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

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

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

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

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

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

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

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

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

Title of each class:

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

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

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

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

Yes þ No o

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

Yes o No þ

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

Yes þ No o

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

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

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

Item 17 o Item 18 þ

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

Yes o No þ

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FORWARD-LOOKING STATEMENTS

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

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

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

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

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

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

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

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

CERTAIN TERMS AND CONVENTIONS

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

PRESENTATION OF FINANCIAL INFORMATION

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

Petrobras

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

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

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

Unless the context otherwise indicates:

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

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

PifCo

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

RECENT DEVELOPMENTS

PESA Issues Notes

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

Acquisition of Assets of the Ipiranga Group

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

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

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

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

Acquisition of Refinery Pasadena Texas

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

Electrical Energy

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

PRESENTATION OF INFORMATION CONCERNING RESERVES

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

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

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

Bolivia and Venezuela implemented new nationalization measures during 2006. The nationalization measures in Bolivia and Venezuela caused a reduction of our reserves in these countries in 2006. The new regulation in Venezuela reduced our reserves as Petróleos de Venezuela S.A. (PDVSA) became the main controller of the companies, created to operate the fields with private companies. Due to new government regulations, our reserves in Bolivia were also reduced. In Nigeria, the consortium in charge of the Akpo field included Total, Petrobras and a Nigerian private company called SAPETRO. The agreement underwritten by these companies established that Total and Petrobras carry the investment cost of the third party and it would be compensated in the future with SAPETRO s production/reserves. Throughout 2006, SAPETRO sold its participation to a Chinese oil company and, as part of this agreement, Petrobras and Total were reimbursed for their past carrying investments. In addition, in Nigeria, due to certain farm-in arrangements in the Akpo field, we reduced our expectations for future production. See Item 4. Information on the Company International.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

Selected Financial Data

Petrobras

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

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

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BALANCE SHEET DATA PETROBRAS

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

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

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

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

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

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INCOME STATEMENT DATA PETROBRAS

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

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

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

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

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

effect of adoption is recorded separately.

(3) Includes impairment charge.

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

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

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

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

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

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

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PifCo

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

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INCOME STATEMENT AND BALANCE SHEET DATA - PifCo

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

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

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

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

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

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

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Exchange Rates

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

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

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

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

Source: Central Bank of Brazil

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

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

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

Risk Factors

Risks Relating to Our Operations

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In June 2003, the State of Rio de Janeiro enacted a law, referred to as the Noel Law, imposing ICMS on upstream activities. The constitutionality of the Noel Law is currently being challenged in the Brazilian Supreme Court (*Supremo Tribunal Federal*, or STF) and although the law was approved by the State Legislature, the government of the State of Rio de Janeiro has not yet enforced it. Currently, the ICMS for fuels derived from oil is assessed at the point of sale but not at the wellhead level. If the State of Rio de Janeiro enforces the Noel Law, it is unlikely (depending on the grounds of the Supreme Court s decision) that the other states would allow us to use the tax imposed at the wellhead level in Rio de Janeiro as a credit to offset the tax imposed at the sale level. Therefore, we would have to pay ICMS at both levels. We estimate that the amount of ICMS that we would be required to pay to the State of Rio de Janeiro could increase by approximately R$9.4 billion (U.S.$4.3 billion) per year. This increase could have a material adverse effect on our results of operations and financial condition.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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Risks Relating to PifCo

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

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

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

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

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

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

Risks Relating to the Relationship between us and the Brazilian Government

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

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

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

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

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

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

Risks Relating to Brazil

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

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

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

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

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

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

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

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

Risks Relating to our Equity and Debt Securities

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

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

The market for PifCo s notes may not be liquid.

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

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

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

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

Our preferred ADSs have been listed on the New York Stock Exchange since February 21, 2001, while our common ADSs have been listed on the New York Stock Exchange since August 7, 2000. We cannot predict whether an active liquid public trading market for our ADSs will be sustained on the New York Stock Exchange, where they are currently traded. Active, liquid trading markets generally result in lower price volatility and more efficient execution of buy and sell orders for investors. Liquidity of a securities market is often a function of the volume of the underlying shares that are publicly held by unrelated parties. We do not anticipate that a public market for our common or preferred shares will develop in the United States.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

ITEM 4. INFORMATION ON THE COMPANY

History and Development of Petrobras

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

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

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

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

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

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

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

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

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

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

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

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

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Competitive Strengths

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

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

Strong reserve base

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

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

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

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

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

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

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

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

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

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

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

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

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

Strong position in Brazil s growing natural gas markets

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

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

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

- expanding of the natural gas transportation network throughout Brazil;

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

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

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

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

Success in attracting international partners in all our activities

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

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

Strategy

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

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

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

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

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

Selectively expand international activities in an integrated manner with our business

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

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

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

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

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

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

Selectively expand our activities in the petrochemicals market

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

Selectively perform in the renewable energy market

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

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

- biomass energy.

Overview by Business Segment

Exploration, Development and Production

Summary and Strategy

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

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

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

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

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

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

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

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

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

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

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

Accelerate the production and supply of natural gas.

Principal Domestic Oil and Gas Producing Regions

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

Our main domestic oil and gas producing regions are:

Campos Basin

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

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

Espírito Santo Basin

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

Santos Basin

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

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Properties

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

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

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

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

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

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

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

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

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

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

Deepwater Expertise

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

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

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

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

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

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

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

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

OFFSHORE PRODUCTION BY WATER DEPTH

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

Exploration Activities

Concessions in Brazil

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

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

Recent discoveries

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

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

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

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

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

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

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

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

Auctions of exploration rights

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

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

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

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

(1) COG Córrego Grande, CCN Córrego Cedro Grande

(2) CDL Cardeal, MP Massapê

(3) CR Curió, FBL Fazenda Belém

(4) SMI São Miguel, PJ Pajeú

(5) BBI Baleia Bicuda, CHT Cachalote

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

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

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

Drilling Activities

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

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

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

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

DRILLING UNITS

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

Development Activities

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

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

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

Main Domestic Production Development Projects

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

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

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

(3)

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

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

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

Production Activities

Our domestic crude oil and natural gas production activities involve fields located on Brazil s continental shelf off the coast of nine Brazilian states, of which the Campos Basin is the most important region, and onshore in

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eight Brazilian states. We are also producing crude oil and natural gas in nine other countries: Angola, Argentina, Bolivia, Colombia, Ecuador, Mexico, Peru, the United States, and Venezuela. See International.

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

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

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

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

(2) Equity method companies in Venezuela.

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

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

ventures.

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

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

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Reserves

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

9.48 billion barrels of crude oil and NGLs; and

11,843.4 billion cubic feet of natural gas.

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

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

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

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

WORLDWIDE ESTIMATED NET PROVED RESERVES

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

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

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

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

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

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

Unconsolidated Companies.

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

CRUDE OIL NET PROVED RESERVES BY REGION

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

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

NATURAL GAS NET PROVED RESERVES BY REGION:

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

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

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

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

Refining, Transportation and Marketing

Summary and Strategy

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

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

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

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

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

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

Our main strategies in refining and transportation are to:

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

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

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

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

Refining

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

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

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

Refinery Production and Capacity

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

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REFINING STATISTICS

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

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

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

(3) We own 70% of this refinery.

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

(5) Located in Bolivia.

(6) Located in Argentina.

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

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

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

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

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

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

DOMESTIC PRODUCTION VOLUME OF OIL PRODUCTS

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

Refinery Investments and Improvements

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

We plan to invest in refinery projects designed to:

- enhance the value of Brazilian crude oil by increasing capacity to refine greater quantities of heavier crude oil that is produced domestically;

- increase production of oil products demanded by the Brazilian market that we currently must import, such as diesel;

- improve gasoline and diesel quality to comply with stricter environmental regulations currently being implemented; and

- reduce emissions and pollutant streams.

Major Refinery Projects

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

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

Lubrificantes e Derivados de Petróleo do Nordeste
(LUBNOR)

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

Imports

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

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

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

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

IMPORTS OF CRUDE OIL BY REGION

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

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

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

IMPORTS OF OIL PRODUCTS

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

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

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

Methanol and others.

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

Exports

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

EXPORTS OF OIL AND OIL PRODUCTS(1)

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

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

(2) Not including fertilizers.

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

Transportation

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

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

Pipelines and Terminals

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

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NATURAL GAS PIPELINES IN BRAZIL

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CRUDE OIL AND OIL PRODUCTS PIPELINES IN BRAZIL

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

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

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

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

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Shipping

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

OWNED/BAREBOAT CHARTERED VESSELS

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

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

PRODUCTS AND QUANTITIES TRANSPORTED

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

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

Petrochemicals

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

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

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

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

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

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

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

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

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

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

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

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

Fertilizers

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

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

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

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

Distribution

Summary and Strategy

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

Our main strategies in distribution and marketing are to:

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

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

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

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

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

OIL PRODUCT SALES

	2006	**2005**	**2004**
		(MMbbl)	
Product			
Diesel	230.9	228.1	224.9
Gasoline	120.0	114.3	104.8
Fuel oil	94.3	77.2	106.1
Naphtha and jet fuel	82.3	79.3	81.5
Others	361.8	343.5	129.1
Total	889.3	842.4	646.4
Customer			
Wholesalers			
Diesel	110.8	105.5	106.6
Gasoline			