

Risk Factors

Risks Relating to Our Operations

Our operations are affected by the volatility of prices for crude oil and oil products.

Until January 2, 2002, the prices we were allowed to charge for crude oil and oil products (and, as a result, our recorded prices for the calculation of net operating revenues) were determined on the basis of a pricing formula established by the Brazilian government designed to reflect changes in the Real/U.S. Dollar exchange rate and international market prices for relevant benchmark products. However, as of January 2, 2002, the crude oil and oil products markets in Brazil were deregulated in their entirety.

Historically, international prices for crude oil and oil products have fluctuated widely as a result of many factors. We do not, and will not, have control over the factors affecting international prices for crude oil and oil products. These factors include:

- global and regional economic and political developments in crude oil producing regions, particularly in the Middle East;
- the ability of OPEC and other crude oil producing nations to set and maintain crude oil production levels and prices;
- other actions taken by major crude oil producing or consuming countries;
- global and regional supply and demand for crude oil and oil products;
- competition from other energy sources;
- domestic and foreign government regulations;
- weather conditions; and
- military action, such as the recent U.S. military action in Iraq.

The average prices of Brent crude, an international benchmark oil, were approximately U.S.\$25.02 per barrel for the year ended December 31, 2002, U.S.\$24.44 per barrel for the year ended December 31, 2001 and U.S.\$28.50 per barrel for the year ended December 31, 2000.

Changes in crude oil prices typically result in changes to prices for oil products. Lower crude oil prices have various effects on us, including decreasing our net operating revenues, net income and cash flows. In comparison, higher crude oil prices generally lead to increases in our net operating revenues, net income and cash flows.

We expect continued volatility and uncertainty in international prices for crude oil and oil products. Declines in international crude oil prices may adversely affect our business, results of operations and financial condition and the value of our proved reserves.

Prices remain regulated for natural gas, electricity and certain petrochemicals. These controls could have an adverse effect on revenues from these business activities.

Because of changes in government regulations, we face increased competition and may lose market share.

Substantial changes have been occurring in the oil and gas industry in Brazil as a result of the continuing process of deregulation by the Brazilian government. As part of this deregulation, the Brazilian government eliminated all price controls on crude oil and oil products in early 2002. Prices remain regulated, however, for natural gas, electricity and certain petrochemicals. The changes in government regulation have enabled multi-national and regional oil companies to enter the Brazilian energy market. We expect that competition in our downstream and upstream activities will increase further, as existing and new participants expand their activities as a result of these regulatory changes.

Although our prices for crude oil and oil products are based on international prices, in periods of high international prices or sharp devaluations of the Real, we may not be able to adjust our prices in Reais sufficiently to maintain parity with international prices.

Since the Brazilian government's elimination of all price controls on crude oil and oil products in January 2002, there have been periods of high international prices or sharp devaluations of the Real when we have been unable to increase prices in Reais sufficiently to maintain parity with international prices. While we do not have an obligation to supply the Brazilian market, during periods when the local prices of crude oil and oil products were below prevailing international prices, our competitors were unwilling to supply the local market. In order to ensure adequate supply of crude oil and oil products in Brazil, we sold crude oil and oil products below prevailing international prices.

As a result of deregulation of the Brazilian market, and the elimination of import tariffs in particular, our competitors can sell products in the Brazilian market at parity with international prices. In light of this increased competition, we have less flexibility to maintain local prices above international prices to compensate for revenues not realized in periods in which we sold crude oil and oil products below prevailing international market prices.

We may be required to sell some of our refining capacity in Brazil.

We presently own 98.6% of the existing refining capacity in Brazil. We plan to upgrade our present refineries and we may build new refineries in Brazil, sell participation interests in our present refineries to new partners or engage in asset swaps, as we did through our business combination in 2001 involving assets of Repsol-YPF S.A. Although we are not presently subject to any requirement to divest any assets, and the Brazilian government has not made any proposal in that respect, it is possible that we will be required to divest a portion of our refining capacity or other assets in the future. Any such divestiture could have a material adverse effect on our financial condition and results of operations.

Our ability to achieve growth is dependent upon our finding or acquiring additional reserves, as well as successfully developing current reserves, and risks associated with drilling may cause drilling operations to be delayed or cancelled.

Our ability to achieve our growth objectives is highly dependent upon our level of success in finding, acquiring or gaining access to additional reserves, as well as successfully developing current reserves. In general, the volume of production from crude oil and natural gas properties declines as reserves are depleted, with the rate of decline depending on reservoir characteristics. 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.

Our exploration and development activities expose us to the inherent risks of drilling, including the risk that no economically productive crude oil or natural gas reserves will be discovered. The costs of

drilling, completing and operating wells are often uncertain and numerous factors beyond our control may cause drilling operations to be curtailed, delayed or cancelled. Our future drilling, exploration and acquisition activities may not be successful and, if unsuccessful, could harm our future results of operations and financial condition.

Our crude oil and natural gas reserve estimates involve some degree of uncertainty and may prove to be incorrect over time.

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 numerous uncertainties inherent in estimating quantities of proved reserves. The reliability of proved reserve estimates depends on:

- the quality and quantity of our geological, technical and economic data;
- the prevailing crude oil and natural gas prices applicable to our production (which in the past have been subject to Brazilian government regulation);
- the production performance of our reservoirs; and
- extensive engineering judgments.

Many of the factors, assumptions and variables involved in estimating reserves are beyond our control and may prove to be incorrect. The results of our future drilling, testing and production activity may lead us to make significant revisions to our reserve estimates.

Our equipment, facilities and operations are subject to numerous environmental and health regulations which may become more stringent in the future and may result in increased liabilities and increased capital expenditures.

Our facilities 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. We could be exposed to civil penalties, criminal sanctions 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. Current and past waste disposal and emissions practices 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 dos Recursos Naturais Renováveis* (Brazilian Institute of the Environment and Renewable Natural Resources), or IBAMA, has been investigating our oil platforms in the Campos Basin, and may impose fines, restrictions on operations or other sanctions in connection with its investigations.

We spent approximately U.S.\$466 million in 2002, U.S.\$473 million in 2001 and U.S.\$356 million in 2000 to comply with environmental laws. However, since environmental laws are becoming more stringent in Brazil and in other jurisdictions where we operate, it is likely that our environmental capital expenditures and costs for environmental compliance will increase, perhaps substantially, in the future. In addition, due to the possibility of unanticipated regulatory or other developments, the amount and timing of future environmental expenditures may vary widely from those currently anticipated. The amount of investments we make in any given year is subject to limitations by the Brazilian government. Accordingly, expenditures required for compliance with environmental

regulation could result in reductions in other strategic investments that we have planned, with a resulting decrease to our profits, and future environmental costs may harm our results of operations or financial condition.

In the past, significant oil spills have occurred and we have incurred, and may continue to incur, liabilities in connection with oil spills, including clean up costs, government fines, and potential lawsuits.

From time to time, oil spills occur in connection with our operations. Since January 1, 2000, we have experienced 11 significant oil spills. In each of these, we undertook cleanup efforts as promptly as possible. Nevertheless, in some situations, we were fined by various state and federal environmental agencies, became the defendant in several civil and criminal suits, and remain subject to several investigations and potential civil and criminal liabilities as a result of past oil spills. These or any future oil spills may have a material adverse effect on our financial condition or results of operations. Accordingly, if one or more of the potential liabilities resulting from these oil spills were to result in an actual fine or civil or criminal liability, our operations and financial condition could be negatively affected.

We may incur losses and spend time and money defending pending litigation and arbitration.

We are currently a party to numerous legal proceedings relating to civil, administrative, environmental, labor and tax claims filed against us. We are also pursuing discussions with various government authorities and with Repsol-YPF over our licenses, including our right to operate certain platforms, in connection with the 2001 Repsol-YPF asset swap. These claims involve a wide range of issues and seek substantial amounts of money and other remedies. Several individual disputes account for a significant part of the total amount of claims against us. Our audited financial statements as of December 31, 2002 include reserves totaling U.S.\$50 million as of that date, for probable and reasonably estimable losses and expenses we may incur in connection with all of our pending litigation and a separate provision of U.S.\$105 million related to various tax assessments received from the *Instituto Nacional de Seguridade Social* (National Security Institute, or INSS), as further described in Item 8 "Financial Information - Legal Proceedings".

In the event that a number of the claims that we consider to represent remote or reasonably possible risks of loss were to be decided against us, or in the event that the losses estimated turn out to be higher than the reserves made, the aggregate cost of unfavorable decisions could have a material adverse effect on our financial condition and results of operations. Additionally, our management may be required to direct its time and attention to defending these claims, which could preclude them from focusing on our core business. Depending on the outcome, certain litigation, including matters involving our platforms and asset swaps, could result in restrictions on our operations and have a material adverse effect on certain of our businesses.

Proposed legislative changes to the ICMS tax imposed by the State of Rio de Janeiro may have a material adverse effect on our results of operation and financial condition.

The governor of the State of Rio de Janeiro is considering signing a bill into law that would increase the amount of *Imposto sobre Circulação de Mercadorias e Serviços* (state value-added tax, or ICMS) that we are required to pay by approximately R\$5.4 billion (U.S.\$1.9 billion) per year. The proposed new law would change the point of collection of part of the ICMS from the refinery level to the wellhead level of production in the State of Rio de Janeiro. If it becomes effective, we may be unable to utilize part of the taxes imposed at the wellhead level in Rio de Janeiro to offset taxes that are imposed at the refinery level in other states, and therefore would be paying taxes on the same oil products at both the production and refining level. We believe that the proposed new law would be an unconstitutional form of taxation,

and intend to challenge the law if it becomes effective. If the law becomes effective, it would significantly increase the amount of taxes we pay, and such increase could have a material adverse effect on our level of investments and, therefore, on our results of operation and financial condition.

Labor disputes, strikes, work stoppages and protests could lead to increased operating costs.

All of our employees, other than our maritime employees, are subject to a collective bargaining agreement with the Oil Workers' Unified Federation, which was signed on December 4, 2002, retroactive to September 1, 2002. This collective bargaining agreement will expire on October 31, 2003. On December 27, 2002, we signed a separate collective bargaining agreement with the maritime employees' union retroactive to November 1, 2002, which will expire on October 31, 2003.

From time to time, we have been subject to strikes and work stoppages. In 2001, our oil workers began a five-day strike. While this strike was settled, it did result in a decrease in crude oil production. If our workers were to strike, the resulting work stoppages could have an adverse effect on us, as we do not carry insurance for losses incurred as a result of business interruptions of any nature, including business interruptions caused by labor action. As a result, our financial condition and results of operations could be adversely affected by future strikes, work stoppages, protests or similar activities.

Our expansion into the domestic power market is relatively recent and has generated losses, and the regulatory environment remains uncertain.

Consistent with the global trend of other major oil and gas companies and to secure demand for our natural gas, we are currently expanding our business into the domestic power market. Despite a number of incentives introduced by the former Brazilian government to promote the development of thermoelectric power plants, development of such plants by private investors has been slow to progress. We currently invest in 16 of the 39 gas-fired power generation plants being built or proposed to be built in Brazil under the program to promote the development of thermoelectric plants, known as the *Programa Prioritário de Termoelectricidade* (Thermoelectric Priority Program, or PPT). We invest in some of these plants with partners, many of whom may have power purchase agreements with the plants. We have had contractual disputes in connection with these investments and other disputes may occur. Depending on the outcome of any such disputes, they could have an adverse economic impact on us, including on the profitability of our investments.

We have a limited history of investing in thermoelectric plants, and thermoelectric plants have not previously operated in a competitive environment in Brazil. Thermoelectric plants have faced difficulties passing on to electricity offtakers foreign currency financing costs of developing new generating capacity, and have had to contend with the reluctance of many distribution companies to sign power purchase agreements due mainly to their existing initial contracts, which provide for a guaranteed price from 1998 to 2002, which is phased out over the following four years. In addition, demand for thermoelectric power in Brazil has been lower than expected. In 2002, Congress passed a law increasing government intervention in the market, and the current administration is studying the implementation of changes that could be material to the natural gas and power sector. It is not clear that thermoelectric power generation will remain a priority for the country. In addition, the energy policy of the new administration remains uncertain.

During 2002, we experienced significant losses relating to our investments in thermoelectric power generation. As a result, in 2002 we created a U.S.\$205 million provision for losses related to our commitments to off-take electricity from certain thermoelectric power plants. We increased this provision in the first quarter of 2003 by a further U.S.\$205 million. After deducting the losses incurred in the first quarter of 2003, which amounted to U.S.\$111 million, the balance of the provision totaled U.S.\$316

million as of March 31, 2003. We have limited our investments in this area, but our participation in the domestic power market may never become profitable. As a result, our participation in this market may adversely affect our operating results and financial condition.

We are in the process of implementing a new Strategic Plan, which may have a material adverse effect on our competitive position or ability to expand our operations.

On April 17, 2003, we announced the adoption of revisions to our Strategic Plan for the period 2003-2007. The new Strategic Plan maintains our core strategies and objectives, but reduces our overall budgeted capital expenditures for the year 2003. The revisions for 2003 reflect an environment of decreased access to financial markets and increased volatility in foreign exchange rates and crude oil prices. The changes to our Strategic Plan, particularly the decrease in overall budgeted capital expenditures, could affect our ability to achieve certain of our strategic goals, and in particular, could negatively impact our competitive position or ability to expand our operations.

We may not be able to obtain financing for all of our planned investments.

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. We are endeavoring to obtain financing that does not require Brazilian government approval, such as structured financings, but there can be no assurance that we will succeed. As a result, 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 future operating results and financial condition may be adversely affected. In addition, failure to make our planned investments in Brazil could hurt our competitive position in the Brazilian oil and gas sector, particularly as other companies enter the market.

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

The principal market for our products is Brazil, and over the last three fiscal years over 86% of our revenues have been denominated in Reais. A substantial portion of our indebtedness and some of our operating expenses and capital expenditures are, and are expected to continue to be, denominated in or indexed to U.S. Dollars and other foreign currencies. In addition, during the year ended December 31, 2002, we imported U.S.\$5.2 billion of crude oil and oil products, the prices of which were all denominated in U.S. Dollars.

As a result of downward pressure on the Real, on January 15, 1999, the Central Bank of Brazil allowed the Real to float freely. The Real depreciated 9.3% in 2000, 18.7% in 2001 and 52.3% in 2002 against the U.S. Dollar. As of June 13, 2003, the exchange rate of the Real to the U.S. Dollar was R\$2.857 per U.S.\$1.00, representing an appreciation of approximately 24.0% in 2003 year-to-date. There is no assurance that this trend will continue, and the Real may depreciate further in the future. We cannot predict the impact on our operations of any future substantial devaluation of the Real, which could adversely affect our operating cash flows and our ability to meet our foreign currency-denominated obligations. You should consider this risk in light of past devaluations of the Real caused by inflationary and other pressures.

We are exposed to increases in prevailing market interest rates.

As of December 31, 2002, approximately 45% of our total indebtedness consisted of floating rate debt. Although we are changing our risk management practices, we have not yet entered into derivative contracts or made other arrangements to hedge against interest rate risk. Accordingly, if market interest rates (principally LIBOR) rise, our financing expenses will increase.

In the aftermath of the U.S. military action in Iraq there may be changes to the international oil markets, some of which could have an adverse effect on us.

Following the U.S. military action in Iraq, the United Nations eliminated sanctions that had limited Iraq's ability to participate in the international oil markets. As a result, it is expected that in the future, Iraq will substantially increase its production and export sales of crude oil and oil products. Given the uncertainty surrounding the circumstances under which Iraq's oil industry will be managed over the next few years, it is impossible to predict the economic or political goals which the United States government or any other party controlling such industry will seek to achieve. The changes to the international oil markets that could result from Iraq's re-entry into such markets could have a material adverse effect on our financial condition and results of operations.

Our ability to obtain affordable insurance coverage may be adversely affected by changes in the insurance markets, our recent history of claims under our insurance policies and changes in the insurance markets following the September 11, 2001 terrorist attacks.

The insurance premiums charged for some or all of the coverage historically maintained by us and our subsidiaries has increased significantly in the past as a result of changes in the insurance markets and claims under our insurance policies. Following the March 15, 2001 explosion that sank Platform P-36, our insurance costs increased substantially, from U.S.\$36.0 million in 2001 to U.S.\$46.4 million in 2002. For 2003, these costs have decreased to U.S.\$30.5 million. Our insurance costs may increase, or coverage may be unavailable, in the future. The premiums for war risk and terrorism insurance have also increased substantially in the past, and in some cases, such insurance is not available. Following the September 11, 2001 terrorist attacks, insurance underwriters have issued general notices of cancellations to their customers for war risk and terrorism insurance in respect of a wide variety of insurance coverage, including, but not limited to, liability coverage. We do not know whether underwriters will offer to reinstate some or all of these types of coverage and, if reinstatement is offered, the extent to which premiums may be increased. The failure to obtain insurance against risks inherent in our business may expose us to catastrophic losses that may materially affect our results of operations.

We may not achieve the anticipated timing, efficiencies and benefits of integrating Perez Companc into our business

On October 17, 2002, we agreed to acquire 58.62% of the capital stock of Perez Companc, the second largest Argentine energy company, from the Perez Companc family and the Perez Companc Foundation for approximately U.S.\$1.03 billion. The completion of the Perez Companc acquisition was contingent upon antitrust approval from the Argentine government's *Comisión Nacional de Defensa de la Competencia* (the "National Council for the Defense of Competition" or the "CNDC"). The CNDC approved the transaction on May 13, 2003. Upon approval of the transaction, Perez Companc agreed to divest itself of its equity interest in Transener S.A., which operates most of Argentina's high-tension electricity lines. This divestiture is in line with Perez Companc's strategic plan and does not affect our strategic plan in Latin America.

It is possible that we may not achieve the anticipated timing, efficiencies and benefits of integrating Perez Companc into our business. Differing corporate cultures, legal and regulatory

environments, personalities, languages and other factors may pose challenges to the success of the acquisition. Failure to achieve the anticipated timing, efficiencies and benefits of integrating Perez Companac into our business may negatively impact us and our ability to implement our strategic objectives in South America.

Perez Companac is subject to substantial risks relating to its business and operations in Argentina and other South American countries.

Perez Companac is an Argentine *sociedad anonima* with approximately 59.6% of its total crude oil and natural gas production and 45.6% of its proved crude oil and natural gas reserves located in Argentina at December 31, 2002. As a result, Perez Companac's financial condition and results of operation may be adversely affected by Argentine political instability, fluctuations in the Argentine economy and governmental actions concerning the economy, including:

- the imposition of exchange controls, which could restrict the flow of capital out of Argentina and make it more difficult for Perez Companac to service its non-Peso denominated debt;
- the imposition of restrictions on the export of crude oil and oil products, which could decrease Perez Companac's U.S. Dollar cash receipts;
- the devaluation of the Argentine Peso, which could lead to significant losses in Perez Companac's net foreign currency position and, therefore, restrict its ability to make payment on its foreign-currency denominated debt;
- increases in export tax rates for crude oil and oil products, which could lead to a reduction in Perez Companac's export margins and cash flows; and
- other measures enacted by the Argentine government to address Argentina's economic crisis, including the pesification of utility rates, which combined with the devaluation of the Argentine Peso, resulted in payment defaults by three of Perez Companac's affiliated utility companies, TGS, CIESA (the parent of TGS), and Transener, and which could lead to defaults by other affiliated utility companies.

Perez Companac is also active in Venezuela, Ecuador, Bolivia, Peru and Brazil. Production from Venezuela accounted for approximately 28.7% of Perez Companac's total average production in barrels of oil equivalent in 2002, constituting the largest operation outside Argentina. Accordingly, Perez Companac's operations may be negatively affected by:

- the continuing political and economic instability in Venezuela, particularly the labor strikes and other forms of political protest directed against the Hugo Chavez administration;
- any decisions by the Organization of Petroleum Exporting Countries ("OPEC") to decrease production volumes, as Venezuela is a member of OPEC; and
- any decision by the Venezuelan government to modify the terms and conditions of Perez Companac's operating agreements in Venezuela.

If one or more of the risks described above were to materialize, we may not be able to realize the benefits that we currently intend to realize from the Perez Companac acquisition, and that development might negatively impact us and our ability to implement our strategic objectives in South America.

Risks Relating to the Relationship between us and the Brazilian Government

The interests of the Brazilian government, as our controlling shareholder, may conflict with the interests of our other shareholders and creditors.

The Brazilian government, as our controlling shareholder, has pursued, and could continue to pursue, certain of its macroeconomic and social objectives through us. These initiatives have not always been in our best interests or the best interests of our other shareholders and creditors. 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 Brazilian government's agenda 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 continue to make investments, incur costs and engage in sales on terms that are not necessarily in our best interests or in the best interests of our shareholders and creditors.

Luiz Inácio Lula da Silva was elected President of Brazil in October 2002 and took office on January 1, 2003. As a result, there have been significant changes in our board of directors and senior management in recent months. The reconstituted board of directors and new senior management may pursue a strategy or conduct operations in a manner that diverges significantly from the strategy and operations pursued by our previous management. Changes in government or government policy could have a material adverse effect on us and our business, results of operations, financial condition or prospects.

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

In the past, the Brazilian government set prices for crude oil and oil products in Brazil, often below prevailing prices on 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, 2002 was U.S.\$182 million. Effective January 2, 2002, all price controls for crude oil and oil products ended, and while no price controls were imposed in 2002, 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.

Brazilian political and economic conditions may have a material adverse effect on us.

The Brazilian economy has been characterized by significant involvement by the Brazilian government, which often changes monetary, credit and other policies to influence Brazil's economy. The Brazilian government's actions to control inflation and other economic policies have often involved wage and price controls, modifications to the Central Bank's base interest rates, and other measures, such as the freezing of bank accounts, which occurred in 1990.

The Brazilian government's economic policies may have important effects on Brazilian corporations and other entities, 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.

In addition, we cannot predict the effect that the policies of the new Brazilian administration may have on Brazilian economic conditions or on our financial condition and results of operations.

The current Argentine economic, political and social crisis could adversely affect the financial condition and results of operation of Perez Companc and our other Argentine operations.

Since 1999, the Argentine economy has been in a recession marked by reduced levels of consumption and investment, increased unemployment, declining gross domestic product and capital flight.

On December 20, 2001, President Fernando de la Rúa resigned, and since then, Argentina has had several presidents, including President Eduardo Duhalde, who held office from January 2002 to May 2003. During his term, President Duhalde and his government undertook a number of far-reaching initiatives, including:

- ratifying the suspension of payment of certain of Argentina's sovereign debt;
- amending Argentina's Convertibility Law to allow the exchange rate of the Argentine Peso to float, breaking the Peso's decade-old one-to-one relationship to the U.S. Dollar, and resulting in a 66.4% decline in the value of the Peso against the U.S. Dollar from January 7, 2002 to March 31, 2003;
- converting certain U.S. dollar-denominated debts into peso-denominated debts at a one-to-one exchange rate and U.S. dollar-denominated bank deposits into peso-denominated bank deposits at an exchange rate of 1.4 Argentine Pesos per U.S.\$1.00;
- restructuring bank deposits and maintaining restrictions on bank withdrawals;
- enacting an amendment to the Argentine Central Bank's charter to (i) allow it to print currency in excess of the amount of the foreign reserves it holds, (ii) make short-term

advances to the Argentine federal government and (iii) provide financial assistance to financial institutions with liquidity constraints or solvency problems;

- imposing restrictions on transfers of funds abroad subject to certain exceptions; and
- requiring the deposit into the banking system of foreign currency earned from exports, subject to certain exceptions.

The rapid and radical nature of recent changes in the Argentine social, political, economic and legal environment created an atmosphere of great uncertainty in the banking system. As a result, commercial and financial activities were virtually paralyzed during 2002, further aggravating the economic recession which precipitated the current crisis. Moreover, due to the depth of the social and political crisis that affected Argentina in 2002, Argentina continues to face risks, including: (i) civil unrest, rioting, looting, nation-wide protests, widespread social unrest and strikes, (ii) expropriation, nationalization and forced renegotiation or modification of existing contracts and (iii) changes in taxation policies, including royalty and tax increases and retroactive tax claims.

On May 25, 2003, a new president, Néstor Kirchner, took office. There is uncertainty as to the nature and scope of the measures to be adopted by Mr. Kirchner's government to address many of the country's unresolved economic problems, including the renegotiation of its external debt. We cannot predict the policies the new Kirchner administration may adopt or the effect that those policies could have on Argentine economic conditions and our investments in Argentina.

We have acquired a majority interest in several entities with operations in Argentina, including Perez Companc. The financial condition and results of operation of Perez Companc and other acquisitions may be adversely affected by Argentine political instability, fluctuations in the Argentine economy and governmental actions concerning the economy, which could result in our failure to realize the benefits we currently expect to realize from those acquisitions.

Historical Brazilian government control of our sales prices and regulation of our operating revenues mean that our results of operations cannot be easily compared from year to year.

One of the tools available to the Brazilian government to control inflation and pursue other economic and social objectives has been the regulation of oil product prices. The method by which the Brazilian government has controlled our prices has varied from year to year. Until December 31, 2001, the Brazilian government regulated the prices at which we were permitted to sell our oil products. The Brazilian government also established freight subsidies to ensure uniform oil product prices throughout Brazil, but these subsidies have since been phased out. Beginning in July 1998, and until the institution of price deregulation on January 2, 2002, the Brazilian government established a new methodology for calculating our net operating revenues.

Because of this government price control and the change in methodology:

- the various line items in our financial statements are not necessarily comparable from period to period; and
- our results of operations reflect not only our consolidated operations, but also the results of economic activity undertaken on behalf of the Brazilian government.

Additionally, from time to time, the Brazilian government may impose specific taxes or other special payment obligations on our operations that may affect our results of operations.

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. As a result, many oil and gas companies own crude oil and natural gas reserves. Under Brazilian law, the Brazilian government owns all crude oil and natural gas reserves in Brazil. We possess the exclusive right to develop our reserves pursuant to concession agreements awarded to us by the Brazilian government, 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.

The Brazilian government is no longer contingently liable for our liabilities in the event of our insolvency.

On March 1, 2002, an amended Brazilian corporate law became effective. Among other changes, the amended law provides for the termination of the contingent liability of the Brazilian government for the liabilities and obligations of mixed capital companies, such as us and, as a consequence, for the termination of mixed capital companies' immunity from bankruptcy legal proceedings. Accordingly, the Brazilian government will not be contingently liable, as it was in the past, for any of our obligations incurred after the enactment of this law.

Risks Relating to Brazil

The Brazilian government's actions to maintain economic stability, as well as public speculation about possible future actions, may contribute significantly to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets.

Our principal market is Brazil, which has periodically experienced extremely high rates of inflation. Inflation, along with recent 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*), have decreased from 2,489.1% in 1993 to 929.3% in 1994, to 8.4% in 1999 and to 5.3% in 2000. The same index increased to 9.4% during 2001 and to 14.7% in 2002.

Brazil may experience high levels of inflation in the future. The lower levels of inflation experienced since 1994 may not continue. Future governmental actions, including actions to adjust the value of the Real, could trigger increases in inflation.

Over the last three fiscal years, approximately 86% of our revenues have been denominated in Reais, although prices for crude oil and oil products have been based on international prices. A substantial portion of our indebtedness and some of our operating expenses and capital expenditures are, and are expected to continue to be, denominated in or indexed to the U.S. Dollar and other foreign currencies. In addition, during the year ended December 31, 2002, we imported approximately U.S.\$5.2 billion of crude oil and oil products, the prices of which were all denominated in U.S. Dollars.

As a result of inflationary pressures, the Real and its predecessor currencies have been devalued periodically during the last four decades. Through this period, the Brazilian government has implemented various economic plans and utilized a number of exchange rate policies, including sudden devaluations, periodic mini-devaluations during which the frequency of adjustments has ranged from daily to monthly, floating exchange rate systems, exchange controls and dual exchange rate markets. From time to time, there have been significant fluctuations in the exchange rates between the Real and the U.S. Dollar and other currencies. For example, the Real declined in value against the U.S. Dollar by 9.3% in 2000, 18.7% in 2001 and 52.3% in 2002.

Devaluation of the Real relative to the U.S. Dollar could create additional inflationary pressures in Brazil by generally increasing the price of imported products and requiring recessionary governmental policies to curb aggregate demand. On the other hand, appreciation of the Real against the U.S. Dollar may lead to a deterioration of the country's current account and the balance of payments, as well as dampen export-driven growth. The potential impact of the floating exchange rate and of measures by the Brazilian government aimed at stabilizing the Real is uncertain. In addition, a substantial increase in inflation may weaken investor confidence in Brazil. Future devaluation of the Real could adversely affect our results of operations and financial condition.

The current crisis in Argentina could adversely affect the Brazilian economy, adversely affecting our ability to finance our operations and our investments in Argentina.

In the past, the Brazilian economy and the securities of Brazilian companies have been, to varying degrees, influenced by economic and market conditions in other emerging market countries, particularly in Latin America, as well as by investors' responses to those conditions.

Any further deterioration of the Argentine economy and further devaluation of the Argentine Peso could adversely affect the Brazilian economy, as Argentina is one of Brazil's principal trading partners, accounting for 26% of Brazil's exports in 2002. Adverse developments in the Brazilian economy could, in turn, negatively impact our business and results of operations.

Risks Relating to our Equity and Debt Securities

The Brazilian securities markets are smaller, more volatile and less liquid than the major U.S. and European securities markets and therefore may limit your ability to sell the common or preferred shares underlying our ADSs.

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

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

Holders of ADSs that are residents of the United States may not be able to exercise the preemptive rights relating to the common or preferred shares underlying our ADSs unless a registration statement under the U.S. Securities Act of 1933 is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement with respect to the common or preferred shares relating to these preemptive rights, and therefore we may not file any such registration statement. If a registration statement is not filed and an exemption from registration does not exist, Citibank N.A., as depositary, will attempt to sell the preemptive rights, and you will be entitled to receive the proceeds of the sale. However, the preemptive rights will expire if the depositary cannot sell them. For a more complete description of preemptive rights with respect to the common or preferred shares, see Item 10 "Additional Information—Memorandum and Articles of Association—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. Although our ADSs are already traded on the New York Stock Exchange, we cannot predict whether an active liquid public trading market for our ADSs will be sustained. 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. Although ADS holders are entitled to withdraw the common or preferred shares underlying the ADSs from the depositary at any time, 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.

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

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

Additionally, if the Brazilian government were to impose restrictions on our ability to convert Reais into U.S. dollars, we would not be able to make payment on our dollar-denominated debt obligations. For example, any such restrictions could prevent us from making funds available to our subsidiary, Petrobras International Finance Company (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 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 Brazilian Stock Exchange. If you do not obtain a certificate of registration or register under Resolution

No. 2,689, you will generally 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, or that additional restrictions applicable to you, the disposition of the underlying common or preferred shares or the repatriation of the proceeds from disposition will not be imposed in the future.

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

Our corporate affairs are governed by our bylaws and the Brazilian 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 or the rights of holders of the common or preferred shares under Brazilian corporate law to protect interests relative to actions by our board of directors may be fewer and less well-defined 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 regarding 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 mixed-capital 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 more difficulties in protecting your interests in the case of 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-Voting Rights" for a discussion of the limited voting rights of our preferred shares.

Developments in other emerging market countries may affect the trading values of our securities.

Securities of Brazilian companies have been influenced by economic and market conditions in other emerging market countries to varying degrees. Although economic conditions are different in each country, investors' reactions to developments in one country may affect the securities of issuers in other countries, including Brazil. Between the fourth quarter of 1997 and the first quarter of 1999, the international financial markets experienced significant volatility, and a large number of market indices, including those in Brazil, declined significantly. The 1997 Asian economic crisis, the 1998 Russian debt moratorium and devaluation of the Russian currency, and the recent uncertainty caused by Argentina's economic crisis, for example, resulted in increased volatility in securities markets in Latin America and in other emerging market countries.

ITEM 4. INFORMATION ON THE COMPANY

History and Development of the Company

Petróleo Brasileiro S.A.—PETROBRAS is a mixed-capital company created pursuant to Law No. 2,004 (effective as of October 3, 1953).

A mixed-capital 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 publicly traded. Our principal executive office is located at Avenida República do Chile, 65, 20035-900 – Rio de Janeiro – RJ, Brazil and our telephone number is (55-21) 2534-4477.

We began operations in Brazil in 1954 as a wholly-owned government enterprise responsible for all hydrocarbon activities in Brazil. From that time until 1995, we had a government-granted monopoly for all crude oil and gas production, refining and distribution activities in Brazil. On November 9, 1995, the Brazilian Constitution was amended to authorize the Brazilian government to contract with any state or privately owned company to carry out the activities related to the upstream and downstream segments of the Brazilian oil and gas sector. This amendment eliminated our legal monopoly.

Based upon our 2002 consolidated revenues, we are the largest corporation in Brazil and the third largest industrial corporation in Latin America. For the year ended December 31, 2002, we had sales of products and services of U.S.\$32,987 million, net operating revenues of U.S.\$22,612 million and net income of U.S.\$2,311 million.

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

- exploration, development and production of crude oil and oil products in Brazil;
- refining, transportation and marketing of crude oil, oil products and fuel alcohol, including investments in petrochemicals;
- distribution of oil products and fuel alcohol to end-users;
- commercialization and transportation of natural gas produced in or imported into Brazil, including participation in natural gas distribution and transportation companies in Brazil and ownership in and development of thermoelectric power projects and related power activities in Brazil; and