximately 25%. 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.

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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 0.96 billion barrels of crude oil and NGLs and 4,355 billion cubic feet of natural gas, which differs by approximately 40 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, without the performance of pilot project tests.

Bolivia and Venezuela announced certain nationalization measures, which we expect will have the effect of reducing our oil and gas reserves in these countries. As a result, the information concerning reserves in Bolivia and Venezuela as provided herein may change. 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.

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, 2005 have been derived from our audited consolidated financial statements, which were audited 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 each of the years ended December 31, 2002 and 2001. 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.

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BALANCE SHEET DATA

	As of December 31,				
	2005	2004	2003	2002	2001
	(in millions of U.S. dollars)				
Assets					
Current assets:					
Cash and cash equivalents	$ 9,871	$ 6,856	$ 8,344	$ 3,301	$ 7,360
Accounts receivable, net	6,184	4,285	2,905	2,267	2,759
Inventories	5,305	4,904	2,947	2,540	2,399
Recoverable taxes	2,087	1,475	917	672	664
Advances to suppliers	652	422	504	794	483
Other current assets	1,679	1,484	1,817	748	661
Total current assets	25,778	19,426	17,434	10,322	14,326
Property, plant and equipment, net	45,920	37,020	30,805	18,224	19,179
Investments in non-consolidated companies and other investments	1,810	1,862	1,173	334	499
Other assets:					
Accounts receivables, net	607	411	528	369	476
Advances to suppliers	489	580	416	450	403
Petroleum and Alcohol Account-Receivable from the Brazilian government(1)	329	282	239	182	81
Government securities	364	326	283	176	665
Unrecognized pension obligation				61	187
Restricted deposits for legal proceedings and guarantees	775	699	543	290	337
Recoverable taxes	639	536	467	156	164
Investments PEPSA and PELSA				1,073	
Goodwill	237	211	183		
Prepaid expenses	246	271	190	100	78
Marketable securities	129	313	806	208	212
Fair value asset of gas hedge	547	635			
Others	755	510	545	209	257
Total other assets	5,117	4,774	4,200	3,274	2,860
Total assets	$ 78,625	$ 63,082	$ 53,612	$ 32,154	$ 36,864
Liabilities and Shareholders equity					
Current liabilities:					
Trade accounts payable	$ 3,838	$ 3,284	$ 2,261	$ 1,702	$ 1,783
Taxes payable	3,423	2,569	2,305	1,801	2,145
Short-term debt	950	547	1,329	671	1,101
Current portion of long-term debt	1,428	1,199	1,145	727	940
Current portion of project financings	2,413	1,313	842	239	680
Current portion of capital lease obligations	239	266	378	349	298

Dividends and interest on capital payable	3,068	1,900	1,955	307	93
Payroll and related charges	918	618	581	283	333
Advances from customers	609	290	258	119	26
Employees postretirement benefits obligations Pension	206	166	160	89	117
Other current liabilities	1,063	1,176	823	976	528
Total current liabilities	18,155	13,328	12,037	7,263	8,044
Long-term liabilities:					
Long-term debt	11,503	12,145	11,888	6,987	5,908
Project financings	3,629	4,399	5,066	3,800	3,153
Employees postretirement benefits obligations Pension	3,627	2,915	1,895	1,363	1,971
Employees postretirement benefits obligation Health Care	3,004	2,137	1,580	1,060	1,409
Capital lease obligations	1,015	1,069	1,242	1,907	1,930
Deferred income tax	2,159	1,558	1,122	259	717
Gas-fired power liabilities		1,095	1,142		
Deferred Purchase Incentive	144	153			
Provision for abandonment of wells	842	403	396		
Other liabilities	556	497	541	350	406
Total long-term liabilities	26,479	26,371	24,872	15,726	15,494
Minority interest	1,074	877	367	(136)	79

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	As of December 31,				
	2005	2004	2003	2002	2001
	(in millions of U.S. dollars)				
Shareholders equity					
Shares authorized and issued:					
Preferred share	4,772	4,772	2,973	2,459	1,882
Common share	6,929	6,929	4,289	3,761	2,952
Capital reserve and other comprehensive income	21,216	10,805	9,074	3,081	8,413
Total Shareholders equity	32,917	22,506	16,336	9,301	13,247
Total liabilities and Shareholders equity	$ 78,625	$ 63,082	$ 53,612	$ 32,154	$ 36,864

(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 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

	For the Year Ended December 31,				
	2005	2004 (11)	2003 (11)	2002(11)	2001(11)
	(in millions of U.S. dollars, except for share and per share data)				
s of products and services	$ 74,065	$ 51,954	$ 42,690	$ 32,987	$ 34,1
ue-added and other taxes on sales and services	(14,694)	(10,906)	(9,527)	(7,739)	(8,6
E(1)	(3,047)	(2,620)	(2,249)	(2,636)	
cific parcel price PPE(2)					(9
operating revenues	$ 56,324	38,428	30,914	22,612	24,5
t of sales(3)	29,828	21,279	15,533	11,506	12,8
reciation, depletion and amortization(4)(12)	2,926	2,481	1,785	1,930	1,7
loration, including exploratory dry holes(4)(5)	1,009	613	512	435	4
ing, general and administrative expenses	4,474	2,901	2,091	1,741	1,7
er operating expense(6)	1,137	572	597	222	2
l costs and expenses	39,374	27,846	20,518	15,834	16,9
ncial income	710	956	634	1,142	1,3
ncial expense	(1,189)	(1,733)	(1,247)	(774)	(8
netary and exchange variation on monetary assets liabilities, net	248	450	509	(2,068)	(9
ployee benefit expense	(994)	(650)	(595)	(451)	(5
er non-operating income (expense), net(7)	(1,133)	(670)	(924)	(1,395)	(1,8
ome before income taxes, minority interest, aordinary item and accounting change	14,592	8,935	8,773	3,232	4,7
ome tax (expense) benefit:					
rent	(4,223)	(2,114)	(2,599)	(1,269)	(1,1
erred	(218)	(117)	(64)	116	(1
l income tax expense	(4,441)	(2,231)	(2,663)	(1,153)	(1,3
ority interests in results of consolidated sidiaries	35	(514)	(248)	232	
ome before extraordinary item and effect of nge in accounting principle	10,186	6,190	5,862	2,311	3,4
aordinary gain net of tax	158				
nulative effect of change in accounting principle, of taxes(4)			697		
income for the year	$ 10,344	$ 6,190	$ 6,559	$ 2,311	$ 3,4
ghted average number of shares Outstanding:(8)					
nmon(8)	2,536,673,672	2,536,673,672	2,536,673,672	2,536,673,672	2,536,673,6
erred(8)	1,849,478,028	1,849,478,028	1,849,478,028	1,807,742,676	1,807,742,6
c and diluted earnings per share:(8)(9)					

nmon and Preferred Shares(8)(9)	$	2.36	$	1.41	$	1.50	$	0.53	$	0
nmon and Preferred ADS(8)(9)	$	9.44	$	5.64	$	6.00	$	2.12	$	3
n dividends per(8)(10):										
nmon and Preferred shares(8)(10)	$	0.68	$	0.42	$	0.37	$	0.29	$	0
nmon and Preferred ADS(8)(10)	$	2.72	$	1.68	$	1.48	$	1.16	$	1

(1) CIDE is a per-transaction tax due to the Brazilian government.

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(2) According to specific legislation applicable to the Petroleum and Alcohol Account through December 31, 2001, the Petroleum and Alcohol Account was realized through collection of the Specific Parcel Price-PPE generated by the sale of the majority of basic oil products (gasoline, diesel oil and LPG). The PPE represented the difference between the selling prices of these products at the refinery (net of *Imposto sobre Circulação de Mercadorias e Serviços* (state value-added tax), or ICMS and other charges levied on sales), fixed in *reais* by the Brazilian Government, and the corresponding realization prices for such products, which is the basis for calculation net operating revenues. The realization prices (PR) for each oil product were determined on the basis of a pricing formula established by the Brazilian Government that, with a lag of approximately one month, reflected

changes in oil products quotations on the international market and the exchange rate. When the invoicing price net of ICMS and PASEP/COFINS exceeded the realization price, the PPE collection was positive and reduced the balance of the Petroleum and Alcohol Account. Conversely, when the invoicing value net of ICMS and PASEP/COFINS was less than the realization price, the PPE collection was negative and increased the balance of the Petroleum and Alcohol Account. See Item 4. Information on the Company Regulation of the Oil and Gas Industry in Brazil Price Regulation The Petroleum and Alcohol Account.

(3) Amounts reported are net of impact of government charges and taxes of U.S.$68 million in 2001. The governmental regulations giving rise to such charges/credits and taxes were abolished in 2002.

(4) 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.

(5) In 2005, we reviewed and revised our estimated costs associated with well abandonment and the demobilization of oil and gas production areas, considering new information about date of expected abandonment and revised cost estimates to

abandon. The changes to estimated asset retirement obligation were principally related to changing expectations about Brent prices, which led the correlated fields to have longer economic lives. This review resulted in a decrease in the related provision of U.S.$21 million with a gain recognized in net income, and recorded in the line titled exploratory costs for oil and gas exploration. See note 2(i) to our audited consolidated financial statements.

(6) Amounts reported are net of impact of government charges and taxes of U.S.$45 million in 2001. The governmental regulations giving rise to such charges and taxes were abolished in 2002.

(7) Amounts reported include financial charges in respect of the Petroleum and Alcohol Account of U.S.$2 million in 2002 and U.S.$16 million in 2001.

(8) 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.

(9) 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).

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

(11)

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

(12) Including in 2005 an impairment charge relating to our operations in Venezuela.

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, 2005 have been derived from PIFCo s audited consolidated financial statements, which were audited 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 each of the years ended December 31, 2002 and 2001. 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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	For the Year Ended December 31,				
	2005	2004	2003	2002	2001
	(in millions of U.S. dollars)				
Income Statement Data:					
Sales of crude oil and oil products and Services:					
Related Parties	$ 13,974.4	$ 10,118.4	$ 5,543.0	$ 5,375.5	$ 5,860.6
Others	3,161.7	2,237.2	1,432.5	1,014.7	399.9
Lease income(1)				36.1	10.7
	$ 17,136.1	$ 12,355.6	$ 6,975.5	$ 6,426.3	$ 6,271.2
Operating Expenses:					
Cost of sales					
Related Parties	(7,780.3)	(4,391.3)	(2,851.4)	(2,409.0)	(1,648.1)
Others	(9,203.0)	(7,844.7)	(4,068.7)	(3,962.5)	(4,604.9)
Lease expense(1)				(24.0)	(10.5)
Selling, general and Administrative expenses					
Related parties	(158.1)	(98.7)	(17.1)		
Others	(7.6)	(1.1)	(1.5)	(1.2)	(0.1)
	(17,149.0)	(12,335.8)	(6,938.7)	(6,396.7)	(6,263.6)
Operating income (loss)	(12.9)	19.8	36.8	29.6	7.6
Financial income(2)					
Related Parties	765.5	568.6	401.7	201.9	155.4
Others	218.5	110.2	41.2	17.7	3.4
Total	984.0	678.8	442.9	219.6	158.8
Financial expense(3)					
Related Parties	(409.8)	(169.0)	(111.9)	(61.3)	(67.4)
Others	(589.1)	(592.2)	(370.8)	(253.4)	(119.7)
Total	(998.9)	(761.2)	(482.7)	(314.7)	(187.1)
Other income, net					
Related Parties		(0.5)			
Others		4.0			0.4
Net loss	$ (27.8)	$ (59.1)	$ (3.0)	$ (65.5)	$ (20.3)
Balance Sheet Data (end of period):					
Cash and cash equivalents	$ 230.7	$ 1,107.3	664.2	260.6	48.6
Trade accounts receivable					
Related parties	8,681.1	7,788.1	5,064.5	4,837.1	2,583.7
Others	212.7	153.6	109.4	57.1	44.7
Notes receivable					
Related parties	3,909.3	1,936.9	1,726.4	1,631.6	283.0

Export Prepayment					
Related parties	943.9	1,414.7	1,479.4	751.2	751.2
Marketable Securities	2,248.6	1,864.8	615.8	96.3	
Total assets	16,748.9	14,670.2	10,196.6	8,697.3	4,277.8
Trade accounts payable					
Related parties	950.7	562.1	271.0	292.0	288.1
Other	616.1	568.1	349.0	281.1	231.0
Notes payable					
Related parties	8,080.3	6,435.0	2,442.8	3,688.2	334.6
Short-term financing and current portion of long-term debt	891.1	680.9	1,076.4	367.5	990.4
Long-term debt(4)	5,908.4	6,151.8	5,825.3	3,850.4	2,335.0
Total stockholders equity	8.0	35.7	94.8	43.9	49.4
Total liabilities and stockholders equity	16,748.9	14,670.2	10,196.6	8,697.3	4,277.8

(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 and 2005.

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(2) Financial income represents primarily the imputed interest realized from PIFCo s sales of crude oil and oil products to us.

(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.

Exchange Rates

All foreign exchange transactions are now carried out in a single foreign exchange market. Prior to March 14, 2005, there were two principal foreign exchange markets in Brazil, the commercial rate exchange market and the floating rate exchange market. Most trade and financial transactions were carried out on the commercial rate exchange market, including the purchase or sale of our shares or the payment of dividends with respect to our shares to shareholders outside Brazil. Transactions not carried out on the commercial rate exchange market were generally carried out on the floating rate exchange market.

Foreign currencies may only be purchased through Brazilian financial institutions authorized to operate in such market and are subject to registration with the Central Bank electronic system. Foreign exchange rates are freely negotiated, but may be influenced by Central Bank intervention. 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 and 11.8% in 2005. As of June 21, 2006, the *real* has appreciated to R$2.238 per U.S.$1.00, representing an appreciation of approximately 4.4% in 2006 year-to-date The *real* may depreciate or appreciate substantially in the future. 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

	For the Year Ended December 31, (R$ /U.S.$)			
	High	Low	Average (1)	Period End
Year ended December 31,				
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
2001	2.835	1.935	2.352	2.320
Month				
November 2005	2.252	2.163	2.211	2.207
December 2005	2.374	2.180	2.286	2.341
January 2006	2.346	2.212	2.273	2.216
February 2006	2.222	2.118	2.159	2.136
March 2006	2.224	2.107	2.148	2.172
April 2006	2.172	2.089	2.131	2.089
May 2006	2.059	2.371	2.170	2.301
June 2006 (through June 21)	2.302	2.238	2.262	2.238

Source: Central Bank of Brazil

(1) Year-end figures stated for calendar years 2005, 2004, 2003, 2002 and 2001 represent the average of the month-end exchange rates during the relevant period. The figures provided for the months of calendar year 2006 and 2005, as well as for the month of June up to and including June 21, 2006, represents 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,

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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 major part 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.$ 54.38 per barrel for 2005, U.S.$38.21 per barrel for 2004 and U.S.$28.84 per barrel for 2003. 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 political developments in crude oil producing regions, particularly in the Middle East;
- the ability of the Organization of Petroleum Exporting Countries (OPEC) and other crude oil producing nations to set and maintain crude oil production levels and prices;
- global and regional supply and demand for crude oil and oil products;
- competition from other energy sources;
- domestic and foreign government regulations;
- weather conditions; and
- global conflicts and acts of terrorism.

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 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 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 36% of the exploratory wells we drilled in 2005, 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 2005, we experienced spills totaling 71,141 gallons of crude oil, as compared to 140,000 gallons in 2004 and 73,000 gallons in 2003. 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 remedy any 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 litigation and arbitration.

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%. They have filed two tax assessments against us in the aggregate amount of R$3,157 million (approximately U.S.$1,098 million). See Item 8. Financial Information Legal Proceedings.

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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. Additionally, 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 ICMS on oil upstream 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 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 is technically in force, the 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$8.51 billion (U.S.$3.52 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 fourteen (twelve in operation and two under construction or development) of the 39 gas-fired power generation plants. Demand for energy produced by our gas-fired power plants has been lower than we expected mainly as a result of good hydrological conditions in the last years that increased the supply and lowered the prices of energy from hydroelectric power plants. The main risks associated with our gas-fired power business are:

- Physical demand for our installed capacity, which is influenced by the current and expected market prices of natural gas;

- The potential mismatch between 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 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 all 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, such as structured financings, 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 principal market for our products is Brazil, and over the last three fiscal years over 78% of our revenues have been denominated in *reais*. A substantial portion of our indebtedness and some of our operating expenses and capital expenditures are, and are expected to continue to be, denominated in or indexed to U.S. dollars and other foreign currencies. In addition, during 2005 we imported U.S.$8.1 billion of crude oil and oil products, the prices of which were all denominated in U.S. dollars.

The *real* depreciated 52.3% in 2002 against the U.S. dollar before appreciating 18.2%, 8.1% and 11.8% against the U.S. dollar in 2003, 2004 and 2005, respectively. As of June 21, 2006, the exchange rate of the *real* to the U.S. dollar was R$2.238 per U.S.$1.00, representing an appreciation of approximately 4.4% in 2006 year-to-date. The value of the *real* in relation to the U.S. dollar may continue to fluctuate and may include a significant depreciation of the *real* against the U.S. dollar as occurred in 2002. Any future substantial depreciation of the *real* may adversely affect our operating cash flows and our ability to meet our foreign currency-denominated obligations.

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

As of December 31, 2005, approximately 52.5% of our total indebtedness consisted of floating rate debt. We have not entered into derivative contracts or made other arrangements to hedge against interest rate risk. 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 and terrorism.

We do not maintain coverage for business interruption for our Brazilian operations. If, for instance, our workers were to strike, the resulting work stoppages could have an adverse effect on us, as we do not carry insurance for losses incurred as a result of business interruptions of any nature, including business interruptions caused by labor action. In addition, we do not insure most of our assets against war and terrorism. A terrorist attack or an operational incident causing an interruption of our business could therefore 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; or
- increases in export tax / income tax rates for crude oil and oil products.

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 40% of our total international crude oil and natural gas production and 28% of our international proved crude oil and natural gas reserves at December 31, 2005. In response to the Argentine crisis, the Argentine government has made a number of changes in the regulatory structure of the electricity and gas sectors and has fixed export tax rates for crude oil, natural gas and oil products. We also have significant operations in Bolivia and Venezuela that represented, respectively, approximately 21% and 18% of our total international production in barrels of oil equivalent and 27% and 22% of our international proved crude oil and natural gas reserves at December 31, 2005. Both Bolivia and Venezuela have recently announced certain nationalization measures that may generate material losses to us. At present, there is much uncertainty in the political, economic and social situations, generally in these two countries. 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 nationalization measures. Deterioration of the situation in Argentina, Bolivia or Venezuela may have an adverse effect on our results of operations and financial condition.

The recent 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.

Our consolidated interests related to Bolivia include two refineries, oil and gas reserves, which represented approximately 2.7% of our total reserves at December 31, 2005 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. We have been operating in Bolivia since 1996. As of December 31, 2005, the book value of Bolivia assets were U.S.$990million. 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, our interest in the two refineries and the oil and gas reserves in Bolivia will be reduced. We have 180 days to comply with the terms and conditions of the nationalization, and it is uncertain if and how we will be compensated for our losses. In 2005, the natural gas we imported from Bolivia represented approximately 53% 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.

Our interests in Venezuela include oil and gas reserves, which represented approximately 2.3% of our total reserves at December 31, 2005. In April 2005, the Venezuelan Energy and Oil Ministry instructed PDVSA 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, Petróleos de Venezuela S.A. (PDVSA) and Corporación Venezolana del Petróleo S.A. (CVP), entered into memorandums 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 will be 60%. The economic effects of the migration are effective since April 1, 2006. See Item 4. Information on the Company International Venezuelan Operations.

As a result of the foregoing, we currently 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.

Risks Relating to PIFCo

PIFCo may not earn enough money from its own operations to meet its debt obligations.

PIFCo is a direct wholly-owned subsidiary of Petrobras incorporated in the Cayman Islands as an exempted company with limited liability. Accordingly, PIFCo s financial position and results of operations are largely affected by our decisions, as its parent company. 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, with financing for such operations provided by us as well as third-party credit providers. PIFCo also buys and sells crude oil and oil products from and to us, third parties and affiliates on a limited basis. PIFCo s ability to pay interest, principal and other amounts due on its outstanding and future debt obligations will depend upon a number of factors, including:

- our financial condition and results of operations;
- the extent to which we continue to use PIFCo s services for market purchases of crude oil and oil products;
- our willingness to continue to make loans to PIFCo and provide PIFCo with other types of financial support;
- PIFCo s ability to access financing sources, including the international capital markets and third-party credit facilities; and
- PIFCo s ability to transfer its financing costs to us.

In the event of a material adverse change in our financial condition or results of operations or in our financial support of PIFCo, PIFCo may not have sufficient funds to repay all amounts due on its indebtedness. See Risks Relating to Our Operations 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.

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.

PIFCo obtains substantially all of its funds from our payments in U.S. dollars for crude oil that we purchase from PIFCo. In order to remit U.S. dollars to PIFCo, we must comply with Brazilian foreign exchange control regulations, including preparing specified documentation to be able to obtain U.S. dollar funds for payment to PIFCo. If Brazilian law were to impose additional 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. Such restrictions could also have a material adverse effect on the Brazilian economy or our business, financial condition and results of operations.

PIFCo may be limited in its ability to pass on its financing costs.

PIFCo is principally engaged in the purchase of crude oil and oil products for sale to Petrobras, as described above. PIFCo regularly incurs indebtedness related to such purchases and/or obtain financing from us or third-party creditors. At December 31, 2005, approximately 20% of PIFCo s indebtedness was floating-rate debt denominated in U.S. dollars. All such indebtedness has the benefit of our standby purchase obligation or other support. PIFCo has historically 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. Although we intend to continue this practice in the future, we cannot assure you that we will. PIFCo s inability to transfer its financing costs to us could have a material 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, often 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, 2005 was U.S.$329 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.

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:

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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.

Political instability may adversely affect our results of operations and the price of our securities.

The performance of the Brazilian economy has historically been influenced by the domestic political scenario. Political crises have, in the past, affected the confidence of investors and of the general public and resulted in economic slowdowns, adversely affecting the market price of the shares of publicly-listed companies.

The Brazilian Congress is currently conducting investigations on, among other matters, allegations related to contributions to political campaigns that were unaccounted for or not publicly disclosed, including contributions made to various important members of the current federal administration. Such allegations have resulted in the replacement of key ministers and occupied most of Congress agenda. In addition, some allegations implicated other companies controlled by the Brazilian government. If these investigations were to impact the confidence of the general public and/or of investors, or result in an economic slowdown in Brazil, our results of operations and the price of our shares could be adversely affected.

Additionally, presidential elections in Brazil will take place in 2006 and we cannot assure you that the next administration will maintain the economic policies that were adopted by the current administration. The uncertainties relating to the election may impact the confidence of the general public and of investors and the price of our securities may be adversely affected.

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 Wide 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 7.60% in 2004 and to 5.69% in 2005. 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.

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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 Brazilian securities markets are smaller, more volatile and less liquid than the major U.S. and European securities markets and therefore you may have greater difficulty selling the common or preferred shares underlying our ADSs

The Brazilian securities markets are smaller, more volatile and less liquid than the major securities markets in the United States and other jurisdictions, and are not as highly regulated or supervised. The relatively small capitalization and liquidity of the Brazilian equity markets may substantially limit your ability to sell the common or preferred shares underlying our ADSs at the price and time you desire. These markets may also be substantially affected by economic circumstances unique to Brazil, such as currency devaluations.

The market for PIFCo s notes may not be liquid.

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 that 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, Citibank 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 are currently traded. Active, liquid trading markets generally result in lower price volatility and more efficient

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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.

Additionally, 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 disposition 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 United States shareholders.

Our corporate affairs are governed by our bylaws and the Brazilian Corporation 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 Corporation 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 represents 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 standby purchase agreements 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 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.

We may not be able to pay our obligations under the standby purchase agreement in U.S. Dollars.

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

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PIFCo. If we are required to make payments under the standby purchase agreement, Central Bank of Brazil approval will be necessary. Any approval from the Central Bank of Brazil may only be requested when such payment is to be remitted abroad by us, and will be granted by the Central Bank of Brazil on a case-by-case basis. It is not certain that any such approvals will be obtainable at a future date. In case 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 believes 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

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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 government enterprise responsible for all hydrocarbon activities in Brazil. Since our foundation, our legal name has been Petróleo Brasileiro S.A. Petrobras. From that time until 1995, we had a government-granted monopoly for all crude oil and natural gas production and refining activities in Brazil. 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 end of our legal monopoly 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 partners.

Based upon our 2005 consolidated revenues, we are the largest corporation in Brazil and one of the largest oil and gas companies in Latin America. In 2005, we had sales of products and services of U.S.$74,065 million, net operating revenues of U.S.$56,324 million and net income of U.S.$10,344 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.

Refining, Transportation and Marketing Our refining, transportation and marketing segment encompasses refining, logistics, transportation and the purchase of crude oil, as well as the purchase and sale of oil products and fuel alcohol. Additionally, this segment includes the petrochemical and fertilizers division, which includes domestic petrochemical companies and our two domestic fertilizer plants.

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

Natural Gas and Power Our natural gas and power segment encompasses the purchase, sale and transportation of natural gas produced in or imported into Brazil. Additionally, this segment includes our domestic electric energy commercialization activities as well as investments in domestic natural gas transportation companies, state owned natural gas distributors and gas-fired power plants.

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

Corporate Our corporate segment includes those activities not attributable to other segments, including corporate financial management and overhead related with central administration.

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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Recent developments relating to compliance with the Sarbanes-Oxley Act

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, beginning with our Annual Report on Form 20-F for the fiscal year ending December 31, 2006, we will be required to furnish a report by our management on our internal control over financial reporting. This report will contain, among other matters, an assessment of the effectiveness of our internal controls over financial reporting as of the end of the fiscal year, including a statement as to whether or not our internal controls over financial reporting are effective. This assessment must include disclosure of any material weakness in our internal control over financial reporting identified by management.

The report will also contain a statement that our auditors have issued a certification report on management s assessment of such internal controls. Deloitte, Touche Tohmatsu has assisted our management in conducting a preliminary assessment and evaluation of our internal controls.. To comply with this requirement, we are creating a system of internal controls over financial reporting through the Integrated Program for Internal Control Systems and Valuation Methodology, known as PRISMA . PRISMA is a program that focuses on constantly reviewing our financial statements and information contained in our consolidated financial reports. In addition, the program follows orientations from the Public Company Accounting Oversight Board (PCAOB) and from the Committee of Sponsoring Organizations of the Treadway Commission (COSO), for the development of better internal control practices, as well as from Control Objectives for Information and Related Technology (COBIT), as it relates to information technology.

Phases 1 and 2 of the PRISMA have already been implemented and we are currently implementing phase 3 of the program.

Competitive Strengths

We have a number of key strengths, including:

- dominant market position in the production, refining and transportation of crude oil and oil products in Brazil;
- strong reserve base;
- deepwater technological expertise;
- cost efficiencies created by large scale operations combined with vertical integration among business segments;
- strong position in Brazil s growing natural gas markets; and
- success in attracting international partners in all activities.

Dominant market position in the production, refining and transportation of crude oil 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 all major development fields in Brazil and substantially all of the country s refining capacity. Our average domestic daily production of crude oil and NGLs increased 12.8% in 2005, decreased 3.1% in 2004 and increased 2.7% in 2003.

Strong reserve base

As of December 31, 2005, we had estimated proved developed and undeveloped crude oil and natural gas reserves of approximately 11.77 billion barrels of oil equivalent in Brazil and abroad. 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, 2005, our worldwide proved reserves to production ratio was 15.4 years.

The majority of our reserves, including recent discoveries, are located in deep-water 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 2006 to 2010, we have been investing the necessary capital to build the offshore platforms needed to monetize these reserves. Although our proved reserve life is higher than the industry average, the additional planning required to bring deep-water 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.

Deepwater technological expertise

While developing Brazil s offshore basins over the past 36 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 9,842 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 2005, excluding government take, increased to U.S.$5.73 per barrel of oil equivalent, as compared to U.S.$4.28 per barrel of oil equivalent for 2004. Including government take, our lifting costs increased to U.S.$14.65 per barrel of oil equivalent for 2005, as compared to U.S.$10.72 per barrel of oil equivalent for 2004.

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

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 80% 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 current production of 1,684 Mbpd, our refining throughput of 1,726 Mbpd and the Brazilian market total demand for hydrocarbon products of 1,800 Mbpd as of December 2005.

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. At present, the ability to meet the potential demand for natural gas is limited, due to constraints in gas supply and to a distribution infrastructure that is still under development. The prices we realize for natural gas, which depend on the costs of other energy sources it can replace, are approximately half of the current market price in the United States, where demand is more developed. The demand for natural gas in Brazil increased 11% in 2005. Although we cannot be certain that natural gas demand will continue to grow at annual rates similar to previous years, we expect continued growth as significant investments in gas transportation pipelines begin operating.

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 our:

- increasing production of non-associated natural gas, and natural gas associated with our domestic crude oil production, combined with the necessary investments to process such gas from recent discoveries of non-associated gas reserves, mainly in the Santos Basin offshore in Brazil;
- planned investments in expansion of the natural gas transportation network throughout Brazil;
- increased 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 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, British Petroleum, Chevron-Texaco 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:

- consolidate and increase competitive advantages in the Brazilian and South American oil and oil products market;
- selectively expand international activities in an integrated manner with the Company s business;
- develop and lead the domestic natural gas market and act in an integrated manner in the gas and power market in the Southern Cone;
- selectively expand our activities in the domestic and Southern Cone petrochemicals market; and
- selectively perform in the renewable energy market.

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

Our 2006-2010 Business Plan contemplates capital expenditures of approximately U.S.$28 billion in exploration and development activities in Brazil. Through these investments, we plan to implement 17 big scope projects, among others, aimed at increasing production to 2.3 million bpd by 2010. Our 2006-2010 Business Plan contemplates capital expenditures of approximately U.S.$7.1 billion in exploration and development activities outside of Brazil. These investments will be primarily exploration and development activities in South America. Our other areas of focus will be the Gulf of Mexico and West Africa. At December 2005, we had exploration, development and production rights in 54 million gross and 35 million net acres (220,000 gross and 141,000 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. Our goal is to maintain a ratio of 15.4 years of reserves to production sustainable in the long-term. We have net exploration, development and production rights in 35.3 million acres (142,691 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 2005 supplied approximately 80% of the crude oil feedstock for our refinery operations in Brazil, as compared to 76% in 2004 and 80% in 2003. 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 98.5% 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 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 to better process our domestic production of heavier crude oil.

Selectively expand international activities in an integrated manner with the Company s business.

In the near 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, 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 the Southern Cone

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 on an integrated manner with other areas of our Company in the production chain and consumption; and

- taking advantage of growing 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.

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Selectively expand our activities in the domestic and Southern Cone petrochemicals market

We intend to expand activities in the petrochemical and fertilizer markets by seeking strategic partnerships and creating synergies with existing business. Our 2006-2010 Business Plan contemplates investments of approximately U.S.$2.0 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 take benefit of the expected growth in the petrochemical market in Brazil. We also intend to build a basic petrochemical complex that will 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. The total estimated aggregate investment for the construction of this petrochemical complex is approximately U.S.$6.5 billion and it is expected that it will begin operating in 2012.

Selectively perform in the renewable energy market

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

- bio-diesel production and H-bio;
- wind power generation;
- biomass energy; and
- photo voltaic.

Overview by Business Segment

Exploration, Development and Production

Summary and Strategy

Our exploration and production segment includes exploration, development and production activities in Brazil. We began domestic production in 1954 and international production in 1972. As of December 31, 2005, our estimated net proved crude oil and natural gas reserves in Brazil were approximately 10.58 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 2005, our average daily domestic production was 1,684 Mbpd of crude oil and NGLs and 1.643 billion cubic feet of natural gas per day. Our aggregate average lifting costs for crude oil and natural gas in 2005 were U.S.$5.73 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.

At December 31, 2005, we held 418 areas, representing 35.3 million net acres (142,691 square kilometers). We currently have joint venture agreements for exploration and production in Brazil with 26 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.   In addition, we have added to our exploration acreage through our participation in bidding rounds that have been conducted annually by the ANP since 1999.

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

- strengthening our expertise in deep and ultra-deep waters;
- focusing on profitable opportunities on-shore and in shallow water fields;
- implementing new practices and new technologies in areas with high exploitation degree in order to optimize recovery factor;
- developing exploratory efforts in new frontiers in order to assure a sustainable reserve/production ratio.

Principal Domestic Oil and Gas Producing Regions

Our annual daily production in Brazil has generally 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 1,684 Mbpd in 2005. 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 45 hydrocarbon reservoirs have been discovered in this region in a 7.5 thousand square kilometers concession area, including eight large oil fields in deepwater and ultra deepwater. 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. 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. The Campos Basin s oil production accounted for approximately 83% of Brazilian oil production in 2005.

At December 31, 2005, we produced crude oil from 36 fields in the Campos Basin and its proved crude oil reserves were 7.89 billion barrels, representing 81% of our total proved crude oil reserves. In 2005, the crude oil we produced in the Campos Basin had an average API gravity of 23.5 and an average water cut of 1%. We currently have 26 floating production systems, 13 fixed platforms and 5,226 kilometers of pipeline and flexible pipes operating in 45 fields at water depths of 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 23 blocks in this Basin, 12 onshore and 11 offshore, with an exploration acreage of 10.4 thousand square kilometers. During 2005, we produced 42.7 Mboe per day of oil and natural gas in the Espírito Santo Basin (25.7 Mboe onshore and 17.1 Mboe offshore). On February 21, 2006, we began gas production in the Basin s Peroá Field.

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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 26 blocks in the Santos Basin, with an exploration acreage of 40.7 thousand square kilometers (as compared to 13.7 thousand square kilometers under concession in the Campos Basin). Current production of oil and natural gas is 10.87 Mboe per day in the Coral and Merluza fields. We have drilled the first exploratory well in the ultra-deep waters of the Basin and have found evidence of oil.

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 pf December 31.,2005				Average Oil and Natural Gas Production for the Year Ended December 31, 2005(1)(4)	Average Oil and Natural Gas Production for the Year Ended December 31, 2004(1)(4)
	Developed		Undeveloped			
	Gross(2)	Net(2)	Gross(2)	Net(2)		
	(in acres)				(boe per day) (3)	
Brazil(1)						
Offshore						
Campos Basin	1,714,851	1,681,740	138,374	99,580	1,530,147	1,311,208
Other offshore	320,979	281,196	329,874	291,327	64,510	68,909
Total offshore	2,035,830	1,962,936	468,248	390,907	1,594,657	1,380,117
Onshore	1,045,466	1,045,466	131,949	131,950	363,203	377,603
Total Brazil	3,081,296	3,008,402	600,197	522,857	1,957,860	1,757,720
International						
Onshore	4,225,975	2,584,034	2,967,718	1,871,834	245,828	247,122
Offshore	123,825	36,381	642,109	81,778	12,909	15,516
Total International	4,349,800	2,620,415	3,609,827	1,953,612	258,737	262,638
Total	7,431,096	5,628,817	4,210,024	2,476,469	2,216,597	2,020,358

(1) Over 75% of our production of natural gas is associated gas.

(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.

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The following table sets forth our total gross and net productive wells as of December 31, 2005:

	Productive Wells		
	Oil	**Gas**	**Total**
Gross productive wells			
Brazil	8,968	468	9,436
International	5,896	302	6,198
Total	14,864	770	15,634
Net productive wells			
Brazil	8,954	465	9,419
International	4,361	235	4,596
Total	13,315	700	14,015

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 leader 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;

- at December 31, 2005, we were operating 37 wells at water depths in excess of 3,281 feet (1,000 meters)

- at December 31, 2005, we had drilled 400 wells at water depths in excess of 3,281 feet (1,000 meters), the deepest well being an exploration well in 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 involve 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 5.92:1 in 2005, 4.96:1 in 2004 and 5.20:1 in 2003.

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 2005 and 2004.

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OFFSHORE PRODUCTION BY WATER DEPTH

Depth	Percentage in 2005	Percentage in 2004
0-400 meters (0-1,312 feet)	18%	21%
400-1,000 meters (1,312 feet-3,281 feet)	56%	55%
More than 1,000 meters (3,281 feet)	26%	24%

Exploration Activities

Concessions in Brazil

We had 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, 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 area aggregating 113.3 million gross acres (458.5 thousand square kilometers).

At December 31, 2005, we had 418 areas, consisting of 243 production areas, 134 exploration areas and 41 development areas, for a total area aggregating 43.3 million gross acres (175.4 thousand square kilometers). This total area represents 2.7% of the Brazilian sedimentary basins.

Recent discoveries

In 2005, we declared the commercial feasibility of many new oil and gas fields, the main ones being located in the Espírito Santo, Campos and Santos Basins. We also made minor discoveries in the onshore coastal basins of Sergipe-Alagoas, Potiguar, Recôncavo and Espírito Santo. In 2005, we presented ANP Declarations of Commerciality for eight (8) new oil and gas fields.

The Papa-Terra field is located in the southern Campos basin and operated by us (with a 62,5% interest) in partnership with Chevron-Texaco, with recoverable volumes that we believe may reach 700 million to 1 billion boe. In addition, we discovered new oil accumulation inside the ring-fence limits of the Marlim Leste field, in deeper reservoirs than the usual ones for the Campos Basin.

In the offshore Santos Basin we discovered light crude oil and gas in the Tambaú and Uruguá fields, with recoverable volumes of more than 270 million boe.

In the Espírito Santo Basin we discovered both light crude oil and gas in the Canapu field.

In the onshore coastal basins we discovered and declared commercial the fields of Acauã, in the Potiguar basin, Anambé, in the Sergipe-Alagoas basin, Jandaia, in the Recôncavo basin and Inhambú in the Espírito Santo basin.

We have a 35% interest in the Abalone, Ostra, Nautilus and Argonauta fields declared commercial by Shell, operator of the concession, in the northern part of the Campos basin, adjacent to the Jubarte/Cachalote area.

We had a 55% success ratio for our exploration wells during 2005, with 38 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

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the table below. We have also relinquished a considerable number of the exploratory areas in which we were not interested or successful in exploring.

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, 2002)	58	39	234	331
Areas redefined (July 2003) (BCAM-40)	1	0	0	1
Areas relinquished (August 6, 2003)	(22)	0	0	(22)
Areas won on Bid, Round 5	17	0	0	17
New concession (January 29, 2003) (Guajá)	0	1	0	1
New concession (August 4, 2003) (Cavalo-Marinho)	0	1	0	1
Areas redefined (February 3, 2003) (Coral)	0	(1)	1	0
Areas redefined (July 15, 2003) (Beija-Flor)	0	(1)	1	0
Joint concession COG to CCN (1)	0	0	(1)	(1)
Joint concession CDL to MP (2)	0	0	(1)	(1)
Areas relinquished (BAS-104)	0	(1)	0	(1)
Areas relinquished (Arraia)	0	(1)	0	(1)
Joint concession CR to FBL (3)	0	(1)	0	(1)
Areas relinquished (ALS-32)	0	(1)	0	(1)
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

	Exploration	Development	Production	Total
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 million acres (as of December 31, 2005)	**31,727,205**	**522,856**	**3,008,401**	**35,258,462**

(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

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Joint Ventures

As of December 31, 2005, we had 68 exploration agreements and 16 production agreements. Our participation ranges from 30% to 85% in the exploration agreements, and in 47 of the 68 agreements we are principally responsible for conducting the exploration activities. During 2005, we entered into 23 partnership projects relating to exploration activities. As of December 31, 2005, we had partnerships in exploration with 20 foreign and domestic companies.

Drilling Activities

During 2005, we drilled a total of 361 wells, 292 development wells and 69 exploratory wells. Of those wells, 251 development wells and 36 exploratory wells were located onshore and 41 development wells and 33 exploratory wells were located offshore. These numbers refer to the wells we drilled in 2005, but such wells may not have been evaluated or reclassified in 2005. The table Exploratory and Development Wells below indicates the number of wells which were evaluated and reclassified in 2005.

We plan to expand exploration and development activities in 2006 by:

- drilling approximately 92 new exploratory and approximately 356 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 the number of wells we drilled, or in which we participated, and the results achieved, for the periods indicated.

EXPLORATORY AND DEVELOPMENT WELLS

Period	**Campos Basin**	**Other**	**Onshore**	**International**	**Total**
2005 Net Exploratory Wells Drilled	19	14	36	4	73
Successful	14	7	17	4	42
Unsuccessful	5	7	19	0	31
Net Development Wells Drilled	20	3	187	207	417
Successful	19	3	181	206	409
Unsuccessful	1	0	6	1	8
2004 Net Exploratory Wells Drilled	21	19	14	7	61
Successful	16	9	4	2	31
Unsuccessful	5	10	10	5	30
Net Development Wells Drilled	25	2	208	235	470
Successful	24	2	205	230	461
Unsuccessful	1	0	3	5	9
2003 Net Exploratory Wells Drilled	21	10	7	4	42
Successful	7	2	2	2	13
Unsuccessful	14	8	5	2	29
Net Development Wells Drilled	12	0	264	26	302
Successful	12	0	256	26	294
Unsuccessful	0	0	8	0	8

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

	2005		2004		2003	
	Brazil	**International**	**Brazil**	**International**	**Brazil**	**International**
Land rigs for onshore exploration and development	22	19	19	28	15	10
Owned	13	0	13	0	13	0
Leased	9	19	6	28	2	10
Semi-submersible rigs	17	1	18	0	17	0
Owned	3	0	4	0	4	0
Leased	14	1	14	0	13	0
Drill ships	7	2	7	1	8	1
Owned	0	0	0	0	0	0
Leased	7	2	7	1	8	1
Jack-up rigs	7	1	6	0	6	0
Owned	6	0	6	0	5	0
Leased	1	1	0	0	1	0
Moduled rigs for offshore exploration and development	11	0	11	0	9	0
Owned	9	0	8	0	6	0
Leased	2	0	3	0	3	0
Total	64	23	61	29	55	11

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 development program in existing fields and in the discovery and recovery of new reserve finds. Over the last five years, 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, 2005, we had a total of 7,961 oil and gas producing wells in Brazil, of which 7,283 were onshore and 678were offshore.

Campos Basin Fields

Marlim. The Marlim field is located at water depths between 2,133 and 3,445 feet (650 1,050 meters). It is our largest field based on production. Average production of crude oil during 2005 was 466.2 Mbpd, or more than 33% of total production in the Campos Basin. We have developed the Marlim field in five modules. We currently have seven floating production systems with total capacity of 710 Mbpd operating in Marlim field. We have a total of 73 production wells and 46 injection wells, and expect to drill four wells in 2006. Peak production of 586.3 Mboe was achieved in 2002.

Roncador. The Roncador field is located in water depths between 4,921 and 6,234 feet (1,500 1,900 meters). Average production of crude oil during 2005 was 83.0 Mbpd. The first module of the development of this field consisted of Platform P-36, which sank in March 2001, and which was producing 80 Mbpd prior to the accident. Since the loss of P-36, we have contracted a temporary Floating Production Storage and Offloading unit (FPSO Brazil) with capacity of 90 Mbpd. First oil from this unit was attained on December 8, 2002. A total of seven wells, which were previously attached to P-36, have been attached to the new FPSO unit. A second platform (P-52) with a 180 Mbpd capacity is under construction. First oil from the unit is expected in 2007. A total of 20 production wells are planned in this module, including nine which were completed before the sinking of P-36.

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The contracts for a third production unit, with production capacity of 180 Mbpd, were signed on June 17, 2004. The production unit consists of an FPSO (P-54), which is expected to begin production in 2007. A total of eleven production wells and six injection wells are planned.

Marlim Sul (South Marlim). The Marlim Sul field is located at water depths between 2,789 and 7,874 feet (850 2,400 meters). Production of crude oil began on December 17, 2001. In 2005, average production for Marlim Sul was 197 Mbpd. We plan to develop the Marlim Sul field in two modules. The first module includes a production system consisting of a semi-submersible platform (P-40), with a total capacity of 155 Mbpd an FSO (P-38) and one FPSO unit (Marlim Sul) with a total capacity of 100 Mbpd 13 wells are currently producing through P-40, out of a total of 16 planned production wells and ten injection wells. Production from the Marlim Sul FPSO unit began on June 7, 2004 and is currently producing 71.0Mboe per day.

The contracts for a second module, with a production capacity of 180 Mbpd, were signed on June 17, 2004. On December 5, 2005, Petrobras contracted funding for U.S.$402 million towards the construction. The production system consists of a semi-submersible unit (P-51), which is expected to begin production in 2008. A total of 14 production wells and ten injection wells are planned.

Barracuda and Caratinga. The Barracuda and Caratinga fields are located at water depths between 2,274 and 3,899 feet (700 1,200 meters). Oil production began in December 2004 through FPSO unit P-43. Another FPSO unit, P-48, started production in the Caratinga field in February 2005. Each FPSO unit has capacity of 150 Mbpd. A total of 32 production wells and 22 injection wells are planned for the two fields. In 2005, the average production for Barracuda was 124,333 bpd and for Caratinga was 80,302 bpd.

Albacora Leste (East Albacora). Albacora Leste is located at water depths between 3,609 and 4,921 feet (1,100 1,500 meters). FPSO unit (P-50) with capacity of 180 Mbpd started production on April 21, 2006. A total of 16 production wells and 14 injection wells are planned.

Other developments in the Campos Basin include: (1) the Jubarte field, which will bring into production an FPSO (P-34) with 60 Mbpd capacity, (2) the Frade field, and (3) the Marlim Leste field, that will have an FPU unit (P-53) with a 180 Mbpd capacity. A contract to increase the production capacity of P-34 to 60 Mbpd was signed on June 17, 2004. During 2005, we made additional discoveries of crude oil in the Jubarte and Marlim Leste fields and we declared the commercial feasibility of the Papa-Terra field.

Espírito Santo Basin Fields

In February of 2006, we started gas production in the Peroá Field, reaching more than 1 million cubic meters per day. The Peroá platform is projected to process 8 million cubic meters per day and investments include one fixed platform, one submarine gas pipeline and one Gas Treatment Unit (UTGC).

The Golfinho field, already producing through a pilot system, that consists of an FPSO unit (Seillean) with a capacity of 25 Mbpd will be developed through three modules. Module I of the Golfinho Field started production on May 8 with a chartered FPSO named Capixaba, which has a capacity to produce 100 thousand barrels per day and has a storage capacity of 1.6 million barrels.The FPSO (Cidade de Vitória) to be allocated to Module II will have a production capacity of 100 thousand barrels per day and will be able to store up to 1.6 million barrels. Finally, an FPSO to Module III will be chartered, with a production capacity of 100 thousand barrels per day.

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.

Santos Basin Fields

In January of 2006, we approved a Master Plan for Development of Natural Gas and Oil Production in the Santos Basin comprising Five Poles: Merluza, Mexilhão, BS-500, Southern and Central.

This Master Plan includes the expansion of the Merluza-1 Platform s output to 2.5 million cubic meters of gas per day, the installation of the Merluza-2 Platform, with a production capacity of 8 million cubic meters of gas per day, and the installation of the Mexilhão Platform with a production capacity of 15 million cubic meters of gas per day.

We also plan to install a gas treatment plant on the coast of São Paulo State to be integrated with the projects in order to expand the Merluza Pole and develop the Mexilhão Pole.

In the BS-500 block we began studies for the production of the Uruguá and Tambaú Fields.

In the Southern area, the Coral platform is already operational, currently producing 9,000 barrels of oil per day. There are plans to start production in the Cavalo Marinho Field in the future with production estimated at similar levels to that of Coral.

Finally, the Central area is in the exploratory stage. We see a major potential in this area of the Santos Basin, informally known as a cluster.

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 2005, 2004 and 2003:

	For the Year Ended December 31,		
	2005	**2004**	**2003(1)**
Crude Oil and NGL Production (in Mbpd)			
Brazil (2)			
Offshore			
Campos Basin	1,405	1,204	1,252
Other	36	38	39
Total offshore	1,441	1,242	1,291
Onshore	243	251	248
Total Brazil	1,684	1,493	1,540
International	163	168	161
Total crude oil and NGL production	1,847	1,661	1,701
Crude Oil and NGL Average Sales Price (U.S. dollars per Bbl)			
Brazil	$ 45.42	$ 33.49	$ 27.01
International	34.91	26.51	23.77
Natural Gas Production (in Mmcfpd)			
Brazil(3)			
Offshore			
Campos Basin	752	645	657
Other	172	184	186
Total offshore	924	829	843
Onshore	719	762	657
Total Brazil	1,643	1,590	1,500

International	575	564	510
Total natural gas production	2,218	2,154	2,010
Natural Gas Average Sales Price (U.S. dollars per Mcf)			
Brazil(4)	$ 2.17	$ 1.93	$ 1.79
International(5)	1.64	1.17	1.26
Aggregate Average Lifting Costs (oil and natural gas) (U.S. dollars per boe)			
Brazil			
With government take	$ 14.65	$ 10.72	$ 8.62
Without government take	5.73	4.28	3.48
International	2.90	2.60	2.46

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(1) International production figures for 2003 include PEPSA and PELSA as of January 1, 2003, although our interests were only acquired in May 2003.

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

(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 2005 increased 12.8% relative to 2004, reaching 1,684 Mbpd, principally as a result of the start-up of FPSO-MLS in June 2004, the P-43 platform in December 2004 and the P-48 platform in February 2005.

Reserves

Our estimated worldwide proved reserves of crude oil and natural gas as of December 31, 2005 totaled 11.77 billion barrels of oil equivalent, including:

- 9.72 billion barrels of crude oil and NGLs; and
- 12,351.9 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 reliability of reserve estimates depends on factors that are beyond our control and many of such factors may prove to be incorrect over time.

DeGolyer and MacNaughton, or D&M, reviewed and certified 90.6% of our domestic proved crude oil, condensate and natural gas reserve estimates as of December 31, 2005. The estimates for the certification were performed in accordance with Rule 4-10 of Regulation S-X of the SEC.

As of December 31, 2005, our domestic proved developed crude oil reserves represented 45% 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 hydrocarbon reserves on a barrel of oil equivalent basis increased at an average annual growth rate of 4.7 % in the last five years. Natural gas proved reserves increased at an average annual growth rate of 7.7% over the same period.

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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, 2005, 2004 and 2003:

WORLDWIDE ESTIMATED NET PROVED RESERVES

	Brazil Crude Oil (MMbbl)	Brazil Natural Gas(1)(3) (Bcf)	Brazil Combined(2)(3) (Mmboe)	International Crude Oil (MMbbl)	International Natural Gas(1) (Bcf)	International Combined(2) (Mmboe)	Combined Global Proved Reserves (Mmboe)
Net Proved Developed and Undeveloped Reserves:							
Reserves as of December 31, 2003	9,051.4	8,111.4	10,403.3	720.7	3,090.9	1,235.9	11,639.2
Revisions of previous estimates	(414.9)	(262.1)	(458.6)	(18.8)	276.4	27.3	(431.3)
Extensions, discoveries and improved recovery	1,129.3	582.6	1,226.4	60.6	116.5	80.0	1,306.4
Sales of reserves in place	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Purchase of reserves in place	0.0	0.0	0.0	0.6	18.5	3.7	3.7
Production for the year	(522.4)	(477.6)	(602.0)	(61.1)	(209.5)	(96.0)	(698.0)
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
Purchase of reserves in place	0	0	0	0.0	0.0	0.0	0
Sales of reserves in place	0	0	0	0.0	0.0	0.0	0
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	10,577.9	682.1	3,088.1	1,196.8	11,774.7
Net Proved Developed Reserves:							
As of December 31, 2003	3,629.5	4,398.1	4,362.5	404.1	2,548.4	828.8	5,191.3

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

(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) Natural gas reserve data for 2005 presented in this table in cubic feet have been restated using a conversion of 6000 cubic feet of natural gas per barrel of oil equivalent, such conversion rate being consistent

with prior years volumetric statements. The FAS 69 information originally published together with the consolidated financial statements for December 31, 2005 converted the natural gas reserves using 5613 cubic feet per barrel of oil, such factor being related to specific gravity and calorific content of Petrobras fields rather than the international average standard. As Petrobras natural gas reserves and production are accounted for in cubic meters, this change which is only for convenience presentation of barrel of oil equivalent, has no effect on the financial results nor on the physical natural gas reserves.

The following tables set forth our crude oil and natural gas proved reserves by region, as of December 31, 2005, 2004 and 2003:

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CRUDE OIL NET PROVED RESERVES BY REGION

	As of December 31,					
	2005		2004		2003	
	Proved Developed and Undeveloped	Proved Developed	Proved Developed and Undeveloped	Proved Developed	Proved Developed and Undeveloped	Proved Undeveloped
	(MMbbl)					
Brazil						
Offshore						
Campos Basin	7,886.0	3,395.9	8,130.4	3,422.7	8,089.1	2,899.6
Other	388.3	101.3	335.4	106.1	159.8	111.7
Total offshore	8,274.3	3,497.2	8,465.8	3,528.8	8,248.9	3,011.3
Onshore	759.6	574.5	777.6	601.0	802.5	618.2
Total Brazil	9,033.9	4,071.7	9,243.4	4,129.8	9,051.4	3,629.5
International						
Other South America(1)	625.8	350.8	678.4	367.0	703.9	387.6
West Coast of Africa	42.6	8.6	11.8	11.8	14.0	14.0
Gulf of Mexico	13.7	6.5	11.8	4.3	2.8	2.4
Total international	682.1	365.9	702.0	383.1	720.7	404.1
Total	9,716.0	4,437.6	9,945.4	4,512.9	9,772.1	4,033.6

(1) Includes Argentina, Bolivia Colombia, Ecuador, Peru and Venezuela.

NATURAL GAS NET PROVED RESERVES BY REGION:

	As of December 31,					
	2005		2004		2003	
	Proved Developed and Undeveloped	Proved Developed	Proved Developed and Undeveloped	Proved Developed	Proved Developed and Undeveloped	Proved Undeveloped
	(Bcf)					
Brazil						
Offshore						
Campos Basin	3,836.5	1,772.3	4,039.3	1,820.4	4,096.2	1,598.0
Other	2,912.1	720.9	1,337.5	854.0	1,291.2	959.5

Total offshore	6,748.6	2,493.2	5,376.8	2,674.4	5,387.4	2,557.5
Onshore	2,515.2	1,595.6	2,577.5	1,753.2	2,724.0	1,840.6
Total Brazil	9,263.8	4,088.8	7,954.3	4,427.6	8,111.4	4,398.1
International						
Other South America(1)	2,951.7	2,270.2	3,162.2	2,456.2	3,058.2	2,526.8
Gulf of Mexico	136.5	63.5	130.6	39.0	32.7	21.6
Total international	3,088.1	2,333.7	3,292.8	2,495.2	3,090.9	2,548.4
Total	12,351.9	6,422.5	11,247.1	6,922.8	11,202.3	6,946.5

(1) Includes Argentina, Bolivia, Colombia, Peru and 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 1.99 million barrels per day. There are only two other competing refineries in Brazil, which have an aggregate installed capacity of approximately 0.03 million barrels per day. Our domestic refining capacity constitutes 98.5% of the Brazilian refining capacity. We built nine of our 11 refineries prior to 1972, and we completed the last refinery (Henrique

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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 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.$2.5 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, 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 2005 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:

- strenghthen solution and relationship processes to the client, by understanding the client s value chain and adjusting the services and products portfolio;
- expand processing, transporting and commercialization activities, using bio-energy sources and raw material produced by us;
- diversify our business portfolio, focusing on synergy 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 on 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, 2005, we had total installed refining capacity of 1.99 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 2005. Worldwide, we processed an average of 1.69 million barrels of crude oil per day in 2005, which represents a utilization rate of 84.9% for the year, calculated over total capacity. This compares with an 85% average utilization rate in 2004 and an 81% average utilization rate in 2003.

Our domestic production in 2005 supplied approximately 80% of the crude oil feedstock for our refinery operations in Brazil, as compared to 76% in 2004 and 80% in 2003. 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 98.5% 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 2005, we processed a total of 633 million barrels of crude oil or on daily basis 1.69 million barrels per day. Our Brazilian production supplied approximately 80% of this crude oil. Our average refining costs (consisting of variable costs and excluding depreciation and amortization) in Brazil were U.S.$1.90 per barrel in 2005, U.S.$ 1.38 per barrel in 2004 and U.S.$1.17 per barrel in 2003. Due to the heavier crude characteristic of many Brazilian fields, we have invested in equipment for conversion of heavy crude oil into lighter products. 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 2005, 2004 and 2003:

REFINING STATISTICS

	2005			**2004**			**2003**		
Refineries	**Capacity (Mbpd)**	**Throughput[1] (Mbpd)**	**Utilization[2] (%)**	**Capacity (Mbpd)**	**Throughput[1] (Mbpd)**	**Utilization[2] (%)**	**Capacity (Mbpd)**	**Throughput[1] (Mbpd)**	**Utilization[2] (%)**
Paulínia	365	320	88%	365	351	96%	365	297	81%
Landulpho Alves (9)	332	249	75	323	237	73	323	200	62
Duque de Caxias (9)	275	242	88	242	230	95	242	214	88
Henrique Lage	251	241	96	251	236	94	251	219	87
Alberto Pasqualini(3)	189	116	61	189	103	54	189	105	56
Pres. Getúlio Vargas(4)	189	186	98	189	165	87	189	191	101
Pres. Bernardes	170	157	92	170	154	91	170	164	96
Gabriel Passos	151	131	87	151	132	87	151	129	85
Manaus	46	44	96	46	45	98	46	44	96
Capuava	53	35	66	53	46	87	53	44	83
Fortaleza	6	5	83	6	5	83	6	5	83
Total Brazilian (9)	2,027	1,726	85	1,985	1,704	86	1,985	1,612	81
Gualberto Villarroel(5)	40	25	63	40	22	55	40	18	45

Ricardo Eliçabe(6)	31	26	84	31	30	98	31	30	97
Guillermo Elder Bell(5)	20	16	80	20	16	80	20	15	75
San Lorenzo (7)	38	37	97	38	33	89	38	33	87
Del Norte (8)									
Total International	129	104	81	129	101	78	129	96	74
Total	2,156	1,830	85%	2,114	1,805	85%	2,114	1,708	81%

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

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

(3) We do not own 100% 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.

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(5) Located in Bolivia. We expect that our participation in this refinery will be reduced as a result of the Bolivian nationalization program announced on May 1, 2006.

(6) Located in Argentina.

(7) Located in Argentina. We acquired this refinery through our acquisition of Petrobras Energía, formerly Perez Companc.

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

(9) Includes NGL Capacity (Mbpd): Landulpho Alves = 9, Duque de Caixas = 33.

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 2005, 2004 and 2003**:**

DOMESTIC PRODUCTION VOLUME OF OIL PRODUCTS

	2005 (Mbpd)	%	2004 (Mbpd)	%	2003 (Mbpd)	%
Product						
Diesel	660.1	38.0%	657.0	38.7%	623.4	38.0%
Gasoline	324.5	18.7	292.8	17.3	290.9	17.8
Fuel oil	257.8	14.9	279.9	16.5	266.4	16.2
Naphtha and jet fuel	218.5	12.6	220.2	13.0	219.6	13.4
Other	274.3	15.8	245.7	14.5	238.6	14.6
Total	1,735.2	100.0%	1695.6	100.0%	1,638.9	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.

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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 2012), thus meeting stricter environmental standards being implemented under Brazilian law. The principal refineries and planned investments (2006 2010) are as follows:

Refinery	**Objective**
Alberto Pasqualini (REFAP)	Expansion and modernization of refinery, including the installation of a coker, residue fluid cat. craking unit, and upgrade gasoline and diesel quality.
Presidente Getúlio Vargas Refinery (REPAR)	Installation of coker, expansion of existing refinery unit and units to upgrade the quality of diesel and gasoline.
Henrique Lage (REVAP)	Installation of coker and units to upgrade the quality of diesel and gasoline.
Paulínia Refinery (REPLAN)	Upgrade the quality of diesel and gasoline.
Landulpho Alves (RLAM)	Expansion of existing refinery unit and units to upgrade the quality of diesel and gasoline.
Duque de Caxias Refinery (REDUC)	Expansion of existing refinery, installation of a coker and units to upgrade the quality of diesel and gasoline.
Gabriel Passos Refinery (REGAP)	Expansion of the coker and upgrade the quality of diesel and gasoline.
Presidente Bernardes Refinery (RPBC)	Upgrade the quality of gasoline.
Capuava Refinery (RECAP)	Upgrade the quality of diesel and gasoline.

Imports

During 2005 we continued to import crude oil and oil products because domestic production was not sufficient 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.

Imported crude oil is transferred into our refineries for storage and processing, with a small percentage being sold to the other two Brazilian refiners. 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 decreased to 352 Mbpd in 2005, as compared to 450 Mbpd in 2004 because of the increase in domestic crude oil production. Part of such increase was allocated to our refineries as result of an improvement of heavy oil conversion capacity and part was allocated to crude oil exports.

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The following table sets forth the percentage of crude oil that we imported during each of 2005, 2004 and 2003 by region.

IMPORTS OF CRUDE OIL BY REGION

	2005	2004	2003
		Volume (%)	
Region			
Africa	67.5%	73.4%	63.7%
Middle East	29.4	24.2	30.9
Central and South America/Caribbean	3.1	2.4	3.1
Oceania	0.0	0.0	0.9
Europe	0.0	0.0	1.4
Total	100.0%	100.0%	100.0%

In 2005, our total costs of imports of crude oil from all these regions was U.S.$6,035 million, as compared to U.S.$5,191 million in 2004 and U.S.$3,541 million in 2003.

We purchased approximately 19.4%, 17.7% and 23.4% of our crude oil imports in 2005, 2004 and 2003, respectively, pursuant to one-year term contracts, which are considered to be long-term contracts within the industry standard practice. We are also a significant buyer of crude oil and oil products from suppliers in the international spot market.

Imports of oil products also decreased to 95 Mbpd in 2005, as compared to 110 Mbpd in 2004 and 122 Mbpd in 2003, primarily as a result of the increase in domestic production. LPG decreased due to replacement by natural gas, and increase in the production as a result of the revamping of the refineries and an increase in production due to the addition of FCC catalizer additives. For distillates, the decrease in the imported amounts is a result of the increase in our processing capacity. For naphtha the increase is a result of imports of light naphtha used in oil chains. The following table sets forth the volume of oil products imported during each of 2005, 2004 and 2003:

IMPORTS OF OIL PRODUCTS

	2005	2004	2003
		Volume (Mbbl)	
Oil Product			
LPG	6,268	11,537	12,034
Distillates(1)	16,740	16,879	23,183
Naphtha	8,243	7,231	5,026
Others(2)	3,523	4,487	4,225
Total	34,774	40,134	44,468

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

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

Methanol and
others.

In 2005, total costs of oil product imports, measured on a cost-insurance-and-freight basis, was U.S.$2,108 million, as compared to U.S.$1,721 million in 2004 and U.S.$1,542 million in 2003. 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 in our refineries because of limited conversion capacity. Our total exports increased to 214 MMbbl in 2005 from 186 MMbbl in 2004 as a result of the increase in production of domestic crude oils and the decrease in the local demand for inferior environmental quality products. The following table sets forth the volumes of oil products we exported during each of 2005, 2004 and 2003:

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EXPORTS OF OIL AND OIL PRODUCTS(1)

	2005	2004	2003
		(Mbbl)	
Crude Oil	96,155	66,319	84,899
Fuel Oil (including bunker fuel)	63,896	107,104	85,740
Gasoline	17,240	11,510	13,656
Other	9,716	1,288	8,250
Total	187,007	186,221	192,545

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

The total value of our crude oil and oil products exports, measured on a free-on-board basis, was U.S$10,086 million in 2005, U.S.$8,938 million in 2004 and U.S.$5,335 million in 2003.

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, 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 shipments, based on the historical level of transportation assessed for each pipeline, formally assigned by the ANP. The excess capacity is 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. Additionally, only vessels flying the Brazilian flag were entitled to carry shipments to and from Brazil. 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 and natural gas pipelines connecting our terminals to refineries and other points of primary distribution throughout Brazil. At December 31, 2005, our onshore and offshore crude oil and oil products pipelines totalled 6,245 miles or 10,048 kilometers in length, our natural gas pipelines aggregated approximately 5,705 miles or 9,179 kilometers in length, including the Brazilian side (1,612 miles or 2,593 kilometers) of the Bolivia-Brazil pipeline, and our flexible pipelines totalled 1,804 miles or 2,902 kilometers in length.

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NATURAL GAS PIPELINES IN BRAZIL

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CRUDE OIL AND OIL PRODUCTS PIPELINES IN BRAZIL

In March 2005, we signed all of the financing documents for the *Plano Diretor de Escoamento e Tratamento* (PDET) project originally designed to enhance our crude oil transportation system extending from the most productive fields, located in the Campos Basin, to the refineries located in the Southeast region of Brazil.

At the end of 2003, change in State of Rio de Janeiro Legislating required evaluation of economic feasibility of the original concept of the onshore portion of PDET. After that, we announced the cancellation of the onshore portion of the PDET project and a revision to the project s original design.

Under the revised project, the original offshore fixed platform (PRA-1) will be connected to five offshore production platforms through pipelines and will transfer the crude oil 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.$760 million and is expected to start its commercial operation in the first quarter of 2007. This project will permit to increase the flow of oil produced in the Campos Basin by up to 630 Mbpd.

Transpetro also operates 44 storage terminals with nominal aggregate capacity of 65.0 million barrels of oil equivalent. At December 31, 2005, tankage 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. In 2005, Transpetro began to operate a new storage terminal (TNC Norte Capixaba Terminal) with the nominal tankage capacity of 491 M barrels.

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. Transpetro s goal is to be able to operate all of its domestic pipelines remotely, initially via the regional stations, and ultimately via the centralized control and operating center located in its headquarters in Rio de Janeiro. In 2005, the Centralized Control and Operating Center began to operate a new gas pipeline, GASCAB III. We will continue to develop this project. 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 pipelines operations.

Shipping

At December 31, 2005, our fleet consisted of the following 52 vessels (46 owned and 6 bareboat chartered), 32 of which are single hulled and 20 of which are double hulled:

OWNED/BAREBOAT CHARTERED VESSELS

	Number	**Capacity (deadweight tonnage in thousands)**
Type of Vessel		
Tankers	44	2,443.4
Liquefied petroleum gas tankers	6	40.2
AHTS Anchor Handling Tug Supply	1	2.2
FSO Floating, Storage and Offloading	1	28.9
Total	52	2,514.7

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. Our Business Plan calls for investment of U.S.$1.0 billion to renew our fleet, by adding 53 vessels by 2015. 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

	2005	**2004**	**2003**
		(millions of tons)	
Product			
Crude oil	92.38	88.4	96.6
Oil Products	40.42	34.0	28.1
Fuel Alcohol	0.04		
Total	132.84	122.4	124.7
Percentage transported by our owned/bareboat chartered fleet	43%	45.1%	45.3%
Coastal transport as a percentage of total tonnage	67%	61.1%	64.2%

The average monthly-chartered tonnage in 2005 amounted to 5.9 million deadweight tons, as compared to 4.6 million deadweight tons in 2004 and 4.0 million deadweight tons in 2003. 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.$972.01 million in 2005, U.S.$701 million in 2004 and U.S.$537 million in 2003.

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Petrochemicals

We conduct 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 petrochemical products and utilities. At December 31, 2005, our ownership percentage of the total capital of these investees ranged from 8.45% to 85.04% and our ownership percentage of the voting capital of these investees ranged from 10.02% to 70.45%. The total book value of these investments was U.S.$820 million on December 31, 2005. Most of such interests are minority voting interests.

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 directly. In 2005, the industry imported approximately 35.6% of its naphtha needs, and we supplied the remainder from our refining operations.

The shareholder equity in the affiliate companies of the petrochemicals business increased by U.S.$12 million between 2004 and 2005. 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.

In line with our strategy of stimulating demand for natural gas products, we also continue to invest in Rio Polímeros S.A.,(Gas Chemical Complex). Located next to our Duque de Caxias Refinery (REDUC). 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. In addition to Petroquisa, the three other investors are BNDESPAR and two leading private Brazilian petrochemical companies, Suzano and Unipar. Petroquisa holds a 16.7% interest of the voting and preferred capital in Rio Polímeros. Of the approximately U.S.$1.08 billion budgeted construction cost, 60% is being provided by long-term loans from, or guaranteed by, U.S. Ex-Im Bank, BNDES (the Brazilian Federal Development Bank) and SACE (the Italian Export Credit Agency), and 40% is funded by equity investments. Rio Polímeros has been in operation since late 2005. In the first quarter of 2006, the Contractor ran reliability and performance tests in order to reach the guaranteed acceptance level and operational stage. On March 31, 2006 the test and commissioning phase of Rio Polímeros was concluded.

According to our 2006-2010 Business Plan, we intend to spend approximately U.S.$2.0 billion in capital expenditures in our Brazilian petrochemicals operation. Such investment will be aimed at increasing production of basic petrochemicals, including polyolefins (polyethylene and polypropylene), acrylic acid and terephtalic acid. These projects will be carried out with other partners. Additionally, the preliminary technical and economic feasibility studies carried out by Petrobras identified the construction of a basic petrochemical complex as an important opportunity. This complex would integrate refinery units and petrochemical facilities to produce petrochemical raw materials like ethylene, propylene, aromatics and its petrochemical derivatives, like polyethylene and polypropylene, in order to supply the growing demand for such products in the Brazilian market. We are currently evaluating the conceptual project for this petrochemical complex. On March 28, 2006 we defined that the Petrochemical Complex of Rio de Janeiro will be built on the border of Itaboraí and São Gonçalo, in the State of Rio de Janeiro, with capacity to process 150 Mbpd and produce petrochemical raw material in the following quantities: 1,3 million tons/year of ethylene, 0.9 million tons/year of propylene, 0.36 million tons/year of benzene, 0.7million tons/year of p-xylene and oil derivatives such as 0.7 million tons/year of coke and small amounts of diesel oil and naphtha. The total global investment is estimated to reach U.S.$6.5 billion, including the second generation units, polyethylenes, polypropylene, styrene and ethylene-glycol. The complex is expected to be operating in 2012.

On April 29, 2005, Odebrecht, Norquisa and ODBPAR (the Odebrecht Group) and Petroquisa entered into a second amendment to the memorandum of understanding under which Petroquisa had an option to acquire an amount of Braskem voting shares sufficient to increase its existing participation in Braskem to up to 30% of Braskem voting share capital (which we refer to as Option Shares). Such memorandum also eliminated the restriction on Petroquisa from owning interests in other petrochemical companies or projects following its possible exercise of the option. On March 31, 2006, after appraisals carried out by the concerned parties, Petroquisa decided

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not to exercise the Option Shares, as the parties were not able to reach a consensus regarding the terms and conditions for this exercise. The current shareholding structure of Braskem will not suffer any change, as the shareholding position currently held by Petroquisa of 10.02% in the voting capital and 8.45% in the total share capital of Braskem will be maintained, as well as the provisions of the Memorandum of Understanding for a Shareholders Agreement of Copene Petroquímica do Nordeste S.A. (the former name of Braskem), signed by Odebrecht and Petroquisa.

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 a 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.$240 million. The commercial operations are projected to begin in the first quarter of 2008. To date, Petroquisa has invested R$3 million.

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. Petroquisa and Citene are considering whether to involve a new partner in the project and are currently negotiating the joint venture, which will be responsible for the development of the project. The plant will have a capacity of 550 thousand tons per year. We are projecting that an investment of U.S.$492 million through 2009 will be required for this project, as an estimate of the start-up costs of the plant through 2009.

On April 17, 2006, our Board of Directors approved the incorporation of all outstanding shares of Petroquisa. Currently, we hold approximately 99% of Petroquisa s capital stock and the remaining 1% is dispersed among minority shareholders. The main purpose of the share incorporation is to align the strategic interests of both companies. Under the terms of the incorporation, each lot of 1,000 common or preferred shares issued by Petroquisa will be exchanged for 4,496 preferred shares of our Company. As a result of such incorporation, we will issue 886,670 new preferred shares. In accordance with Brazilian Corporation Law, the share incorporation is still subject to approval by the shareholders of both companies, and the dissenting shareholders of Petroquisa have the right to withdraw.

Distribution

Summary and Strategy

Through Petrobras Distribuidora S.A., or BR, we distribute oil products and, fuel alcohol to retail, commercial and industrial customers throughout Brazil. Our operations are supported by tankage capacity of approximately 14.6 million boe, at 111 storage facilities and 96 aviation product depots at airports throughout Brazil.

Our main strategies in distribution and marketing are to:

- be the preferred brand of the consumer, with a multi-business retail network that offers excellence in the quality of products and services, expanded leadership and guaranteed ex