

PETROBRAS ENERGIA PARTICIPACIONES SA

Form 20-F

May 08, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 20-F
ANNUAL REPORT PURSUANT TO SECTION 13
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended: December 31, 2006
Commission file number 333-11130
PETROBRAS ENERGÍA PARTICIPACIONES S.A.
(Exact name of Registrant as specified in its charter)

N/A

REPUBLIC OF ARGENTINA

(Translation of Registrant's name into English)

(Jurisdiction of incorporation of organization)

Maipú 1, 22nd Floor
(C1084ABA) Buenos Aires
Argentina

(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 |
|----------------------------|------------------------------------------------------|
|----------------------------|------------------------------------------------------|

American Depositary Shares, each representing 10
Class B shares

New York Stock Exchange

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:

None

The number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2006 was:

Class B ordinary shares, par value P\$1.00 per share 2,132,043,387

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

Yes No

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 No

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 No

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 Accelerated filer Non-accelerated filer

Indicate by check mark which financial statement item the Registrant has elected to follow:

Item 17 Item 18

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

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INTRODUCTION

All references in this Annual Report to:

Petrobras Energía Participaciones, we, us, our, and similar terms refer to Petrobras Energía Participaciones S.A. its subsidiaries, but excludes affiliates and companies under joint control. Prior to July 2003, our corporate name was Perez Companc S.A.

Petrobras Energía refers to Petrobras Energía S.A., a subsidiary of Petrobras Energía Participaciones together with its controlled subsidiaries, but excludes affiliates and companies under joint control. Prior to July 2003, the corporate name of Petrobras Energía was Pecom Energía S.A. See Item 4. Information About the Company Our History and Development .

Petrobras refers to Petróleo Brasileiro S.A. PETROBRAS.

Argentine pesos , pesos or P\$ refer to the currency of the Republic of Argentina.

U.S. dollars or U.S.\$ refer to the currency of the United States of America.

FORWARD-LOOKING STATEMENTS

Some of the information included in this Annual Report contains information that is forward looking, including statements regarding capital expenditures, competition and sales, oil and gas reserves and prospects and trends in the oil and gas, refining and distribution, petrochemicals and electricity industries.

Certain statements contained in this Annual Report are forward-looking statements and are not based on historical fact, such as statements containing the words believe, may, will, estimate, continue, anticipate, intend, similar words. These forward-looking statements are subject to risks, uncertainties and assumptions, including those discussed in Item 3. Key Information Risk Factors and elsewhere in this Annual Report. Factors that could cause actual results to differ materially and adversely include, but are not limited to:

Changes in general economic, business, political or other conditions in Argentina or changes in general economic or business conditions in other Latin America countries;

The availability of financing at reasonable terms to Argentine companies, such as us;

The failure of governmental authorities to approve proposed measures or transactions described in this Annual Report;

Changes in the price of hydrocarbons and oil products;

Changes to our capital expenditure plans;

Changes in laws or regulations affecting our operations;

Increased costs; and

Other factors discussed under Risk Factors in Item 3 of this Annual Report.

Forward-looking statements speak only as of the date they were made. We undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict all of these factors. In light of these limitations, you should not place undue reliance on forward looking statements contained in this Annual Report.

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Items 1-2. NOT APPLICABLE

Item 3. KEY INFORMATION

SELECTED FINANCIAL DATA

The financial information set forth below may not contain all of the financial information that you should consider when making an investment decision. This information should be read in conjunction with, and is qualified in its entirety by reference to, the Risk Factors included in this Annual Report. See Risk Factors. You should also carefully read our financial statements and Item 5. Operating and Financial Review and Prospects included in this Annual Report for additional financial information about us.

Our consolidated financial statements are prepared in accordance with regulations of the National Securities Commission (*Comisión Nacional de Valores*) or the CNV, and, except for the matters described in note 3 to our consolidated financial statements, with generally accepted accounting principles in Argentina (as approved by the Professional Council of Economic Sciences of the City of Buenos Aires, or CPCECABA), or Argentine GAAP. Argentine GAAP differs in certain significant respects from generally accepted accounting principles in the United States, or U.S. GAAP. Note 21 to our financial statements provides a description of the principal differences between Argentine GAAP and U.S. GAAP as they relate to us, and note 22 provides a reconciliation to U.S. GAAP of net income, shareholders' equity and certain other selected financial data.

Proportional consolidation of companies under which we exercise joint control

In accordance with the procedure set forth in Technical Resolution No. 21 of the Argentine Federation of Professional Councils in Economic Science, or FACPCE, we have consolidated our financial statements line by line on a proportional basis with the companies in which we exercise joint control (other than Compañía Inversora en Transmisión Eléctrica Citelec S.A., or Citelec). See Item 5. Operating and Financial Review and Prospects Proportional Consolidation and Presentation of Discussion. In the consolidation of companies over which we exercise joint control, the amount of the investment in the companies under joint control and the interest in their income (loss) and cash flows are replaced by our proportional interest in the subsidiaries assets, liabilities and income (loss) and cash flows. In addition, related party receivables, payables and transactions within the consolidated group and companies under joint control are eliminated on a pro rata basis pursuant to our ownership share in that company.

Changes in professional accounting standards

On August 10, 2005, the Board of the CPCECABA approved Resolution CD No. 93/2005, which introduced a series of changes to professional accounting standards, effective for fiscal years beginning on or after January 1, 2006. In addition, it contemplates transition standards that defer the mandatory effectiveness of certain changes for fiscal years beginning on or after January 1, 2008. Through General Resolution Nos. 485 and 487, dated December 29, 2005, and January 26, 2006, respectively, the CNV approved the abovementioned changes, which are effective for fiscal years beginning on or after January 1, 2006.

Figures for the years 2005 and 2004 have been restated to give effect to the abovementioned changes in the professional accounting standards.

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The effects of these changes on our income statement and shareholders' equity as of December 31, 2005 and 2004 are described below:

| | Gain (loss) | | Increase (decrease) | |
|--------------------------------------------------|--------------------|-------------|-----------------------------------|-------------|
| | Income for | | Shareholders' equity as of | |
| | 2005 | 2004 | 2005 | 2004 |
| Comparison with recoverable values (i) | (120) | 10 | (190) | (70) |
| Deferred tax (ii) | 272 | 118 | (1,060) | (1,332) |
| Minority interest | (36) | (31) | 303 | 339 |
| Total effect on unappropriated retained earnings | | | (947) | (1,063) |
| Deferred loss (iii) | | | (22) | (49) |
| Total effect on Shareholders' equity | 116 | 97 | (969) | (1,112) |

(i) In calculating the recoverability of Property, plant and equipment and certain intangible assets, the recoverable value is considered to be the higher of the net realizable value and the discounted value of the expected cash flows. Before the changes in the standards, the book value was adjusted to its recoverable value if its carrying amount exceeded the undiscounted value in use. This first comparison has now been eliminated.

(ii) The difference between the inflation-adjusted

book value of Property, Plant and Equipment and other non-monetary assets and their tax basis is considered to be a temporary difference that gives rise to the recognition of a deferred liability, which as provided by CNV General Resolution No. 487 can either be booked or disclosed in notes to financial statements. The Company Management opted to book this effect.

- (iii) The effects of the translation of foreign operations net of the foreign-exchange differences generated by the debt denominated in foreign currency designated as hedge of net investment abroad no longer classified between liabilities and shareholders equity, and instead, are classified in shareholders equity.

Presentation of information related to income (loss) per share

Our net income per share under Argentine and U.S. GAAP was calculated as follows:

The basic earning per share is calculated by dividing the Company's net income for the year by the weighted average number of shares outstanding during that year, net of the treasury stock. The diluted earning per share is calculated by dividing the Company's net income for the year by the weighted average number of shares outstanding during that year, net of the treasury stock and the shares deliverable in connection with the Stock Option Plan.

U.S. GAAP Information

Neither the effects of inflation accounting nor the proportional consolidation of Distrilec Inversora S.A., a company under joint control which we refer to as Distrilec, under Argentine GAAP have been reversed in the U.S. GAAP information.

The proportional consolidation of Compañía de Inversiones de Energía S.A., which we refer to as CIESA, another company under joint control, in 2006, 2005 and 2004 under Argentine GAAP has been reversed in the U.S. GAAP information. This reversal was a result of (1) CIESA having negative shareholders' equity for the years ended 2006, 2005 and 2004 for purposes of U.S. GAAP, and (2) our not having assumed commitments to make capital contributions or to provide financial assistance to CIESA, which caused our interests in CIESA to be valued at zero.

Selected financial data for the years ended December 31, 2003 and 2002 is not presented because we were not able to restate it to reflect the abovementioned changes in professional accounting standards without unreasonable effort or expense.

The following tables set forth selected financial data including data for joint control companies consolidated under the proportional consolidation method, as of and for the years ended December 31, 2006, 2005 and 2004:

Table of Contents**Income Statement Data**

| | Year Ended December 31, | | |
|---------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| | (in millions of pesos, except for per share amounts and share capital or as otherwise indicated) | | |
| Income Statement Data | | | |
| Argentine GAAP: | | | |
| Net sales | 11,745 | 10,655 | 8,763 |
| Cost of sales | (8,251) | (7,046) | (5,781) |
| Gross profit | 3,494 | 3,609 | 2,982 |
| Administrative and selling expenses | (1,094) | (941) | (847) |
| Exploration expenses | (117) | (34) | (133) |
| Other operating expense, net | (135) | (329) | (324) |
| Operating income | 2,148 | 2,305 | 1,678 |
| Equity in earnings of affiliates | 219 | 281 | 102 |
| Financial income (expense) and holding gains (losses) | (506) | (899) | (1,265) |
| Other (expense) income, net | 93 | (459) | (40) |
| Income before income tax and minority interest in subsidiaries | 1,954 | 1,228 | 475 |
| Income tax provision | (465) | (211) | 317 |
| Minority interest in subsidiaries | (425) | (288) | (17) |
| Net income | 1,064 | 729 | 775 |
| Basic/diluted Earning per Share Class A (1) | | | |
| Basic/diluted Earning per Share Class B | 0.501 | 0.343 | 0.365 |
| Number of shares outstanding (in millions): | | | |
| Class B | 2,132 | 2,132 | 2,132 |
| U.S. GAAP: | | | |
| Net sales | 11,085 | 10,129 | 8,232 |
| Operating income | 1,934 | 613 | 1,348 |
| Net income (loss) | 972 | (77) | 760 |
| Basic/ diluted net income (loss)per share Class B: | 0.458 | (0.036) | 0.356 |
| (1) As from October 2002, there were no Class A Shares outstanding. | | | |

Table of Contents**Balance Sheet Data**

| | Year Ended December 31, | | |
|-----------------------------------|--------------------------------------------------------------------------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| | (in millions of pesos, except for per share amounts and share capital or as otherwise indicated) | | |
| Argentine GAAP: | | | |
| Consolidated Balance Sheet | | | |
| Assets | | | |
| Current assets | | | |
| Cash | 86 | 104 | 139 |
| Investments | 1,479 | 857 | 934 |
| Trade receivables | 1,416 | 1,596 | 1,181 |
| Other receivables | 1,182 | 627 | 756 |
| Inventories | 888 | 782 | 627 |
| Other assets | 1 | | 1 |
| Total current assets | 5,052 | 3,966 | 3,638 |
| Non-current assets | | | |
| Trade receivables | 124 | 78 | 47 |
| Other receivables | 691 | 672 | 943 |
| Inventories | 81 | 79 | 71 |
| Investments | 3,630 | 1,072 | 1,107 |
| Property, plant and equipment | 10,838 | 12,657 | 12,277 |
| Other assets | 41 | 47 | 65 |
| Total non-current assets | 15,405 | 14,605 | 14,510 |
| Total assets | 20,457 | 18,571 | 18,148 |
| Liabilities | | | |
| Current liabilities | | | |
| Accounts payable | 1,603 | 1,483 | 1,181 |
| Short-term debt | 2,646 | 1,805 | 1,709 |
| Payroll and social security taxes | 276 | 177 | 98 |
| Taxes payable | 331 | 228 | 215 |
| Reserves | 95 | 48 | 31 |
| Other current liabilities | 192 | 168 | 657 |
| Total current liabilities | 5,143 | 3,909 | 3,891 |
| Non-current liabilities | | | |
| Accounts payable | 49 | 14 | 26 |
| Long-term debt | 4,716 | 5,708 | 6,248 |
| Other liabilities | 1,492 | 1,404 | 1,692 |
| Taxes payable | 402 | 356 | 190 |
| Reserves | 85 | 103 | 76 |

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| | | | |
|-------------------------------------------|--------|--------|--------|
| Total non-current liabilities | 6,744 | 7,585 | 8,232 |
| Total liabilities | 11,887 | 11,494 | 12,123 |
| Minority interest in subsidiaries | 2,350 | 1,922 | 1,626 |
| Total Shareholders Equity | 6,220 | 5,155 | 4,399 |
| Total liabilities and shareholders equity | 20,457 | 18,571 | 18,148 |
| Capital Stock | 2,132 | 2,132 | 2,132 |
| U.S. GAAP: | | | |
| Total assets | 18,017 | 16,158 | 16,751 |
| Shareholders equity | 6,195 | 5,233 | 5,286 |

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From April 1, 1991 until the end of 2001, the Convertibility Law established a fixed exchange rate under which the Central Bank was obliged to sell U.S. dollars at a fixed rate of one peso per U.S. dollar. On January 6, 2002, the Argentine Congress enacted the Public Emergency and Foreign Exchange System Reform Law No. 25,562 (The Public Emergency Law), which suspended certain provisions of the Convertibility Law, including the fixed exchange rate of P\$1 to U.S.\$1, and granted the executive branch of the Argentine government the power to set the exchange rate between the peso and foreign currencies and to issue regulations related to the foreign exchange market. Following a brief period during which the Argentine government established a temporary dual exchange rate system, pursuant to the Public Emergency law, the peso has been allowed to float freely against other currencies since February 2002.

The following table sets forth the annual high, low, average and period-end exchange rates for the periods indicated, expressed in Argentine pesos per U.S. dollar and not adjusted for inflation. There can be no assurance that the Argentine peso will not depreciate or appreciate again in the future. The Federal Reserve Bank of New York does not report a noon buying rate for pesos.

| | Argentine peso per U.S. dollar (1) | | | |
|-------------|-------------------------------------------|------------|----------------|-------------------|
| | High | Low | Average | Period-end |
| 2007 | | | | |
| April | 3.10 | 3.06 | 3.09 | 3.09 |
| March | 3.11 | 3.10 | 3.11 | 3.10 |
| February | 3.11 | 3.10 | 3.11 | 3.10 |
| January | 3.11 | 3.06 | 3.09 | 3.11 |

For the year ended December 31,

| | | | | |
|------|------|------|------|------|
| 2006 | 3.08 | 3.05 | 3.06 | 3.07 |
| 2005 | 3.03 | 2.86 | 2.92 | 3.03 |
| 2004 | 2.99 | 2.94 | 2.97 | 2.98 |
| 2003 | 3.37 | 2.73 | 2.95 | 2.94 |
| 2002 | 3.90 | 1.60 | 3.14 | 3.38 |
| 2001 | 1.00 | 1.00 | 1.00 | 1.00 |

(1) As quoted by Banco De La Nación Argentina

Exchange controls

Prior to December 1989, the Argentine foreign exchange market was subject to exchange controls. From December 1989 until April 1991, Argentina had a freely floating exchange rate for all foreign currency transactions, and the transfer of dividend payments in foreign currency abroad and the repatriation of capital were permitted without prior approval of the Central Bank. From April 1, 1991, when the Convertibility Law became effective, until December 21, 2001, when the Central Bank decided to close the foreign exchange market, the Argentine currency was freely convertible into U.S. Dollars.

On December 3, 2001, the Argentine government imposed a number of monetary and currency exchange control measures, which included restrictions on the free disposition of funds deposited with banks and tight restrictions on transferring funds abroad without the Central Bank's prior authorization subject to specific exceptions for transfers related to foreign trade. The Central Bank has gradually eased these restrictions with a view to gradually normalizing the domestic exchange market, and as a result, most restrictions relating to the repayment of foreign creditors and the payment of dividends to foreign shareholders have been lifted. In June 2003 the Argentine government set restrictions on capital flows into Argentina, which mainly consisted of a prohibition against the transfer abroad of any funds until 180 days after their entry into the country. Furthermore, in June 2005 the Argentine government established further restrictions on capital flows into Argentina, including increasing the period that certain incoming funds must remain in Argentina to 365 calendar days and requiring that 30% of such incoming funds be deposited with a bank in Argentina

in a non-transferable, non-interest bearing account for 365 calendar days. Among other, export and import financing operations, as well as primary public offerings of debt securities listed on self-regulated markets, are exempt from the foregoing provision.

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RISK FACTORS

Factors Relating to Argentina

Political and economic instability in Argentina has affected and may continue to adversely affect our financial condition and results of operations.

We are an Argentine corporation (*sociedad anónima*). As of December 31, 2006, approximately 59% of our total assets, 71% of our net sales, 62% of our combined crude oil and gas production and 53% of our proved oil and gas reserves were located in Argentina. Fluctuations in the Argentine economy and actions adopted by the Argentine government have had and can be expected to continue to have a significant impact on us. Specifically, we have been affected and may continue to be affected by inflation, interest rates, the value of the peso against foreign currencies, price controls, business and tax regulations and in general by the political, social and economic scenario in Argentina and in other countries that may affect Argentina.

The Argentine economy has experienced a significant volatility in recent decades, characterized by periods of low or negative growth, high and variable levels of inflation and currency devaluation. During 2001 and 2002, Argentina went through a period of severe political, economic and social crisis. See Business Overview Our Principal Market . The crisis had significant and adverse consequences on our company, including (1) losses derived from the effects of the peso devaluation on our affiliates and our affiliates net borrowing position, which primarily was denominated in U.S. dollars, (2) the impairment of the book value of certain gas areas and tax assets due to material changes in the prospects of our operations, (3) a decrease in U.S. dollar cash flows due to the imposition of export taxes, (4) limits on the availability in the financial market to renew our short-term lines of credit and the current portion of our medium and long-term financings at maturity and (5) restrictions on our ability of passing through the effects of inflation to the prices of products sold by us in the domestic market. In 2002, we reported a significant net loss, which was a significant departure from the historical evolution of our results. Within this context and in order to secure compliance with our financial commitments, we reduced our investment plan and reached an agreement with our financial creditors and holders of notes to extend the maturity profile of a substantial portion of our debt, at face value. As a result, capital expenditures in 2002, net of divestments, totaled only P\$139 million, a relatively low amount compared to our historical average investment.

Although the economy has recovered significantly over the past four years, uncertainty remains as to whether the current growth and relative stability is sustainable. Sustainable economic growth is dependent on a variety of factors, including international demand for Argentine exports, the stability and competitiveness of the peso against foreign currencies, confidence among consumers and foreign and domestic investors and a stable and relatively low rate of inflation. As in recent years, Argentina s economy may suffer if political and social pressures inhibit the implementation by the Argentine government of policies designed to maintain price stability, generate growth and enhance consumer and investor confidence. We cannot provide any assurance that future economic, social and political developments in Argentina, over which we have no control, will not adversely affect our financial condition or results of operations including our ability to pay our debts at maturity.

The lack of financing alternatives may impact on the execution of our strategic business plan.

After the default on the Argentine sovereign debt, Argentine companies have had significantly fewer opportunities to access the international credit market. In spite of the renegotiation of a significant portion of the Argentine sovereign debt and the improvement in the financing capacity of Argentine companies, the prospects for all Argentine companies, including us, of accessing financial markets could be limited in terms of amounts, terms and financial costs. If we are unable to have access to the international financial markets to refinance our indebtedness at reasonable cost or under adequate conditions, we may have to reduce our projected capital expenditures, which, in turn, may affect the implementation of our business plan.

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Fluctuations in the value of the peso may adversely affect the Argentine economy, our financial condition and the result of operations.

The value of the peso has fluctuated significantly in the past and may do so in the future. Since the end of the U.S. dollar-peso parity in January 2002, the peso has fluctuated significantly in value. As a result, the Central Bank of Argentina (Central Bank) has taken several measures to stabilize the exchange rate and preserve its reserves. The marked devaluation of the peso in 2002 had a negative impact on the ability of the Argentine government and Argentine companies to honor their foreign currency-denominated debt, led to very high inflation initially and had a negative impact on businesses whose success is dependent on domestic market demand, including public utilities.

The significant peso devaluation during 2002 adversely affected our results and financial position. Substantially all of our financial debt and a significant portion of our affiliates' debt were denominated in U.S. dollars. Before the enactment of the Public Emergency Law, our cash flow, generally denominated in U.S. dollars or dollar-adjusted, provided a natural hedge against exchange rate risks. The Argentine regulatory framework after the enactment of the Public Emergency Law (which included the pesification of utility rates, regulatory issues related to the renegotiation of pesified utility rates, new taxes on hydrocarbon exports, the implementation of regulations to prevent an increase in prices to final users in the domestic market and restrictions on exports), however, limited our ability to mitigate the impact of the peso devaluation.

If the peso devalues significantly, all of the negative effects on the Argentine economy related to such devaluation could recur, with adverse consequences to our business. On the other hand, a substantial increase in the value of the peso against the U.S. dollar also presents risks for the Argentine economy since it may lead to a deterioration of the country's current account balance and the balance of payments.

We are unable to predict whether, and to what extent, the value of the peso may further depreciate or appreciate against the U.S. dollar and how any such fluctuations would affect the demand of our products and services. Moreover, we cannot assure you that the Argentine government will not make regulatory changes that prevent or limit us from offsetting the risk derived from our exposure to the U.S. dollar and, if so, what impact these changes will have on our financial condition and results of operations.

Inflation may escalate and undermine economic growth in Argentina and adversely affect our financial condition and results of operations.

In the past, inflation has undermined the Argentine economy and the government's ability to stimulate economic growth. During 2002, the Argentine consumer price index increased by 41%, and the wholesale price index increased by 118.2%.

From 2003 to 2005 inflation showed clear signs of acceleration (the consumer price index decreased by 3.7% in 2003, but increased again 6.1% in 2004 and 12.3% in 2005 and the wholesale price index rose 2% in 2003, 7.9% in 2004 and 10.8% in 2005). In 2006, both indexes maintained an upward trend, with increases of 9.8% and 7.1%, respectively. Uncertainty surrounding future inflation may result in a slowdown in the activity level and thus reduce economic growth. A return to a high inflation environment would also undermine Argentina's foreign competitiveness by diluting the effects of the peso devaluation, with negative effects on the level of economic activity and employment. Sustained inflation in Argentina, without a corresponding increase in the price of our products in the local market, would have a negative effect on our results of operations and financial position. The variability of inflation in Argentina makes it impossible to estimate with a reasonable degree of certainty how our activities and results of operations will be affected in the future.

Argentina has imposed exchange controls in recent periods that may impair our ability to service our foreign currency-denominated debt obligations and pay dividends.

After December 2001, Argentine authorities implemented a number of monetary and currency exchange control measures that included restrictions on the withdrawal of funds deposited with banks, the obligation to deposit with the Argentine Central Bank foreign currency from exports, restrictions on the transfers of funds abroad as well as restrictions relating to the servicing of foreign debt. The Central Bank has since issued a number of regulations aimed at gradually normalizing the domestic exchange market and, as a result, most restrictions in connection with the repayment of foreign creditors and the payment of dividends to foreign shareholders have been lifted.

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We cannot assure you as to how long these more flexible regulations will be in effect or whether they will become more restrictive again in the future. If the Argentine government decides further to tighten the restrictions on the transfer of funds, we may be unable to make principal or interest payments on our debt when they become due or to pay dividends.

On June 9, 2005, the Federal Executive Branch issued Executive Order No. 616/05, requiring that any repayment obligation related to proceeds derived from foreign loans to private Argentine entities (such as ourselves) must have a maturity of at least 365 days from the date of receipt of such proceeds. In addition, 30% of the amount of the relevant proceeds must be deposited with domestic financial institutions. Such deposit must (1) be registered, (2) be non-transferable, (3) be non-interest bearing, (4) be made in U.S. dollars, (5) have a term of 365 days and (6) not be used as security or collateral in connection with other credit transactions. Export and import financing and primary public offerings of debt securities listed on self-regulated markets are exempt from the foregoing provisions.

This Executive Order may limit our capacity to finance our operations through new intercompany loans or other kinds of foreign financial loans.

Limits on exports of hydrocarbons and related oil products have affected and may continue to affect our results of operations.

In recent periods, Argentina has faced difficulties in satisfying its domestic energy needs. As a result, the government has enacted a series of measures limiting the export of hydrocarbons and related oil products.

On May 23, 2002, the Argentine government enacted Executive Order No. 867/02 declaring a state of emergency in the supply of hydrocarbons in Argentina until September 30, 2002 and empowering the Secretary of Energy to determine the volumes of crude oil and liquefied petroleum gas produced in Argentina that should be used to supply the domestic market and be sold in the local market.

In March 2004, the Secretary of Energy issued Resolution No. 265/04, which authorizes the imposition of limits on natural gas exports. This resolution instructs the Undersecretary of Fuels to create a program for the rationing of gas exports and for the regulation of the use of gas transportation capacity. Temporary limits on certain natural gas exports have been imposed under the program to avoid a crisis in the local supply of natural gas. In April 2004, in order to facilitate the recovery of natural gas prices, the Secretary of Energy entered into an agreement with natural gas producers requiring them to sell a specified amount of gas in the local regulated market to the different segments of demand (distribution companies, CNG, thermal plants and industry). This agreement has been extended for four months after its original termination date of December 2006. Although a new agreement among natural gas producers was expected, as of the date of this Annual Report, no agreement has yet been reached. Therefore, the Secretary of Energy is expected to determine the new specified amount of gas directed to the local market and the conditions under which the gas will be sold.

Furthermore, in December 2006, pursuant to Resolution No.1886, the Secretary of Energy ratified that gas natural exports are subject to an adequate supply to meet domestic demand and that exports will be subject to the prior authorization, on a case-by-case basis, of the Executive Branch, with the Secretary of Energy having the discretion to approve or deny export applications.

During 2005 and 2006, the Secretary of Energy requested producers to redirect gas for export to supply thermal plants and gas distribution companies. This decision limited our total gas export volumes by a daily average of about 110 thousand cubic meters and 339 thousand cubic meters, respectively, depriving us of the higher margins offered by export prices. See [Business Overview](#) [Regulation of Our Businesses](#) [Argentine Regulatory Framework](#) [Natural Gas](#) for further details.

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Pursuant to Resolution No.1679/04, enacted in December 2004, producers must obtain the approval of the Argentine government prior to exporting crude oil or diesel oil. To obtain this approval, exporters must demonstrate that they have either satisfied local demand requirements or have granted the domestic market the opportunity to acquire oil or diesel oil under terms similar to current domestic market prices and, in the case of diesel oil, they must also demonstrate, if applicable, that commercial terms offered to the domestic market are at least equal to those offered to their own gas station network. Furthermore, in December 2006, pursuant to Resolution No.1338/06, the Secretary of Energy extended these regulations to the export of gasoline, fuel oil, jet fuel, lubricants, asphalts, coke and by-products for use in the petrochemical industry. See [Business Overview](#) [Regulation of Our Businesses](#) [Argentine Regulatory Framework](#) [Petroleum Refining](#) .

We cannot assure you that the Argentine government will not increase export restrictions on hydrocarbons and related oil products. If it were to do so, our results of operations could be adversely affected.

Export taxes on our products have negatively affected, and may continue to negatively affect, the profitability of our operations.

In order to discourage exports, secure domestic supply and fix a reference price for crude between producers and refineries, on March 1, 2002, the Argentine government imposed, for a five-year term, a 20% tax on exports of crude oil and a 5% tax on exports of certain oil related products. In May 2004, taxes on exports of crude oil and LPG increased to 25% and 20%, respectively, and a 20% tax was levied on exports of natural gas. Effective August 4, 2004, the Argentine government increased taxes on exports of crude oil by 25% when the price per barrel is U.S.\$32 or lower and applied additional incremental taxes ranging between 3% and 20% when the price per barrel of oil ranges between U.S.\$32.01 and U.S.\$45, with a cap set at 45% when the price exceeds U.S.\$45. In 2006, the Argentine government increased taxes on natural gas exports to 45% of the price of gas imported from Bolivia. See [Analysis of the Consolidated Results of Operations](#) [Factors Affecting our Consolidated Results of Operations](#) [Argentine Economic Situation](#) [Price Stabilization and Supply](#) [Hydrocarbons](#)

This tax regime has prevented us from fully benefiting from the significant increases in international oil, oil products and natural gas prices.

We cannot assure you that the Argentine government will reduce the current export tax rates or will not increase them further. We do not know the government's future intentions in regard to export taxes. As a consequence, we cannot predict the impact that any changes may have on our results of operations.

Price controls have affected, and may continue to affect, our results of operations and capital expenditures.

For purposes of reducing inflationary pressures generated by the sharp Argentine peso devaluation in 2002, the Argentine government issued a set of regulations aimed at controlling the increase in prices to end users. These regulations were particularly focused on the energy sector. See [Regulation of our Businesses](#) .

Gas and electricity

Pursuant to the Public Emergency Law, we were precluded from increasing the price of the gas and electricity sold in the domestic market. This limitation, within the context of the peso devaluation and subsequent inflation, resulted in a substantial change in the economic and financial balance of our energy and gas-related businesses, significantly affecting our operating results and prospects.

In April 2004, we, along with the remaining gas producers, entered into an agreement with the Argentine government, which provides for a schedule of gradual increases in gas prices in the domestic market, that culminates in complete deregulation of the wellhead price of natural gas by 2007.

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With respect to electricity generation, in December 2004, the Secretary of Energy agreed to approve successive seasonal electricity price increases to reach values covering at least total monomic costs by November 2006. However, this situation was not reflected in practice and price increases do not account for costs actually incurred in terms of generation. In addition, as soon as the market returns to normal following the start of commercial operations of the new generation capacity derived from the FONINVEMEM, the Secretary of Energy has committed to pay for energy at the marginal price obtained in the spot market and to pay for power capacity at the U.S. dollar values that were in effect prior to the enactment of the Public Emergency Law. Nevertheless, the abovementioned discrepancy between seasonal electricity prices and total monomic costs could lead to a new deficit in the Stabilization Fund which may have an impact on future collections in a way similar to that of the period 2001-2006. See *Analysis of the Consolidated Results of Operations Factors Affecting our Consolidated Results of Operations Argentine Economic Situation Price Stabilization and Supply*.

Through these combined measures, the Argentine government is expected to gradually restore the economic and financial balance in the natural gas and electricity sectors. Our results and capital expenditure plans, however, may be adversely affected if (1) the agreed schedule of increases in natural gas prices or the commitments with respect to electricity price increases fail to be fully implemented by the Argentine government or (2) the government applies its regulatory emergency authority or adopts other regulations to control prices or supply.

Downstream margins

The downstream business in Argentina has been and may continue to be subject to extensive regulatory changes that affect prices and profitability, and these changes had and may continue to have an adverse effect on the results of our operations.

Downstream margins have significantly declined since the enactment of the Public Emergency Law. As part of its effort to control inflation, the Argentine government has limited the increase in prices of gasoline and diesel oil at the retail level that would have resulted from (1) higher costs due to increases in the West Texas Intermediate Crude reference price, or WTI, (2) the peso devaluation and (3) domestic inflation. These measures affected the sector's profitability.

In line with Argentine macroeconomic indicators and the economic recovery started in 2003, in 2006 the fuel oil market grew for the third year in a row. Total sales volumes increased 8.1% in 2006. Sales of diesel oil grew 5.9%, boosted by the strong demand from the agricultural, industrial and transport sectors, and the domestic gasoline sales totaled 4.3 million cubic meters, in 2006, 16% more than in 2005. In terms of supply, refining units in Argentina are operating at levels very close to the maximum installed capacity. The lack of elasticity in supply could result in temporary shortages.

Since this situation might hinder the evolution of the Argentine economy, regulatory framework changes led refining companies to take all actions necessary to meet the growing demand for diesel oil, including import of the product. In addition, in October 2006, the Secretary of Domestic Trade issued Resolution No. 25, which provided that refining companies are obliged to cover the total market demand for diesel oil with a minimum calculated on the basis of previous year's demand plus an estimated market variation. In order to comply with this resolution, we were required to import 85 thousand cubic meters of diesel oil during the year. Considering the differential between import and retail prices and the impossibility of passing it through to consumers, imports of diesel oil have resulted in significant losses to refining companies. Specifically, in 2006 and 2005 we posted P\$38 million and P\$82 million losses in relation to import operations.

In the future, and subject to the production capacity of our plants and the actual market growth, pursuant to Resolution No.25, we may be required to import additional diesel oil volumes, which may adversely impact our results of operations.

Table of Contents***The Argentine government and our affiliated utility companies are in the process of renegotiating utility contracts, and the recovery of these affiliates depends on the successful completion of these negotiations.***

The macroeconomic state of the country after the enactment of the Public Emergency Law impacted the economic and financial balance of utility companies in Argentina. The combined effect of (1) the peso devaluation, (2) the pesification of rates on a one-to-one basis and (3) financial debts primarily denominated in foreign currency, adversely affected the utility companies' financial position, results of operations and ability to satisfy financial obligations and pay dividends. Although some of these utility companies have been successful in restructuring their indebtedness, their return to financial stability and profitability on a long-term basis depends on a successful negotiation of tariff increases with the Argentine government. UNIREN (the agency created by the Argentine government to, among other things, provide assistance in the utility renegotiation process, execute comprehensive or partial agreements with utility companies and submit regulatory projects related to provisional rate adjustments) is currently in the process of renegotiating contracts with our affiliates Edesur S.A. (Edesur), TGS, Transener and Empresa de Transporte de Energía Eléctrica por Distribución Troncal de la Provincia de Buenos Aires S.A. (Transba). These discussions are in different stages, and some of our affiliates have stated that UNIREN's latest proposals were not sufficient. See Business Overview Gas and Energy Gas Transportation TGS Regulated Energy Segment and Business Overview Gas and Energy Electricity Electricity Transmission: Transener, Yacylec and Enecor Transener and Regulation of Our Businesses Argentine Regulatory Framework Natural Gas .

We cannot assure you that these discussions will ultimately result in a level of tariff increases sufficient for our affiliated utility companies to return to financial stability and profitability in the near future and on a long-term basis.

Factors Relating to the Company***Substantial or extended declines in the prices of crude oil and related oil products may have an adverse effect on our results of operations and financial condition.***

A significant amount of our revenue is derived from sales of crude oil and related oil products. We do not and will not have control over factors affecting international prices for crude oil and related oil products. These factors include: political developments in crude oil producing regions; the ability of the Organization of Petroleum Exporting Countries (OPEC) and other crude oil producing nations to set and maintain crude oil production levels and prices; global supply and demand for crude oil; competition from other energy sources; government regulations; weather conditions and global conflicts or acts of terrorism.

Changes in crude oil prices generally result in changes in prices for related oil products. International oil prices have fluctuated widely over the last ten years. In 2006, crude oil prices continued their upward trend, exceeding 2005 historical records. The WTI closed at U.S.\$60.8 per barrel, with an average of U.S.\$66 per barrel during the year. During 2005 and 2004 the average WTI was U.S.\$56.6 and U.S.\$41.5 per barrel, respectively, compared to an average of U.S.\$22.56 per barrel for the 1994-2003 period.

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 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 account for 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. with prices and costs as of the estimate date). Our proved crude oil and natural gas reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Our reserve estimates have been audited by Gaffney, Cline & Associates, an international technical consulting firm for the oil and gas industry. As of December 31, 2006, the audit covered 93% of the Company's estimated reserves for 2006. See Business Overview Oil and Gas Exploration and Production - Reserves for more information about our reserve estimates and the related audit process. Crude oil and natural gas reserves are reviewed annually taking into consideration many factors, including:

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new production or drilling activities;

field reviews;

the addition of new reserves from discoveries or extensions of existing fields;

changes in the international prices of oil and gas;

the application of improved recovery techniques; and

new economic conditions.

Proved reserve estimates could be materially different from the quantities of crude oil and natural gas that are ultimately recovered, and downward revisions of our estimates could impact in the future our results of operations and business plan, including our level of capital expenditures.

We may not be able to replace our oil and gas reserves and this may have an adverse impact on our future results of operations and financial position.

In recent years, we have experienced a decline in reserves and production. The possibility to replace our crude oil and gas reserves in the future is dependent on our ability to access new reserves, both through successful exploration and reserve acquisitions. We consider exploration, which carries inherent risks and uncertainties, the main vehicle for future growth and reserve replacement.

We have limited capital resources to implement an ambitious capital expenditure program. Moreover, we face strong competition in bidding for new production blocks, especially those blocks with the most attractive crude oil and natural gas reserves.

Without successful exploration activities or reserve acquisitions, our proved reserves will decline as our oil and gas production will be forced to rely on our existing proved developed reserves.

The decline in reserves and production may limit the integration of our upstream and downstream operations, since, in order to maximize the volumes of crude oil processed in our refineries, we would require a greater supply of crude oil from third parties, including imports.

We cannot guarantee that our exploration, development and acquisition activities will result in significant additional reserves. If we are not able to successfully find, develop or acquire additional reserves, our reserves and therefore our production may continue to decline and, consequently, may adversely affect our future results of operations and financial position.

Production of oil in Block 31 in Ecuador may be delayed significantly.

Block 31 is principally located in the Yasuní National Park, a highly ecologically sensitive area in the Amazon region of Ecuador (an area included in the National Heritage of Natural Areas and Protective Woods and Vegetation). Indigenous associations, NGOs and environmental groups have made public demonstrations against the development of Block 31 arguing that hydrocarbon activities would endanger the Park's biodiversity.

On July 7, 2005, the Ministry of the Environment decided not to authorize the beginning of certain construction works on the Tiputini River (boundary of Parque Nacional Yasuní) and denied us access to Parque Nacional Yasuní. Petrobras Energía changed the Development Plan for Block 31 in order to address the objections posed by the Ecuadorian Ministry of the Environment and ultimately, after a process involving participation of the affected communities, submitted a new Environmental Impact Assessment (EIA). The new EIA was approved by the Ministry of the Environment and the Ministry of Energy and Mines, and the issuance of a new environmental license to resume development works in Block 31 was officially requested on January 4, 2007. All relevant formalities have been completed in connection with this request, and the request for a license is awaiting approval by the Ecuadorian Minister of the Environment.

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We cannot predict when or to what extent competent authorities will ultimately authorize us to commence planned works to develop the block. Further delays in the development of Block 31 could have an adverse impact on our results of operations and financial position, in light of our Ship or Pay obligations pursuant to a transportation agreement executed with OCP, under which we must fulfill our contractual obligations for the total volume committed even if no crude oil is transported.

Our operations could be adversely affected by events beyond our control

Our activities are subject to numerous risks, many of which are beyond our control. Our operations may be curtailed, delayed, interrupted or canceled as a result of weather conditions, mechanical difficulties, shortages or delays in the delivery of equipment, coercive actions and compliance with governmental requirements, events that could adversely impact our costs of production, results of operation and financial position. For example, from March 9, 2007 to April 10, 2007, operations in Block 18 were curtailed as a result of coercive actions taken by local communities. During this period, cumulative oil production decreased by approximately 305,000 barrels of oil equivalent in our participation.

Our activities may be adversely affected by events in countries in which we do business.

Our operations are concentrated in Latin America, a region that has experienced significant economic, social, political and regulatory volatility. In recent periods, many governments in Latin America have taken steps to assert greater control or increase their share of revenues from the energy sector, spurred by soaring oil and gas prices and nationalistic politics. See Regulation of our Businesses Venezuelan and Ecuadorian Regulatory Framework Petroleum and Gas .

These steps have included:

Venezuela

In March 2006, Petrobras Energía, through its controlled and affiliated companies in Venezuela, entered with PDVSA and Corporación Venezolana de Petróleo S.A. (CVP) into memoranda of understanding (MOUs) in order to effect the migration of the operating agreements in the areas of Oritupano Leona, La Concepción, Acema and Mata. These MOUs established that private investors would hold a 40% share in these mixed-owned companies, with the Venezuelan Government being entitled to a 60% ownership interest. As a result, the direct and indirect interests of Petrobras Energía in the mixed-owned companies that would operate the areas of Oritupano Leona, La Concepción, Acema and Mata would be 22%, 36%, 34.5% and 34.5%, respectively. The MOUs establish that CVP will recognize a divisible and freely transferable credit in favor of Petrobras Energía in the amount of U.S.\$88.5 million. These credits will not bear interest and may be used only for the payment of acquisition bonds under any new mixed company project for the development of oil exploration and production activities in Venezuela or licenses for the development of gas exploration and production operations, in Venezuela.

In August 2006, the relevant conversion agreements were signed for the Oritupano Leona, La Concepción, Acema and Mata areas, which were consistent with the terms agreed in the MOUs. Subsequently, the companies Petroritupano S.A., Petrowayú S.A., Petrovenbras S.A. and Petrokariña S.A. were organized and registered with the Public Registry of Commerce of Venezuela. The Venezuelan government has issued the relevant decrees granting the necessary powers to these four companies, and the respective shareholders subsequently made the required capital contributions See Business Overview Oil and Gas Exploration and Production Oil and Gas Exploration and Production Interest Production Production outside of Argentina Venezuela .

The MOUs established that the economic effects of the migration would become effective on April 1, 2006. From this date to October the fields were under the management of a provisional executive committee formed primarily by PDVSA. Since October the fields have been under the management of the mixed companies themselves. From April to December mixed companies have been financed by Petrobras Energía Venezuela and the other members of the consortiums.

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In view of the new contractual framework, as of December 31, 2005, we recognized impairment charges of P\$424 million to adjust the book value of our assets in Venezuela to their estimated recoverable values.

Bolivia

In May 2006, the Bolivian government enacted Supreme Decree No. 28,701, which provides, among other things, for the nationalization of hydrocarbon resources in Bolivia. This decree provides that, as from May 1, 2006, oil companies must deliver to Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) the property of all hydrocarbon production for sale. Oil companies had a 180-day transition period to subscribe the new agreements, which would be individually authorized and approved by the Bolivian Congress. The Ministry of Hydrocarbons and Mines would determine, on a case-by-case basis, the interest in each field corresponding to oil companies by means of audits of investments, operational costs and profitability indicators.

Accordingly, in October 2006, our Bolivian branch signed with YPFB a new agreement for the Colpa Caranda area. See Business Overview Oil and Gas Exploration and Production Oil and Gas Exploration and Production Interests Production Production outside of Argentina Bolivia .

In addition, Supreme Decree No.28,701 provides that the Bolivian government shall recover full participation in the entire oil and gas production chain and to that end provides for the nationalization of the shares of stock necessary for YPFB to have at least 50% plus one of the shares in a number of companies, among which is Petrobras Bolivia Refinación S.A., our affiliate in Bolivia. Such stock transfer will be made once both parties have agreed on the economic compensation YPFB will pay us and once certain corporate and legal requirements have been complied with.

We are not able to estimate the effects of the new law on Petrobras Bolivia Refinación S.A..

Ecuador

In April 2006, the Ecuadorian government approved the Oil & Gas Reform Law, which assigns to the government an interest of at least 50% of the excess revenues resulting from the increase in the price of Ecuadorian crude (effective monthly average price of FOB price) over the average monthly sales price of such oil at the execution date of the relevant production agreement, expressed in constant values for the month in which settlement occurs. In July 2006, the competent authorities published the relevant regulations implementing the law, and subsequently Ecuadortlc and Petroecuador expressed divergent interpretations of the regulations.

In order to resolve these differences and after the request of Ecuadortlc, Petroecuador asked the Attorney General to issue an opinion on this matter. In the meantime, Ecuadortlc paid U.S.\$12 million in aggregate to Petroecuador, which payments correspond to amounts purportedly owed to the Ecuadorian Government under the new law. In October 2006, Ecuadortlc was informed that the Attorney General's opinion exempted the income derived from the Palo Azul field from the scope of application of the new law, given that the development agreement for Palo Azul contains provisions under which the Ecuadorian Government receives more than 50% of the benefits.

Notwithstanding the Attorney General's opinion, in January 2007, Petroecuador submitted a claim to Ecuadortlc in favor of the government for U.S.\$26 million in respect of the benefits corresponding to the government under the new law from April 2006 to December 2006. In its counsel's opinion, Ecuadortlc has legal grounds to consider this claim as invalid. Although Ecuadortlc is of the view that it has valid legal grounds not to make payments under the new law, as of December 31, 2006, Ecuadortlc maintained an allowance of P\$37 million (U.S.\$12 million) on receivables in respect of such payments.

On February 15, 2007, Ecuadortlc paid the remaining amount of Petroecuador's claim (U.S.\$14 million), reserving its right to seek reimbursement.

These measures, and any other similar measures taken in the future by governments in countries where we conduct business, have had and may have a material adverse effect on our business and results of operations.

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Our operations run the risk of causing environmental damage, and any changes in environmental laws may increase our operational costs.

Some of our operations are subject to environmental risks that may arise unexpectedly, and result in material adverse effects on our results of operations and financial position. In 2006, 2005 and 2004, environmental remediation costs charged to income totaled P\$5 million, P\$29 million and P\$51 million, respectively. We may have to incur additional costs related to the environment in the future, which may negatively impact our results of operations.

In addition, we are subject to extensive environmental regulation both in Argentina and in the other countries in which we operate. Local, provincial and national authorities in Argentina and the other countries where we operate are moving towards more stringent enforcement of present or future environmental laws, which may require us to incur higher compliance costs. We cannot predict what additional environmental legislation or regulations will be enacted in the future or the potential effects on our financial position and results of operations.

Item. 4 INFORMATION ABOUT THE COMPANY

OUR HISTORY AND DEVELOPMENT

Our History

We are a holding company that operates exclusively through our subsidiary Petrobras Energía and its subsidiaries, which are engaged in oil and gas exploration and production, refining and distribution, petrochemicals and gas and energy. We conduct operations in Argentina, Bolivia, Brazil, Colombia, Ecuador, Mexico, Peru, and Venezuela. We are a corporation organized and existing under the laws of the Republic of Argentina with a duration of 99 years from the date of our incorporation, September 25, 1998. Our legal name is Petrobras Energía Participaciones S.A. and we are known commercially as Petrobras Energía Participaciones. Our principal executive offices are located at Maipú 1, 22nd Floor, C1084ABA Buenos Aires, Argentina, Telephone: 54 11 4344-6000. Our process agent in the U.S. is CT Corporation System, located at 111 Eighth Avenue, New York, New York 10011.

Our original name was PC Holdings S.A. We were formed in 1998 for the sole purpose of owning shares of Petrobras Energía, and both we and Petrobras Energía were controlled at the time by members of the Perez Companc family. As of December 31, 1999, we owned 28.92% of Petrobras Energía's common stock.

We acquired control of Petrobras Energía on January 25, 2000 as a result of the consummation of an exchange offer pursuant to which we issued 1,504,197,988 Class B shares, with one vote per share, in exchange for 69.29% of Petrobras Energía's outstanding capital stock, thereby increasing our ownership interest in Petrobras Energía to 98.21%. Since January 26, 2000, our Class B shares have been listed on the Buenos Aires Stock Exchange and our American Depositary Shares, each representing ten Class B shares, have been listed on the New York Stock Exchange. In July 2000, we completed the change in our corporate name from PC Holdings S.A. to Perez Companc S.A.

On October 17, 2002, Petrobras Participaciones, S.L., or PPSL, a wholly owned subsidiary of Petrobras, acquired from the Perez Companc family and Fundación Perez Companc their entire ownership interest, or 58.6%, in our capital stock. Petrobras is a Brazilian company whose business concentrates on exploration, production, refining, sale and transportation of oil and by-products in Brazil and abroad. Petrobras is a mixed-capital company with a majority of its voting capital owned by the Brazilian federal government.

On April 4, 2003, at a regular and special shareholders' meeting, shareholders approved the change of our corporate name to Petrobras Energía Participaciones S.A. from Perez Companc S.A. On the same date, shareholders of Pecom Energía S.A., or Pecom, approved the change of its name to Petrobras Energía S.A.

On January 21, 2005, the special shareholders' meetings of Petrobras Energía, EG3 S.A., or EG3, Petrobras Argentina S.A., or PAR, and Petrolera Santa Fe SRL, or PSF, approved the merger of EG3, PAR and PSF into Petrobras Energía effective January 1, 2005. As result of the merger our interest in Petrobras Energía decreased to 75.82% from 98.21%.

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History of Petrobras Energía

Petrobras Energía was founded in 1946 as a shipping company by the Perez Companc family. In 1960, Petrobras Energía began servicing oil wells and, over time, its maritime operations were gradually discontinued and replaced by oil-related activities. Petrobras Energía has become one of the largest oil and gas producers in Argentina.

Since 1994, when Petrobras Energía was awarded an exploration and production service contract for the Oritupano Leona area in Venezuela, Petrobras Energía has expanded its operations outside Argentina. Currently Petrobras Energía conducts operations in Venezuela, Peru, Ecuador, Brazil, Bolivia, Colombia and Mexico as part of its strategy to become a leading integrated energy company with an international presence.

Petrobras Energía developed its other energy businesses primarily through the acquisition of interests in state-owned companies that were privatized by the Argentine government between 1990 and 1994. Petrobras Energía acquired interests in companies operating in refining and petrochemicals, hydrocarbon transportation and distribution and power generation, transmission and distribution. These companies have formed the core of Petrobras Energía's energy businesses.

In addition to the energy sector, Petrobras Energía has in the past conducted operations in other industries, including construction, telecommunications, forestry and mining. These businesses were sold by Petrobras Energía as part of Petrobras Energía's strategy to focus its operations on the energy sector. As a result of these divestitures and the development of Petrobras Energía's energy businesses, Petrobras Energía has become a vertically integrated energy company.

Petrobras Energía Merger

On January 21, 2005, the Special Shareholders' Meetings of Petrobras Energía, EG3, PAR, and PSF, approved the merger of EG3, PAR and PSF into Petrobras Energía. Prior to the merger, Petrobras, through its subsidiary PPSL, held a 99.6% interest in EG3 and a 100% interest in each of PAR and PSF. Subsequently, on March 3, 2005 the definitive merger agreement was executed. On June 28, 2005, the CNV approved the merger and authorized the public offering of the Petrobras Energía shares. On September 16, 2005, the merger was registered in the Public Registry of Commerce. The effective merger date was set at January 1, 2005: as from this date all assets, liabilities, rights and obligations of the absorbed companies are considered incorporated into Petrobras Energía. After the merger, Petrobras Energía is the surviving entity. Pursuant to the merger, PPSL received 229,728,550 newly issued Class B shares of Petrobras Energía, representing 22.8% of Petrobras Energía's capital stock. As a result of the merger, our ownership interest in Petrobras Energía decreased from 98.21% to 75.82%.

Through this merger, Petrobras Energía enlarged its oil and gas assets with the incorporation of six fields (a gas field in the Noroeste Basin and five crude oil fields in the Neuquén, San Jorge and Cuyana Basins). As of December 31, 2004, these areas had an aggregate production volume of approximately 19,000 barrels of oil equivalent per day and proved reserves of 95 million barrels of oil equivalent. Petrobras Energía also incorporated the Bahía Blanca refinery and a wide network of gas stations (approximately 620) throughout the country, that operate under the Petrobras and EG3 brands.

Petrobras Energía recorded the effects of the merger under the pooling of interests method. According to this method, the assets, liabilities and shareholders' equity of the combining entities are recorded by the surviving entity according to the accounting measurements used by the combining entities on the effective date of the merger. In addition, according to the pooling of interest method, financial statements for previous years reflect the assets, liabilities, results and cash flows of the surviving entity as if the pooling of interests had occurred at the beginning of the earliest fiscal year presented.

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Accordingly, this Annual Report presents information for the year ended as of December 31, 2004, assuming that the merger of EG3, PAR and PSF into Petrobras Energía had occurred on January 1, 2004.

Capital Expenditures and Divestitures

For a description of our capital expenditures see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources . For a description of our most significant divestitures see Item 5. Operating and Financial Review and Prospects Factors Affecting Our Consolidated Results of Operations Divestment of Assets and Divestments of Non-Core Assets .

BUSINESS OVERVIEW

Our Strategy

Our long-term strategy is to grow as an integrated energy company with an international presence, while focusing on profitability as well as social and environmental responsibility.

The main points of this strategy are:

Increasing oil and gas reserves and production in Argentina and Latin America, to secure sustainable growth.

Growing downstream in Argentina, while balancing the crude production refining logistics distribution chain and differentiating ourselves through the quality of our products and services.

Developing businesses in the gas and energy areas that will allow for the best overall use of our gas reserves.

Consolidating our leading position in the regional petrochemicals market, by maximizing the use of our raw materials.

Using capital in a disciplined manner, with a view to optimizing our debt to capital ratio and maintaining our financial solvency.

In order to adhere to this strategy, we consider the following to be essential:

A commitment to protect the quality of our goods and services, the environment and the health and safety of our employees, contractors and neighboring communities.

Adoption of, and compliance with, corporate governance practices in line with recognized best practices.

Maintenance of a management style that favors communication and teamwork, fostered by the value of the people that work in our organization.

Developing new business opportunities by maximizing potential synergies and capitalizing on complementary business opportunities with Petrobras.

We currently manage our activities, with the support of corporate staff, in four business segments: (1) Oil and Gas Exploration and Production, (2) Gas and Energy, (3) Refining and Distribution, and (4) Petrochemicals.

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Our Principal Market

We are an Argentine corporation and, as of December 31, 2006, 59% of our total assets, 71% of our net sales, 62% of our combined oil and gas production and 53% of our proved oil and gas reserves were located in Argentina. Fluctuations in the Argentine economy and actions adopted by the Argentine government have had and may continue to have a significant effect on Argentine private sector entities, including us. Specifically, we have been affected and may be affected by inflation, interest rates, the value of the peso against foreign currencies, price controls, business regulations, tax regulations and in general by the political, social and economic environment in and affecting Argentina and other countries. See Risk Factors Factors Relating to Argentina .

The Argentine economy has experienced significant volatility in recent decades, characterized by periods of low or negative growth and high and variable levels of inflation and currency devaluation. In 1988, 1989 and 1990, the annual inflation rates were approximately 388%, 4,924% and 1,344%, respectively, based on the Argentine consumer price index and approximately 422%, 5,386% and 798%, respectively, based on the Argentine wholesale price index. As a result of inflationary pressures, the Argentine currency was devalued repeatedly during the 1960s, 1970s and 1980s. Macroeconomic instability led to broad fluctuations in the real exchange rate of the Argentine currency relative to the U.S. dollar. To address these pressures, the Argentine government implemented various plans and utilized a number of exchange rate systems and controls.

In April 1991, the Argentine government launched a plan aimed at controlling inflation and restructuring the economy, and enacted the Convertibility Law. The Convertibility Law fixed the exchange rate at one peso per U.S. dollar and required that the Central Bank maintain reserves in gold and foreign currency at least equivalent to the monetary base. Following the enactment of the Convertibility Law, inflation declined steadily and the economy experienced growth through most of the period from 1991 to 1997. In the fourth quarter of 1998, however, the Argentine economy entered into a recession that caused the gross domestic product to decrease by 3.4% in 1999, 0.8% in 2000 and 4.4% in 2001.

Beginning in the second half of 2001, Argentina's recession worsened significantly. As the public sector's creditworthiness deteriorated, interest rates reached record highs, bringing the economy to a virtual standstill. The lack of confidence in the country's economic future and its ability to sustain the peso's parity with the U.S. dollar led to a massive withdrawal of deposits from banks and capital outflows. To prevent further capital flights, on December 1, 2001, the Argentine government implemented a number of monetary and exchange control measures which further paralyzed the economy and caused a sharp rise in social discontent, ultimately triggering public protests, outbreaks of violence and the looting of stores throughout Argentina.

On December 20, 2001, after declaring a state of emergency and suspending civil liberties, President Fernando de la Rúa tendered his resignation to Congress. After a series of interim presidents, on January 1, 2002, Eduardo Duhalde was appointed by Congress at a joint session to complete the remaining term of former President de la Rúa. The new president, among other measures, ratified the suspension of payment of a portion of Argentina's sovereign debt declared by Interim President Rodríguez Saá.

On January 6, 2002, the Argentine Congress enacted the Public Emergency Law, which introduced dramatic changes to Argentina's economic model and put an end to the U.S. dollar-peso parity established since the enactment of the Convertibility Law in 1991, leading to a significant devaluation of the Argentine peso. The Public Emergency Law also empowered the Federal Executive Branch of Argentina to implement, among other things, additional monetary, financial and exchange measures to overcome the economic crisis in the short term, such as determining the rate at which the peso was to be exchanged into foreign currencies.

The Federal Executive Branch implemented a number of far-reaching initiatives, which included:

- Pesification of certain assets and liabilities denominated in foreign currency and held in the country;

- Amendment of the charter of the Central Bank authorizing it to issue money in excess of the foreign currency reserves, grant short-term loans to the federal government and provide financial assistance to financial institutions with liquidity or solvency problems;

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Pesification and elimination of indexing clauses on utility rates, fixing those rates in pesos at the P\$1=U.S.\$1 exchange rate; and

Implementation of taxes on hydrocarbon exports and certain oil products, among others.

In 2002, our financial results were negatively impacted by significant political and economic changes that resulted from the severe crisis that broke out in Argentina late in 2001. Due to high level of institutional instability, which included social conflicts, the default on most of Argentina's sovereign debt, the abandonment of convertibility, the freeze on and rescheduling of banking deposits, the pesification and the elimination of indexation on utility rates and, in general, active intervention by the government in the development of the economy, commercial and financial activities were virtually paralyzed in 2002, further aggravating the economic recession, which included a 10.9% decline in GDP. In addition, as a consequence, the peso devalued 238% against the dollar, the wholesale price index rose 118.2% and the consumer price index increased 41%. Towards the end of 2002, the Argentine government implemented different measures aimed at stimulating the economy and abrogating certain restrictions to gradually normalize the foreign exchange market and the commercial and financial flow of foreign currency.

In September 2003, Argentina and the IMF entered into a three-year standby credit agreement. This new agreement guaranteed the refinancing of all principal maturities of credit facilities granted by multilateral agencies. The agreement specified a series of quantitative and qualitative conditions to be met by the Argentine government during the 2003-2004 period.

In 2003 and 2004, the Argentine economy continued to exhibit signs of stability. Real GDP grew 8.7% and 9.0%, respectively. In 2003, the peso appreciated significantly against the U.S. dollar, as the Central Bank made numerous currency purchases to attempt to maintain a high rate of exchange. Inflation was below 4% during 2003. In 2004, both inflation and the peso nominal exchange rate were stable, with 6.1% and 7.9% increases in the consumer price and wholesale price indexes, respectively, while the peso devaluated 1.3%. During 2005, Argentina experienced high growth rates. Real GDP growth was 9.2% for the year. After three years of growth at around 9%, the Argentine economy was able to surpass the levels recorded in 1998, before the crisis. Argentine exports hit a historic record of U.S.\$40 billion, although it was not enough to keep the trade surplus of the last years due to increased imports (around 30%). In line with the explicit decision of the government to maintain a stable exchange rate between the U.S. dollar and the peso, the Central Bank systematically intervened in the foreign exchange market to prevent the Argentine peso from appreciating. Furthermore, in 2005, inflation notably accelerated and reached 12.3% for retail prices and 10.8% for wholesale prices. In 2005, the administration was able to restructure the government debt in default (76% of creditors accepted the government's exchange proposal) with a significant nominal reduction in principal amount, a term extension and a reduction in interest coupons. It also called for the first debt auction after the default. These factors, together with an international favorable climate, helped reduce the country risk to an annual average of 450 basis points (Boden 2012).

In 2006, and for the fourth consecutive year, Argentina experienced high growth rates. Real GDP grew approximately 8.5%, especially in terms of investments, and even more significantly in terms of construction and consumption, boosted by a sizeable increase in credit and the recovery of wages in real terms. Industrial production recorded a growth slightly below the rate of GDP growth with several industrial sectors increasingly making use of their installed capacity. The Argentine Government addressed inflationary pressures through a wide range of sectoral agreements and specific actions that prevented the official rate of inflation from exceeding 10%. Adjustments to utility rates were postponed.

Excess supply of foreign currency continued as a result of the large surplus in the balance of trade, with record exports notwithstanding the strong growth in imports and significant capital flows favored by high liquidity worldwide. As in previous years and in line with the official strategy of maintaining a high rate of exchange, the Central Bank bought the excess supply of dollars and adopted several other actions in accordance with the goals of the monetary program. International reserves were approximately U.S.\$32 billion dollars at year-end, notwithstanding the advance payment of approximately U.S.\$10 billion in debt to the IMF at the beginning of the year with freely available reserves.

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OIL AND GAS EXPLORATION AND PRODUCTION

Overview

The core of our operations is the oil and gas exploration and production business segment, as it is a key link in our business chain. The business segment's strategy is to increase oil and gas reserves and production in Argentina and other countries in Latin America, in order to secure our sustainable growth. In line with this strategy, our business goals are:

Increasing oil and gas production and reserves by capitalizing on our experience and presence in nearly all Latin American oil producing countries;

Optimizing our investment portfolio by balancing exploration projects with development projects; and

Performing efficient operations under high safety and environmental care standards.

We currently participate in oil and gas exploration and production activities in Argentina, Venezuela, Peru, Ecuador, Bolivia and Colombia. In addition, we act as contractor and provide technical and operating support in Mexico.

As of December 31, 2006, our combined crude oil and natural gas proved reserves, including our share of the reserves of our unconsolidated investees, were estimated at 527.2 million of oil equivalent, approximately 56.4% of which were proved developed reserves and approximately 43.6% of which were proved undeveloped reserves. Crude oil accounted for approximately 61.4% of our combined proved reserves, while natural gas accounted for about 38.6%. As of December 31, 2006, 53.2% of our total combined proved reserves were located in Argentina and 46.8% were located abroad.

During the year ended December 31, 2006, combined crude oil and natural gas production, including our share of the production of our unconsolidated investees, averaged 154,200 barrels of oil equivalent per day. Crude oil accounted for approximately 103,400 of barrels per day, while natural gas accounted for about 304,700 of cubic feet per day. Approximately 47.6% of our oil production and 17.9% of our gas production were produced outside of Argentina.

Integration with our Refining and Distribution business segment enables us to process a large part of our crude oil production in Argentina. The Genelba Thermal Power Plant, which we refer to as Genelba, allows us to use approximately 2.8 million cubic meters of natural gas per day of our own reserves. In addition, we supply gas to our Petrochemical and Refining operations in Argentina.

Our Oil and Gas Exploration and Production Interests

As is commonplace in the oil and gas exploration and production business, we generally participate in exploration and production activities in conjunction with joint venture partners. Contractual arrangements among participants in a joint venture are usually governed by an operating agreement, which provides that costs, entitlements to production and liabilities are to be shared according to each party's percentage interest in the joint venture. One party to the joint venture is usually appointed as operator and is responsible for conducting the operations under the overall supervision and control of an operating committee that consists of representatives of each party to the joint venture. While operating agreements generally provide for liabilities to be borne by the participants according to their respective percentage interest, licenses issued by the relevant governmental authority generally provide that participants in joint ventures are jointly and severally liable for their obligations to that governmental authority pursuant to the applicable license. In addition to their interest in field production, contractual operators are generally paid their direct administrative expenses on a monthly basis by their partners in proportion to their participation in the relevant field.

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As of December 31, 2006, we had interests in forty six blocks: twenty four oil and gas production blocks (sixteen in Argentina and eight outside of Argentina) and twenty two exploration blocks located within exploration areas or pending authorization for production (fifteen in Argentina and seven outside of Argentina). We are directly or indirectly the contractual operator of thirty two of the forty six blocks in which we have an interest.

As of December 31, 2006, our total gross and net productive wells were as follows:

| | Oil | Gas | Total |
|---------------------------------------|------------|------------|--------------|
| Gross productive wells ⁽¹⁾ | 5,585 | 323 | 5,908 |
| Net productive wells ⁽²⁾ | 3,913 | 213 | 4,126 |

(1) Refers to number of wells completed.

(2) Refers to fractional ownership working interest in gross wells.

As of December 31, 2006, our total producing and exploration acreage, both gross and net, was as follows:

| | Average | | | |
|-----------|--------------------------------|--------------------------|----------------------------------|---------------------------|
| | Producing⁽¹⁾ | | Exploration⁽²⁾ | |
| | Gross | Net⁽³⁾ | Gross | Net ⁽³⁾ |
| | (in thousands of acres) | | | |
| Argentina | 4,807 | 3,233 | 18,274 ⁽⁴⁾ | 6,639 ⁽⁵⁾ |
| Peru | 116 | 116 | 14,219 | 11,734 |
| Venezuela | 485 | 126 | 157 | 79 |
| Ecuador | 62 | 54 | 714 | 637 |
| Bolivia | 56 | 56 | | |
| Total | 5,526 | 3,585 | 33,364 | 19,089 |

(1) Includes all areas in which we produce commercial quantities of oil and gas or areas in the development stage.

(2) Includes all areas in which we are allowed to perform exploration activities but where

commercial quantities of oil and gas are not produced or areas that are not in the development stage.

(3) Represents our fractional ownership working interest in the gross acreage.

(4) Includes 14,300 thousand exploration acres in off-shore areas.

(5) Includes 4,138 thousand exploration acres in off-shore areas.

The following table sets forth the number of total wells we drilled in Argentina and outside of Argentina and the results for the relevant periods. A well is considered productive for purposes of the following table if it justifies the installation of permanent equipment for the production of oil or gas. A well is deemed to be a dry well if it is determined to be incapable of commercial production. Gross wells drilled in the table below refers to the number of wells completed during each fiscal year, regardless of the spud date, and net wells drilled relates to the fractional ownership working interest in wells drilled. This table includes wells drilled by both our consolidated subsidiaries and unconsolidated investees.

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| | Year ended December 31, | | | | | |
|-----------------------------|-------------------------|----------------------|-----------|----------------------|-----------|----------------------|
| | 2006 | | 2005 | | 2004 | |
| | Argentina | Outside of Argentina | Argentina | Outside of Argentina | Argentina | Outside of Argentina |
| Gross wells drilled: | | | | | | |
| Production: | | | | | | |
| Productive wells: | | | | | | |
| Oil | 218 | 60 | 256 | 85 | 275 | 45 |
| Gas | 3 | 2 | 7 | 2 | 5 | |
| Dry wells | 3 | | 2 | | 2 | 1 |
| Total | 224 | 62 | 265 | 87 | 282 | 46 |
| Exploration: | | | | | | |
| Discovery wells: | | | | | | |
| Oil | 5 | | 11 | | 3 | 1 |
| Gas | 6 | | | | | |
| Dry wells | 4 | 1 | | | | 1 |
| Total | 15 | 1 | 11 | | 3 | 2 |
| Net wells drilled: | | | | | | |
| Production: | | | | | | |
| Productive wells: | | | | | | |
| Oil | 100.4 | 57.4 | 110.7 | 75.2 | 131.1 | 35.2 |
| Gas | 0.6 | 1.0 | 2.9 | 1.0 | 2.8 | |
| Dry wells | 0.6 | | 1.7 | | 1.7 | 0.9 |
| Total | 101.6 | 58.4 | 115.3 | 76.2 | 135.6 | 36.1 |
| Exploration: | | | | | | |
| Discovery wells: | | | | | | |
| Oil | 1.7 | | 8.5 | | 2.0 | 2.0 |
| Gas | 3 | | | | | |
| Dry wells | 2 | 0.5 | | | | 0.7 |
| Total | 6.7 | 0.5 | 8.5 | | 2.0 | 2.7 |

Production*Argentine Production*

Our proved reserves in Argentina as of December 31, 2006 were 122.4 million barrels of crude oil and 949.2 billion cubic feet of natural gas. For the year 2006, our daily production was 54.2 thousand barrels of crude oil and 250.0 million cubic feet of natural gas. Oil and gas production activities in Argentina are mainly developed in mature fields undergoing secondary recovery operations, which are capital-intensive projects.

Oil and natural gas reserves in Argentina have had a downward trend during the last few years. According to official data from the Argentine Oil and Gas Institute, proved oil and gas reserves for the 2001-2005 period dropped

approximately 34%.

Oil production in Argentina declined for the ninth year in a row, though to a lesser extent compared to previous years. In 2006, oil production totaled 659,000 barrels per day, a decline of about 0.7% compared to 2005.

In 2006 our oil and gas reserves in Argentina declined 7% for the fourth year in a row. During the same year, our production of oil equivalent in Argentina increased about 3% compared to 2005.

Exploration is our main vehicle for growth and reserve replacement, including exploration of off-shore fields. Due to the risks inherent in exploration activities, we cannot assure that the downward trend in reserves will be reversed in the future.

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In fiscal year ended December 31, 2006, our oil and gas production accounted for 7.4% and 6.7% of total oil and gas production in Argentina, respectively, and positioned us as the third largest producer in the country. Rights to develop oil and gas fields in Argentina are granted through concessions and exploration permits. Concessions are generally granted for periods of 25 years and are typically renewable for a maximum term of ten years, and permits are generally granted for initial periods of four years. Concessionaires in Argentina are entitled to gross proceeds from production sales. All permanent fixtures, materials and equipment are under the control of the concessionaire, although they revert to the Argentine government at the end of the concession. Royalties based on production are paid to the respective Argentine provinces. These royalties are in general 12% of the wellhead price for oil and gas. The wellhead price is calculated by deducting freight and other expenses to make oil and gas available for sale from the sales price obtained in transactions with third parties, or from the product price prevailing in the domestic market if the product is subject to industrialization processes.

Our production is concentrated in four basins, the Neuquén, Austral, San Jorge and Noroeste basins. The Neuquén basin is the most important basin in Argentina in terms of oil and gas production. We own approximately 670,000 net acres under production concessions. Our most important fields in the Neuquén basin are Puesto Hernández, 25 de Mayo-Medanito S.E. and Sierra Chata. In the Austral basin, we own approximately 2,456,000 net acres under production concessions, with Santa Cruz I and Santa Cruz II being our main concessions.

In 2006, we divested our assets in the Atamisqui and Refugio - Tupungato areas located in the Cuyana basin. Divestment of the blocks will permit us to optimize the allocation of efforts and resources in assets with more strategic value. In addition, we sold a 16.66% interest in the Atuel Norte area in the Neuquén basin. Combined production from these assets accounted for less than 2% of our production and reserves in Argentina.

In February 2007, we acquired from Conoco Phillips its 25.67% and 52.37% interests in Sierra Chata and Parva Negra assets, respectively, for an acquisition price of U.S.\$77.6 million. As a result of this acquisition, our interest in Sierra Chata and Parva Negra increased to 45.5523% and 100%, respectively. As of the date of this Annual Report, approval of the transaction by the Argentine antitrust authorities is still pending.

Production outside of Argentina

As of December 31, 2006, 46.8% of our combined proved reserves were located outside of Argentina. In addition, approximately 47.6% of our oil production and 17.9% of our gas production came from outside of Argentina in 2006. We have working interests in eight oil and gas production blocks outside of Argentina: Oritupano Leona, La Concepción, Acema and Mata (these four through 22%, 36%, 34.5% and 34.5% direct and indirect interest in Petroritupano S.A., Petroven-Bras S.A., Petrowayu S.A. and Petrokariña S.A.) in Venezuela, Lote X in Peru, Block 18 and Block 31 in Ecuador and Colpa Caranda in Bolivia.

Venezuela

As of December 31, 2006, estimated proved oil and gas reserves attributable to operations in Venezuela amounted to 78.6 million barrels of oil equivalent, accounting for 14.9% of our total reserves. In 2006, our net production in Venezuela was approximately 24,600 barrels of oil equivalent per day, or 16% of our total production. Information on oil and gas producing activities as of December 31, 2006 attributable to our operations in Venezuela was calculated on the basis of three months of production under operating service contracts and nine months of production as mixed company.

In 1994, we were awarded the first service contract by Petróleos de Venezuela S.A. (PDVSA) at the Oritupano-Leona field to provide production services for a 20-year period. We had a 55% interest in the block.

In 1997, PDVSA awarded us three 20-year service contracts for the exploration and production of La Concepción, Acema and Mata blocks, with interests of 90%, 86.23% and 86.23%, respectively.

Under these types of contracts, the government maintained the full ownership of all hydrocarbons.

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In April 2005, the Venezuelan Energy and Oil Ministry instructed PDVSA to review the 32 operating agreements signed by PDVSA with oil companies from 1992 through 1997, including agreements with Petrobras Energía, through our subsidiaries and affiliates in Venezuela, in connection with production in the areas of Oritupano Leona, La Concepción, Acema and Mata. The Venezuelan Energy and Oil Ministry instructed PDVSA to take measures in order to convert all effective operating agreements into mixed companies and grant the Venezuelan government, through PDVSA, more than 50% ownership of each field.

During 2005, through different actions, PDVSA exercised pressure on the effective operating agreements as a way to promote migration. Among others: (a) PDVSA approved a reduced amount of investments for the development of the Oritupano Leona area, (b) The SENIAT (National Integrated Tax Administration Service) performed several tax inspections on the companies that operate the 32 oil operating contracts and, as a result, challenged prior tax filings, and (c) the applicable income tax rate was increased from 34% to 50%.

On September 29, 2005, as a step toward the adjustment of the operating agreements in force to the new business scheme, Petrobras Energía, through its subsidiaries and affiliates in Venezuela, signed provisional agreements with PDVSA, whereby it agreed to negotiate the terms and conditions for conversion of the operating agreements of the Oritupano Leona, La Concepción, Acema and Mata areas into mixed companies. The provisional agreement for the Oritupano Leona area was signed subject to approval by Petrobras Energía's Regular Shareholders Meeting and Petrobras Energía Participaciones S.A.'s Special Shareholders Meeting. These Shareholders meetings adopted favorable resolutions.

In March 2006, Petrobras Energía, through its controlled and affiliated companies in Venezuela, entered with PDVSA and Corporación Venezolana de Petróleo S.A. (CVP) into Memoranda of Understanding (MOUs) in order to effect the migration of the operating agreements. These MOUs established that private investors would hold a 40% share in these mixed-owned companies, with the Venezuelan Government being entitled to a 60% ownership interest. As a result, the direct and indirect interests of Petrobras Energía in the mixed-owned companies that would operate the areas of Oritupano Leona, La Concepción, Acema and Mata would be 22%, 36%, 34.5% and 34.5%, respectively. The MOUs established that CVP will recognize a divisible and freely transferable credit in favor of Petrobras Energía in the amount of U.S.\$88.5 million. These credits will not bear interest and may be used only for the payment of bonds purchased in relation to the participation in any new mixed company project for the development of oil exploration and production activities in Venezuela or licenses for the development of gas exploration and production operations in Venezuela.

In August 2006, the relevant conversion agreements were signed for the Oritupano Leona, La Concepción, Acema and Mata areas, which were consistent with the terms agreed in the MOUs. Subsequently, the companies Petroritupano S.A., Petrowayú S.A., Petrovenbras S.A. and Petrokariña S.A. were organized and registered with the Public Registry of Commerce of Venezuela. The Venezuelan government has issued the relevant decrees granting the necessary powers to these four companies, and the respective shareholders subsequently made the required capital contributions. The MOUs established that the economic effects of the migration would become effective on April 1, 2006. From this date to October the fields were under the management of a provisional executive committee formed primarily by PDVSA. Since October the fields have been under the management of the mixed companies themselves. From April to December mixed companies have been financed by Petrobras Energía Venezuela and the other members of the consortiums.

Mixed companies are subject to royalty payments of 30% and to an additional royalty payment of 3.33%, known as a special advantage payment, based on production. In addition, they are required to pay to the government an amount equivalent to any difference between (1) 50% of the value of oil and gas sales during each calendar year and (2) total royalty payments made during such year plus income tax and any other tax or duty calculated on the basis of the sales revenues paid during such year. Each mixed company will be the operator of the areas, and the crude oil produced by the mixed companies has to be sold and delivered to PDVSA at market prices.

The Venezuelan government may set a limit on the oil production of mixed companies. Venezuela is a member of OPEC and has set forth a policy of strict compliance with the production quotas decided upon within OPEC. According to the Venezuelan Hydrocarbon Law, any decisions made by the federal administration in connection with agreements or international treaties involving hydrocarbons are applicable to any party that carries out the activities

governed by the law. As a result, if there are production cuts approved by OPEC, these cuts will affect PDVSA and mixed companies. See - Regulation of Our Businesses - Venezuelan Regulatory Framework Petroleum and Gas Additional Matters OPEC .

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Peru

In 1996, the Company acquired through a public bidding process 30-year oil and 40-year natural gas production rights in Lote X, an approximately 116,000-acre block in Peru's Talara Basin. Lote X is operated pursuant to concession production agreements with free crude oil availability. As of December 31, 2006, Lote X had 2,472 productive wells. Perupetro S.A.'s Talara refinery is the sole customer of our crude oil production.

As of December 31, 2006, estimated proved oil and gas reserves attributable to operations in Peru amounted to 88 million barrels of oil equivalent, accounting for 16.7% of the Company's total reserves. In 2006, our net daily production in Peru was 14.5 thousand barrels of oil equivalent or 9.4% of the Company's total production.

In November 2003, the Peruvian government approved the National Law for the Promotion of Investment in the Exploitation of Resources and Marginal Reserves of Hydrocarbons (*Ley para la Promoción de la Inversión en la Explotación de Recursos y Reservas Marginales de Hidrocarburos a Nivel Nacional*), which authorizes Perupetro to reduce royalty payments.

In accordance with the new law, the Company entered into an agreement with the Peruvian government whereby we undertook to make investments of approximately U.S.\$97 million in Lote X during the 2004-2011 period. By December 31, 2006, almost all the amount committed had been used. Works covered by this agreement include the drilling of 51 wells, the workover of 525 wells, the reactivation of 177 temporarily abandoned wells, the implementation and expansion of the water injection project and the development of a gas injection project. The Peruvian government, in turn, reduced the royalty rate for crude oil and gas production. In Peru, the royalties paid for the production of crude oil are determined on the basis of the price of a basket of varieties of crude oil, starting at the rate of 13% for prices of up to U.S.\$23.9 per barrel. The royalty rate applicable for oil at December 2006 was 25%. Production of natural gas in Peru is subject to a fixed royalty of 24.5%.

Ecuador

In Ecuador we operate Blocks 18 and 31 under participation agreements, in which as of December 31, 2006, we hold a 70% and 100% interest, respectively. Under these agreements, Petroecuador, the Ecuadorian national oil company, is entitled to a share in production, which fluctuates depending on oil prices and production levels.

As of December 31, 2006, estimated proved oil and gas reserves attributable to operations in Ecuador amounted to 53.9 million barrels of oil equivalent, accounting for 10.2% of the Company's total reserves. In 2006, our oil production in Ecuador totaled 11.8 thousand barrels per day, accounting for 7.7% of our total average production in barrels of oil equivalent in 2006.

In January 2005, we entered into a preliminary agreement with Teikoku Oil Co. Ltd. (Teikoku), whereby, subject to obtaining approval from the Ministry of Energy and Mines of Ecuador, we would transfer 40% of our working interest in Blocks 18 and 31. On January 11, 2007, the Ecuadorian Ministry of Energy and Mines approved the agreement. As a result of this authorization, the parties are currently in the process of completing the necessary formalities, including the necessary steps towards obtaining amendments to the participation contracts, in order to incorporate Teikoku as a partner in the agreements for Blocks 18 and 31.

Once the amendments are finalized, the terms and economic conditions of the Teikoku transaction will go into effect. In 2001, we acquired a working interest in Block 18, located in the Oriente Basin. Block 18 covers approximately 180,000 net acres and has a significant potential of 28° to 33° API light crude oil reserves. The concession for production activities in Block 18 is for an initial 20-year term, which commenced in October 2002. Once this term expires, Ecuadorian hydrocarbon laws provide for the possibility of a five-year extension period.

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Block 18 comprises the Pata and Palo Azul fields. In the Palo Azul field the agreement includes differential production sharing percentages according to a formula that considers the sales price and total proved reserves. If the sales price of crude from Palo Azul is lower than U.S.\$15 per barrel, the government receives about 30% of the crude produced, but, if the sales price of crude is U.S.\$24 or higher, the government receives about 50% of production. It is also adjusted depending on the crude oil quality factor. The sales price of the Palo Azul crude is calculated considering as reference the WTI, net of the standard market discount for Oriente crude. In the Pata field, the government receives a production share ranging from 25.8%, if daily production is lower than 35,000 bbl/d, to 29%, if production exceeds 45,000 barrels per day. It is also adjusted depending on the crude oil quality factor. As of December 31, 2006, the government's share of oil produced at the Pata and Palo Azul fields was 33.8% and 50.5%, respectively.

As of December 31, 2006, Block 18 had twenty five productive wells, twenty two located at the Palo Azul field and three located at the Pata field. In December 2006, the new oil treatment plant and ducts became operational. The investment allowed the increase in treatment capacity of the plant, up to 40,000 bbl/d of oil

During the first quarter of 2007 our operations in Block 18 were interrupted for 30 consecutive days (March 9, 2007 to April 10, 2007) as a result of coercive actions taken by local communities. During this period, cumulative oil production decreased by approximately 305,000 barrels of oil equivalent in our participation.

A large part of Block 31 is located in Parque Nacional Yasuní, a highly sensitive ecological area of the Amazon jungle in the central part of the eastern border of the upper Amazon basin and covers an area of approximately 460,000 net acres. Pursuant to the block's production sharing agreement between Petroecuador and us, Petroecuador is entitled to a crude oil production share ranging between 12.5% and 18.5%, depending on daily production volumes and oil density. We have conducted extensive exploratory work in the block, including the drilling of four exploratory wells in Apaika, Nenke, Obe and Minta. These wells were successful and led to the discovery of the Apaika/Nenke, Obe, and Minta fields. In order to further develop the block, significant investments are required prior to the production phase.

In August 2003, the Ministry of Energy and Mines approved the development plan for the Apaika Nenke field. In August 2004, the Ecuadorian Ministry of the Environment approved the environmental management plan for the development and production of Block 31 and granted an environmental license in connection with the development phase for the Nenke and Apaika fields. In addition, in August 2004, the Ministry of Energy and Mines approved the development plan for Block 31, thereby establishing the start of the 20-year exploitation term. The concession contract of Block 31 provides for the free availability of the crude oil produced. Native and environmentalist groups made public statements against the Block 31 development, arguing that oil and gas activities endangered the park's biodiversity.

On July 7, 2005, the Ministry of the Environment decided not to authorize the beginning of certain construction works on the Tiputini River (boundary of Parque Nacional Yasuní) and denied us access to Parque Nacional Yasuní. This suspension prevents us from continuing the development works in Block 31. Petrobras Energía changed the Development Plan for Block 31 in order to address the objections posed by the Ecuadorian Ministry of the Environment and finally, after a process involving participation of the affected communities, submitted a new Environmental Impact Assessment (EIA). The new EIA was approved by the Ministry of the Environment and the Ministry of Energy and Mines, and the issuance of a new environmental license to resume development works in Block 31 was officially requested on January 4, 2007. All relevant formalities have been completed in connection with this request, and the request for a New Environmental License is awaiting approval by the Ecuadorian Minister of the Environment. Such license will allow the restart of the works for development of the block.

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In April 2006, the Ecuadorian government approved the Oil & Gas Reform Law, which assigns to the government an interest of at least 50% of the excess revenues resulting from the increase in the price of Ecuadorian crude (effective monthly average price of FOB price) over the average monthly sales price of such oil at the execution date of the relevant production agreement, expressed in constant values for the month in which settlement occurs. In July 2006, the competent authorities published the relevant regulations implementing the law, and subsequently Ecuadortlc and Petroecuador expressed divergent interpretations of the regulations. See Risk Factors .

Ship or Pay Obligations with Oleoducto de Crudos Pesados (OCP)

With respect to the exploitation of Blocks 18 and 31, the Company executed a transportation agreement with OCP whereby we acquired an oil transportation capacity of 80,000 barrels per day for a 15-year term, starting November 10, 2003. Under the Ship or Pay clause included in the agreement, we, as well as all other producers, must pay a fee covering OCP operating costs and financial services even when no crude oil is transported. As of December 31, 2006, such fee amounted to U.S.\$2.27 per barrel. Costs in connection with the transportation capacity are invoiced by OCP and charged to expenses on a monthly basis.

We expect that during the effective term of the transportation agreement, oil production will be lower than the aggregate committed transportation capacity. This assumption is based on: (i) the estimated delays in the development of Block 31 and (ii) the current vision of reserve potential in Block 31. Considering this situation, we have sold transportation capacity under the following transportation agreements:

1. Under a transportation agreement signed in June 2004, Murphy Oil will be able to transport its working interest (an average of 8,000 barrels per day between December 2004 and December 2006) from Block 16 through our committed capacity in the OCP. The expiration date of this agreement is January 31, 2012.
2. Under the transportation agreement signed in December 2006 and retroactively applied to May 2006, Petroecuador will be able to transport production from Block 15 (an average of 80,000 barrels per day) through all shippers committed capacity, except for Occidental, in the OCP. As a result of this agreement, expiring on December 14, 2008, we are able to reduce by 16,380 barrels per day our 80,000 barrels per day committed transportation capacity in connection with OCP.

Pursuant to the preliminary agreement signed with Teikoku, once all formalities and governmental approvals are completed or obtained, Teikoku has agreed to assume 40% of our rights and obligations resulting from the crude oil transportation agreement with OCP. Allocation of the transportation capacity to Teikoku will enable us to further reduce the current oil production deficit.

Bolivia

Petrobras Energía has operated the Colpa Caranda Block since 1989 under a share risk contract signed with YPF, under which Petrobras Energía had free oil production availability. As of December 31, 2006, we hold a 100% interest in the Colpa Caranda Block. Colpa Caranda is an approximately 56,000 net acre block located in the Sub Andina Central basin and has 49 producing wells.

As of December 31, 2006, estimated proved oil and gas reserves attributable to operations in Bolivia amounted to 26.1 million barrels of oil equivalent, accounting for 4.1% of our total reserves. In 2006, our net daily production in Bolivia was 7.4 thousand barrels of oil equivalent or 4.8% of our total production. Approximately 87% of our proved developed reserves in Bolivia are gas reserves. These fields, which originally exported gas to Argentina, currently have priority in the delivery of gas to the Santa Cruz-São Paulo pipeline that transports gas to Brazil.

In January 2005, we entered into an assignment agreement with Petrobras Bolivia whereby we transferred, subject to the approval of YPF, a 5% interest in Colpa Caranda. As of the date of this Annual Report, approval by YPF is pending.

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In May 2006, the Bolivian government enacted Supreme Decree No. 28,701, which provided that as from May 1, 2006 oil companies will have to deliver to YPFB the property of all hydrocarbon production for sale. Oil companies will have a 180-day transition period to subscribe new agreements, which must be individually authorized and approved by the Bolivian Legislature. The Ministry of Hydrocarbons and Mines would determine, on a case by case basis, the interest in each field corresponding to oil companies by means of audits of investments, operational costs and profitability indicators. During the transition period, in the case of fields with a certified average production of natural gas for 2005 lower than 100 million cubic feet per day, such as the Colpa Caranda area, the previous distribution of the oil and gas production value was maintained.

On October 28, 2006, Petrobras Energía and YPFB entered into a new operating agreement for the Colpa Caranda area, pursuant to the terms of the Hydrocarbon Law No.3,058 and Supreme Decree No. 28,701, whereby Petrobras Energía performs at its own risk and for its own account, in the name of and on behalf of YPFB, exploration and production activities within the area that is the subject of the agreement. Pursuant to the agreement, YPFB owns the hydrocarbons and pay royalties, direct interest and direct tax on hydrocarbons, which in the aggregate amounts to 50% of the production valued on the basis of sales prices, and applies the remaining amount first to pay operating services provided by Petrobras Energía, including depreciation, and then the rest is shared by YPFB and Petrobras Energía on the basis of an index calculated based on production volumes, depreciation rate, prices and taxes paid, among other items, securing the free availability of foreign currency. The Company's Management believes the new contractual conditions have no significant impact on the book value of this asset. The agreement was approved by the Bolivian Legislature in November 2006, enacted on January 11, 2007 and entered into force on May 2, 2007, after final certification of the government.

Colombia

With a 30% working interest, Petrobras Energía formed the Tibú Consortium for the exploitation of the Tibú Field in the Catatumbo basin, Colombia. This consortium signed with the state-owned company Ecopetrol an agreement for the additional development of the Tibú field. This project to which Petrobras Energía will contribute its know-how in the development and exploitation of mature fields is aimed at promoting our strategy for international growth and diversification of the portfolio of assets.

During the initial phase of the project (for a term of two and a half years from January 2007), the Tibú Consortium will make investments in the amount of U.S.\$40 million in studies and works to determine the actual potential of the field currently producing 1,800 barrels of oil per day (Bpd). During the second phase, the Tibú Consortium will be in charge of 55% of the investments (Ecopetrol being responsible for the remaining 45%) and will be entitled to 40% of the field's production after royalties. The Tibú Consortium will execute investment projects to generate additional production while Ecopetrol will continue to operate the field.

As of the date of this Annual Report, the final amendments to the joint operating agreement required to establish the Company's share in the Tibu project are still pending. The *Agencia Nacional de Hidrocarburos* (the National Hydrocarbon Agency) is expected to authorize Ecopetrol to assign its right in favour of the Tibú Consortium.

Statistical Information Relating to Oil and Gas Production

The following table sets forth our oil and gas production during 2006. Production figures represent our working interest in production (and are therefore net to us). In addition, the table includes our working interest in each field, the number of producing wells and the expiration date of the concessions, in each case as of December 31, 2006. Although some of these concessions may be extended at their expiration, the expiration dates set forth below do not include any extensions.

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| Production Areas | Location | Basin | 2006 Production | | Oil and Gas Wells | Interest | Expiration | |
|--------------------------------------------|----------------|------------------------|--------------------|--------------------|-------------------|--------------|------------|-----------|
| | | | Oil ⁽¹⁾ | Gas ⁽²⁾ | | | | |
| Argentina: | | | | | | | | |
| 25 de Mayo S.E. | Medanito | La Pampa and Río Negro | Neuquén | 5,447 | 2,599 | 555 | 100.00% | 2016 |
| El Mangrullo | | Neuquén | Neuquén | | 579 | 6 | 100.00% | 2025 |
| Jagüel de los Machos | | Río Negro and La Pampa | Neuquén | 1,013 | 3,023 | 90 | 100.00% | 2015 |
| Puesto Hernández | | Mendoza and Neuquén | Neuquén | 4,082 | | 769 | 38.45% | 2016 |
| Bajada de Palo | | Neuquén | Neuquén | 69 | | 4 | 80.00% | 2015 |
| Santa Cruz II | | Santa Cruz | Austral | 2,126 | 10,393 | 74 | 100.00% | 2017/2024 |
| Río Neuquén | | Neuquén and Río Negro | Neuquén | 535 | 6,844 | 131 | 100.00% | 2017 |
| Entre Lomas | | Neuquén and Río Negro | Neuquén | 855 | 1,437 | 396 | 17.90% | 2016 |
| Veta Escondida and Rincón de Aranda U.T.E. | | Neuquén | Neuquén | | | | 55.00% | 2016 |
| Aguada de la Arena | | Neuquén | Neuquén | 69 | 7,296 | 10 | 80.00% | 2022 |
| Santa Cruz I U.T.E. | | Santa Cruz | Austral | 2,656 | 44,074 | 92 | 71.00% | 2016/2023 |
| Sierra Chata | | Neuquén | Neuquén | 157 | 6,399 | 38 | 19.89% | 2022 |
| Atamisqui ⁽⁵⁾ | | Mendoza | Cuyana | 107 | | | | |
| Refugio Tupungato ⁽⁵⁾ | | Mendoza | Cuyana | 352 | | | | |
| Atuel Norte | | Neuquén | Neuquén | 6 | | 6 | 33.33% | 2016 |
| La Tapera | Puesto Quiroga | Chubut | San Jorge | | | | 21.95% | 2016 |
| El Tordillo | | Chubut | San Jorge | 2,139 | 46 | 753 | 21.95% | 2016 |
| Aguaragüe | | Salta | Noroeste | 182 | 8,571 | 48 | 15.00% | 2017/2021 |
| Total Argentina | | | | 19,795 | 91,261 | 2,972 | | |
| Outside of Argentina: | | | | | | | | |
| Colpa Caranda | | Bolivia | Sub Andina | 509 | 13,063 | 49 | 100.00% | 2029 |
| Oritupano Leona ⁽³⁾ | | Venezuela | Oriental | | | | | |
| | | | Maturín | 2,403 | | | | |
| Acema ⁽³⁾ | | Venezuela | Oriental | | | | | |
| | | | Maturín | 151 | | | | |
| La Concepción ⁽³⁾ | | Venezuela | Lago Maracaibo | 1,070 | 223 | | | |
| Mata ⁽³⁾ | | Venezuela | Oriental | | | | | |
| | | | Maturín | 258 | 26 | | | |

| | | | | | | | |
|-----------------------------------|-----------|------------------|---------------|----------------|--------------|---------|------|
| Oritupano Leona ⁽⁴⁾ | Venezuela | Oriental Maturín | 2,780 | | 231 | 22.00% | 2025 |
| Acema ⁽⁴⁾ | Venezuela | Oriental Maturín | 182 | 64 | 27 | 34.49% | 2025 |
| La Concepción ⁽⁴⁾ | Venezuela | Lago Maracaibo | 1,333 | 2,411 | 86 | 36.00% | 2025 |
| Mata ⁽⁴⁾ | Venezuela | Oriental Maturín | 264 | 476 | 46 | 34.49% | 2025 |
| Lote X | Peru | Talara | 4,680 | 3,694 | 2,472 | 100.00% | 2024 |
| Bloque 31 | Ecuador | Oriente | | | | 100.00% | 2024 |
| Bloque 18 | Ecuador | Oriente | 4,321 | | 25 | 70.00% | 2022 |
| Total Outside of Argentina | | | 17,951 | 19,957 | 2,936 | | |
| Total | | | 37,746 | 111,218 | 5,908 | | |

(1) In thousands of barrels.

(2) In millions of cubic feet. Gas production figures represent actual sales gas.

(3) Correspond to former operating agreements.

(4) Indirect interests through mixed companies, accounted for as equity method investments.

(5) Sold in October 2006.

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The following table sets forth our average daily production of oil, including other liquid hydrocarbons, for the three fiscal years ended December 31, 2006, 2005 and 2004. This table includes our net share of production for both consolidated subsidiaries and unconsolidated investees.

| | Year ended December 31, | | |
|----------------------|--------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| | (average barrels per day) | | |
| Argentina | 54,233 | 54,516 | 61,427 |
| Outside of Argentina | 49,181 | 67,962 | 66,973 |
| Total | 103,414 | 122,478 | 128,400 |

The following table sets forth our average daily gas production for the three fiscal years ended December 31, 2006, 2005 and 2004. This table includes our net share of production for both consolidated subsidiaries and unconsolidated investees.

| | Year ended December 31, | | |
|----------------------|---------------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| | (average thousand cubic feet per day) | | |
| Argentina | 250,030 | 231,830 | 262,371 |
| Outside of Argentina | 54,677 | 61,855 | 64,657 |
| Total | 304,707 | 293,685 | 327,028 |

The following table sets forth the average sales price per barrel of oil and per million cubic feet of gas for each geographic area for the three fiscal years ended December 31, 2006, 2005 and 2004, of our consolidated subsidiaries.

| | Year ended December 31 | | |
|---------------------------------------------|-------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Argentina: | | | |
| Oil (in pesos per barrel of oil equivalent) | 124.4 | 99.91 | 86.72 |
| Gas (in pesos per million cubic feet) | 3.54 | 2.74 | 2.01 |
| Outside of Argentina: | | | |
| Oil (in pesos per barrel of oil equivalent) | 144.3 | 94.65 | 61.91 |
| Gas (in pesos per million cubic feet) | 10.52 | 5.21 | 3.79 |

The following table sets forth our average lifting cost, royalties and depreciation cost of oil and gas fields in each geographic area for the three fiscal years ended December 31, 2006, 2005 and 2004. This table includes the net share of production of our consolidated subsidiaries.

| | Year ended December 31, | | |
|-------------------|-----------------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| | (in pesos per barrel of oil equivalent) | | |
| Argentina: | | | |
| Lifting Cost | 13.50 | 11.05 | 7.91 |
| Royalties | 9.42 | 7.73 | 6.35 |
| Depreciation | 13.91 | 12.95 | 11.28 |
| Total | 36.83 | 31.73 | 25.54 |

Outside of Argentina:

| | | | |
|--------------|-------|-------|-------|
| Lifting Cost | 12.10 | 10.03 | 8.92 |
| Royalties | 23.72 | 8.08 | 5.08 |
| Depreciation | 13.91 | 13.97 | 11.67 |
| Total | 49.73 | 32.08 | 25.67 |

Table of Contents**Exploration**

We consider exploration as the main vehicle for future growth and replacement of reserves. Our strategy is focused on constantly searching for new exploration opportunities aligned with our growth targets. Accordingly, we expect an increase in our exploration investments, including exploration opportunities in Argentina's off-shore areas. In exploring off-shore areas, we will use the expertise and know-how of Petrobras, a world leader in off-shore exploration and a pioneer in deep and ultra deep water activities.

The following table lists exploration areas as of December 31, 2006, the location and basin of each area, our working interest and the expiration date for the exploration authorization.

| | Location | Basin | Interest | Expiration |
|------------------------------|-------------------|---------------------|-----------------|-------------------|
| In Argentina: | | | | |
| Glencross | Santa Cruz | Austral | 87.00% | (3) |
| Estancia Chiripá | Santa Cruz | Austral | 87.00% | (3) |
| Cerro Manrique | Rio Negro | Neuquén | 50.00% | (2) |
| Parva Negra | Neuquén | Neuquén | 47.63% | 2001 (1) |
| Cerro Hamaca | Mendoza | Neuquén | 39.64% | 2004 (1) |
| Gobernador Ayala | Mendoza | Neuquén | 22.51% | 2004 (1) |
| Cañadón del Puma | Neuquén | Neuquén | 50.00% | 2008 |
| Estancia Agua Fresca | Santa Cruz | Austral | 50.00% | (1) |
| Puesto Oliverio | Santa Cruz | Austral | 50.00% | (1) |
| El Campamento | Santa Cruz | Austral | 50.00% | (1) |
| El Cerrito Oeste | Santa Cruz | Austral | 50.00% | (1) |
| Chirete | Salta | Noroeste | 100.00% | 2010 |
| Hickman | Salta | Noroeste | 50.00% | 2011 |
| Enarsa 1 (E1) | Continental Shelf | Off-shore Argentina | 25.00% | |
| Enarsa 3 (E3) | Continental Shelf | Off-shore Argentina | 35.00% | |
| Outside of Argentina: | | | | |
| Tinaco | Venezuela | Guarico | 50.00% | 2007 |
| Block 57 | Peru | Madre de Dios | 35.15% | 2008 |
| Block 58 | Peru | Madre de Dios | 100.00% | 2007 |
| Block 103 | Peru | Marañón | 30.00% | 2008 |
| Block 110 | Peru | Madre de Dios | 100.00% | 2007 |
| Block 112 | Peru | Marañón | 100.00% | 2007 |
| Block 117 | Peru | Marañón | 100.00% | 2008 |

(1) We have requested an exploitation concession with respect to this field, which is still pending.

(2)

The grant of an exploration permit is pending.

- (3) We signed two Master Agreements with the Province of Santa Cruz to continue demarcation and production activities.

Exploration in Argentina

As of December 31, 2006, we held interests in approximately 18,274 thousand gross exploration acres in Argentina. In 2006, the Company and Energía Argentina S.A. (Enarsa) signed an association agreement whereby two consortia (Enarsa 1 and 3) were created for the exploration, development, production and distribution of hydrocarbons in off-shore areas located on the Argentine continental shelf. During 2006, the Company signed two Master Agreements with the Province of Santa Cruz to continue demarcation and production activities in connection with two gas fields: Glencross and Estancia Chiripa. In addition, two exploration blocks were pre-awarded to Petrobras Energía on the First Round of Bids of the Province of Salta.

In 2006, we completed a 118 km² 3D seismic survey in El Cerrito area in the Austral basin, and shooting of approximately 1900 km² in Enarsa 1 off-shore area started. In the Neuquén and Austral basins, 15 exploratory wells were drilled, 11 of which were successful. In 2006, we discovered 35 million barrels of oil equivalent in Argentina through exploration. Additional investments are required in reservoir demarcation and characterization to determine the possibility of adding proved reserves.

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Exploration Outside of Argentina

Peru

In 2004, we entered into an agreement with Repsol Exploración Perú S.A. to jointly perform exploration activities in Block 57, located in the Madre de Dios basin. Pursuant to this agreement, our interest in the Block is 35.15%. In 2005, we pursued an aggressive policy to increase our acreage position, through exploration license applications and farm-ins. During 2005, we applied for four exploration blocks: Blocks 58 and 110 in the Madre de Dios basin and Blocks 112 and 117 in the Marañón basin (the first three were granted during 2005 and the last one was granted during 2006).

As of December 31, 2006, the total gross exploration area was 14,219 thousand acres.

In addition, through a farm-in, we acquired a 30% working interest in Lote 103, operated by Occidental, in the Huallaga basin.

In 2007, we agreed to acquire from Conoco Philips an additional 11.01% working interest in Block 57. As of the date of this Annual Report, the final amendments to the joint operating agreement required to establish the Company's share in Block 57 are still pending.

In Peru, exploration licenses are granted for a total of seven years. The first exploration period of 12 to 24 months generally requires a low level of capital expenditures, primarily on geological studies or seismic reprocessing. Subsequent periods require more substantial investments in seismic registration and drilling.

Venezuela

In Venezuela, the company has a 50% working interest in the Tinaco area under a license for the exploration and production of gas. In 2006, drilling of La Yaguara well in the Tinaco area yielded no encouraging results.

Colombia

In 2005, we agreed to acquire a 10% working interest in the Tierra Negra Block from Petrobras, who operates the block with a 60% working interest. As of the date of this Annual Report, the final amendments to the joint operating agreement required to establish the Company's share in the Tierra Negra Block are still pending.

The block has a high reserve potential and is located in the Llanos Orientales basin, adjacent to the main oilfields and pipelines in Colombia. Entry into Colombia, in association with Petrobras, presents new opportunities for the development of our exploration and production business in such country. Completion of the first exploratory well is expected during the first half of 2007.

Ecuador

The concession contract for Block 31 allows us to perform additional exploratory works for a period of three years following commencement of the development stage. We therefore may perform exploratory activities until August 2007. The Block 31 exploration drilling and seismic acquisition program was suspended because the competent authorities have not issued the necessary environmental licenses. Furthermore, for planned exploration activity in the western part of Block 18, local communities did not allow the Company to enter the area to carry out fieldwork. This prompted us to invoke *force majeure* and request an extension of the remaining exploration period until the problem is solved. As of the date of this Annual Report, we have not been granted the extension.

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Service Agreement in Mexico

In 2003, as part of a bidding process launched by Petróleos Mexicanos, or PEMEX, for the operation of areas under multiple service agreements, agreements for the Cuervito and Fronterizo areas were awarded to a joint venture composed of Petrobras, Teikoku and Diavaz. Under the relevant operating agreement, the Company act as contractor and provide the joint venture with the administrative, technical and operating support required for the operation of these blocks.

Reserves

We believe our estimates of remaining proved recoverable oil and gas reserve volumes to be reasonable. Pursuant to Rule 4-10 of Regulation S-X under the Securities Act, proved oil and natural gas reserves are those estimated quantities of crude oil, natural gas and natural gas liquids that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs, under existing economic, operating and regulatory conditions, i.e. prices and cost at the date of estimation. Gaffney, Cline & Associates, Inc. or GCA, an international technical and management advisory firm for the oil and gas industry, audited our oil and gas reserves as of December 31, 2006, 2005 and 2004. The technical audit covered 93%, 95% and 95% of the Company's estimated reserves for the years 2006, 2005 and 2004, respectively. Reserves that were not audited are mainly estimated reserves related to areas where the Company does not act as operator. In 2006, non-audited reserves also include reserves from areas where we act as operator, representing 0.7% of our total reserves as of December 31, 2006.

The estimates of reserves were first prepared by us and subsequently audited by GCA. The reported hydrocarbon reserves were estimated based on professional, geological and engineering judgment and on information supplied by us prior to January 9, 2007. Thus they are subject to revisions, upward or downward, as a result of future operations or as additional information becomes available. GCA's audit examination included those tests and procedures considered necessary by them in view of the circumstances prevailing in each case. These tests and procedures included a review of the appropriateness of the methodologies employed by us in estimating reserves, the adequacy and quality of the data obtained and used by us in estimating reserves, the scope and completeness of the process used by us in estimating reserves and our classification of reserves in accordance with relevant definitions and guidance, as well as an economic test of the proved developed and total proved categories of reserves for each audited property.

An audit of proved reserves is an examination of proved reserves that is conducted by the auditor for the purpose of expressing an opinion as to whether such reserve information, in the aggregate, is reasonable. The estimation of reserves is an imprecise science due to many unknown geologic and reservoir factors that can only be estimated through sampling techniques. Since reserves are therefore only estimates, such cannot be audited for the purpose of verifying exactness. Instead, reserve information is audited for the purpose of reviewing in sufficient detail the policies, procedures and methods used by us, engaged in the exploration and production of oil and gas in estimating our reserves so that the auditor may express an opinion as to whether, in the aggregate, the reserve information furnished by us is reasonable.

For the year 2006, Gaffney, Cline & Associates has concluded that our estimated total proved oil and natural gas reserve volumes set forth in this report are, in the aggregate, reasonable and have been prepared in accordance with Rule 4-10 of Regulation S-X of the SEC and in accordance with oil and gas reserve disclosure provisions of the Financial Accounting Standards Board FASB No. 69 Statement of Standards. GCA has conducted audit examinations on our properties for the last twelve years (in most cases) and has built on this knowledge base in the conduct of this audit. All questions that arose during the course of the audit process were resolved to GCA's satisfaction.

As of December 31, 2006, liquid hydrocarbon and natural gas proved developed and undeveloped reserves amounted to 527.2 million barrels of oil equivalent (323.9 million barrels of oil and 1,219.8 billion cubic feet of natural gas), representing a 30.6% decline compared to audited proved reserves as of December 31, 2005 (a decline of 39.8% for liquid hydrocarbons and 8.3% for natural gas).

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Liquid hydrocarbons and natural gas accounted for 61.4% and 38.6%, respectively, of our total proved reserves as of December 31, 2006. Approximately, 46.8% of our total proved reserves as of December 31, 2006 were located outside of Argentina, as compared to 60.2% as of December 31, 2005. This reflects principally a decline in proved reserves in Venezuela as a result of the migration of our operating agreements. As of December 31, 2006, proved developed reserves of crude oil equivalent represented 56.4% of our total proved reserves of crude oil equivalent.

During 2006 production totaled 56 million barrels of oil equivalent. In addition, a review of net reserves of approximately 172 million barrels of oil equivalent was recorded as detailed below:

A decrease of 181 million barrels of oil equivalent was recorded in connection with the conversion of agreements in Venezuela.

A reduction of 16 million barrels of oil equivalent in Peru.

Through extensions of known accumulations 25 million barrels of oil equivalent were added in Argentina and in Ecuador.

As a result of divestment of assets in the Cuyana basin in Argentina, reserves dropped by approximately 5 million barrels of oil equivalent.

As of December 2006, we had proved reserves equal to 9.4 years of production at 2006 rates.

The table below sets forth, by geographic area, total proved reserves and proved developed reserves of crude oil, condensate and natural gas liquids and reserves of natural gas at the indicated dates. This table includes our net share of the proved reserves of our consolidated subsidiaries and unconsolidated investees. Our net share of the proved reserves of our unconsolidated investees represented 16% of our total proved reserves as of December 31, 2006.

| | Crude oil, condensate and natural gas liquids | | | Natural gas Outside of | | | Combined (in millions of barrels of oil equivalent) |
|-------------------------------------------------------------------------|--------------------------------------------------------------|---------------------------------|--------------|---------------------------------------|---------------------------------|--------------|------------------------------------------------------------------------------------|
| | Argentina | Argentina Outside of | Total | Argentina | Argentina Outside of | Total | |
| | (in thousands of barrels) | | | (in millions of cubic feet) | | | |
| Total proved developed and undeveloped reserves as of December 31, 2004 | 176,290 | 406,466 | 582,756 | 1,099,515 | 365,987 | 1,465,502 | 827.0 |
| Proved developed reserves as of December 31, 2004 | 118,654 | 168,119 | 286,773 | 554,138 | 208,436 | 762,574 | 413.9 |
| Increase (decrease) originated in: | | | | | | | |
| Revisions of previous estimates | (7,165) | 4,183 | (2,982) | (87,864) | 22,612 | (65,252) | (13.9) |
| Improved recovery | (9,485) | | (9,485) | 56 | | 56 | (9.5) |
| Extensions and discoveries | 4,082 | 8,762 | 12,844 | 23,774 | 13,787 | 37,561 | 19.1 |
| Purchase of proved reserves in place | | | | | | | |
| Sale of proved reserves in place | | | | | | | |
| Year's production | (19,889) | (24,814) | (44,703) | (84,618) | (22,577) | (107,195) | (62.6) |
| Total proved developed and undeveloped reserves as of | 143,833 | 394,597 | 538,430 | 950,863 | 379,809 | 1,330,672 | 760.2 |

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| | | | | | | | |
|-------------------------------------------------------|----------|-----------|-----------|----------|----------|-----------|---------|
| December 31, 2005 | | | | | | | |
| Proved developed reserves as of | | | | | | | |
| December 31, 2005 | 98,093 | 176,227 | 274,320 | 457,378 | 203,255 | 660,633 | 384.4 |
| Increase (decrease) originated in: | | | | | | | |
| Revisions of previous estimates | (2,636) | (186,724) | (189,360) | 25,264 | (96,042) | (70,778) | (201.2) |
| Improved recovery | 38 | 4,705 | 4,743 | 724 | 6,830 | 7,554 | 6.0 |
| Extensions and discoveries | 5,510 | 6,900 | 12,410 | 63,595 | | 63,595 | 23.0 |
| Purchase of proved reserves in place | | | | | | | |
| Sale of proved reserves in place | (4,541) | | (4,541) | | | | (4.5) |
| Year s production | (19,795) | (17,951) | (37,746) | (91,261) | (19,957) | (111,218) | (56.3) |
| Total proved developed and undeveloped reserves as of | | | | | | | |
| December 31, 2006 | 122,409 | 201,527 | 323,936 | 949,185 | 270,640 | 1,219,825 | 527.2 |
| Proved developed reserves as of | | | | | | | |
| December 31, 2006 | 81,845 | 102,735 | 184,580 | 497,680 | 179,884 | 677,564 | 297.5 |

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The following table sets forth the breakdown of our total proved reserves of liquid hydrocarbons and natural gas into proved developed and undeveloped reserves as of December 31, 2006, 2005 and 2004.

| | 2006 | | 2005 | | 2004 | |
|--------------------------------|---------------------------------------------------|-------------------------------------|---------------------------------------------------|-------------------------------------|---------------------------------------------------|-------------------------------------|
| | Millions of barrels of oil equivalent | % of total proved reserves | Millions of barrels of oil equivalent | % of total proved reserves | Millions of barrels of oil equivalent | % of total proved reserves |
| Proved developed reserves | 297.5 | 56.4% | 384.4 | 50.6% | 413.9 | 50.0% |
| Proved undeveloped reserves | 229.7 | 43.6% | 375.8 | 49.4% | 413.1 | 50.0% |
| Total Proved Reserves | 527.2 | 100% | 760.2 | 100% | 827.0 | 100% |

Approximately 5% of our proved developed reserves as of December 31, 2006 are non-producing reserves.

Estimated reserves were subject to economic evaluation to determine their economic limits. Estimated reserves in Argentina, Peru and Bolivia are stated before royalties, as the latter have the same attributes as taxes on production and as they are not paid in kind, and therefore are treated as operating costs. In Ecuador, due to the type of contract involved in which the government has the right to a share of production and takes it in kind, reserves are stated after government's share.

Estimated reserves in Venezuela were calculated on the basis of the contractual structure in force as of the end of each year presented. As of December 31, 2006, estimated reserves are stated before royalties and are computed by multiplying our ownership in each mixed company by the proved reserve volumes of the relevant mixed company. As of December 31, 2005 and 2004, reserve volumes in Venezuela were computed by multiplying our working interest by the gross proved volumes in each area.

As of December 31, 2006, Bolivian operations reserves are calculated using the economic method, according to the terms of the new operating agreement signed in October 2006.

There are many uncertainties in estimating quantities of proved reserves and in projecting future rates of production and the timing of development expenditures, including certain factors that are beyond our control. The reserves data set forth in this Annual Report solely represents estimates of our proved oil and gas reserves. Reserve engineering is a subjective process of estimating underground accumulations of crude oil and natural gas that cannot be precisely measured. The accuracy of a reserve estimate stems from available data, engineering and geological interpretation and judgment of reserves and reservoir engineering. As a result, different engineers often obtain different estimates. In addition, results of drilling, testing and production subsequent to the date of an estimate may justify revision of such estimate, so the reserve estimates at a specific time are often different from the quantities of oil and gas that are ultimately recovered. Furthermore, estimates of future net revenues from our proved reserves and the present value thereof are based upon assumptions about future production levels, prices and costs that may not prove to be correct over time. The meaningfulness of such estimates is highly dependent upon the accuracy of the assumptions upon which they are based. Accordingly, we cannot ensure that any specified production levels will be reached or that any cash flow arising therefrom will be produced. The actual quantity of our reserves and future net cash flows therefrom may be materially different from the estimates set forth in this Offering Annual Report. See Risk Factors Factors Relating to the Company Our crude oil and natural gas reserve estimates involve some degree of uncertainty and may prove to be incorrect over time.

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We replace our reserves through the acquisition of new producing fields, new exploration of our existing fields, the exploration of new fields and by proving up reserves in existing fields. Proving up is the process by which additional reserves classified as probable and possible reserves in a producing field are accessed and reclassified as proved reserves. We prove up reserves with reservoir management techniques by implementing waterflood and enhanced oil recovery projects. Reservoir management techniques currently used include water injection and drilling of horizontal wells, including producing and injection wells. In addition, technologies such as 3D seismic process, horizontal and step out wells, underbalance drilling and reservoir numerical stimulation are also used.

Transportation and Sales

We transport our oil and gas production in several ways depending on the infrastructure availability and the cost efficiency of the transportation system in a given location. We use the oil pipeline system and oil tankers to transport oil to our customers. Oil is customarily sold through FOB contracts and, therefore, producers are responsible for transporting oil produced from the field to a port for shipping, with all costs and risks associated with transportation borne by the producer. Gas, however, is sold at the delivery point of the gas pipeline system near the field and, therefore, the customer bears most of the transportation costs and risks associated therewith. Oil and gas transportation in Argentina operates in an open access non-discriminatory environment under which producers have equal and open access to the transportation systems. The privatization of the transportation system led to capital investments in the systems. We maintain limited storage capacity at each oil site and at the terminals from which oil is shipped. In the past, these capacities have been sufficient to store oil without reducing current production during temporary unavailability of the pipeline systems, due, for example, to maintenance requirements or temporary emergencies.

Sales for the year ended December 31, 2006, were made mainly to Petroperú Petróleos del Perú S.A., Petrobras International Finance Co. Ecuador, Empresa Nacional de Petróleo (ENAP) and Petróleos de Venezuela S.A. and, and sales to such entities represented about 19%, 13%, 7% and 7%, respectively, of sales for such year for the Oil and Gas Exploration and Production business segment, before deducting export duties. During 2006, oil and gas exports totaled approximately P\$1,061 million or 23% of total consolidated crude oil and gas sales (calculated before deducting export duties). In 2006, exports sales were made principally to Chile.

Oleoducto de Crudos Pesados (OCP)

The government of Ecuador awarded OCP with the construction and operation for a 20-year term of the 503 km long pipeline that runs from the northeastern region of Ecuador to the Balao distribution terminal on the Pacific Ocean coast. As of December 31, 2006, we held an 11.42% interest in OCP. OCP's other shareholders are Encana, Perenco, Occidental, Repsol-YPF and AGIP.

The oil pipeline has a transportation capacity of approximately 450,000 barrels per day, of which at least 350,000 barrels per day have been committed under transportation agreements that include a ship or pay clause. Because the oil pipeline runs across ecologically sensitive areas, the pipeline was constructed under stringent environmental protection and technical standards.

The construction of the oil pipeline was completed in 2003. After testing the system at its maximum capacity and obtaining approval by the Ministry of Energy and Mines of Ecuador, the oil pipeline officially started operations on November 10, 2003.

In connection with production from Blocks 18 and 31 in Ecuador (Block 31 has no production yet as it is in the early stages of development), we, through our subsidiaries in Ecuador, entered into a transportation agreement that includes a ship or pay clause with OCP, whereby OCP has committed to transport 80,000 barrels per day for a 15-year term, as from November 2003. For a more detailed discussion see Business Overview Oil and Gas Exploration and Production Oil and Gas Exploration and Production Interests Production Production outside of Argentina Ecuador.

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Oleoductos del Valle S.A. Oldelval

Oldelval, a company in which we have a 23.1% interest, holds the concession for the transportation of crude oil through 888 km-long oil pipelines with 1,706 km of installed piping between the Neuquén Basin and Puerto Rosales (located in the Province of Buenos Aires). The concession has a 35-year term starting in 1993, with an option to renew for ten years. Oldelval's other shareholders are Repsol-YPF, Petrolera San Jorge, Pluspetrol, Pan American and Tecpetrol.

The pipeline between Allen and Puerto Rosales has a transportation capacity of approximately 265,000 barrels per day, with one million barrels of storage capacity.

During 2006, oil volumes transported by Oldelval from Allen to Puerto Rosales totaled 70.5 million barrels.

The applicable laws governing the transportation of hydrocarbons through oil pipelines, which are based on the free access notion, assign loading preference quotas to pipeline owners based on their shareholdings. Oil transportation rates are set by the Argentine Secretary of Energy.

Competition

Our oil and gas related businesses are subject to oil price fluctuations determined by international market conditions. In executing our strategy to expand our oil and gas operations both in and outside of Argentina, we face competition from oil and gas producers throughout the world.

REFINING AND DISTRIBUTION

Our presence in the Refining and Distribution business is a further step towards the vertical integration of our operations and enables us to capitalize on our hydrocarbon reserves. Refining and distribution operations, are a necessary link in the business value chain, starting with crude oil and gas exploration and processing and ending with customer service at the gas station network and the supply of petrochemical products.

Our main strategy in the Refining and Distribution segment is to grow in the Argentine market while balancing the crude oil production refining logistics distribution chain with quality differentiated products and services.

Our Refining and Distribution operations are developed in Argentina and Bolivia. In Argentina, we operate two refineries and a network of 719 gas stations. One of the refineries is located in San Lorenzo (Province of Santa Fe) and the other in Bahía Blanca (Province of Buenos Aires). In addition, we have a 28.5% interest in Refinería del Norte S.A. (Refinor). In Bolivia, the Company has a 49% interest in Petrobras Bolivia Refinación S.A. (PBR).

The refining and distribution business in Argentina

The Argentine fuel market grew in 2006 for the third year in a row at an improved pace compared to the two previous years. Gasoline and diesel oil sales volumes were over 17 million cubic meters (the highest level since 1998), accounting for an 8.1% increase compared to 2005. Diesel oil sales increased 5.9% to 12.7 million cubic meters, boosted by the strong agricultural, industrial and transportation demand. Gasoline sales volumes grew 15.5% compared to 2005, totaling 4.3 million cubic meters. This variation was driven by a strong growth in the Argentine economy during recent years, the increase in the purchasing power, higher sales of new cars and stabilization of fuel prices since 2004. Premium gasoline increased 42.5% compared to regular gasoline which dropped 16.0%.

Compressed Natural Gas (CNG) sales volumes, in turn, dropped 3.9% in 2006 and reverted the upward trend of recent years due to a reduction in the conversion rate of gasoline-powered cars, the increase in CNG prices vis-à-vis the stabilization of naphta prices and the uncertainty as to gas availability, especially during wintertime.

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In terms of prices, the Argentine government continued exerting pressure to limit the increase in retail prices for gasoline and diesel oil and issued many resolutions to ensure supply to the domestic market. The inability to raise sales prices since 2004 adversely affected the sector's profitability. The Company's nature as an oil producer allowed it to partially mitigate the distortive effect of the government's actions. In terms of supply, in October 2006, the Secretary of Domestic Trade issued Resolution No.25 under which refining companies are obliged to cover the total market demand for diesel oil with a minimum calculated on the basis of 2005's demand plus an estimated market variation. To comply with this resolution, we had to import 85 thousand cubic meters of diesel oil during the year. Considering the differential between import and retail prices and the impossibility of passing it through to consumers, imports of diesel oil have resulted in significant losses to refining companies. Specifically, in 2006 and 2005 we posted P\$38 million and P\$82 million losses in relation to import operations. In the future, and subject to the production capacity of our plants and the actual market growth, under Resolution No.25 we may be obliged to import diesel oil volumes, with the consequent adverse impact on the results of operations.

Refining Division

In Argentina, the Company has a total refining capacity of 80,800 barrels of oil per day: 50,300 from the San Lorenzo refinery and 30,500 from the Ricardo Eliçabe refinery.

San Lorenzo Refinery

The San Lorenzo Refinery, located in the Province of Santa Fé, is strategically located along the main distribution system. The refinery's processing capacity is approximately 50,300 barrels of oil per day after an expansion in October 2006 from 37,700 barrels. The refinery has three atmospheric distillation units, two vacuum distillation units, a heavy diesel oil thermal cracking unit and an aircraft fuel production unit which produce the following products: premium, Podium and regular gasoline, jet fuel, diesel oil, fuel oil, kerosene, solvents, aromatics and asphalts. We are one of the few oil companies in Argentina that owns facilities for the production of asphalt products. This unique feature has enabled us to supply asphalt products for many of the most important road construction works in the country.

The Refinery has two fuel storage and dispatch plants located in the Provinces of Santa Fe and Buenos Aires, respectively. At our Dock Sud facilities, in the Province of Buenos Aires, crude oil is received, stored and dispatched. The Dock Sud facility has a total storage capacity of approximately 238,000 barrels of heavy products and 525,000 barrels of light products. Crude oil is received from the oil pipeline connecting Bahía Blanca with Dock Sud and is dispatched to tankers transporting the oil to the San Lorenzo refinery. In addition, the San Lorenzo refinery, located on the right bank of the Paraná River, with access from the so-called hydroway forming part of the Océano-Santa Fé trunk navigation route, has three docks for 250 meter-long vessels having 70,000 ton displacement. The refinery has a storage capacity for 817,000 barrels of heavy products and 312,000 barrels of light products. Ricardo Eliçabe Refinery The Ricardo Eliçabe Refinery is located in Bahía Blanca, Province of Buenos Aires, in a strategic location for the reception of crude oil coming through an oil pipeline from the Neuquén Basin or other Argentine crude oils coming by sea from the Golfo San Jorge or Santa Cruz Sur basins or for imports from international markets. With a crude processing capacity of approximately 30,500 barrels per day, it manufactures a wide variety of products: regular gasoline (86 octanes), high-grade gasoline (95 octanes), and Podium gasoline (100 octanes), kerosene, diesel oil, fuel oil, asphalts and liquefied gases (propane and butane). As from February 2007, and as the San Lorenzo Refinery was producing Podium gasoline at full capacity, we started to produce this type of fuel at the Ricardo Eliçabe Refinery. In this way, we capitalize on the plant strategic location, supplying the South and Center of the country more efficiently and increasing the supply of this product.

This refinery also produces intermediate fuel oil mixes used as fuel in vessels, raw materials for solvents and varieties for the petrochemical industry. The refinery has a storage capacity of 420,000 barrels of heavy products and 230,000 barrels of light products.

Table of Contents***Refining Master Plan***

In line with our business strategy, we have designed and begun to implement the Refining Master Plan aimed at adjusting diesel oil and motor gasoline qualities to Argentine standards, increasing conversion to diesel oil and processing higher fractions of heavy crude oils.

The plan encompasses a significant number of works, which are expected to be completed by 2011. By that time, our own production of diesel oil is expected to have increased and our fuels are expected to have met the most stringent standards in terms of sulfur content in diesel oil and sulfur, benzene and aromatics content in gasoline.

Works will allow for increasing total crude oil processing capacity to approximately 83,600 barrels of oil per day. The San Lorenzo Refinery capacity has already increased in 2006 from 37,700 barrels per day to 50,300 barrels per day. The Ricardo Pedro Eliçabe Refinery in Bahía Blanca, in turn, will increase its production capacity from 30,500 barrels per day to 33,300 barrels per day. Works to be performed include revamping of the primary distillation and vacuum units.

Distribution division

As of December 31, 2006 we had a commercial network of gas stations, wholesale customers and final consumers to deliver products and services to a number of regions in Argentina.

We have a network of 719 gas stations, located all around the country. We have pursued a business strategy involving the development and growth of Petrobras image across gas stations from our former SL and Eg3 brands. Throughout 2006, 41 retail outlets were rebranded to Petrobras, making for a total of 492 gas stations under the Petrobras brand as of December 31. As a result, 68% of retail outlets already operate under the Petrobras brand. In addition, we also have 41 agro-centers (outlets designed to meet the needs of the agricultural sector), of which 38 are identified under Petrobras brand. The rebranding of gas stations and agro-centers to the Petrobras brand is aimed at strengthening the positive attributes associated with our brand. Petrobras has built an excellent image for Petrobras brands, products and services in Argentina, currently competing with the image of the leading companies in the country.

Petrobras Energía's points of sale (gas stations) in Argentina were as follows:

| | As of December 31, 2006 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|
| Owned (1) | 144 |
| Franchised (2) | 575 |
| Total | 719 |
| (1) Owned or controlled by Petrobras Energía under long-term commercial contracts or other types of contractual relationships that secure a long-term direct influence over such points of sale. | |
| (2) The term franchised is | |

used to refer to gas stations owned by third parties with which Petrobras Energía has signed a franchise agreement that provides Petrobras Energía with the right (i) to become the gas stations exclusive supplier and (ii) to brand the gas station with its corporate image. Current laws establish that the duration of contracts with gas stations should be 5 years for existing stations, and 8 years for new constructions.

Petrobras Energía sells fuels to the public in Argentina under the Petrobras, Eg3, and San Lorenzo brand names with the following distribution at December 31, 2006:

Table of Contents**Gas Stations**

| | |
|---------------------------|------------|
| Petrobras | 492 |
| Eg3 | 190 |
| San Lorenzo | 37 |
| Total Gas Stations | 719 |

We are developing convenience stores, named Spacio 1, throughout our gas station network. In this first stage, we are opening convenience stores exclusively in gas stations owned by us. The Company currently has 20 Spacio 1 convenience stores.

As part of our marketing strategy to offer products and services of high quality and technology to the Argentine market, in mid 2004 we launched Podium, Petrobras Energía's premium gasoline and the first 100-octane gasoline in the Argentine market. With Podium, our share in the premium gasoline market increased from 5.3% in 2003 to 9.2% in 2006. Podium gasoline sales increased 58.1% during 2006.

In November 2006, Petrobras Energía launched Premmia, a brand loyalty program in Rosario (Santa Fe) for final consumers of liquid fuels and lubricants. The program involves the accumulation of points resulting from the purchase of fuels and lubricants that can be later exchanged for a reward or benefit. In addition, instant rewards and benefits are also granted by means of the Premmia checks. The program aims at generating a database with accurate and true information on customers, strengthening the relationship with them, retaining the most profitable ones and optimizing marketing actions. In the short term, the Strategic Plan aims at implementing this program throughout the country.

As of December 31, 2006, our share in the gasoline market was 14.6% and 13.6% in the diesel oil market.

Domestic market share of gasoline and diesel oil reached 13.8%, propelled us into the third place in the market.

The Distribution business is also significantly focused on lubricants. In recent years, we aimed at consolidating the Lubrax brand in the Argentine market through the development of exclusive lubricant customers, the leverage of combined sales with liquid fuels, promotions at retail outlets and mass media communication involving the brand. As a result, Lubrax sales hit a new record in 2006 with sales volumes amounting to 32,611 cubic meters in the Argentine market. This figure accounts for a 28.7% growth compared to 2005, while the market recorded only a 2.6% increase. Thus, our share in the lubricant market was 11.1%.

We also sell petroleum products to the industry, construction and marine markets. Products sold in these markets include marine fuels and lubricants, asphalts, and other products that are beyond governmental price stabilization policies. Our strategy is to consolidate our presence within these markets in order to maximize profits and increase the value generated to the Company.

In Argentina, with a market share of 47.9%, we are a leading company in the bunkering segment (production and supply of marine fuels and lubricants).

With respect to the road asphalt market, our sales volumes were 2.2% lower compared to 2005, mainly as a result of the revamping of San Lorenzo Refinery which limited product availability. In Argentina we rank second in the asphalt market. In addition, we have a leading position in the asphalt markets in Bolivia and Paraguay.

The following table shows production and sales for our consolidated Refining and Distribution business segment for fiscal years ended December 31, 2006, 2005 and 2004:

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| | Year Ended December 31, | | |
|---------------------------------------------|--------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Production (thousands of tons): | | | |
| Virgin naphtha | 737 | 810 | 742 |
| Diesel oil | 1,282 | 1,226 | 1,220 |
| Other products | 1,229 | 1,156 | 1,203 |
| Sales: | | | |
| Aromatics (thousands of tons) | 30 | 46 | 37 |
| Benzene (thousands of tons) | 51 | 58 | 54 |
| Gasoline (thousands of m3) | 837 | 715 | 689 |
| Diesel oil (thousands of m3) | 1,767 | 1,741 | 1,787 |
| Other medium distillates (thousands of m3) | 15 | 13 | 15 |
| Asphalts (thousands of tons) | 184 | 188 | 153 |
| Reformer plant products (thousands of tons) | 118 | 135 | 93 |
| Other heavy products (thousands of tons) | 819 | 686 | 674 |
| Paraffins (thousands of tons) | 163 | 163 | 193 |
| Sales (in millions of pesos): | | | |
| Argentina | 3,361 | 2,991 | 2,594 |
| Outside of Argentina | 1,170 | 865 | 765 |
| Total | 4,531 | 3,856 | 3,359 |

During 2006, 2005 and 2004 the Company processed, respectively, an average of 63,100, 62,900 and 63,100 barrels per day through our two refineries.

Refinor

We have a 28.5% interest in Refinería del Norte S.A. (Refinor). Refinor's other shareholders are Repsol-YPF (50%) and Pluspetrol S.A. (21.5%). Refinor is engaged in crude refining, gas production, product transportation, marketing and sales.

Refinor owns the only refinery in the northern region of Argentina, which is located in Campo Duran, Province of Salta. Refinor's refining capacity is approximately 26,400 barrels of oil per day and its natural gas processing capacity is 19.5 million cubic meters per day.

Refinor has the following processing plants: an atmospheric distillation unit (Topping), a vacuum distillation unit, a gasoline hydrotreatment unit, a catalytic reformer plant, two LPG turboexpander and fractioning plants in addition to a plant for the production of auxiliary services (industrial water, steam, electricity, air) used in the different processing plants.

The Campo Durán Refinery receives crude oil/condensate and natural gas from the northwestern basin and from Bolivia. These operations are conducted through two oil pipelines and three gas pipelines.

In addition, Refinor operates a 1,100 km long poliduct running from Campo Durán (Salta) to Montecristo (Province of Córdoba) for the distribution of its products. Along the pipeline, the Banda Río Salí (Tucumán), Güemes (Salta) and Leales (Tucumán) dispatch plants are supplied. This poliduct is the most important distribution means of all liquids generated in the Noroeste basin in the Republic of Argentina and transports diesel oil, gasoline for petrochemical use, gasoline for automotive use, kerosene, butane and propane.

Throughout 2006, the refinery processed all the crude oil and condensate of the Argentine northwestern basin. However, the supply of condensate from Bolivia was irregular as from May and lower than expected as a result of the hydrocarbon nationalization policy implemented in the neighboring country. Nevertheless, crude oil volumes processed during the year averaged 17.1 Mbbl/day accounting for a 65% use of the processing installed capacity at the

Topping unit. Sales of fuels produced from crude oil amounted to 9,565 bbl/day in the domestic market and 11,456 bbl/day in the foreign market, of which 86% were attributable to virgin naphtha.

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Regarding LPG production at the Turboexpander plants, during 2006 Refinor recorded a monthly average of 29.5 thousand tons, setting a historical record for us and increasing sales of this product to 354.2 thousand tons per year.

As of December 31, 2006, Refinor has a commercial network of 75 gas stations (14 operated by Refinor) located in the Provinces of Salta, Tucumán, Jujuy, Córdoba, Santiago del Estero, La Rioja, Catamarca and Chaco. Through these gas stations, Refinor sells a high performance fuel line: Refinor 97 (97 octanes), High grade (95 octanes), Regular (85 octanes) and Eco Diesel.

In 2006 we maintained our interest of approximately 23% and 21% in the motor gasoline and diesel oil markets, respectively, in the northwestern region of Argentina. Considering the size of its gas station network, Refinor continues to be the oil company with the second highest number of retail outlets and sales volumes in the northwestern region of Argentina.

The following table sets forth Refinor's production and sales for fiscal years ended December 31, 2006, 2005 and 2004:

| | Year ended December 31, | | |
|--------------------------------------|--------------------------------|--------------|--------------|
| | 2006 | 2005 | 2004 |
| Production: | | | |
| Gasoline (thousands of m3) | 93 | 102 | 101 |
| Virgin naphtha (thousands of m3) | 420 | 441 | 387 |
| Diesel oil (thousands of m3) | 331 | 358 | 354 |
| Natural gasoline (thousands of m3) | 130 | 121 | 132 |
| Propane/butane (thousands of tons) | 357 | 357 | 363 |
| Other products (thousands of m3) | 127 | 138 | 158 |
| Sales: | | | |
| Gasoline (thousands of m3) | 95 | 106 | 109 |
| Virgin naphtha (thousands of m3) | 573 | 573 | 529 |
| Diesel oil (thousands of m3) | 450 | 505 | 406 |
| Propane/butane (thousands of tons) | 354 | 352 | 354 |
| Other products (thousands of m3) | 101 | 111 | 81 |
| Sales (in millions of pesos): | | | |
| Argentina | 731 | 696 | 557 |
| Outside of Argentina | 785 | 733 | 533 |
| Total | 1,516 | 1,429 | 1,090 |

Petrobras Bolivia Refinación (PBR)

The Company has a 49% interest in PBR. Petrobras is our strategic partner, with a 51% interest.

PBR owns two refineries located in Cochabamba and Santa Cruz de la Sierra, Bolivia, with an estimated maximum production capacity of 60,000 barrels of oil per day, accounting for 92% of Bolivia's total refining capacity. During 2006, PBR processed levels of crude oil averaging 39,900 barrels per day. During 2005 and 2004, crude oil processed averaged 39,800 and 37,460 barrels per day, respectively.

In May 2006, the Bolivian government issued Supreme Decree N° 28,701, which provides, among other things, that the Bolivian government shall recover full participation in the entire oil and gas production chain, and for this purpose provides for the nationalization of the shares of stock necessary for YPFB to have at least 50% plus one of the shares in a number of companies, including PBR. We are currently in the process of evaluating the effects of the recently announced measures on our operations. The implementation of these measures requires a number of steps that have not yet been fully defined, including a comprehensive restructuring of YPFB. Until April 2006, the refinery, through its subsidiary Petrobras Bolivia Distribución, increased the market share in the domestic market to almost 34%. Thereafter, and pursuant to new government regulations, YPFB (Yacimientos Petrolíferos Fiscales Bolivianos) became the only wholesaler in the market.

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The following table sets forth PBR's sales and production for fiscal years ended December 31, 2006, 2005 and 2004:

| | Year ended December 31, | | |
|---------------------------------------|--------------------------------|--------------|--------------|
| | 2006 | 2005 | 2004 |
| Production: | | | |
| Gasoline (thousands of m3) | 612 | 600 | 618 |
| Diesel oil (thousands of m3) | 668 | 669 | 660 |
| Propane/butane (thousands of tons) | 76 | 76 | 69 |
| Reconstituted Oil (thousands of tons) | 574 | 565 | 467 |
| Other products (thousands of m3) | 216 | 398 | 360 |
| Sales: | | | |
| Gasoline (thousands of m3) | 601 | 552 | 606 |
| Diesel oil (thousands of m3) | 648 | 655 | 666 |
| Propane/butane (thousands of tons) | 76 | 80 | 71 |
| Reconstituted Oil (thousands of m3) | 616 | 427 | 379 |
| Other products (thousands of m3) | 272 | 386 | 280 |
| Sales (in millions of pesos): | | | |
| Bolivia | 1,974 | 1,812 | 1,886 |
| Outside of Bolivia | 705 | 535 | 674 |
| Total | 2,679 | 2,347 | 2,560 |

Competition

We compete in Argentina principally with Repsol-YPF S.A., Shell CAPSA and Esso S.A., with shares in the motor gasoline and diesel oil domestic market of approximately 54.7%, 14.3% and 12.4%, respectively.

PETROCHEMICALS

The Petrochemicals business is a key component in our strategy to vertically integrating our operations. Our goal in the petrochemical business is to consolidate our regional leadership by:

Maximizing the use of our own petrochemical raw materials.

Capitalizing on current conditions in the styrenics market by expanding its regional demand and particularly supporting, in the local market, the growth currently experienced by customers.

Consolidating the fertilizer business, which uses natural gas and, therefore, adds value to the business.

Our petrochemical operations are performed in Argentina and Brazil. We produce a wide array of products, such as styrene, polystyrene, synthetic rubber, fertilizers and polypropylene, both for the domestic and export markets.

Through Innova, a wholly owned subsidiary in Brazil, and our operations in Argentina, we have the region's largest installed capacity to produce styrene and polystyrene, and can provide services to clients in both Brazil and Argentina.

We also have a 40% interest in Petroquímica Cuyo S.A (Cuyo), a producer and marketer of polypropylene.

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Argentine operations

Argentine styrenics division

In Argentina, we are the only producer of styrene, polystyrene and elastomers and the only integrated producer of products from oil and natural gas to plastics. As part of our efforts to integrate our operations, we use a substantial amount of styrene for the production of polystyrene and synthetic rubber.

The styrenics division has the following plants:

A styrene and synthetic rubber plant at Puerto General San Martín, Province of Santa Fé, with a production capacity of 160,000 tons of styrene per year and 57,000 tons of synthetic rubber per year. In 2006 the plant capacity was expanded from 110,000 to 160,000 tons per year. This expansion allows us to consolidate our leadership and support the growth of markets in the region.

A polystyrene plant located at Zárate, Province of Buenos Aires, with a production capacity of 66,000 tons of polystyrene per year and 14,000 tons of bioriented polystyrene (Bops), per year. This state-of-the-art plant of Bops is the only one of its type in South America.

An ethylene plant located in San Lorenzo, with a production capacity of 20,000 tons per year. It is located along the Paraná river coast, near our San Lorenzo refinery, which provides the oil feedstock necessary for operation, and the Puerto General San Martín petrochemical complex, which uses ethylene as raw material for the production of ethylbenzene and ultimately styrene. This ethylene plant, which was acquired in 2004, has allowed us to expand our business value chain and our product offering, resulting in an increase in our share of the plastic raw material market. As part of the integration of our business, it has allowed us to increase production capacity at the Puerto General San Martín ethylbenzene plant from 116,000 to 180,000 tons per year.

With a view to capitalizing on the business opportunities offered by a rapidly expanding regional market for synthetic rubber, particularly due to the growth in the tire industry, and by good margins in the international market due to limited supply, we made capital expenditures that will enable us to expand our production capacity for synthetic rubber to 59,000 tons per year by 2007.

As of December 31, 2006, our estimated share in the Argentine market was:

Styrene 100%

Styrene butadiene rubber (SBR) 97%.

In addition, we are market leaders in the Argentine polystyrene market, with an 82.4% market share.

Exports are a significant part of our business. In 2006, we exported 35%, 52% and 24% of our total sales volumes of styrene, rubber and polystyrene, respectively. Exports were primarily to Mercosur member countries and Chile. In 2006, we exported 10.5 tons of bioriented polystyrene, primarily to Europe, the United States and South America.

Fertilizers division

We are pioneers in the production and distribution of fertilizers in Argentina. We supply approximately 22% of the market with a wide array of specific solutions and are the only producer of liquid fertilizers in Argentina.

The fertilizers division has an industrial complex at Campana, Province of Buenos Aires, with a production capacity of 200,000 tons per year of urea and 560,000 tons per year of liquid fertilizers.

Liquid fertilizers storage capacity totals 75,000 tons, which, together with automatic loading and mixing facilities, allow us to manage the growth in liquid fertilizer production.

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In line with the strategy associated with liquid fertilizers, in November 2006, a new Plant for the production of potassium thiosulphate became operational at the Campana complex. Production of liquid potassium offers several competitive advantages: it results in strong cost synergies in connection with the production of ammonium thiosulphate, improves the liquid fertilizer technological portfolio devoted to regional intensive crops and also opens up prospects for the production of water treatment industrial components.

We have 600 customers throughout Argentina. Of these, 130 are distributors with their own storage facility centers, complementing our warehouses and assistance centers in twelve different strategically - located agronomic regions.

The following table sets forth production and sales by major product for both the styrenics and fertilizers divisions for fiscal years ended December 31, 2006, 2005 and 2004:

| | Year ended December 31, | | |
|----------------------------------------|--------------------------------|--------------|--------------|
| | 2006 | 2005 | 2004 |
| Production (thousands of tons): | | | |
| Styrene ⁽¹⁾ | 95 | 107 | 111 |
| Synthetic rubber ⁽²⁾ | 53 | 55 | 58 |
| Urea | 54 | 169 | 188 |
| UAN and other liquid fertilizers | 492 | 261 | 248 |
| Polystyrene | 57 | 58 | 62 |
| Bops | 13 | 13 | 12 |
| Sales (thousand of tons): | | | |
| Styrene ⁽¹⁾ | 100 | 89 | 52 |
| Synthetic rubber ⁽²⁾ | 56 | 53 | 60 |
| Fertilizers | 747 | 676 | 713 |
| Polystyrene and Bops | 72 | 65 | 63 |
| Propylene | 23 | 23 | 20 |
| Sales (in millions of pesos): | | | |
| Argentina Sales | 1,084 | 963 | 873 |
| Outside of Argentina | 500 | 413 | 270 |
| Total Argentina | 1,584 | 1,376 | 1,143 |

(1) Including ethylbenzene.

(2) Including SBR, NBR and butadiene.

Petroquímica Cuyo (Cuyo)

Cuyo is primarily involved in the production and marketing of polypropylene. Admire Trading Company and Petrobras Energía S.A. are Cuyo's main shareholders, with a 50.5% and a 40% interest, respectively. Cuyo's industrial plant, located at Luján de Cuyo, Province of Mendoza, has a production capacity of approximately 120,000 tons per year. During 2006, works related to the installation and start-up of the third extrusion line were completed and resulted in an increase in production volumes of approximately 20%. The quality and specialization of its products have enabled Cuyo to access international markets and export to several countries, especially to Mercosur member countries and Chile.

Approximately 82% of the propylene feedstock required for Cuyo's operations is supplied by Repsol-YPF from its Luján de Cuyo refinery under a long-term contract scheduled to expire in 2014. In addition, in 2005 Cuyo signed an agreement with us, scheduled to expire in 2015, for the supply of 22,000 tons of propylene per year. In addition, on

December 1, 2006, Cuyo signed another contract with us, for a term of two years, for the supply of an additional 5,000 tons of propylene per year.

Cuyo is a licensee of Novolen Technology Holdings (NTH), a company belonging to the ABB Lummus Group, engaged in the licensing and technical assistance related to polypropylene manufacturing technology. In addition, Cuyo and NTH maintain a Joint Development Agreement (JDA), enabling Cuyo to be a leading company in product applications and to serve the market with world-class products.

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The following table sets forth Cuyo's production and sales for fiscal years ended December 31, 2006, 2005 and 2004.

| | Year ended December 31, | | |
|--------------------------------|--------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Production (thousands of tons) | 97.0 | 85.6 | 88.7 |
| Sales (in millions of pesos) | 470 | 337 | 293 |

Brazilian Operations

Our petrochemical operations in Brazil are conducted through Innova, our wholly owned subsidiary.

Innova has the first integrated complex in Latin America for the production of ethylbenzene, styrene and polystyrene. It is located at Triunfo Petrochemical Pole, Rio Grande do Sul, in the south of Brazil. The styrene plant has a production capacity of 250,000 tons per year and the polystyrene plant has a production capacity of 135,000 tons per year. Copesul, a Brazilian company, supplies the benzene and ethylene feedstock necessary for the production of styrene pursuant to a long-term contract.

The polystyrene plant uses approximately 127,000 tons of styrene as feedstock to produce two grades of polystyrene (Crystal and High Impact). The remaining styrene is sold mainly in the Brazilian market for the production of synthetic rubber, expanded polystyrene, polyester and acrylic resins.

Innova is the leading styrene and polystyrene producer and supplier in Brazil with a combined market share of approximately 38%.

In maintaining its leading position in the region, in an increasingly competitive regional market, the Company approved the construction of a new ethylbenzene plant at Innova, with investments in an amount of approximately U.S.\$70 million. The plant will have a potential production capacity of 540,000 tons per year. At the start of production, scheduled for May 2008, the plant is expected to operate at 50% of this capacity (270,000 tons per year) in order to supply feedstock to the current styrene plant. The plant's state-of-the-art technology and its location on the same styrene plant site will allow for reduced costs.

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The following table sets forth Innova's styrene and polystyrene production and sales for fiscal years ended December 31, 2006, 2005 and 2004.

| | 2006 | 2005 | 2004 |
|-------------------------------------------|--------------|-------------|-------------|
| Production (in thousands of tons): | | | |
| Styrene | 234 | 205 | 202 |
| Polystyrene | 113 | 95 | 105 |
| Sales (in thousands of tons): | | | |
| Styrene | 136 | 118 | 101 |
| Polystyrene | 114 | 95 | 103 |
| Other | 94 | 53 | 58 |
| Sales (in millions of pesos): | | | |
| Brazil | 1,007 | 856 | 720 |
| Outside of Brazil | 207 | 116 | 53 |
| Total sales | 1,214 | 972 | 773 |

Competition

The petrochemical market in which we compete is highly cyclical, and world market conditions have a strong impact on results in these operations. We are the only producer of styrene, polystyrene and elastomers in Argentina, but compete with other foreign producers, especially those in Brazil. In the fertilizers market, we compete with Profertil S.A., a local urea and ammonia producer with a production capacity of one million tons per year and other companies who import and mix fertilizers such as Cargill, Nidera and Yara. Profertil is owned by Repsol - YPF and Agrium S.A. In the polypropylene business, Petroken S.A. is Cuyo's main competitor, with a production capacity of 180,000 tons per year.

In Brazil, we mainly compete with Dow Chemical, Basf and Videolar, the latter being the leading player in the polystyrene market, with significant tax benefits in the Trade Free Zone of Manaus. Videolar only produces polystyrene, with an annual capacity of 120,000 tons. Dow and Basf each have a polystyrene production capacity of 190,000 tons per year and a styrene production capacity of 160,000 and 120,000 tons per year, respectively.

GAS AND ENERGY

The Gas and Energy segment serves to link the Company's energy businesses. As part of this segment, we provide oil and gas and liquefied petroleum gas (LPG) brokerage and trading services. In addition, through our stake in Transportadora de Gas del Sur S.A. or TGS, we are engaged in the transportation of gas in the south of Argentina and in the processing and marketing of natural gas liquids. In the electricity business, we are engaged in all the industry segments: generation, transmission and distribution, and have emerged as a major player in the Argentine electricity market.

In the Gas and Energy segment our main business objectives are:

Growing profitably in the gas business.

Growing profitably in the LPG business by increasing sales in retail markets.

Growing profitably in the electricity market.

Gas**Marketing**

We provide oil, gas and LPG brokerage and trading services in order to expand our production opportunities. This business segment enables us to position ourselves as a leading commercial service provider because we assist clients not only in sales but also in logistics, foreign trade and market knowledge.

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During 2006, sales volumes in Argentina for gas produced by us and imported gas totaled 267.8 million cubic feet per day. We sold 157.3 million cubic feet per day in the gas brokerage service. LPG sales volumes totaled 181.6 thousand tons, while in the LPG brokerage service, we sold 73.4 thousand tons.

During 2006, the start of LPG sales in bulk, directly to final users, was a major event. The first step was the installation of tanks on more than 25 customers' premises, mainly for chicken breeding facilities and grain dryers. Sales volumes of LPG in bulk amounted to 486 tons.

Gas Transportation TGS***Our interest in TGS and Corporate Developments***

We hold indirectly a 27.65% interest in TGS. TGS's controlling shareholder is CIESA, which as of the date of this Annual Report holds approximately 55.3% of TGS's capital stock. The remaining 44.7% of TGS's capital stock is publicly held. TGS's shares are listed on the Buenos Aires Stock Exchange and on the New York Stock Exchange. As of the date of this Annual Report, the common stock of CIESA is owned 50% by Petrobras Energía (directly and indirectly through its subsidiary Petrobras Hispano Argentina S.A.), 40% by an Argentine affiliate of ABN AMRO BANK N.V Trust (the Trust), and the remaining 10% by a subsidiary of Enron Corp. The current ownership of CIESA's and TGS's common stock is the result of the implementation of the first stage of the Master Settlement Agreement and the Mutual Release Agreement, signed by Petrobras Energía and certain Enron subsidiaries on April 16, 2004 (the Master Settlement Agreement), in connection with the restructuring of CIESA's indebtedness. CIESA's Board of Directors is composed of three of our representatives, two representatives of the Trust and one Enron representative. TGS's Board of Directors is composed of nine members, six of them are CIESA's representatives (three of whom are our representatives, two are representatives of the Trust and one is an Enron representative), and three independent Directors, which must be unanimously approved by all the shareholders of CIESA. Pursuant to a Shareholders' Agreement entered into on August 29, 2005 (the Shareholders' Agreement), by Enron, the Trust and us, we have the right to appoint the chairman of the Board of Directors of both TGS and CIESA and the chief executive officer of TGS.

Due to the abrupt changes subsequent to the enactment of the Public Emergency Law in Argentina, CIESA and TGS both defaulted on their debt. CIESA failed to repay corporate notes having a principal amount of U.S.\$220 million and derivative instruments of approximately U.S.\$2 million in value. CIESA's shareholders, including us, have not assumed any financial obligations to assist CIESA.

In 2004, TGS successfully restructured substantially all of its debt (U.S.\$1,019 million), pursuant to a proposal accepted by almost all of its creditors.

Regarding CIESA's debt restructuring, in July 2005, ENARGAS approved the implementation of the first stage of the transactions contemplated by the Master Settlement Agreement, and as a result, on August 29, 2005, (a) Enron transferred 40% of CIESA's shares to a newly created trust, the Trust and (b) Petrobras Energía and its subsidiary, Petrobras Hispano Argentina, transferred class B common shares of TGS, representing 7.35% of TGS's capital stock, to subsidiaries of Enron, which in turn were subsequently sold to third parties.

On September 7, 2005, CIESA, its current shareholders and creditors entered into a Restructuring Agreement, which provides for the implementation of the second phase of the transactions contemplated by the Master Settlement Agreement. As a first step, CIESA refinanced approximately U.S.\$23 million of its debt. As a second step, which will be completed after and subject to approval by the CNV, ENARGAS and the Argentine antitrust authorities (Comisión Nacional de Defensa de la Competencia), CiesA will deliver about 4.3% of the Class B Shares of common stock held in TGS to CIESA's financial creditors as a partial debt repayment. The creditors will transfer the shares to Enron in exchange for the 10% remaining shares held by Enron in CIESA. In addition, creditors will contribute the balance of the outstanding debt subject to the restructuring to CIESA's capital. Upon the implementation of this second step, we will own 50% of CIESA's capital stock and the creditors will own the remaining 50%, and CIESA will own 51% of TGS's common stock.

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We provide services to TGS related to the operation and maintenance of the gas transportation system and related facilities and equipment to ensure that the performance of the system is in conformity with international standards and in compliance with certain environmental standards, pursuant to a Technical Assistance Agreement entered into by Enron Pipeline Company Argentina S.A. and TGS in 1992. This agreement was assigned to us on July 15, 2004, pursuant to the terms of the Master Settlement Agreement. For these services, TGS pays us an annual fee equal to the greater of (1) P\$3 million and (2) 7% of the amount obtained after subtracting P\$3 million from TGS's net income before financial income (expense) and holding gains (losses) and income taxes. Effective on January 1, 2007, we have assigned 40% of this fee to CIESA's creditors.

Business

TGS began operations in late 1992 as a part of the privatization of the Argentine energy sector. Currently, TGS is the leading gas transportation company in Argentina, delivering about 67% of total gas demand. TGS is also one of the leading natural gas liquids producers and traders, both in the domestic and international markets, and an important provider of midstream services, including business and financial structuring, turnkey construction and operation and maintenance of facilities used for gas storage, conditioning and transportation.

The following chart shows statistical information relating to TGS's business segments for fiscal years ended December 31, 2006, 2005 and 2004.

| | 2006 | 2005 | 2004 |
|------------------------------------------------|-------------|-------------|-------------|
| Regulated Segment: | | | |
| Average firm committed capacity ⁽¹⁾ | 71.6 | 68.3 | 63.6 |
| Average daily deliveries ⁽¹⁾ | 61.2 | 57.6 | 55.6 |
| Annual load factor ⁽²⁾ | 86% | 84% | 87% |
| Unregulated Segment: | | | |
| Liquids total production ⁽³⁾ | 1,036.4 | 882.5 | 969.0 |
| Processing capacity at year end ⁽¹⁾ | 43.0 | 43.0 | 43.0 |

(1) In millions of cubic meters per day.

(2) Corresponds to the quotient of the average daily deliveries and the average firm contracted capacity.

(3) In thousands of tons.

Regulated Energy Segment

Within the regulated energy segment, TGS is the gas transportation licensee in the south of Argentina and is the largest transporter of natural gas in Argentina and all Latin America. TGS's pipeline system connects Argentina's southern and western gas reserves with the main consumption centers in those regions, including Greater Buenos Aires. TGS has an exclusive license for the use of the southern gas transportation system, which is due to expire in 2027 with an option to extend for ten additional years if certain conditions are fulfilled.

TGS transports gas through more than 7,900 km of pipelines, of which almost 7,500 km belong to TGS, with a current firm contracted capacity, as of December 31, 2006, of 71.6 million cubic meters per day. Pursuant to these contracts, the capacity is reserved and paid for irrespective of the actual use by the customer. Almost all capacity of the gas transportation pipelines in Argentina is currently apportioned among gas distribution companies, large industrial

customers and gas-fired power plants under firm long-term contracts. The total average life of its firm transportation contracts is approximately eight years. In addition, TGS provides interruptible transportation services under which gas transportation is dependent on the availability of capacity.

Transportation services begin with the receipt of gas owned by a shipper (e.g., distribution companies, producers, marketers or large users) at one or more reception points. It is then transported and delivered to delivery points along the system. The total service area includes approximately 4.9 million end users, approximately 3.4 million of which are in Greater Buenos Aires. Direct services to residential, commercial, industrial users and electric power plants are mainly rendered by four gas distribution companies, which are connected to the TGS system: Metrogas S.A., Gas Natural Ban S.A., Camuzzi Gas Pampeana S.A. and Camuzzi Gas del Sur S.A. Some important industries and electric power plants are also located within TGS's operational area.

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TGS has made significant investments in its business since the privatization. As a result, approximately 833 km of gas pipelines have been laid in addition to the existing pipelines, compression power has been increased from 429,030 HP in 1992 to 579,090 HP in 2006 and transportation capacity has been increased from 42.9 million cubic meters per day to 71.7 million cubic meters per day by the end of 2006.

As a consequence of the enactment of the Public Emergency Law, which pesified and froze tariffs, revenues from the regulated segment have significantly decreased. In 2006, the gas transportation segment accounted for 38% of TGS's total revenues compared to 43%, 44% and 47% in 2005, 2004 and 2003, respectively, and approximately 80% since the start of the service until 2001.

Gas Trust

In light of the lack of expansion of the natural gas transportation system over recent years (as a consequence of the pesification of tariffs and the fact that the renegotiation of the terms of the utility contracts is still pending) and a growing gas demand in certain segments of the Argentine economy, the Argentine government established the framework for the creation of a trust fund, the Gas Trust, that would finance gas transportation system expansions.

In June 2004, TGS submitted to the Secretary of Energy a project for the expansion of transportation capacity of the San Martín pipeline by approximately 2.9 million cubic meters per day. This project involved the construction of approximately 509 km of pipeline and an increase in compression capacity of 30,000 HP, through the construction of a new compressor plant and the revamping of some existing units. The project was completed in August 2005. In its role as project manager, TGS rendered engineering, project management and control, procurement and administrative services. TGS is responsible for the operation and maintenance of the new pipelines, which are owned by the Trust Fund.

In April 2006, the Ministry of Federal Planning and Public Service, the Secretary of Energy and gas transporters, among others, signed a letter of intent to carry out the second expansion of the gas pipeline system.

In December 2006, TGS entered into an agreement under which TGS will manage the expansion of its pipeline system to an incremental capacity of 7.0MMm³/d, starting in 2007. The works will involve the installation of 705km of loops in different sections of the San Martín and Neuba II gas pipelines, the construction of a new compressor plant and the upgrading of existing plants, which will increase compression capacity by 146,500 HP. Ownership of the new assets will belong to a financial trust relating to construction work.

Renegotiation process

TGS is still engaged in discussions with UNIREN regarding the renegotiation of its tariffs. As a result, and despite of contracted capacity increases, the profitability of the regulated business has not yet been restored.

After several proposals aimed at adjusting TGS's license contractual terms, which were rejected by TGS considering that they did not reflect preliminary agreements, in 2005, UNIREN proposed a 10% tariff increase and an overall tariff review effective in 2006. This proposal requires that TGS and its shareholders waive any future claim against the Argentine government resulting from the Public Emergency Law and/or the failure to adjust tariffs during 2000 and 2001 based on the United States Industrial Goods Producer Price Index. TGS responded by rejecting the initial 10% increase as insufficient, and jointly with CIESA and Petrobras Energía agreed not to pursue any such claims if the parties reach a reasonably satisfactory agreement on tariff adjustments. Currently, the tariff renegotiation process is delayed by, among other issues, the refusal by Ponderosa Assets L.P. to abandon a claim jointly initiated with Enron Corp. against the Republic of Argentina before the International Centre for the Settlement of Investment Disputes (ICSID). Ponderosa has stated that it will only consider the abandonment of this claim if Ponderosa is fairly compensated. During 2006, UNIREN made two proposals to TGS under terms identical to those previously stated.

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In addition to the regulated segment of natural gas transportation, TGS is also one of the leading processors of natural gas and one of the largest traders of natural gas liquids (NGL). NGL production and distribution involves the extraction of ethane, propane, butane, and natural gasoline from the gas flow that arrives to the General Cerri Complex, located near Bahía Blanca, in the Province of Buenos Aires, which is connected to TGS's main pipelines. TGS has two gas processing plants at the General Cerri Complex: (1) an ethane, propane, butane and natural gasoline turbo expander separating plant and (2) an absorption plant which extracts propane, butane and gasoline from the gas transported through the TGS pipeline system, with a gas processing capacity of 43 million cubic meters per day and a storage capacity of 54,840 tons. After extraction, TGS sells these products in the domestic and international market. TGS also stores and ships the products at facilities located in Puerto Galván. These activities are not regulated by ENARGAS.

NGL production and distribution net revenues accounted for approximately 55%, 51% and 51% of TGS's net revenues in 2006, 2005 and 2004, respectively. TGS's operations are benefited by a significant increase in market price for exports of propane, butane and natural gasoline. NGL production in 2006, 2005 and 2004 totaled 1,036 thousands of tons, 886,000 tons and 969,000 tons, respectively.

The increase in production in 2006 resulted from firm gas purchase agreements and other actions. This production level allowed us to comply with the commitments contemplated under the regulations in force relating to the supply of propane and butane to the domestic market provided for in the agreements with the Secretary of Energy, as well as to direct a significant volume for exports.

TGS sells its NGL production to brokers and refineries in the local market and part of the production is exported to Petrobras International Finance Company, or PIFCo, a subsidiary of Petrobras, at current international market prices. During 2006, the agreements entered into with PIFCo for the sale of natural gasoline and propane and butane were renewed for a three-year term. One hundred percent of TGS's ethane is sold in the domestic market to PBB-Polisur S.A. at prices agreed between the parties.

Midstream services

Through the provision of midstream services, TGS provides integral solutions for natural gas treatment at the wellhead, including conditioning, gathering and gas compression services. These services also include those related to the construction, operation and maintenance of gas pipelines and treatment plants provided by TGS or its related companies.

Competition

TGS's gas transportation business, which provides an essential service in Argentina, faces only limited direct competition. In view of the characteristics of the markets in which TGS operates, it would be very difficult for a new entrant in the transportation market to pose a significant competitive threat to TGS, at least in the short to medium term. In the longer term, the ability of new entrants to successfully penetrate TGS's market would depend on a favorable regulatory environment, an increasing and unsatisfied demand for gas by end users, and sufficient investment in gas transportation to accommodate increased delivery capacity from the transportation systems.

On a day-to-day basis, TGS competes, to a limited extent, with Transportadora de Gas del Norte S.A. for interruptible transportation services and for new firm transportation services made available as a result of expansion projects from the Neuquén basin to the Greater Buenos Aires area. Interruptible transportation services accounted for only 7% of TGS's regulated net revenues for 2006. The relative volumes of such services will depend mainly upon the specific arrangements between buyers and sellers of gas in such areas, the perceived quality of services offered by the competing companies, and the applicable rate for each company.

With respect to natural gas liquids processing activities, TGS competes with Compañía MEGA S.A., which owns a gas processing plant at the Neuquén basin and has a processing capacity of approximately 36 million cubic meters per day. Our controlling company, Petrobras, has a 34% interest in Compañía MEGA S.A.

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Electricity

Electricity generation allows us to accelerate the monetization of gas reserves. Integration in the business chain provides us with new growth opportunities, adding value through the sale of power and energy services to end users, as well as, through the development of cutting edge technology.

We conduct electricity generation activities through Genelba Power Plant in the Province of Buenos Aires and the Pichi Picún Leufú Hydroelectric Complex, or HPPL, in the Comahue region, on the Limay River, Province of Neuquén.

We are engaged in the transmission business through our interests in Transener (through Citelec), currently undergoing a divestment process, Enecor S.A. and Yacylec S.A. and in electricity distribution business through our interest in Edesur (through Distrilec).

The changes resulting from the enactment of the Public Emergency Law adversely impacted the economic and financial balance of the electricity business in Argentina. In particular, the devaluation of the peso and the subsequent inflation, within a context of fixed revenues from utility companies as a consequence of the pesification of rates, affected the financial position and results of operations of the electricity utility companies and significantly hindered their ability to comply with their financial obligations.

The Argentine Electricity Market

In Argentina, in the early 1990s, within the state-reform general framework, the Argentine government carried out a thorough restructuring of the electricity sector, transforming it into a more decentralized system with greater private sector participation. Up to then, the electricity system was characterized by the inability to meet short- and long-term demand and low service quality, all within a framework of a limited capacity on the part of the state to make necessary investments. Over the last ten years, electricity demand in Argentina has strongly increased at an average rate of 5.8%, exceeding the growth in gross domestic product for the same period. In 2006, electricity demand grew approximately 5.5% to 97,510 GWh from 87,779 GWh in 2005, mainly as result of increased industrial and residential consumption. Total electricity generation including imports and exports totaled 104,343 GWh (51.5% attributable to thermoelectric plants, 40.6% to hydroelectric plants, 6.9% to nuclear plants and 1.1% to imports).

As of December 2006, installed generation capacity reached 24,080 MW, accounting for a growth of approximately 70% from privatization of electricity services.

Electricity Generation

Following the Public Emergency Law, the Argentine government implemented the pesification of U.S. dollar-denominated prices in the wholesale electricity market and set a price cap for the gas used to supply electricity generation. This had an impact on the determination of prices for the energy sold in the spot market and led generation companies to fix prices based on the price for natural gas, regardless of the fuel used in generation activities. This regulatory change caused a deviation from the marginal cost system which had been previously implemented.

As a result of the Argentine government's measures, electricity prices have failed to reflect total generation costs adequately. This discrepancy led to the gradual depletion of the Stabilization Fund (*Fondo de Estabilización*), causing an increasing deficit, which in turn prevented Compañía Administradora del Mercado Eléctrico S.A., or CAMMESA, from settling accounts with market agents. In an effort to reduce the Stabilization Fund deficit, the Argentine government first made successive contributions to the fund and subsequently reinstated seasonal adjustments for certain periods, recognizing some increased costs resulting from the recovery of natural gas prices in the determination of wholesale spot prices. However, these actions have not been enough to restore the Stabilization Fund.

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In order to replenish the Stabilization Fund, the Secretary of Energy created an investment fund called Fund for Investments Necessary to Increase Supply of Electric Power in the Wholesale Electricity Market (FONINVEMEM). This fund encouraged WEM creditors to participate in investments in electric power generation in order to increase the available supply of electric power generation in Argentina. The Secretary of Energy invited WEM agents to participate in these investments by contributing outstanding credits balances against CAMMESA resulting from the spread between sale prices and generation variable costs, and determined that non-participating agents would only receive payment on any such credits as from the date on which the generators constructed with FONINVEMEM's resources provide sufficient funds. We participated with 65% of the credit balances recorded for the 2004-2006 period with respect to this spread. Total credit balances contributed as of December 31, 2006 amounted to U.S.\$41 million.

On October 17, 2005 and under the terms of Resolution No. 1,193 of the Secretary of Energy we, together with other WEM creditors, formally announced our decision to participate in the construction, operation and maintenance of two plants of at least 800 MW each. Open cycle operations are scheduled to start in 2008 first semester and closing of the combined cycle is scheduled by the beginning of 2009. Construction costs for both plants are estimated at approximately U.S.\$1,080 million. Approximately 48% of this amount will be financed through contributions to the FONINVEMEM and the remaining balance through an additional demand charge.

Two trusts were created within CAMMESA's sphere of responsibility for the purchase of equipment and the construction, operation and maintenance of the power plants. The funds corresponding to the FONINVEMEM and the specific charge will be deposited in the trusts. Purchase of the equipment, construction, operation and maintenance of each power plant will be the responsibility of Termoeléctrica José de San Martín S.A. and Termoeléctrica Manuel Belgrano S.A., who will act on behalf of the respective trusts. These plants will be subject to a 10-year electric power supply agreement with CAMMESA for 80% of generated power, at a price covering all their costs and the payments to the FONINVEMEM. The companies may freely dispose of the remaining 20% of generated power. Upon expiration of the supply agreement, ownership of the assets under the trust will be transferred to the companies.

Petrobras Energía holds an interest of approximately 8% in both companies. The amount of funds to be contributed by all MEM creditors is initially estimated at U.S.\$520 million, of which U.S.\$41.3 million would be provided by Petrobras Energía. Petrobras Energía, as the other WEM creditors, will be reimbursed the amounts contributed, converted into U.S. dollars and adjusted at a rate of LIBOR plus 1% per year in 120 monthly installments out of the trust funds received during the life of the electric power supply agreement with CAMMESA.

In order to restore the regular operation of the WEM as a competitive market that provides sufficient supply, in December 2004, the Secretary of Energy committed to approving successive seasonal price increases to reach values covering at least total monomic costs by November 2006. However, this situation was not reflected in practice and price increases do not account for costs actually incurred in terms of generation. The Secretary of Energy was committed to pay for energy at the marginal price obtained in the spot market and to pay for power capacity at the U.S. dollar values that were in effect prior to the enactment of the Public Emergency Law, as soon as the market returns to normal conditions following the start of commercial operations of the new generation capacity derived from the FONINVEMEM.

Electricity Generation Genelba and HPPL

Genelba Thermal Power Plant is a 660MW combined cycle gas-fired generating unit located at the central node in the Argentine electricity network, at Marcos Paz, about 50 km from the City of Buenos Aires. As part of our strategy to increase vertical integration, Genelba allows us to use approximately 2.8 million cubic meters per day of our own gas reserves.

Genelba, which commenced commercial operations in February 1999, has two gas-fired turbines that receive gas through an 8 km duct connected to the transportation system operated by TGS. The electricity produced at Genelba is distributed via the national grid through a connection to the Ezeiza transformer station (owned by Transener) located only 1 km away from Genelba.

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The allocation of electricity dispatch to the wholesale electricity market, whether the electricity is produced under firm contracts or for the spot market, is subject to market rules based on the lowest variable cost of electricity generation. See Regulation of our Businesses Argentine Regulatory Framework Electricity . Since Genelba uses combined cycle technology for a natural gas-fired power plant, our short-run variable cost is expected to be lower than the cost of most other thermoelectric power plants, granting significant competitive advantages for Genelba. Therefore, CAMMESA is expected to dispatch Genelba's generating capacity before that of most other thermoelectric plants.

The Genelba Power Plant stands out in the Argentine electricity market for its high reliability and efficiency. The Power Plant is recognized as one of the combined cycle electric power plant with highest availability.

In 2005, Genelba achieved certification to SA8000 Standard A Social Accountability System and Petrobras Energía thus became the first company in the Argentine energy sector and one of the three companies in the country to achieve this certification.

We were awarded a 30-year concession beginning in August 1999 for hydroelectric power generation at Pichi Picún Leufú Hydroelectric Complex. The complex has three generating units with an installed capacity of 285 MW. Units 1 and 2 began commercial operations during the third quarter of 1999, and Unit 3 started commercial operations in December 1999.

Pursuant to our concession contract and applicable law, since August 2003, we have paid 1% in hydroelectric royalties, which are increased by 1% annually until reaching a 12% maximum tax rate, on the amount resulting from applying to the energy sold the tariff corresponding to block sales. In addition, we pay the Argentine government a monthly fee for the use of the water source amounting to 0.5% of the same amount used for the calculation of these hydroelectric royalties.

Genelba and HPPL, together, account for approximately 6.2% of the power generated in the Argentine electricity system. The joint operation of the generating units minimizes income volatility, capitalizing on the natural barriers existing among the different energy resources used for power generation.

In 2006, Genelba Thermoelectric Plant generated 5,005 GWh, and set a historical record since start up in 1997, with a reliability factor of 99.4% and an availability factor of 99%.

In addition, in 2006, HPPL generation, taking advantage of the high flow of Limay and Collón Curá Rivers, totaled 1,430 GWh, accounting for a 21.5% increase compared to 2005 and also setting a record since start up.

The following chart details energy generation and sales figures for Genelba and HPPL for fiscal years ended December 31, 2006, 2005 and 2004:

| | Year ended December 31, | | |
|-------------------------------------|--------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Power Generated (Gwh) | 6,434 | 6,114 | 5,689 |
| Power Sold (Gwh): | | | |
| Forward market | 2,300 | 1,255 | 1,437 |
| Spot market | 4,621 | 5,486 | 4,719 |
| Total sales | 6,921 | 6,741 | 6,156 |
| Sales (in millions of pesos) | 500 | 355 | 280 |

Table of Contents**Electricity Transmission: Transener, Yacylec and Enecor***Transener*

We currently own a 26.8% indirect interest in Transener. Transener is the leading power transmission company in Argentina. Transener is controlled by Citelec, who owns 52.65% of Transener's capital stock. Citelec, in turn, is owned on a 50/50 basis by Petrobras Energía and Pampa Holding S.A. (which interest was previously owned by Dolphin Fund Management). We committed to divesting our aggregate equity interest in Citelec as required under the Argentine Antitrust Commission's resolution approving the purchase of Petrobras Energía Participaciones majority stock by Petrobras. No time limit was set to effect this divestiture. Pursuant to Resolution No. 941, Petrobras Energía presented to the Argentine Secretary of Energy a plan to divest completely its equity interest in Citelec. In June 2006, the Board of Directors of Petrobras Energía accepted the terms of the binding offer submitted by Eton Park Capital Management for the acquisition of our 50% equity interest in Citelec and, as part of this offer, our 22.22% interest in Yacylec. The terms of the offer provided for the transfer of the shareholding in Citelec at a fixed price of U.S.\$54 million, plus an earn out relating to the result of the comprehensive rate review determined for Transener and its controlled company Empresa de Transporte de Energía Eléctrica por Distribución Troncal de la Provincia de Buenos Aires S.A. (Transba). In August 2006, Petrobras Energía entered into a stock purchase agreement with EP Primrose Spain S.L. (a company controlled by Eton Park Capital Management) with respect to Eton Park's offer. Under the terms of the stock purchase agreement and the terms of Petrobras Energía's divestment commitment, the consummation of the transaction with Eton Park is subject to the approval by the pertinent regulatory agencies and authorities. On February 9, 2007, the Argentine Antitrust Commission issued a resolution rejecting the sale of Citelec shares to Eton Park Capital Management. In March 2007, Petrobras Energía received an offer from Energía Argentina S.A. (Enarsa) and Electroingeniería S.A. for the purchase of its shares in Citelec and Yacylec, proposing legal, economic and financial conditions identical to those previously agreed with Eton Park Capital Management. As a result of this offer, a letter of agreement was executed subject to approval by the Board of Directors of Petrobras Energía, Enarsa and Electroingeniería. The letter of agreement provides that the offer will be accepted if the rejection of EP Primrose Spain S.L.'s proposed transaction becomes final through administrative or legal proceedings or if the agreement entered into with EP Primrose Spain S.L. were terminated for failure to obtain all required governmental authorizations.

Under a 95-year concession, due to expire in 2088, Transener operates and maintains approximately 6,938 km of 500 Kv transmission lines and 568 of 220 kV transmission lines, and 31 substations. This network is the core of the power transmission system in Argentina.

Additionally, Transener was awarded an exclusive license for the rest of the term of the original concession to construct, maintain and operate the fourth line of the Comahue-Buenos Aires electricity transmission system, which began operations late in 1999 and consists of approximately 1,292 km of 500 kV transmission lines.

In July 1997, Transener was awarded the exclusive 95-year concession to operate Transba, which expires in 2091. Transba operates approximately 6,005 km of electricity transmission lines (most of them 132 Kv lines) and 83 substations.

Transener operates approximately 95% of the Argentine extra high voltage power transmission system. Transener and Transba jointly operate approximately 75% of the Argentine high-voltage power transmission system. We have agreed with Pampa (as assignee of Dolphin Fund Management) to jointly manage Transener and Transba and to share equally in the management fees received under a management agreement with Transener. In addition, shareholders have a right of first refusal in any transfer of Transener's shares. Under the concession agreement with the government, certain shares of Transener are pledged as guarantee for the execution of obligations under such agreement.

The following chart details the evolution of Transener's failure rate for fiscal years ended December 31, 2006, 2005 and 2004. The failure rate represents the service quality provided by the company to users. The maximum admissible failure rate under the concession contract is 2.50 failures per year per every 100 km.

| | Year ended December 31, | | |
|------------------------|--------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Transener failure rate | 0.44 | 0.33 | 0.49 |

Maintenance of this low failure rate resulted from operating improvements, acquisition of special equipment and agreements with public safety agencies.

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We endeavored to maintain service quality according to the standards provided for in the concession contract considering the significant growth in GDP and electricity consumption in Argentina. Since no major expansion works were performed, many lines and substations operated by Transener are overloaded or nearly overloaded, with the consequent danger to energy supply.

Notwithstanding that, and even though the network is operating at full capacity, we complied with most operating and maintenance requirements through works granting the system greater reliability and allowing it to continue offering high efficiency rates even in difficult scenarios.

The provisions of the Public Emergency Law severely affected the economic and financial balance of Transener's business. In April 2002, as a result of the changes caused by the Public Emergency Law, Transener publicly announced the suspension of principal and interest payments on all its financial debt. In June 2005, Transener concluded the restructuring of its financial debt, pursuant to a proposal accepted by 98.8% of its creditors. As part of the restructuring, Transener redeemed debt with a nominal value of about U.S.\$460 million, in exchange for a combination of cash payments and new issuances of shares and corporate bonds. Following the restructuring, Citelec's participation in Transener decreased from 65% to 52.65%. Also after this process, Transener S.A. is subject to certain restrictions including, among others, limits on the issue of debt, investments, sale of assets and distribution of profits.

On February 2, 2005, Transener entered into a Memorandum of Understanding (the "Transener MOU") with UNIREN, in connection with the renegotiation of its tariffs. The Transener MOU contemplates:

- (i) a 31% increase in tariffs over those outstanding at the time of the agreement and other minor service adjustments, applicable until the completion of the integral revision of Transener's tariffs. In the case of TRANSBA, the increase is of 25%;
- (ii) an investment plan for the refurbishment and maintenance of the company's assets and extension of the useful life of its equipment; and
- (iii) the rules for an integral revision of Transener's tariffs, which should, within ENRE's framework, be applicable for the five-year period between 2006 and 2011. In that respect, in August 2005, Transener presented to ENRE a proposal for the recalculation of its compensation for such five-year period, as well as revisions of its asset base and rate of return.

The Federal Executive Branch of Argentina ratified the Transener MOU in November 2005, and an increase in Transener and Transba tariffs was retroactively applied as from the date of the Transener MOU.

Regarding the tariff proposal submitted by Transener, in connection with the integral review contemplated by the Transener MOU, the ENRE, through Resolution N° 51/2006, called a Public Hearing for February 23, 2006. However, this Public Hearing was postponed by the ENRE through Resolution No.60/2006 citing observations made by the Unión Industrial Argentina (Argentine Industry Organization) at a similar hearing called by the ENRE regarding the distribution company EDELAP S.A. The ENRE has not yet established a new date for the hearing. See

Regulation of Our Businesses Argentine Regulatory Framework Electricity .
Yacylec S.A (Yacylec)

Yacylec is an independent transmission company formed by a consortium of construction and engineering companies of Argentina and Europe, including Empresa Nacional de Electricidad S.A. of Spain, or ENDESA, Impregilo International Infrastructures N.V. of The Netherlands and Dumez S.A. of France, which currently hold 22.2%, 18.67% and 1.78% interests in Yacylec, respectively. We have a 22.22% interest in this consortium. In June 2006, the Board of Directors of Petrobras Energía accepted an offer for the transfer of its equity in Yacylec for U.S.\$6 million. This transaction was rejected by the Argentine Antitrust Commission. (See "Transener"). The consortium operates and maintains a 500 Kv and 280 km-long electric power transmission line from the Yacyretá hydroelectric complex to the Argentine national grid under a 95-year concession that expires in 2091. Under the concession agreement, ENRE's approval is necessary to transfer or sell shares representing up to 49% of the capital stock of Yacylec. The transfer of a higher percentage requires a public tender. Under the shareholders' agreement, shareholders have a right of first refusal in any transfer of shares.

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Enecor S.A.

Enecor is an independent electricity transmission company. We own 69.99% of Enecor and Impregilo International Infrastructures N.V. of The Netherlands owns the remaining interest in the company. Enecor has a 95-year concession, expiring in 2088, to construct, operate and maintain approximately 22 km of electricity lines and a 500 Kv/132 Kv transformer station in the Province of Corrientes. Enecor has entered into a maintenance agreement with Transener until 2008. Under the concession contract, certain shares of Enecor are pledged in favor of the Province of Corrientes.

Electricity Distribution: Edesur

We currently own a 27.33% indirect interest in Edesur, which is controlled by Distrilec which owns 56.35% of Edesur. We own 48.5 % of Distrilec.

In 1992, Edesur was awarded an exclusive license by the Argentine government to distribute electricity in the southern area of the Federal Capital and 12 districts of the Province of Buenos Aires, serving a residential population of approximately 6 million inhabitants. By the end of 2006, Edesur's clients numbered 2,195,914, accounting for a 1.45% net increase compared to 2005. This indicator maintains the upward trend resumed in 2003 after two years of decline. Edesur has added more than 200,000 customers since its privatization. Some of these customers were added as a result of new electricity lines and others, who had been receiving electricity outside the system, are now fully connected and accurately billed.

The license will expire in 2087 and is renewable for an additional 10-year period. Edesur was created as part of the privatization of the Buenos Aires electricity distribution network. We own 48.5% of Distrilec which, in turn, owns 56.35% of Edesur.

We and the Enersis/Chilectra group, owned by ENDESA, are the only shareholders of Distrilec and, pursuant to a shareholders' agreement, we each have the right to elect an equal number of directors.

The unanimous approval of the Board of Directors is necessary for the grant of any lien on Edesur's shares or any merger, reorganization, dissolution or spin-off of Distrilec. Shareholders also have preferential rights on any transfer or new issue of shares.

In compliance with the terms and conditions of the privatization, Edesur entered into an operating agreement with Chilectra S.A. for the provision of technical advisory services. This agreement is effective through August 2007, and we are reimbursed for costs incurred by us in connection with the management agreement.

Under the concession contract, Edesur is subject to a fixed cap on what it may charge each customer for the distribution of electricity to that customer. However, Edesur may pass through to the customer the cost of the electricity purchased, limited only by the pre-adjusted seasonal wholesale electricity market price. Customers are divided into tariff categories based on the type of consumption required. Under the current regulations, large users may purchase energy and power directly from the wholesale electricity market. Edesur charges these large users a wheeling fee for the provision of distribution services. Residential consumers purchase power only from distributors. These customers are generally daylight and weather sensitive and their consumption of electricity is different in summer and winter. Peak demand occurs in July, when there is the least amount of sunlight, and in January, which is usually the hottest summer month in Argentina.

The enactment of the Public Emergency Law significantly affected Edesur's economic and financial balance and its ability to comply with its contractual commitments. For this reason, Edesur's efforts were focused on refinancing financial liabilities, reducing risks and optimizing working capital. Based on these guidelines, Edesur was able to refinance all of its financial debt, achieving a better maturity profile and lower average costs.

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In June 2005, Edesur signed a Letter of Agreement with the UNIREN as part of the renegotiation process involving the related concession contract. Based on this Letter of Agreement, in August 2005, the parties signed a Memorandum of Understanding (the Edesur MOU) that includes, among other matters, the terms and conditions that, once the procedures established by regulations are fulfilled, shall form the substantive basis for amending the concession agreement. The Edesur MOU establishes that from its execution through June 30, 2006, an integral tariff review would be performed, which would allow Edesur to fix a new rate system effective August 1, 2006, and for the following five years. Also, it established a transition period for which the following was agreed upon: (i) a transitional rate system as from November 1, 2005, with an increase in the average service rate not exceeding 15%, applicable to all rate categories, except for residential rates; (ii) a mechanism to monitor costs, which allows for reviewing rate adjustments; (iii) restrictions on dividend distributions and debt interest payments during 2006; (iv) investment commitments for 2006; (v) service provision quality standards; and (vi) restrictions on Distrilec regarding a change in its interest or the sale of its shares in Edesur. As a preliminary condition for the Executive Branch to ratify the Edesur MOU, Edesur and its shareholders shall suspend all pending claims that are based on the measures taken pursuant to or in furtherance of the Public Emergency Law. The Edesur MOU was ratified by Executive Order No. 1,509 issued in December 2006. As a result, on February 5, 2007, the ENRE published in the Official Gazette Resolution N° 50/2007 approving the values stated in Edesur's Rate Schedule effective February 1, 2007 resulting from the Interim Rate Schedule provided for in the Edesur MOU. As a consequence, a 23% increase is applied on Edesur's own distribution rates (not affecting T1R1 and T1R2 residential rates), connection rates and the reconnection service charged by Edesur, and an additional average increase of 5% is also applied on the aforementioned distribution rates for the execution of a work plan. In addition, the ENRE authorized to apply to the aforementioned rates, effective May 1, 2006, the 9.962% positive variation in the cost monitoring system indexes provided under the Edesur MOU. The ENRE provided that the amounts resulting from the application of the Interim Rate Schedule for consumptions accrued between November 1, 2005 and January 31, 2007, be invoiced in 55 equal and consecutive installments. On April 30, 2007, Resolution N° 433/2007 of the Secretary of Energy was published in the Official Gazette, and the term of the transition period and its effects were extended until the integral tariff review is fulfilled, which is scheduled for February 2008.

The chart below sets forth Edesur's annual power sales for each type of customer for fiscal years ended December 31, 2006, 2005 and 2004.

| | Annual sales in Gwh | | |
|------------------------------|----------------------------|---------------|---------------|
| | 2006 | 2005 | 2004 |
| Type of user: | | | |
| Residential (in Gwh) | 5,638 | 5,046 | 4,796 |
| General (in Gwh) | 2,967 | 2,948 | 2,798 |
| Large users (in Gwh) | 6,232 | 6,024 | 5,729 |
| Total | 14,837 | 14,018 | 13,323 |
| | | | |
| Sales (in millions of pesos) | 1,412 | 1,339 | 1,104 |

Argentina's recent economic growth has had an impact on the demand for electricity, which surpassed consumption levels recorded prior to the 2001 crisis. Within Edesur's concession area, demand increased 4.9% compared to 2005, with a historical 3,028 MW maximum demand for power in December 2006. As a result, the network is close to overloading. In addition, electricity sales also hit maximum historical values with total annual sales of 14,837 GWh, accounting for a 6% increase compared to 2005.

Since its privatization, Edesur has made investments of about P\$3,363 million, most of which was invested before the enactment of the Public Emergency Law. As a result of these investments, Edesur has been able to satisfy an increase in demand of over 35% reaching its highest levels of output while maintaining a high quality of service.

Competition

We compete with other generators in the wholesale electricity market, both in the spot market and for contracts (mainly short-term contracts).

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INSURANCE

Our insurance programs principally focus on the concentration of risks and the importance and replacement value of assets. Under our risk management policy, risk associated with our principal assets, such as oil and gas facilities, refineries, petrochemical plants and power generation plants are insured for their replacement value.

We also insure against business interruption as a consequence of material damages (except in oil and gas Exploration and Production fields), control of wells, especially where we have gas production and third-party liabilities including marine liabilities.

Our reinsurers have ratings equal or above A- from Standard & Poor's, A3 from Moody's and/or B+ from A.B. Best.

Insurance companies submitted the coverage in each and every country where Petrobras Energía has controlled interests, following terms and conditions given by our reinsurers.

We maintain coverage for operational third-party liability with respect to our onshore and marine activities, including environmental risks such as oil spills.

We carry insurance of up to U.S.\$100 million for each and every loss in ocean marine and non-ocean marine third-party liability coverage.

We maintain control of wells coverage in many gas and oil fields located in Argentina, Bolivia and Ecuador.

We also carry marine cargo insurance and directors and officers insurance coverage.

All projects and installations under construction require us to be insured in compliance with the applicable contract for any damage and liability risk.

We also carry insurance for workmen's compensation and automobile liabilities.

Our main coverages include the following different types of deductibles:

U.S.\$10,000,000 for combined claims for property damage and business interruption for all our businesses, except for the oil and gas exploration and production businesses;

U.S.\$10,000,000 for claims for each property of our oil and gas exploration and production business;

U.S.\$5,000,000 for control of wells;

U.S.\$5,000,000 in non-ocean marine third-party liability; and

U.S.\$5,000,000 in ocean-marine third-party liability.

Our insurance decisions are based on our requirements and available commercial and market opportunities.

Our facilities are regularly subject to risk surveys undertaken by international risk consultants

PATENTS AND TRADEMARKS

Minor portions of our commercial activities are conducted under licenses granted by third parties. Royalties related to sales associated with such commercial activities are paid under the relevant licenses. We use the name Petrobras with the permission of Petrobras.

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QUALITY, SAFETY, ENVIRONMENT AND HEALTH

We are a socially and environmentally responsible corporation in continued search for excellence in management. This commitment lies in the core of our corporate identity and is part of our corporate mission. We believe that caring for the environment in which we operate and for the safety and health of individuals is an essential condition for the activities we develop. Along these lines, our strategic and business plans include goals involving excellence in management and performance in Quality, Safety, Environment and Health (QSEH).

Our QSEH policy, which was launched in April 2004, incorporates state-of-the-art concepts, including: ecoefficiency, life cycle, continuous improvement and leadership. This is implemented through the use of 15 guidelines for practical and customary action, each aimed at behavior-based responsible development. The foregoing policies and actions have been enhanced through our relationship with Petrobras.

We have complied with international audits and certifications with respect to environmental management, quality, safety and occupational health. We have 23 assets certified, including ISO 14001, ISO 9001 or OHSAS 18001/IRAM 3800, which are maintained through regular third-party audits.

Excellence in Management

Petrobras Energía is moving forward with our initiative *Excellence in Management* in order to achieve the highest standards of excellence in corporate management. This initiative is implemented through an ongoing evaluation process and the implementation of management enhancement programs based on Petrobras *Guide of Excellence in Management*. In 2004 and 2005 we conducted the first evaluation cycle, comprising 10 organization units of all our businesses (Genelba, Lubricant Plant, Innova, E&P-Venezuela and E&P-Argentina, Pichi Picún Leufu Hydroelectric Complex, Bahía Blanca Refinery, Poliestirenos Argentina, our Own Network of Gas Stations and Information Technology) and in 2006, we commenced the second evaluation cycle at Genelba and Innova. Additionally, as from 2005, we have advanced in the implementation of permanent management enhancement programs in all the assessed units, which are subject to annual reviews in order to consider business priorities.

New policy and guidelines, new management tools Process Safety Program

To guarantee the effective implementation of the new Safety, Environmental and Health (SEH) policy and guidelines, we have developed a set of corporate management tools in the Process Safety Program (PSP). This program was launched in April 2004 with a diagnosis of management that encompassed 23 production units and centralized functions and included interviews with over 300 members of management, our employees and contractors, and its implementation concluded in October 2006. Among its main results:

The Governance System structured in committees and subcommittees;

The standardization of the Safety, Health and Environmental Management Manual and its 15 guidelines ;

The Plan of relationship with contractors, ; and

The first Petrobras Energía SMS Best Practices Workshop that allowed to share different works made by internal and external personnel.

During this period, PSP sought to review business production unit action plans, production and centralized functions through the progress and enhancement of several projects. The major items are summarized below:

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Safety

In order to reduce the 2005 increasing accident rate, a series of preventive measures have been developed and were implemented in January 2006, which focused on and were addressed to our own supervisors and contractors supervisors as well as to Petrobras Energía's management staff through the Proactive Leadership Program. We have also launched the implementation of the Leadership Program in Injury Prevention, essentially addressed to contractors supervisors, who are trained so that they may, in turn, provide employees in their area with specific training in safety movement and accident prevention. As for the Contractor Staff Ranking and Certification process, during 2006, more than 4,000 employees were trained. Indicator traceability audits were also conducted to ensure the correct operation of the Integrated Management System.

For the year 2007, we plan to continue implementing these actions and to deepen their contents and scope. We have also launched a significant program of asset audits in order to monitor the status of compliance with the prevention processes.

Environment

We implemented several actions to minimize the environmental impact of operations and reduce associated risks. Among them, we implemented a maintenance and replacement pipeline program, redefined our waste treatment plans and started projects to improve the performance of effluent treatment plants and fire fighting systems.

Since July 2003, we have put into operation a project called Inventory System of Atmospheric Emissions, or SIGEA. The main goal of this project is the creation of a tool for the management of atmospheric emissions that will help in the decision-making process for new investments (especially related to energy conservation and ecoefficiency). In the second place, the purpose of SIGEA is to help us detect improvements that will support our participation in the carbon credit markets. At the San Lorenzo Refinery and at the Austral Basin, the survey helped to identify project prospects that could result in energy efficiencies and which could help meet the requirements of the Clean Development Mechanism (CDM) of the Kyoto Protocol.

We implemented clean-up projects in the oil fields and refineries focused on contaminated water and soils. The Waste Corporate Management System in the Refining and Petrochemical Business Unit was also created with its goal of recording and supervising waste inventories in the business units and developing this system throughout the rest of the organization during 2007 and 2008.

Petrobras Energía is committed to producing with the lowest possible impact on the environment, and thus is working on developing the concept of eco-efficiency and creating a framework to assess and report on the eco-efficiency across all the Business Units. Eco-efficiency is based on the concept of creating more goods and services while using fewer resources and creating less waste and pollution, and these are the kinds of indicators we are introducing in our internal reporting.

In line with our strategic commitment to environmental responsibility, we have been working to ensure that increased production is as compatible as possible with the efficient use of natural resources such as water and energy, and generates the least possible amount of effluents and emissions in all of our business units.

The use of the Corporate Biodiversity Standard in order to manage the biodiversity in sensitive areas is a commitment of ours that goes beyond producing. The standard includes all the issues we have to consider before, during and after the development of any project in sensitive areas in order to protect biodiversity.

Environmental Training

In 2006, Petrobras Energía also worked to promote the environmental knowledge and awareness of internal and external stakeholders in the communities around its assets, and organized an e-learning course about Sustainability, Life Cycle Analysis and Eco-efficiency with the participation of employees from all South America countries where the company operates.

Emergency Response

Quick and correct decisions-making is crucial to minimize eventual damages and rapidly restore previous conditions in the event of an accident. It is essential to have reliable, qualified and updated information available for this purpose. Geographical data platforms are among the newest technological tools used internationally to obtain this type of data.

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We signed a Mutual Assistance Agreement with Petrobras Brazil to help each other in coping with possible spill situations in our land and maritime operations.

In 2005, we created fourteen emergency response bases distributed throughout different strategic points in the country (five nautical bases, eight ground bases and a logistic base), all of them with the required equipment and personnel for effective performance in an emergency.

During 2006 we conducted eight land drills and five nautical drills. Drills are performed within the framework of the QSEH policy of our fifteen directives. The purpose of such drills is to develop skills and to generate competence by performing the contingency plans in the different sectors, to put into play the interlinked roles of the Coordinated Services of Emergencies, Fire Department, Police, Customer Centers, the contractors and us, and to generate responses and to analyze the information, assess the situation by ranking the seriousness of each scenarios in the actual site, to establish response strategies and to study in depth the development of joint intervention techniques, rescue assistance and protection.

On November 21, 2006, we performed a major human lives rescue and environmental protection drill in an oil spill scenario in Río de la Plata. The drill was jointly conducted by Comisión Administradora del Río de la Plata (CARP), the Argentine Navy, the Argentine Coast Guard (*Prefectura Naval*), the Uruguayan Navy, the Uruguayan Coast Guard and us.

We are the only company in Argentina that develops the Environmental Agents Program based in a growth oriented, proactive and responsible focus, and involving three players: the community, the authorities and the Company itself. During 2004 and 2005, approximately 450 people were trained and during 2006 an aggregate of 201 people participated in the Program.

Health

We have implemented a Health Promotion and Protection Program (HPPP), which prioritizes the quality of life of our employees. The principal components of the program are health promotion, stress management, physical activity, healthy diet and accident prevention actions. Program activities include workshops on stress, sedentary life-style, healthy diet and a smoking reduction plan. In order to encourage physical activity, we opened health promotion centers gyms and aerobics tracks in several plants and executed agreements with fifteen private gyms in Buenos Aires. As a result, 1,500 of our staff and related family members are exercising at those facilities.

Actions undertaken in 2006 included an important number of workshops on stress reduction, changing sedentary life-style, giving up cigarette smoking and a healthy diet, with 2,300 individuals in attendance. In addition, the Company provided CPR (cardiopulmonary resuscitation) and first-aid training to 1,100 individuals. Family participation in the Health Promotion Program workshops was encouraged. We also provided an automated external defibrillator to all the units and we have begun to provide these devices in service stations.

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REGULATION OF OUR BUSINESSES

Argentine Regulatory Framework

Petroleum

The Argentine oil and gas industry is regulated by Law No. 17,319, which we refer to as the Hydrocarbons Law, enacted in 1967, and the Natural Gas Act No. 24,076, enacted in 1992. The Hydrocarbons Law allows the federal executive branch of the Argentine government to establish a national policy for the development of Argentina's hydrocarbon reserves, with the principal purpose of satisfying domestic demand.

A new regulatory framework was required in order to respond to several changes in the Argentine oil and gas industry after the privatization of Yacimientos Petrolíferos Fiscales Sociedad del Estado, or YPF, and Gas del Estado, or GdE. Pursuant to Law No. 24,145, which is referred to as the Privatization Law, the Argentine government transferred to the provinces ownership of oil and gas reserves located within their territories. The transfers will be implemented once (1) the Hydrocarbons Law is modified for the purpose stated in Law No. 24,145 and (2) the rights of holders of existing exploration permits and production concessions, as applicable, have expired. In connection with this legislation, certain issues remain unresolved with respect to the relevant regulatory authority of the federal executive branch and the provinces, regarding oil and gas exploration, production, and transportation activities.

Exploration and Production

The Hydrocarbons Law sets forth the basic legal framework for the current regulation of oil and gas exploration and production in Argentina. The Hydrocarbons Law permits surface reconnaissance of territory not covered by exploration permits or production concessions upon authorization of the Secretary of Energy and with permission of the property owner. Information gained as a result of surface reconnaissance must be provided to the Secretary of Energy, who is prohibited from disclosing such information for a period of two years, without the permission of the party that conducted the reconnaissance, except in connection with the grant of exploration permits or production concessions.

The Hydrocarbons Law provides for the grant of exploration permits by the federal executive branch following submissions of competitive bids. Permits granted to third parties in connection with the deregulation and demonopolization process were granted in accordance with procedures specified in certain decrees, known as the Oil Deregulation Decrees, issued by the federal executive branch. In 1991, the federal executive branch established a program under the Hydrocarbons Law, known as the Argentina Exploration Plan, pursuant to which exploration permits may be auctioned. The holder of an exploration permit has the exclusive right to perform the operations necessary or appropriate for the exploration of oil and gas within the area specified by the permit. Each exploration permit may cover only unexplored areas up to 10,000 km² (15,000 km² off-shore), and may have a term of up to 14 years (17 years for off-shore exploration).

In the event that the holder of an exploration permit discovers commercially exploitable quantities of oil or gas, the holder may apply for, and is entitled to receive, an exclusive concession for the production and development of such oil and gas. A production concession vests in the holder the exclusive right to produce oil and gas from the area covered by the concession for a term of 25 years (plus, in certain cases, a part of the unexpired portion of the underlying exploration permit), which may be extended for an additional ten-year term by application to the federal executive branch. A production concession also entitles the holder to obtain a transportation concession for the transport of the oil and gas produced.

Holders of exploration permits and production concessions are required to carry out all necessary works to find or extract hydrocarbons, using appropriate techniques, and to make the investments specified in such holders' permits or concessions. In addition, these holders are required to avoid damage to oil fields and waste of hydrocarbons, to adopt adequate measures to avoid accidents and damage to agricultural activities, the fishing industry, communications networks and the water table, and to comply with all applicable federal, provincial and municipal laws and regulations.

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Holders of production concessions are also required to pay a 12% royalty to the government of the province in which production occurs, calculated on the wellhead price (equal to the FOB price less transportation costs and certain other reductions) of crude oil and natural gas produced. The Hydrocarbons Law authorizes the government to reduce royalties up to 5% based on the productivity and location of a well and other special conditions. Any oil and gas produced by the holder of an exploration permit prior to the grant of a production concession is subject to the payment of a 15% royalty.

Resolution No. 435/04 issued by the Secretary of Energy, which updates Resolution No. 155 dated December 23, 1992, (1) imposes additional reporting requirements with respect to royalties, (2) introduces certain changes with respect to the powers of provinces, (3) amends certain parts of the royalty determination system, including applicable deductions and exchange rates and (4) establishes penalties upon default of a reporting duty. This resolution has been applicable to permit and concession holders since June 2004.

Concession holders are required to file sworn statements with the Secretary of Energy and the relevant provincial authorities, informing them of:

The quantity and the quality of extracted hydrocarbons, including (1) the computable production levels of liquid hydrocarbons and (2) a break down of the crude oil (specifying the type), condensate and total natural gas recovered (with a 0.1% maximum error tolerance);

Sales to domestic and foreign markets;

Reference values for transfers made at no cost for purposes of further industrialization;

Freight costs from location where marketable condition is acquired to location where commercial transfer takes place; and

Description of sales executed during the month.

In addition to the sworn statement, concession holders must file receipts evidencing payment of royalties. Upon breach of any reporting duty, provincial authorities are entitled to make their own assessment of royalties.

Resolution No. 435/04 also provides that if a concession holder allots crude oil production for further industrialization processes at its or affiliated plants, the concession holder is required to agree with provincial authorities and the Secretary of Energy, as applicable, on the reference price to be used for purposes of calculating royalties and payments. Upon default by the concession holder, provincial authorities may fix this reference price. The concession holder is eligible for certain deductions including (1) inter-jurisdictional freight costs, which can be deducted from the selling price, as long as transportation is made by means other than a pipeline and monthly invoices and any relevant agreements are provided and (2) internal treatment costs (not exceeding 1% of the payment) incurred by authorized permit or concession holders.

By Decrees 225/2006 and 226/2006, the Province of Neuquén sought to change the reference price to be used for calculating royalties using the West Texas Intermediate Crude reference price, or WTI, for petroleum and import prices at the border for gas. Those decrees are currently being challenged by all the upstream companies which have activities in Neuquén Province.

Exploration permits and production or transportation concessions are subject to termination in the event of certain breaches or defaults of laws or regulations or upon the bankruptcy of the concessionaire. Upon the expiration or termination of a production concession, all oil and gas wells, operating and maintenance equipment and facilities ancillary thereto automatically revert to the Argentine government, without payment to the concessionaire.

Law 25,943, enacted on October 20, 2004, established the creation of a federal state-owned energy company called Energía Argentina S.A. (ENARSA), whose stated purpose is to carry out, through third parties or through joint ventures with third parties, (1) the study, exploration and exploitation of hydrocarbon natural reserves, (2) the transportation, processing and sale of hydrocarbons and their direct and indirect by-products, (3) the transportation and distribution of natural gas and (4) the generation, transportation, distribution and sale of electricity.

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Furthermore, Law 25,943 granted to ENARSA exploration permits over all the national off-shore areas not covered by existing exploration permits or exploitation concessions at the time of its enactment. Therefore, any future exploration of off-shore areas must be done in joint venture with ENARSA.

Net Worth Requirements

Resolution No. 193/03 of the Secretary of Energy implements mandatory minimum net worth requirements for companies that wish to acquire or maintain exploration permits, exploration concessions and hydrocarbon transportation concessions in Argentina.

This resolution provides that, in order to be a holder of a permit or concession, the company or group of companies (for example, companies associated through a joint operating or joint venture agreement) shall have a minimum net worth of P\$2,000,000 for land-based areas and U.S.\$20,000,000 for off-shore areas. This minimum net worth amount must be maintained during the whole term of the permit or concession. The breach of this obligation may result in sanctions, including fines, or in the revocation of a company's registry with the Secretary of Energy as a petroleum company. To comply with these requirements, other companies, local or foreign, may grant financial support or guarantees of up to 70% of the minimum net worth requirements in favor of the entity requesting a permit or concession.

Short Law

Law No. 26,197 (the Federalization Law or Short Law), promulgated on December 6, 2006 and published in the Official Bulletin on January 3, 2007, amended the Hydrocarbons Law, which now provides that liquid and gaseous hydrocarbon fields belong either to the federal or provincial government, depending on the territory where they are located.

Fields located in the area lying between 12 nautical miles from the coast line and the outer boundary of the continental shelf belong to the federal government. All the fields lying on their territories and those located on the sea adjacent to the coast up to a distance of 12 nautical miles shall remain the property of the provinces and the City of Buenos Aires. On January 3, 2007, provincial governments took over original ownership and management over the fields located in their territories, pursuant to these provisions.

The Federalization Law also transfers, by operation of law, all hydrocarbons exploration permits and exploitation concessions as well as other types of exploration and/or exploitation contracts executed with the federal government, without affecting the rights or obligations of permit and concession holders.

In addition, the Federalization Law sets forth that the hydrocarbon royalties due upon the effective date of the Law shall be assessed according to the provisions of the respective permit or concession agreement and shall be paid to the jurisdictions where the fields are located. Before the Law, royalties were also paid directly to the provinces where the fields are located under Resolutions 155/1992 and 435/2004 of the Secretary of Energy.

Likewise, the provinces (as well as the federal government in relation to the fields located on federal jurisdiction) shall have the powers set forth in the Hydrocarbons Law and supplementary regulations to grant permits and concessions over the fields located within their respective territories and to determine the enforcement authorities. However, the Federalization Law provides that federal energy policies shall be implemented by the Federal Executive.

As of the enactment of the Federalization Law on January 3, 2007, each enforcement authority shall act as counterparty in connection with the different permits and concessions granted, with all the powers set forth in the Hydrocarbons Law and its supplementary regulations, and the rights derived therefrom.

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As of the date of this filing, we are evaluating the effects of this law on our petroleum and gas exploration and production activities.

Transportation

The Hydrocarbons Law grants hydrocarbon producers the right to obtain from the federal executive branch a 35-year transportation concession for the transportation of oil, gas and their by-products through public tenders. Producers granted a transportation concession remain subject to the provisions of the Natural Gas Act, and in order to transport their hydrocarbons do not need to participate in public tenders. The term of a transportation concession may be extended for an additional ten years upon application to the federal executive branch.

Transporters of hydrocarbons must comply with the provisions established by Decree No. 44/91, which implements and regulates the Hydrocarbons Law as it relates to the transportation of hydrocarbons through oil pipelines, gas pipelines, multiple purpose pipelines and/or any other services provided by means of permanent and fixed installations for transportation, loading, dispatching, tapping, compression, conditioning infrastructure and hydrocarbon processing. This decree is applicable currently and primarily to oil pipelines and not to gas pipelines. (Gas pipelines are subject to ENARGAS regulations, see Natural Gas ENARGAS).

The transportation concessionaire has the right to transport oil, gas, and petroleum products and to construct and operate oil pipelines and gas pipelines, storage facilities, pumping stations, compressor plants, roads, railways and other facilities and equipment necessary for the efficient operation of a pipeline system. While the transportation concessionaire is obligated to transport hydrocarbons on a non-discriminatory basis on behalf of third parties for a fee, this obligation applies only if such producer has surplus capacity available and after such producer's own transportation requirements are satisfied.

Depending on whether gas or crude oil is transported, transportation tariffs are subject, respectively, to approval by ENARGAS or the Secretary of Energy. Resolution No. 5/04 of the Secretary of Energy sets forth:

Maximum amounts for tariffs on hydrocarbon transportation through oil pipelines and multiple purpose pipelines, as well as for tariffs on storage, use of buoys and the handling of liquid hydrocarbons; and
Maximum amounts that may be deducted in connection with crude oil transportation by producers that, as of the date of the regulation, transport their production through their own unregulated pipelines, for the purpose of assessing royalties.

Upon expiration of a transportation concession, ownership of the pipelines and related facilities is transferred to the Argentine government at no cost.

Refining and Marketing

Hydrocarbon refining activities by oil producers and other third parties have been regulated ever since the enforcement of Executive Decree No. 1212/89 by the regulations under Hydrocarbons Law No. 17,319. Together with other rules and regulations issued by the Secretary of Energy, this legal framework essentially regulates the commercial, environmental, quality and safety aspects related to refineries and gas stations. This law authorized imports, abolished oil assignments by the Secretary of Energy and deregulated the installation of refineries and gas stations. Certain supervisory and control powers of the Secretary of Energy have also been delegated to provincial and municipal authorities and therefore the refining and sale of refined products must also comply with provincial and municipal technical, health, safety and environmental regulations.

The refining of hydrocarbons is subject to requirements established by the Secretary of Energy, including registration of oil companies. Approval of registration is granted on the basis of financial, technical and other standards. As described below, liquid fuel retail outlets, points of sale for fuel fractioning, the resale to large users and supply contracts between gas stations and oil companies are also subject to the registration requirements set by the Secretary of Energy.

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Refiners are authorized to freely sell their products in the domestic market and to freely install gas stations under their own brand or third-party brands. Gas stations directly operated by refiners must not exceed 40% of their total distribution network (Executive Decree 1060/2000). In such respect, the Undersecretary for Fuel provides under Resolution No.157/06 that gas stations under an exclusive agreement with a refining and/or fuel distribution company which, for any reason, are determined to terminate the agreement, shall submit the decision to the affirmative or negative opinion of the Domestic Trade Secretary, and the necessary steps shall be taken so that the gas station in question enters into a new agreement with another refining and/or distribution company securing adequate supply. Regarding exports of refined products, with priority given to the supply of the domestic market, producers must obtain the approval of the national government prior to performing export operations. (Executive Decree 645/02 and Resolutions SE No.1679/04 and 1338/06).

The Secretary of Energy also regulates the quality content of fuels. These regulations have become significantly more stringent in recent periods. Under Resolution SE 1283/06, a new structure of economic sanctions for violations to applicable quality standards was approved. The new quality content regulations shall be gradually applied as from June 1, 2008.

The national government, in turn, issued certain rules and regulations that have an impact on the refining and marketing segment:

Resolution No. 1104/04 issued by the Secretary of Energy requires refineries and gas station owners to submit monthly sales information; otherwise, they shall be subject to monetary penalties.

Resolution No. 1679/04 issued by the Secretary of Energy requires oil producers to obtain governmental approval prior to exporting crude or diesel oil. In general, producers must demonstrate that they have either satisfied local demand requirements or granted the domestic market the opportunity to purchase oil on similar terms, in order to obtain approval to export. In addition, this resolution requires companies that wish to export diesel oil to register in order to obtain prior governmental approval to guarantee a sufficient domestic supply of oil.

This resolution is complemented by the Secretary of Energy Resolutions No.1834/05 and 1879/05 that create a mechanism to guarantee the supply of diesel oil by refiners to gas stations and permit gas stations to acquire diesel oil from third parties if regular suppliers fail to deliver it. In the latter case, refiners must bear any additional costs borne by gas stations in procuring the diesel oil.

In addition, under Resolution No. 25/06 issued by the Domestic Trade Secretary, refining companies and/or wholesalers and/or retailers are obliged to reasonably cover total diesel oil demand (according to volumes required under usual market practice) by supplying on a regular and continuous basis every geographical area within the Republic of Argentina with at least the same volumes supplied during the corresponding month of the immediately preceding year, plus the existing positive correlation between the increase in diesel oil demand and the increase in the gross domestic product, accumulated from the reference month up to the relevant date.

Resolution No. 1102/04 issued by the Secretary of Energy created a regulatory framework for new gas stations, other fuel retail outlets and distribution channels including the creation of a registry for the liquid fuel market. Severe sanctions are imposed on the execution of commercial transactions with unauthorized parties, and repetitive violations may result in suspension and withdrawal from the registry. The resolution also establishes several requirements for all fuel market participants and makes brand owners jointly and severally liable for breaches by companies operating under their brands.

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Resolution No.1103/04 issued by the Secretary of Energy provides, pursuant to Executive Decree 1212/89, section 17, that in the case of gas stations operating under a brand, the owner of the brand under which fuels are sold shall be responsible for the specification, quality and quantity of products sold and for compliance thereof with reported requirements, and in the case of gas stations operating under no brand, the operator shall be the responsible party and fuel suppliers may also be jointly and severally liable when duly identified.

Law No. 26.022 exempts, for all the Argentine market imports of up to 500,000 cubic meters of diesel oil for domestic consumption from the Fuel Liquids and Natural Gas Tax, as well as from the Diesel Oil Tax. In addition, this law establishes severe penalties applicable to the solid, liquid and gaseous hydrocarbons segment, for breaches relating to health, safety, environmental, product quality and reporting issues.

Law No. 26.074 exempts, for all the Argentine market imports of up to 800,000 cubic meters of diesel oil for domestic consumption from the Fuel Liquids and Natural Gas Tax, as well as from the Diesel Oil Tax. The Secretary of Energy is entitled to increase that amount by up to 20% for 2006 and to exempt an amount for 2007 that is up to 20% higher than the amount exempted during 2006.

Regarding fuel sales prices at gas stations, under Resolutions SE N° 938/06 and 959/06, the Secretary of Energy provides an obligatory schedule of differential prices for fuel purchases by vehicles bearing foreign license plates at all gas stations located in bordering areas.

Resolution N° 1334/06 issued by the Secretary of Energy provides that marketing of any new type of fuel within the Republic of Argentina, whether in compliance with applicable quality standards, technological improvements, environmental standards or business policies of the sector's companies, regardless of the brands or trade names used, shall be previously authorized by the Fuels Under secretariat of the Republic of Argentina.

Market Regulation

Under the Hydrocarbons Law and the Oil Deregulation Decrees, the holders of exploitation concessions have the right to freely dispose of their production either through sales in the domestic market or abroad. However, as explained elsewhere in this report, since 2002, the Argentine government has imposed restrictions on the export of hydrocarbons. See *Refining and Taxation*.

Pursuant to Decree No. 1589/89, relating to the deregulation of the upstream oil industry, companies engaged in oil and gas production in Argentina are free to sell and dispose of the hydrocarbons they produce and are entitled to keep out of Argentina up to 70% of the foreign currency proceeds they receive from crude oil and gas sales, while being required to repatriate the remaining 30% through Argentine exchange markets.

The Hydrocarbons Law authorizes the federal executive branch to regulate the Argentine oil and gas markets and prohibits the export of crude oil during any period in which the federal executive branch finds domestic production to be insufficient to satisfy domestic demand. In the event the federal executive branch restricts the export of oil and petroleum products or the free disposal of natural gas, the Oil Deregulation Decrees provide that producers, refiners and exporters shall receive a price, in the case of crude oil and petroleum products, not lower than that of similar imported crude oil and petroleum products and, in the case of natural gas, not less than 35% of the international price per cubic meter of Arabian light oil, at 34 degrees.

Taxation

Holders of exploration permits and production concessions are subject to federal, provincial, and municipal taxes and regular customs duties on imports. The Hydrocarbons Law grants such holders a legal guarantee against new taxes and certain tax increases at the provincial and municipal levels. Permit holders and concessionaires must pay an annual surface tax based on the area held.

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In January 2002, the Public Emergency Law established a five-year export tax on hydrocarbon exports and empowered the federal executive branch to establish the applicable tax rate. On March 1, 2002, the Argentine government imposed a 20% tax on exports of crude oil and a 5% tax on exports of certain oil products. In May 2004, the tax on exports of crude oil and liquefied petroleum gas was increased to 25% and 20%, respectively, and a 20% tax was levied on exports of natural gas. Effective August 4, 2004, the Argentine government further increased taxes on exports of crude oil by an additional 3% to 20%, with a cap set at 45%. The determination of the additional rate depends on the price per barrel of crude oil, increasing gradually from 3% when crude oil price is U.S.\$32.01 per barrel to 20% when the price is U.S.\$45 or more per barrel.

Through Resolution No. 77, the Secretary of Energy regulates the payment of tolls by persons and companies that are subject to audit and control under technical and security regulations for the fractionation and sale of liquid gas and the transportation of liquid hydrocarbons and its derivatives through pipelines. It provides the methods and terms and conditions for payment of the tolls.

Quarterly agreements for the supply of diesel oil to public transportation companies

In light of the request by the federal executive branch to maintain the conditions for the supply of diesel oil at differential prices for regulated-rate public transportation services, as provided under Executive Decree No. 675/03 as amended by Executive Decrees No. 159/04, 945/04, 280/05 and 564/05, several agreements were subsequently signed whereby refining companies agreed to supply diesel oil at lower than market price, depending on the kind of services provided by the transportation companies.

Refining companies, in turn, will receive economic compensation for the lower revenues resulting from compliance with the agreement. In order to calculate the lower revenues received, the government will consider the difference between net revenues from the sale of diesel oil at contractual prices and the net revenues that would have been obtained from the sale of the same diesel oil volumes at market price.

Refining companies processing the crude oil they produce, as is our case, will be entitled to a direct compensation, by deducting it from any amount payable for export duties. The Secretary of Energy will issue a fiscal credit certificate for the appropriate amount of compensation.

Stability of Fuel Prices

In an effort to mitigate the impact of the significant increase in the West Texas Intermediate Crude reference price, or WTI, on local prices and ensure price stability for crude oil, gasoline and diesel oil, since January 2003, at the request of the federal executive branch, hydrocarbon producers and refineries entered into a series of temporary agreements, which contained price limits with respect to crude oil deliveries. By the end of 2004, in light of further increases in the WTI, the Argentine government established a series of measures to ensure the supply of crude oil to local refiners at price levels consistent with the local retail price of refined products, which in the case of diesel oil, oil and gasoline have remained constant, in peso terms, from July 29, 2004 to present.

Royalties Exchange Rates

Under Resolution No. 76/02 of the Ministry of Economy, royalties on oil exports must be fixed taking into account the seller exchange rate of Banco de la Nación Argentina on the day before the royalty is paid.

However, from December 2001 until May 2002, producers and refiners agreed to negotiate a reduced exchange rate in order to moderate the impact of the devaluation in product price. Producers calculated and paid royalties according to this reduced exchange rate. These calculations have been rejected by Neuquén Province, which have presented a claim for any shortfall arising from this agreement. This claim is still pending a judgment from the Supreme Court.

Natural Gas

In 1992, the Natural Gas Act was passed providing for the privatization of Gas del Estado, or GdE, and the deregulation of the price for natural gas. To effect the privatization, the assets of GdE were divided among two new transportation companies and eight new regional distribution companies. The transportation assets were divided into two systems on a geographical basis, the northern and southern area pipeline systems, designed to give both systems access to gas sources and to main centers of demand, including the greater Buenos Aires region. A majority of the shares of each of the transportation and distribution companies was sold to private bidders.

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The Natural Gas Act established a regulatory framework for the privatized industry and created ENARGAS, an autonomous entity under the Ministry of Economy and Public Works that is responsible for the regulation of the transportation, distribution, marketing and storage of natural gas.

Regulatory framework

Natural gas transportation and distribution companies operate in an open access, non-discriminatory environment under which producers, large users and certain third parties, including distributors, are entitled to equal and open access to the transportation pipelines and distribution systems. In addition, exploitation concessionaires may transport their own gas production pursuant to certain concessions granted under the Hydrocarbons Law.

The Natural Gas Act prohibits gas transportation companies from buying and selling natural gas. Additionally, gas producers, storage companies, distributors and consumers who contract directly with producers may not own a controlling interest (as defined in the Natural Gas Act) in a transportation company. Furthermore, gas producers, storage companies and transporters may not own a controlling interest in a distribution company, and no seller of natural gas may own a controlling interest in a transportation or distribution company (unless such seller neither receives nor supplies more than 20% of the gas received or transported, on a monthly basis, by the relevant distribution or transportation company).

Contracts between affiliated companies engaged in different stages of the natural gas industry must be reported to ENARGAS, which may refuse to authorize such contracts only if it determines that they were not entered into on an arms-length basis.

ENARGAS

ENARGAS is an autonomous entity which functions under the Ministry of Economy and Public Works and Services of Argentina and is responsible for a wide variety of regulatory matters regarding the natural gas industry, including the approval of rates and rate adjustments and transfers of controlling interests in the distribution and transportation companies. ENARGAS is governed by a board of directors composed of five full-time directors who are appointed by the federal executive branch subject to confirmation by the Argentine Congress.

ENARGAS has its own budget, which must be included in the Argentine national budget and submitted to Congress for approval. ENARGAS is funded principally by annual control and inspection fees that are levied on regulated entities in an amount equal to the approved budget, net of collected penalties, and allocated proportionately to each regulated entity.

Conflicts between two regulated entities or between a regulated entity and a third party arising from the distribution, storage, transportation or marketing of natural gas must first be submitted to ENARGAS for its review. ENARGAS's decisions may be appealed through an administrative proceeding to the Ministry of Economy or directly to the federal courts.

Rate Regulation

Prior to the enactment of the Public Emergency Law, the provisions of the Natural Gas Act regulated the rates for gas transportation and distribution services, including those of TGS. Tariffs to end-users consist of the sum of three components: (1) the price of the gas purchased; (2) a transportation tariff for transporting gas from the production area through the distribution system; and (3) a distribution tariff. Under the Natural Gas Act and TGS license, TGS was permitted to adjust rates (1) semi-annually to reflect changes in the U.S. producer price index, and (2) every five years in accordance with efficiency and investment factors to be determined by ENARGAS. In addition, subject to ENARGAS's approval, rates were subject to adjustment from time to time to reflect cost variations resulting from changes in the tax regulations (other than income tax) applicable to TGS, and for objective, justifiable and non-recurring circumstances. The ratemaking methodology contemplated by the Natural Gas Act and the TGS license is the price-cap with periodic review methodology, a type of incentive regulation designed to allow regulated companies to retain a portion of the economic benefits arising from efficiency gains.

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UNIREN

The Public Emergency Law pesified tariffs for public utility services at a P\$1=U.S.\$1 parity and prohibited the increase of these tariffs based on indexation factors. Pursuant to this law, the Argentine federal executive branch was authorized to renegotiate the terms of contracts relating to the provision of public utility services without being constrained by the applicable regulatory framework. This authority was later delegated by the executive to the Ministry of the Economy, which created, in July 2003, the Unidad de Renegociación, or UNIREN, for the purpose of assisting in the renegotiation process. The renegotiation must take into account the following criteria, among others:

- Impact of tariffs on economic competitiveness and on income distribution;
- Quality of services to be provided and/or the capital expenditure programs provided for in the contracts;
- Interest of customers and accessibility to the services;
- The safety of the systems; and
- The company s profitability.

On October 1, 2003, the Argentine Congress passed a bill allowing the executive branch of the government to set public utility rates until the completion of the renegotiation process. TGS is in the process of re-negotiating a tariff structure with UNIREN. See Electricity UNIREN .

Modifications to the regulatory framework

On February 16, 2004, the government, through Decree No. 180/04, took a number of significant steps that have altered the regulatory framework for the Argentine gas industry. The decree authorized the Secretary of Energy to take any necessary measures to maintain an adequate level of services in the event of a supply crisis. In addition, Decree No. 180/04 provided for:

- The creation of a trust fund (to be funded by tariffs payable by users of the service, special credit programs and contributions from direct beneficiaries) to finance the expansion of the industry and the creation of an electronic market;
- The creation of an electronic wholesale market to coordinate spot transactions of the sale of natural gas and secondary market transactions for transportation and distribution of natural gas. This electronic market was in full operation as of the date of this Annual Report; and
- A prohibition on distributors or their shareholders from having a controlling participation in more than one gas dealer.

Decree No. 181/04 also instructed the Secretary of Energy to design a framework for the normalization of prices of natural gas at the wellhead. The decree authorizes the Secretary of Energy to negotiate with gas producers on a price framework for the adjustment of prices in sale contracts to distributors. Natural gas prices for residential consumers were excluded from the process. It also authorizes the Secretary of Energy to create a new category of users who must buy gas directly from producers.

The prices resulting from this new framework shall be used as a reference for calculating and paying royalties and will be used by ENARGAS in calculating any necessary adjustments in tariffs that result from variations in the price of purchased gas. In addition, the decree requires that all agreements for the sale of natural gas be filed with the gas electronic market, and grants authority to the Secretary of Energy to regulate the sale of gas (1) between producers and (2) between producers and their affiliates.

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On April 2, 2004, the Secretary of Energy entered into an agreement with natural gas producers, in which the following was agreed to:

Minimum volumes that natural gas producers must supply to the local market, including specified amounts to: (1) distributors for the supply to industrial users, (2) clients of distributors, or new direct consumers, who are required to buy directly from producers and (3) power stations that generate electricity for the local market; Authorization for producers to increase the prices of natural gas for sales to industrial users, electric generation companies and direct consumers according to a price roadmap which differs for each basin and that culminates in complete deregulation of the wellhead price of natural gas by January 1, 2007;

Distribution and generation companies must renegotiate the price and volumes of their supply contracts with producers in line with this agreement. If an agreement is not reached after a 45-day period, producers are released from their obligation to supply natural gas to these distribution and generation companies;

Regulated prices through June 31, 2005 for new direct customers; and

Notice of all new supply agreements must be given to the Secretary of Energy and will be published in the electronic gas market once this market starts functioning.

This agreement was approved by Resolution No. 208 of the Ministry of Federal Planning, Public Investments and Utilities.

On May 23, 2005, pursuant to Resolution No. 752/05, the Secretary of Energy established a mechanism by which new direct consumers will be able to buy natural gas directly from producers. If no agreement is reached with producers, as from December 31, 2006 new direct consumers will be able to buy natural gas through the electronic gas market, which was originally created for spot transactions but now permits long-term operations. In order to purchase gas in the electronic market, new direct customers must post irrevocable purchase orders that contain the following minimum terms:

Term: 36 months;

Price: export parity; and

Volume: 1,000 cubic meters per day.

If the irrevocable offer is not accepted, new direct consumers may require the Secretary of Energy to require export producers to provide natural gas for a period of six months pursuant to the prices approved by Resolution No. 208 of the Ministry of Federal Planning, Public Investments and Utilities.

On December 28, 2006, pursuant to Resolution No. 1886/2006, Resolution No. 752/05 was extended until December 31, 2016.

Restrictions on Exports of Gas

In March 2004, in order to prevent a crisis in the supply of gas to the domestic market, the Secretary of Energy suspended all prior export authorizations and exports of natural gas surplus volumes and instructed the Undersecretary of Fuels to create a program for the rationing of gas exports and the use of the country's transportation capacity. The Undersecretary of Energy subsequently adopted a program, known as the Program for the Rationalization of Natural Gas Exports, that established a mechanism for the determination of export restrictions based on various factors and contemplated monthly and quarterly limits on gas exports. In addition, during 2004, the Undersecretary of Fuels did not authorize exports of volumes (excluding surplus volumes) in excess of those exported during 2003. This program was replaced in June 2004 with the Complementary Program to Supply Natural Gas to the Domestic Market, which eased the monthly and quarterly limits established under the Program for the Rationalization of Natural Gas Exports.

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During 2005, as part of the Complementary Program to Supply Natural Gas to the Domestic Market, the Secretary of Energy requested producers to redirect export gas to supply thermal plants and gas distribution companies. This decision limited our total gas export volumes by an average of about 110 thousand cubic meters per day, which deprived us of the higher margins offered by export prices. See Risk Factors Factors Relating to Argentina Limits on exports of hydrocarbons and related oil products have affected and may continue to affect our results of operations . Since March 2004, exports of natural gas have been subject to a 20% tax.

Transportation companies are prohibited from transporting natural gas for export purposes as long as local demand is not satisfied.

Compressed Natural Gas for Vehicles

Effective April 1, 2006, distributors may not provide compressed natural gas to gas stations. Instead, gas stations will be required to purchase compressed natural gas through the electronic wholesale market pursuant to a mechanism of irrevocable purchase orders designed by the Secretary of Energy. See Natural Gas Modifications to the regulatory framework . The mechanism is decided to conceal the identity of buyers and sellers. Buyers will be able to make joint offers, and agreements may not have a term that expires after April 30, 2007. If any purchase orders are not satisfied through this system, exports of natural gas will be diverted to cover the unsatisfied demand. This mechanism is expected to continue until the Secretary of Energy determines that it is no longer necessary, in light of the status of the domestic supply of natural gas.

Liquefied Petroleum Gas

Prior to the enactment of Law No. 26,020 on April 8, 2005, the Argentine liquefied petroleum gas market was regulated by the Hydrocarbons Law, as supplemented by several technical and commercial rules, and regulations issued by the Undersecretary of Fuels, which covered all activities related to liquefied petroleum gas. Under Resolutions No. 49/01 and No. 52/01, the Secretary of Energy was responsible for enforcing the rules and regulations applicable to the liquefied petroleum gas industry and a liquefied petroleum gas board, which reports to the National Refining and Marketing Board, which, in turn, reports to the Undersecretary of Fuels, was in charge of supervising and auditing the industry.

Regulatory framework

In 2005, the Argentine Congress established, pursuant to Law 26,020, a new regulatory framework for the liquefied petroleum gas industry that is intended to guarantee regular, reliable and cost effective provision of liquefied petroleum gas to low-income residential sectors that currently are without natural gas network services. This new regime regulates the production, fractioning, transportation, storage, distribution and sale of liquefied petroleum gas. These activities are considered of public interest. The enforcement of Law 26,020 is in the charge of the Secretary of Energy, which may delegate supervision and control tasks to ENARGAS. The relevant portions of this law are summarized below:

Prices. The Secretary of Energy determines reference prices (which must be below export parity prices) for the domestic market with the goal of guaranteeing regular supply in that market and may establish price stabilization mechanisms in order to avoid price fluctuations in the domestic market. The Secretary of Energy will determine and disseminate a reference price for each region every six months.

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Market limitations. The Secretary of Energy together with the Antitrust Commission, or CNDC, are authorized to analyze the sector, for the purpose of fixing limits at each stage of vertical integration of the industry.

Open Access. An open access regime is established in connection with the storage of liquefied petroleum and the Secretary of Energy establishes terms and conditions for the determination of maximum tariffs for storage. Imports/Exports. No restrictions are imposed, and no prior authorization is required, for the import of liquefied petroleum gas, and the Secretary of Energy may authorize the export of liquefied petroleum gas without restriction, so long as the domestic market is satisfied. No shortage of supply is currently experienced in the domestic market.

Trust Fund. A trust fund was established for the purpose of subsidizing the consumption of liquefied petroleum gas by the low-income residential sector and expanding the distribution network to areas without service. The trust is to be funded from the sanctions collected under this law and contributions from the national budget.

Electricity

By 1990, virtually all of the electricity supply in Argentina was controlled by the public sector (97% of total generation). In 1991, as part of the economic plan adopted by former President Carlos Menem, the Argentine government undertook an extensive program of privatization of all major state-owned industries, including the electricity generation, transmission and distribution sectors. In January 1992, the Argentine federal congress adopted the Regulatory Framework Law (Law No. 24,065), which established guidelines for the restructuring and privatization of the electricity sector. This Regulatory Framework Law, which continues to provide the framework for regulation of the electricity sector since the privatization of this sector, distinguished the generation, transmission and distribution of electricity as separate businesses and subjected each to appropriate regulation.

The ultimate objective of the privatization process was to reduce rates paid by users and improve quality of service through competition. The privatization process commenced in February 1992 with the sale of several large thermal generation facilities, and continued with the sale of transmission and distribution facilities (including those currently operated by our company) and additional thermoelectric and hydroelectric generation facilities.

The Public Emergency Law, combined with the devaluation of the Peso and high rates of inflation, had a severe effect on public utilities in Argentina. Because public utilities were no longer able to increase tariffs at a rate at least equal to the rate of inflation in Argentina, increases in the rate of inflation led to decreases in their revenues in real terms and a deterioration of their operating performance and financial condition. Most public utilities had also incurred large amounts of foreign currency indebtedness under the Convertibility regime and, following the elimination of the Convertibility regime and the resulting devaluation of the Peso, the debt service burden of these utilities increased sharply, which led many of these utilities to suspend payments on their foreign currency debt in 2002. This situation caused many Argentine electricity generators, transmission companies and distributors to defer making further investments in their networks. As a result, Argentine electricity market participants, particularly generators, are currently operating at near full capacity, which could lead to insufficient supply to meet a growing national energy demand.

To address the electricity crisis generated by the economic crisis, the Argentine government has repeatedly intervened in and modified the rules of the wholesale electricity market since 2002. These modifications include the establishment of caps on the prices paid by distributors for electricity power purchases and the requirement that all prices charged by generators be calculated based on the price of natural gas (which are also regulated by the Argentine government), regardless of the fuel actually used in generation activities, which together have created a huge structural deficit in the operation of the wholesale electricity market. More recently, in December 2004, the Argentine government adopted new rules to readapt or readjust the marketplace, but these rules will not come into effect until the construction of two new 800 MW combined cycle generators is completed. The construction of these generators is scheduled to be completed in late 2008 and will be partially financed with credit balances of generators resulting from the spread between the sales price of energy and generation variable cost, which will be deposited with the Fund for Investments Required to Increase Electricity Supply in the Wholesale Electricity Market (*Fondo de Inversiones Necesarias que permitan incrementar la oferta de energía eléctrica en el Mercado Eléctrico Mayorista*, or FONINMEM). We cannot assure you that the Argentine government will complete these projects in a timely

manner, or at all.

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The planned construction of these new generators reflects a recent trend by the Argentine government to take a more active role in promoting energy investments in Argentina. In addition to these projects, in April 2006 the Argentine congress enacted a law that authorized the executive branch to create a special fund to finance infrastructure improvements in the Argentine energy sector through the expansion of generation, distribution and transmission infrastructure relating to natural gas, propane and electricity. The fund will obtain funds through *cargos específicos* (specific charges) passed on to customers as an itemization on their energy bills. We cannot assure you that the Argentine government will complete the implementation of these new projects in a timely manner, or at all.

Regulatory authorities

The principal regulatory authorities responsible for the Argentine electricity industry are:

- (1) the Secretary of Energy of the Ministry of Federal Planning, Public Investment and Services, and
- (2) the National Electricity Regulator (*Ente Nacional Regulador de la Electricidad*, or ENRE).

The Secretary of Energy advises the Argentine government on matters related to the electricity sector and is responsible for the application of the policies concerning the Argentine electricity industry.

The ENRE is an autonomous agency created by the Regulatory Framework Law. The ENRE has a variety of regulatory and jurisdictional powers, including, among others:

- enforcement of compliance with the Regulatory Framework Law and related regulations;
- control of the delivery of electric services and enforcement of compliance with the terms of concessions;
- adoption of rules applicable to generators, transmitters, distributors, electricity users and other related parties concerning safety, technical procedures, measurement and billing of electricity consumption, interruption and reconnection of supplies, third-party access to real estate used in the electricity industry and quality of services offered;
- prevention of anticompetitive, monopolistic and discriminatory conduct between participants in the electricity industry;
- imposition of penalties for violations of concessions or other related regulations; and
- arbitration of conflicts between electricity sector participants.

The ENRE is managed by a five-member board of directors appointed by the executive branch of the Argentine government. Two of these five members are nominated by the Federal Council on Electricity (*Consejo Federal de la Energía Eléctrica*, or CFEE). The CFEE is funded with a percentage of revenues collected by CAMMESA (as defined below) for each MWh sold in the market. Sixty percent of the funds received by the CFEE are reserved for the *Fondo Subsidiario para Compensaciones Regionales de Tarifas a Usuarios Finales* (Regional Tariff Subsidy Fund for End Users), from which the CFEE makes distributions to provinces that have met certain specified tariff provisions. The remaining forty percent is used for investments related to the development of electrical services in the interior regions of Argentina.

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The Wholesale Electricity Market

Overview

The Secretary of Energy established the wholesale electricity market in August 1991 to allow electricity generators, distributors and other agents to buy and sell electricity in spot transactions or under long-term supply contracts at prices determined by the forces of supply and demand.

The wholesale electricity market consists of:

- a term market in which generators, distributors and large users enter into long-term agreements on quantities, prices and conditions;
- a spot market, in which prices are established on an hourly basis as a function of economic production costs, represented by the short-term marginal cost of production measured at Ezeiza 500 kV substation, the system's load center; and
- a stabilization system for spot market prices applicable to purchases by distributors, which operates on a quarterly basis.

Operation of the wholesale electricity market

The operation of the wholesale electricity market is administered by the Wholesale Electricity Market Administration Company (*Compañía Administradora del Mercado Mayorista Eléctrico S.A.*, or CAMMESA). CAMMESA was created in July 1992 by the Argentine government, which currently owns 20% of CAMMESA's capital stock. The remaining 80% is owned by various associations that represent wholesale electricity market participants, including generators, transmitters, distributors, large users and electricity brokers.

CAMMESA is in charge of:

managing the national interconnection system pursuant to the Regulatory Framework Law and related regulations, which includes:

- determining technical and economic dispatch of electricity in the national interconnection system;
- maximizing the system's security and the quality of electricity supplied;

minimizing wholesale prices in the spot market;

planning energy capacity needs and optimizing energy use pursuant to the rules set out from time to time by the Secretary of Energy; and

monitoring the operation of the term market and administering the technical dispatch of electricity pursuant to any agreements entered into in such market;

acting as agent of the various wholesale electricity market participants;

purchasing or selling electricity from or to other countries by performing the relevant import/export operations; and

providing consulting and other services related to these activities.

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The operating costs of CAMMESA are covered by mandatory contributions made by wholesale electricity market participants. CAMMESA's annual budget is subject to a mandatory cap equivalent to 0.85% of the aggregate amount of transactions in the wholesale electricity market projected for that year.

Wholesale electricity market participants

The main participants in the wholesale electricity market are generation, transmission and distribution companies. Large users and traders participate also in the wholesale electricity market, but to a lesser extent.

Generators

According to a recent report issued by CAMMESA, there are 43 generation companies in Argentina, most of which operate more than one generation plant. As of March 31, 2006, Argentina's installed power capacity was 24,080 MW. Of this amount, 55% was derived from thermal generation, 41% from hydraulic generation and 4% from nuclear generation, provided by 40 private companies using conventional thermal equipment and hydraulic generation technology, 2 bi-national companies using hydraulic generation technology and one national state-owned company using nuclear generation technology. Private generators participate in CAMMESA through the Argentine Association of Electric Power Generators (*Asociación de Generadores de Energía Eléctrica de la República Argentina*, or AGEERA), which is entitled to appoint two acting and two alternate directors of CAMMESA.

Transmitters

Electricity is transmitted from power generation facilities to distributors through high voltage power transmission systems. Transmitters do not engage in purchases or sales of power. Transmission services are governed by the Regulatory Framework Law and related regulations promulgated by the Secretary of Energy.

In Argentina, transmission is carried at 500 kV, 220 kV and 132 kV through the national interconnection system. The national interconnection system consists primarily of overhead lines and sub-stations and covers approximately 90% of the country. The majority of the national interconnection system, including almost all of the 500 kV transmission lines, has been privatized and is owned by Transener, which is partially owned by us. Regional transmission companies, most of which have been privatized, own the remaining portion of the national interconnection system. Supply points link the national interconnection system to the distribution systems, and there are interconnections between the transmission systems of Argentina, Brazil, Uruguay and Paraguay allowing for the import or export of electricity from one system to another.

Transmission companies also participate in CAMMESA by appointing two acting and two alternate directors through the Argentine Association of Electric Power Transmitters (*Asociación de Transportistas de Energía Eléctrica de la República Argentina*, or ATEERA).

Distributors

Each distributor supplies electricity to consumers and operates the related distribution network in a specified geographic area pursuant to a concession. Each concession establishes, among other things, the concession area, the quality of service required, the rates paid by consumers for service and an obligation to satisfy demand. ENRE monitors compliance by federal distributors with the provisions of their respective concessions and with the Regulatory Framework Law, and provides a mechanism for public hearings at which complaints against distributors can be heard and resolved. In turn, provincial regulatory agencies monitor compliance by local distributors with their respective concessions and with local regulatory frameworks.

The largest distribution companies are Edesur and Empresa Distribuidora y Comercializadora Norte S.A.

Distributors participate in CAMMESA by appointing two acting and two alternate directors through the Argentine Association of Electric Power Distributors (*Asociación de Distribuidoras de Energía Eléctrica de la República Argentina*, or ADEERA).

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Large users

The wholesale electricity market classifies large users of energy into three categories: Major Large Users (Grandes Usuarios Mayores, or GUMAs), Minor Large Users (Grandes Usuarios Menores, or GUMEs) and Particular Large Users (Grandes Usuarios Particulares, or GUPAs).

Each of these categories of users has different requirements with respect to purchases of their energy demand. For example, GUMAs are required to purchase 50% of their demand through supply contracts and the remainder in the spot market, while GUMEs and GUPAs are required to purchase all of their demand through supply contracts.

Large users participate in CAMMESA by appointing two acting and two alternate directors through the Argentine Association of Electric Power Large Users (Asociación de Grandes Usuarios de Energía Eléctrica de la República Argentina, or AGUEERA).

Traders

Since 1997, traders are authorized to participate in the wholesale electricity market by intermediating block sales of energy. Currently, there are eight authorized traders in the wholesale electricity market, several of which conduct transactions with Comercializadora de Energía del Mercosur S.A. (CEMSA) in the export market.

Spot market

Spot prices

The emergency regulations enacted after the Argentine crisis in 2001 had a significant impact on energy prices. Among the measures implemented pursuant to the emergency regulations were the pesification of prices in the wholesale electricity market, known as the spot market, and the requirement that all spot prices be calculated based on the price of natural gas, even in circumstances where alternative fuel such as diesel is purchased to meet demand due to the lack of supply of natural gas.

Prior to the crisis, energy prices in the spot market were set by CAMMESA, which determined the price charged by generators for energy sold in the spot market of the wholesale electricity market on an hourly basis. The spot price reflected supply and demand in the wholesale electricity market at any given time, which CAMMESA determined using different supply and demand scenarios that dispatched the optimum amount of available supply, taking into account the restrictions of the transmission grid, in such a way as to meet demand requirements while seeking to minimize the production cost and the cost associated with reducing risk of system failure.

The spot price set by CAMMESA compensated generators according to the cost of the last unit to be dispatched for the next unit as measured at the Ezeiza 500 Kv substation, which is the system's load center and is in close proximity of the City of Buenos Aires. Dispatch order was determined by plant efficiency and the marginal cost of providing energy. In determining the spot price, CAMMESA also would consider the different costs incurred by generators not in the vicinity of Buenos Aires.

In addition to energy payments for actual output at the prevailing spot market prices, generators would receive compensation for capacity placed at the disposal of the spot market, including stand-by capacity, additional stand-by capacity (for system capacity shortages) and ancillary services (such as frequency regulation and voltage control).

Seasonal Prices

The emergency regulations also made significant changes to the seasonal prices charged to distributors in the wholesale electricity market, including the implementation of a cap (which varies depending on the category of customer) on the cost of electricity charged by CAMMESA to distributors at a price significantly below the spot price charged by generators.

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Prior to implementation of the emergency regulations, seasonal prices were regulated by CAMMESA as follows: prices charged by CAMMESA to distributors and large users changed only twice per year (in summer and winter), with interim quarterly revisions in case of significant changes in the spot price of energy, despite prices charged by generators in the wholesale electricity market fluctuating constantly; prices were determined by CAMMESA based on the average cost of providing one MW of additional energy (its marginal cost), as well as the costs associated with the failure of the system and several other factors; and CAMMESA would use seasonal database and optimization models in determining the seasonal prices and would consider both anticipated energy supplies and demand as follows:

in determining supply, CAMMESA would consider energy supplies provided by generators based on their expected availability, committed imports of electricity and the availability declared by generators;

in determining demand, CAMMESA included the requirements of distributors and large users purchasing in the wholesale electricity market as well as committed exports.

Stabilization Fund

The stabilization fund, managed by CAMMESA, absorbs the difference between purchases by distributors and large users at seasonal prices and payments to generators for energy sales at the spot price. When the spot price is lower than the seasonal price, the stabilization fund increases, and when the spot price is higher than the seasonal price, the stabilization fund decreases. The outstanding balance of this fund at any given time reflects the accumulation of differences between the seasonal price and the hourly energy price in the spot market. The stabilization fund is required to maintain a minimum amount to cover payments to generators if prices in the spot market during the quarter exceed the seasonal price.

Billing of all wholesale electricity market transactions is performed monthly through CAMMESA, which acts as the clearing agent for all purchases between participants in the market. Payments are made approximately 40 days after the end of each month.

The stabilization fund was adversely affected as a result of the modifications to the spot price and the seasonal price made by the emergency regulations, pursuant to which seasonal prices were set below spot prices resulting in large deficits in the stabilization fund. As of February 2006, the stabilization fund deficit totaled P\$1,710.6 million. This deficit has been financed by the Argentine government through loans to CAMMESA and by generators through contributions to FONINVEMEM.

Term market

Historically, generators were able to enter into agreements in the term market to supply energy and capacity to distributors and large users. Distributors were able to purchase energy through agreements in the term market instead of purchasing energy in the spot market. Term agreements typically stipulated a price based on the spot price plus a margin. Prices in the term market were at times lower than the seasonal price that distributors were required to pay in the spot market. However, as a result of the emergency regulations, spot prices are currently higher than seasonal prices, particularly with respect to residential tariffs, making it unattractive to distributors to purchase energy under term contracts while prices remain at their current levels.

Table of Contents*Renegotiation of Utility Tariffs*

Our affiliates Edesur, Transener and Transba are negotiating their utility contracts with UNIREN. These discussions are in different stages. See Gas and Energy Gas Transportation - TGS Regulated Energy Segment and Electricity Electricity Transmission: Transener, Yacylec and Enecor Transener . We cannot guarantee that these discussions will ultimately result in a level of tariff increases sufficient to restore the economic and financial position of these utility companies.

Concealment and Money Laundering

Argentine Law No. 25,246 categorizes money laundering as a crime, which is defined as the exchange, transfer, management, sale or any other use of money or other assets obtained through a crime, by a person who did not take part in such original crime, with the potential result that such original assets (or new assets resulting from such original assets) have the appearance of having been obtained through legitimate sources, provided that the aggregate value of the assets involved exceeded in the aggregate (through one or more related transactions) \$50,000.

The money laundering legal framework in Argentina also assigns information and control duties to certain private sector entities, such as banks, agents, stock exchanges, insurance companies, according to the regulations of the Financial Information Unit, and for financial entities, the Central Bank. These obligations consist mainly of maintaining internal policies and procedures aimed at money laundering prevention and financing of terrorism, especially through the application of the policy know your client .

Among other duties, each financial entity is required to establish a control and money laundering prevention committee and to appoint a senior official as responsible of the money laundering prevention policies, who shall be in charge of centralizing and processing any information that the Central Bank and/or the Financial Information Unit may require.

Furthermore, the financial entities are required to report to the Financial Information Unit any transaction that may be considered suspicious or unusual, or which lacks of economic or legal justification, or involves unjustified complexity, whether such transaction is recurring or not. Financial entities must pay special attention to transactions arising from or relating to jurisdictions included in the Central Bank s list of non-cooperating jurisdictions. As of the date of this Annual Report, Myanmar is the only jurisdiction included in such list.

Law No. 25,246 has been amended by Laws No. 26,087 and 26,119.

Venezuelan Regulatory Framework*Petroleum and Gas*

The Venezuelan state owns all hydrocarbon fields and has established methods for regulating the exploitation of hydrocarbons in Venezuelan fields that are different from those in Argentina.

The Gas Hydrocarbons Organic Law published on September 23, 1999 regulates the exploitation of free or non-associated gas and the transportation, distribution, collection, storage, industrialization, handling and internal and external sale of associated (gaseous hydrocarbon that is extracted jointly with crude oil) gas and free or non-associated gas (hydrocarbon that is extracted from a field which does not contain crude oil), permitting the private sector s participation in these activities.

The new Venezuelan Constitution, effective December 1999, contains provisions related to petroleum activity, including Article 12, which states that oil fields are the property of the Venezuelan state, and Article 302, which reserves petroleum activity to the Venezuelan state. The Constitution tasks Petróleos de Venezuela S.A., PDVSA, a state-owned entity, with responsibility for managing petroleum activity.

The new Hydrocarbons Organic Law published on November 13, 2001 effectively reversed most prior related legislation, except for the Gas Hydrocarbons Organic Law, and granted ample opportunity for the private sector to participate in the industry, limiting the activities reserved by the Venezuelan state to primary activities (which include exploration, extraction and initial transportation and storage) and to the sale of crude oil and specific products.

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The Hydrocarbons Organic Law regulates the exploration, exploitation, refinery, industrialization, transportation, storage, sale and conservation of hydrocarbons and refined products. The law sets forth the following principles: (1) hydrocarbon fields are public property, (2) hydrocarbon activities are activities of public utility and of social interest, and (3) activities described in the law are subject to decisions of the Venezuelan state adopted in connection with international treaties and agreements on hydrocarbons.

The Performance of Hydrocarbon Related Activities

The primary activities expressly reserved by law to the Venezuelan state can only be performed by: (1) the executive branch, (2) wholly-owned state entities or (3) companies in which the Venezuelan state maintains direct control by owning fifty percent (50%) or more of the shares or quotas that represent the capital stock. The sale of natural hydrocarbons and certain specified by-products can only be performed by wholly-owned state entities. Installations and existing facilities dedicated to the refining of natural hydrocarbons in the country and to the transportation of products and gas are to the property of the Venezuelan state.

The National Assembly must grant prior approval to the creation of these entities and the conditions under which they will carry out their activities. These entities must meet the following minimum conditions: (1) each must have a maximum duration of 25 years (which may be extended for 15 years), (2) each must provide information regarding location, orientation and extension of the area, (3) all of the entity assets must be reserved and turned over to the Venezuelan state once the activity ends and (4) any dispute among its shareholders must be resolved through private negotiations or arbitration and shall be subject to the Venezuelan legal system.

Traditionally, our interest in Venezuelan oil and gas fields have been held through operating service agreements with PDVSA, which established the terms of our compensation for production activities and investments. These contracts were awarded during 1994 and 1997 through bidding processes known as second round bids and third round bids, respectively. In 2005, the Venezuelan government announced that these operating service agreements did not comply with the Hydrocarbons Organic Law and instructed the Ministry of Energy and Petroleum to commence negotiations with private operators to convert all operating agreements into mixed-ownership ventures where more than 50% of each field is state-owned. These negotiations were completed in March 2006, and as a result, all operating service agreements previously awarded during the second and third bidding rounds will be converted to mixed ownership companies (*empresa mixta*) in which the Venezuelan government, through the Corporación Venezolana de Petróleo, S.A. (CVP), will hold at least 60% of the share capital and private companies will hold the remainder. The shareholdings allocated to private companies were determined on the basis of the value attributed to the different operating service agreements during the negotiations.

The National Assembly has approved (i) the principal terms of the conversion agreements and the form of organizational documents for the mixed ownership companies, (ii) amendments to the Hydrocarbons Organic Law and certain tax laws to allow the mixed ownership companies to sell their production of crude oil to PDVSA and its affiliates and to qualify as exporters for value-added tax purposes and (iii) a new law, the Law for Regulating the Participation of Private Entities in Primary Activities, that allows private companies to participate in primary activities in Venezuela only through mixed ownership companies.

Licenses and permits

Entities that wish to carry out activities related to the refining of natural hydrocarbons must obtain a license from the Ministry of Energy and Mines. Entities that wish to carry out activities related to the processing or domestic sale of refined hydrocarbons must obtain a permit from the Ministry of Energy and Mines.

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Relevant Tax Features

Income tax

Venezuelan income tax law imposes a tax at a rate of 50% on the net taxable income of persons involved in hydrocarbon related activities, or activities related to the purchase or acquisition of hydrocarbons and by-products for export. These persons may be authorized to deduct from their income tax 8% of the value of new investments in fixed assets up to a maximum amount equal to 2% of their annual income for the relevant fiscal year. Any excess may be used in the following three fiscal years. Four percent of the value of certain investments in high waters may also be deducted. Accelerated amortization and depreciation of fixed assets and direct or indirect expenses necessary for the drilling of oil wells is permitted.

Activities related to the export of extra-heavy hydrocarbons through vertically integrated projects or the exploration or exportation of natural non-associated gas are subject to a 34% rate.

Contractors dedicated to exploration and production activities under operating agreements with state companies are also subject to a 50% rate.

Value Added Tax

Subject to certain exceptions, in particular for exporting companies, imports and local purchases of goods and services are subject to a value added tax, or VAT, at a rate of 15%, with a limited number of goods and services subject to VAT at a rate of 8%.

Municipal taxes

Hydrocarbon activities are not subject to municipal taxes, as these taxes are exclusively reserved for the national executive branch.

Income from contractors that have entered into operative contracts with state companies for the rehabilitation of marginal fields is generally subject to a municipal tax on gross income.

Additional Matters

OPEC

Venezuela is a founding member of OPEC. In the past, PDVSA, under instructions from the Ministry of Energy and Mines, has adjusted its own production to ensure that Venezuela, as a whole, complies with the production ceilings set forth by OPEC.

The Venezuelan government has created a policy of strict compliance with the production quotas established within OPEC. Article 6 of the new Hydrocarbons Organic Law requires all persons who perform activities regulated by the Hydrocarbons Law to comply with production cuts, such as those that may be set by OPEC. Hence any production cuts may directly affect private producers and contractors as well as PDVSA.

Royalties

Since January 2002, royalties on oil and gas production have been set at a rate of 30%.

Exchange control system

On February 5, 2003, the Venezuelan government set forth an exchange control system. These regulations state that companies established for the purpose of developing any of the activities described in the Hydrocarbons Organic Law may maintain accounts in currency other than the currency of Venezuela in banking or similar institutions outside of Venezuela only for purposes of meeting their obligations outside Venezuela. The Central Bank of Venezuela must approve these accounts. Any other foreign currency generated by these companies must be sold to the Central Bank of Venezuela. These companies do not have the right to acquire foreign currency from the Central Bank of Venezuela to make foreign currency payments. These same exchange control measures will also be applicable to mixed-ownership companies.

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Ecuadorian Regulatory Framework

Petroleum and Gas

Petroleum activity in Ecuador is regulated by (1) the Ecuadorian Hydrocarbons Law and its regulations, (2) certain regulations of the Ministry of Energy and Mines and (3) the specific terms of a tender for public auction.

The executive branch regulates hydrocarbon policies. The Ministry of Energy and Mines is responsible for developing hydrocarbon policies for the President's consideration.

The National Directorate of Hydrocarbons, which is under the authority of the Ministry of Energy and Mines, is the technical and administrative entity in charge of controlling and auditing hydrocarbon operations. The National Directorate for Environmental Protection, also under the authority of the Ministry of Energy and Mines, is in charge of approving environmental impact studies and environmental management plans that apply to Natural Protected Areas.

Exploration and Exploitation of Hydrocarbons

Hydrocarbons and related products are the property of the Ecuadorian state. Hydrocarbon activities are performed by the Empresa Estatal de Petroleos Ecuador, or Petroecuador, by and through third parties.

The award of exploration and exploitation agreements is performed through a special tender mechanism. In order to reach the exploitation phase, the contractor may only retain those areas with commercially exploitable hydrocarbons. If the contractor fails to comply with this requirement, that contractor will be forced to return those areas to the state. The exploration and exploitation agreements for crude oil in Ecuador are generally divided into two stages. The first stage, or the exploration period, lasts four years and is renewable for another two years. The second stage, or the exploitation period, may be up to 20 years in duration and is renewable. A minimum average investment of U.S. \$120 to U.S. \$180 per hectare, either on land and/or in seawater, must be made during each of the first three years of the exploration period. Royalties are paid as follows: (1) 12.5% for daily gross production levels less than 30,000 barrels, (2) 14% when these daily levels are between 30,000 and 60,000 barrels, and (3) 18.5% when gross production exceeds 60,000 barrels per day. The contractor is not obliged to pay royalties on contracts for specified services or for marginal or participation fields. The contractor may not sell any of the assets related to the agreement without authorization from the Ministry of Energy and Mines. At the end of the term of the agreement, the contractor must deliver to Petroecuador, at no cost, all these assets.

The contractor assumes at its own risk and expense all investments, costs and expenses required to perform these hydrocarbon related activities, and, in turn, it has the right to receive a portion of the production of the area covered by the agreement, with Petroecuador having the right to the other portion. Petroecuador may enter into joint venture agreements by contributing rights over areas, fields, hydrocarbons or other rights. Petroecuador's joint venture party, in turn, acquires these rights and is obligated to make the investments agreed to by the parties. In services agreements, the contractor provides exploration and exploitation services in the agreed area at its own risk and expense. If the contractor finds commercially exploitable fields, it has the right to be reimbursed for its investments, costs and expenses and to be paid for its services.

Prior to initiating any work, an environmental impact study and an environmental management plan must be prepared, in accordance with consultation and participation procedures referred to in the National Constitution.

In April 2006, the Ecuadorian Hydrocarbons Law was amended to require that the government benefit from at least 50% of any income derived from oil price increases over the average monthly sales price for such oil at the execution date of the relevant production agreement, expressed in constant values as of the calculation date. The government's share is only dependent on oil price fluctuations and not on the volume of oil produced. See Business Overview Oil and Gas Exploration and Production Oil and Gas Exploration and Production Interests Production Production outside of Argentina Bolivia .

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Other Countries Regulatory Framework

In addition to Argentina, Venezuela and Ecuador, our businesses must comply with regulations in the other countries where we are located, including Peru, Bolivia and Brazil.

In Peru, the petroleum, transportation, gas and liquefied petroleum gas industry are each regulated under Peru's regulatory framework, which includes taxation, environmental codes and payments of royalties. In 1993, Perupetro, a state owned company functioning under private law, was created under Organic Hydrocarbon Law No. 26221 and has assumed significant powers within the Peruvian energy industry. It represents the Peruvian State as contracting party and has authority to grant areas for hydrocarbon exploration and exploitation activities and to supervise the activities carried out in those areas. Perupetro was also given the authority to negotiate contracts, including the payment of royalties, which is further governed by a series of national decrees. Certain consultation and participation procedures must be followed.

In Bolivia, the petroleum and gas industry is regulated by the System of Regulation by Sectors, which regulates, controls and supervises telecommunications, electricity, hydrocarbons, transportation and water activities, to ensure that they operate efficiently and protect the interest of users, service providers and the Bolivian state by contributing to the development of the country. In May 2005, a new hydrocarbons law, Law No.3058 was enacted, which, among other things, significantly increased taxes for companies in the industry. The law imposed an 18% royalty and a 32% direct tax on hydrocarbons (DTH) applicable on 100% of production. These new taxes are in addition to applicable taxes under existing law, Law No.843.

In May 2006, the Bolivian government enacted the so-called hydrocarbon nationalization under Supreme Decree No. 28,701. This Decree provides that as from May 1, 2006 oil companies must deliver to YPFB the property of all hydrocarbon production for sale. Oil companies will have a 180-day transition period to subscribe new agreements, which must be individually authorized and approved by the Bolivian Legislature. The Ministry of Hydrocarbons and Mines will determine, on a case by case basis, the interest in each field corresponding to oil companies by means of investment audits, operational costs and profitability indicators. The current distribution of the oil and gas production value will be maintained during the transition period, in the case of fields whose certified average production of natural gas for 2005 was lower than 100 million cubic feet per day. In addition, the abovementioned decree provides, among other things, that the Bolivian government shall recover full participation in the entire oil and gas production chain, and for this purpose provides for the nationalization of the shares of stock necessary for YPFB to have at least 50% plus one of the shares in a number of companies, among which is Petrobras Bolivia Refinación. The implementation of these measures requires a number of steps that have not yet been fully defined, including a comprehensive restructuring of YPFB. See Risk Factors Factors Relating to the Company Our activities may be adversely affected by events in countries in which we do business .

In Brazil, the petrochemical industry is regulated by laws affecting petrochemicals, as well as, certain environmental, health and safety regulations, which affect our subsidiary Innova.

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ORGANIZATION STRUCTURE

Below is a diagram of our corporate organization structure as of the date of this Annual Report.

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In addition to the companies included in this chart, we have holding companies in Spain, Austria, Bolivia, the Cayman Islands the Bermudas and Argentina, which are not reflected in the chart. Some of our material subsidiaries and affiliates are held through such holding companies.

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PROPERTY, PLANTS AND EQUIPMENT

We have freehold and leasehold interests in various countries in South America, but there is no specific interest that is individually material to our company. The majority of our property, consisting of oil and gas reserves, service stations, refineries, petrochemical plants, power plants, manufacturing facilities, power distribution systems, stock storage facilities, gas pipelines, oil and gas wells, pipelines and corporate office buildings, is located in Argentina. We also have interests in crude oil and natural gas operations outside Argentina in Venezuela, Ecuador, Bolivia, Peru and Colombia, a petrochemical plant in Brazil and interest in two refineries in Bolivia. For a more detailed description of our property, plants and equipment, including information on our oil and gas reserves and production see Oil and Gas Exploration and Production .

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Item 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion should be read in conjunction with, and is entirely qualified by reference to, our consolidated financial statements and the notes to those financial statements. Our consolidated financial statements were prepared in accordance with Argentine GAAP, which differs in certain significant respects from U.S. GAAP. Note 21 to our consolidated financial statements provides a description of the principal differences between Argentine GAAP and U.S. GAAP as they relate to us, and note 22 provides a reconciliation to U.S. GAAP of net income, shareholders' equity and certain other selected financial data.

Analysis of Consolidated Results of Operations

Petrobras Energía's Corporate Reorganization

Effective January 1, 2005, EG3, PAR and PSF merged into Petrobras Energía, and as from such date all the assets, liabilities, rights and obligations of EG3, PAR and PSF have been assumed by Petrobras Energía. See Item 4. Information About the Company Our History and Development Petrobras Energía Merger .

Petrobras Energía recorded the effects of the merger under the pooling of interests method. According to the method, the assets, liabilities and components of the shareholders' equity of the transferring entities are recognized in the combined entity based on their carrying amounts as of the effective merger date. In addition, according to the pooling of interest method, financial statements for previous years reflect the assets, liabilities, results and cash flows of the surviving entity as if the pooling of interests had occurred at the beginning of the earliest fiscal year presented.

Accordingly, this Annual Report presents information for the year ended as of December 31, 2004 assuming that the merger of EG3, PAR and PSF into Petrobras Energía had occurred on January 1, 2004. Considering that the effective date of the merger is January 1, 2005, total shareholders' equity and net income for the previous year shown on a comparative basis do not change as a result of the merger. For this reason, the balancing item of the net effect of additions, both in terms of the shareholders' equity and net income, is recorded under Minority Interest in Subsidiaries.

PROPORTIONAL CONSOLIDATION AND PRESENTATION OF DISCUSSION

In accordance with the procedures set forth in Technical Resolution No. 21 of the Argentine Federation of Professional Councils in Economic Sciences, or FACPCE, we are required to consolidate on a proportional basis the financial statements of companies over which we exercise joint control. Joint control exists where all shareholders, or shareholders representing a voting majority, have resolved, on the basis of written agreements, to share control over defining and establishing the company's operating and financial policies. When consolidating companies over which we exercise joint control, the amount of our investment in the companies under our joint control and the interest in their income (loss) and cash flows are replaced by our proportional interest in the company's assets, liabilities and income (loss) and cash flows. In addition, related party receivables, payables and transactions among members of the consolidated group and companies under joint control are eliminated on a pro rata basis pursuant to our ownership share in those companies.

The Company has joint control over the following companies:

Citelec, a company engaged in the electricity transmission business in Argentina through its subsidiary, Transener.

CIESA, a company mainly engaged in the gas transportation business in the south of Argentina through its subsidiary, TGS.

Distrilec, a company engaged in the electricity distribution business in the southern area of the Federal Capital and 12 districts of the Province of Buenos Aires, through its subsidiary, Edesur.

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The three companies are considered part of the Gas and Energy Business segment.

Despite being a company under our joint control, we did not consolidate proportionally the financial statements of Citelec because we have committed to sell such interest as required in connection with the Argentine Antitrust Commission's Resolution approving the transfer of our control to Petrobras.

Even though we consolidate the results of CIESA and Distrilec proportionally in our financial statements, our management analyzes our results and financial condition separately from the results and financial condition of these companies. Accordingly, we believe financial information without proportional consolidation is useful to investors in evaluating our financial condition and results of operations.

Unless otherwise provided, the discussion below is presented on the basis of our consolidated financial data without proportionally consolidating CIESA or Distrilec, and, therefore, is not directly comparable to the corresponding financial data set forth in our financial statements. For the results of CIESA and Distrilec (both of which are presented under proportional consolidation in our consolidated financial statements) and Citelec (which is presented under the equity method of accounting in our consolidated financial statements) please refer to our discussion under Analysis of Consolidated Results of Operations - Equity in Earnings of Affiliates.

The table below presents selected consolidated financial data of us and our subsidiaries, including the proportional consolidation of CIESA and Distrilec, as compared to such data excluding the proportional consolidation of such companies under joint control, in each case for the fiscal years indicated. To this effect, the Company's equity in the earnings of companies under joint control is shown under Equity in Earnings of Affiliates.

| | With proportional consolidation | | | Without proportional consolidation | | |
|-------------------------------------------------------|----------------------------------------|-------------|-------------|-------------------------------------------|-------------|-------------|
| | For the year ended December 31, | | | For the year ended December 31, | | |
| | 2006 | 2005 | 2004 | (Unaudited) | | |
| | 2006 | 2005 | 2004 | 2006 | 2005 | 2004 |
| Net sales | 11,745 | 10,655 | 8,763 | 10,458 | 9,512 | 7,756 |
| Cost of sales | (8,251) | (7,046) | (5,781) | (7,377) | (6,243) | (5,113) |
| Gross Profit | 3,494 | 3,609 | 2,982 | 3,081 | 3,269 | 2,643 |
| Administrative and selling expenses | (1,094) | (941) | (847) | (977) | (850) | (765) |
| Exploration expenses | (117) | (34) | (133) | (117) | (34) | (133) |
| Other operating expenses, net | (135) | (329) | (324) | (96) | (321) | (296) |
| Operating income | 2,148 | 2,305 | 1,678 | 1,891 | 2,064 | 1,449 |
| Equity in earnings of affiliates | 219 | 281 | 102 | 253 | 315 | 122 |
| Financial income (expense) and holding gains (losses) | (506) | (899) | (1,265) | (363) | (752) | (1,101) |
| Other income (loss), net | 93 | (459) | (40) | 102 | (448) | (33) |
| Subtotal | 1,954 | 1,228 | 475 | 1,883 | 1,179 | 437 |
| Income tax provision | (465) | (211) | 317 | (477) | (218) | 310 |

| | | | | | | |
|-----------------------------------|-------|-------|------|-------|-------|-----|
| Minority interest in subsidiaries | (425) | (288) | (17) | (342) | (232) | 28 |
| Net income | 1,064 | 729 | 775 | 1,064 | 729 | 775 |

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OVERVIEW

We are an integrated energy company engaged in:

- Exploration and production of oil and gas;
- Refining and distribution;
- Petrochemicals; and
- Gas and energy.

Our long-term strategy is to grow as an integrated energy company with a leading presence in Latin America, while focusing on profitability as well as social and environmental responsibility.

Our principal place of business has historically been Argentina, but we also conduct operations in Venezuela, Ecuador, Peru, Bolivia, Brazil, Colombia and Mexico. Approximately 59% of our total assets, 71% of our net sales, 62% of our combined crude oil and gas production and 53% of our proved oil and gas reserves were located in Argentina as of December 31, 2006. Fluctuations in the Argentine economy and actions adopted by the Argentine government have had and will continue to have a significant effect on Argentine private sector entities, including us. See Item Key Information Risk Factors .

Year to year fluctuations in our income are a result of a combination of factors, including principally:

- The volume of crude oil, oil products and natural gas we produce and sell;
- Changes in international prices of crude oil and oil products, which are denominated in U.S. dollars;
- Fluctuations in the Argentine peso/U.S. dollar exchange rate;
- Interest rates;
- Changes to our capital expenditures plan;
- Price controls; and
- Changes in laws or regulations affecting our operations, including tax and environmental matters.

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FACTORS AFFECTING OUR CONSOLIDATED RESULTS OF OPERATIONS

1) Argentine Economic Situation

Fluctuations in the Argentine economy and actions adopted by the Argentine government have had and will continue to have a significant effect on Argentine private sector entities, including the Company. Specifically, the Company has been affected and might be affected by inflation, interest rates, the value of the peso against foreign currencies, price controls, business regulations, tax regulations and in general by the political, social and economic environment in and affecting Argentina.

a) Peso Devaluation

As of December 31, 2006, the peso-U.S. dollar rate of exchange was P\$3.07 per U.S., dollar as compared to P\$ 3.03 and P\$ 2.98 per U.S. dollar as at December 31, 2005 and 2004, respectively.

Almost all of the Company's financial debt, as well as a significant portion of the debt of its related companies, is denominated in U.S. dollars, which exposes the Company to exchange risks. The diversification of the Company's business, with foreign operations having a cash flow primarily denominated in U.S. dollars and commodity prices that are sensitive to U.S. dollar changes help us mitigate our Peso-U.S. dollar exchange exposure. Exchange differences arising from liabilities in foreign currency assumed to hedge the net investment in foreign entities are not directly charged to Results but to the item Deferred Results within Stockholders' Equity, to which results for conversion of operations abroad are also charged.

With the accounting considerations stated, the exchange differences determined for fiscal years 2006, 2005 and 2004 losses for P\$6 million, P\$11 million and P\$19 million, respectively.

b) Inflation

In accordance with accounting principles generally accepted in Argentina, the Argentine Federation of Professional Councils in Economic Sciences is responsible for determining inflation.

Historically, the Argentine economy has exhibited significant volatility, characterized by periods with high rates of inflation.

In March 2003, the CNV, under Resolution No. 441, provided that starting on March 1, 2003, financial statements must be stated in nominal currency. Accordingly, we discontinued inflation accounting and the corresponding restatement of our financial statements, which was imposed in 2002.

Inflation has significantly accelerated since 2004, driven by the pace of economic growth in Argentina. The consumer price index increased by 6.1% in 2004, 12.3% in 2005 and 9.8% in 2006, while the wholesale price index increased by 7.9% in 2004, 10.8% in 2005 and 7.1% in 2006.

If inflation accounting were reinstated, financial statements would have to be stated in constant currency.

In the past, inflation has materially undermined the Argentine economy and the government's ability to stimulate economic growth. While inflation indexes currently are within reasonable parameters, we cannot assure you that this situation will remain stable. Sustained inflation in Argentina, without the passing through to prices of products sold by us in the domestic market, would have an adverse effect on our results of operations and financial position.

c) Investments in Utility Companies

The new macroeconomic scenario after enactment of the Public Emergency Law impacted the economic and financial balance of utility companies in Argentina. The combined effect of (1) the devaluation of the peso, (2) the pesification of tariffs at a rate of P\$1.00 to U.S.\$1.00 basis and (3) financial debts primarily denominated in foreign currency, adversely affected utility companies' financial position, results of operations and ability to satisfy certain loan agreement provisions.

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In light of the adverse conditions faced by utility companies during 2002, CIESA, TGS, and Transener defaulted on their financial debt. TGS and Transener restructured their financial debt through restructuring proposals, which were accepted by about 99.8% and 98.8% of the related creditors, respectively. In September 2005, CIESA signed an agreement to restructure its financial debt with all its creditors. The consummation of the restructuring is subject to certain regulatory approvals. Until a successful restructuring of this debt, substantial doubt will remain surrounding the ability of CIESA to continue operating as a going concern.

The Public Emergency Law pesified tariffs for public utility services at a P\$ \$1=U.S.\$1 parity and prohibited the increase of these tariffs based on indexation factors. In addition, the Argentine Federal Executive Branch was authorized to renegotiate the terms of contracts relating to the provision of public utility services, taking into account the following criteria: i) impact of tariffs on economic competitiveness and on income distribution; ii) quality of services to be provided and/or the capital expenditure programs provided for in the contracts; iii) interest of customers and accessibility to services; iv) the safety of the systems; and v) the companies' profitability.

On February 12, 2002, the Argentine federal executive branch enacted Decree No. 293/02 whereby the Ministry of Economy was entrusted the power to renegotiate contracts with public utility companies. In July 2003, the UNIREN (Utilities Contract Renegotiation and Analysis Committee) under the joint jurisdiction of the Ministry of Economy and Production and the Ministry Federal Planning, Public Investment and Services. The UNIREN's mission is, among other purposes, to provide assistance in the utility renegotiation process, execute comprehensive or partial agreements with utility companies and submit regulatory projects related to transitory price and rate adjustments.

UNIREN is currently renegotiating the contracts with our affiliates Edesur, TGS and Transener. These discussions are in different stages, and some of our affiliates have stated that UNIREN's latest proposals were not sufficient.

We are unable to predict the future development of the renegotiation process involving rates and concession contracts or the impact it may have on the results of operations or the financial position of those companies.

d) Price Stabilization and Supply

For the purpose of lessening inflationary pressures caused by the sharp devaluation of the peso in 2002, the Argentine government issued a set of regulations aimed at controlling the increase in prices payable by the final customer. These regulations have focused particularly on the energy sector.

Gas

In February 2004, the Argentine government, through Decree No.181/04, mandated the creation of a plan for the recovery of natural gas prices, following the freezing provided for by the Public Emergency Law, which prohibited gas price increases in the domestic market. In April 2004, the Company, along with the remaining gas producers, entered into an agreement with the Argentine government, which provides for a schedule of gradual increases in gas prices in the domestic market that would culminate in complete deregulation of the wellhead price of natural gas by 2007. As from September 1, 2005, wellhead prices have been deregulated for sales to electricity generation companies and gas distribution companies supplying industrial clients directly, with the Gas Electronic Market (*Mercado Electrónico del Gas*) starting operations only for such gas surplus spot transactions. The Argentine government has imposed restrictions on the ability of producers to export gas, which have deprived us of the ability to benefit from the higher margins offered by export prices. The April 2004 agreement included minimum commitments from producers for supply to the domestic market to the different segments of demand (distribution companies, CNG, thermal plants and industry). This agreement has been extended for four months beyond its original termination date in December 2006. Although a new agreement among natural gas producers was expected, no agreement has been reached to this Annual Report's date. Therefore, the Secretary of Energy is expected to determine the new specified amount of gas directed to the local market and the conditions under which the gas will be sold.

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In December 2006, through Resolution 1886, the Secretary of Energy ratified that the ability to export natural gas volumes is subject to an adequate satisfaction of domestic needs and that exports sales must be authorized on a case-by-case basis by the Executive Branch, with the Secretary of Energy being authorized to approve or reject export applications.

During 2005 and 2006, the Secretary of Energy requested producers to redirect gas for export to supply thermal plants and gas distribution companies. This decision limited our total gas export volumes by a daily average of about 110 thousand cubic meters and 339 thousand cubic meters, respectively, depriving us of the higher margins offered by export prices.

During 2006, the governments of Argentina and Bolivia entered into long-term gas supply agreements, whereby gas imports became the responsibility of ENARSA, the state-owned energy company. As a result, the Company had to assign to ENARSA its gas import agreement with Bolivia. At present, the Company is in discussions with ENARSA regarding the terms on which ENARSA will supply the Company with imported gas.

The agreements between Argentina and Bolivia established an initial gas price U.S.\$5 per million British thermal units (MMBtu), which is subject to adjustment pursuant to a formula based on international reference prices for gas and its byproducts. To prevent that this increase impact domestic consumers, the Argentine government has required that the increased import gas price be directed to exports, and as a result, tax withholdings on gas exports were increased to 45% over the gas import price from Bolivia. The Company has already negotiated with all its foreign customers new contractual terms to pass along the increased costs resulting from the increased withholdings.

Hydrocarbons

As from October 2004, hydrocarbon producing and refining companies have freely negotiated crude oil prices using the international market price net of export taxes.

With a view to discouraging exports and securing domestic supply, on March 1, 2002, the Argentine Government imposed, for a five-year term, a 20% tax on exports of crude oil and a 5% tax on exports of certain oil products. In May 2004, the tax on exports of crude oil and LPG increased to 25% and 20%, respectively, and a 20% tax was levied on exports of natural gas. Effective August 4, 2004, the Argentine government further increased taxes on exports of crude oil by 25% when the price per barrel is U.S.\$32 or lower and applied additional incremental taxes ranging between 3% and 20% when the price per barrel of oil ranges between U.S.\$32.01 and U.S.\$45, with a cap set at 45% when the price exceeds U.S.\$45. In 2006, the Argentine government increased taxes on natural gas exports to 45% in the price of gas imported from Bolivia.

This tax regime has adversely affected the profitability of our upstream operations and has prevented the Company from fully benefiting from the significant increases in international oil prices.

Downstream margins

The downstream business in Argentina has been and may continue to be subject to extensive regulatory changes that have affected the sector's prices and profitability, and these changes have had and may continue to have an adverse effect on the results of the Company's operations.

Downstream margins have significantly declined since the enactment of the Public Emergency Law. As part of its effort to control inflation, the Argentine government has limited the increase in prices of gasoline and diesel oil at the retail level in the domestic market that would have resulted from (1) higher costs due to increases in WTI prices, (2) the peso devaluation and (3) domestic inflation.

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During 2006, the Argentine government exerted increasing pressure on the fuel market, especially on diesel oil. Through a series of rules, regulations and actions, it sought to stabilize domestic prices of fuels and to secure supply for the domestic market. Resolution 25 of the Secretary of Domestic Trade, which was published in October 2006, requires refining companies to satisfy minimum levels of diesel oil demand in the domestic market, with a baseline equal to the prior year demand plus an estimated market variation.

In 2006, the fuel oil market grew for the third consecutive year. Total sales volumes increased by 8.1% and 7.9% in 2006 and 2005, respectively. Sales of diesel oil grew 5.9% boosted by the strong demand from the agricultural, industrial and transport sectors and the domestic gasoline sales totaled 4.3 million cubic meters, 16% more than in 2005. Refineries in Argentina are operating at levels very close to maximum installed capacity. Capacity constraints could result in a temporary lack of supply. Within this context, refining companies have taken several actions to satisfy the growing diesel oil demand, including the import of diesel oil. In light of Resolution 25, we imported 85 thousand cubic meters of diesel oil during 2006.

Considering the gap between import and retail prices, and the restrictions against increasing local prices, the import of diesel oil results in significant losses for the Company. During 2006 and 2005, the Company recognized losses of P\$ 38 million and P\$ 82 million, respectively, in connection with these imports. Depending on the productive capacity of the Company's refineries and levels of real market growth, the application of Resolution 25 could require us to continue importing diesel oil, with the consequent adverse effect on our results of operations.

Electricity Generation

Following the enactment of the Public Emergency Law, the Argentine government implemented the pesification of dollar-denominated prices in the Wholesale Electricity Market, or WEM, and set a price cap for gas supplied for electric power generation. This had the impact of fixing the price for energy sold in the spot market and causing generators to set prices based on the price of natural gas, regardless of the fuel actually used in generation activities. This regulatory change implied a deviation from the marginal cost system previously applied.

As a result of the Argentine government's measures, electricity prices failed to reflect total generation costs adequately. This discrepancy led to the gradual depletion of the Stabilization Fund (*Fondo de Estabilización*), causing an increasing deficit, which in turn prevented Compañía Administradora del Mercado Eléctrico S.A., or CAMMESA from settling accounts with market agents. In an effort to reduce the Stabilization Fund deficit, the Argentine government first made successive contributions to the fund and subsequently reinstated seasonal adjustments for certain periods, recognizing some increased costs resulting from the recovery of natural gas prices in the determination of wholesale spot prices. Notwithstanding, these actions have not been enough to restore the Stabilization Fund.

In order to replenish the Stabilization Fund, the Secretary of Energy created an investment fund called the Fund for Investments Required to Increase the Electric Power Supply in the Wholesale Electricity Market (FONINVEMEM or the *Fondo para las Inversiones Necesarias que permitan incrementar la oferta de energía eléctrica en el Mercado Eléctrico Mayorista*). This fund encouraged WEM creditors to participate in investments in electric power generation in order to increase the available supply of electric power generation in Argentina. The Secretary of Energy invited WEM agents to participate in these investments by contributing outstanding credit balances against CAMMESA resulting from the spread between sale prices and generation variable costs, and determined that non-participating agents would only receive payment on any such credits as from the date on which the generators constructed with FONINVEMEM's resources provide sufficient funds. The Company participated with 65% of the credit balances recorded for the 2004-2006 period with respect to this spread. Total credit balances contributed as of December 31, 2006 amounted to U.S.\$41 million.

On October 17, 2005, and under the terms of Resolution No. 1.193 issued by the Secretary of Energy, Petrobras Energía, together with other WEM creditors, formally announced their decision to participate in the construction, operation and maintenance of two plants, of at least 800 megawatts each. Commercial operations in open cycle are expected to commence during the first half of 2008, and in combined cycle by the end of that year. The estimated cost for construction of both plants is approximately U.S.\$1,080 million, which is expected to be funded by approximately 48% with contributions made to FONINVEMEM and the remaining balance with an additional charge to demand.

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To purchase units and construct, operate and maintain the power plants, two trusts were created within CAMMESA, and the funds corresponding to FONINVEMEM contributions and customer charges will be deposited in the trusts. The construction, operation and maintenance of the power plants will be the responsibility of Termoelectrica José de San Martín S.A. and Termoelectrica Manuel Belgrano S.A., which will act for the account of the relevant trusts. These companies are expected to enter into 10-year agreements for the supply of 80% of their electric generation to CAMMESA, at a price that covers all of their costs and allows the trust to reimburse FONINVEMEM contributions. The companies have the power to freely dispose of the remaining 20% of the generated energy. Upon expiration of the supply agreement, the ownership of the assets in trust shall be transferred to generation companies.

The Company has a share of about 8% in both companies. Petrobras Energía, as well as the other WEM creditors, are expected to recover the contributed funds, converted to U.S. dollars and adjusted at a rate of Libor + 1% per annum, in 120 monthly installments, with the funds received by the trusts during the effective term of the supply agreement.

In order to restore the regular operation of the WEM as a competitive market that provides sufficient supply, in December 2004, the Secretary of Energy committed to approving successive seasonal price increases to reach values covering at least total monomic costs by November 2006. However, established prices continue to fail to cover actual costs incurred in generation.

In addition, the Secretary of Energy has undertaken to compensate energy with the marginal cost of the system established in the spot market and capacity with values in U.S. dollars prior to the enactment of the Public Emergency Law, once the market returns to normal conditions with the start of commercial operation of the additional capacity contributed by FONINVEMEM.

e) Recoverability of Assets

Tax loss: As of December 31, 2003, Petrobras Energía recorded a P\$1,397 million allowance on loss carry forwards. Considering the then-prevailing Argentine economic situation, the uncertainties related to recovery from the 2002 crisis, and particularly exposure of the Company's results to fluctuations in the Argentine economy and actions taken by the Argentine government, the recoverability of such tax loss carry forwards remained uncertain at December 31, 2003.

As of December 31, 2005 and 2004, taking into consideration profitability expectations under Petrobras Energía's business plan, the Company partially reversed this allowance and recorded P\$197 million and P\$268 million gains in 2005 and 2004, respectively. These reversals were due, among other key factors, to expectations of high and sustained prices for commodities, the recovery of the Argentine economy, the relative stability of and expectations for the main macroeconomic variables in Argentina and measures taken by the Argentine government in connection with the recovery of energy and gas prices. As of December 31, 2006, Petrobras Energía maintained a P\$754 million allowance for tax loss carry forwards, which to a large extent expire during 2007.

Minimum presumed income tax credit: As of December 31, 2004, Petrobras Energía recorded a P\$72 million allowance on credits paid as a minimum presumed income tax from 1998 to 2002, considering the uncertainty with respect to our ability to use amounts paid under alternative minimum tax rules for the reduction of our future income taxes.

The minimum presumed income tax is complementary to the income tax, since, while the latter is levied on the taxable income for the year, the former represents a minimum tax on potential income on certain assets at a 1% rate. During any given fiscal year, Petrobras Energía's tax liability is the higher of both taxes. However, if the taxpayer's liability under the minimum presumed income tax exceeds its liability under the income tax for a given year, the amount in excess may be credited against any income tax payment over the minimum presumed income tax during the following ten fiscal years.

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As of December 31, 2005, since the Petrobras Energía's management believed that it was highly probable that those payments would be used within the statute of limitations period, the relevant allowance was reversed, accounting for a P\$45 million gain (attributable to the discounted value of such payments).

Gas areas in Argentina: In 2005, taking into account the regulatory changes introduced by the Argentine government with a view to restoring profitability in the gas business, including the establishment of a framework for the recovery of gas prices, the Company recorded a P\$44 million gain from the reversal of previously recorded allowances on the recoverability of investments in gas areas.

2) Migration of Operating Agreements in Venezuela

In April 2005, the Venezuelan Energy and Oil Ministry (MEP) instructed Petróleos de Venezuela S.A. (PDVSA) to review the 32 operating agreements signed by PDVSA affiliates with oil companies from 1992 through 1997, including agreements signed with Petrobras Energía, through their controlled and affiliated companies in Venezuela to develop the Areas of Oritupano Leona, La Concepción, Acema and Mata. The instruction given by MEP established that PDVSA should take all required actions to convert the operating agreements into mixed-owned companies where the Venezuelan Government, through PDVSA, would be entitled to more than 50% ownership.

During 2005, through different actions, PDVSA exercised pressure on the effective operating agreements as a way to promote migration. Among others: (a) PDVSA approved a reduced amount of development investments for the Oritupano Leona area; (b) the SENIAT (National Integrated Tax Administration Service) performed several tax inspections on the companies that operate the 32 oil operating contracts and, as a result, challenged prior tax filings (as a result of which, the Company recorded P\$18 million and P\$54 million in losses in 2006 and 2005, respectively); and (c) the applicable income tax rate was increased from 34% to 50%.

On September 29, 2005 and prior to the migration of operating agreement to the new business scheme, Petrobras Energía, through its controlled and affiliated companies in Venezuela, signed provisional agreements with PDVSA, whereby it agreed to negotiate the terms and conditions of the conversion of the operating agreements in the areas of Oritupano Leona, La Concepción, Acema and Mata into mixed-owned companies. The provisional agreement for the Oritupano Leona Area was signed subject to the condition of its prior approval by the Annual Shareholders Meeting of the Company and by a Special Shareholders Meeting of Petrobras Energía Participaciones S.A., which subsequently approved the agreement.

In March 2006, Petrobras Energía, through its controlled and affiliated companies in Venezuela, entered with PDVSA and Corporación Venezolana de Petróleo S.A. (CVP) into memoranda of understanding (MOUs) in order to effect the migration of the operating agreements. These MOUs established that private investors would hold a 40% share in these mixed-owned companies, with the Venezuelan Government being entitled to a 60% ownership interest. As a result, the direct and indirect interests of Petrobras Energía in the mixed-owned companies that would operate the areas of Oritupano Leona, La Concepción, Acema and Mata would be 22%, 36%, 34.5% and 34.5%, respectively. The MOUs establish that CVP will recognize a divisible and freely transferable credit in favor of Petrobras Energía in the amount of U.S.\$88.5 million. These credits will not bear interest and may be used only for the payment of acquisition bonds under any new mixed company project for the development of oil exploration and production activities or licenses for the development of gas exploration and production operations, both in Venezuela.

In August 2006, the relevant conversion agreements were signed for the Oritupano Leona, La Concepción, Acema and Mata areas, which were consistent with the terms agreed in the MOUs. Subsequently, the companies Petroritupano S.A., Petrowayú S.A., Petrovenbras S.A. and Petrokariña S.A. were organized and registered with the Public Registry of Commerce of Venezuela. The Venezuelan government has issued the relevant decrees granting the necessary powers to these four companies, and the respective shareholders subsequently made the required capital contributions. The MOUs established that the economic effects of the migration would become effective on April 1, 2006. From this date to October the fields were under the management of a provisional executive committee formed primarily by PDVSA. Since October the fields have been under the management of the mixed companies themselves. From April to December mixed companies have been financed by Petrobras Energía Venezuela and the other members of the consortiums. See Business Overview Oil and Gas Exploration and Production Oil and Gas Exploration and Production Interest Production Production outside of Argentina Venezuela .

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Due to the ownership structure and governance system defined for the mixed companies, we discontinued the consolidation of our investments in Venezuela in our financial statements as from April 1, 2006. We now record our investments in our Venezuelan affiliates under the equity method, and present their net assets and results in our consolidated financial statements under non-current investments and equity in earnings of affiliates, respectively.

In view of the new contractual framework, as of December 31, 2005, we recognized impairment charges of P\$424 million to adjust the book value of our assets in Venezuela to their estimated recoverable value. Of this amount, P\$255 million related to property, plant and equipment, P\$110 million to deferred tax assets, and P\$59 million to non-current investments.

As of December 31, 2006, investments in mixed companies in Venezuela (P\$2,510 million) are stated net of an impairment allowance of P\$186 million to adjust their book value to their estimated recoverable cost. In addition, as of such date, the Company recorded an asset in respect of the divisible and transferable credit assigned to it upon execution of the conversion agreements, since all of the conditions for the recognition of the credit have been satisfied. This asset, net of an impairment allowance of P\$92 million to adjust its book value to its estimated recoverable cost, amounts to P\$180 million. The realization of the recorded estimated value of these assets depends on future events, some of which are beyond the Company's direct control. As a result, actual results could vary significantly from these estimates.

3) Commodity Prices

The Company's results of operations and cash flows are exposed to risks related to the volatility of international prices, mainly crude oil and by-product prices.

During 2006, oil prices reached a high of approximately U.S.\$80 per barrel on a nominal basis and stabilized at approximately U.S.\$60 per barrel. The WTI closed at U.S.\$60.8 per barrel as of December 31, 2006, averaging U.S.\$66 per barrel during the year. During 2005 and 2004 the average WTI was U.S.\$56.6 and U.S.\$41.5 per barrel, respectively.

In line with our business integration strategy, the Company manages price risks with a focus on measuring its net risk exposure and monitoring the risks that affect its overall portfolio of assets. Within this policy, the Company's management regularly evaluates the possibility of using derivative instruments to hedge the exposure to commodity prices. In Argentina, as the Company grows as an integrated energy company and assigns a greater portion of its crude oil production to processing at the Company's own refineries, the Company's exposure to fluctuations in the price of crude oil is reduced and a risk profile is created that is increasingly tied to the price of oil byproducts.

4) Oil and gas production in Argentina

Oil and gas reserves in Argentina have followed a downward trend in recent years. According to official data from the Argentine Oil and Gas Institute, proved oil and gas reserves dropped by 34% in the 2001-2005 five-year period.

In 2006, oil production in Argentina declined for the ninth year in a row, though to a lesser extent than in previous years. During the first eleven months of 2006, oil production reached 660,000 barrels per day, a decline of approximately 1% over 2005.

In this context, the Company's oil and gas reserves in Argentina declined 7% in 2006 and 8.1% in 2005. During the same year, we recorded a 3% increase in production as compared to 2005. See [Business Overview](#) [Oil and Gas Exploration and Production](#) [Reserves](#) .

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As of December 31, 2005, as a result of the decline in reserves, the Company adjusted the book value of certain oil and gas assets to their relevant recoverable value, recognizing a P\$132 million loss.

The Company's business plan provides for major exploratory investments in Argentina, both onshore and off-shore. Due to risks inherent in exploration activities, the Company's management cannot provide assurance that this downward trend in the Company's reserves in Argentina can be reversed in the future.

5) Operations in Ecuador

Block 31

Block 31 is mostly located in the Yasuní National Park, a highly ecologically sensitive area in the Amazon region of Ecuador (an area included in the National Heritage of Natural Areas and Protective Woods and Vegetation).

In August 2004, the Ecuadorian Ministry of the Environment approved the Environmental Management Plan in connection with the Project for the Development and Production of Block 31 and granted an environmental license in connection with the Nenke and Apaika fields for the construction stage of the project. In addition, in August 2004, the Ministry of Energy and Mines approved the development plan for Block 31, representing the start of the 20-year exploitation term. The concession contract for Block 31 provides for the free oil production availability.

On July 7, 2005, the Ministry of the Environment decided not to authorize the beginning of certain construction works on the Tiputini River (boundary of Parque Nacional Yasuní) and denied us access to Parque Nacional Yasuní. Petrobras Energía changed the Development Plan for Block 31 in order to address the objections posed by the Ecuadorian Ministry of the Environment and finally, after a process involving participation of the affected communities, submitted a new Environmental Impact Assessment (EIA). The new EIA was approved by the Ministry of the Environment and the Ministry of Energy and Mines, and the issuance of a new environmental license to resume development works in Block 31 was officially requested on January 4, 2007. All relevant formalities have been completed in connection with this request, and the request for a license is awaiting approval by the Ecuadorian Minister of the Environment.

Crude oil transportation agreement with Oleoductos de Crudos Pesados Ltd. (OCP)

Regarding the exploitation of Blocks 31 and 18, the Company entered into an agreement with OCP, whereby an oil transportation capacity of 80,000 barrels per day is secured for a 15-year term, starting November 10, 2003. Under the ship or pay transportation agreement clause, the Company must fulfill its ship or pay contractual obligations for the aggregate oil volume committed, even though no crude oil is transported, and pay, as well as all other producers, a fee covering OCP's operating costs and financial services. As of December 31, 2006, this fee amounted to U.S.\$2.27 per barrel. Costs in connection with the transportation capacity are invoiced by OCP and charged to expenses on a monthly basis.

The Company expects that during the effective term of the Ship or Pay transportation agreement, oil production will be lower than the aggregate transportation capacity committed. This assumption is based on: estimated delays in the development of Block 31 and the current estimated reserve potential of Block 31. Considering this situation and with a view to mitigating its effects, the Company has sought to sell a portion of the contracted transportation capacity volumes. As of December 31, 2006, the Company had sold a transportation capacity of about 8,000 barrels of oil per day for the July 2004/December 2012 period and of 16,000 barrels per day of oil for a two-year period as from December 2006. The impact of the net shortfall is considered for the purpose of analyzing the recoverability of assets in Ecuador.

Table of Contents**Tax credits derived from operations**

In August 2001, the Ecuadorian Tax Authority (SRI) notified that it would not refund credits maintained with respect to value added taxes paid for the import and domestic purchase of goods and services required for the production of hydrocarbons intended for export, based on its position that these value added taxes were considered at the time of determining the sharing of oil production between the government and producers. This resolution was challenged in the competent tax court, but no decision has been made as of the date of this Annual Report. On August 11, 2004, Ecuador's National Congress enacted a new law on value added taxes, which law established that the refund of value added taxes does not apply to oil activities. By reason of the degree of uncertainty related to the recoverability of VAT credits, as of December 31, 2005, the Company maintained an allowance of P\$ 88 million.

On December 12, 2006, Ecuadortlc S.A., our subsidiary in Ecuador, signed a Memorandum of Agreement with SRI, the Attorney General's Office and Petroecuador for the assessment and settlement of credits on value added taxes paid upon purchase of goods and services related to hydrocarbon exploration and development in Block 18. Under the agreement, Ecuadortlc S.A. is entitled to a refund of U.S.\$8 million in respect of credits accrued in the July 1999-May 2005 period. The agreement also provides that the same recognition criterion will be used to assess the refund of subsequent credits accumulated from June 2005 to December 2006, in respect of which period the Company estimates a U.S.\$12 million recovery. This criterion will be valid until the time when the parties renegotiate their share in the production of the block to take into account the application of value added taxes.

Since as of the date of the financial statements included in this Annual Report, the Company had not begun similar negotiations in connection with the refund of the VAT credits corresponding to Block 31, as of December 31, 2006, the Company maintains an allowance on such credits of P\$46 million. The Company believes, however, that it is entitled to similar compensation, either by way of payment by SRI or by renegotiating its share in oil production, because the export of goods and the provision of services were not subject to VAT when the production sharing for the block was established.

Law Amending the Hydrocarbon Law in Ecuador

In April 2006, the Ecuadorian government approved the Oil & Gas Reform Law, which assigns to the government an interest of at least 50% of the excess revenues resulting from the increase in the price of Ecuadorian crude (effective monthly average price of FOB price) over the average monthly sales price of such oil at the execution date of the relevant production agreement, expressed in constant values for the month in which settlement occurs. In July 2006, the competent authorities published the relevant regulations implementing the law, and subsequently Ecuadortlc and Petroecuador expressed divergent interpretations of the regulations.

In order to resolve these differences and after the request of Ecuadortlc, Petroecuador asked the Attorney General to issue an opinion on this matter. In the meantime, Ecuadortlc paid U.S.\$12 million in aggregate to Petroecuador, which payments correspond to amounts purportedly owed to the Ecuadorian Government under the new law. In October 2006, Ecuadortlc was informed that the Attorney General's opinion exempted the income derived from the Palo Azul field from the scope of application of the new law, given that the development agreement for Palo Azul contains provisions under which the Ecuadorian Government receives more than 50% of the benefits. Notwithstanding the Attorney General's opinion, however, in January 2007, Petroecuador submitted a claim to Ecuadortlc in favor of the government for U.S.\$26 million in respect of the benefits corresponding to the government under the new law from April 2006 to December 2006. In its counsel's opinion, Ecuadortlc has legal grounds to consider this claim as invalid. Although Ecuadortlc is of the view that it has valid legal grounds not to make payments under the new law, as of December 31, 2006, Ecuadortlc maintained an allowance of P\$37 million (U.S.\$12 million) on receivables in respect of such payments.

On February 15, 2007, Ecuadortlc paid the remaining amount of Petroecuador's claim (U.S.\$14 million), reserving its right to seek reimbursement.

Preliminary Agreement with Teikoku Co. Ltd. Teikoku

In January 2005, the Company entered into a preliminary agreement with Teikoku, whereby after receipt of approval and authorization from the Ministry of Energy and Mines of Ecuador, the Company would assign 40% of the rights and obligations resulting from the Blocks 18 and 31 participation agreements. In addition, the parties agreed that, when the production in Block 31 reaches an average of 10,000 barrels per day within a period of 30 calendar days,

Teikoku would assume payment of 40% of the crude oil transportation agreement with OCP. On January 11, 2007, the agreement was approved by the Ministry of Energy and Mines of Ecuador. As a result of this authorization, the parties are currently in the process of completing the necessary formalities, including the necessary steps towards obtaining amendments to these participation contracts, which Petroecuador must sign, in order to incorporate Teikoku as a partner in the agreements. Once the amendments are finalized, the terms and economic conditions of this transaction will go into effect.

Table of Contents**6) Operations in Bolivia**

The new Hydrocarbons Law No.3058, effective May 19, 2005, abrogates former Hydrocarbons Law No. 1689 enacted on April 30, 1996. This law provides, among other things, increased taxes for companies in this sector by means of a 18% royalty percentage and a 32% Direct Tax on Hydrocarbons (DTH) directly applicable on 100% of production. Such taxes are in addition to the taxes in force under Law No. 843.

In May 2006, the Bolivian government established the so-called hydrocarbon nationalization under Supreme Decree No. 28,701. This Decree provides that as from May 1, 2006 oil companies must deliver to YPFB the property of all hydrocarbon production for sale. Under the Decree, oil companies had a 180-day transition term to subscribe new agreements, which must be individually authorized and approved by the Bolivian Legislature. The Ministry of Hydrocarbons and Mines would determine, on a case-by-case basis, the interest corresponding to oil companies by means of investment audits, operational costs and profitability indicators. The current distribution of the oil and gas production value was maintained during the transition period, in the case of fields, such as the Colpa Caranda field, that had certified average production of natural gas for 2005 lower than 100 million cubic feet per day.

In October 2006, our Bolivian branch entered into an agreement with Yacimientos Petrolíferos Fiscales Bolivianos, or YPFB, under which we agreed to conduct, at our expense and account, exploration and production activities at the Colpa Caranda field on behalf of YPFB. Under the agreement, YPFB is the owner of all hydrocarbons. YPFB is required to pay all royalties and taxes, which in the aggregate represent approximately 50% of the value of production, and apply the remainder first to the payment of the expenses and depreciation incurred by our Bolivian branch for the development and exploitation of the field and then distribute any remaining balance between YPFB and our branch on the basis of a formula that considers, among other factors, production volumes, the rate of depreciation, sales prices and taxes paid. The agreement was approved by the Bolivian Legislature in November 2006 and enacted on January 11, 2007. As of the date of the Annual Report, the agreement is not fully effective as some formalities are still pending.

In addition, Decree No. 28,701 provides, among other things, that the Bolivian government shall recover full participation in the entire oil and gas production chain, and for this purpose provides for the nationalization of the shares of stock necessary for YPFB to have at least 50% plus one of the shares in a number of companies, among which is Petrobras Bolivia Refinación. This transfer will be made after both parties agree on the value of the economic compensation that YPFB shall pay to the Company and completion of certain corporate and legal steps. The Company's management does not have sufficient information to estimate the effects, if any, of the new business scenario arising from the new law.

7) Tax benefits regarding Innova operations FUNDOPEM

The Company, through Innova's operations in Brazil, enjoys a tax benefit pursuant to an incentive program granted by the state of Rio Grande do Sul, in Brazil, for companies located in that state. The benefit consists of a 60% reduction of the ICMS (interstate goods transport tax) until 2007.

Under this program, the Company recorded P\$46 million and P\$42 million gains in 2006 and 2005, respectively.

In 2006, Innova started construction of a new ethylbenzene plant. This new plant is expected to meet the legal requirements necessary to extend Innova's rights to receive this tax benefit until 2015.

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8) Derivative financial instruments

As of December 31, 2006 and 2005, the Company no longer had any crude oil hedging derivative instruments. As of December 31, 2004, we had derivative instruments outstanding, and our derivative position was fully composed of instruments that did not qualify for hedge accounting. We recognized financial losses attributable to such instruments in the amount of P\$295 million, P\$687 million in 2005 and 2004, respectively.

9) Environmental matters

Liabilities for future environmental remediation costs are recorded when environmental assessment is probable and costs of remediation can be reasonably estimated.

Remediation liabilities are determined on the basis of our best estimate of future costs, using available technology and applying environmental protection rules and regulations in force, as well as our own environmental protection policies. Actual remediation costs may differ from previously estimated liabilities as a result of a number of factors, including changes in environmental laws and regulations or in available technology and increased knowledge of applicable conditions.

In 2006, 2005 and 2004 environmental remediation costs charged to income totaled P\$5 million, P\$29 million and P\$51 million, respectively.

Table of Contents**DISCUSSION OF RESULTS**

The following tables set out net sales, gross profit and operating income for each of our business segments for the years ended December 31, 2006, 2005 and 2004, both including proportional consolidation, which is required by Argentine general accounting standards, and excluding the proportional consolidation of the companies under common control. Our management analyzes our results and financial condition separately from the results and financial conditions of these companies and we believe financial information without proportional consolidation is useful to investors in evaluating our financial condition and results of operations. See Proportional Consolidation and Presentation of Discussion and Reconciliation Tables . Net sales eliminations relate to intersegment sales. Gross profit eliminations relate to adjustments related to intersegment sales and costs associated with such sales. Intersegment transactions are made at market prices.

The business segment year-to-year comparisons that follow the table do not exclude intersegment sales.

| With Proportional Consolidation | For the year ended December 31, | | |
|----------------------------------------|----------------------------------------|---------------|--------------|
| | 2006 | 2005 | 2004 |
| | (in millions of pesos) | | |
| Net sales (1) | | | |
| Oil and Gas Exploration and Production | 4,781 | 4,657 | 3,647 |
| Refining and Distribution | 4,531 | 3,856 | 3,359 |
| Petrochemicals | 2,490 | 2,178 | 1,877 |
| Gas and Energy | 2,593 | 2,136 | 1,804 |
| Corporate and Eliminations (2) | (2,650) | (2,172) | (1,924) |
| Total | 11,745 | 10,655 | 8,763 |
| Gross Profit (3) | | | |
| Oil and Gas Exploration and Production | 2,662 | 2,635 | 1,910 |
| Refining and Distribution | (184) | 107 | 257 |
| Petrochemicals | 307 | 377 | 374 |
| Gas and Energy | 680 | 530 | 465 |
| Corporate and Eliminations (2) | 29 | (40) | (24) |
| Total | 3,494 | 3,609 | 2,982 |
| Operating Income | | | |
| Oil and Gas Exploration and Production | 2,179 | 2,039 | 1,270 |
| Refining and Distribution | (468) | (149) | 10 |
| Petrochemicals | 162 | 267 | 278 |
| Gas and Energy | 537 | 450 | 378 |
| Corporate and Eliminations (2) | (262) | (302) | (258) |
| Total | 2,148 | 2,305 | 1,678 |

(1) Royalties with respect to the oil

and gas business
in Argentina,
Peru and
Bolivia are
accounted for as
a cost or
production and
are not deducted
in determining
net sales.

- (2) Eliminations
correspond to
sales between
our business
units and their
associated costs.
- (3) Net sales less
cost of sales.

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| Without Proportional Consolidation (Unaudited) | For the year ended December 31, | | |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|--------------|--------------|
| | 2006 | 2005 | 2004 |
| | (in millions of pesos) | | |
| Net Sales (1) | | | |
| Oil and Gas Exploration and Production | 4,781 | 4,657 | 3,647 |
| Refining and Distribution | 4,531 | 3,856 | 3,359 |
| Petrochemicals | 2,490 | 2,178 | 1,877 |
| Gas and Energy | 1,306 | 972 | 784 |
| Corporate and Eliminations (2) | (2,650) | (2,151) | (1,911) |
| Total | 10,458 | 9,512 | 7,756 |
| Gross Profit (2) | | | |
| Oil and Gas Exploration and Production | 2,662 | 2,635 | 1,910 |
| Refining and Distribution | (184) | 107 | 257 |
| Petrochemicals | 307 | 377 | 374 |
| Gas and Energy | 267 | 190 | 129 |
| Corporate and Eliminations (2) | 29 | (40) | (27) |
| Total | 3,081 | 3,269 | 2,643 |
| Operating Income | | | |
| Oil and Gas Exploration and Production | 2,179 | 2,039 | 1,270 |
| Refining and Distribution | (468) | (149) | 10 |
| Petrochemicals | 162 | 267 | 278 |
| Gas and Energy | 280 | 209 | 149 |
| Corporate and Eliminations (2) | (262) | (302) | (258) |
| Total | 1,891 | 2,064 | 1,449 |
| (1) Royalties with respect to the oil and gas business in Argentina, Peru and Bolivia are accounted for as a cost or production and are not deducted in determining net sales. | | | |

(2) Eliminations correspond to sales between our business units and their associated costs.

(3) Net sales less cost of sales.

Year ended December 31, 2006 compared to year ended December 31, 2005

Net income: Net income for 2006 fiscal year increased P\$335 million, or 46%, to P\$1,064 million from P\$729 million in 2005.

Net sales: Net sales increased P\$1,090 million or 10.2% to P\$11,745 million from P\$10,655 million in 2005. Net sales for 2006 fiscal year include P\$632 million and P\$695 million attributable to our share of the net sales (net of intercompany sales of P\$40 million) of CIESA and Distrilec, respectively. Net sales for 2005 fiscal year include P\$513 million and P\$651 million attributable to our share of the net sales (net of intercompany sales of P\$21 million) of CIESA and Distrilec, respectively.

Without proportional consolidation, net sales increased P\$946 million, or 9.9%, to P\$10,458 million in 2006 from P\$9,512 million in 2005, boosted by the significant increase in the WTI and in the price for the main petrochemical and refined products. Sales in the Oil and Gas Exploration and Production, Petrochemicals, Refining and Distribution, Gas and Energy business segments (including intercompany sales) increased P\$124 million, P\$312 million, P\$675 million, P\$188 million and P\$146 million, respectively. Intercompany sales increased to P\$2,650 million in 2006 from P\$2,172 million in 2005. Most of these sales were attributable to the Oil and Gas Exploration and Production and the Refining and Distribution and Hydrocarbon Marketing and Transportation business segments or sectors.

Gross profit: Gross profit decreased P\$115 million, or 3.2%, to P\$3,494 million from P\$3,609 million. Gross profit for 2006 includes P\$312 million and P\$101 million attributable to our share of the gross profit of CIESA and Distrilec, respectively. Gross profit for 2005 includes P\$243 million and P\$97 million attributable to our share of the gross profit of CIESA and Distrilec, respectively.

Without proportional consolidation, gross profit declined P\$188 million, or 5.8%, to P\$3,081 million in 2006 from P\$3,269 million in 2005. This drop mainly resulted from a decline in gross profit from the Refining and Distribution (P\$291 million) and the Petrochemicals (P\$70 million) business segments, partially offset by increases in the Oil and Gas Exploration and Production (P\$63 million) and Electricity (P\$80 million) business segments or sectors.

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Administrative and selling expenses: Administrative and selling expenses increased P\$153 million, or 16.3%, to P\$1,094 million in 2006 from P\$941 million in 2005. Administrative and selling expenses for 2006 include P\$23 million and P\$94 million attributable to our share of the administrative and selling expenses of CIESA and Distrilec, respectively. Administrative and selling expenses for 2005 include P\$18 million and P\$73 million attributable to our share of the administrative and selling expenses of CIESA and Distrilec, respectively.

Without proportional consolidation, administrative and selling expenses increased P\$127 million, or 14.9%, to P\$977 million in 2006 from P\$850 million in 2005.

Exploration expenses: Exploration expenses increased P\$83 million to P\$117 million in 2006 from P\$34 million in 2005.

Other operating expense, net: Other operating expense, net accounted for a P\$135 million loss in 2006 compared to a P\$329 million loss in 2005. Other operating expense, net for 2006 includes losses of P\$1 million and P\$38 million attributable to our share of other operating expense, net of CIESA and Distrilec, respectively. Other operating expense, net for 2005 includes losses of P\$3 million and P\$5 million, attributable to our share of other operating expense, net of CIESA and Distrilec, respectively.

Without proportional consolidation, other operating expense, net accounted for losses of P\$96 million and P\$321 million in 2006 and 2005, respectively.

Operating income: Operating income declined P\$157 million, or 6.8%, to P\$2,148 million in 2006 from P\$2,305 million in 2005. Operating income for 2006 includes a P\$288 million gain attributable to our share of the operating income of CIESA and a P\$31 million loss attributable to our share of the operating income of Distrilec. Operating income for 2005 includes P\$222 million and P\$19 million gains attributable to our share of the operating income of CIESA and Distrilec, respectively.

Without proportional consolidation, operating income decreased P\$173 million, or 8.4%, to P\$1,891 million in 2006 from P\$2,064 million in 2005. This decline was mainly attributable to operating losses reported by the downstream business.

Equity in earnings of affiliates: Equity in earnings of affiliates decreased P\$62 million, or 22.1%, to P\$219 million in 2006 from P\$281 million in 2005. Without the proportional consolidation of CIESA and Distrilec, equity in earnings of affiliates decreased P\$62 million, or 19.7%, to P\$253 million in 2006 from P\$315 million in 2005. See Analysis of Equity in Earnings of Affiliates .

Financial (expense) income and holding (losses) gains: Financial (expense) income and holding (losses) gains decreased P\$393 million, or 43.7%, to P\$(506) million in 2006 from P\$(899) million in 2005. Losses for 2006 include financial expenses of P\$132 million and P\$11 million attributable to our share of the financial income (expense) and holding gains (losses) of CIESA and Distrilec, respectively. Losses for 2005 include financial expenses of P\$128 million and P\$19 million attributable to our share of the financial income (expense) and holding gains (losses) of CIESA and Distrilec, respectively.

Without proportional consolidation, financial (expense) income and holding (losses) gains decreased P\$389 million, or 51.7%, to P\$(363) million in 2006 from P\$(752) million in 2005. This decline reflects the absence of losses from derivative instruments in 2006, as compared to losses of a P\$295 million loss recorded in 2005 from derivative instruments. In addition, this decrease also derived from the decline in interest expense 4.6% to P\$457 million in 2006 from P\$479 million in 2005, in line with a 7.1% reduction in average indebtedness, and improved results from the sale of securities, a P\$48 million gain in 2006 compared to a P\$4 million loss in 2005.

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Other income (expenses), net: Other income (expenses), net totaled a P\$93 million gain in 2006 compared to a P\$459 million loss in 2005. Other income (expenses), net include P\$9 million and P\$11 million losses attributable to our share of other income (expenses), net of Distrilec in 2006 and 2005, respectively.

Without proportional consolidation, other income (expenses), net accounted for a P\$102 million gain compared to a P\$448 million loss in 2005.

Other income (expenses), net for 2006 mainly reflect:

P\$85 million gain from the sale of oil areas in Argentina.

P\$23 million gain from the reversal of an allowance on the investment in Citelec S.A.

P\$10 million gain from the reversal of an allowance on the investment in Hidroneuquén S.A.

P\$18 million assessment by SENIAT Venezuela.

P\$6 million impairment charge on assets in Venezuela. Other income (expenses), net for 2005 mainly reflect:

P\$310 million impairment charge on assets in Venezuela.

P\$88 million impairment charge on areas in Argentina.

P\$54 million assessment by SENIAT Venezuela.

Income Tax: Income tax charge for 2006 and 2005 accounted for P\$465 million and P\$211 million losses, respectively. The income tax for 2006 reflects P\$6 million and P\$6 million gains attributable to our share of the income tax of CIESA and Distrilec, respectively. The income tax for 2005 reflects P\$6 million and P\$1 million gains attributable to our share of the income tax of CIESA and Distrilec, respectively.

Without proportional consolidation, income tax accounted for losses of P\$477 million and P\$218 million in 2006 and 2005, respectively.

Our income tax for 2005 includes a P\$197 million gain from the reversal of previously created allowances for tax credits on tax loss carryforwards and a P\$45 million gain from the reversal of a previously created allowance on credits recorded with respect to minimum presumed income taxes paid in Argentina from 1998 to 2002. In addition, during 2005, recoverability of the book value of assets in Venezuela was assessed and as a result, a P\$110 million impairment charge on deferred tax assets was recorded in 2005.

Excluding the effects mentioned above, income tax charge for 2006 increased to P\$477 million compared to P\$350 million in 2005, mainly derived from improved results of operations in Ecuador and Peru.

Table of Contents**ANALYSIS OF OPERATING RESULTS BY BUSINESS SEGMENT****Oil and Gas Exploration and Production**

Operating income: Operating income for the Oil and Gas Exploration and Production business segment increased P\$140 million, or 6.9%, to P\$2,179 million in 2006 from P\$2,039 million in 2005. Operating income for 2006 and 2005 includes P\$186 million and P\$639 million gains, respectively, attributable to operations in Venezuela (see Factors Affecting our Consolidated Results of Operations – Migration of Operating Agreements in Venezuela). Excluding such results, operating income increased P\$593 million, or 42.4%, mainly as a consequence of the 36.6% increase in average sales prices of oil equivalent stemming from the 17% rise in the international reference price (WTI).

Net sales: Net sales for this business segment increased P\$124 million, or 2.7%, to P\$4,781 million in 2006 from P\$4,657 million in 2005. This increase was predominately due a rise in the average sales price per barrel of oil which, including the effect of taxes on exports, rose 36.6% to P\$132.5 in 2006 from P\$97 in 2005, partially offset by a 19% reduction in oil and gas daily sales volumes to 138.4 thousand barrels of oil equivalent in 2006 from 170.9 thousand barrels of oil equivalent in 2005.

In 2006, oil sales volumes dropped 27.6% to 87.3 thousand barrels per day from 120.5 thousand barrels per day in 2005, while daily gas sales volumes increased 2% to 306.7 million cubic feet from 300.8 million cubic feet in 2005.

Net sales for 2006 and 2005 include P\$312 million and P\$1,175 million, respectively, attributable to the consolidation of operations in Venezuela. Without consolidation of these operations, net sales for the business segment rose P\$987 million or 28.3%. As a result of changes in our operating regime in the operating framework in Venezuela, we discontinued the consolidation of our Venezuelan operations as from April 1, 2006. See Factors Affecting our Consolidated Results of Operations – Migration of Operating Agreements in Venezuela .

Argentina

Net sales in Argentina increased P\$512 million, or 23.5%, to P\$2,694 million in 2006 from P\$2,182 million in 2005, mainly boosted by a 20.2% increase in average sales prices of oil equivalent and a 2.4% rise in combined oil and gas daily sales volumes, which averaged 94.1 thousand barrels of oil equivalent per day. We have made significant investments in oilfields, mainly to improve these basic production curves, which have allowed us to reverse the natural decline of mature fields in Argentina.

Crude oil sales increased P\$405 million, or 20.8%, to P\$2,349 million in 2006 from P\$1,944 million in 2005. This increase was attributable to a 24.5% rise in the average sales price to P\$124.4 per barrel in 2006 from P\$99.9 per barrel in 2005, mainly from the rise in international reference prices. Average crude oil daily sales volumes dropped 3% to 51.7 thousand barrels in 2006 from 53.2 thousand barrels in 2005.

Total gas sales increased 41.8%, or P\$97 million, to P\$329 million from P\$232 million, mainly as a result of a 29.2% rise in the average sales price and a 9.7% growth in average daily sales volumes. The average sales price for gas increased to P\$3.54 per million cubic feet from P\$2.74 per million cubic feet, mainly as a consequence of higher export prices for methanol, the renegotiation of Sierra Chata agreements as from May 2005, the deregulation of the gas price for industrial clients and electricity generation companies as from August 1, 2005 and the effect of the increase in international reference prices on some gas contracts. These factors were partially offset by higher taxes on exports. Daily gas sales volumes increased to 254.3 million cubic feet from 231.7 million cubic feet due to higher production at the Austral Basin.

Outside of Argentina

Combined oil and gas sales outside of Argentina decreased P\$390 million, or 15.8%, to P\$2,072 million in 2006 from P\$2,462 million in 2005 mainly due to our operations in Venezuela (see Factors Affecting our Consolidated Results of Operations – Migration of Operating Agreements in Venezuela). Without consolidation of operations in Venezuela, combined oil and gas sales increased P\$473 million, or 36.8%, mainly due to a 29.9% rise in the average sales prices of oil equivalent to P\$146 and, to a lesser extent, a 5.3% rise in sales volumes.

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Ecuador

In Ecuador, oil sales increased 46.2% to P\$652 million in 2006 from P\$446 million in 2005, boosted by higher sales volumes and increased sales prices.

Daily oil sales volumes rose to 10.9 thousand barrels, or 15.8%, in 2006. Oil sales volumes for 2005 include the sale of 202.7 thousand barrels attributable to December 2004 production, which was postponed to January 2005 for commercial reasons. Without considering this effect, daily sales volumes increased 23.1%. This improvement was mainly attributable to the progressive development of Block 18, in line with investments made, which included drilling of eight wells and different workovers.

Average sales price increased 26.4% to P\$163.6 per barrel in 2006 from P\$129.4 per barrel in 2005 mainly due to the rise in the international reference price.

Peru

In Peru, oil and gas sales increased 27.9% to P\$902 million in 2006 from P\$705 million in 2005, mainly as a result of a 26.1% rise in the average sales price of oil equivalent.

Average crude oil price increased 24.9% to P\$184.8 per barrel in 2006 from P\$147.9 per barrel in 2005, mainly as a result of the increase in the WTI and, to a lesser extent, amendments to the agreement for the sale of crude oil as from the last quarter of 2006 that changed the composition of the reference crude oil basket. In addition, the average gas sales price increased 73.5% to P\$8.5 from P\$4.9 per million cubic feet, as a consequence of the rise in fuel oil prices, included in the formula for price calculation.

Daily sales volumes increased 1.4% to 14.7 thousand barrels of oil equivalent in 2006 from 14.5 thousand barrels of oil equivalent in 2005.

Bolivia

In Bolivia, oil and gas sales increased to P\$207 million, or 52.2%, in 2006 from P\$136 million in 2005 due to changes in the average sales price of oil equivalent. Combined oil and gas daily sales volumes averaged 7.4 thousand barrels of oil equivalent in 2006 and 2005.

Average sales price for gas increased 64.9% to P\$12.2 per million cubic feet in 2006 from P\$7.4 per million cubic feet in 2005. This improvement was mainly attributable to the rise in fuel oil price, which is included in the formula for calculation of the price for exports to Brazil. In addition, the crude oil average sales price rose 10% due to the increase in export prices.

Mexico

In 2006, sales for other services increased to P\$14 million, or 7.7%, compared to P\$13 million in 2005.

Gross Profit: Gross profit for this business segment increased P\$27 million to P\$2,662 million in 2006 from P\$2,635 million in 2005. Margin on sales was 55.6% in 2006 and 56.6% in 2005. Without consolidation of operations in Venezuela, gross profit increased P\$530 million, or 27.2%, and margin on sales decreased to 55.5% in 2006 from 56.03% in 2005. The average lifting cost rose 21% to P\$13.3 per barrel of oil equivalent in 2006 from P\$11 per barrel of oil equivalent in 2005, mainly as a consequence of increased oil service rates and growing costs due to inflation in Argentina.

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Administrative and selling expenses: Administrative and selling expenses rose P\$40 million, or 16.1%, to P\$288 million in 2006 from P\$248 million in 2005. This increase was mainly attributable to increases in labor costs and, to a lesser extent, in the cost of crude oil transportation derived from the rise in sales volumes in Ecuador.

Exploration expenses: Exploration expenses totaled P\$117 million in 2006 and P\$34 million in 2005. Expenses for 2006 were mainly attributable to 3D seismic works and unsuccessful exploratory wells in Argentina. In 2005, exploration expenses were mainly attributable to 3D seismic works at the Austral and Neuquén basins, in Argentina.

Other operating expense, net: Other operating expense, net accounted for losses of P\$78 million in 2006 and P\$314 million in 2005. Losses for 2006 were mainly attributable to costs associated with the unused transportation capacity under the ship or pay contract with OCP in Ecuador (P\$178 million), partially offset by a P\$74 million gain attributable to the favorable resolution of certain commercial claims in Venezuela. Losses for 2005 mainly reflect costs associated with the unused transportation capacity under the ship or pay contract with OCP (P\$184 million), an allowance for tax credits relating to VAT (P\$78 million), and environmental remediation expenses (P\$27 million).

Refining and Distribution

Operating expenses: Operating expenses for the Refining and Distribution business segment reflected losses of P\$468 million and P\$149 million in 2006 and 2005, respectively. During 2006, the business operating margin was significantly affected by price control measures in Argentina that prevented us from passing through to market prices the 22% increase in crude oil prices and domestic inflation.

Net sales: Net sales for refinery products increased P\$675 million, or 17.5%, to P\$4,531 million in 2006 from P\$3,856 million in 2005, due to the combined effect of a 8.6% increase in sales prices mainly due to a rise in the price of products not subject to price control measures and, to a lesser extent, a 5.7% increase in sales volumes, specially of gasoline, heavy distillates and VGO.

In line with the significant 17% rise in the price of WTI, average sales prices of aromatics, paraffins, asphalts, VGO and heavy distillates showed improvements of 59%, 27%, 27%, 24% and 21%, respectively, and export sales prices increased 23.9% as a consequence of the increase in international reference prices.

Crude oil volumes processed at the refineries were at similar levels in both years, 63.1 thousand and 62.9 thousand barrels per day in 2006 and 2005, respectively. In October 2006 the overall revamping at San Lorenzo Refinery was completed, which resulted in an increase of 18% in the consolidated crude oil processing capacity of the plant to 80,800 barrels per day.

Total diesel oil sales volumes rose 1.5% to 1,767 thousand cubic meters as a result of higher sales volumes in the domestic market, which in turn derived from a 5.9% increase in demand boosted by the agricultural, industrial and transportation sectors. Our estimated market share in this market declined to 13.6% in 2006 from 14.2% in 2005.

Total gasoline sales volumes rose 17% to 837 thousand cubic meters, mainly due to a 16.4% increase in domestic sales. In 2006 the domestic market for gasoline increased by 15.5%, as a result of economic growth, an increase in purchasing power and the stabilization of sales prices. Within this context, our market share remained close to 14.6% during both 2006 and 2005. In the premium gasoline market, as a result of the 58% increase in sales of Podium gasoline in 2006 (the only gasoline with 100 octanes in the Argentine market), our market share increased to 9.2%.

Asphalt sales volumes declined 2.2%, mainly as a result of a reduction in production due to scheduled shutdowns during the year at the San Lorenzo Refinery. Within this context, domestic market sales increased 1.2%, while exports declined 26.3%.

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As regards heavy distillates and VGO, sales volumes increased 21% and 14.5% to 617 thousand and 202 thousand tons, respectively, primarily due to the decrease in stock to average levels.

Gross profit: Gross profit for 2006 accounted for a P\$184 million loss compared to a P\$107 million gain in 2005. Price control measures that prevented us from passing through crude oil increases and domestic inflation to final prices was a determining factor in our negative gross margins during 2006. In addition, the commitment to meet the growing domestic demand resulted in a lower export surplus. In addition, diesel oil imports (85 thousand and 272 thousand cubic meters in 2006 and 2005, respectively) had a negative impact on our gross profit, particularly in 2005. Considering the differential between import prices and retail prices and the impossibility of passing it through to consumer prices, these imports resulted in negative margins on sales.

Administrative and selling expenses: Administrative and selling expenses increased 15.5% to P\$290 million in 2006 from P\$251 million in 2005, mainly due to a rise in labor costs.

Other operating income (expense), net: Other operating income (expense), net recorded a P\$6 million gain in 2006 and a P\$5 million loss in 2006 and 2005, respectively.

Petrochemicals

Operating income: Operating income for the Petrochemicals business segment declined P\$105 million, or 39.3%, to P\$162 million in 2006 from P\$267 million in 2005, due to a reduction on the spread of styrenics products in Argentina, and higher administrative and selling expenses.

Net sales: Net sales (net of eliminations in the amount of P\$308 million and P\$170 million for inter-segment sales between our Argentine and Innova's styrenics operations) increased P\$312 million, or 14.3%, to P\$2,490 million in 2006 from P\$2,178 million in 2005, due to increased sales volumes, both in Argentina and Brazil, and higher sales prices in line with the rise in international reference prices.

Styrenics Argentina

In Argentina, styrenics sales increased P\$155 million, or 17.5%, to P\$1,039 million in 2006 from P\$884 million in 2005 due to the combined effect of a 9% increase in sales volumes and a 7.8% improvement in average sales prices.

In 2006, in line with the rise in international reference prices, average sales prices for this business improved compared to 2005 with increases of 11.1%, 9.7% and 2.8% for the styrene, synthetic rubber and polystyrene lines, respectively.

Sales volumes rose basically as a result of increased consumption in the domestic market and the consequent improvement in the industrial activity level. In the domestic market, the market share remained at 100% for styrene and reached 82.4% for polystyrene.

During 2006, styrenics performance was as follows:

a) Styrene and propylene propane sales volumes increased 6.6% to 74.1 thousand tons, with an 8% rise in export volumes and a 6% improvement in domestic sales, boosted by increased consumption and construction growth. As from the third quarter of 2006, production capacity at Puerto General San Martin styrene plant increased from 110 to 160 thousand tons per year. This increase in capacity was achieved as a consequence of works performed during a 2-month plant shutdown.

b) Ethylbenzene sales volumes increased 13.3% compared to 2005, to 48.6 thousand tons due to increased sales to Innova. The Puerto General San Martin plant shutdown generated ethylbenzene surplus production, which was sent to Innova for processing and conversion into styrene and polystyrene.

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c) Polystyrene and bops sales volumes climbed 11% to 72.1 thousand tons, with a 26% increase in the domestic market and a 10% reduction in exports. Polystyrene sales volumes in the domestic market achieved a historical record. The Company's nature as the only domestic producer of polystyrene granted it competitive advantages within the context of the price control policy implemented by the National Government. This helped us achieve a market share increase of approximately 10 points from 73% to 82.4%. The reduction in export volumes derived from the need to meet domestic demand and the lower styrene availability as a consequence of the San Martín plant shutdown, and trade union conflicts that limited plant availability. In light of these events and in line with the regional integration of our operations, demand was satisfied with imports from Innova.

d) Synthetic rubber sales volumes increased to 55.8 thousand tons, or 5.9%, mainly due to an increase in exports to the Asian market. In the domestic market, the Company maintained its leading position with sales volumes similar to those recorded in 2005.

Styrenics Brazil Innova

Innova sales increased by P\$242 million, or 24.9%, to P\$1,214 million in 2006 from P\$972 million in 2005, due to the combined effect of a rise in sales volumes and increased prices.

Styrene sales volumes rose 15.4% to 136.4 thousand tons due to higher demand from domestic clients in the polyester and acrylic resin segments and increased exports to Argentina. Polystyrene sales volumes increased 19.8% to 114.3 thousand tons due to higher domestic sales and increased exports to Argentina. The integration of operations in Argentina and Brazil served to overcome the product shortage resulting from the Puerto General San Martín plant shutdown in Argentina and meet the growing demand. Styrene and polystyrene average prices recorded 6.7% and 0.8% increases, respectively, as a consequence of a rise in international references.

Fertilizers

Fertilizers sales increased P\$53 million, or 10.8%, to P\$545 million in 2006 from P\$492 million in 2005, mainly due to a 10.6% increase in sales volumes to 747 thousand tons. Volume increases resulted from a 24% increase in demand derived from favorable weather conditions and expectations of higher future grain prices. With a growing share in the product mix, sales of liquid fertilizers increased 28%.

Gross profit: Gross profit decreased P\$70 million, or 18.6%, to P\$ 307 million in 2006 from P\$377 million in 2005, due to higher costs of raw materials and labor in Argentina, partially offset by higher sales volumes. Gross margin on sales decreased to 12.3% from 17.3% reflecting the impact of reduced margins in Argentina and in fertilizers.

Styrenics Argentina

Gross profit declined P\$71 million, or 38.8%, to P\$112 million in 2006 from P\$183 million in 2005, mainly due to the rise in variable production costs, mainly derived from the increase in imported volumes of styrene and polystyrene to replace the Company's own production during the Puerto General San Martín plant shutdown and in fixed labor costs. Gross margin on sales declined to 10.8% from 20.7%.

Styrenics Brazil

Gross profit increased P\$35 million, or 44.3%, to P\$114 million in 2006 from P\$79 million in 2005. Gross margin on sales rose to 9.4% from 8.1% mainly as a consequence of lower benzene costs under agreements with suppliers.

Fertilizers

Gross profit decreased P\$34 million, or 29.6%, to P\$81 million in 2006 from P\$115 million in 2005, and gross margin on sales declined to 14.9% from 23.4% as a consequence of higher raw material costs in line with the rise in international reference prices, the impact of which could only be partially passed through to sales prices.

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Administrative and selling expenses: Administrative and selling expenses increased P\$34 million, or 23.8%, to P\$177 million in 2006 from P\$143 million in 2005, primarily due to higher labor costs and, to a lesser extent, higher freight costs derived from increased export volumes.

Other operating income, net: Other operating income, net recorded P\$32 million and P\$33 million gains in 2006 and 2005, respectively, mainly attributable to the collection of FUNDOPEM tax benefits.

Gas and Energy

Marketing and Transportation of Gas

Operating income: Operating income for the Marketing and Transportation of Gas operations increased P\$ 65 million or 23.2% to P\$345 million in 2006 from P\$280 million in 2005. Operative income includes P\$288 million and P\$222 gains in 2006 and 2005, respectively, attributable to the proportional consolidation of CIESA. Excluding proportional consolidation, operating income for this sector did not record significant changes compared to 2005 totaling P\$57 million and P\$58 million in 2006 and 2005, respectively.

Net sales: Sales revenues increased P\$188 million, or 31%, to P\$794 million in 2006 from P\$606 million in 2005, mainly due to the rise in gas and liquid fuel prices.

Revenues from the sale of gas produced by us and imported gas increased P\$97 million, or 31.4%, to P\$406 million in 2006 from P\$309 million in 2005, mainly as a result of a 26.1% rise in sales prices derived from the recovery of the gas price for industrial clients and electricity generation companies in line with the scheduled price increases determined by the Secretary of Energy and higher export prices due to the rise in international reference prices. Sales volumes recorded a 2.6% increase from 260.9 million cubic feet per day in 2005 to 267.8 million cubic feet per day in 2006 as a result of higher volumes of gas produced by the Company, mainly from fields at the Austral Basin.

Revenues from the sale of liquid fuels increased P\$42 million, or 16%, to P\$304 million in 2006 from P\$262 million in 2005 due to a 15% increase in sales prices as a consequence of higher international reference prices. Sales volumes recorded a 1.2% increase from 267.1 thousand tons in 2005 to 270.3 thousand tons in 2006.

Gas and LPG brokerage services accounted for P\$84 million and P\$35 million in sales revenues during 2006 and 2005, respectively.

Gross profit: Gross profit in 2006 declined P\$3 million, or 11.1%, to P\$24 million in 2006 from P\$27 million in 2005.

Other operating income, net: Other operating income, net (mainly attributable to income from technical assistance services to TGS) totaled P\$38 million and P\$35 million gains in 2006 and 2005, respectively.

Electricity

Operating income: Operating income for the Electricity sector of the Gas and Energy business segment increased P\$22 million or 12.9% to P\$192 million from P\$170 million. Operating income includes a loss of P\$31 million compared to a P\$19 gain in 2005, attributable to the proportional consolidation of Distrilec. Excluding proportional consolidation, operating income for this sector increased P\$72 million, or 47.7%, to P\$223 million in 2006 from P\$151 million in 2005, mainly as a consequence of increased generation margins derived from a rise in average prices, partially offset by higher variable costs for generation and purchase of energy.

Electricity Generation

Net sales: Net sales of electricity generation increased P\$145 million, or 40.8%, to P\$500 million in 2006 from P\$355 million in 2005, primarily due to a 36.5% improvement in generation prices. The increase in average energy sales prices is primarily attributable to the scheduled price increases implemented during the second quarter of 2004 by the Secretary of Energy in line with the recovery of gas prices.

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Net sales attributable to the Genelba Power Plant increased P\$109 million, or 37.6%, to P\$399 million in 2006 from P\$290 million in 2005, primarily due to an increase in the average sales price to P\$73.3 per MWh, or 38.6%, in 2006 from P\$52.9 per MWh in 2005. Energy delivered was at similar levels in both years totaling 5,446 GWh in 2006. The Genelba Power Plant's availability factor increased to 96% from 94% and the plant factor was close to 91% in both years.

Net sales attributable to the Pichi Picún Leufú Hydroelectric Complex increased P\$36 million, or 55.4%, to P\$101 million in 2006 from P\$65 million in 2005, due to the combined effect of an improvement in sales prices and higher generation volumes. The average sales price increased 31.2% to P\$66.9 per MWh in 2006 from P\$51.2 per MWh in 2005. During 2006, energy delivered increased to 1,510 GWh, or 20.3%, from 1,255 GWh in 2005, primarily due to increased water supply at the Comahue Basin and a higher demand for energy.

Gross profit: Gross profit for the generation business sector increased P\$79 million, or 49.1%, to P\$240 million from P\$161 million. Gross margin rose to 48% from 45.4% mainly due to the significant improvement in prices and, to a lesser extent, increased sales volumes. The Company's competitive advantages resulting from being an integrated energy company and operating both thermal and hydroelectric generation plants allowed the Company to capitalize on market opportunities and increase sales volumes.

Administrative and selling expenses: Administrative and selling expenses for the generation business sector increased P\$4 million, or 33.3%, to P\$16 million in 2006 from P\$12 million in 2005.

ANALYSIS OF EQUITY IN EARNINGS OF AFFILIATES

In the following discussion, unless we specifically mention that a figure represents our share of the affiliate's results, the amounts attributed to each affiliate or company represents the total amount recorded by that affiliate or company.

Compañía de Inversiones de Energía S.A. (CIESA) / Transportadora de Gas del Sur S.A. (TGS): Our equity in the earnings of CIESA and TGS increased P\$11 million to P\$71 million in 2006 from P\$60 million in 2005 mainly as a consequence of the favorable performance of TGS's NGL production and marketing segment.

Total sales revenues increased approximately 23% or P\$245 million to P\$1,309 million. Sales revenues from the gas transportation segment increased 7% or P\$32 million to P\$492 million. This improvement was mainly attributable to the execution of new settled transportation agreements. Some of these agreements were subscribed as a consequence of the expansion of the San Martín Gas Pipeline completed in August 2005, which resulted in an increase in transportation capacity of 2.9 million cubic meters per day. Revenues from NGL production and marketing activities increased 33% or P\$180 million to P\$726 million mainly as a result of: (i) a 16% increase in sales volumes; (ii) a rise in the sales price of ethane agreed with Polisur, effective January 2006, and (iii) an increase in export prices in line with international reference prices.

CIESA's operating income increased P\$127 million, or 28.7%, to P\$569 million in 2006, mainly as a consequence of higher sales revenues from the unregulated segment, partially offset by a rise in natural gas prices and, to a lesser extent, increased labor costs.

Distrilec Inversora S.A. (Distrilec)/Edesur S.A. (Edesur): Our equity in the earnings of Distrilec accounted for a P\$29 million increase in losses to P\$37 million in 2006 from P\$8 million in 2005.

Income from Edesur services increased P\$73 million, or 5%, to P\$1,412 million in 2006 due to a 4.9% growth in the demand for energy.

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Distrilec's operating income accounted for a P\$41 million loss in 2006 compared to a P\$9 million gain in 2005, mainly as a consequence of a rise in costs for the purchase of energy, and increased services under contract and higher compensation.

Refinería del Norte S.A. (Refinor): In 2006, our equity in the earnings of Refinor decreased P\$15 million to P\$32 million from P\$47 million in 2005. This decline resulted primarily from a drop in gross profit derived from an increase in crude oil costs, which could not be fully passed through to domestic sales prices due to price control measures.

Refinor's sales increased 6.1% or P\$87 million to P\$1,516 million in 2006 from P\$1,429 million in 2005, mainly as a result of a 10.7% average rise in sales prices, partially offset by a 4% average reduction in sales volumes.

In 2006, in line with the increase in international reference prices, Refinor's average sales prices were higher compared to 2005, primarily for exports and products not subject to the inflation control policy implemented by the Argentine Government.

The volume of crude oil processed decreased 4.5% to 17.1 thousand barrels per day due to the discontinued supply of condensate from Bolivia as from May 2006 on account of the hydrocarbon nationalization policy implemented by the Bolivian government. The volume of gas processed averaged 18.7 million cubic meters per day, a level similar to that recorded in 2005.

Refinor's operating income dropped 19.6% or P\$48 million to P\$197 million, mainly reflecting the decline in gross profit and increased transportation and freight expenses and labor costs.

Petroquímica Cuyo S.A. (Cuyo): Our equity in the earnings of Cuyo increased P\$8 million to P\$15 million in 2006 from P\$7 million in 2005. This increase is mainly attributable to an improvement in gross profit resulting from higher sales volumes, partially offset by reduced margins on sales.

Cuyo's sales increased 39.4% or P\$133 million to P\$470 million in 2006, mainly due to a 25% increase in sales volumes attributable to the scheduled plant shutdown in 2005, and, to a lesser extent, a 12% improvement in sales prices in line with the rise in crude oil prices which resulted in strong increases in international reference prices for the petrochemical industry.

Cuyo's operating income increased 25% or P\$16 million to P\$80 million mainly due to higher sales volumes. Operating margins dropped to 17% from 19% since increased costs could only be partially passed through to sales prices.

Petrobras Bolivia Refinación (PBR): Our equity in the earnings of PBR increased by P\$28 million to P\$82 million in 2006 from P\$54 million in 2005 as a consequence of an improvement in gross profit derived from a 5% increase in sales volumes and a 5.2% rise in the average sales price. The average sales price was positively affected by the rise in international reference prices. In 2005, the recognition of bad debt allowances, especially for credits with the Bolivian government and tax claims, had an adverse impact on PBR's results.

Crude oil volumes processed in 2006 increased 0.2% to 39.9 thousand barrels per day as a consequence of a greater operating availability of refining units. Gasoline volumes exceeded 2005 figures with a monthly average of 49.5 thousand cubic meters. Reconstituted oil reached monthly average sales levels of 51.3 thousand cubic meters. Diesel oil volumes were slightly lower compared to 2005, with average sales of 53.6 thousand cubic meters per month.

Oleoductos del Valle S.A. (Oldelval): Our equity in the earnings of Oldelval increased P\$4 million to P\$8 million from P\$4 million as a consequence of an improvement in gross profit derived from a significant rise in sales, partially offset by increased operation costs.

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Oldelval's sales revenues increased 26.3% or P\$31 million to P\$149 million mainly due to a rise in rates of approximately 17% and, to a lesser extent, a 7.8% increase in transported volumes to 70.5 million barrels.

Petrolera Entre Lomas S.A (PELSA): Our equity in the earnings of PELSAs increased P\$6 million to P\$33 million from P\$27 million, mainly due to the combined effect of improved margins on sales and increased crude oil sales volumes.

Sales revenues increased 28.8% or P\$106 million to P\$474 million due to the combined effect of a 20% improvement in prices attributable to the rise in the international price of crude oil and increased volumes (9%).

Year ended December 31, 2005 compared to year ended December 31, 2004

Net income: Net income decreased P\$46 million, or 5.9%, to P\$729 million in 2005 from P\$775 million in 2004.

Operations for the year were developed within a context characterized by high prices of international crude oil and main by-products, in which operating income significantly increased.

However, the estimated significant negative effects resulting from migration of operating agreements in Venezuela had a strong impact on the results for the year and weakened the magnitude of the operating income improvement. In addition, the increase in the income tax charge, which in 2004 was offset against the allowance provided for tax loss carry forwards, had a negative impact.

Conversely, the reduced position of derivative instruments that do not qualify for hedge accounting derived in a significant reduction in related losses, thus offsetting the negative effects mentioned above.

Net sales: Net sales increased P\$1,892 million, or 21.6%, to P\$10,655 million in 2005 from P\$8,763 million in 2004. Sales for 2005 reflect P\$513 million and P\$651 million attributable to the share of the net sales (net of intercompany sales of P\$21 million) of CIESA and Distrilec, respectively. Net sales for 2004 reflect P\$485 million and P\$535 million, attributable to the share of the net sales (net of intercompany sales of P\$13 million) of CIESA and Distrilec, respectively.

Without proportional consolidation, net sales increased P\$1,756 million, or 22.6%, to P\$9,512 million in 2005 from P\$7,756 million in 2004 boosted by the significant increase in the WTI and the main petrochemical and refined products. Sales in the Oil and Gas Exploration and Production, Petrochemicals and Refining and Distribution business segments (including intercompany sales) increased P\$1,010 million (28%), P\$301 million (16%) and P\$497 million (15%), respectively. Reflecting the growing integration of business operations, intercompany sales increased to P\$2,172 million in 2005 from P\$1,924 million in 2004. Most of these sales are attributable to the Oil and Gas Exploration and Production and the Refining and Distribution business segments.

Gross profit: Gross profit increased P\$627 million, or 21%, to P\$3,609 million in 2005 from P\$2,982 million in 2004. Gross profit for 2005 reflects P\$243 million and P\$97 million attributable to the share of the gross profit of CIESA and Distrilec, respectively, and P\$3 million in eliminations. Gross profit for 2004 reflects P\$250 million and P\$86 million, attributable to the share of the gross profit of CIESA and Distrilec, respectively.

Without proportional consolidation, gross profit grew P\$626 million, or 23.7%, to P\$3,269 million in 2005 from P\$2,643 million in 2004. This increase mainly stems from a rise in the Oil and Gas Exploration and Production (P\$725 million) and Electricity (P\$52 million) business segments, partially offset by a P\$150 million drop in the Refining and Distribution segment. See Analysis of Operating Income .

Administrative and selling expenses: Administrative and selling expenses increased P\$94 million, or 11.1%, to P\$941 million in 2005 from P\$847 million in 2004. The 2005 fiscal year reflects P\$18 million and P\$73 million attributable to the share of the administrative and selling expenses of CIESA and Distrilec, respectively. The 2004 fiscal year reflects P\$16 million and P\$66 million attributable to the share of the administrative and selling expenses of CIESA and Distrilec, respectively.

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Without proportional consolidation, administrative and selling expenses increased P\$85 million, or 11.1%, to P\$850 million in 2005 from P\$765 million in 2004. See *Analysis of Operating Income* .

Exploration expenses: Exploration expenses decreased P\$99 million to P\$34 million in 2005 from P\$133 million in 2004. See *Analysis of Operating Income Oil and Gas Exploration and Production* .

Other operating income (expense), net: Other operating income (expense), net accounted for P\$329 million losses in 2005 compared to P\$324 million losses in 2004. Other operating income (expense), net for 2005 reflects losses of P\$3 million and P\$5 million, attributable to the share of other operating income (expense), net of CIESA and Distrilec, respectively. Other operating income (expense), net for 2004 reflects losses of P\$19 million and P\$6 million, attributable to the share of other operating income (expense), net of CIESA and Distrilec, respectively, and P\$3 million in eliminations.

Without proportional consolidation, other operating income (expense), net accounted for losses of P\$321 million in 2005 and P\$296 million in 2004. See *Analysis of Operating Income* .

Operating income: Operating income grew P\$627 million, or 37.4%, to P\$2,305 million in 2005 from P\$1,678 million in 2004. Operating income for 2005 reflects P\$222 million and P\$19 million attributable to the share of operating income of CIESA and Distrilec, respectively. Operating income for 2004 reflects P\$215 million and P\$14 million attributable to the share of operating income of CIESA and Distrilec, respectively.

Without proportional consolidation, operating income increased P\$615 million, or 42.4%, to P\$2,064 million in 2005 from P\$1,449 million in 2004. This increase mainly derived from the rise in gross profit in the Oil and Gas Exploration and Production segment. See *Analysis of Operating Income Without Proportional Consolidation* .

Equity in earnings of affiliates: Equity in earnings of affiliates increased P\$179 million, or 175.5%, to P\$281 million in 2005 from P\$102 million in 2004. Without proportional consolidation, equity in earnings of affiliates increased P\$193 million, or 158.2%, to P\$315 million in 2005 from P\$122 million in 2004. This increase basically derives from improvements in the results of Citelec, CIESA and PBR, partially offset by the Coroil and Mata impairment charge. See *Analysis of Equity in Earnings of Affiliates* .

Financial income (expense) and holding gains (losses): Financial income (expense) and holding gains (losses) decreased P\$366 million, or 29%, to P\$899 million in 2005 from P\$1,265 million in 2004. The year 2005 reflects financial expenses of P\$128 million and P\$19 million, attributable to the share of the financial income (expense) and holding gains (losses) of CIESA and Distrilec, respectively. The year 2004 reflects Financial expenses of P\$144 million and P\$20 million, attributable to the share of the financial income (expense) and holding gains (losses) of CIESA and Distrilec, respectively.

Without proportional consolidation, financial income (expense) and holding gains (losses) reflected losses of P\$752 million in 2005 and P\$1,101 million in 2004. The drop is primarily attributable to the decline in losses relating to derivative instruments used to hedge the price of crude oil to P\$295 million from P\$687 million, respectively, as a consequence of: (a) a reduced position, and (b) a lower increase in the future curve of oil, 30.4% compared to 53.9%.

Conversely, results from the sale of securities in 2005 recorded a P\$4 million loss compared to a P\$103 million gain in 2004, mainly on account of the changes implemented by PDVSA in the payment of the compensations provided for in operating agreements. Interest expense slightly increased 1.9% to P\$479 million in 2005 from P\$470 million in 2004, in line with the rise in the exchange rate on indebtedness mostly denominated in U.S. dollars. U.S. dollar-denominated average indebtedness fell 5%.

Other expenses, net: Other expenses, net recorded losses of P\$459 million in 2005 and P\$40 million in 2004. Other expenses, net reflect an P\$11 million loss in 2005 attributable to the share of other expenses, net of Distrilec compared to a P\$14 million loss in 2004 attributable to the share of other expenses, net of CIESA and a P\$7 million gain attributable to the share of other expenses, net of Distrilec.

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Without proportional consolidation, other expenses, net accounted losses of P\$448 million and P\$33 million losses, respectively.

Other expenses, net for 2005 mainly reflect:

P\$310 million impairment charge for assets in Venezuela.

P\$54 million assessment by SENIAT Venezuela.

P\$88 million impairment charge on areas in Argentina.

Other expenses, net for 2004 mainly reflect:

P\$12 million impairment charge for the Acema area in Venezuela.

P\$15 million allowance on the book value of the loans granted to joint venture partners in Venezuela.

Income Tax: Income tax accounted for a loss of P\$211 million in 2005 compared to a gain of P\$317 million in 2004. The income tax charge for 2005 reflects gains of P\$6 million and P\$1 million, attributable to the share of the income tax of CIESA and Distrilec, respectively. The income tax charge for 2004 reflects gains of P\$11 million and losses of P\$4 million attributable to the share of the income tax of CIESA and Distrilec, respectively.

Income tax charge for 2005 and 2004 fiscal years reflects tax gains from the reversal of allowances provided for tax credits resulting from tax loss carry forwards in the amount of P\$197 million in 2005 and P\$299 million in 2004, which amount includes P\$31 million attributable to Petrobras Energía Perú S.A. In addition, in 2005 fiscal year, a P\$45 million gain was recognized by Petrobras Energía from reversal of the allowance for payments made for the minimum presumed income tax for 1998 to 2002 fiscal years. As a result of the recoverability analysis of the book value of assets in Venezuela, a P\$110 million impairment charge for deferred tax assets was provided in 2005.

Excluding the effects mentioned above, income tax charge for 2005 increased to P\$350 million compared to a gain of P\$11 million, mainly due to the fact that in 2004 the allowance for taxes attributable to Petrobras Energía S.A. was offset against the allowance provided for tax loss carry forwards. In addition, this increase is also attributable to the rise in the income tax rate in Venezuela (from 34% to 50%) in addition to improved results of operations in Ecuador and Peru.

ANALYSIS OF OPERATING RESULTS BY BUSINESS SEGMENT

Oil and Gas Exploration and Production

Operating income: Operating income for the Oil and Gas Exploration and Production business segment increased P\$769 million, or 60.6%, to P\$2,039 million in 2005 from P\$1,270 million in 2004. This increase was predominately due to the 34.7% rise in average sales prices of oil equivalent resulting from (i) the 36.5% increase in the WTI, and (ii) the accrual of the additional compensation provided for in the operating agreements of the Oritupano Leona area in Venezuela, net of the 66.67% limit on sales price imposed by the Venezuelan Government, which accounted for additional sales in the amount of P\$284 million.

Net sales: Net sales for the Oil and Gas Exploration and Production business segment increased P\$1,010 million, or 27.7%, to P\$4,657 million in 2005 from P\$3,647 million in 2004. This increase was predominately due to the 34.7% rise in the average sales price of oil equivalent partially offset by a 5% reduction in sales volumes of oil equivalent.

In 2005, daily oil and gas sales volumes decreased to 170.9 thousand barrels of oil equivalent from 179.9 thousand barrels of oil equivalent in 2004. Oil sales volumes dropped 2.7% to 120.5 thousand barrels per day in 2005 from 123.9 thousand barrels per day in 2004, while daily gas volumes fell 10.8%, totaling 300.8 million cubic feet in 2005 and 336.2 million cubic feet in 2004.

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Net sales in Argentina increased P\$138 million, or 6.7%, to P\$2,182 million in 2005 from P\$2,044 million in 2004. Combined oil and gas daily sales volumes decreased 10.3% to 91.7 thousand barrels of oil equivalent in 2005 from 102.2 thousand barrels of oil equivalent in 2004, mainly attributable to the natural decline of oilfields in Argentina which is considerable since they are mature fields under production through secondary recovery. In such respect, major investments made during the year, basically in projects to improve the oilfields' basic production curve, allowed to mitigate such curve.

Crude oil sales increased P\$94 million, or 5.1%, to P\$1,944 million in 2005 from P\$1,850 million in 2004. This increase was attributable to a 15.2% increase in the average sales price to P\$99.9 per barrel in 2005 from P\$86.7 per barrel in 2004. Along these lines, the applicable export tax scheme did not allow to capitalize on the benefits of a favorable price scenario. Such scheme was a conditioning reference for the fixing of domestic sales prices to the downstream segment in line with the Argentine government's intention to establish a price stability framework in the fuel market. Sales volumes of crude oil dropped 8.7% to 53.2 thousand barrels from 58.3 thousand barrels.

Total gas sales increased P\$38 million, or 19.6%, to P\$232 million in 2005 from P\$194 million in 2004, mainly as a result of a 36.3% rise in the sales price, partially offset by a 12.1% decline in daily sales volumes. The average sales price for gas increased to P\$2.74 per million cubic feet in 2005 from P\$2.01 per million cubic feet in 2004, mainly as a consequence of the path of prices implemented by the Secretary of Energy as from May 2004, increased export prices due to the rise in the price of methanol and the renegotiation of contracts with industrial clients. Daily gas sales volumes fell to 231.7 million cubic feet from 263.7 million cubic feet.

Outside of Argentina

Combined oil and gas sales outside of Argentina increased P\$875 million, or 55.1%, to 2,462 million in 2005 from P\$1,587 million in 2004. Total daily oil and gas sales volumes slightly increased 1.4% to 78.8 thousand barrels of oil equivalent in 2005 from 77.7 thousand barrels of oil equivalent. The average sales price per barrel of oil equivalent increased 53.1% to P\$85.4 from P\$55.8.

Venezuela

In Venezuela, oil and gas sales grew P\$364 million, or 44.9%, to P\$1,175 million in 2005 from P\$811 million in 2004. In 2005, the average price per barrel of oil grew 55.3% to P\$72.2 from P\$46.5. This variation is predominately attributable to the WTI behavior mentioned above and the accrual of the additional compensation provided for in the operating agreement of the Oritupano Leona area. Accumulated production at the Oritupano Leona oilfield during 2005 first quarter exceeded 155 million barrels. As from this milestone, an additional incentive started to be applied to any incremental production. This additional compensation was subsequently limited by the application of the 66.67% limit on sales price imposed by the Venezuelan government under the provisional agreements relating to migration to the partially-state owned companies. Considering this limit, the compensation mentioned above accounted for additional sales in the amount of P\$284 million.

Daily sales volumes of oil equivalent dropped to 47.6 thousand barrels of oil equivalent, or 7.2%, in 2005 from 51.3 thousand barrels of oil equivalent in 2004 mainly as a consequence of the significant cuts in the investment plan for the Oritupano-Leona area established by Petr leos de Venezuela at the time of approval of 2005 fiscal year budgets. Since they are mature fields, reduced investments did not allow to revert the oilfields' natural decline.

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Ecuador

In Ecuador, oil sales increased 113.4% to P\$446 million in 2005 from P\$209 million in 2004 boosted by increased volumes and higher sales prices. Daily oil sales volumes rose to 9.5 thousand barrels, or 63.8%. Oil sales in 2005 include the sale of 202.7 thousand barrels attributable to December 2004 production, the sale of which was postponed to January 2005 for commercial reasons. Without considering this effect, daily sales volumes increased to 8.9 thousand barrels or 40.7%. This improvement is mainly attributable to the progressive development of the block, in line with the investments made which include drilling of eleven wells and different workovers.

Sales price increased 30.6% to P\$129.4 per barrel from P\$99.1 per barrel mainly due to the rise in the international reference price (Oriente crude oil). The increase in the Oriente crude oil reference price was lower than that of the WTI due to an increased discount in this type of crude oil.

Peru

In Peru, oil and gas sales increased P\$247 million or 53.9% to P\$705 million in 2005 from P\$458 million in 2004, mainly as a result of a 36.9% positive variation in the sales price of oil equivalent and the 12.4% rise in sales volumes of oil equivalent.

Crude oil price increased 40.3% to P\$147.9 per barrel from P\$105.4 per barrel boosted by a 39% increase in the international reference price (a combination of Oriente crude oil and WTI). Gas price slightly decreased 4.3% to P\$4.9 from P\$5.12 per million cubic feet, as a consequence of the increase in gas supply resulting from entry in the gas market of the Camisea field, which is the most important gas reserve in Peru and one of the largest gas reserves in Latin America.

Daily sales volumes of oil equivalent increased to 14.5 thousand barrels in 2005 from 12.9 thousand barrels in 2004. Such improvement was driven by drilling of 30 producing wells and performance of 15 primary and secondary repair works.

Bolivia

In Bolivia, oil and gas sales increased to P\$136 million in 2005 from P\$108 million. Combined oil and gas daily sales volumes dropped 4.1% to 7.4 thousand barrels of oil equivalent due to reduced gas deliveries to Brazil.

Average sales price for gas increased 41% to P\$7.37 per million cubic feet from P\$5.23 per million cubic feet. This improvement is mainly attributable to the rise in fuel oil used as the basis for calculation of the price for exports to Brazil.

Mexico

In 2005, sales for other services increased to P\$13 million, or 20% compared to P\$10 million in 2004.

Gross Profit: Gross profit for this business segment increased P\$725 million, or 38%, to P\$2,635 million in 2005 from P\$1,910 million in 2004. Margin on sales rose to 56.6% from 52.1%. This improvement is mainly attributable to the increase in average sales prices of oil equivalent. The lifting cost rose 26.4% to P\$11 per barrel of oil equivalent from P\$8.7 per barrel of oil equivalent, predominately as a consequence of the increase in oil services and electric power rates and to incremental costs associated with the implementation of new safety and environmental standards.

Administrative and selling expenses: Administrative and selling expenses rose P\$27 million, or 12.2%, to P\$248 million in 2005 from P\$221 million in 2004. This variation is mainly attributable to the increase in the cost of crude oil transportation derived from the rise in sales volumes and rates in Ecuador and, to a lesser extent, the increase in labor costs.

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Exploration expenses: Exploration expenses totaled P\$34 million in 2005 and P\$133 million in 2004. Expenses for 2005 are mainly attributable to 3D seismic works at the Austral and Neuquén basins. In 2004, the Company charged to income exploratory investments in the amount of P\$80 million for Block 31 in Ecuador and in the amount of P\$41 million for Aguaragüe and Puesto Zuñiga areas in Argentina.

Other operating income (expense), net: Other operating income (expense), net accounted for losses of P\$314 million in 2005 and P\$286 million in 2004. Losses for 2005 are mainly attributable to costs associated with the unused transportation capacity under the Ship or Pay contract with OCP in Ecuador (P\$184 million), allowance for tax credits relating to VAT (P\$78 million) and environmental remediation expenses (P\$27 million). In 2004, other operating income (expense), net mainly reflects costs associated with the unused transportation capacity under the Ship or Pay contract (P\$184 million), environmental remediation expenses (P\$51 million), project discontinuance (P\$5 million) and losses derived from contract renegotiation.

Refining and Distribution

Operating income: Operating income for the Refining and Distribution business segment reflected a loss of P\$149 million in 2005 compared to a P\$10 million gain in 2004.

Within the context of an inflation control policy carried out by the Argentine government, in 2005 diesel oil and gasoline margins in the domestic market dropped again vis-à-vis the 17% increase in crude oil costs. Along these lines, the implementation of the oil export tax regime could mitigate the 36.5% increase in the international reference. In addition, the year 2005 reflected significant operating losses due to the need to import diesel oil to meet a growing domestic demand and production deficits derived from shutdowns scheduled for maintenance works at the refineries. The combined effect of increasing international prices and controlled domestic prices derived in negative import margins. Provisional actions taken by the Argentine government relating to exemption from the tax on liquid fuels and the diesel oil tax rate on imports, allowed to mitigate such effects. During 2005 diesel oil imports dropped to 272 thousand cubic meters from 322 thousand cubic meters in 2004. However, due to the incidence of the increase in international prices, related losses rose to P\$82 million in 2005 from P\$21 million in 2004.

Net sales: Net sales for refinery products increased P\$497 million, or 14.8%, to P\$3,856 million in 2005 from P\$3,359 million, mainly boosted by an increase in sales prices of products not subject to the price stabilization policy mentioned above. Total sales volumes increased 2.6% with an 8% rise in the domestic market, partially offset by a reduction in exports.

In line with the significant 36.5% rise in the price of WTI, average sales prices of bunker diesel oil, heavy distillates, asphalts, paraffins and reformer plant by-products, improved 63%, 47%, 35%, 26% and 15%, respectively.

Crude oil volumes processed at the refineries in 2005 and 2004 were at similar levels, averaging 62.9 thousand barrels per day and 63.1 thousand barrels per day, respectively.

Total diesel oil sales volumes moved down 2.6% to 1,741 thousand cubic meters in 2005, mainly due to the drop in export volumes, partially offset by increased sales in the domestic market. The reduction in export volumes is mainly attributable to changes in the trade policy implemented as from merger of the Company's operations with Eg3. In 2004, in a stage prior to full integration and complementation of operations, surplus production from the San Lorenzo refinery was sold in the export market while Eg3's network shortfall in connection with its own production from the Bahía Blanca Refinery was made up by purchases from third parties. Though domestic sales increased 4%, the combined effect of the reduction in diesel oil imports and the 7.5% increase in the domestic market resulted in a slight decline in the Company's market share to 14.2% in 2005 from 14.6% in 2004.

Total gasoline sales volumes rose 3.8% to 715 thousand cubic meters in 2005 mainly due to a 7.4% increase in domestic sales in addition to an 8.9% rise in the gasoline market. Within this context, the Company's market share was 14.5% in 2005 and 14.7% in 2004. In the premium gasoline market, in which the Company participates with Podium gasoline, the market share moved up from 7.8% in 2004 to 9.7% in 2005.

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Asphalt sales volumes grew 23.2% in 2005, mainly boosted by a program of infrastructure works performed by the government, mainly in the south of the country. Within this context, domestic market sales grew 31% while exports declined 10%.

As regards heavy distillates, sales volumes for 2005 and 2004 were at similar levels. On the other hand, sales volumes of reformer plant by-products rose 36% basically due to 91% and 34% increases in domestic market sales of LPG and hexane, respectively, and a 48% rise in exports of paraffin varieties.

Gross profit: Gross profit for 2005 declined P\$150 million, or 58.4%, to P\$107 million from P\$257 million in 2004. Gross margin was adversely affected by the impossibility of passing through crude oil increases to market prices, and, in addition, by the incidence of diesel oil resale operations. Crude oil cost increased 17% to P\$111.5 bbl from P\$95.4 bbl.

Administrative and selling expenses: Administrative and selling expenses increased 2.9% to P\$251 million in 2005 from P\$244 million in 2004 mainly due to the rise in transportation and shipment costs.

Other operating income (expense), net: Other operating income (expense), net recorded losses of P\$5 million in 2005 and P\$3 million in 2004.

Petrochemicals

Operating income: Operating income for the Petrochemical business segment dropped P\$11 million, or 4%, to P\$267 million in 2005 from P\$278 million in 2004.

Net sales: Net sales (net of eliminations in the amount of P\$170 million and P\$39 million for styrenics operations in Argentina and Innova) increased P\$301 million, or 16%, to P\$2,178 million in 2005 from P\$1,877 million in 2004, due to increased styrenics sales volumes, both in Argentina and Brazil, and to higher sales prices in line with the behavior of the respective international references.

Styrenics Argentina:

In Argentina, styrenics sales increased P\$218 million, or 32.7%, to P\$884 million in 2005 from P\$666 million in 2004 due to the combined effect of an 18% increase in sales volumes and a 13% improvement in average sales prices. The start-up of the ethylene plant in October 2004 allowed to increase production of the ethylbenzene plant, thus generating surplus production and allowed the Company to make full use of the installed capacity of the Puerto General San Martín plant in Argentina and the Innova plant in Brazil, helping to grow in the business value chain. These values include exports to Innova in the amount of P\$136 million and P\$36 million, respectively.

In 2005, in line with the rise in international reference prices, average sales prices for the business segment improved 13% compared to 2004, with increases of 10%, 8% and 34% for the styrene, polystyrene and synthetic rubber lines, respectively.

Styrenics performance was as follows:

- a) Styrene monomer sales volumes increased approximately 9%, to 46 thousand tons, with a 30% rise in export volumes. In 2005, due to interruptions in production at the polystyrene plant, a styrene surplus was recorded and was mainly directed to export markets.
- b) Polystyrene and bops sales volumes climbed to 65 thousand tons or 3% in 2005, with similar percentage increases both in domestic sales and exports. Though a 7% reduction in polystyrene production volumes was recorded as a consequence of trade union conflicts at the Zarate plant, the demand could be met by imports from Innova.

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c) Ethylbenzene sales volumes, as from the start of operations of the ethylene plant in 2004 fourth quarter, totaled 43 thousand tons in 2005 and 9.5 thousand tons in 2004.

d) Rubber sales volumes decreased to 53 thousand tons, or 13%, compared to 2004, mainly due to a 23% drop in export volumes derived from the combined effect of increased supply at international level, a drop in the regional market activity level and high levels of customers' stocks by the end of 2004.

Styrenics Brazil Innova:

Innova sales increased P\$ 199 million, or 25.7%, to P\$972 million in 2005 from P\$773 million in 2004, due to the combined effect of a 20% improvement in average sales prices and a 5% rise in sales volumes.

In 2005, styrene and polystyrene prices rose 20% and 19%, respectively, as a consequence of an increase in international references.

Styrene sales volumes rose 18% due to a higher availability of ethylbenzene from the Puerto General San Martín plant and to a rise in exports to Argentina. Conversely, polystyrene volumes decreased 8% due to lower domestic sales (16%) as a consequence of greater competition in the Brazilian market, partially offset by increased exports to the Zarate plant as mentioned above.

Fertilizers:

Fertilizers sales increased P\$15 million, or 3.1%, to P\$492 million in 2005 from P\$477 million in 2004, mainly due to a 9% increase in the average sales price as a consequence of the rise in the international price of urea, partially offset by a 5% drop in sales volumes derived from a lower demand due to reduced corn and wheat sown areas (accounting for approximately 70% of the demand), the drought in several regions at the time of fertilization, increased costs of some fertilizers and reduced grain prices.

Gross profit: Gross profit increased P\$3 million, or 0.8%, to P\$ 377 million in 2005 from P\$374 million in 2004, reflecting the improvement in styrenics in Argentina, offset by a reduction in gross profit for Innova. Gross margin on sales decreased to 17.3% from 19.9% reflecting the impact of reduced margins for Innova.

Styrenics Argentina:

Gross profit increased P\$51 million, or 38.6%, to P\$183 million in 2005 from P\$132 million in 2004, mainly due to the strong rise in sales volumes. Gross margin on sales slightly rose to 20.7% from 19.8%.

Styrenics Brazil:

Gross profit decreased P\$50 million, or 38.8%, to P\$79 million in 2005 from P\$129 million in 2004. Gross margin on sales declined to 8.1% from 16.7% as a consequence of the rise in raw material costs, mainly benzene, which could only be partially passed through to sales prices, and of increased fixed production costs derived from scheduled plant shutdowns in 2005.

Fertilizers

Gross profit increased P\$2 million, or 1.8%, to P\$115 million in 2005 from P\$113 million in 2004, and gross margin on sales was at similar levels in both fiscal years. The growing share of liquid fertilizers in the product mix, with a rise of approximately 12% in 2005, allowed to offset (in terms of gross margin) the decline in sales volumes.

Administrative and selling expenses: Administrative and selling expenses increased P\$20 million, or 16%, to P\$143 million in 2005 from P\$123 million in 2004, primarily due to higher staff expenses, the rise in variable selling expenses attributable to increased rates and higher freight costs derived from increased ethylbenzene exports.

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Other operating income (expense), net: Other operating income (expense), net recorded P\$33 million and P\$27 million gains in 2005 and 2004, respectively, mainly attributable to the collection of FUNDOPEM tax benefits granted by Rio Grande do Sul State, Brazil.

Gas and Energy***Marketing and Transportation of Gas***

Operating income: Operating income for the Marketing and Transportation of Gas increased P\$35 million, or 14.3%, to P\$280 million in 2005 from P\$245 million in 2004. Operating income reflects P\$222 million and P\$215 million gains in 2005 and 2004, respectively, attributable to the proportional consolidation of CIESA. Excluding proportional consolidation, operating income for the business segment increased P\$28 million, or 93.3%, to P\$58 million in 2005 from P\$30 million in 2004.

Net sales: Sales revenues increased P\$112 million to P\$606 million in 2005 from P\$494 million in 2004, mainly due to the rise in gas and liquids prices. Gas sales prices increased on account of the application of the path of prices scheme established by the Secretary of Energy and the rise in international references applicable to certain export contracts and contracts with industrial clients. As regards liquids, improved prices derive from an increase in international reference prices.

Revenues from the sale of gas and liquids produced by the Company and imported gas and liquids totaled P\$309 million and P\$262 million in 2005 and P\$205 million and P\$270 million in 2004. Sales volumes of gas produced by the Company and imported gas in Argentina declined to 260.9 million cubic feet per day in 2005 from 274.7 million cubic feet per day in 2004 as a consequence of the drop in the Company's own production due to the decline of fields located in Argentina and the trade union strike held at the Austral basin during the last quarter of 2005. Sales volumes of liquids declined to 267.1 thousand tons in 2005 from 309.5 thousand tons in 2004, as a consequence of reduced gas volumes processed and lower yields obtained from processing gas with lower richness and heavier crude oils.

Gas and LPG brokerage services accounted for P\$35 million and P\$19 million sales revenues during 2005 and 2004, respectively. The increase in 2005 is attributable to gas brokerage operations performed for the purpose of offsetting the decline in the Company's own production mentioned above. Within this context, sales volumes increased to 18 million cubic feet per day in 2005 from 3 million cubic feet per day in 2004.

Gross profit: Gross profit in 2005 improved P\$9 million, or 50%, to P\$27 million from P\$18 million. This significant rise is mainly attributable to increased margins on sales.

Other operating income (expense), net: Other operating income (expense), net mainly attributable to income from technical assistance services to TGS totaled P\$35 million and P\$18 million gains in 2005 and 2004. As from July 2004, within the framework of the Agreement signed with Enron, the Company is providing technical assistance services to TGS.

Electricity

Operating income: Operating income for the Electricity operations increased P\$37 million, or 27.8%, to P\$170 million in 2005 from P\$133 million in 2004. Operating income reflects gains of P\$19 million in 2005 and P\$14 million in 2004, due to our share of the operating income of Distrilec. Excluding proportional consolidation, operating income rose to P\$151 million in 2005 from P\$119 million in 2004, primarily due to increased margins in the generation activity as a result of a rise in average prices and an increased volume of energy delivered.

Electricity Generation

Net sales: Net sales of electricity generation increased P\$75 million, or 26.8%, to P\$355 million in 2005 from P\$280 million in 2004, primarily due to a 17% improvement in generation prices and a 9.5% rise in sales volumes. The Company's competitive advantages resulting from being an integrated energy company and the joint operation of thermal and hydroelectric generation plants allowed the Company to capitalize on market opportunities and reach increased sales volumes compared to 2004.

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The increase in energy average prices was primarily attributable to (i) higher demand for energy within a context of lower water flow contribution at the different basins during the first half of the year and gas supply restrictions, which resulted in energy deliveries by less efficient machines, (ii) the passing through of increased gas costs to sales prices as a result of the path of prices implemented during the second quarter of 2004.

Net sales attributable to the Genelba Power Plant increased P\$66 million, or 29.5%, to P\$290 million in 2005 from P\$224 in 2004, primarily due to the combined effect of improved sales prices and increased generation volumes. The average sales price increased 16.5% to P\$52.9 per MWh in 2005 from P\$45.4 per MWh in 2004. Payment of additional compensation for guaranteed supply to the electricity market reflected increased sales of P\$30 million in 2004. Energy delivered increased 11.3%, to 5.486 GWh in 2005 from 4.931 GWh in 2004. In 2005 a significant generation increase was recorded (8.5%) compared to 2004. During 2005, the integration of operations with the Oil and Gas business segment was a key factor in overcoming gas supply restrictions faced by thermal plants. The Genelba Power Plant factor increased to 91% from 83% and the availability factor climbed to 94% from 85% as a consequence of the scheduled plant shutdown in 2004.

Net sales attributable to the Pichi Picún Leufú Hydroelectric Complex increased P\$12 million, or 23.1%, to P\$64 million in 2005 from P\$52 million in 2004, due to the combined effect of an improvement in sales prices and higher generation volumes. The average sales price increased 20.8% to P\$51.2 per MWh in 2005 from P\$42.4 per MWh in 2004, due to the above-mentioned market reasons and the implementation of a dynamic and flexible policy in terms of the mix of spot and futures sales. During 2005, energy delivered increased to 1,255 GWh, or 2.4%, in 2005 from 1,226 GWh in 2004, primarily due to increased consumption of water stored in the upper reservoirs of the Comahue Basin's power plants in order to substitute thermal supply, which was not available due to fuel supply problems.

Gross profit: Gross profit for the generation business increased P\$51 million, or 46%, to P\$161 million in 2005 from P\$110 million. This significant increase is attributable to the combined effect of improved prices and increased sales volumes.

Administrative and selling expenses: Administrative and selling expenses for the generation activity increased P\$2 million, or 20%, to P\$12 million in 2005 from P\$10 million in 2004.

Other operating income (expense), net: Other operating income (expense), net dropped P\$16 million to P\$1 million from P\$17 million mainly due to the decline in income from technical assistance services provided to Chilectra S.A., as technical operator of Edesur S.A. In November 2004, Chilectra S.A. and Edesur S.A. renegotiated the terms of the technical assistance agreement, with a substantial reduction in the economic terms of the agreement. No significant results were recorded in that respect as from such date.

ANALYSIS OF EQUITY IN EARNINGS OF AFFILIATES

In the following discussion, unless we specifically mention that a figure represents our share of the affiliate's results, the amounts attributed to each affiliate or company represents the total amount recorded by that affiliate or company.

Compañía de Inversiones de Energía S.A (CIESA) / Transportadora de Gas del Sur S.A (TGS) /: Our equity in the earnings of CIESA and TGS increased P\$23 million to P\$60 million in 2005 from P\$37 million in 2004 mainly as a consequence of the positive impact of reduced financial expense in 2005.

Financial expense, net decreased to P\$288 million from P\$348 million, mainly as a consequence of interest reduction associated with TGS's lower average indebtedness. In line with the global restructuring of the financial debt agreed upon with financial creditors, TGS's average indebtedness declined approximately 13% in 2005.

Sales revenues increased 5.8%, or P\$56 million, to P\$1,026 million in 2005 from P\$970 million in 2004.

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Sales revenues from the gas transportation segment increased 5.9% or P\$26 million to P\$460 million. This improvement is mainly attributable to the execution of new firm transportation agreements in connection with: (i) expansion of the Gral. San Martín Gas Pipeline completed in August 2005 which allowed to increase transportation capacity by 2.9 MMm³/d, (ii) a new contract with a joint venture of gas producers at the Austral basin, effective February 2005 which allowed to increase the transportation capacity by 1 MMm³/d, and (iii) open bids for transportation capacity carried out by TGS in March 2004 which allowed to rise the committed transportation capacity by 3.6 MMm³/d.

Revenues from the NGL production and marketing segment increased 7.9% or P\$43 million to P\$526 million mainly as a result of the 12% increase in the average sales price of NGL due to the rise in international reference prices which was partially offset by reduced sales volumes (approximately 4%) and the increase in NGL export tax rates as from May 2004, which moved up from 5% to 20%.

Operating income of CIESA decreased P\$11 million, or 2.4%, to P\$442 million in 2005, mainly as a consequence of the rise in natural gas price and, to a lesser extent, increased labor costs.

Distrilec Inversora S.A. (Distrilec) /Edesur S.A (Edesur): Our equity interest in the earnings of Distrilec accounted for a P\$4 million increase in losses to P\$8 million in 2005 from P\$4 million in 2004.

Distrilec's income from services increased 21% to P\$1,339 million in 2005 from P\$1,104 million in 2004, due to the combined effect of a 14.5% rise in sales prices and a 4.7% growth in the demand for energy.

Distrilec's operating income increased to P\$39 million from P\$30 million in 2004 reflecting the rise in sales, which was partially offset by increased costs for the purchase of energy and the application of fines by the regulatory entity.

Distrilec's financial income (expense) was similar in both fiscal years, accounting for losses of P\$39 million and P\$41 million in 2005 and 2004, respectively.

Distrilec's other operating income (expense), net accounted for a loss of P\$22 million in 2005 compared to a P\$14 million gain in 2004. The gain of P\$36 million in 2004 resulted from the settlement reached with Alstom Argentina in connection with January 15, 1999 events at Azopardo Substation. Such agreement ends all the claims between the parties.

Refinería del Norte S.A. (Refinor): In 2005, our equity in the earnings of Refinor increased P\$5 million to P\$47 million from P\$42 million in 2004. This increase resulted primarily from a rise in gross profit derived from a strong increase in sales, partially offset by a reduction in the margin on sales due to the effect of higher purchase costs derived from crude oil and fuel gas increase.

Refinor's sales increased 31.1% or P\$339 million to P\$1,429 million in 2005 from P\$1,090 million in 2004, mainly as a result of the significant rise in sales prices, both international prices of fuels and domestic prices of LPG and, to a lesser extent, increased crude oil volumes. In 2005, in line with the increase in international references, Refinor's average sales prices were 36% higher compared to 2004. The volume of crude oil processed increased 4%, to 17.9 thousand barrels per day with greater crude oil availability from Bolivia which allowed to revert the drop in volumes at Cuenca del Norte oilfields. The volume of gas processed averaged 19.1 million cubic meters per day, a level similar to that recorded in 2004. The greater amount of supply required on account of energy problems in Argentina was met by running the plant at almost its full installed capacity and the Madrejonas gas pipeline interconnection.

Refinor's operating income climbed to P\$245 million from P\$217 million in 2004 reflecting the rise in gross profit, partially offset by increased expenses in transportation and freight.

Citelec S.A. (Citelec): Equity in earnings of Citelec accounted for a gain of P\$136 million in 2005 compared to a loss of P\$19 million in 2004. As from September 30, 2005, upon submittal of the plan for Citelec divestment, equity interest in Citelec was valued at the recoverable value determined on the basis of the probable net realization value.

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Petroquímica Cuyo S.A. (Cuyo): Our equity interest in the earnings of Cuyo decreased P\$6 million to P\$7 million in 2005 from P\$13 million in 2004. This decline is basically attributable to a strong reduction in margins on sales mainly as a consequence of increased costs derived from the rise in crude oil, the impact of which could only be partially passed through to sales prices and, to a lesser extent, increased costs derived from the scheduled plant shutdown in 2005.

Cuyo's sales increased 15% to P\$337 million in 2005 from P\$293 million in 2004, mainly due to a 25% increase in sales prices, partially offset by a 8.5% decline in sales volumes. The improvement in average sales prices reflects the rise in crude oil prices which resulted in strong increases in international reference prices for the petrochemical industry. The decline in sales volumes was attributable to the scheduled plant shutdown in 2005.

Cuyo's operating income decreased to P\$33 million from P\$64 million in 2004 mainly due to the combined effect of reduced margins on sales and lower sales volumes as a consequence of the scheduled plant shutdown.

Petrobras Bolivia de Refinación (PBR): Our equity interest in the earnings of PBR moved up P\$36 million to P\$54 million in 2005 from P\$18 million in 2004 as a consequence of the combined effect of improved margins, with a 14% rise in the average sales price, and increased sales volumes.

In 2005, contribution margins significantly improved, mainly due to the fact that PBR's operations were positively affected by the rise in international reference prices and better discounts in crude oil and gasoline exports.

In addition, in 2005 PBR achieved record levels in crude oil, diesel oil and lubricants processing amounting to 39.8 thousand barrels per day, 55.5 thousand cubic meters per month and 1.16 thousand cubic meters per month, respectively. Along these lines, reconstituted crude oil sales set record levels with average monthly volumes of 269 thousand barrels, and diesel oil sales amounted to levels similar to those in 2004 with 54.5 thousand cubic meters per month. In the domestic market, marketing activities were performed through its subsidiary PBD, with an increase in its market share to about 30%, with a commercial network of 104 retail points, of which 12 were added in 2005.

Oleoductos del Valle S.A. (Oldelval): Our equity interest in the earnings of Oldelval decreased P\$4 million to P\$4 million from P\$8 million as a consequence of the recognition of a gain derived from the unusual sale of crude oil surplus in 2004.

Oldelval's sales revenues increased 5% to P\$118 million due to a 9% rise in rates effective April 2005, partially offset by a 1.03% slight decline in transported volumes, to 65.4 million barrels, as a direct consequence of the natural decline trend in the Neuquén basin oilfields. In addition, operating costs increased basically due to the performance of maintenance works for the purpose of securing reliability in the pumping system.

Petrolera Entre Lomas S.A (PELSA): Our equity interest in the earnings of PELSAs increased P\$9 million to P\$27 million from P\$18 million, mainly due to the combined effect of an improvement in margins on sales and increased sales volumes, both of crude oil and natural gas.

Sales revenues increased 34% to P\$368 million from P\$ 274 million due to the combined effect of a 24% improvement in prices attributable to the rise in the international price of crude oil and increased volumes (8%).

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CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with Argentine GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. While it is believed that such estimates are reasonable, actual results could differ from those estimates.

We believe the following represent our critical accounting policies. Our accounting policies are more fully described in notes 2 to 5 to our financial statements.

Estimates of oil and gas reserves

Evaluations of oil and gas reserves are important to the effective management of upstream assets. They are used to help make investment decisions about oil and gas properties. Oil and gas reserve quantities are also used as the basis of calculating the unit-of-production rates for depreciation and evaluating for impairment. Oil and gas reserves are divided between proved and unproved reserves. Proved reserves are estimated quantities of crude oil, natural gas and natural gas liquids that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from reservoirs under existing economic, operating and regulatory conditions, i.e., prices and costs at the date of estimation. Unproved reserves are those with less than reasonable certainty of recoverability and are classified as either probable or possible. Probable reserves are reserves that are more likely than not to be recovered and possible reserves are less likely to be recovered.

Estimates of oil and gas reserves have been prepared in accordance with Rule 4-10 of Regulation S-X. The choice of method or combination of methods employed in the analysis of each reservoir was determined by the stage of development, quality and reliability of basic data, and production history.

Our management must make reasonable and supportable assumptions and estimates with respect to (1) the market value of reserves, (2) oil fields production profiles, (3) future investments and their amortization, taxes and costs of extraction and (4) appropriate risk factors for unproved reserves and other factors. Such assumptions and estimates have a significant impact on our calculations. As such, any change in variables used to prepare such assumptions and estimates may have, as a consequence, a significant effect on both the depreciation of, and the impairment tests relating to, investments in areas with oil and gas reserves. Therefore, the reserves estimates, as well as future production profiles, are often different from the quantities of hydrocarbons that are ultimately recovered. The accuracy of such estimates depends, in general, on the assumptions on which they are based.

Downward revision in our reserves estimates may result in: (a) higher depreciation and depletion charges in future periods; (b) an immediate write-down of an asset's book value. If, on the other hand, the oil and gas reserve quantities were revised upward, our per barrel depreciation and depletion expense would be lower. Changes in proved oil and gas reserves will also affect the standardized measure of discounted cash flows presented in note 24 to our financial statements.

Significant changes in market or political conditions, such as the pesification of gas prices during 2002 and the changes in the Venezuelan regulatory regime during 2005, may cause us to revise our reserve estimates downward due to our determination that reserves are no longer recoverable in light of new market conditions. In 2005, we recorded an impairment charge of P\$255 million with respect to our assets in Venezuela, as a result of changes in the Venezuelan regulatory framework. (See Factors Affecting our Consolidated Results of Operations Migration of Operating Agreements in Venezuela). In addition, in 2005, as consequence of the drop in reserves mainly resulting from the technical review of ongoing projects, we adjusted the book value of certain oil and gas assets to their recoverable value, accounting for a loss of P\$132 million.

Table of Contents***Impact of oil and gas reserves on depreciation and depletion***

The calculation of unit-of-production depreciation and depletion is a critical accounting estimate used to allocate costs of upstream assets to the revenues recognized. It is the ratio of (1) actual volumes produced to (2) total proved developed reserves (those proved reserves recoverable through existing wells with existing equipment and operating methods) applied to (3) asset cost except for leasehold acquisition costs. Proved undeveloped reserves are considered in the amortization of leasehold acquisition costs. The volumes produced and asset cost are known and while proved developed and undeveloped reserves have a high probability of recoverability, they are based on estimates that are subject to some variability. This variability may result in net upward or downward revisions of proved reserves in existing fields, as more information becomes available through research and production. While the revisions we have made in the past are an indicator of variability, they have had a small impact on the unit-of-production rates because they have been small compared to our large reserves base.

Impairment of long-lived assets

Our long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. Impairment can also occur when we decide to dispose of assets.

Company Management assesses the recoverability of long-lived assets whenever events or changes in circumstances occur that could indicate that the value of an asset or of a group of assets might not be recoverable. The book value of a long-lived asset is adjusted to its recoverable value if its carrying amount exceeds the recoverable value in use.

From a regulatory standpoint, recoverable value is defined as the larger of net realizable value and discounted value in use, defined as the addition of the discounted expected net cash flows that arise as a direct result of the use and eventual disposition of the assets. Among other elements, the premises that represent the best estimate made by Management of the economic conditions that will prevail throughout the useful life of the assets are considered.

In the determination of the discounted value in use, discount rates used by market participants to evaluate the time value of money and the specific risk of the asset are considered.

Under Argentine GAAP, impairment charges can be reversed in subsequent years so that the reduced carrying amount does not represent the new cost basis of the long-lived assets should the facts and circumstances change in the future. In general, we do not view temporarily low prices as a trigger event for conducting the impairment tests. The markets for crude oil and natural gas and oil related products have a history of significant price volatility. Although prices will occasionally drop precipitously, industry prices over the long term will continue to be driven by market supply and demand fundamentals. Accordingly, any recoverability tests that we perform make use of our long-term price assumptions. These are the same price assumptions that are used in our planning and budgeting processes and our capital investment decisions, and they are considered to be reasonable, conservative estimates given market indicators and past experience. Significantly lower future prices could lead to impairments in the future, if such decreases were considered to be indicative of long-term trends.

As of December 31, 2005, based on the changes in the gas production business in Argentina, and after analyzing the recoverability of its assets, we recognized earnings in the amount of P\$44 million related to the reversal of prior impairments.

Successful efforts method of accounting

We follow the successful efforts method of accounting for our oil and gas activities.

Occasionally, an exploratory well may determine the existence of oil and gas reserves but the reserves cannot be classified as proved when drilling is complete.

In those cases, incorporating prospectively the changes introduced by the interpretation FASB Staff Position 19-1, starting July 2005, such costs continue to be capitalized insofar as (i) the well has determined the existence of sufficient reserves to warrant its completion as a production well and (ii) the company is making sufficient progress in evaluating the economic and operating feasibility of the project.

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Before such interpretation, SFAS 19 provided: (I) if the well found reserves in an area requiring major capital expenditures before production may start, classification of such reserves as proved is dependent upon whether any additional reserves are found justifying the abovementioned investment. In this case, the cost of the exploratory well continues to be capitalized as long as it meets the following two conditions: (a) reserves found are sufficient to justify completion of the well as producing if the capital investment is made, and (b) the drilling of additional exploratory wells is in progress or firmly planned for the near future. Otherwise, drilling costs are charged to expense; (II) if the reserves are not classified as proved for any other reason, drilling costs of exploratory wells should not remain capitalized for a period exceeding one year after the completion of the drilling. If after one year no reserves are classified as proved, exploratory well costs should be charged to expense.

The application of the successful efforts method can cause material fluctuations between periods in exploration expenses if drilling results are different than expected or if we change our exploration and development plans. If we change our views, as a result of changed circumstances or otherwise, during a later period, we would expense the relevant exploratory drilling cost during such later period.

As of December 31, 2006 and 2005, we maintained capitalized exploratory well costs amounting to P\$106 million and P\$61 million, respectively.

Contingencies

Certain conditions may exist as of the date of the financial statements, which may result in a loss to us, but which will only be resolved when one or more future events occur or fail to occur. We assess contingent liabilities based on the opinion of our legal counsel and available evidence. If the assessment of a contingency indicates that it is probable that a loss has been incurred and the amount can be estimated, a liability is accrued. If the assessment indicates that a potential loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the possibility of occurrence, is disclosed in a note to the financial statements. Loss contingencies considered remote are not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed.

Changes in the facts or circumstances related to these types of contingencies, as well as the future outcome of these disputes, can have a significant effect on the amount of provisions for contingencies recorded. As of December 31, 2006 and 2005, contingent liabilities (including current and non-current) amount to P\$180 million and P\$151 million, respectively.

Income tax

We estimate income tax on an individual basis under the deferred tax method. The deferred tax balance as of the end of each period has been determined on the basis of the temporary differences generated in certain items that have a different accounting and tax treatment.

To book such differences, we use the liability method, which establishes the determination of net deferred tax assets and liabilities on the basis of temporary differences determined between the accounting measurement of assets and liabilities and the related tax measurement. Temporary differences determine the balance of tax assets and liabilities where its future reversal decreases or increases the taxes determined. In the event there are unused tax loss carry forwards that may be offset against future taxable income, we will evaluate the recoverability of a deferred tax asset, only to the extent that it is probable that some portion or all of the deferred tax asset will be realized.

Judgment is required in determining the amounts of future income tax assets and liabilities and the related valuation allowance recorded against the net future income tax assets. In assessing the potential realization of future income tax assets, management considers whether it is probable that some portion or all of the future income tax assets will be realized. The ultimate realization of future income tax assets is dependent upon us generating sufficient future taxable income from operations during the period in which the future income tax assets are recoverable. Due to the fact that uncertainty exists surrounding our ability to generate sufficient taxable income from operations before the expiration of the loss carry forwards, we have provided a valuation allowance of P\$1,028

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million against tax loss carry forwards as at December 31, 2006, which to a large extent expire during 2007. In future periods, we, after evaluating more recent data about our recent tax history and future performance and prospects, may reverse a part of this allowance. In 2005 and 2004, for example, after taking into consideration the profitability expectations arising from our business plan, we partially reversed an allowance for tax loss carry forwards and recognized gains of P\$197 and P\$299 million, respectively.

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LIQUIDITY AND CAPITAL RESOURCES

During 2005, the Argentine Government successfully restructured a substantial portion of its sovereign debt, which was previously in default. Although this represents a significant step towards the reintegration of our country in the international financial market, Argentina and Argentine companies are still subject to a series of significant restrictions on access to the international credit markets at competitive costs. In spite of a sustained growth scenario in recent years in Latin America, typical fluctuations in emerging markets may generate volatility in financial indicators and capital flows to the region.

In view of these limitations and risks, we closely monitor liquidity levels in order to secure compliance with our obligations and achievement of our growth objectives. Along these lines, and as a guiding principle, financial solvency is the foundation on which sustainable development of our businesses is built.

Pursuant to these strategic guidelines, we seek to:

Gradually reduce our level of indebtedness, by designing a capital structure in line with industry standards adaptable to the financial markets in which we operate and by establishing a debt maturity profile consistent with cash generation.

Gradually reduce indebtedness costs.

Have adequate flexibility to overcome the volatility inherent to emerging capital markets, by adhering to a conservative cash management policy that minimizes the risks of financial distress.

Adhering to these guidelines will allow the Company to treat financial management as a key element in the value-creation process.

Consistent with these guidelines, we achieved the following during 2006:

Over 54% growth in operating cash flow.

Strict compliance with all financial obligations, with a 4% decline in our annual average indebtedness, measured in U.S. dollars.

A significant increase in capital expenditures, supporting our growth strategy.

Reduction in indebtedness costs.

In the short term, the most significant factors generally affecting the Company's cash flow from operating activities are: (1) fluctuations in prices for crude oil, (2) fluctuations in production levels and demand for our products, (3) fluctuations in margins in refining and distribution and petrochemicals, (4) changes in regulations, such as taxes, taxes on exports, changes in royalty payments and price controls and (5) fluctuations in exchange and interest rates.

In the longer term, our ability to replace oil and gas reserves will affect future production levels, which, in turn, will affect cash flow provided by operating activities. Nonetheless, the Company does not believe that the risks associated with failure or delay of any single project would have a significant impact on our overall liquidity or ability to generate cash flows, since the Company has a diverse portfolio of development projects and exploration opportunities, which helps to mitigate the risks inherent to oil and gas exploration and production and the associated cash flow provided by operating activities.

Analysis of Liquidity and Capital Resources

The Company's management analyzes our results and financial condition separately from the results and financial condition of affiliates under joint control. The discussion below, therefore, relates to the liquidity and capital resources of the Company and its subsidiaries, excluding proportional consolidation of companies over which the Company exercises joint control, and as a result may not be directly comparable to figures reflected in its financial statements.

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The table below reflects our statements of cash flow for the fiscal years ended December 31, 2006, 2005 and 2004 under Argentine GAAP and, for comparative purposes, the pro forma results excluding the effect of proportional consolidation of companies under joint control. Amounts are stated in millions of pesos.

| | With Proportional Consolidation | | | Without Proportional Consolidation (Unaudited) | | |
|-------------------------------------------------------|----------------------------------------|-------------|-------------|-----------------------------------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 | 2006 | 2005 | 2004 |
| Cash and cash equivalent at the beginning of the year | 790 | 1,067 | 1,091 | 474 | 846 | 709 |
| Net cash provided by operations | 2,877 | 1,998 | 1,632 | 2,506 | 1,626 | 1,438 |
| Net cash used in investing activities | (2,022) | (1,682) | (1,199) | (1,888) | (1,544) | (1,072) |
| Net cash used in financing activities | (295) | (602) | (451) | (48) | (463) | (222) |
| Effect of exchange rate change on cash | | 9 | (6) | | 9 | (7) |
| Cash and cash equivalent at the end of the year | 1,350 | 790 | 1,067 | 1,044 | 474 | 846 |

Cash

As of December 31, 2006, 2005 and 2004, cash and cash equivalents, excluding proportional consolidation of companies under joint control, were P\$1,044 million, P\$474 million and P\$ 846 million, respectively.

The Company's goal is to maintain excess cash primarily in U.S. dollars and in short-term investments in order to ensure adequate liquidity levels. The Company predominately invests in money market mutual funds and overnight deposits.

Operating activities

Net cash from operations, excluding proportional consolidation of companies under joint control, totaled P\$2,506 million in 2006, P\$1,626 million in 2005 and P\$1,438 million in 2004.

Net cash from operations in 2006 increased P\$880 million or 54.1%. The increase in net cash from operations during 2006 was mainly attributable to reduced working capital requirements and the rise in commodity prices. The Company was able to better capitalize on this increase since we did not use derivative instruments to hedge the price of crude oil in 2006.

Net cash from operations in 2005 increased P\$188 million or 13.1% primarily due to the increase in commodity prices, particularly in the WTI.

Investing activities

Cash used in investing activities, excluding proportional consolidation of companies under joint control, was P\$1,888 million in 2006, P\$1,544 million in 2005 and P\$1,072 million in 2004.

Supported by the increase in operating cash flow and with the liquidity at target levels, net capital expenditures, excluding proportional consolidation of companies under joint control, increased by P\$325 million during 2006 to P\$1,944 million from P\$1,619 million in 2005 and by P\$552 million during 2005 from P\$1,067 in 2004.

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The table below reflects total capital expenditures, net, in millions of pesos:

| | 2006 | 2005 | 2004 |
|------------------------------------------|-------------|-------------|-------------|
| - Oil and Gas Exploration and Production | 1.544 | 1.235 | 872 |
| - Petrochemical | 195 | 119 | 96 |
| - Refining and Distribution | 249 | 199 | 81 |
| - Corporate | 76 | 64 | 11 |
| - Other | 4 | 2 | 7 |
| | | | |
| Total capital expenditures | 2.068 | 1.619 | 1.067 |
| | | | |
| - Divestments | (124) | | |
| | | | |
| Total net capital expenditures | 1.944 | 1.619 | 1.067 |

Oil and Gas Exploration and Production

Capital expenditures in the Oil and Gas Exploration and Production segment totaled P\$1,544 million, P\$1,235 million and P\$872 million in 2006, 2005 and 2004, respectively.

In 2006 capital expenditures in the Oil and Gas Exploration and Production segment were primarily directed towards maintaining production levels and prioritizing investments in countries and products with higher expected profit margins. The development of reserves continued through well drilling, expansion of secondary recovery projects and the expansion of surface facilities. Two hundred and fifty six (256) wells were drilled, of which 223 are located in Argentina and 424 units were repaired, of which 191 are located in Argentina. In December 2006 works at El Mangrullo field were completed and the field became operational, with a gas production of 800 million cubic meters per day. The Mercury Removal Plant in Santa Cruz started operations by mid-year for the treatment of Santa Cruz crude oil. This allows us to reduce the metal content in oil, with the consequent expected positive impact on the basin projects through the improvement of marketing conditions and an increased volume of incoming oil to be processed at our refineries. In Ecuador, construction of the treatment plant at Palo Azul and the duct network were completed. This is expected to allow the Block to increase gross production to 40 thousand barrels of oil per day as from 2007.

Refining and Distribution

Capital expenditures in the Refining and Distribution segment totaled P\$249 million, P\$199 million and P\$ 81 million in 2006, 2005 and 2004, respectively.

In 2006, we performed works outlined in the Refining Master Plan aimed at producing fuels according to stringent quality specifications. At the Bahía Blanca refinery, works were conducted on the reformat plant. The light reformat plant will allow us to improve the quality of our gasolines and produce a grade with a high benzene content, a high value input for the petrochemical industry but subject to environmental regulatory restrictions when used in gasolines. In connection with environmentally-oriented investments in the sulfur recovery unit, sulfur compounds in oil are no longer burnt in the flare stack but are converted into raw material for the production of fertilizers. In this way, this effluent is converted into a raw material that returns to the community as a feeding product. At San Lorenzo refinery, a revamping of the topping and vacuum units was performed in order to increase processing capacity by 33% to 50,300 barrels per day, with the consequent increase in our capacity to supply the market. In the distribution segment, the Company continued with the rebranding of gas stations, with a view to a selective growth of new businesses and a focus on service, quality and brand development.

Petrochemicals

In the Petrochemicals segment, capital expenditures totaled P\$195 million, P\$119 million and P\$96 million in 2006, 2005 and 2004, respectively.

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In 2006, capital expenditures in styrene mainly focused on increasing production capacity of the styrene plant, from 110,000 tons per year to 160,000 tons per year, allowing us to increase product supply and meet higher demand from the regional market. At the Campana plant, the potassium thiosulphate plant project was completed. We commenced works on the revamping of the ammonia plant to increase production capacity, and investments were made in storage and logistics to continue selling liquid fertilizers.

Financing activities

Net cash used in financing activities totaled P\$48 million, P\$463 million and P\$222 million, in 2006, 2005 and 2004, respectively.

We paid long-term debt in the amount of P\$272 million, P\$1,967 million and P\$988 million, in 2006, 2005 and 2004, respectively.

In 2006, we paid at maturity Class B Notes under the U.S.\$2.5 billion Corporate Notes Program in an aggregate amount of P\$15 million (U.S.\$5 million). In addition, Petrobras Energía S.A. and Petrobras Energía Perú S.A. repaid bank loans and long-term lines of credit in an amount of P\$129 million and P\$128 million, respectively.

In 2005, Classes C, M and K Notes under the U.S.\$2.5 billion Global Corporate Notes Program were fully prepaid, in the aggregate amount of P\$1,251 million (U.S.\$428 million). In addition, we paid at maturity Class F Notes under the Program for an aggregate amount of P\$184 (U.S.\$64 million). Petrobras Energía Venezuela S.A. and Innova S.A. paid debt owed to the International Finance Corporation (IFC) in the amount of P\$415 million (U.S.\$137 million). In addition, we repaid bank loans in the amount of P\$117 million.

In 2004, we made principal payments on Classes C, M and K Notes under the U.S.\$2.5 billion Global Corporate Notes Program and paid in full at maturity Class O and P Notes under that Program and the Fourth Series of the U.S.\$1.2 billion Global Program, for a total payment of P\$881 million. In addition, we paid P\$107 million mainly in debt, principally bank loans.

Cash provided by long-term financing totaled P\$220 million, P\$747 million and P\$669 million in 2006, 2005 and 2004, respectively.

In 2006, Petrobras Energía S.A. received P\$82 (U.S.\$26 million) for foreign trade financing. In addition, Petrobras Energía Perú S.A. received cash provided by other bank financing in the amount of P\$138 million (U.S.\$45 million).

In 2005, Petrobras Internacional Braspetro BV, a subsidiary of Petrobras, granted us a P\$582 million (U.S.\$200 million) loan. The funds were used to prepay Class M and K notes under the U.S.\$2.5 billion Program. In addition, cash provided by other bank financing totaled P\$165 million (U.S.\$56 million).

In April 2004, we issued a second Tranche of the Series R Notes in an aggregate face value of U.S.\$100 million, or P\$289 million, which represents a single class with the Class R Notes issued in October 2003. In September 2004, Petrobras Internacional Braspetro BV granted us a P\$150 million (U.S.\$50 million) loan, see *Related Party Transactions*. The IFC completed the financing granted in 2003 to our subsidiary Petrobras Energía Venezuela S.A. in the amount of P\$85 million (U.S.\$29 million) and Petrobras Energía del Perú S.A. received financing in the amount of P\$85 million (U.S.\$30 million), which partly completed the financing granted in 2003 by a syndicate of banks. In addition, cash provided by foreign trade financing totaled P\$60 million.

Net cash provided by short-term financing totaled P\$4 million, P\$757 million and P\$ 138 million in 2006, 2005 and 2004, respectively, primarily from foreign trade financing.

In 2004, Petrolera Santa Fe S.R.L., a company that was merged into the Company effective January 2005, paid P\$41 million in dividends.

Table of Contents**DESCRIPTION OF INDEBTEDNESS**

Most of the Company's financial debt and a significant portion of the debt of the Company's main affiliates are denominated in U.S. dollars.

As of December 31, 2006, total indebtedness, excluding the proportional consolidation of companies under joint control, totaled P\$5,679 million, of which P\$3,546 million was long-term indebtedness. This compares to P\$5,646 million as of December 31, 2005, of which P\$4,367 was long-term indebtedness. As of December 31, 2006, short-term indebtedness totaled P\$2,133 million, of which P\$960 million represents the current portion of long-term obligations and P\$1,173 million represents short-term indebtedness with financial institutions under loan agreements and foreign trade financing.

Petrobras Energía maintains a global corporate note program, for a maximum principal amount at any time outstanding of U.S.\$2.5 billion or its equivalent in any currency. This program was authorized by the CNV under Certificate N. 202 dated May 4, 1998, Certificate N. 290 dated July 3, 2002 and Certificate N. 296 dated September 16, 2003. Currently, the Company's ability to issue notes under this program expires in May 2008. As of December 31, 2006, notes in an aggregate principal amount of U.S.\$1,072 million were outstanding under this program. Notes under the program are not subject to acceleration in the event that the Company's credit ratings are downgraded.

The following is the debt maturity profile of the Company as of December 31, 2006:

| | 1 year | 2 years | 3 years | 4 years | 5 years | 6 or more years |
|-------------------|--------|---------|---------|---------|---------|--------------------|
| Millions of pesos | 2,133 | 238 | 617 | 1,132 | 304 | 1,255 |

On June 9, 2005, the federal executive branch issued Executive Order 616/05, establishing that any cash inflow to the domestic market derived from foreign loans to the Argentine private sector shall have a maturity for repayment of at least 365 days as from the date of the cash inflow. In addition, at least 30% of the amount must be deposited with domestic financial institutions. This deposit (1) must be registered, (2) must be non-transferable, (3) must be non-interest bearing, (4) must be made in U.S. dollars, (5) must have a term of 365 days and (6) cannot be used as security or collateral in connection with other credit transactions. Export and import financing and primary public offerings of debt securities listed on self-regulated markets are exempt from the foregoing provisions.

This Executive Order may limit the Company's ability to finance its operations through new intercompany loans or any other kind of foreign financial loans.

Cross Default Provisions

Series H, I, N, Q and R notes under our global corporate note program include cross default provisions, whereby the trustee under those notes, if instructed by the noteholders representing at least 25% of the outstanding principal amounts of a series of notes, shall declare all the amounts owed due and payable, if any debt of ours or our significant subsidiaries is not paid when due, provided that (1) those due and unpaid amounts exceed the higher of U.S.\$25 million or 1% of Petrobras Energía's shareholders' equity at the time such debt is due, and (2) the default has not been cured within 30 days after we have been served notice of the default.

Certain other loan agreements include cross default provisions, whereby the lender may declare all the amounts owed as due and payable, if any debt of ours exceeding U.S.\$10 million or 1% of our shareholders' equity is not paid when due.

As of December 31, 2006, we and our controlled subsidiaries are in compliance with all covenants under our respective debt agreements.

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In January 2007, all of the outstanding Series G Notes were paid in full and cancelled at maturity for an aggregate total of U.S.\$250 million (P\$768 million, at the exchange rate in effect as of December 31, 2006).

On May 7, 2007, Petrobras Energía issued Series S Notes (the Notes) for a face value of U.S.\$300 million, due 2017, with an interest coupon of 5.875% p.a., at a price of 99.617%. Interest will be payable semiannually and principal will be repaid in a single installment at maturity. The proceeds of the offering may be used for: working capital in Argentina and/or investments in tangible assets located in Argentina and/or debt refinancing. The Notes are supported by a Standby Purchase Agreement provided by PESA's ultimate controlling shareholder, Petroleo Brasileiro S.A. Pursuant to this Agreement, in the event the Issuer fails to make payment of principal, interest or any other amount owed by the Issuer in connection with the Notes, PETROBRAS is obligated to purchase the rights of noteholders to receive such payments on the Notes.

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FUTURE CAPITAL REQUIREMENTS

The Company estimates our investments for 2007 at approximately U.S.\$800 million. This level of investments is part of the Company's strategy for sustained growth, which we have pursued in accordance with growth and expansion targets contemplated in the business plan.

The Company estimates that its capital expenditure requirements, debt payment obligations, dividends payments and working capital will be financed by cash from operations and, to a lesser extent, by new debt financings and possible divestments. The Company's level of investments will depend on a variety of factors, many of which are beyond our control. These include the future price evolution of the commodities we sell, the behavior of energy demand in Argentina and in regional markets, the existence and competitive impact of alternative projects, the enforcement of regulations and changes in applicable taxes and royalties and the political, economic and social situation prevailing in the countries where the Company operates.

Oil and Gas Exploration and Production

The Company's 2007 business plan focuses on the Oil and Gas Exploration and Production segment, with special emphasis on operations in Argentina, Ecuador and Peru. Projected investments in this segment will be in line with reserve replacement and production goals, as a crucial step in securing the Company's sustainable growth.

Argentina. Efforts will continue at the Neuquén basin to develop oil reserves through well drilling and expansion of secondary recovery projects and relevant surface facilities. As regards gas production, works involving demarcation of wells and development of average compression are expected to commence at El Mangrullo. At the Austral basin, investments will be focused on well drilling for the development and demarcation of oil reserves and on maintenance of the curve of injection to the gas pipeline obtained as a result of the interconnection plan implemented during 2006. In addition, exploration activities involving seismic shooting and well drilling are expected to be performed.

Ecuador. Development of Block 18 is expected to continue through drilling of new producing and injection wells, as well as the construction of facilities to enhance and improve processes. In Block 31, works relating to the construction of facilities and infrastructure are expected to continue in order to prepare for the start of production activities at the Apaika Nenke Field. In addition, drilling of exploratory wells is expected to be performed on other areas within the block.

Peru. Drilling activities in connection with the development of Lote X are expected to continue on an intensive basis. As regards exploration, preliminary works in connection with seismic shooting and drilling of the first exploratory well in Lote 57 are expected to be performed.

Refining and Distribution

In 2007, works outlined in the Refining Master Plan aimed at producing fuels according to stringent quality specifications will continue.

At the Bahía Blanca refinery, works relating to the reformat plant are expected to continue. The light reformat plant is expected to allow us to improve the quality of our gasolines and produce a grade with a high benzene content, a high value input for the petrochemical industry but subject to environmental regulatory restrictions when used in gasolines. Works to be performed at the hydrotreatment plant are expected to allow it to operate at 100% of design capacity.

At San Lorenzo Refinery, a new benzene tower is expected to be erected and a revamping of the Aromatics Recovery Unit is expected to be performed. These works is expected to allow for the processing of light reformat streams from the Bahía Blanca refinery and other suppliers of gasolines with high benzene contents.

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During 2007, new marine transportation activities are expected to include the operation of double hull tankers under international operating standards. This is expected to result in enhanced efficiency in the supply of crude oil to refineries, reduce logistics costs and increase safety and environmental conditions.

In the distribution segment, we expect to continue with the rebranding of gas stations, with a view to a selective growth of new businesses and a focus on service, quality and brand development.

Petrochemicals

At the Puerto General San Martín Plant, investments are expected to be focused on reducing variable costs (raw material and services) and minimizing environmental impact, as well as on reliability projects aimed at achieving increased yield and safety for operating processes. At the Zárate plant, we expect to complete two important projects: loading of bulk products in the polystyrene segment and a new 500-ton bops storage facility. These projects are expected to allow the plant to consolidate competitive advantages and operate under the highest environmental and safety standards.

With respect to the fertilizers business, works are expected on the revamping of one of the ammonia plants, in order to increase production capacity by 12% to 290 tons per year. Operating improvements at the plant are also planned to achieve increased yield and safety for operating processes. We plan to continue making investments in storage and logistics in order to maintain sales of liquid fertilizers to the agricultural sector.

In October 2006, the Company approved construction of a new ethylbenzene plant at Innova, with an investment in the amount of U.S.\$70 million (of which a total of U.S.\$44 are estimated to be invested in 2007). The plant will have an initial production capacity of 270 thousand tons per year and the flexibility necessary to allow for future capacity increases.

The plant's state-of-the-art technology and its location on the same styrene plant site will allow a significant cost reduction. The plant is expected to start operations by mid 2008.

OFF-BALANCE SHEET TRANSACTIONS

Other than the transactions described below, we do not have any off-balance sheet arrangements required to be disclosed by Item 5 of Form 20-F.

OCP Investment's Letters of Credit

In order to guarantee the compliance with the Company's financial commitments related to the Ship or Pay transportation agreement executed with OCP and a portion of OCP's contractual obligations, the Company is required to procure letters of credit. These letters of credit are required to remain in effect until December 2018. As of December 31, 2006, the Company had procured letters of credit for a total amount of about U.S.\$123 million. As the letters of credit expire, the Company will be required to renew or replace them. Otherwise, we would have to deposit cash in amounts equal to our guarantee obligations, which would have a material adverse effect on our cash flows.

Table of Contents**CONTRACTUAL OBLIGATIONS**

The following table summarizes certain contractual obligations as of December 31, 2006. The table does not include accounts payable or pension liabilities. Amounts in the table do not include interest.

| | Total | Payments due by period | | | More than 5 years |
|-------------------------------------------------------------------|--------------|---------------------------------|--------------------|--------------------|----------------------------------|
| | | Less than 1 year | 1 - 3 years | 3 - 5 years | |
| | | (in millions of pesos) | | | |
| Debt Obligations | 5,679 | 2,133 | 855 | 1,436 | 1,255 |
| Purchase Obligations | | | | | |
| Ship or pay agreement with OCP (1) (2) (6) | 2,692 | 168 | 389 | 430 | 1,705 |
| Long-term service agreement (6) | 159 | 133 | 26 | | |
| Bolivian gas and oil transportation agreement (6) | 133 | 11 | 11 | 22 | 89 |
| Petroleum services and materials (6) | 417 | 236 | 138 | 21 | 22 |
| Ethylene (4)(6) | 1,483 | 203 | 319 | 261 | 700 |
| Benzene (5)(6) | 3,357 | 416 | 755 | 602 | 1,584 |
| Oil Purchase agreements for Refinery (6) | 1,468 | 1,468 | | | |
| Gas transportation capacity with TGS (3) | 189 | 27 | 54 | 54 | 54 |
| Gas purchase agreements for Genelba (6) | 114 | 84 | 30 | | |
| Pension Plan | 113 | 10 | 22 | 21 | 60 |
| Total | 15,804 | 4,889 | 2,599 | 2,847 | 5,469 |
| Sales Obligations | | | | | |
| Natural gas | 1,423 | 247 | 338 | 329 | 509 |
| Styrene | 744 | 123 | 621 | | |
| Electric power | 144 | 100 | 44 | | |
| LPG | 82 | 82 | | | |
| Oil sale agreement | 3,350 | 1,579 | 1,771 | | |
| Total | 5,743 | 2,131 | 2,774 | 329 | 509 |
| (1) Net of transportation capacity sold to third parties | | | | | |
| (2) Estimated price US\$2.73 per barrel. | | | | | |

- (3) Estimated price
P\$7.9 million
per million of
cubic meters.

- (4) Estimated price
US\$920 per ton.
Contractual
prices are in US
Dollars. Peso
amounts
translated using
exchange rate as
of December 31,
2006.

- (5) Estimated price
US\$744 per ton.
Contractual
prices are in US
Dollars. Peso
amounts
translated using
exchange rate as
of December 31,
2006.

- (6) Prices are
generally
determined by
formulas based
on future market
prices. Estimated
prices used to
calculate the
monetary
equivalent of
these purchase
obligations for
purposes of the
table are based
on current
market prices as
of December 31,
2006 and may
not reflect
actual future
prices of these
commodities.
Accordingly,
the peso

amounts
provided in the
this table with
respect to these
obligations are
provided for
illustrative
purpose only.

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The following table sets forth volume information with regards to our commitment under commercial contracts:

| | Total | Obligations by period | | | More than 5 years |
|-----------------------------------------------------------------------------------------------------------------------------------|--------------|---------------------------------|--------------------|--------------------|----------------------------------|
| | | Less than 1 year | 1 - 3 years | 3 - 5 years | |
| Purchase Obligations | | | | | |
| Ship or pay agreement with OCP (in million of barrels) | 321 | 20 | 47 | 53 | 201 |
| Bolivian gas and oil transportation agreement (in millions of cubic meters) | 6,490 | 569 | 1,139 | 1,139 | 3,643 |
| Ethylene (in thousands of tons) | 525 | 56 | 112 | 102 | 255 |
| Benzene (in thousands of tons) | 1,469 | 155 | 315 | 286 | 713 |
| Oil Purchase agreements for Refinery (in million of barrels) | 12 | 12 | | | |
| Gas transportation capacity with TGS (in million of cubic meters) | 24 | 3 | 7 | 7 | 7 |
| Gas purchase agreements for Genelba (in million of cubic meters) | 564 | 367 | 197 | | |
| Sales Obligations | | | | | |
| Natural gas (in millions of cubic meters) | 7,806 | 1,411 | 1,801 | 1,647 | 2,947 |
| Styrene (in thousands of tons) | 165 | 29 | 136 | | |
| Electric power (in MWh) | 1,938 | 1,299 | 639 | | |
| LPG (in thousands of tons) | 58 | 58 | | | |
| Oil sale agreement (in millions of bbls) | 17 | 9 | 8 | | |
| <i>Long Term Service Agreement.</i> We have entered into a long-term service agreement for the maintenance and repair of Genelba. | | | | | |

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OCP Oil Transportation Agreement. Regarding the future exploitation of Blocks 18 and 31, we have executed an agreement with OCP whereby we acquired an oil transportation capacity of 80,000 barrels per day for a term of 15 years starting with the commencement of OCP operations. We, as well as the remaining producers, that have entered into capacity agreements with OCP, are required to pay a ship or pay fee that will cover, among other items, OCP's operating costs and financial services. We have assigned part of our committed transportation capacity. In addition, pursuant to the preliminary agreement signed with Teikoku, once completed all formalities and governmental approvals, Teikoku has agreed to assume 40% of our rights and obligations resulting from the crude oil transportation agreement with OCP. See Item 4. Information About the Company Oil and Gas Exploration and Production Production Production outside of Argentina Ecuador Ship or Pay Contract with Oleoducto de Crudos Pesados (OCP) .

Bolivian gas transportation agreement. We entered into transportation agreements with Transredes, in order to comply with contracts signed with YPFB.

Benzene and ethylene supply agreements. Innova purchases benzene and ethylene feedstock from Copesul, a Brazilian company, pursuant to a long-term contract that expires in 2014.

Gas Transportation Agreements. We have entered into various firm gas transportation agreements with TGS to provide gas transportation services to Genelba.

Gas Purchase Agreement for Genelba. We have entered into a gas natural supply agreement with Pluspetrol, Petrolera Entre Lomas and Compañía General de Combustibles, in order to ensure the supply of our Genelba Power Plant, in order to satisfy the Plant's contractual commitments to deliver energy.

Oil purchase agreements for Refinery. We have entered into several purchase agreements with major Argentine oil producers, in order to ensure the usual supply to our refineries.

Styrene: Our controlled company, Innova has entered into several sale agreements with its styrene customers with the goal of maintaining its local leadership.

Oil Sales: Mainly corresponds to oil sales commitments in order to ensure the sale of the oil production in Perú and Ecuador.

U.S. GAAP RECONCILIATION

We had net income under U.S. GAAP of P\$972 million in 2006, as compared to a net loss of P\$77 million in 2005 and a net income of P\$760 million in 2004. Under Argentine GAAP, we reported net income of P\$1.064 million in 2006, P\$729 million in 2005 and P\$775 million in 2004.

There are several differences between Argentine GAAP and U.S. GAAP that significantly affect our net income and shareholders' equity. The most significant differences in their effect on 2006 net income are mainly related to purchase price allocation and its impact on impairment, depreciation of property, plant and equipment. See note 21 to our financial statements. Neither the effects of inflation accounting nor the proportional consolidation of Distrilec, a company under joint control, under Argentine GAAP have been reversed in the reconciliation to U.S. GAAP. The proportional consolidation of CIESA, another company under joint control, in 2006, 2005 and 2004 under Argentine GAAP was reversed in the reconciliation to U.S. GAAP.

RECONCILIATION TABLES

The following tables reconcile our results for the years ended December 31, 2006, 2005 and 2004 with proportional consolidation (as required by Argentine GAAP), with our results as adjusted to reflect the elimination of proportional consolidation:

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| | For the Year Ended December 31, 2006 | | | Without Proportional Consolidation (Unaudited) |
|-----------------------------------------------------------------------|-------------------------------------------------|----------------------------|--------------------------------|-------------------------------------------------------------------|
| | With Proportional Consolidation | CIESA⁽¹⁾ | Distrilec⁽¹⁾ | |
| | | (in millions of pesos) | | |
| Net sales ⁽²⁾ | 11,745 | (592) | (695) | 10,458 |
| Costs of sales | (8,251) | 280 | 594 | (7,377) |
| Gross profit | 3,494 | (312) | (101) | 3,081 |
| Administrative and selling expenses | (1,094) | 23 | 94 | (977) |
| Exploration expenses | (117) | | | (117) |
| Other operating expenses net | (135) | 1 | 38 | (96) |
| Operating income | 2,148 | (288) | 31 | 1,891 |
| Equity in earnings of affiliates | 219 | 71 | (37) | 253 |
| Financial income (expense) and holding gains (losses) | (506) | 132 | 11 | (363) |
| Other income, net | 93 | | 9 | 102 |
| Income (loss) before income tax and minority interest in subsidiaries | 1,954 | (85) | 14 | 1,883 |
| Income tax provision | (465) | (6) | (6) | (477) |
| Minority interest in subsidiaries | (425) | 91 | (8) | (342) |
| Net income | 1,064 | | | 1,064 |

(1) Both the results of CIESA and Distrilec are proportionally consolidated in our Gas and Energy segment.

(2) Net of P\$40 million in intercompany sales.

| | For the Year Ended December 31, 2005 | | | Without Proportional Consolidation (Unaudited) |
|--|-------------------------------------------------|----------------------------|--------------------------------|-------------------------------------------------------------------|
| | With Proportional Consolidation | CIESA⁽¹⁾ | Distrilec⁽¹⁾ | |

| | | (in millions of pesos) | | |
|-----------------------------------------------------------------------|---------|------------------------|-------|---------|
| Net sales ⁽²⁾ | 10,655 | (492) | (651) | 9,512 |
| Costs of sales | (7,046) | 249 | 554 | (6,243) |
| Gross profit | 3,609 | (243) | (97) | 3,269 |
| Administrative and selling expenses | (941) | 18 | 73 | (850) |
| Exploration expenses | (34) | | | (34) |
| Other operating expenses net | (329) | 3 | 5 | (321) |
| Operating income | 2,305 | (222) | (19) | 2,064 |
| Equity in earnings of affiliates | 281 | 42 | (8) | 315 |
| Financial income (expense) and holding gains (losses) | (899) | 128 | 19 | (752) |
| Other expenses, net | (459) | | 11 | (448) |
| Income (loss) before income tax and minority interest in subsidiaries | 1,228 | (52) | 3 | 1,179 |
| Income tax provision | (211) | (6) | (1) | (218) |
| Minority interest in subsidiaries | (288) | 58 | (2) | (232) |
| Net income | 729 | | | 729 |

(1) Both the results of CIESA and Distrilec are proportionally consolidated in our Gas and Energy segment.

(2) Net of P\$21 million in intercompany sales.

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| | For the Year Ended December 31, 2004 | | | Without Proportional Consolidation (Unaudited) |
|--------------------------------------------------------------------------|-------------------------------------------------|----------------------------|--------------------------------|-------------------------------------------------------------------|
| | With Proportional Consolidation | CIESA⁽¹⁾ | Distrilec⁽¹⁾ | |
| | | (in millions of pesos) | | |
| Net sales ⁽²⁾ | 8,763 | (472) | (535) | 7,756 |
| Costs of sales | (5,781) | 219 | 449 | (5,113) |
| Gross profit | 2,982 | (253) | (86) | 2,643 |
| Administrative and selling expenses | (847) | 16 | 66 | (765) |
| Exploration expenses | (133) | | | (133) |
| Other operating expense, net | (324) | 22 | 6 | (296) |
| Operating income | 1,678 | (215) | (14) | 1,449 |
| Equity in earnings of affiliates | 102 | 24 | (4) | 122 |
| Financial income (expense) and holding gains (losses) | (1,265) | 144 | 20 | (1,101) |
| Other expenses, net | (40) | 14 | (7) | (33) |
| Income (loss) before income tax and minority interest in subsidiaries | 475 | (33) | (5) | 437 |
| Income tax provision | 317 | (11) | 4 | 310 |
| Minority interest in subsidiaries | (17) | 44 | 1 | 28 |
| Net income | 775 | | | 775 |

(1) Both the results of CIESA and Distrilec are proportionally consolidated in our Gas and Energy segment.

(2) Net of P\$13 million in intercompany sales.

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The following tables reconcile our statements of cash flow for the fiscal years ended December 31, 2006, 2005 and 2004 with proportional consolidation as required by Argentine GAAP to these statements as adjusted to reflect the elimination of proportional consolidation.

| | With Proportional Consolidation | For the Year Ended December 31, 2006 | | Without Proportional Consolidation (Unaudited) |
|-------------------------------------------------------|------------------------------------------------|-------------------------------------------------|------------------|-------------------------------------------------------------------|
| | | CIESA (in millions of pesos) | Distrilec | |
| Cash and cash equivalent at the beginning of the year | 790 | 257 | 59 | 474 |
| Net cash provided by operations | 2,877 | 326 | | |