

PETROBRAS ENERGIA PARTICIPACIONES SA
Form 6-K
March 23, 2005

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

March 23, 2005

PETROBRAS ENERGIA PARTICIPACIONES S.A.

(formerly PEREZ COMPANC S.A. and PC HOLDING S.A.)

(Exact Name of Registrant as Specified in its Charter)

Maipú 1, Piso 22

(1084) Buenos Aires, Argentina

(Address of Principal Executive Offices)

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.)

Form 20-F Form 40-F

(Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.)

Yes No

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b):82

N/A

PETROBRAS ENERGIA PARTICIPACIONES S.A.

Annual Report and Financial Statements and Summary of Events

as of December 31, 2004

Independent Public Accountant's Report

LETTER TO THE SHAREHOLDERS

To Our Shareholders:

Petrobras Energia enjoyed a great year in 2004. The successful bottom line mirrors the efforts devoted to achieving the two goals of: building the foundation for sustained profitable growth, which will impact the Company beginning next year while, in turn, closing the year profitably. In fact, we addressed the issues with a long term vision, but also managed to take advantage of the opportunities offered by the current scenario.

Many of these opportunities were supported by the high international price of oil and oil products. The daily volumes of oil and gas sales increased 2.7 per cent, reaching 162.2 thousand barrels of oil equivalent (BOE).

As to petrochemicals fertilizer production accompanied the agricultural export boom. Styrene and polystyrene production volumes in Brazil also reached record volumes, consolidating the company's leadership in the region.

The downstream business also performed very well: beside the big effort to restyle service stations to the Petrobras brand, Podium, Petrobras premium 100-octane gasoline was launched during 2004. Sales of Podium, considered best of its kind in the Argentine market, surpassed the product it replaced by 66 per cent only a few months after it was launched.

And in an energy crisis environment, the Company, benefiting from its position as an integrated energy company and by the complementarity of thermal and hydroelectric generation, managed to meet growing power demand.

The best perspectives, however, are still in the future. Petrobras Energía and its personnel prepared themselves spiritedly to face the very good prospects that appear in the horizon: high, sustained commodity prices, and relative stability the main macro-economic variables of Argentina, the nucleus of its operations, a, including the recovery of energy and gas prices, according to initial statements of the Argentine Government on this subject.

On this point, one of the most visible signs that indicates that the Company is preparing itself forcefully and strengthening for the times to come is the corporate reorganization of the Petrobras Group in Argentina, as approved by the relevant Special Shareholders Meetings held on January 21, 2005.

This transaction assures the benefits of a more extended synergy throughout the operation, through centralized management of the production, refining and distribution activities, which will translate into renewed competitive capacity. The merger is scheduled to be completed by the second quarter of 2005, after the approval by the Argentine regulatory authorities.

In line with this transaction and with the spirit of anticipation, Petrobras Energía has issued its Mission, Vision and Values statement, and drafted its Business Plan for 2005-2009. The Plan describes objectives, goals and courses for all of the Company's businesses and defines the strengths and resources available to accomplish them. The Oil Exploration and Production segment received special attention. We will give priority to profitable projects that secure the fastest return on investment. Focus on growth will be enhanced, but from a financially solvent framework.

We have moved forward, and will continue to pursue a gradual reduction of debt, aiming for a new capital structure in line with industry standards and the requirements of the financial markets in which we operate. This goal will permit the Company to become more attractive, by projecting its sound financial management as a key element in the value creation process.

This year the Company also announced its management policy, a key instrument in developing the capabilities required for the current and future development of its businesses. Our staff will continue to meet head-on the challenges ahead.

The Safety, Health and Environmental policies were also announced, as well as the Quality policy. These are the foundations of one of the Company's principal commitments and one of the main pillars that will assure sustainable growth, respect for life and preservation of the environment we live in.

Finally, the Company gave evidence of its alignment with the best corporate transparency practices. In the last year, the Audit Committee of the Board of Directors was constituted, systems and procedures were developed to report irregularities, and rules and practices were set up to disclose relevant information to the markets. There are efforts currently in progress toward meeting the requirements of the Sarbanes-Oxley Act, which sets forth serious penalties, both for individuals and for companies, for infringement of this law.

Ultimately, all these initiatives uniquely reflect the process by which a large company, Petrobras Energía, is built. A Company with clear foresight, precise goals, sufficient resources and people with integrity, qualified and excited about building its future.

That is my final focus here, Petrobras Energía's people. To them, our deepest thanks. Not only for the achievements and efforts of the present but for the promises of success that those achievements and efforts are saving for the future.

Outlook

A new year starts for Petrobras Energía presenting great prospects in the horizon as a result of efforts and achievements of 2004. Prospects that are also supported by independent factors such as high commodities prices in the international market and by a more stable domestic macro-economic scenario including better prices for energy products. But, above all, a renewed and strengthened Petrobras Energía appears on the horizon.

The fact is that the Company has incorporated four companies that will operate as one, centralizing its hydrocarbon production, refining and marketing activities. The objective: to consolidate management and improve synergy among

the business units. Upon completion of the Petrobras Group corporate reorganization process in Argentina, Petrobras Energía will have fully optimized competitive capabilities.

Efforts continue to optimize the portfolio by integrating new projects with high long term growth and profitability expectations.

Petrobras Energía plans to make significant investments in oil and gas exploration and production to achieve its production growth and reserve replacement targets, mainly in Argentina, Venezuela and Ecuador. Investments will be directed to areas where the Company is already operating and to new on-shore and off-shore opportunities, with increased investments in exploration, pursuing more aggressive growth.

In Argentina, as a result of the addition of new assets belonging to Petrobras companies and incorporated into Petrobras Energía, reserves and production prospects for the year 2005 increased significantly.

As regards exploration activities, the offshore areas along the coasts of Argentina are worth mentioning as where Petrobras Energía will capitalize upon Petrobras experience as a world leader in deep-water exploration and production activities.

In Venezuela, efforts will focus on drilling and workover of oil producing wells, mainly in Oritupano Leona and La Concepción operations, and maintenance of existing facilities.

In Ecuador, works relating to the start up of the development project for Block 31 will be performed, with first production expected for the first half of 2006.

In Peru, as a result of the enactment of the "Law for the Promotion of Investment in the Exploitation of Hydrocarbon Resources and Marginal Reserves Nationwide", a more favorable context is foreseen for the development of hydrocarbon reserves at Lote X.

As regards the Refining business, current trends are expected to continue, with the diesel oil and gasoline markets reflecting a recovery when compared to the previous year, mainly boosted by consumption growth of with higher octane rating gasolines. This trend reverses performance in recent years. The refinery will continue operating at close to maximum capacity.

In the Petrochemicals business segment, a growth scenario is foreseen with increased international margins for styrene and polystyrene. Domestic demand for all the business products is expected to grow. In the fertilizers business, forecasts suggest that urea international prices will track higher than the historical average. As a result, the business will continue to add significant value to the Company's natural gas.

Increases in gas prices are foreseen for the year 2005, driven by the Decree which provides a course of prices for natural gas and by an increased demand for hydrocarbons.

In the Electricity segment, a rise in energy prices is foreseen as a result of the passing through to prices of higher gas costs. Moreover, the demand for energy is expected to continue growing, albeit at a slower pace.

As regards utility companies, significant steps are expected to be taken during 2005 to restore the economic and financial balance of such companies. In the light of the letters of intent recently subscribed by the UNIREN with several companies in the energy sector, further progress is expected in the renegotiation of utility contracts. In addition, and as a key piece for utility companies to be commercially viable, continued progress is expected toward the financial debt restructuring of Ciesa and Transener.

MACROECONOMIC OVERVIEW

INTERNATIONAL SCENARIO

Growing Economies

The world economy again grew at a good pace throughout 2004, after a meager 2003 and a definitely poor 2002. Two economies led this growth: United States and China.

The United States' gross domestic product (GDP) rose driven by the good performance of investments and exports. Imports, however, grew more than expected and expanded the gap between the trade balance and the current account. This phenomenon, plus the country's high fiscal deficit, caused the Dollar depreciation against major international

currencies, such as the Euro and the Yen.

The Dollar devaluation, however, found a brake. Asian central banks bought huge quantities of United States currency and government bonds, thus preventing a greater depreciation. With this measure, they also prevented long-term interest rates from boosting. The reference interest rate, on the other hand, grew due to the attempts of the United States Federal Reserve to be neutral and not to stimulate the activity level, within a high-growth context. Finally, the United States economy showed a slight inflationary acceleration that was kept low.

China experienced a strong economic growth, with rates near two digits. China's national government attempted to turn this development into a sustainable phenomenon. Thus, it directed growth toward infrastructure sectors that are, today, in deficit, such as the energy and transportation sectors.

For the second year in a row, Japan showed an important progress in its GDP as a result of its large export numbers. Europe, more moderate, evidenced some activity, after having been practically at a standstill throughout 2003.

Oil Price Escalation

The oil price hit new records in 2004. Even though the WTI reference averaged US\$41 per barrel 33% higher vis-à-vis the previous year it peaked above US\$50. Both demand and supply factors have joined to keep these high prices.

Crude oil demand grew unpredictably by more than 3% (2.5 million barrels per day). Price elasticity was very low and leveraged by the subsidies for oil derivatives granted by many governments. Moreover, many countries have accumulated preventive stocks, anticipating an eventual shortage that, finally, never occurred.

On the other hand, crude oil supply was adversely impacted by several factors throughout the year: frequent terrorist attacks against oil facilities in the Middle East, especially in Iraq; damages to the oil infrastructure in the Mexican Gulf as a result of several consecutive hurricanes; oil strikes in Nigeria; and political uncertainty in Venezuela. In spite of all these difficulties, world production considerably increased to 3.5 million barrels per day. The leading producers were the OPEC and, to a lesser extent, Russia and the Caspian Sea's countries.

The implementation of more stringent specifications for gasoline in some regions of the United States tended to privilege the use of light crude oils over heavy crude oils. This expanded the price gap between both types of crude.

ARGENTINA

Economic Performance

For the second year in a row, the Argentine economy achieved growth rates above 8%, with a good performance of all the components of its gross domestic product. This growth was evidenced mainly in the industrial and construction sectors, achieving two-digit rates. The production installed capacity increased progressively, which required new investments in several sectors.

Economic growth helped improve social indicators: the unemployment rate was reduced by 13% and the poverty and extreme poverty rates by 44% and 17%, respectively. Minimum wages and pensions increased, driven by the national Government.

The trade balance evidenced a new surplus, although not so sizable as the one evidenced in the previous year due to the increase in imports. This favorable trade balance generated an excess of foreign currency, increased by the partial suspension of the public debt payments, which was absorbed, to a greater extent, by the Central Bank in order to avoid the appreciation of the Peso. The local currency - US Dollar exchange rate averaged 2.94 \$/USD in 2004 (like figure to that of 2003). The Government, in turn, kept an explicit position in favor of a high exchange rate.

Both deposits - mainly public - and the credit for the private sector increased at a good pace throughout the year. The high liquidity allowed a pronounced decrease in interest rates. Indexed placements CER (Reference Stabilization Coefficient) also became more attractive, due to the mild acceleration of inflation, which barely exceeded an annual 6%.

The national public sector ended the year with a record primary surplus of 4 points of the gross domestic product. This was due to two main reasons: the increase in the fiscal pressure and an adequate management of the government spending. In the second quarter of the year, the Government decided to suspend performance of the agreement with the IMF, when it was entering the final stage of the renegotiation with its defaulted creditors, although it continued to repay non-postponable maturities with the agency.

As regards public debt restructuring, the swap was finally launched in mid-January, 2005. The official proposal considers a strong principal reduction, extension of terms and reduction in interest coupons.

Energy Market

The Argentine energy sector faced a year with gas supply problems, especially throughout the first half of the year. Several measures were adopted in order to face this shortage: export cuts, gas imports from Bolivia, use of liquid fuels (mainly imported fuel oil) for power generation, consumption restrictions for power plants and industries, natural gas and electric power rational use programs, and electricity imports from Brazil, among others. Several infrastructure works for the energy sector have been planned for the next few years. Among other actions, the Government is planning to expand gas transportation capacity, improve and expand the electricity transmission system, build a new gas pipeline from Bolivia and new thermal plants, complete the works at the Atucha II nuclear plant, and increase the water height of the Yacyretá bi-national dam.

The Government, in an attempt to regain participation in the energy sector, created the national energy company ENARSA, and sent to Congress the new hydrocarbons law, the consideration of which is still pending, and a bill providing for a new regulatory framework for the privatized utilities. Throughout 2004, no significant progress was made in the renegotiation of the agreements with the privatized utilities.

Oil production dropped for the third year in a row, this time by 5.5%, accumulated as of November. While crude oil processed grew by 1.5 %, exportable oil surpluses decreased. Domestic sales of liquid fuels showed an uneven outcome: a strong drop in regular gasoline, a stable behavior of high-grade gasoline, a high increase in premium gasoline and a moderate increase in diesel oil.

The original agreement between crude oil producers and refineries, which ensured local fuel price stability, was replaced by several shorter-term partial agreements.

The Government increased the oil tax exports from 20 to 25%, and then an additional growing rate was applied subject to the WTI reference price. At the end of the year, the Government also imposed restrictions on diesel oil and crude oil exports in order to privilege domestic supply, after noticing a gas oil shortage during the wheat harvest.

Gas production increased by 3.6% in the first eleven months of the year, but the demand increased even more: an 8%, mainly driven by CNG sales and power plants consumption. Exports increased in a similar fashion, although the Government imposed 20% taxes, and it was necessary to import gas from Bolivia (4 million cubic meters per day). On the other hand, the Government also fixed a price recovery path for natural gas.

Energy supply increased in proportion to the increase in the GDP, by 8.5%. This increase was mostly covered by thermal generation, which offset a 10% drop in hydraulic generation. Fifty four (54%) of the supply was covered by thermal generation, 36% by hydraulic generation, 8% by nuclear generation, and 2% by imports. Domestic electricity energy demand rose 6.7% throughout the year.

LATIN AMERICA

Venezuela's economy went through a strong growth in 2004, of around 17%, thus overcoming two consecutive years of fall. The country's activity level again reached the levels existing prior to the crisis. Both the oil and non-oil sectors grew at a good pace - 14% and 18%, respectively.

The economy's recovery improved social indicators. The unemployment rate decreased by 3%, and poverty and extreme poverty rates also decreased.

Both the trade and current account balances showed a high surplus, mainly due to the increase in oil exports, benefited by crude oil record prices.

The favorable external situation allowed the Venezuelan Government to continue to improve the maturity profiles of the domestic and foreign debt. The debt/GDP ratio was reduced and the main credit risk rating agencies improved the rating of the sovereign debt. Within this context, the country risk fell to 400 basic points.

In February, the Government devaluated the official exchange rate by 20%, which remained unchanged throughout the rest of the year, thus reducing the gap with the parallel exchange rate. Inflation experienced an important deceleration vis-à-vis previous years, although still remained at levels of around 20%.

In the political arena, the broadly negative result of the revocatory referendum that sought to remove President Chavez from his office stands out. The party in office was also strengthened by the regional and local elections that took place in October, against an opposition that seemed to be fractioned.

Brazil, in turn, grew at a record pace of 5%. Its economic development was fueled, mainly, by the industrial sector, followed by a recovered services sector.

Industrial production increased above 8%. By the end of the year, however, it showed deceleration signs as a result both of limitations to the capacity as well as of a more restrictive currency policy. The change in the currency policy, which was evidenced as from September, was due both to inflation control factors and the intention to prepare a more stable basis to absorb a possible external shock in the event of a hike in international interest rates.

The rise in commodity prices, especially oil and its derivatives, plus the readjustments of utility rates and the expansive dynamics of the domestic demand were the main factors that impacted on inflation, which reached 7.6%. Although it was well below the inflation rate of the previous year, it was higher than the annual 5.5% target.

The external sector continued to show record figures: it achieved a trade balance of US\$33.70 billion, and a current account surplus of 2% of the GDP. Exports showed an extraordinary increase of 32%, boosted by quite a favorable international context, a competitive exchange rate and the signing of several trade agreements that strongly introduced Brazil into the world marketplace. Imports shared this dynamics as a consequence of the greater economic activity.

The recovery of direct foreign investment was also noticeable, and practically doubled the values of 2003, reaching US\$18 billion. This slackness in the external sector, plus a strong growth and fiscal discipline, favored by broad international liquidity and the devaluation of the Dollar, resulted in a significant appreciation of the Real: the exchange rate at the end of the year was Real 2.65 per Dollar.

This revaluation of the local currency came along with a deep decrease in the country risk (to 400 basic points). Credit rating agencies confirmed this scenario and improved the rating of Brazil's sovereign debt.

In the fiscal arena, Brazil surpassed the primary surplus target of 4.5% of the GDP, and it reduced its total deficit to 2.7% of the GDP. Its debt/GDP ratio ended the year at 52%, more than 5 points below the previous fiscal year, thanks to the appreciation of the Real, the strong economic growth and lower interest rates.

CORPORATE REORGANIZATION

On November 12, 2004, the Boards of Directors of Petrobras Energía S.A. (Petrobras Energía), Eg3 S.A. (EG3) and Petrobras Argentina S.A. (PAR) and the Management of Petrolera Santa Fe S.R.L. (PSF) (absorbed companies), approved at their respective meetings the preliminary merger commitment whereby Petrobras Energía will absorb these companies which will be dissolved without liquidation.

The Special Shareholders Meetings of Petrobras Energía, EG3, PAR and PSF held on January 21, 2005 approved the merger of EG3, PAR and PSF into Petrobras Energía.

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As a consequence of the merger, Petrobras, holder of a 99.6% interest in EG3 and a 100% interest in PAR and PSF, all of them through its controlled company Petrobras Participaciones SL (PPSL), will receive through the latter 230,194,137 newly issued Class B shares of Petrobras Energía, of a nominal value of P\$1 each and entitled to one vote per share, representing 22.8% of Petrobras Energía's capital stock. Accordingly, the new capital stock of Petrobras Energía will be P\$1,009,618,410.

After registration of the merger with the Public Registry of Commerce, Petrobras Energía Participaciones S.A.'s interest in Petrobras Energía will amount to 75.8%. Considering its 58.62% shareholding in Petrobras Energía Participaciones S.A., Petrobras' equity interest in Petrobras Energía will increase to 67.2%.

The effective date of the merger will be January 1, 2005. As from this date, all assets, liabilities, rights and obligations of the absorbed companies will be deemed merged into Petrobras Energía's assets.

This transaction will allow the vertical complementation of PAR, PSF and EG3 businesses with those of Petrobras Energía, thus optimizing the business value chain of such companies. In such respect, the merger will allow the realization of operating synergies and economies of scale that may only be captured by way of the integration of the companies, such as, the positive impact on the exploration and production portfolio in Argentina, the growth and optimization of the hydrocarbon and by-product refining and marketing operations in Argentina in addition to the reduction in administrative, selling and management expenses through the centralized organization of the participating companies' functional operations. The merger of companies with reduced or no debt will improve the credit profile of the absorbing company.

EG3 is mainly engaged in the refining and processing of oil and its by-products and the distribution and marketing of liquid and gaseous fuels, CNG and lubs through gas stations and/or fuel retail outlets.

EG3 has a refinery located at Bahía Blanca, Buenos Aires, a neuralgic point for the delivery of crude oil from the Neuquén Basin and at an excellent position for the supply by sea of crude oil coming from the south of the country or from international markets. With a crude processing capacity of approximately 31 thousand barrels per day, EG3 manufactures a wide variety of products: high-grade gasoline, regular gasoline, super 97 SP gasoline, raw materials for the production of solvents and petrochemical products, kerosene, diesel oil, fuel oil, asphalts base, propane, propylene and butanes, among others. EG3 has a wide network of gas stations (approximately 610), throughout the country that operate under Petrobras and EG3 brands.

PAR is mainly engaged in oil and gas production and the award of a production area at the Noroeste basin, with a production volume of approximately 7 thousand barrels of oil equivalent per day and 17 million barrels of oil equivalent of proved reserves as of December 31, 2004.

PSF is engaged in oil and gas production with 5 oil fields in the Neuquén, San Jorge and Cuyana basins and a production of approximately 11 thousand barrels of oil equivalent per day and 78 million barrels of oil equivalent of proved reserves as of December 31, 2004.

OUR PERFORMANCE IN 2004

OIL AND GAS EXPLORATION AND PRODUCTION

Overview

In 2004, the international price context was very positive for the business with the international crude oil price hitting new records. Even though the WTI reference price remained at an average of US\$41 per barrel - 33% higher than the previous year - it peaked above US\$50. Both demand and supply factors have joined to keep these high prices.

In Argentina, the business scenario exhibited a negative development. The Argentine government increased crude oil export taxes from a single nominal 20% rate to variable percentages, subject to the WTI price, that reached a 45% maximum rate.

In 2004, a 20% rate was applied on gas exports that were not subject to taxes and on liquefied petroleum gas exports previously subject to a 5% tax..

Crude oil sales price negotiations between producers and refineries continued according to a schedule of variable discounts subject to the WTI price. This mechanism partially offset the rise in the international reference price.

Production

In 2004, oil and gas production of Petrobras Energía and related companies grew 3% to 166.7 thousand boe/d. Crude oil production volumes climbed 4.5% to 119.7 thousand bbl/d and gas volumes moved up 1% to 282.2 million cubic feet.

This growth was in part driven by the recovery in volumes derived from operations in Venezuela, which were adversely affected by the oil strike early in 2003.

The successful capital expenditures made in Block 18 in Ecuador, which led to a 68% increase in oil production in this country, also drove the production improvement.

In Argentina, however, production of oil equivalent dropped 6%. This decline was attributable to the fact that most assets in Argentina are mature fields under production through secondary recovery with a considerable natural decline.

In Peru and Bolivia, production volumes in 2004 did not record significant changes compared to 2003.

Capital Expenditures

In 2004, Petrobras Energía's capital expenditures, both in production and exploration activities increased 23% to about P\$950 million from P\$770 million in 2003.

Most of these expenditures were directed at maintaining production, with priority given to countries and products offering higher contribution margins. In 2004, 246 wells were drilled (of which 202 were located in Argentina) and 394 units were repaired (of which 203 were located in Argentina).

In the Neuquén Basin, Petrobras Energía completed significant well drillings and workovers at Medanito and Puesto Hernández.

At Medanito, the Company performed 54 drillings and completed 23 workovers. In addition, two major projects were carried out: the Infill Project - 21 wells drilled- and the Norte Project - 14 wells involved. Though both projects were successful the decline in basic production could not be offset.

At Puesto Hernández, Petrobras Energía performed 101 well drillings (71 producing wells and 30 injection wells) and completed 132 workovers. The most important project in this field was the Infill Project, which involved 55 drillings and had the expected results. On the contrary, basic production in the area significantly declined, with a higher than expected increase in water flow.

In Santa Cruz I and II areas in the Austral Basin, the Company performed 19 well drillings, 13 in Polo Bardas las Vegas, 4 in Boleadoras, 1 in La Porfiada and 1 in Le Marchand. In addition, 15 workovers and major works were completed in pipelines between La Porfiada and Laguna del Oro and between Boleadoras and Bardas las Vegas.

As regards infrastructure works, Petrobras Energía started the construction of the Mercury Removal Plant for crude oil treatment in the Santa Cruz I area.

In Venezuela, the Company performed 24 well drillings, 63 workovers and 5 conversions, mainly at Oritupano-Leona and La Concepción fields.

In Block 18 in Ecuador, Petrobras Energía drilled 3 wells at Palo Azul field and 1 well at Pata field, and started works to expand production facilities and build an oil pipeline with a view to increasing production by approximately 30 thousand barrels per day in mid 2005. In addition, construction works started in connection with the definitive oil pipeline for transportation of the block production.

As regards Block 31, after compliance with the Ecuadorian government's and environmental agency's requirements, Petrobras Energía's Environmental Impact Study and Development Plan for a 20-year production term was approved in August. In December, the Company started infrastructure works with the construction of a pier on the Napo river.

In Peru, a program involving 20 well drillings, 113 workovers (99 primary and 14 secondary), 124 well reactivations, 7 conversions of wells and maintenance and infrastructure works was developed with a view to optimizing operating costs.

Exploration

Petrobras Energía considers exploration as the most important vehicle for growth and reserve replacement. As a consequence, the Company developed a strategy designed at permanently searching for new virgin fields with long term production prospects and performed several exploration activities throughout 2004.

In Argentina, the Company completed a 580 Km² 3D seismic survey in El Campamento - El Martillo exploratory blocks, in the province of Santa Cruz, an area previously explored by other companies. A successful well was drilled and yielded 190 barrels of oil per day and 60,000 cubic meters of gas during the first tests. This finding resulted from the geological knowledge acquired throughout a 10 year-exploration period in the Austral Basin and investments in

new technologies.

At the Santa Cruz Oeste field another well was drilled which also proved to be a discovery well. During the tests, production volumes totaled 50 cubic meters of oil per day and 4,200 cubic meters of gas per day at a depth of 1,400 meters. Seismic shooting is scheduled for next year.

In addition, Petrobras Energía participated in biddings for exploratory areas in the province of Neuquén, which were temporarily suspended later on by the local government. Anyway, and with an eye on 2005, Petrobras Energía continued evaluating the exploration potential of several areas including the Austral Marina and Malvinas basins, in addition to other exploration frontier areas and regions to be awarded through bidding by the provinces of Santa Cruz, Mendoza, Chubut and Neuquén.

Another milestone for the year in terms of exploration was Petrobras Energía's decision to perform offshore activities in the Argentine marine basin. To such end, the Company participated and became the awardee in a bidding for the seismic survey and exploration of two blocks: CAA 01, located 220 Km to the east of Mar del Plata, and CAA 08, 420 Km to the south of the same city. Water depth in these blocks ranges between 400 and 3,000 meters and no company has performed exploration activities in this area to date.

Petrobras Energía, in exploring these areas, is planning to apply the technology and know-how of Petrobras, a world leader in offshore exploration and a pioneer in deep and ultra deep water activities. Petrobras received twice the most important award in the international offshore oil industry for its deep-water technology, the Offshore Technology Conference Distinguished Achievement Award .

Petrobras Energía will start working on this Project once the pertinent exploration permit has been granted by the Argentine Executive Branch.

In Venezuela, Petrobras Energia completed a 200 Km seismic survey in San Carlos and Tinaco and a successful well was drilled at La Concepción.

Liquid Hydrocarbon and Natural Gas Reserves

As of December 31, 2004, liquid hydrocarbon and natural gas proved reserves, audited by Gaffney, Cline & Associates, totaled 732 MMboe (553 million barrels of oil and 1.077 billion cubic feet of gas). This accounts for a 3.5% decline compared to reserves certified as of December 31, 2003 (2.9% for liquid hydrocarbons and 5.1% for natural gas).

During 2004 fiscal year, production totaled 59.9 MMboe and was partially offset by a net addition of 34 MMboe as detailed below:

14 MMboe were added from improved recovery in production areas. The reduction royalties in Peru provided under the new Law 28109 For the Promotion of Investment in the Exploitation of Hydrocarbon Resources and Marginal Reserves had a great impact on such addition. As a result, new development projects were incorporated.

45 MMboe were added from extensions on discoveries, mostly as a result of the classification as proved reserves of discoveries and extensions of proved areas in our assets in Ecuador. To a lesser extent, reserves in the Argentine Austral Basin and in Venezuela were added from extensions on producing fields.

Moreover, technical reviews based on the performance of the different fields and the projects implemented during 2004, resulted in reductions of previous estimates by 25 MMboe at fields where secondary recovery operations were performed in Argentina and Venezuela.

Liquid hydrocarbons and natural gas account for 75% and 25%, respectively, of total proved reserves. Sixty four per cent (64%) of total proved reserves are located outside of Argentina. This higher percentage compared to previous year is attributable to increased reserves in Ecuador.

As of December 2004, we had total oil and gas proved reserves equal to 12.2 years of production at 2004 oil and gas production levels.

REFINING

REFINING AND MARKETING DIVISION

Adding value is one of the guiding principles supporting Petrobras Energía's corporate conduct. This objective becomes apparent in every operation of the Company, especially in the Refining activities. This business segment does not only deliver the best service to customers with a strong sense of mission through its gas station network, but also anticipates their needs by creating cutting-edge products such as the first 100-octane gasoline in the Argentine market: Podium.

This was not, however, the only achievement during 2004: crude oil volumes processed improved by 5.9% to 33 thousand bbl/d, business synergies with other companies in the Petrobras group continued to be achieved and the number of gas stations under its own brand increased.

Market share

The downward trend exhibited during the last nine months in the Argentine liquid fuel market and boosted by the growth of compressed natural gas (CNG) as substitute fuel reversed (for example, in the 1999-2002 period the demand for liquid fuels shrank 16%).

Domestic demand for diesel oil grew approximately 9% in 2004, in line with the recovery started in 2003 after a four-year shrinkage.

In spite of this mild improvement, the liquid fuel market is still subject to severe pressures. High taxes on fuels continued favoring the use of CNG over gasoline and diesel oil. In addition, as a consequence of the significant increase in the international oil price, government controls continued to be applied.

In the case of Argentina, the government increased crude oil export taxes to maximize the volume refined in the country. This action aims at keeping domestic economy away from foreign fluctuations and avoiding their impact on the level of activity, employment and prices in the domestic market.

In the gasoline segment, the market share increased from 3.1% to 3.4%. As regards the diesel oil market, even though volumes grew 3.4%, the respective share fell from 4.7% to 3.5% since the Company decided to prioritize sales to more profitable channels over channels that determine the market share.

Business synergy with Petrobras

Like in 2003, the business strategy of the Refining segment was focused on capitalizing on the competitive advantages offered by the complementation with the businesses of other companies of the Petrobras group. Two actions were the key elements of this synergy in 2004: the sale of diesel oil to and the purchase of gasoline from EG3 and the change of flag of former Pecom gas stations.

Since last year, Petrobras Energía and EG3 have taken advantage of the benefits involved in the integration of operations to maximize value. Since the volume of diesel oil produced by Petrobras Energía at its San Lorenzo refinery exceeds the demand of its gas station network, sales of diesel oil to EG3 continued. In the year under review, diesel oil sales volumes reached 382 thousand cubic meters, quite above the 210 thousand cubic meters in 2003. EG3, in turn, sold Petrobras Energía its surplus of both component and finished gasolines.

As regards the change of name of Pecom gas stations for the Petrobras brand, Petrobras Energía continued the process started in 2003 aimed at capitalizing on the positive attributes of the group image. The fact is that in recent years Petrobras was able to develop an excellent brand equity whose interesting benefits are reflected at dispensers.

Podium: a new technological conquest

In terms of fuels and also as a result of the synergy with the Petrobras group, Petrobras Energía continued adding value. In mid 2004 it launched Podium, the gasoline with the highest octane rating in the Argentine market. Created jointly by the Company's technicians and technicians from Petrobras Brazil, Podium is produced at the San Lorenzo refinery, in Santa Fe, and is distributed on an exclusive basis throughout the country.

However, Podium is not only the first Argentine premium gasoline that offers a 100 octane rating but also contains multifunctional additives to help keep the engine clean. Podium also meets the highest quality and environmental safety standards. It was awarded quality certifications by the Petrobras Research Center (CENPES) in Brazil and the South West Research Institute (SWRI) of Houston, United States.

Podium was well received by the market. By the end of the year it had gone beyond the premium gasoline it replaced (Magnum) by 66% per cent. This figure does not only exceed the Company's expectations but also improves Petrobras Energía's performance in the segment of fuels of high quality, power and cost.

Asphalt market

In 2004 the Argentine road asphalt market recovered after the 2002 crisis. This segment, of which 80% commercializes asphalt cements and 20% commercializes a variety of asphalt specialties (diluted asphalts, asphaltic emulsions and polymer-modified asphalts), reached sales volumes over 300 thousand tons in 2004.

Petrobras Energía maintained its leading position in this recovering market, with a 25% market share. As a consequence, the Company is ranked second in one of the most profitable downstream businesses. In spite of this position, Petrobras Energía is the only oil company in Argentina that has its own facilities for the production of asphalt specialties. This unique feature has enabled it to supply asphaltic products for many of the most important road construction works in the country, including, among others: the Rosario-Córdoba highway, the Rosario-Victoria bridge, the Aramburu highway connecting Rosario and Buenos Aires, and National Road 43.

In addition, for the second year in a row, Petrobras Energía sold polymer-modified asphalts. Total sales volumes reached 2.1 thousand tons, a significant volume considering a country's aggregate market of approximately 8 thousand tons.

In addition, the Company maintained its leading position in the asphalt market of bordering countries (Bolivia and Paraguay). During 2004, sales totaled 29.2 thousand tons, a slightly lower volume compared to the record 31.9 thousand tons in 2003.

Gas stations

Petrobras Energía continued pursuing its commercial strategy involving the development and reidentification of gas stations. Throughout 2004, 39 retail outlets were customized to the Petrobras brand and 106 retail outlets were added to its network: 87 gas stations (of which 8 are directly operated by the Company and 79 are operated by third parties) and 19 Diesel Centers, of which four are mobile centers.

The Company's efforts were also directed at increasing the number of retail outlets using the Tarjeta Flota sales system. Tarjeta Flota is a brand loyalty program aimed at increasing sales volumes and establishing a more stable and lasting relationship with customers. As a result, the number of gas stations implementing the Tarjeta Flota system grew from 45 to 59 during 2004.

REFINERIA DEL NORTE S.A. - Refinor

The year 2004 was positive for Refinor in terms of hydrocarbon refining. In addition to a 14% increase in gas production volumes compared to 2003 (an average of 18.9 million cubic meters per day), seven new retail outlets were added to its Service Centers network (CCSS), one of them directly operated by Refinor.

Oil processing volumes slightly dropped 1 per cent (an average of 17.4 thousand barrels per day) due to lower crude oil availability.

This network, serving eight provinces located in the central and northern regions of Argentina, extended to Bolivia, where 13 production agreements and agreements for brand use were entered into. By the end of 2004, the gas station network comprised 98 retail outlets, of which 15 were operated by Refinor.

EMPRESA BOLIVIANA DE REFINACIÓN - EBR

EBR showed a good economic performance in 2004. As a major milestone, EBR contribution margins significantly recovered compared to the situation in 2003 in which as a result of the price fixing mechanisms imposed by the Bolivian government on refined products EBR had no refining margins.

EBR maintained a good level of crude oil processing with a view to producing a higher diesel oil volume and capitalizing on the WTI high international price. In 2004, the Company processed an average crude oil volume of 37.4 thousand barrels per day.

From the commercial standpoint, the Company was able to exceed annual targets in terms of product sales to the domestic and foreign markets and capitalize on high international prices. In this respect, EBR's commercial network played a major role since it incorporated eleven new retail outlets through its subsidiary EDB. By the end of the year, the network had a total of 92 gas stations.

PETROCHEMICALS

The year 2004 was marked by a series of achievements in the Petrochemicals business segment: record production of styrene and polystyrene in Brazil, consolidating its leadership in the region; record production of rubber and bi-oriented polystyrene; 60% growth in sales of liquid fertilizers; and start-up of a new fertilizer manufacturing plant. In addition, the Company acquired an ethylene production plant, implying a growth in the business value chain and product offering.

ARGENTINE STYRENICS DIVISION

In Argentina, the industrial activity maintained the recovery trend started in 2003 which boosted 30%, 14% and 20% increases in the demand for styrene, polystyrene and rubber, respectively.

Petrobras Energía provided an efficient response to market opportunities and adjusted them to production from the Puerto General San Martín and Zarate plants. During 2004, the Company decided to maximize styrene production, thus prioritizing positioning in the domestic market which offers higher margins than exports.

During 2004, production volumes from Puerto General San Martín (PGSM) complex totaled 110.5 thousand tons of styrene, 4% higher than in the previous year. Volumes from the Zarate plant, in turn, increased 8% compared to volumes recorded in 2003, with a production of 62 thousand tons of polystyrene. These figures confirm Petrobras Energía's leadership as the main styrene producer in Argentina.

In 2004, Petrobras Energía hit a new record of 12 thousand tons of bi-oriented polystyrene, 11% higher than the previous year, of which the Company exported 9.6 thousand tons to Europe and the United States, one thousand more than in 2003.

Rubber production, in turn, totaled 58.4 thousand tons (4% higher than volumes recorded in 2003), setting a historical record boosted by domestic demand, with a market share increasing from 90% to 95%.

A new asset – The SL Ethylene Plant

Located in San Lorenzo (Province of Santa Fe), the SL Ethylene plant was acquired in February 2004 and became operational in October 2004.

The new plant is located along the Paraná river coast, adjacent to the San Lorenzo refinery which provides the oil feedstock necessary for its operation, and to the PGSM petrochemical complex which uses ethylene as raw material for the production of ethylbenzene and then ethylene. It is also located near the Zarate plant where the Company manufactures polystyrene.

This acquisition helps the Company grow in the business value chain and expand its product offering, increasing its share in the plastic raw material market. As a result of the acquisition of the SL Ethylene plant, Petrobras Energía increased production capacity of its PGSM ethylbenzene plant from 116 thousand tons to 180 thousand tons per year. With this additional ethylbenzene production, the Company will be able to make full use of the production installed capacity of Innova plants, thus broadening the regional leadership in this market.

Summing up, the styrenics business performed very well during 2004. This segment generated significant profit margins and low levels of inventory and trade receivables. Along with Innova's performance, it helped strengthen Petrobras Energía's leadership in this market in the Mercosur region and consolidate the Company's commercial presence in Chile.

INNOVA S.A. - Innova

The economic activity in Brazil is on a clear development path boosting the demand for styrene. During the last year, the polystyrene and styrene markets grew 15% and 4%, respectively.

In this favorable business context, Innova plants produced a record of 208 thousand tons of ethylbenzene and 202 thousand tons of styrene under ordinary operating conditions. The latter figure was highly above the 179 thousand tons recorded in 2003 and enabled Petrobras Energía to partially offset the product deficit in the regional market and also increase polystyrene production, with volumes hitting a historical record of 105 thousand tons per year.

In Brazil, Innova consolidated its position as a leading styrene and polystyrene producer and marketer, with a market share of approximately 73%.

Innova was also able to increase its businesses in foreign markets. Exports grew 23% compared to 2003, with volumes mostly directed towards Africa and the United States.

Customer-oriented strategy

In Brazil, Innova continued implementing its commercial strategy directed at developing new products and solutions jointly with customers to which it delivers high value added in terms of technical assistance. In addition, its most important and demanding - in terms of suppliers' qualifications - customers approved the new polystyrene compounds.

One of these customers, Sony, authorized the use of polystyrene compounds manufactured by Innova in its electronic products. In addition, companies in the footwear industry purchased from the Company new products to substitute ABS (Acrylonitrile Butadiene Styrene), a byproduct of styrene used in the manufacture of inner parts of automobiles and household appliances casings, among other applications. Innova is currently performing final tests of high resistance products together with customers from the household appliances and packaging industries.

Summing up, Innova closed 2004 fiscal year with good economic results, further strengthening Petrobras Energía's leading position in the region's styrenics business.

FERTILIZERS

The year 2004 was positive for agricultural activities in Argentina. Sown areas remained almost unchanged, with increased expectations of improved yields and a rise in the use of nutrients. As a result of this situation, total demand for fertilizers grew 31% in the country.

Petrobras Energía, a leading company in the Argentine market of granular fertilizers, partially capitalized on this growth: total sales volumes increased 31%, the liquid fertilizer segment recording a 60% rise, including resale.

In line with its growth and innovation strategy, Petrobras Energía produced 246 thousand tons of liquid fertilizers at its Campana plant. This figure widely exceeded the 186 thousand tons recorded in the previous year and results from a greater production of UAN (nutrient containing urea and ammonium nitrate) and the start up of a the new thiosulfate plant, a product containing nitrogen and sulfur used for soybean fertilization.

Urea production, in turn, was impacted by gas supply interruptions during the summer season, totaling 188 thousand tons, compared to 193 thousand tons in 2003.

The price for products in this market hit all-time highs. This fact, in addition to increased sales volumes generated high profit margins for the segment. With a view to leveraging this growth opportunity, Petrobras Energía is planning to make investments to facilitate distribution and sales logistics and achieve greater business development.

PETROQUIMICA CUYO S.A.

Throughout 2004, international polypropylene prices continued showing an upward trend that drove the price increase in the Argentine market. In spite of this rise, demand grew 17% compared to the previous year. The polypropylene domestic market has not commercialized such a great volume since 2001.

Petroquímica Cuyo S.A. did not remain outside this market reality: production from its Luján de Cuyo (Mendoza) plant surpassed by 2% the maximum historical value for 2003. In addition, the Company continued developing and commercializing the new random-block polymer families used in the high resistance packaging industry.

As regards polyolefins, a substance used in the production of a wide variety of products ranging from disposable products to household appliances, Petroquímica Cuyo S.A. also had positive results. The Company not only increased by 98% its sales volumes of copolymers and terpolymers for special applications of its successful Cuyotec line, but also consolidated its international positioning strategy designed to introduce its special products into the United States and European marketplace.

HYDROCARBON MARKETING AND TRANSPORTATION

HYDROCARBON MARKETING

With a view to integrating and optimizing all links in the energy chain, Petrobras Energía has an active involvement in the hydrocarbon marketing and transportation segment. During 2004, it continued providing oil, gas and liquefied petroleum gas (LPG) brokerage and trading services to other manufacturing companies in order to expand production commercial opportunities.

During 2004, the Company sold 190 tons of LPG per day and 3.9 million cubic meters of gas per day under the brokerage and trading modality.

HYDROCARBON TRANSPORTATION

TRANSPORTADORA DE GAS DEL SUR S.A. - TGS

TGS's sustained recovery from 2001 crisis continued. The year 2004 was marked by TGS's emergence from default. By the end of 2004, the company under joint control was able to restructure its debt and design a maturity profile consistent with its business development strategy.

In the transportation regulated segment, the distortion in fuel domestic prices leveraged the demand for natural gas and put service capacity to the test. Once again and as a result of the excellent maintenance conditions of the gas transportation system, TGS was able to meet a greater operational demand represented by a 17% increase in average daily deliveries in 2004.

In terms of sales revenues, gas transportation continued to lose relative weight vis-à-vis the unregulated segment accounting for 44% of total revenues in 2004 compared to 47% in 2003. While firm transportation capacity increased about 3.6 million cubic meters per day as a result of a better use of the system operating availability, the profitability of the regulated segment was not able to recover due to rate adjustments made after the major devaluation and inflation process of the last three years. During 2004 no progress was made in terms of a renegotiation of the gas transportation license.

In light of the absence of key definitions and a growing demand for natural gas, the Argentine government implemented the trust concept to finance the system expansion, thus changing the paradigm of the investment process in the utility sector. TGS once again provided its support and strived to reach an agreement with the Argentine government to increase the capacity of the San Martín gas pipeline by approximately 2.9 million cubic meters through the laying of 509 Km of additional pipelines for the 2005 winter season. A major investment would be required for this expansion, TGS acting as Project manager and being responsible for the operation and maintenance of the new facilities.

Development of the unregulated business segment remained favorable in 2004, accounting for 56% of total revenues and boosting cash generation. The natural gas liquids (NGL) production and marketing segment was positively impacted by high international prices which remained constant throughout the year and, to a lesser extent, higher volumes processed as a result of the increase in gas demand, with a record volume of liquids production at the Cerri Complex.

As regards operations, from the very beginning TGS has given priority to the implementation of cutting-edge technology and to the leading position in the industry with a view to providing safe, reliable and efficient services. To such effect and for the purpose of preventing pipeline deterioration mainly caused by external corrosion, in 2004 TGS

developed a prevention system for crack detection which, together with the implementation of a new internal inspection technology, is unique in Latin America.

OLEODUCTOS DEL VALLE S.A. - Oldelval

Oil volumes transported by Oldelval from Allen to Puerto Rosales were similar to volumes transported in 2003, but exhibited a slight 1.97% increase (a total of 66.5 MM barrels per year). This increase derived from the decline in crude oil transportation through the Trasadino Oil Pipeline used for exports to Chile and reduced pumping at the Luján de Cuyo distillery.

During 2004, for the purpose of securing the system's reliability, Oldelval performed several maintenance works. Major investments include, among others, the internal inspection of piping using state-of-the-art ultrasound tools.

OLEODUCTO DE CRUDOS PESADOS Ltd - OCP

OCP started commercial operations by the end of 2003. During 2004, the first year of operations, it transported over 75 million barrels of heavy crude oil which were shipped on more than 138 vessels from its offshore facilities on the Ecuadorian coast.

In the financial arena, OCP succeeded in significantly reducing 2004 basic transportation rate from US\$2.41 per barrel of crude oil at the beginning of the year to US\$2.20 as a consequence of revisions made in the financing parameters and adjustments to the oil pipeline operating budget.

In June 2004, Petrobras Energía Ecuador subscribed a Transportation Agreement with Murphy/Canam Oil whereby it committed itself to transport, using the capacity committed to Petrobras in the OCP, 20% of crude oil production from Block 16 until 2012. Under this Agreement, Petrobras transported approximately 1.6 million barrels of crude oil in 2004, thus mitigating the economic commitment under the Ship or Pay agreement by US\$3.6 million.

By the end of the year, OCP hit records in terms of safety and complied with priority goals in terms of quality and environmental issues. Since the oil pipeline runs across ecologically sensitive areas, OCP focused its efforts on the safe operation of certain sectors such as the fluids shut-off and check valves (automatic valves) and the Supervisory Control and Data Acquisition System - SCADA-.

In 2004, OCP's marine terminal obtained the certificate for compliance with the Code of Protection of Vessels and Port Facilities required by the International Marine Organization, thus becoming one of the first ports in Latin America to obtain this certification.

ELECTRICITY

The Argentine Electricity Market

The rebound in the Argentine economic activity had an impact on the growth of the demand for energy. With a 6.7% increase, electricity consumption returned to levels similar to those prior to the 2001 crisis. Total electricity generation, in turn, increased 8.5%, including exports.

In 2004, gas supply restrictions at thermal power plants increased compared to previous years. As regards hydraulic power plants, flows from incoming rivers declined as from the second half of the year, compared to historical average values, as a result of less snow water supplying the river basins.

ELECTRICITY GENERATION

GENELBA POWER PLANT The Power Plant

In 2004, the Genelba Power Plant operated with a 98% reliability level and reached an 84% availability factor which was affected by scheduled major maintenance works during the year.

During 2004 first and fourth quarters, one or two of the Power Plant's three turbines were alternatively stopped. This operation lasted 74 days divided into two periods, with no significant deficiencies detected.

As a result of the gradual scheduled maintenance works performed, the Power Plant, for the second year in a row, was able to successfully comply with the compensation scheme for guaranteed supply, thus obtaining P\$30 million additional revenues.

Surpassing historical monthly and daily generation records was yet another achievement in 2004: the plant generated 480 Gwh of electricity in July with a 16,445 Mwh peak on day 16.

In May, Genelba was authorized by CAMMESA, the Wholesale Market Manager, to start commercial operations of the Primary Frequency Response System under the Joint Control modality. As a result of this project, the Power Plant not only obtains significant economic benefits but also becomes the first plant in the wholesale electricity market to operate under this modality, thereby strengthening its leadership as a technologically innovative company.

In 2004, another fact ratified the market's recognition of Genelba expertise in the operation and maintenance of power plants. The Power Plant subscribed an agreement with Termorio S.A, independent producer of electricity in Brazil, whereby it will provide management and technical assistance services in the operation and maintenance of Termorio combined cycle power plant.

PICHI PICUN LEUFU HYDROELECTRIC COMPLEX

In 2004, incoming mean flows from the Limay and Collon Curá rivers were lower than the historical average (2% and 7%, respectively). These water supply levels resulted in a 1,142 GWh generation volume and a 45% plant factor. The level of power discharges as a result of spilling of water without generation was very low (0.1 Gwh).

Scheduled maintenance works for the three generation units of the hydroelectrical plant were successfully performed during a term of 52 days. International independent experts performed a safety technical audit of the dam with highly satisfactory results.

ELECTRICITY TRANSMISSION

TRANSENER S.A. - Transener

The Argentine economic growth, especially the GDP growth, had an impact on the increase in electricity consumption. This phenomenon forced Transener to double its efforts to maintain service quality according to the standards provided for under the concession agreement. Along these lines, in 2004, the Company worked hard to strengthen the quality commitment to its customers.

Transener's own failure rate in transmission lines remained at satisfactory levels (0.49 failures every 100 km of lines), well below the 2.5 limit provided under the Concession Contract.

The continuing lack of definition regarding electricity transmission rates, the filing of a bill for Public Utility Regulation which would include significant regulatory changes, in addition to the critical situation in the electricity sector as a whole have resulted in a strong decline in investments generated by the market's own dynamics and in reduced business opportunities in the domestic market.

With a view to regionally expanding the activities and developing a policy for the insertion of Transener in the Latin American market, during 2004 Transener continued conducting business development activities abroad.

Transener completed the first works relating to the 500 Kv line in the transmission system in Paraguay which was financed by the BID and awarded to the Company on the basis of a public international bidding. The project encompasses 15 Km of lines, a 500 Kv yard and a 200 Kv extension of the transformer station. On August 3, Provisional Acceptance of the works took place, with no significant works pending completion.

In Brazil, the Company maintained operation and maintenance agreements. In addition, it executed a new five-year-term agreement with the ETIM Consortium (Expansión Itumbiara-Marimondo Ltda.) to operate and maintain the 500 Kv Itumbiara-Marimondo high voltage line and two transformer stations located in the Goias and Minas Gerais states.

Regarding the defaulted debt, the company estimates that in 2005 an agreement will be reached with the financial creditors' committee, taking into consideration the new economic reality of the company and the country.

ELECTRICITY DISTRIBUTION

EDESUR S.A. - Edesur

Argentina's economic rebound during 2004 had an impact on the demand for electricity which surpassed consumption levels recorded prior to the 2001 crisis. During the year under review, the demand for energy in Edesur's concession area increased by 5.2% compared to 2003. Energy delivered to Edesur's network reached 15,097 GWh. In April, in turn, the Company recorded a historical 2,650 MW maximum demand for power, a 2.2% higher than previous values (July 2000). Maximum demand for power increased by 4.1% compared to 2003.

Edesur was not able to restore its economic and financial balance which was adversely impacted by devaluation and pesification in January 2002. For that reason, during 2004, Edesur strived to reduce the effects of such a situation.

In spite of the restrictions imposed by the emergency, Edesur's technical management had positive results. This was due to an efficient management of resources, with strategies and objectives commensurate with the circumstances and with a stringent control on key management variables.

The Company used all resources available to make the investments necessary to support the provision of services. In 2004, the Company invested P\$147 million, resulting in an accumulated amount of P\$2,981.3 million as from the beginning of the concession.

Technical service quality indicators – number and duration of outages – did not show significant changes compared to 2003. As regards technical product quality – voltage level and disturbances – metering cycles throughout the year yielded an acceptable quality level.

On the other hand, Edesur increased its customer portfolio by 1.02% to 2,138,753 users. This indicator keeps the upward trend resumed the previous year after two critical periods showing signs of decline.

Electricity sales also hit maximum historical values with total annual sales of 13,323 Gwh, accounting for a 5.3% increase compared to 2003. This figure reflects 1,913 Gwh for distribution services (wheeling) to large users.

Another achievement by the Company in 2004 was the reduction, for the first time as from the beginning of the crisis, of energy losses from 11.83% in 2003 to 11.75% (variable annual rate), a significant decline considering that the Company had increased technical losses.

Edesur was able to regain its borrowing capacity in the financial market. It became one of the first companies to place, after the crisis, an issuance in the domestic market of peso-denominated notes, with very favorable terms and rates. The proceeds from the issuance were mostly used to repay dollar-denominated financial liabilities, resulting in an extension of the average life of the outstanding debt and a reduction in the exposure to the exchange rate.

HUMAN RESOURCES

A company is the people who work for it. Therefore, Petrobras Energía devoted the entire 2004 to prepare its people to work in the integrated energy company it has currently turned into. It is quite a challenge: the Petrobras corporate reorganization process in Argentina combines business practices for a better use of know-how while simultaneously valuing convergent work histories and cultures to make the new Petrobras Energía a more successful company.

Values, the backbone of the corporate conduct

Petrobras Energía knows that a merger of companies can only be successful if it manages to achieve a unique identity and a common philosophy. For this purpose, this year the company has continued its efforts to define the values that represent its culture and to which it aspires. That is, the manner in which the Company mission and vision will be reflected through the day-to-day behavior of its people.

This definition of values mirrors the respect that Petrobras Energía feels towards its employees. The Company's personnel participated in this task: through focus groups and in-depth interviews, they had a chance to express their ideas and opinions. The Company also took into account the results of the values dimension included in the Organizational Climate Survey conducted in March.

Thus, after several months of intensive work geared towards the selection and definition of concepts, Petrobras Energía developed its five new values. These consist of five guidelines that support and project its corporate conduct and, in turn, include multiple attributes: agility, flexibility, ethics, respect for individuals and their environment, integration, teamwork, self-improvement, search for excellence and frontier technology.

A harmonic and motivating work environment

As one of the goals for 2004, Petrobras Energía set out to become the preferred employer at each location where it operates. To that end, the Company attempts to create a challenging work environment that attracts employees and enables their development guided by the competences required to meet business goals.

Petrobras Energía specifically emphasized the diagnosis and improvement of this climate taking a twofold path: the Organizational Climate Survey and a series of actions that contributed to the integration and involvement of its employees.

Organizational Climate Survey

The Organizational Climate Survey was an anonymous and voluntary survey conducted by Petrobras Energía in March 2004 for in-house personnel. Its goal was to detect factors impacting employee satisfaction, motivation and sense of belonging to further develop action plans that would improve work environment and relations.

In addition, the mission of the survey consisted in generating a data base against which future results would be compared. Two thousand nine hundred and sixteen individuals (62 per cent of personnel invited to participate) from its operations in Argentina, Bolivia, Brazil, Peru and Venezuela participated in the survey.

The Organizational Climate Survey enables the Company to obtain a series of indicators: the Organizational Commitment Index, the Employee Satisfaction Index (ESI) a measurement system established by the Petrobras group for all of its companies and the Direct Satisfaction Index (DSI). All of them are essential to identify the degree of employee satisfaction in terms of Company resources, processes and practices, and they have enabled Petrobras Energía to work on opportunities for improvement throughout the year.

In order to measure the scope of the organizational actions the Company worked on throughout the year, a new Climate Survey was launched from December 2004 through February 2005. This process was conducted simultaneously to that of Petrobras and encompasses all of the countries where the Company operates.

Towards greater integration and participation

The year 2004 was highly dynamic for Petrobras Energía in terms of activities aimed at the integration and participation of employees and their families. Among them, we can mention the following events: recognition to the career path of employees with greatest seniority and participation of almost 1,900 persons in the Energy Games organized by Petrobras to celebrate its 50th anniversary.

The Company also sought to encourage employees to share their artistical skills, stimulate their creativity and appreciate art and culture. To that end, Petrobras Energía participated in the Prata da Casa corporate contest, which Petrobras has been organizing in Brazil for the last nine years, awarding prizes to works of art within the categories of plastic arts, photography, music, literature and gastronomy.

In addition, the Company continued developing a series of activities designed to promote the pride of belonging, encourage integration and move people to act in line with the Company values. Among them, we had several seminars focused on integration of the family and the community with the Company, the presentation of new products, and closer interaction with the Chief Executive Officer and the Directors of the Company.

This new closeness between the Chief Executive Officer and the employees of Petrobras Energía, in turn, attempted to create greater room for communication and interrelation between them. This was the goal sought by management in Road Show 2004, as well as in Exchange Day, a monthly activity that promotes interest in and understanding of the Company's businesses and boosts integration among personnel from different areas.

Training and development

In 2004, Petrobras Energía set out to homogenize the business practices of all of the companies that integrate it. To that end, it implemented the Performance Management Cycle with a comprehensive vision and introduced the new training policy involving all of its operations.

Performance Management Cycle and new training policy

The Company carried out the performance management Cycle with the purpose of evaluating the contribution of all its employees and promoting their development. This cycle involves all employees, either from the assistant or the leader role.

This cycle is implemented through the evaluation of individual management objectives, which contribute to the goals established by the organizational strategy, and attitudinal competences.

The competencies model serves as a guide of the management and leadership style promoted by the Company. It was designed in line with the definition of competencies established in the Petrobras Brazil model and added an additional competence: value-based management.

The new training policy was implemented within the framework of this comprehensive performance management model. Its purpose is to establish that training actions are related to the performance management cycle in order to

meet individual training needs, facilitate achievement of individual management objectives and promote the development of attitudinal competences.

Petrobras University

Petrobras University is a corporate university created to provide professional training to all Company business units and exchange knowledge among them.

In 2004, we strengthened the bond between Petrobras Energía and the University to optimize training resources and access to its educational proposals through courses, seminars and technical meetings.

Towards a better quality of life

Petrobras Energía is a Company that seeks the professional development of its people, as well as its personal and family development. Thus, it attempts to improve their quality of life through different programs, such as the benefit and the health protection and promotion programs.

Employee benefits

Petrobras Energía offers its personnel a set of benefits that exceed those required by law and are aimed at contributing to their development and improving their standard of living. These benefits, which as all other processes are in line with the corporate vision, mission and values of Petrobrás Energía, encompass issues such as health, education and attention on special occasions, among others.

During 2004, the core of this area of work was integrating the benefit plan of each of the companies that joined Petrobras Energía. For employees based abroad, the Company performed a situation analysis and adapted the benefit package in an effort to make it more attractive and competitive. It simultaneously worked on the extension of benefits to all Company personnel.

Compensation

Petrobras Energía developed a single compensation policy for the entire Company aligned with the guidelines set forth by Petrobras Brazil. This policy includes personnel excluded from collective agreements, and complies with the pertinent Collective Labor Agreement in relation to the remaining employees.

The guidelines stated therein seek internal equity and external competitiveness, helping leaders to manage their work teams effectively. These have been designed maintaining the commitment towards legislation, which Petrobras Energía expressly states in all its management policies.

The Company manages compensation according to its strategic positioning, which responds both to market trends and to its Business Plan's requirements, while taking into account the roles, responsibilities and performance of its employees.

Union Relations

Based on a model of continued negotiation, in 2004 Petrobras Energía renewed several agreements. The purpose behind this measure was to become an agile, integrated and flexible organization, thus favoring the quality of labor of its employees.

Renewed agreements

As regards petrochemical operations, the Company updated the 100/75 Company-Union Agreement with SOEPU (Sindicato de Obreros y Empleados Petroquímicos Unido) after remaining unchanged for 29 years. In addition, it simplified the salary structure and implemented a new work shift in order to reduce the number of hours per day and thus improve the quality of life and efficiency of the plant's staff.

The Company entered into a new agreement with Sindicato Luz y Fuerza of the Autonomous City of Buenos Aires for the Genelba Thermal Power Plant. The objective of this agreement, which affected neither working conditions nor work schedules, was to maintain the competitiveness that has always been a distinctive feature of this business unit.

The E&P area has also updated the collective agreement with its work force. After almost four years under the previous agreement, it was ratified by the National Ministry of Labor of the new CCT 340/04, executed between Federación Argentina Sindical del Petróleo y Gas Privados (FASPyGP - Unionized Argentine Federation for Private Oil and Gas), Cámara de Exploración y Producción de Hidrocarburos (CEPH - Chamber for Hydrocarbon Exploration

and Production) and Cámara de Empresas de Operaciones Petroleras Especiales (CEOPE - Chamber of Companies for Special Oil Operations). The term of the CCT 340/04 agreement expires on December 31, 2007.

At the Cojedes State, Venezuela, the Company has executed a hiring agreement for gas production activities unrelated to oil with Fedepetrol and FetraHidrocarburos. The purpose of this agreement is to seek cost-efficiency for the San Carlos Tinaco project.

CORPORATE SOCIAL RESPONSIBILITY

For the Company, being a responsible corporation is a way of doing business. It is not an option, but rather a condition for the sustainable development of its businesses while simultaneously molding its corporate mission and vision. Along these lines, in 2004 the Company supported its economic growth with an organizational responsibility program that sought to achieve ethical, human, social and environmental value. Through this program and its several action plans the Company has:

- woven alliances with public institutions and non-governmental organizations
- developed community promotion plans within its influence areas
- sponsored institutions with similar social objectives
- generated or participated in Corporate Social Responsibility (CSR) training projects

In addition, the Company has started to disseminate its CSR activities internally and taken the first steps towards corporate volunteering, a way to integrate its social vocation with that of its people. The final goal: to consolidate its relationship with society and simultaneously build an organizational culture based on ethics and respect for individuals, the environment and the community.

Alliances

During 2004, Petrobras Energía set up several medium-term alliances with governmental and non-governmental organizations to capitalize on the synergies of networking. Some of these institutions were:

- Asociación Argentina de Tenis Adaptado (AATA)
- Fundación Crear vale la pena
- Asociación Civil Crear-te
- Fundación Huésped

The purpose of these alliances focused on improving levels of social inclusion and integration, especially for underprivileged children, teenagers and youngsters, in communities where the company operates. The contribution of Petrobras Energía led to positive results reflecting its leadership as a committed social player in all cases.

Sports and social integration

Working jointly with Asociación Argentina de Tenis Adaptado (AATA), Petrobras Energía has promoted social integration through sports. Besides sponsoring the Argentina Open Adapted Tennis International Tournament, the Company funded the works for the enclosure of the tennis court of Centro de Rehabilitación y Recreación para Personas con Discapacidad (Rehab and Recreational Center for the Handicapped) and supported the participation of AATA players in international tournaments. Petrobras Energía also gave widespread exposure to wheelchair-tennis at the ATP 2004 tournament final.

Support to artistic expression

Art is yet another field through which Petrobras Energía seeks to promote social inclusion. Towards this end, the Company has established an alliance with Crear Vale la Pena , a foundation engaged in the training of young individuals in musical arts and artistic production. In 2004, Petrobras Energía supported these training activities and supplied students with quality instruments for their educational process.

Art as a path to social inclusion

Petrobras Energía has also assisted in the creation of job opportunities for young individuals with different capacities. In association with Asociación Civil Crear-te, it conceived a strategy for the marketing of their works of art that would enable them to generate income.

Fight against AIDS

Petrobras Energía formed an alliance with Fundación Huésped in order to disseminate and make the society aware of the HIV issue. This alliance was molded into several actions, the Preventoon Project -which the National Ministry of Education declared of Educational Interest- and the Calendar Project, among others.

Preventoon is an educational video on HIV prevention which Petrobras Energía distributed in public schools located in the Southern area of Greater Buenos Aires and Rosario, both to teachers and students.

The Calendar Project is a photo almanac with pictures of renowned personalities aimed at raising funds for Fundación Huésped as well as promoting social awareness on the subject. In this case, Petrobras Energía contributed monies to the campaign and made its network of gas stations available for the sale of the calendars.

Community promotion plans

The Company is well aware of the fact that an ethical corporation that cares about its people and their environment cannot leave behind the communities where it operates. It also knows that a solid corporation may only exhibit growth if it, in turn, becomes a determinant for growth. Bearing this in mind, the Company thinks out and develops social actions to improve the living conditions of the communities within its influence area.

The Company implements this task through its business units. Each business unit has its own strategy in terms of community support, which varies according to the needs and bonds established with the area's residents and institutions.

In 2004, Petrobras Energía carried out community promotion plans related to the following issues: education, sports, health prevention, social integration, Latin American awareness, local development, art and culture, music and recreation, environment and safety. The following communities have benefited from them:

Rosario and its influence areas: The Company fostered several plans for community development in this area, together with Puerto General San Martín and San Lorenzo Refinery. It initially contributed to the refurbishment of Campo de la Gloria, the historical location where the San Lorenzo battle was waged. On the other hand, the Company joined Asociación Civil Responde to carry out a project that seeks to recover populations on a path to extinction, promoting their economic, social and cultural development, boosting their entrepreneurial capacity to prevent uprooting, and revaluing the collective identity of its residents. This project started out with populations residing in Rafael Morante and Godoy Cruz.

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Neuquén and its influence areas: through the Oil and Gas Exploration and Production business unit, the Company worked on activities developed with Crear-te and in a CSR colloquium organized in Bariloche with Fundación Arelauquen. In addition, they also developed the educational project entitled "Dinosaurs go to school" for kindergartens located in Rincón de los Sauces.

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Cañuelas: in this case, the Company worked jointly with the thermal and hydroelectrical stations Genelba and Pichi Picún Leufú for the donation of equipment to Piedra del Águila Hospital.

Sponsorships and public welfare campaigns

In reply to specific requests and needs, Petrobras Energía supported cultural, scientific and social institutions sharing similar goals in the organization of social interest events and activities.

Among other actions, the Company contributed funds to Grupo Promotor de Empresas en Contra del Trabajo Infantil (Business Group Against Child Labor) and to the campaign organized by MACMA for the purchase of a portable mammograph. It also participated in fund raising campaigns for ALPI, Fundación Cimientos, Fundación Cruzada Patagónica, Fundación San Jorge, Asociación Nordelta, Colegio Las Lomas Oral, Cedemil, Hogar María del Rosario de San Nicolás, Fleni and Adana, among others.

Corporate Social Responsibility Training

The Company is aware of the fact that Corporate Social Responsibility, both worldwide and in Argentina, is a relatively new management concept. This situation has led the company to share the concept with its internal public in order to achieve a multiplying effect.

To this end, the Company organized conferences with specialists on the matter and participated in the II Corporate Social Responsibility Congress organized by *Fundación del Tucumán*. In addition, it summoned several assistants to participate in the Corporate Social Responsibility and Responsible Business Practice program of Instituto de *Estudios para la Sustentabilidad Corporativa* (Institute for Studies on Corporate Sustainability).

QUALITY, SAFETY, ENVIRONMENT AND HEALTH

Petrobras Energía is a socially and environmentally responsible corporation in continued search for excellence in management. This commitment lies in the core of its corporate identity and is part of its corporate mission. Petrobras Energía believes that caring for the environment in which it operates and for the safety and health of individuals is an essential condition for the activities it develops. Along these lines, its Strategic and Business Plans include goals involving excellence in management and performance in Quality, Safety, Environment and Health (QSEH).

Within the scope of this philosophy, in April 2004 Petrobras Energía launched its new QSEH policies, each of which implies evolution as regards the principles currently in force. The new Quality Policy provides a more comprehensive, executable and applicable approach. The new Safety, Environment and Health (SEH) Policy, on the other hand, incorporates state-of-the-art concepts: ecoefficiency, life cycle, continuous improvement and leadership, among others. This is implemented through the use of fifteen guidelines for practical and customary action aiming at behavior-based responsible development.

Parallel to the implementation of these changes, Petrobras Energía maintained the guarantee granted by international audits and certifications in terms of Environment (ISO 14001), Quality (ISO 9001) and Safety and Occupational Health (OHSAS 18001).

Within this context, the Company concentrated its QSEH efforts on two backbones:

Excellence in management

In order to achieve high standards of excellence in management, Petrobras Energía implemented a cycle of evaluations aimed at measuring the global quality of corporate performance. This cycle was started at Vector Units Genelba, Innova, E&P-Venezuela and E&P-Argentina and involved participation of over one thousand employees in evaluator training courses, sensitization lectures, training courses and management report writing courses.

The standards used for evaluation were the excellence criteria for the Brazilian National Award to Quality and the conformity criteria for the Petrobras System.

Presently, and due to the results of these measurements, each Vector Unit is developing its respective Plan for Management Improvement.

New policy and guidelines, new management tools Process Safety Program

To guarantee the effective implementation of the new SEH policy and guidelines, the Company has 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 assets and centralized functions and included interviews with over 300 leaders, Company employees and contractors.

During a second stage, PSP sought to review business unit action plans, assets and centralized functions through the progress and enhancement of several projects.

A brief overview of each project is described below:

Safety

Prevention Systems

To minimize the occurrence of operation-related casualties and contingencies, Petrobras Energía developed the following preventive measures:

- * technical audits in 280 facilities to evaluate their reliability and integrity,
- * over 3000 behavioral audits with their respective deviation analyses,
- * corrective actions to address the deviations detected in both technical and behavioral audits,
- * training of 70 professionals involved in the risk engineering business,
- * enhancement of operational standards and training in electrical risk, work permits, area classification, load movement and high-altitude work,
- * implementation of a learning process based on the analysis of individual accidents and accidents occurred within the entire Petrobras System.

In addition, Petrobras Energía expanded SEH management to its contractors by implementing the following actions:

- * meetings with directors of contractor companies to specify the Company's standards in terms of SEH, inform them about the new consequence system and establish agreements regarding performance,
- * review of all contracts, focusing on the update of and compliance with SEH requirements,
- * over fifty thousand man-hours of training in SEH issues.

One of the areas where Petrobras Energía identified great opportunities for improvement was road safety management. To minimize and control the risks involved in this operation, the Company designed and implemented the 2004 Road Safety Plan, one of the main prevention tools in terms of resource mobilization.

Contingency Systems

Petrobras Energía is aware of the accident and eventual damage risk involved in its activities and the conditions of the developing countries where it operates. Therefore, it believes that it is essential for a socially responsible company to have adequate contingency plans.

With this in mind and according to the new SEH guidelines, in 2004 Petrobras Energía successfully completed strong improvements in contingency systems. Thus, a series of contracts for response upon nautical and land emergencies, supplemented by mutual assistance agreements for major emergencies with Petroleos Brasileños SA, are pending execution.

At present, the Company has thirteen emergency response bases distributed in different strategic locations of the country (five nautical bases and eight land bases). All of them are well equipped and have the necessary personnel for efficient action in the event of an emergency.

- Information technology for a fast and efficient response

Petrobras Energía understands it is imperative to make the right decisions fast in order 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.

The Company has developed a support system for contingencies named Geodatabase, which includes all relevant facilities and the information available at each operating unit. Geodatabase provides detailed geographical information and also interrelates spatial references with a powerful data base. In this manner, each spatial reference is accompanied by additional information: satellite images, plans, digital photographs, process sketches and other documents. In addition, the data base is supplemented with information on resources, either human or material, available in over two thousand population centers.

Another technological tool used by the Company to solve contingencies is INFOPAE, created to specifically respond to each scenario where an accident occurs, providing key information for the initial decision-making process and the guidance of response groups prior to (through emergency simulation), during (on-time assistance to response personnel) and after (during the preparation of reports and the evaluation of actions taken) the accident.

- Ongoing evaluations

Petrobras Energía evaluates its contingency programs on an ongoing basis. In 2004, the Company organized accident prevention drills and trained operating center squad members as well as over 200 individuals from the communities, environmental agencies and fire departments. These training programs included the fight against pollution to reduce the presence of hydrocarbons in water, hazardous substance handling, duct integrity, fire drills at gas stations and water spillage drills, among others.

One of these training activities developed jointly with municipal public authorities from environmental, civil defense and other interested bodies was the Voluntary Environmental Agent program. As a primary objective, the project sought to make training extensive to the inhabitants of neighboring communities in order to modify their behavior and obtain a rapid response in the event of a major contingency.

Environment

Waste, effluent and emission management

Throughout 2004, Petrobras Energía implemented several actions to minimize the environmental impacts of its operations and reduce associated risks. Among them, the Company implemented waste treatment plans and projects for the improved performance of effluent treatment plants. Specifically, the San Lorenzo Refinery and the Campana Plant implemented projects for improvement in their liquid effluent systems, and the polystyrene plant in Zarate inaugurated a new treating unit.

One of the projects where Petrobras Energía enjoyed continued success throughout the year was the Atmospheric Emission Inventory System (SIEA), launched in July 2003. Its main goal is the development of a tool for the management of atmospheric emissions that will help in the decision-making related to new investments (especially related to energy conservation and ecoefficiency). Secondly, the SIEA has been designed to inform the Company about its atmospheric emissions, existing controls and its participation in the carbon credit markets. To date, the inventory has completed the following stages: source diagnosis, protocol development, emission inventory consolidation and development of the Intranet network system of Petrobras Energía.

In some of the plants, the SIAE also involved a special emission inventory phase. At the San Lorenzo Refinery and the Austral Basin, the survey assisted in the identification of potential new businesses involving energetic efficiency and clean development mechanism (CDM) projects.

Training and environmental awareness actions

Petrobras Energía developed two parallel programs aimed at training in and raising awareness on environmental care. These projects were:

* In-house training program: its mission was reviewing and updating know-how about: Environmental Impact Study, Environmental Technology, Life Cycle and Environmental Management, among others. The total program exceeded sixty thousand hours of training.

* GLOBE Program: this is an international, scientific and educational program that promotes the practical study of science and environmental education, bringing together students, teachers and investigators from the international scientific community. Under the motto "Global Learning and Observations to Benefit the Environment", it intends to increase environmental awareness among individuals worldwide, contribute to the scientific understanding of planet Earth, and help all students improve their achievement in science and math. In Argentina, the GLOBE Program is advocated by the United States Embassy and technically and financially supported by Petrobras Energía in the provinces where the Company operates.

Health

Health Promotion and Protection Program (HPPP)

This program, which prioritizes the quality of life of employees, is developed through health promotion, stress management, physical activity, healthy diet and accident prevention actions.

Actions undertaken during 2004 included over 70 workshops on stress, sedentary life-style, smoking and healthy diet, with 1,400 individuals in attendance. In addition, the Company provided CPR (cardiopulmonary resuscitation) and first-aid training to 1,600 individuals, and more than 90 individuals participated in the smoking reduction plan.

Aimed at encouraging physical activity, the Company opened health promotion centers (gyms and aerobics tracks) in several plants and executed agreements with fifteen private gyms in Buenos Aires. The results: 380 Company employees and 75 family members participated in some type of physical activity at these facilities.

In addition, the Company added the Occupational Oral/Dental Health Plan to the HPPP Program. The first stage of this plan involved the survey of the oral/dental condition of employees in Company-owned and hired professional odontological offices.

ANALYSIS OF CONSOLIDATED RESULTS OF OPERATIONS

Proportional Consolidation and Presentation of Discussion

In accordance with the procedures set forth in Technical Resolutions Nos. 4 and 19 of the Argentine Federation of Professional Councils in Economic Sciences, or FACPCE, we have consolidated line by line on a proportional basis our financial statements with the financial statements of the companies over which we exercise either control or 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 that company's 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.

There are three companies over which we exercise joint control: Citelec, which is engaged in the electricity transmission business in Argentina through its subsidiary, Transener; CIESA, which is principally engaged in the gas transportation business in the south of Argentina through its subsidiary, TGS; and Distrilec, which is engaged in the electricity distribution business in and around the southern part of Buenos Aires through its subsidiary, Edesur.

Despite being a company under our joint control, the Company has not consolidated proportionately the financial statements of Citelec S.A. under the disinvestment commitment of such interest assumed by Petrobras Energia S.A. upon the transfer of 58.62% of the shares of Petrobras Energía Participaciones S.A. to Petróleo Brasileiro S.A.

Petrobras. While we do 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. CIESA and Distrilec are primarily engaged in regulated energy businesses in Argentina, through TGS and Edesur, respectively. These companies have been significantly affected by the economic crisis in Argentina and the Public Emergency Law (See Situation of Investments in Utility Companies). Moreover, we are not committed, and do not expect, to provide financial assistance to either CIESA or Distrilec, and have not received dividends from these companies since 2001. Accordingly, our management analyzes their results separately from our results.

Unless otherwise provided, the discussion below is presented on the basis of our consolidated financial data without proportionally consolidating Citelec, CIESA and 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) and Citelec (which is presented under the equity method of accounting) please refer to our discussion under Analysis of Equity in Earnings of Affiliates .

Introduction

1)

Economic Developments in Argentina

We are an Argentine corporation with 55.2% of our total assets, 60.9% of our net sales, 52.5% of our combined crude oil and gas production and 36% of our proved oil and gas reserves located in Argentina as of December 31, 2004. 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. Specifically, we have been affected and might be affected by inflation, interest rates, the value of the peso against foreign currencies, price controls, regulatory policies, business regulations, tax regulations and in general by the political, social and economic environment in and affecting Argentina.

In 2002, our financial results were negatively impacted by drastic 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 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, the GDP experienced a record decline of 10.9%. Within this context, the peso devalued 238%, the wholesale price index rose 118.2% and the consumer price index increased 41%.

In 2003, the Argentine economy began to recover, with GDP growing 8.7%. This recovery, at first based almost exclusively on import substitution, broadened as the level of consumption and investment increased. Exchange rate and price stability led to a significant recovery in consumer confidence which translated into higher consumption indexes. The domestic demand for energy and gas grew in line with GDP growth. With respect to gas, the increased use of CNG as substitute fuel was also a key factor in its increased demand. Oil production, however, declined 2%, despite crude oil processing having increased by 4%.

In 2004, after a 2% increase in the first semester, the growth pace of the economy accelerated in the third quarter along with the industrial recovery, with a rise of above 8% late in the year and good performance in all GDP components. This growth was most evident in the industry and construction sectors, which experienced two-digit growth rates. The gradual increase in installed production capacity led to new investments.

Notwithstanding this growth, oil production in Argentina continued to fall (-5.5% accumulated as of November), while crude oil processing increased 1.5% during the year, with a decline in oil exportable surplus. Liquid fuel domestic sales had mixed results, with a strong decline in regular gasoline sales, stable performance for high-grade gasoline, high growth for premium gasoline and a moderate increase in diesel oil. Gas production increased 3.6% during the first 11 months of the year. The domestic demand for gas rose about 8%, mainly driven by CNG and power plants, while exports reflected similar growth and gas imports from Bolivia resumed (at approximately 4 million cubic meters per day). Energy supply increased 8.5%, which was in line with GDP growth.

In 2005, the Argentine economy should be able to consolidate its growth so long as the country manages to overcome the remaining effects of the default on its sovereign debt and investments are made to expand production capacity. Nonetheless, the long-term evolution of the Argentine economy remains uncertain. The country still faces significant challenges, including the restructuring of Argentina's sovereign debt and the renegotiation of utility contracts. In light of this uncertain situation, the following discussion may not be indicative of our future results of operations, liquidity or capital resources.

The most important factors arising from Argentina's economic crisis that have affected and may affect our future results of operations are the following:

a) Argentine Peso Devaluation

As of December 31, 2004, the peso's nominal exchange rate was P\$2.98 to US\$1, compared to P\$2.94 and P\$3.38 to US\$1 rates as of December 31, 2003 and 2002.

In 2002, the Argentine peso experienced 238% devaluation against the US dollar. Following this depreciation and the abandonment by the Argentine government of its parity commitment of one peso to one dollar, in 2003 the peso began to recover its value. The balance of trade yielded a strong surplus, which, together with the continuing default in partial foreign debt payments, caused an excess supply of foreign currency. Only numerous currency purchases by the Central Bank, supported by the explicit intention of the Argentine government to maintain a high rate of exchange, prevented greater appreciation of the Argentine peso against the US dollar. In 2004, the balance of trade continued to yield a strong surplus, although this surplus was lower compared to 2003 due to a strong increase in imports. This, together with the continuing default in partial debt payments by the government, once again caused an excess supply of foreign currency. The Central Bank made numerous currency purchases to prevent the appreciation of the peso. In an effort to maintain the rate of exchange at about P\$ 3 to US\$ 1, by the end of the year purchases by the Central Bank achieved record levels of approximately US\$ 100 million per day. In the future, the Central Bank intervention in the exchange market will be subject to compliance with the monetary program guidelines in line with inflation targets.

As a result of the different performance of the exchange rate in 2004 compared to 2003, exchange differences accounted for a P\$ 19 million loss and a P\$ 106 million gain, respectively. Exchange differences arising from liabilities in foreign currency assumed to hedge the net investment in foreign entities are not charged to income but

recorded in the Transitory differences foreign currency translation account where the effect arising from the translation of the financial statements into Argentine pesos is recorded.

Almost all our financial debt and a significant portion of our affiliates' debt are denominated in US dollars. Nonetheless, the strength of our foreign operations with a cash flow primarily denominated in US dollars, along with the price behavior for the main commodities we sell in the domestic market, in addition to the strengths of a trade policy of consolidation and opening of export markets to capitalize on asymmetries between domestic and export prices, provide us with a natural hedge for our US dollar-exposure.

It is impossible to predict if, and to what extent, the value of the peso against the US dollar will further depreciate or appreciate, and the impact these uncertainties will have on the results of the Company.

b) Inflation

In 2002, as a result of the devaluation of the peso and in light of the unstable and uncertain situation prevailing in Argentina throughout 2002, the inflation rate in Argentina exhibited rapid and significant growth, with consumer and wholesale price indices (the IPC and IPIM, respectively) growing at 41% and 118.2%, respectively. Due to the instability context prevailing in 2002, on March 6, 2002 the Professional Council in Economic Sciences of the Autonomous City of Buenos Aires, or CPCECABA, approved Resolution M.D. No. 3/02, that required (1) the reinstatement of the adjustment-for-inflation method of accounting applicable to financial statements for fiscal years or interim periods ending on or after March 31, 2002, inclusive, and (2) the accounting measurements prior to January 1, 2002 to be considered as stated using December 2001 currency values. On July 25, 2002, under Resolution No. 415/02, the CNV reinstated the requirement to submit financial statements in constant currency.

In 2003, inflation decelerated sharply, and the IPC and IPIM indices slightly increased to 3.7% and 2.0%, respectively. The recovery of domestic demand did not lead to further pressure on prices since, in average terms, economic indicators reflected a use of resources below maximum capacity. In March 2003, the Federal Executive Branch, understanding that the performance of macroeconomic variables was in line with a monetary stability context, issued Decree No. 664, which provided that financial statements for fiscal years ended after March 1, 2003 must be stated in nominal currency. As a result, in accordance with Resolution No. 441 issued by the CNV, starting on March 1, 2003, we discontinued inflation accounting and the corresponding restatement of our financial statements. On October 1, 2003, the CPCECABA also discontinued inflation accounting. In the March/September 2003 period, the IPIM evolution recorded a 2.1% deflation. In 2003, we recorded a P\$ 30 million gain for exposure to inflation during the January/February period during which the restatement method was applicable.

In 2004, the IPC index increased 6.1%. The strong recovery of domestic demand caused an acceleration of retail inflation, due to in large part the fluctuations in utility prices. Wholesale inflation in 2004 also showed clear signs of

acceleration driven by the high growth pace. The IPIM recorded a 7.9% increase during the year, with a significant rise in prices for manufactured product, electric power and mineral products, and, to a lesser extent, imported products. Increases in these items are in contrast with the slight rise in the price of the remaining primary products.

In the past, inflation has materially undermined the Argentine economy and the government's ability to stimulate economic growth. Despite the significant recent decline in inflation rates, we cannot be certain that this trend will continue.

c) Investments in Utility Companies:

The new scenario after enactment of the Public Emergency Law deeply changed the economic and financial balance of utility companies. Specifically, the dramatic effect of devaluation, within a context where revenues remained unchanged as a consequence of the pesification of rates, affected the financial position of these companies, as well as their ability to comply with certain provisions and obligations of their loan agreements.

The Public Emergency Law ordered the pesification of utility rates, fixing them at an exchange rate of P\$ 1 = US\$ 1, and the elimination of certain indexation clauses in utility contracts. In addition, the 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: (1) the impact of rates on economic competitiveness and income distribution, (2) the quality of services and capital expenditure programs, if contractually provided for, (3) user interest and accessibility to services, (4) the safety of the systems involved and (5) company profitability.

On February 12, 2002, the Federal Executive Branch issued Decree No. 293/02 under which the Ministry of Economy was empowered to renegotiate utility contracts. In accordance with that decree, the Ministry of Economy should submit a renegotiation proposal to the Federal Executive Branch or otherwise recommend the termination of concession contracts. This proposal or recommendation should be subsequently submitted to the relevant congressional commissions for analysis.

In order to secure the supply of utilities, and in line with the renegotiation process, the Federal Executive Branch authorized an increase in gas and electricity rates under Decree No. 146/03. (This increase amounted to an average of 10% for TGS, 9% for Edesur, and 22% for Transener.) The Argentine National Ombudsman and consumer organizations challenged this increase. On February 25, 2003, a Court of First Instance issued a provisional remedy and suspended the tariff increase.

In July 2003, the Utilities Contract Renegotiation and Analysis Committee, or UNIREN, was created within the scope of the Ministries of Economy and Production and Federal Planning, Public Investment and Services. UNIREN was created in part to assist in the renegotiation process of contracts for public works and services, subscribe

comprehensive or partial agreements and submit regulatory projects concerning temporary price and rate adjustments.

On October 1, 2003, the Argentine Congress enacted a law whereby the term granted to the Federal Executive Branch under the Public Emergency Law to renegotiate contracts with privatized utility companies was extended until December 2004. In addition, under this law, the Federal Executive Branch may fix temporary utility rates until completion of the renegotiation process. Subsequently, Law No. 25.792 further extended the term to renegotiate contracts for public works and services until December 31, 2005.

We currently have a controlling interest in several utility companies (Transener, CIESA, TGS, Distrilec), which have been significantly affected by the Argentine economic crisis and the laws which were subsequently enacted.

Transener: Transener has defaulted on its debt and is attempting to restructure it. In February 2005, Transener and UNIREN signed a Memorandum of Understanding. The Memorandum of Understanding sets forth rules for the renegotiation of Transener's concession contract, including aspects related to rates, investments and quality of service. In accordance with this renegotiation process, we expect a rate increase based on total current compensation, the addition of a reagent charge and the addition to compensation of non-dedicated transformers applied to demand. These modifications would be effective as of April 1, 2005, subject to compliance with several administrative procedures, including the conduct of public hearings and the review and approval by legislative and supervisory bodies and ratification by the Federal Executive Branch.

As of the date of these financial statements, no substantial progress has been made in the renegotiation of contracts nor the recovery of rates corresponding to the rest of the utility companies.

CIESA: CIESA failed to repay the principal amount and the last installment of interest for the issue of corporate notes with a nominal value of US\$220 million at maturity originally April 2002. It also failed to repay cap and collar agreements. CIESA's management is currently negotiating with creditors in order to agree an extension for the performance this payment. CIESA's shareholders, including PEPSA, have not assumed any obligation to financially assist the company.

In order to provide the flexibility required to make progress in the restructuring process of CIESA's financial debt, in April 2004, CIESA's shareholders entered into a Master Agreement, which provides for the following share transfers. In stage one, subject to approval by the Argentine regulatory entity for gas, Enron will transfer CIESA's shares representing 40% of the shares issued by CIESA to either a newly created trust or to an alternative entity, and the Company will transfer its 7.35% interest in TGS Class B common stock to Enron. If CIESA and its creditors reach an agreement with respect to the renegotiation of CIESA's financial debt, in stage two, Enron will transfer the remaining 10% of its shareholding in CIESA to the same newly created trust or to an alternative entity, against the simultaneous transfer of Class B common stock issued by TGS (which represents approximately 4.3% of TGS's capital stock) from CIESA to Enron. Under no circumstances will the Company hold, either directly or indirectly, more than its current 50% shareholding in CIESA or a controlling interest in CIESA. In April 2004, the bankruptcy court with jurisdiction

over Enron's bankruptcy approved the Master Agreement. The agreed upon share transfers have been submitted to the consideration of the Argentine regulatory entity for gas and the Argentine National Commission of Competition Defense (Comisión Nacional de Defensa de la Competencia). As of the date of these financial statements, a decision had yet to be issued.

TGS: TGS failed to comply with certain financial restrictions contemplated in its debt obligations. As a result, in February 2003, TGS started an overall restructuring process involving US\$ 1,027 million of its current financial debt, which accounts for almost all its debt. This process mainly aims at extending short-term maturities, modifying certain financial restrictions contemplated in financial agreements and adjusting interest rate and repayment terms to align the cash flows required to repay the debt with its expected cash flows, without making reductions in principal.

Initially, the restructuring agreement would be implemented through an out-of-court reorganization agreement (Acuerdo Preventivo Extrajudicial, or APE), which is a new structure recently introduced under Argentine law. An APE requires approval by two-thirds of the creditors, to be endorsed by an Argentine Court. Since TGS could not achieve two-thirds approval, on May 14, 2003, it withdrew its restructuring proposal and simultaneously announced the postponement of the payment of interest on its financial debt. On October 1, 2004, TGS made a new restructuring proposal involving US\$ 1,018 million of its financial debt, which ended on November 12, 2004. As of November 12, 2004, the debt tendered in the exchange amounted to US\$ 1,016 million, accounting for almost 99.76% of TGS's financial debt. Creditors who accepted the proposal received a payment in cash equal to 11% of the principal amount and new debt securities amounting to 89% of the remaining principal amount, implemented in two stages with repayment terms of six and nine years, respectively, and annual interest rates ranging between 5.3% and 10%.

The impact of the actions taken by the Argentine government on the financial statements of these companies was recognized according to the assessments and estimates conducted by their respective managements. Actual future results might differ from the assessments and estimates so conducted, and such differences might be significant. In addition, we can predict neither the future development of the rate and concession contract renegotiation processes nor their impact on the results of operations or the financial situation of such companies.

As of December 31, 2004, the value of our investments in CIESA, TGS and Citelec was P\$206 million, P\$151 million and P\$116 million, respectively. As of December 31, 2003, the value of our investments in CIESA, TGS and Citelec was P\$190 million, P\$140 million and P\$158 million, respectively. The book value of such shareholdings was below their recoverable value as of such dates.

d) Taxes on Exports

The Argentine government has levied a series of tax increases on crude oil, its by-products and gas. 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 by-products, which are due to expire in five years. 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 established increases in crude oil export taxes, with additional increases ranging between 3% and 20%, subject to fluctuations in the price per barrel of crude oil in a range between US\$ 32.01 and US\$ 45, with a maximum 45% tax for prices above US\$ 45. Because PEPSA is an integrated energy company, that continues to further integrate its upstream and downstream activities, and also due to the competitive advantages it has realized via its relationship with Petrobras, we have been able to minimize the impact of these recent increases.

During 2004 and 2003, sales volumes of crude oil among our business segments increased 7.2% and 21.6%, respectively, to 34 thousand bbl/d and 31.7 thousand bbl/d, while exports of crude oil in the 2004/2002 period declined approximately 75%. In addition, in 2004 and 2003, 466 thousand cubic meters and 248 thousand cubic meters of refined products were sold to EG3, with the consequent increase in crude oil volumes processed at San Lorenzo refinery to levels significantly higher than those recorded over the last few years, at a profit.

e) Price Stabilization and Supply

In order to decrease inflationary pressures caused by the sharp devaluation of the peso, the Argentine government issued a set of regulations in 2002 aimed at controlling the increase in prices payable by final customers. These along with subsequent regulations have affected the price and supply of gas, hydrocarbons and electricity.

Gas:

Pursuant to the Public Emergency Law, we were precluded from increasing the price of the gas and energy we sold in the domestic market. As a result of this law, we postponed developments and exploration of additional gas reserves. With respect to existing gas and electricity sales agreements entered into with industrial clients, the Company renegotiated the terms and conditions of these agreements in order to adjust them to the new economic scenario and have gradually increased sales prices to reflect the effects of peso devaluation. The Company has also attempted to maximize export opportunities in an effort to capitalize on higher prices offered by foreign markets. As part of these efforts, during the first quarter of 2003, the Company started exporting gas to Chile from the Austral basin, which accounted for approximately 15% of total gas produced in 2004. In order to secure the supply of gas for domestic consumption and thermal generation, during 2004, the Argentine government on several occasions imposed restrictions on gas exports. While these measures had a limited effect on the total volume of exports to Chile, we cannot be certain of their future impacts with respect to gas exports to Chile or other foreign markets.

In February 2004, the Argentine government, through Decree No. 181/04, mandated the creation of a plan to recover natural gas prices. In April 2004, the Company along with the remaining gas producers entered into an agreement with the Argentine government implementing such plan. The agreement initially provides for a schedule of gradual increases in gas prices until July 2005, which is applicable to industrial clients and electric generation clients and which would increase gas wellhead prices to approximately US\$ 1.07/MMBTU and US\$ 0.90/MMBTU in the Neuquén and Austral basins, respectively, representing a price recovery ranging between 100% and 150%. This recovery is applicable to all sales of gas made to generation companies, and applicable on a pro rata basis to

distributors based on each distributor's percentage of sales made to industries. With respect to lower consumption users, such as residential consumers, the plan calls for the Secretariat of Energy to furnish a normalization schedule in order for lower consumption users to be able to pay the final values as determined in the agreement by December 31, 2006. As of December 31, 2004, average prices were US\$ 0.74/MMBTU and US\$ 0.55/MMBTU for PEPSA's generation company clients and distributor clients, respectively. The agreement provides for a guarantee of supply until 2006, under which each producer has committed to make the necessary investments to reach their agreed upon volumes.

Hydrocarbons:

With respect to domestic prices for hydrocarbons, in January 2003, at the request of the Argentine Federal Executive Branch, hydrocarbon producers and refineries entered into a temporary agreement to maintain price stability for crude oil, gasoline and diesel oil in the domestic market. This agreement requires crude oil deliveries to be invoiced and paid based on a WTI reference price of US\$ 28.5 per barrel. Any positive or negative difference between the actual WTI price and the reference price, not exceeding US\$ 36 per barrel, would be paid out of any balances generated in the periods in which the actual WTI price fell below US\$ 28.5 per barrel. Refineries, in turn, reflected the crude oil reference price in domestic market prices, a criterion that was equally applied to determine intercompany transfer prices. After successive renewals, this agreement expired in May 2004. Thereafter, hydrocarbon producers and refineries executed a new agreement effective until June 2004, which provided that, while the WTI per barrel ranged between US\$ 32 and US\$ 42, crude oil deliveries would be invoiced and paid considering a reference price equal to: (1) 86% of the WTI as long as such price did not exceed US\$ 36 per barrel, or (2) 80% of the WTI, in cases when this price exceeded US\$ 36 per barrel. In August 2004, having exceeded the WTI cap of US\$ 42, the Argentine government established a cap on the domestic price of crude oil equal to the international market price net of the taxes imposed on exports (see *Taxes on Exports*). As of October 2004, hydrocarbon producers and refiners now negotiate crude price freely, based on the export parity reference price. These regulations have not had a significant effect on our results, given the strong integration of our upstream and downstream operations in Argentina.

Electricity Generation:

With respect to electricity generation, following 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 the energy sold in the spot market, which as of 2004 equaled approximately P\$ 40/MWh. This price is determined by the cost of thermal generation regardless of the use of liquid fuels. This regulatory change implied a deviation from the marginal cost system, which had been implemented in 1992 and the provisions in Electricity Law No. 24.065.

As a result of the Argentine government's decision to suspend seasonal increases in electricity prices, these prices have failed to reflect total generation costs adequately. This lag led to the gradual depletion of the Stabilization Fund (Fondo de Estabilización), causing an increasing deficit thereof, which in turn prevented Compañía Administradora del Mercado Eléctrico S.A., or CAMMESA, to settle accounts with market agents. To address this situation, the Secretariat of Energy established a new methodology to manage the lack of funds. This consisted in the establishment of an order of cancellation of credits with generation companies. In an effort to restore the Stabilization Fund,

between December 2003 and August 2004, the Argentine government made a P\$ 650 million contribution. According to official data, as of October 2004, energy generation companies recorded financial claims payable by CAMESA amounting to approximately P\$ 780 million. In December 2004, the government authorized the National Treasury to grant an additional P\$ 300 million loan. In addition, seasonal adjustments were reinstated for the February-April and August-October 2004 periods, recognizing the greater costs resulting from the recovery of natural gas prices in the determination of wholesale spot prices. Also in December 2004, the Argentine government approved a new increase of approximately 19% in seasonal prices, which became effective in January of 2005.

In order to adjust the Stabilization Fund deficit, the Secretariat of Energy created FONINVEMEM, through Resolution No. 712/04, to increase the available supply of electric power generation in Argentina and encourage WEM's creditors to participate in investments in electric power generation, thereby seeking to achieve sustainability for the benefit of consumers and investors. FONINVEMEM's funds will be used to build a new thermal generation plant. The plant is estimated to start commercial operations in late 2007. The Secretariat of Energy, through Resolution No. 826/04, has invited WEM's agents to participate and has determined that credit balances resulting from the spread between the sales price of energy and the generation variable cost for agents who choose not to participate in the creation thereof will be paid as of the date in which the works constructed with FONINVEMEM's resources have sufficient funds. The Company has accepted the invitation and will participate with 65% of the credit balances recorded for the 2004-2006 period with respect to this spread. Total credit balances contributed for the 2004 fiscal year amounted to US\$ 5 million in nominal value. The estimated total contribution for the entire 2004-2006 period would amount to US\$ 35 million and accounts for approximately 8% of the fund's capital. The final amount will depend on, among other factors, water conditions, the dispatch of the Company's generation units determined by CAMESA and the resulting prices of energy.

In order to restore the regular operation of WEM as a competitive market that provides sufficient supply, in December 2004, the Secretariat of Energy committed to approve successive seasonal price increases to reach values covering at least total [monomic] costs by November 2006. In addition, it committed to compensate energy with the marginal price obtained in the spot market, and power with the values that were in effect prior to the enactment of the emergency law once the market returns to normal, as from the start of the commercial operation of the additional capacity contributed by FONINVEMEM.

During 2004, for the second consecutive year, the Secretariat of Energy decided to make a call for bids for Fuel Reserve, REDISCOM, aimed at guaranteeing the supply of electricity. Generation companies are paid an additional amount to the market price for electricity in exchange for guaranteed availability. The Company participated in the bid receiving an additional price of \$12/MWh, which generated a total additional income of P\$ 30 million in 2004 and P\$ 17 million in 2003.

f) Recoverability of Assets

In addition to the information provided above relating to Utilities, the Argentine peso devaluation, the enactment of the Public Emergency Law and subsequent legislation resulted in a substantial change in the assessment of recoverability of certain businesses and assets, and we adjusted the book value of certain investments and assets to the respective recoverable value. The following is a description of some of these adjustments:

- *Gas areas in Argentina:* Due to (1) the strong deterioration of the domestic price of gas in real terms, (2) the limited possibilities of negotiating price increases within the context of the Public Emergency Law and (3) the decline in gas reserve volumes as a result of reduced expenditures, the Company recorded impairment charges in 2003 in the amount of P\$ 37 million.

- *Argentine government bonds:* Following the default by Argentina on its sovereign debt, the Argentine government did not allow to apply the nominal value of Patriotic bonds toward the payment of our Argentine federal tax liabilities until a debt exchange was concluded and, therefore, as of December 31, 2002, the Company created a provision for the decrease in value of our investment in these government bonds in the amount of P\$ 30 million. As of December 31, 2004, this provision amounted to P\$ 23 million. The Company has since decided to participate in the debt exchange launched by the Argentine government with its residual portfolio having a nominal value of US\$ 10.8 million.

- *Tax loss carry forwards:* As of December 31, 2003, Petrobras Energía recorded a P\$ 1,189 million charge corresponding to the allowance for tax loss carry forwards. Despite a partial recovery in economic activity, the future course of the economy as of December 31, 2003 was still uncertain, and considering the recent actions taken by the Argentine government, the recoverability of such tax loss carry forwards remained uncertain as of December 31, 2003.

As of December 31, 2004, Petrobras Energía partially reversed this allowance and recorded a P\$ 268 million gain. This reversal was due to, among other factors, expectations of high and sustained prices for commodities, the relative stability of the main macroeconomic variables in Argentina, including positive developments with respect to the recovery of energy and gas prices, and expected synergies resulting from the merger with EG3, Petrobras Argentina and Petrolera Santa Fe (See Corporate Reorganization). As of December 31, 2004, the Company recorded a charge of P\$ 855 million corresponding to the allowance for tax loss carry forwards. In the future, the Company's management will continue to evaluate the reversal of allowances as the Business Plan assumptions are validated, mainly in connection with the positive changes in macroeconomic variables, the recovery of the Argentine economy and the progress attained in the resolution of key issues, including the restructuring of Argentina's sovereign debt and the renegotiation of utility contracts. The above tax loss carry forwards can be used until the fiscal year ending December 31, 2007.

- *Minimum presumed income tax credit:* After taking into consideration the uncertainty with respect to our ability to use amounts paid under alternative minimum tax rules for the reduction of our future income taxes, which will occur after absorption of tax losses that are not barred by the statute of limitations, the Company recorded a P\$ 72 million charge as of December 31, 2004 that corresponded to the allowance for the amounts paid as minimum taxes from 1998 to 2002.

2) Political and Economic Situation in Venezuela

Operations in Venezuela are an important component of the Company's business. In 2004, Venezuela's oil and gas sales volumes accounted for 31.6% of the Company's total volumes of barrels of oil equivalent and as of December 31, 2004, a significant percentage of the Company's total combined proved reserves were located in Venezuela. The Company's operations, therefore, are affected by the political and economic events in Venezuela.

Throughout 2003, Venezuela faced one of its worst political and economic crises in the last 40 years. The country fell into severe economic recession that resulted in significant increases in inflation, unemployment and violence rates. On December 2, 2002, a nationwide strike was organized, which involved the country's main production areas, including PDVSA. This situation affected the operations of the three fields located in the east of the country (Oritupano-Leona, Mata and Acema), significantly reducing their production. Throughout the first quarter of 2003, oil production average volume dropped by 40.2% to 30.4 thousand barrels per day compared to the same quarter of 2002. After the conclusion of the nationwide strike, the situation gradually reversed.

The year 2004 was marked by economic recovery, triggered by high prices of hydrocarbons in the international market and recovery of the national oil production, as well as changes within the political environment after a referendum and regional elections, which provided more political stability to the country. Venezuela's economy recorded growth of approximately 17% in 2004, and the country's activity level returned to levels similar to those existing prior to the crisis. Both the oil and non-oil sectors recorded a growth approximately 14% and 18%, respectively.

The economy's growth was leveraged by the expansion of the governmental social programs (supported, in turn, by oil tax revenues), currency allocation flexibilization, price control and lower, more stable interest rates. Moreover, it is highly important to consider the statistical contrast of a comparison made between a relatively stable economic year, as it was the case of 2004, and 2003, when the country was immersed in one of the worst political and economic crisis in the last 40 years.

The official exchange rate was devalued by 20% in February and remained unchanged throughout the rest of the year, thus reducing the gap with the parallel exchange rate. Inflation experienced an important deceleration vis-à-vis previous years, although still remained at levels of around 20%.

The high prices of hydrocarbons and the economic stability experienced in Venezuela throughout 2004 allowed the Company to carry out its operations smoothly. The positive expectations for year 2005 allow us to think that the Company will consolidate its position in the country, and thus meet the objectives set forth in the business plan.

Due to the fact that oil production in Venezuela is strictly controlled by the government through PDVSA, the Company's operations in this country are conditioned to the outcome of the economic, social and political developments. Additionally, as Venezuela is a member of the OPEC, the Company is subject to the production cut decisions that such organization may adopt. Venezuela's government might pass new legislation to modify the terms and conditions of the operating agreements entered into with the Company, which might have a negative impact on the Company's operations. Such amendments might include the payment of greater royalties, production cuts or a reduction in forecast investment.

The Company provided P\$15 million and P\$27 million allowances on the book value of the loans granted to joint venture partners in 2004 and 2003, respectively. As of December 31, 2004, the total allowance amounts to US\$35 million. By means of such loan agreements, the Company often provides its joint venture partners with the cash required to comply with their obligations related to the joint venture's cash flow. The allowance was recorded to adjust loan quality to probable recoverable value, taking into account that such loans are secured by a pledge as fiduciary bond.

3) Capital Expenditures

In 2004, with support provided by the recovery of operating cash flow and liquidity at target levels, capital expenditures increased P\$216 million to P\$1,098 million. This behavior, in addition to the P\$368 million increase to P\$882 million during 2003, evidences the new dynamics of the investment plan and its expected recovery following the significant decline resulting from the Argentine crisis. In the past, significant investments laid the foundation for the expansion and growth of the Company's operations.

In line with the Company's long-term strategy to grow as an integrated energy company in Latin America, capital expenditures outside of Argentina accounted for about 55% of total investments in 2004.

The level of investments is estimated to gradually increase in the future, with priority awarded to those projects with secure the fastest return on investments. The Company's focus will be kept on growth, while maintaining a financially solvent platform.

4) Divestment of Assets

In January 2005, the Company entered into a sale and association agreement with Teikoku Oil Co., Ltd., (Teikoku) whereby the Company transferred 40% of its interest in Blocks 18 and 31 located in Ecuador (see Operations in Ecuador). The Company expect that this agreement will help expedite the development of assets in Ecuador, consolidating operations in such country as a relevant component of the Company s business portfolio.

During 2003, the Company sold its interest in the Catriel Oeste and Faro Vírgenes areas. These assets had low production levels, no significant potential and high operating costs.

In June 2003, the Company sold its 50% interest in the Faro Vírgenes area concession, accounting for a P\$11 million loss.

In August 2003, the Company sold its 85% interest in the Catriel Oeste area concession. Considering the transfer price (US\$ 7 million), we recorded a P\$28 million loss.

5) Commodities Prices

The Company s results of operations and cash flow are exposed to risks related to the volatility of international prices, mainly crude oil and by-product prices. The strong positioning of foreign operations, in addition to the implementation of a trade policy of opening and consolidation of export markets, contribute to the above mentioned sensibility to fluctuations in the peso-denominated prices of commodities. Within this context, the Company permanently evaluates the possibility to use hedging derivative instruments to mitigate risks related to such exposure. (See Management of Crude Oil Price Risk).

In 2004, crude oil hit record prices. The WTI closed at 43.5 US\$ per barrel, with an average of 41.5 US\$ per barrel during the year (32.5 US\$ per barrel and 31 US\$ per barrel, respectively, in 2003). High prices were sustained by both demand and supply factors. Acceleration in world growth, the tension in the Middle East and low inventory levels in

the United States, among other factors, led to an escalation of price increases, which does not show signs of a rapid decline. In 2004, the Company's average sales prices for crude oil, gasoline, diesel oil, styrene and polystyrene grew 19.4%, 12%, 18%, 41% and 31%. In 2003, average prices for crude oil, gasoline, diesel oil and polystyrene rose 4.8%, 16.5%, 7.3% and 2%, respectively, with styrene exhibiting a 9% decline.

6) Commodity Prices and Management of Crude Oil Price Risk

In line with the business integration strategy, our risk management policy focuses on measuring our net risk exposure and monitoring the risks that affect our overall portfolio of assets.

This approach allows for an efficient growth in the vertical integration of businesses, while balancing market risks in the business value chain. This provides the Company with an advanced knowledge of the uncertainty sources affecting the business and enables us to better allocate capital in order to optimize the long-term return/risk ratio, helping to sustain capital expenditures plans and securing certain levels of profitability and cash generation.

The Company uses hedging derivative instruments, such as futures, swaps, options and other instruments, to mitigate risks related to results and cash flow volatility as a result of fluctuations in the price of crude oil.

On January 1, 2003, Technical Resolutions Nos. 16, 17, 18, 19 and 20 of the FACPCE became effective and introduced material changes in the guidelines regarding the recognition, measurement and disclosure of derivatives and hedging transactions. These new regulations, whose principles are consistent with the international accounting standards issued by the International Accounting Standards Committee, or IASC, provide that derivative financial instruments are recorded at their fair value, and as to the balancing item, allow, on a very restrictive basis, for the implementation of hedge accounting under which changes in the accounting measurement of such derivatives are recognized under *Transitory differences* Measurement of derivative financial instruments designated as effective hedge and subsequently reclassified to income (loss) for the year or years in which the hedged item affects such results. If the financial derivative instrument is not designated as an effective hedge, changes in the accounting measurement of such derivatives are recognized in the income statement under *Financial Income (Expense) and Holding Gains (losses)*.

Notwithstanding the objectives behind the relevant derivative contract, under the new regulations some of the Company's derivative instruments do not qualify for hedge accounting. Therefore, and in connection with instruments not designated as efficient hedge, a significant asymmetry is shown between recognition of gain or losses for the instruments and gains or losses for the items originally hedged. As of December 31, 2004 and 2003, the Company's derivative portfolio consisted solely of instruments that did not qualify for hedge accounting.

In view of the high crude oil prices recorded during 2004 and 2003, the Company recognized: (i) for instruments that qualify for hedge accounting, reduced sales in the amount of P\$81 million in 2003, and (ii) for instruments that do not qualify for hedge accounting, financial losses of P\$687 million in 2004 and P\$294 million in 2003.

As of December 31, 2004, crude oil price hedging instruments that do not qualify for hedge accounting account for a P\$507 million liability, whose effect on results will be offset at the time of the sale of hedged production at market prices. As of December 31, 2004, for 2005 the Company has swaps in place for 20 thousand bbl/d, at an average settlement price of 19 U\$/bbl.

7) Operations in Ecuador

The Company operates two fields in Ecuador - Block 18 and Block 31. As of December 31, 2004 the Company had a 70% and 100% interest, respectively, in these fields. In addition, the Company had an 11.42% interest in Oleoductos de Crudos Pesados Ltd. (OCP), a company set up, in part, for the purpose of transporting oil from those fields.

Block 18 has a significant potential of light crude oil reserves, from 28° to 33° API. Block 18 concession was granted for an initial period of 20 years, as from October 2002, renewable for another 5-year period.

Block 31 is an exploratory area with a significant reserve potential. As a result of successful exploratory works, significant volumes of heavy crude oil reserves were discovered.

In 2000, as a result of the successful drilling of two exploratory wells, heavy crude oil reserves were discovered. The significant volume of reserves would have allowed to complete the wells and turn them into producing wells as long as significant infrastructure investments were made to construct oil pipelines and facilities related thereto. Accordingly, in 2001, OCP began to build an oil pipeline to transport production, and the oil pipeline started operations in late 2003. The reductions made to our investment plan as a consequence of the Argentine crisis in 2002 delayed the development of Block 31. In 2003, two additional wells were drilled, which confirmed the potential of this area. Because as of December 31, 2003 drilling of new exploratory wells was not planned for the near future and

as of such date no reserves had been proved in Block 31, in accordance with SFAS 19, the Company (1) charged to income P\$ 106 million of previously capitalized exploratory costs in connection with the drilling of the first two wells and (2) capitalized exploratory costs for wells where less than one year had elapsed since the completion of drilling. During 2004, we charged to income P\$ 80 million of these exploratory costs, as one year elapsed from completion of drilling.

In March 2004, with the approval by the Ecuadorian Ministry of Energy of the Environmental Impact Studies in connection with the Apaika and Nenke fields, all requirements necessary for the approval of the block development plan were met. Following this approval, a 20-year production period started. As of December 31, 2004, the Company has certified crude oil reserves in connection with Block 31.

OCP was awarded 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. The oil pipeline has a 450,000 bbl/d transportation capacity and started commercial operations on November 10, 2003. In May 2004 the Company increased its interest in OCP by 2.46%, upon exercise by Techint Internacional Construction Corp. of an option to sell its shares and subordinated debt, with a US\$ 14 million payment in such respect.

With respect to the exploitation of Blocks 18 and 31, the Company has executed an agreement with OCP, whereby an oil transportation capacity of 80,000 barrels per day is secured for a 15-year term, starting on November 10, 2003. Under the Ship or Pay transportation agreement, the Company must fulfill the Ship or Pay contractual obligations for the aggregate oil volume committed, even if no crude oil is transported, and pay, as well as all other producers, a fee covering OCP operating costs and financial services. As of December 31, 2004, this fee amounted to US\$ 2.2 per barrel. Costs in connection with the transportation capacity are invoiced by OCP and charged to expenses on a monthly basis. The Company has sold part of our allotted transportation capacity, which is an average of 8,000 barrels per day, for the period starting in July 2004 until the termination of our agreement with OCP.

Despite having sold a portion of the commitment, the Company estimates that during the term of the contract with OCP, oil production will be lower than the transportation capacity committed, creating what we refer to as an oil production deficit. The Company's estimate is based on expected delays in connection with the development of Block 31, the revised estimated potential for Block 31 and the new schedule of investments required for the development of Blocks 18 and 31. In light of the significant economic effects of this oil production deficit, as of December 31, 2004 we recorded a P\$ 324 million impairment allowance in connection with our group of assets in Ecuador. In 2003, we recorded a similar loss of P\$ 309 million.

Sale and association agreement with Teikoku Oil Co Ltd.

In January 2005, the Company subscribed to a sale and association agreement with Teikoku Oil Co., Ltd., (Teikoku) whereby it transferred its 40% interest in Blocks 18 and 31 located in Ecuador, as well as 40% of its rights and obligations in the crude oil transportation agreement entered into, with OCP.

Teikoku, in turn, will make a US\$ 5 million payment and a US\$ 10 million subsequent payment upon performance of certain infrastructure works necessary for the development of Block 31, which will be carried out jointly by Teikoku and the Company. No significant results were recorded in connection with this transaction.

In addition, the agreement involves the following key aspects:

1. Teikoku will make investments in Block 31 in excess of its interest in the joint venture, causing an accelerated development of the block.
2. Teikoku will assume 40% of the Company's rights and obligations resulting from the crude oil transportation agreement entered into with OCP, once production in Block 31 reaches an average of 10,000 barrels of oil per day for a period of 30 consecutive days. Allocation of the transportation capacity to Teikoku will enable the Company to minimize the effect of the oil production deficit previously recorded.
3. As a result of this agreement, 40% of the letters of credit the Company has in place to secure compliance with the commitments assumed in connection with the transportation agreement with OCP shall be released. The financial burden, therefore, will be reduced and credit will be available to the Company.

Upon execution of this agreement, which is subject to approval by the Ministry of Energy of Ecuador, Petrobras Energía S.A. through its controlled companies in Ecuador, will hold a 60% interest in Block 31 and a 30% interest in Block 18. Petrobras Energía S.A. will continue acting as operator for both blocks.

8) Operations in Peru

In 2004, the Company, through Petrobras Energía Perú S.A., entered into an agreement with the Peruvian government, whereby it undertakes to make investments of about US\$ 97 million in Lote X during the 2004-2011 period. The Peruvian government, in turn, will reduce the royalties percentage it receives for hydrocarbon production. Efforts involved in this agreement include drilling of 51 wells, workover of 526 wells, reactivation of 177 temporarily abandoned wells, and the implementation and expansion of a water injection project.

In light of the significance of this agreement, economic projections in connection with operations in Peru have changed. As a result, in 2004 a P\$31 million partial recovery for tax loss carry forwards for which allowances were provided was recorded. In addition, proved reserves were added, since the new royalties regime allowed for the incorporation of development projects that became profitable.

9) Tax Benefit regarding Innova Operations - FUNDOPEM

The Company, through Innova's operations in Brazil, enjoys a tax benefit, pursuant to an incentive program granted by the Rio Grande do Sul State, Brazil, for companies located in that state. The benefit consists of a 60% reduction of the ICMS (interstate goods transport tax), for a term of 8 years, until December 31, 2007. The results arising from such benefit will be recorded when relevant. As of the fiscal year ended December 31, 2004, ICMS tax amounts were payable due to differences between debits and credits, and the benefit should be acknowledged. In 2004, the Company, therefore, recognized a P\$ 27 million gain.

10) Environmental Matters

In 2003 we retained an international consulting company to conduct an environmental audit of our operations. The final audit report set forth an action plan to enforce our Safety, Environmental and Occupational Health Policy. To execute this action plan, the Company will make investments of approximately US\$23 million to improve, among other things, our prevention systems and production facilities. In addition, we will implement several corrective and remediation actions, for which a P\$45 million loss was recorded in fiscal year ended December 31, 2003. In 2003 we also recorded expenses of P\$58 million for environmental remediation.

In April of 2004, Petrobras Energía launched new Quality and Safety, Environmental and Occupational Health policies, each of which represents a change from those principles previously in force. The new Safety, Environmental and Occupational Health policies incorporate cutting-edge concepts, such as ecoefficiency, life cycle and sustainability of the operations.

Pursuant to the objectives of this policy, an environmental study was produced for the fiscal year ended December 31, 2004, as a supplement to the audit performed in 2003. Under the standards of the new Safety, Environmental and Occupational Health policies, the study enabled the Company to identify the need to apply remediation measures, in relation to which the Company recorded a loss amounting to P\$33 million. In 2004, we accounted for expenses of P\$51 million for environmental remediation activities.

11) Agreements in San Carlos and Tinaco, Venezuela

The Company began exploration activities in the San Carlos Block in 1996. Total expenditures required for initial exploration in the block totaled US\$ 32 million, mainly including acquisition of 2-D seismic data and drilling of two exploratory wells. The Block was awarded to the Company as an oil exploration block, but its exploration activities in this block yielded gas findings. In June 2001, upon the opening of free gas exploration areas, the Company was awarded a license for the exploration of non-associated gas in the Tinaco Block, a field adjacent to the San Carlos Block, which enables the Company to confirm gas reserves related to the San Carlos Block.

In October of 2002, we subscribed to an association agreement with Teikoku under which we transferred 50% of our rights and obligations in non-associated gas production in the San Carlos and Tinaco Blocks. As a result of this transaction, the Company recorded a P\$37 million loss. In view of the future joint exploitation of both blocks, the Company negotiated the replacement of the terms of the San Carlos agreement with terms similar to the Tinaco agreement.

The political and economic crisis that broke out in Venezuela late in 2002 mainly caused the delay of exploratory works in the San Carlos and Tinaco areas. Since as of December 31, 2003, the Company did not anticipate drilling of an additional exploratory well to confirm additional reserves that justify performance of infrastructure works for field development, such as gas pipelines and treatment facilities, the Company charged to income P\$29 million attributable to the remaining capitalized investment in the San Carlos Block.

Analysis of Consolidated Results of Operations

The table below shows the Company's results of operations for the fiscal years ended December 31, 2004 and 2003 under professional accounting standards and, for comparative purposes, the pro forma results, which excludes the effects of proportional consolidation of affiliates under joint control.

(in millions of pesos)

Net income: Net income increased P\$297 million, or 78%, to P\$678 million in 2004 from P\$381 million in 2003. Operations for the year were positively impacted by the increase in international crude oil prices, which the Company was generally able to pass through to prices for the main refined and petrochemical products. Within this context, operating income increased significantly, partially offset by losses derived from derivative instruments valued at fair value that do not qualify for hedge accounting. In addition, the reversal of the allowance recorded in prior years for tax loss carry forwards had a significant favorable impact on the results for the year.

Net sales: Net sales increased P\$1,480 million, or 26.9%, to P\$6,974 million in 2004 from P\$5,494 million in 2003. Sales for 2004 reflect gains of 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. Net sales for 2003 reflect gains of P\$446 million and P\$447 million, attributable to the share of the net sales (net of intercompany sales of P\$14 million) of CIESA and Distrilec, respectively.

Without proportional consolidation, net sales increased P\$1,352 million, or 29.3%, to P\$5,967 million in 2004 from P\$4,615 million in 2003. The significant increase in the WTI and the related price increases for the main petrochemical and refined products and, to a lesser extent, growth in sales volumes resulted in sales increases in the

Oil and Gas Exploration and Production, Petrochemicals and Refining business segments, equal to P\$630 million, P\$583 million and P\$443 million, respectively (including intercompany sales). Electricity business segment also experienced sales increases (P\$46 million in 2004), predominantly due to improved generation prices. As the business operations continue to integrate, intercompany sales increased to P\$1,680 million in 2004 from P\$1,029 million in 2003.

Gross profit: Gross profit increased P\$656 million, or 31.1%, to P\$2,764 million in 2004 from P\$2,108 million in 2003. This increase reflects gains of P\$250 million and P\$86 million, attributable to the share of the gross profit of CIESA and Distrilec, respectively, and P\$3 million in eliminations. Gross profit for 2003 reflects gains of P\$236 million and P\$74 million, attributable to the share of the gross profit of CIESA and Distrilec, respectively.

Without proportional consolidation, gross profit for 2004 grew P\$627 million, or 34.9%, to P\$2,425 million from P\$1,798 million in 2003. Generally in line with the increase in sales, gross profit for the Oil and Gas Exploration and Production, Petrochemicals and Refining business segments increased P\$484 million, P\$62 million and P\$59 million, respectively. Gross profit for the Electricity and Hydrocarbon Marketing and Transportation business segments rose P\$17 million and P\$16 million, respectively.

Administrative and selling expenses: Administrative and selling expenses increased P\$81 million, or 14.4%, to P\$640 million in 2004 from P\$559 million in 2003. The expenses for 2004 reflect P\$16 million and P\$66 million, attributable to the share of the administrative and selling expenses of CIESA and Distrilec, respectively. The expenses for 2003 reflect P\$30 million and P\$65 million, attributable to the share of the administrative and selling expenses of CIESA and Distrilec, respectively.

Without proportional consolidation, administrative and selling expenses increased P\$94 million, or 20.2%, to P\$558 million in 2004 from P\$464 million in 2003. This increase is primarily due to the increased scale of the operations in Ecuador, higher sales volumes and increased institutional advertising expenses.

Exploration expenses: Exploration expenses decreased P\$107 million to P\$89 million in 2004 from P\$196 million in 2003 (see Analysis of Operating Income Oil and Gas Exploration and Production).

Other operating income (expense), net: Other operating income (expense), net accounted for P\$304 million in losses in 2004 compared to P\$121 million in losses in 2003. Other operating income (expense), net for 2004 reflects losses of P\$19 million and P\$17 million, attributable to the share of CIESA and Distrilec, respectively (net of intercompany sales of P\$3 million). Other operating income (expense), net for 2003 reflects losses of P\$12 million and P\$5 million, attributable to the share of other operating income (expense), net of CIESA and Distrilec, respectively.

Without proportional consolidation, other operating income (expense), net accounted for losses of P\$265 million for 2004 and P\$104 million for 2003. This increase in losses is mainly attributable to expenses for unused transportation capacity in connection with the Ship or Pay contract with OCP in the amount of P\$184 million.

Operating income: Operating income grew P\$499 million, or 40.5%, to P\$1,731 million in 2004 from P\$1,232 million in 2003. Operating income for 2004 reflects P\$215 million and P\$3 million, attributable to the share of operating income of CIESA and Distrilec, respectively. Operating income for 2003 reflects P\$194 million and P\$4 million, attributable to the share of operating income of CIESA and Distrilec, respectively.

Without proportional consolidation, operating income increased P\$479 million, or 46.3%, to P\$1,513 million in 2004 from P\$1,034 million in 2003. For an explanation of why this income increased see *Analysis of Operating Income* .

Equity in earnings of affiliates: Equity in earnings of affiliates decreased P\$87 million, or 53.4%, to P\$76 million in 2004 from P\$163 million in 2003. Without proportional consolidation, equity in earnings of affiliates decreased P\$292 million, or 78.7%, to P\$79 million in 2004 from P\$371 million in 2003. See *Analysis of Equity in Earnings of Affiliates* .

Financial income (expense) and holding gains (losses): Financial income (expense) and holding gains (losses) increased P\$844 million, or 202%, to P\$1,261 million in 2004 from P\$417 million in 2003. Financial expense and holding losses for 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. Financial expense and holding losses for 2003 reflects financial income in the amount of P\$123 million and P\$28 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\$1,097 million in 2004 and P\$568 million in 2003. The increase in 2004 is principally attributable to the following:

* An increase in losses resulting from the valuation at fair value of derivative instruments that do not qualify for hedge accounting, to P\$687 in 2004 from P\$294 million in 2003. This increase reflects principally a 53.9% increase in the futures curve of crude oil prices during 2004, as compared to a 1.8% increase in 2003.

* The impact of the evolution of the exchange rate between the peso and U.S. dollar (1.3% and 11.8% appreciation in 2004 and 2003 respectively) and the inflation rate on the Company's net borrowing position, which together resulted in a P\$19 million loss in 2004 compared to a P\$136 million gain in 2003; and

* a decrease in interest expense in the amount of P\$420 million in 2004, or 1.6%, from P\$427 million in 2003, reflecting the decline in dollar-denominated average indebtedness.

Other expenses, net: Other expenses, net equaled losses of P\$27 million in 2004 and P\$421 million in 2003. In 2004, other expenses, net reflect a P\$14 million loss, attributable to the share of the other expenses, net of CIESA and a gain of P\$18 million, attributable to the share of the other expenses, net of Distrilec. In 2003, other expenses, net reflect losses of P\$1 million and P\$12 million, attributable to the share of the other expenses, net of CIESA and Distrilec, respectively.

Without proportional consolidation, other expenses, net accounted for losses of P\$31 million in 2004 and P\$408 million in 2003.

The other expenses, net for 2004 primarily reflect the following:

- * P\$12 million impairment charge for the Acema area, in Venezuela; and
- * P\$15 million allowance on the book value of the loans granted to joint venture partners in Venezuela (see Political and Economic Situation in Venezuela).

The other expenses, net for 2003 primarily reflect the following:

- * P\$309 million impairment charge for the operations in Ecuador (see Operations in Ecuador);
- * P\$39 million loss attributable to the sale of oil and gas areas (see Divestment of Assets);
- * P\$37 million impairment charge for oil production areas (see Recoverability of Assets); and
- * P\$27 million allowance for the book value of the loans granted to joint venture partners in Venezuela (see Political and Economic Situation in Venezuela).

Income Tax: Income tax accounted for a gain of P\$198 million in 2004 compared to a loss of P\$18 million in 2003. Income tax in 2004 reflects losses of P\$6 million and P\$20 million, attributable to the share of the income tax of CIESA and Distrilec, respectively. The income tax charge for 2003 reflects a gain of P\$58 million, attributable to the share of the income tax of CIESA, and a P\$29 million loss, attributable to the share of the income tax of Distrilec.

Without proportional consolidation, income tax accounted for a gain of P\$224 million in 2004 compared to a loss of P\$47 million in 2003. As of December 31, 2004, in light of considerations made by the Company's management in formulation of the business plan, Petrobras Energía partially reversed an allowance for tax loss carry forwards and recognized a gain of P\$268 million. See Recoverability of Assets. In addition, Petrobras Energía Perú S.A. recorded a gain of P\$31 million, derived from the conditions of Lote X Agreement with the Peruvian government, which had a positive impact on the economic projections. See Operations in Peru.

Analysis of Operating Income

Oil and Gas Exploration and Production

In 2004, international prices were highly favorable for Oil and Gas Exploration and Production business segment. The WTI averaged US\$ 41.4 per barrel, which was 33% higher than the average price in 2003. In Argentina, however, large increases in taxes on crude oil exports counterbalanced increases in oil process. In 2003, taxes were at a single nominal rate of 20% and increased to a 25% rate plus additional taxes in 2004 (ranging from 3% to 20% based on the price of crude oil, with a maximum 45% tax for prices above US\$ 45). This tax scheme, which impacted domestic sales prices in the Argentine refining industry, was part of the National government's greater plan to establish a price stability framework. This market price applies as reference price to crude transfers to the Refining business segment.

Operating income: Operating income for the Oil and Gas Exploration and Production business segment increased P\$321 million, or 37.3%, to P\$1,182 million in 2004 from P\$861 million in 2003. This increase was predominately due to the 19.4% rise in average sales prices of oil equivalent resulting from (1) the 33.1% increase in the WTI, and (2) the absence of derivative financial instruments qualifying for hedge accounting in 2004. This increase, however, was partially offset by charges derived from the Ship or Pay crude oil transportation agreement with OCP that accounted for a loss of P\$184 million in 2004.

The table below shows the Company's operating income for this business segment:

Net sales: Net sales for the Oil and Gas Exploration and Production business segment increased P\$630 million, or 23.1%, to P\$3,359 million in 2004 from P\$2,729 million in 2003. This increase was predominately due to the 19.4% increase in the average sales price of oil equivalent and, to a lesser extent, to a 2.7% increase in sales volumes of oil equivalent.

In 2004, daily oil and gas sales volumes increased to 162.2 thousand barrels of oil equivalent from 157.9 thousand barrels of oil equivalent in 2003. Oil sales volumes increased to 115.5 thousand barrels per day, or 3.9%, in 2004 from 111.2 thousand barrels per day in 2003, while gas daily volumes remained substantially unchanged, totaling 280.4 million cubic feet in 2004 and 280.0 million cubic feet in 2003. As discussed below, volume sale increases arose from sales outside Argentina. In 2004, the average sales price per barrel of oil, including the effects of hedging transactions and taxes on exports, increased 19.7% to P\$ 73.2 from P\$ 61.2, due to the increase in WTI.

During 2004, because the Company did not use derivative instruments that qualify for hedge accounting, no decreases in sales were recorded for these instruments. The crude oil hedging policy accounted for an opportunity cost of P\$85 million in 2003.

Argentina

Net sales in Argentina increased by P\$ 217 million, or 14.1%, to P\$1,755 million in 2004 from P\$1,538 million in 2003. Combined oil and gas daily sales volumes decreased 6.6% to 84.5 thousand barrels of oil equivalent in 2004 from 90.4 thousand barrels of oil equivalent in 2003.

Crude oil sales increased by P\$ 207 million, or 14.8%, to P\$ 1,608 million in 2004 from P\$ 1,401 million in 2003. This increase was due to a 26% increase in the average sales price to P\$88.1 per barrel in 2004 from P\$69.8 per barrel in 2003, which, in turn, was predominately due to (1) the increase of the WTI and (2) the absence of derivative instruments qualifying for hedge accounting in 2004. The ability to benefit from the WTI increase was limited by the export tax regime in Argentina and the transfer price agreements with refiners in Argentina.

During 2004, the Company was able to mitigate the impact of the increase in export taxes by transferring more crude oil to the downstream operations in Argentina. As a result, the Company experienced a 75% decline in export volumes in 2004 as compared to 2003 and taxes on exports decreased to P\$26 million from P\$60 million in 2003.

Daily oil sales volumes declined 9.3% to 49.9 thousand barrels in 2004 from 55.0 thousand barrels in 2003, predominately because the Argentine assets are mature assets, which are under production through secondary recovery methods and, therefore, experience considerable natural declines. In order to address this, the Company made significant investments in 2004, mainly in projects aimed at improving the fields' production, which allowed the Company to mitigate this decline.

Total gas sales increased 7.3% to P\$ 147 million in 2004 from P\$ 137 million in 2003, mainly as a result of a 9.6% rise in the average sales price, which was partially offset by a 2.5% decline in sales volumes. The average sales price for gas increased to P\$ 1.93 per million cubic feet in 2004 from P\$ 1.76 per million cubic feet in 2003, mainly as a consequence of the April 2004 agreement between gas producers and the Secretary of Energy of Argentina, which allowed for natural gas price increases and [the renegotiation of contracts with certain distribution and generation companies]. The effect of these domestic price increases was mitigated by a 30% decrease in exports volumes, resulting from export limitations imposed by the Argentine government in response to the energy crisis. Domestic sales are made at lower prices than export sales.

Daily gas sales volumes declined 2.3% to 207.9 million cubic feet in 2004 as compared to 2003, primarily due to the decline in demand associated with the shutdown of the Genelba Power Plant for maintenance works, during November 2004, and repair works to the gas treatment equipment at the Austral Basin fields.

Outside of Argentina

. Combined oil and gas sales outside of Argentina increased P\$ 413 million, or 34.7%, to P\$ 1,604 million in 2004 from P\$ 1,191 million in 2003. Total oil and gas sales volumes increased 15.3% to 77.7 thousand barrels of oil

equivalent per day in 2004 from 67.4 thousand barrels of oil equivalent per day in 2003. The average sales price of oil equivalent per barrel increased 15.5% to P\$ 55.8 in 2004 from P\$ 48.3 in 2003, mainly due to an increase in the WTI and the absence of derivative instruments qualifying for hedge accounting in 2004.

Venezuela

In Venezuela, oil and gas sales increased P\$ 217 million, or 36.6%, to P\$ 811 million in 2004 from P\$ 594 million in 2003. In 2004, the average price per barrel of oil was P\$ 46.5, which was a 15.1% increase from P\$ 40.4 in 2003. This change was predominately attributable to the increase in the WTI. The impact of the WTI increase was limited by the compensation formula contained in third round agreements. The average price for gas decreased 35.5% to P\$ 1.20 in 2004 from P\$ 1.86 per million cubic feet in 2003 as a consequence of a decrease in the reference price in Venezuela, which is regulated by the government.

Daily sales volumes of oil equivalent increased 19.9% to 51.3 thousand barrels of oil equivalent in 2004 from 42.8 thousand barrels of oil equivalent in 2003, due to the magnitude of its investments in Venezuela and the adverse impact of the oil strike in the beginning of 2003. In 2004, with respect to its investments, 23 wells were drilled, 63 repair works and 5 conversions were made, mainly in the Oritupano-Leona and La Concepción oilfields. As regards maintenance works, 22 extraction improvements and investments in overhaul and surface and sub-surface equipment are worth a mention.

Ecuador

In Ecuador, oil sales increased 81.7% to P\$ 209 million in 2004 from P\$ 115 million in 2003. Investments made in Block 18, which include drilling of four wells and construction of surface facilities, contributed to a 47.9% increase in daily oil sales volumes to 5.8 thousand barrels per day. The average sales price increased 25.1% to P\$ 99.1 per barrel from P\$ 79.2 per barrel mainly due to the rise in the international reference price (Oriente crude oil). The increase in the Oriente crude oil reference price during 2004 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\$ 84 million or 22.5% to P\$ 458 million in 2004 from P\$ 374 million in 2003, mainly as a result of a 24% increase in the sales price of oil equivalent.

The average crude oil price increased 27.1% to P\$ 105.4 per barrel from P\$ 82.9 per barrel, as a result of changes in the international reference price (Oriente crude oil). The average gas price decreased 24.4% to P\$ 5.12 from P\$ 6.77 per million cubic feet as a consequence of the increase in gas supply resulting from the entry in the gas market of sales from the Camisea field, which is the most important gas reserve in Peru and one of the most important gas reserves in Latin America.

Daily sales volumes of oil equivalent decreased by 0.8% to 12.9 thousand barrels per day in 2004 from 13.0 thousand barrels per day in 2003.

Bolivia

In Bolivia, oil and gas sales did not suffer significant changes between 2004 and 2003, amounting to P\$ 108 million in both periods. Combined oil and gas daily sales volumes increased by 1.0% to 7.8 thousand barrels of oil equivalent in 2004 compared to 2003. The average sales price for gas remained at P\$ 5.23 per million cubic feet from year to year.

Gross profit: Gross profit for this business segment increased by P\$ 484 million, or 37.8%, to P\$ 1,765 million in 2004 from P\$ 1,281 million in 2003. The margin on sales increased to 52.5% from 46.9% in 2003. This increase in margin was mainly attributable to the 19.4% increase in sales average prices of oil equivalent. Average lifting costs increased 9.9% to P\$ 8.46 per barrel of oil equivalent in 2004 from P\$ 7.70 per barrel of oil in 2003, mainly due to an increase in oil services and electric power rates and to incremental costs associated with new safety and environmental standards. The price rise was mitigated by increased royalties paid in Argentina, which are settled without considering the impact of taxes on exports.

Administrative and selling expenses: Administrative and selling expenses increased P\$ 34 million, or 19.1%, to P\$ 212 million in 2004 from P\$ 178 million in 2003. This increase was mainly attributable to the impact of the rise in sales volumes in Ecuador and, to a lesser extent, an increase in labor costs.

Exploration expenses: Exploration expenses totaled P\$ 89 million in 2004 and P\$ 196 million in 2003. Expenses for 2004 year were mainly attributable to the expensing of exploratory drilling costs in Block 31 for P\$ 80 million. Drilling occurred during 2003, and these costs had been capitalized. In addition, exploration expenses during 2004 reflect expenses in connection with 3D seismic works in the Santa Cruz I Oeste area in Argentina for P\$ 6 million.

In 2003, according to the requirements of SFAS 19, the Company charged to income exploratory investments capitalized in previous years corresponding to Block 31 in Ecuador and the San Carlos area in Venezuela in the amount of P\$ 141 million (including P\$ 35 million for costs of feasibility studies) and P\$ 29 million, respectively, and additionally, costs of non-producing exploratory wells drilled in Santa Cruz II and Lote XVI in Peru and the seismic works related to such wells.

Other operating income (expense), net: Other operating income (expense), net accounted for losses of P\$ 282 million in 2004 and P\$ 46 million in 2003. Losses for 2004 are mainly attributable to costs associated with the unused transportation capacity under the Ship or Pay contract with OCP in Ecuador (P\$ 184 million), environmental remediation expenses (P\$ 51 million), [project discontinuance (P\$ 5 million) and losses derived from contract renegotiation]. Losses in 2003 include P\$ 26 million for environmental remediation expenses and P\$ 32 million for other allowances. Losses in 2003 were partially offset by the favorable resolution of commercial claims in Venezuela.

Hydrocarbon Marketing and Transportation

In 2004, The Company implemented changes in the way it allocated certain of its product sales among its different business segments. As a result, the Hydrocarbon Marketing and Transportation business segment now sells the gas produced in Argentina and the liquids obtained from gas processing, which is transferred to it at market prices from the Oil and Gas Exploration and Production segment. In addition, the Hydrocarbon Marketing and Transportation business segment's operations now include gas and LPG brokerage activities. Also, as of 2004, oil brokerage services are now provided through its Refining business segment.

Operating income: Operating income for the Hydrocarbon Marketing and Transportation business segment increased P\$ 42 million, or 20.5%, in 2004 to P\$ 247 million from P\$ 205 million in 2003. 2004 Operating income reflects gains of P\$ 215 million in 2004 and P\$ 194 million in 2003, attributable to the proportional consolidation of CIESA.

Without proportional consolidation, the operating income for this business segment increased by P\$ 21 million, or 190.9%, in 2004 to P\$ 32 million from P\$ 11 million in 2003, reflecting principally increased net sales.

The table below reflects operating income for the Hydrocarbon Marketing and Transportation business segment, excluding effects of the proportional consolidation of CIESA:

(in millions of pesos)

Net sales: Sales revenues increased P\$ 301 million to P\$ 376 million in 2004 from P\$ 75 million in 2003, due to the above-mentioned allocation related changes among its business segments. In 2004, revenues from the sale of gas and liquids produced by the Company totaled P\$ 158 million and P\$ 193 million, respectively. Sales volumes of gas produced by the Company in Argentina totaled 205.5 million cubic feet per day, and sales volumes of liquids amounted to 232 thousand tons. Gas and LPG brokerage services accounted for P\$ 25 million and P\$ 75 million in sales revenues during 2004 and 2003, respectively.

Gross profit: As a consequence of the changes implemented in 2004, gross profit increased P\$ 16 million to P\$ 20 million in 2004 from P\$ 4 million in 2003.

Other operating income (expense), net: Other operating income (expense), net from the advisory services the Company provided to TGS's technical operator, accounted for gains of P\$ 18 million in 2004 and P\$ 11 million in 2003. As of July 2004, pursuant to an assignment entered into with Enron (See Situation of Investments in Utility Companies), Petrobras Energía is now providing technical assistance to TGS, among other things, for the operation and maintenance of TGS's gas transportation system and facilities and related equipment to ensure that TGS's operations comply with international environmental standards. TGS, in return, pays the Company monthly fees, which are based on its results and which must annually exceed a minimum amount. The initial term of this agreement is eight years, commencing on December 28, 1992, and automatically renews every eight years.

Refining

As previously mentioned, in 2004, the Company implemented changes in the way it allocate certain of the product sales among its different business segments. As a result, the Refining business segment as of 2004, provides oil brokerage-related services, previously performed by the Hydrocarbon Marketing and Transportation business segment. These operations accounted for P\$ 46 million in sales revenues during 2004.

Operating income: Operating income for the Refining business segment increased P\$ 66 million, or 122.2%, to P\$ 120 million in 2004 from P\$ 54 million in 2003. In 2004, prices of refined products increased significantly both in Argentina and abroad. This resulted in improved average contribution margins. In addition, since the second semester of 2004, because of the implementation of a new export tax regime, which offset the significant rise in the WTI, the Company was able to improve its refining margins.

The table below reflects operating income for the Refining business segment:

(in millions of pesos)

Net sales: Net sales of refinery products increased P\$ 443 million, or 34%, to P\$ 1,745 million in 2004 from P\$ 1,302 million in 2003. This increase was primarily a result of significant price increases and, to a lesser extent, an 8% average rise in sales volumes and the reallocation of the oil brokerage activities to this segment.

Average sales prices of benzene, heavy distillates, paraffins, aromatics, diesel oil, medium distillates, gasolines, reformer plant by-products and asphalts increased 83%, 24%, 21%, 20%, 18%, 16%, 12%, 4% and 4%, respectively, mainly as a result of the significant increase in crude oil international prices.

As a result of the competitive advantages derived from integration of the upstream and downstream operations, as well as, the ability to benefit from the services provided by EG3, the Company was able to refine a higher volume of crude oil. The Company's ability to refine more oil, in turn, has assisted to mitigate the effects of the export tax regime on the crude oil production activities. In 2004, crude oil volumes processed at the refinery increased 5.9% to 33,129 barrels per day.

Domestic sales volumes increased 12% in 2004 compared to 2003, primarily due to diesel oil and gasoline sales to other oil companies. Export sales volumes increased 3%, primarily as a result of gasoline dispatch.

Total diesel oil sales volumes increased 3.4% to 913 thousand cubic meters in 2004. This increase was due to a 7% increase in the domestic market, which was partially offset by a decline in the Company's exports. Sales increased in Argentina, predominately due to increased sales to EG3 and, to a lesser extent, increased demand from the agricultural sector. The new sales strategy combined with growth in the diesel oil domestic market, resulted in a decreased market share of 3.5% in 2004 compared to a domestic market share of 4.7% in 2003.

Total gasoline sales volumes increased 74% to 207 thousand cubic meters in 2004, due to increased sales to the domestic market including increased sales to EG3. The market share was 3.4% in 2004 and 3.1% in 2003.

Asphalt sales volumes grew 33.8% in 2004 and the market share in the road asphalt segment increased to 24.6% in 2004 from 23.6% in 2003. Domestic market sales increased 59.2%, as a result of an increase in road construction and the participation as provider of asphalt products in various road construction projects, such as, National Road 43, the Buenos Aires Córdoba highway, the Rosario Buenos Aires highway and the Rosario Victoria Bridge. The increased share in the domestic market resulted in a reduction in the export levels, predominately to Paraguay and Bolivia.

Sales volumes of heavy distillates increased 4.5% in 2004, primarily due to a 24.1% growth in the domestic market, which is predominately due to fuel oil sales to thermal power plants. The exports declined 3.6%, as a result of reduced fuel oil and Ifos sales, partially offset by increased cracking feedstock sales.

Sales volumes for reformer plant by-products declined 3.6% in 2004, generally due to reduced LPG exports. Aromatics sales volumes declined 22.5% in 2004, while paraffins sales volumes increased 8.6%.

Gross profit: Gross profit increased P\$ 59 million, or 48% to P\$ 182 million in 2004 from P\$ 123 million in 2003, due in large part to the combined effect of increased sales volumes and improved margins. Gross margin on sales increased to 10.4% in 2004 from 9.4% in 2003.

In order to optimize the marketing margins, the Company focused on products and distribution channels with higher profit margins. In addition, the agreements entered into between producers and refineries for price stability allowed the Company to mitigate the 33% average increase of the WTI. As a result, sales prices increased an average of 21% in 2004, compared to an 18.2% increase in the average cost of crude oil processed to P\$ 95.4 per barrel from P\$ 80.7 per barrel.

Administrative and selling expenses: Administrative and selling expenses increased 5.3% to P\$ 60 million in 2004 from P\$ 57 million in 2003, primarily due to an increase in variable expenses.

Other operating income (expense), net: Other operating income (expense), net recorded losses of P\$ 2 million in 2004 and P\$ 12 million in 2003. In 2003, the under-absorption of fixed costs derived from the optimization policy of crude oil processed resulted in a P\$ 6 million loss, and P\$ 8 million in environmental remediation expenses were recorded.

Petrochemicals

With respect to the styrenics business, and in line with the upward trend in oil prices, 2004 was characterized by high international prices in both finished products and major raw materials. Styrene, polystyrene and benzene (main feedstock) international prices showed increases of 50%, 46% and 87%, respectively. The international spreads for styrene and polystyrene grew 16% and 18%, respectively.

The demand for styrenics in the domestic market increased significantly in Argentina during 2004 -- 30% for styrene, 14% for polystyrene and 20% for bops. This increase was predominately due to economic growth which fueled demand in these products.

The Mercosur region and Chile continued to show a downward trend in terms of styrene supply, while, in contrast, polystyrene recorded a significant supply surplus, due to installed production capacity increases in Brazil.

In the fertilizers business, urea international prices increased to US\$175 per ton, or 25.9%, in 2004 from an average of US\$ 139 per ton in 2003, due to an increase in demand in the Southeast of Asia and a decrease in global supply as a result of the high costs of natural gas in the major manufacturing centers of urea around the world.

Total demand for fertilizers in Argentina recorded a significant increase of 31% in 2004, due to an increase in international prices of grains during the first semester of 2004, which fostered agricultural production in the country, a greater use of nutrients and improved yields.

In October 2004, the new ethylene plant began operations. This plant further integrates the petrochemical business operations, increasing the production capacity of the ethyl benzene plant from 116 thousand tons per year to 180 thousand tons per year. This additional ethyl benzene production will enable the Company to maximize the installed capacity of the Innova styrene and polystyrene plants in Brazil.

The table below reflects operating income for the Petrochemicals business segment:

Operating income: Operating income for the Petrochemical business segment increased P\$ 93 million, or 50.3%, to P\$ 278 million in 2004 from P\$ 185 million in 2003, predominately due to gross profit increases and the recognition of tax benefits derived from Innova's operations.

Net sales: Net sales (net of eliminations in the amount of P\$ 39 million and P\$ 5 million) increased P\$ 583 million, or 45.1%, to P\$ 1,877 million in 2004 from P\$ 1,294 million in 2003, primarily due to increased sales prices and, to a

lesser extent, increased sales volumes.

- Styrenics - Argentina:

Sales of styrenics in Argentina increased P\$ 181 million, or 37.3%, to P\$ 666 million in 2004 from P\$ 485 million in 2003, primarily due to price increases. These sales amounts include exports to Innova in the amount of P\$ 39 million in 2004 and P\$ 5 million in 2003.

In 2004, in line with increases with international reference prices, average sales prices for the business segment increased 31% compared to 2003, with increases of 50%, 30% and 16% for the styrene, polystyrene and synthetic rubber lines, respectively.

Styrenics sales volumes increased 5.4% to 195 thousand tons in 2004 compared to 2003, predominately due to higher ethylbenzene export volumes (approximately 10 thousand tons) to Innova, as a result of the start up of the San Lorenzo ethylene plant.

As the Argentine market recovered, the Company made changes in sales channels in order to privatize higher-margin domestic market sales over exports. As a result, styrene volumes in the domestic market increased 30%, but the Company experienced a 38% decline in exports, particularly to Chile, Uruguay and Peru.

Along these lines, polystyrene sales volumes increased an average of 7%, with a 14% increase in the domestic market and a 2% decline in exports, mainly to Chile and Uruguay (polystyrene) and the United States and Europe (bi-oriented polystyrene).

Synthetic rubber sales volumes increased 5.8%, with 20% average growth in the domestic market, in 2004, due to an increased demand for products derived from import substitution, which resulted in a 5% increase in share in the SBR Argentine market. Exports decreased 4% in 2004 compared to 2003, mainly due to decreases in exports to Brazil, Chile and Peru.

- Styrenics-Brazil - Innova:

Innova sales increased P\$ 271 million, or 54%, to P\$ 773 million in 2004 from P\$ 502 million in 2003, due to the combined effect of higher prices and increased sales volumes. In 2004, styrene and polystyrene prices increased 41%

and 33%, respectively. The increase in sales volumes (up 13.5% in 2004) were due to an increase in demand as a result of the economic recovery in Brazil and problems with production plants in 2004. The sales strategy implemented in 2004 focused on the domestic market, which offered higher margins and, partially as a result of these efforts, styrene and polystyrene sales volumes increased 11% and 16%, respectively. Export sales of polystyrene increased 10% compared to 2003, mainly due to increased sales to the USA and Africa.

- Fertilizers:

Fertilizer sales increased P\$ 165 million, or 52.9%, to P\$ 477 million in 2004 from P\$ 312 million, due to the combined effect of (1) a 31% increase in sales volumes, resulting from higher fertilizer consumption attributable to the strong growth in the agricultural industry and commercial restructuring which extended sales areas, and (2) the 18% price increase, in line with changes in the WTI.

Gross profit: Gross profit increased P\$ 62 million, or 19.9%, to P\$ 374 million in 2004 from P\$ 312 million in 2003. Gross margin on sales decreased to 19.9% from 24.1% in 2004, reflecting the impact of the increase in the international prices of raw materials and, to a lesser extent, the increase in production costs.

- Styrenics - Argentina:

Gross profit increased P\$ 3 million, or 2.3%, to P\$ 132 million in 2004 from P\$ 129 million in 2003. Gross margin on sales decreased to 19.8% from 26.6%, primarily due to the increase of benzene prices and higher fixed production costs associated with the start up costs of the new San Lorenzo ethylene plant.

- Styrenics - Brazil:

Gross profit increased P\$ 40 million, or 44.9%, to P\$ 129 million in 2004 from P\$ 89 million in 2003. Increased gross profit was predominately due to significant price improvement. Gross margin on sales declined to 16.7% from 17.7% as a consequence of raw material price increases, mainly benzene.

- Fertilizers:

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Gross profit increased P\$ 19 million, or 20.2%, to P\$ 113 million in 2004 from P\$ 94 million in 2003, while gross margin decreased to 23.7% from 30.1%. The increase in gross profit was attributable to significant sales volumes and improved prices, while the decrease in gross margin reflects higher costs of imported products for resale and the increase in the gas rate.

Administrative and selling expenses: Administrative and selling expenses increased P\$ 13 million, or 11.8%, to P\$ 123 million in 2004 from P\$ 110 million in 2003, primarily due to higher expenses derived from increased sales volumes and the start up of the San Lorenzo ethylene plant.

Other operating income (expense), net: Other operating income (expense), net recorded a gain of P\$ 27 million in 2004 compared to a loss of P\$ 17 million in 2003. The gain in 2004 is attributable to the collection of tax benefits granted by the Rio Grande do Sul State, Brazil, to companies settled in that state. The loss in 2003 is predominately due to the impact of environmental remediation expenses.

Electricity

Operating income for the Electricity business segment increased P\$ 10 million, or 8.9%, to P\$ 122 million in 2004 from P\$ 112 million in 2003. Operating results reflect gains of P\$ 3 million in 2004 and P\$ 4 million in 2003, due to our share of the operating income of Distrilec. Excluding proportional consolidation, operating income increased to P\$ 119 million in 2004 from P\$ 108 million in 2003, primarily due to increased margins in generation activity.

The table below reflects operating income for the business segment, excluding the effects of proportional consolidation of Distrilec:

(in millions of pesos)

The table below reflects operating income for the business segment:

Electricity Generation

Net sales: Net sales of electricity generation increased P\$ 45 million, or 19.1%, to P\$ 280 million in 2004 from P\$ 235 million in 2003, primarily due to a 17% improvement in generation prices. 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 keep operation levels similar to those of 2003, in spite of shutdowns to the Genelba Power Plant during major maintenance works during 2004.

The increase in energy prices was primarily attributable to (i) higher demand for energy within a context of lower water flow contribution at the different basins 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 price plan implemented during the fourth quarter of 2004, and (iii) higher compensation for guaranteed supply to the electricity market, because the Secretariat of Energy guarantees a price in excess of market price for guaranteed availability of generation companies.

Net sales attributable to the Genelba Power Plant increased P\$ 28 million, or 14.3%, to P\$ 224 million in 2004 from P\$ 196 in 2003, primarily due to improved generation prices. The average sales price increased P\$ 13.8 to P\$ 45.4 per MWh in 2004 from P\$ 39.9 per MWh in 2003. Payment of additional compensation for guaranteed supply to the electricity market reflected increased sales of P\$ 30 million in 2004 and P\$ 17 million in 2003. Energy delivered remained almost unchanged in both years, 4,931 GWh in 2004 and 4,918 GWh in 2003. A significant generation increase was recorded during the first three quarters of 2004. During that period, the integration of operations with the Oil and Gas Exploration and Production business segment was a key factor in overcoming gas supply restrictions faced by thermal plants in 2004. This integration was offset by reduced volumes recorded in the fourth quarter of 2004 derived from the scheduled shutdown of the Genelba Power Plant. The Genelba Power Plant factory increased its capacity to 82.7% in 2004 from 79.1% in 2003 and the availability factor decreased to 85% from 96.5% as a consequence of the scheduled plant shutdown.

Net sales attributable to the Pichi Picún Leufú Hydroelectric Complex increased P\$ 16 million, or 44.4%, in 2004 to P\$ 52 million from P\$ 36 million in 2003, due to the combined effect of an improvement in sales prices and higher generation volumes. The average sales price increased 32.1% to P\$ 42.4 per MWh in 2004 from P\$ 32.1 per MWh in 2003, 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 2004, energy delivered increased to 1,226 GWh, or 9.5%, in 2004 from 1,120 GWh in 2003, 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\$ 19 million, or 20.9%, to P\$ 110 in 2004 from P\$ 91 million, predominately due to improved sales prices.

Administrative and selling expenses: Administrative and selling expenses for generation activity increased P\$ 2 million, or 25%, to P\$ 10 million in 2004 from P\$ 8 million in 2003.

Analysis of Equity in Earnings of Affiliates

Equity in earnings of affiliates decreased P\$ 87 million, or 53.4%, to P\$ 76 million in 2004 from P\$ 163 million in 2003. Without proportional consolidation, equity in earnings of affiliates declined P\$ 292 million, or 78.7%, to P\$ 79 million in 2004 from P\$ 371 million in 2003.

This decline was primarily due to the effects of peso appreciation in 2003 on the net borrowing position of its utility companies, which is predominately denominated in US dollars.

This was partially offset by increased equity by its earnings from Empresa Boliviana de Refinación and Refinor in the amount of P\$ 23 million and P\$ 12 million, respectively.

The table below shows the Company's results of equity in earnings of affiliates for the fiscal years ended December 31, 2004 and 2003 under professional accounting standards and, for comparative purposes, the pro forma results, which excludes the effects of proportional consolidation of affiliates under joint control.

CIESA/TGS: Equity in earnings of CIESA and TGS decreased P\$ 212 million, or 78.8%, to P\$ 26 million in 2004 from P\$ 238 million in 2003. The earnings for both years were impacted by peso appreciation/devaluation, though with a different incidence. Because of the significant US dollar-denominated financial indebtedness of both companies, a loss of P\$ 37 million exchange difference was recorded in 2004 and a gain of P\$ 527 million was recorded in 2003.

In 2004, TGS restructured its debt, which resulted in a gain of P\$ 33 million, primarily due to the recovery of punitive interest, net of deferred charges reduction.

As of December 31, 2002, CIESA's shareholders' equity amounted to negative P\$ 66 million, after reconciling CIESA's valuation methods with ours. Given our 50% equity interest in CIESA, our equity interest as of December 31, 2002 in CIESA would have been valued at negative P\$ 33 million. However, because the Company had not assumed commitments to make capital contributions or to provide financial assistance to CIESA, under Argentine GAAP, our shareholder equity interest in CIESA for 2002 was valued at zero. As of December 31, 2003, CIESA reported positive shareholders' equity. In accordance with Argentine GAAP, the Company adjusted downwards our equity in earnings of affiliates for 2003 by P\$ 33 million, representing our share of CIESA's negative shareholders' equity as of December 31, 2002.

Total sales revenues for CIESA and TGS increased P\$ 78 million, or 8.7%, to P\$ 970 million in 2004 from P\$ 892 million in 2003.

Sales revenues for CIESA and TGS from the gas transportation segment increased P\$ 12 million, or 2.9%, to P\$ 434 million in 2004. This increase was primarily attributable to the execution of new firm transportation agreements, effective May 2004, in the amount of P\$ 5 million and to increased interruptible transportation services in the amount of P\$ 5 million. The increased transportation capacity committed (3.6 MMm³ per day) is a result of competitive biddings for transportation capacity conducted by TGS in March 2004.

CIESA's and TGS's income from the NGL production and marketing segment increased P\$ 64 million, or 15.2%, to P\$ 483 million in 2004, primarily due to the 21% increase the average sale price of NGL and, to a lesser extent, an increase of approximately 5% in sales volumes. These effects, however, were partially offset by the increase from 5% to 20% in taxes on exports of NGL, which have been in effect since May 2004.

In 2004, CIESA's operating income increased P\$ 42 million, or 10.8%, to P\$ 430 million, primarily due to an increase in the prices of NGL.

Distrilec/Edesur: Equity in earnings of Distrilec accounted for losses of P\$ 13 million in 2004 and P\$ 11 million in 2003.

Distrilec's income from services increased P\$ 1,104 million, or 19.7%, in 2004 from P\$ 922 million in 2003. This increase was due to a 13% increase in sales prices and a 5.2% increase in the demand for energy.

Distrilec's operating income, under Argentine GAAP, slightly increased to P\$ 10 million in 2004 from P\$ 8 million in 2003, as a result of an increase in demand and reduced costs. The margin reflected the price increase mentioned above [what price increases?] since the portion of the rate for distribution services remained unchanged as from the enactment of the Public Emergency Law.

Distrilec's financial income (expense) accounted for a loss of P\$ 44 million in 2004 compared to a gain of P\$ 58 million in 2003. This significant variation was primarily due to the fluctuations in the exchange rate and their corresponding effect on Distrilec's US dollar-denominated net borrowing position.

Distrilec's other operating income (expense), net accounted for a gain of P\$ 37 million in 2004 compared to a loss of P\$ 27 million in 2003. The gain in 2004 was primarily due to a gain of P\$ 36 million, as a result of the settlement reached with Alstom Argentina in connection with the events on January 15, 1999 at Azopardo Substation. Such agreement definitively ends all the claims between the parties.

Citelec/Transener: Equity in earnings of Citelec accounted for a loss of P\$ 42 million in 2004 compared to a gain of P\$ 87 million in 2003. Equity in earnings for 2003 includes the reversal of a P\$ 66 million allowance the Company recorded in 2002. The variation is primarily due to the fluctuations in the exchange rate and their corresponding effect on Citelec's financial indebtedness, which is predominately denominated in US dollars. As a result of peso appreciation in 2003, Citelec recorded a significant gain in 2003.

Citelec's sales revenues increased 10.7% to P\$ 305 million, primarily due to increased revenues from the unregulated services outside of Argentina and the regional expansion of Transener's activities in Latin America, mainly in Paraguay and Brazil. Regulated rates were not subject to adjustments during 2004 and 2003.

Citelec's operating income declined P\$ 10 million, or 23.8%, to P\$ 32 million in 2004 compared to P\$ 42 million in 2003, primarily due to increased labor costs, which resulted from new labor regulations imposed by the Argentine government in 2004. This was partially offset by increased contribution from unregulated activities.

Refinor: Equity in earnings of Refinor increased P\$ 12 million, or 42.9%, to P\$ 40 million in 2004 from P\$ 28 million in 2003. This significant increase is generally due to increased fuel marketing margins and, to a lesser extent, increased gas sales volumes and the re-valuation of inventories due to the increase in WTI.

Refinor's sales increased P\$ 214 million, or 23.7%, to P\$ 1,116 million in 2004 from P\$ 902 million in 2003. In 2004, in line with the increase in WTI, Refinor's average sales prices were 22% higher compared to 2003. The volume of gas processed averaged 18.9 million cubic meters per day in 2004, 14% higher than in 2003, due to the incorporation of the gathering and compression system of the gas-rich Chango Norte Field, which commenced operations in May 2003. Oil volumes processed totaled an average of 17.4 thousand barrels per day, which was a 1% decrease compared to 2003, due to lower crude oil availability.

- *Petroquímica Cuyo S.A. (Cuyo):* Equity in earnings of Cuyo accounted for P\$16 million gains in both years.

Cuyo sales increased 31.6% to P\$ 283 million in 2004 from P\$ 215 million in 2003, primarily due to a significant increase in sales prices, which was partially offset by a 2% fall in sales volumes. Average sales prices increased 34% in 2004 compared to 2003 as a result of the increase in oil prices, which, in turn, caused significant increases in international reference prices of the petrochemical industry.

The 46% improvement in Cuyo's operating income was also attributable to the increase in prices and was offset by an increase in income tax rates

Empresa Boliviana de Refinación (EBR): Equity in earnings of EBR accounted for a gain of P\$ 18 million in 2004 compared to a loss of P\$ 5 million loss in 2003, due to the combined effect of improved margins and higher volumes.

In 2004, EBR contribution margins significantly recovered as a result of increases in WTI compared to 2003. In 2003, as a result of the price fixing mechanisms imposed by the Bolivian government on refined products, EBR had no refining margins.

In addition, EBR recorded a 15% increase in crude processing and an 11% increase in sales volumes (mainly of gasoline and diesel oil). These increased volumes were sold through EBR's extended commercial network, which in 2004 added 11 new sale points through its subsidiary Empresa Boliviana de Distribución (EBD).

Oleoductos del Valle S.A. (Oldelval): Equity in earnings of Oldelval increased to P\$ 7 million in 2004 from P\$ 2 million in 2003, primarily due to the recognition of a gain from the extraordinary sale of crude oil surplus.

Oldelval's sales revenues increased 10% to P\$ 112 million in 2004, due to the combined effect of increased transported volumes and improved average prices. Crude oil transported volumes increased 1.97% to 66.5 million barrels in 2004, generally due to the decline in exports to Chile (transported through the Trasandino Oil Pipeline) and in pumping activities to the Luján de Cuyo distillery. Though no changes were adopted in the rate regime that has been in force since mid 2003, the continued application of this regime in 2004 resulted in improved average prices.

LIQUIDITY AND CAPITAL RESOURCES

After the default on most of its sovereign debt, Argentina and Argentine companies have had significantly fewer opportunities to access international credit markets. Even considering a successful renegotiation of the Argentine foreign debt, as a result of fluctuations in emerging countries and cash flow instability, the financial market is likely to see reduced liquidity and/or increased volatility of interest rates.

Within this context, the Company closely monitor the liquidity levels to secure compliance with its financial obligations while continuing to support its growth strategy. Financial solvency is the foundation and the guiding principle on which sustainable development of its businesses is built.

Pursuant to these strategic guidelines, the Company seek to:

- * Gradually reduce the level of indebtedness, by creating and maintaining a capital structure in line with industry standards and adaptable with those financial markets in which the Company operate, and by establishing a debt maturity profile which fosters cash generation.

- * Gradually reduce the indebtedness costs.

- * Have adequate flexibility to overcome high volatility levels, inherent in emerging capital markets, by adhering to a conservative cash management policy, which minimizes the risks of financial distress.

- * Limit the level of the investments in order to focus on cash generation, by prioritizing profitable projects with faster returns.

From 2002 through 2004, by adhering to these guidelines, the Company has achieved the following:

- * 138% growth in the operating cash flow.

- * Strict compliance with all the financial obligations, with a 12% decline in annual average indebtedness.

- * With the issuance in October 2003 of US\$ 100 million aggregate principal amount of its Series R notes due 2013, the Company became the first Argentine company to place an issuance in the international market following the Argentine government's default. In addition, in April of 2004 the Company successfully reopened this series of notes to obtain an additional US\$ 100 million in financing.

- * Significant increase in investments, supporting the growth strategy. See Increase in Capital Expenditures .

Analysis of Liquidity and Capital Resources

The Company's management analyzes its 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 controlled subsidiaries, excluding proportional consolidation of companies over which the Company exercise joint control, and as a result may not be directly comparable to amounts reflected in its financial statements.

There are three companies over which the Company exercise joint control: Citelec, CIESA and Distrelec. Despite being a company under its joint control, the Company did not consolidate proportionally the financial statements of Citelec because the Company committed to sell its interest in Citelec in connection with the sale of its control to Petrobras. While the Company does consolidate the results of CIESA and Distrelec proportionally in its financial statements, its management analyzes the results and financial condition separately from the results and financial condition of these companies. CIESA and Distrelec are primarily engaged in regulated energy businesses in Argentina, through TGS and Edesur, respectively. These companies have been significantly affected by the economic crisis in Argentina and the Public Emergency Law (See Situation of Investments in Utility Companies). Moreover, the Company is not committed, and does not expect to provide financial assistance to either CIESA or Distrelec, and has not received dividends from these companies since 2001. Accordingly, the management analyzes their results separately from the results.

The table below reflects its statements of cash flow for the fiscal years ended December 31, 2004 and 2003 under Argentine GAAP and, for comparative purposes, the pro forma results excluding the effect of proportional consolidation of companies under joint control.

(in millions of pesos)

Hoja1

	Petrobras Energía Participaciones, Affiliates and Companies under Joint Control		Petrobras Energía Participaciones and Affiliates	
	2,004	2,003	2,004	2,003
Cash and cash equivalents at beginning of period	927	725	545	693
Additions (deductions) of cash and cash equivalents from proportional interest in CIESA at beginning of period	-	103	-	-
Net cash provided by operations	1,463	1,353	1,269	1,003
Net cash used in investing activities	(1,039)	(915)	(912)	(857)
Net cash provided by (used in) financing activities	(432)	(251)	(203)	(206)
Devaluation and inflation effects on cash	(6)	(88)	(7)	(88)
Cash and cash equivalents at end of period	913	927	692	545

Cash

As of December 31, 2004 and 2003, cash and cash equivalents totaled P\$ 692 million and P\$ 545 million, respectively. The increase in operating cash flow in 2004 caused an increase in liquidity levels. The Company's goal is to maintain excess cash, primarily in US dollars, in short-term investments in order to ensure adequate liquidity levels. The Company predominately use fixed income mutual funds and overnight deposits.

Operating activities:

Net cash from operations increased P\$ 266 million to P\$ 1,269 million in 2004 from P\$ 1,003 million in 2003. The increase in net cash from operations in 2004 was primarily due to the increase in the WTI, an increase in the refining margins and increased sales volumes of petrochemical and refined products.

Investing activities:

Cash used in investing activities increased P\$ 55 million to P\$ 912 million in 2004 from P\$ 857 million in 2003. Because of the recovery in operating cash flow and improved liquidity, the Company was able to increase net capital expenditures by P\$ 131 million to P\$ 909 million in 2004 from P\$ 778 million in 2003.

The table below reflects total capital expenditures, net:

Hojal

	Fiscal years ended December 31,	
	<u>2004</u>	<u>2003</u>
- Oil and Gas Exploration and Production	766	696
- Petrochemicals	96	32
- Refining	29	25
- Hydrocarbon Marketing and Transportation	6	11
- Electricity	1	-
- Corporate Structure and Other Investments	11	14
Total capital expenditures, net	909	778
- Divestments	-	(20)
Total net capital expenditures	909	758

In 2004, capital expenditures in the Oil and Gas Exploration and Production business segment were primarily directed towards maintaining production levels and prioritizing investments in countries and products with higher expected profit margins. In 2004, 246 wells were drilled, of which 202 are located in Argentina and 394 units were repaired, of which 203 are located in Argentina. In addition, significant infrastructure work was carried out. In Argentina, development of reserves continued through well drilling and expansion of surface facilities. Work relating to the La Porfiada Field Interconnection Project started, and led to the development of gas reserves. In Venezuela, capital expenditures were primarily directed towards the construction of development wells, and, to a lesser extent, investments were made in lifting improvements and additional surface equipment. The capital expenditure efforts led to a 22% increase in oil production volumes in Venezuela. In Ecuador, at Block 18, four wells were drilled and began expansion works in the production facilities, resulting in a gross production of 25 thousand barrels per day.

In 2004, the capital expenditures in the Petrochemical and Refining business segments totaled P\$ 96 million and P\$ 29 million, respectively. Capital expenditures in these segments were primarily directed towards maintaining efficient operating conditions. In addition, US\$ 9 million went towards the new ammonium thiosulphate plant, which started operations in 2004 with a capacity of 140 thousand tons per year of fertilizers. The Company also invested approximately US\$ 6 million in the acquisition and commissioning of a 20,000 ton per year ethylene plant.

In the Hydrocarbon Marketing and Transportation business segment, in May 2004 the Company increased its interest in OCP by 2.46%, when Techint Internacional Construction Corp. exercised an irrevocable option to sell its shares and subordinated debt to the Company for P\$ 6 million.

Financing activities

Net cash provided by (used in) financing activities totaled P\$ 203 million in 2004 and P\$ 206 million in 2003.

The Company paid off long-term liabilities in the amount of P\$ 988 million in 2004 and P\$ 629 million in 2003. In 2004, payments of principal in connection with Series C, M and K under the US\$ 2.5 billion corporate notes program were made. The Company repaid at maturity Series O and P of the same program and the Fourth Series of the US\$ 1.2 billion global program, accounting for a total payment of P\$ 881 million. In addition, the Company repaid bank loans in the amount of P\$ 107 million. In 2003, Series E, J and L of corporate notes were repaid at maturity in an amount of P\$ 421 million (US\$ 146 million). In addition, the Company repaid bank loans and long-term lines of credit in an amount of P\$ 208 million.

Cash provided by long-term financing totaled P\$ 669 million in 2004 and P\$ 591 million in 2003. The long-term financing in 2004 consisted of the following:

- * In April 2004, the Company issued Tranche 2 of the Class R corporate notes for an aggregate principal amount of P\$ 289 million (US\$ 100 million) which represents a single class with the Class R medium-term issued in October 2003. The new Class R notes are due October 2013 and will accrue interest at a rate of 9.375% per annum.
- * In September 2004, Petrobras Internacional Braspetro BV, a subsidiary of Petrobras, granted a P\$ 150 million loan (US\$ 50 million), payable semiannually at a rate of 7.5% per annum. The loan is repayable semiannually in 42 months and may be prepaid without penalties.
- * The International Finance Corporation made the last disbursement of P\$ 85 million (US\$ 29 million) under the loan granted in 2003 to the subsidiary Petrobras Energía Venezuela S.A.
- * Cash provided by foreign trade financing totaled P\$ 60 million (US\$ 20 million).
- * Petrobras Energía del Perú S.A. received a P\$ 84 million (US\$ 30 million) disbursement, this being the last disbursement under the loan granted by Banco de Crédito de Perú and Interbank in 2003.

The long-term financing in 2003 consisted of the following:

- * In October 2003, the Company issued Class R medium-term notes in the amount of P\$ 286 million (US\$ 100 million).
- * In December 2003, the first disbursement in the amount of US\$76 million (P\$ 206 million) was received under a US\$ 105 million loan entered into between Petrobras Energía Venezuela S.A. and International Finance Corporation.

* In August 2003, our subsidiary Petrobras Energía del Perú S.A. received a first disbursement of P\$ 87 million (US\$ 30 million) under a US\$ 40 million loan entered into with Banco de Crédito de Perú and Interbank.

Cash provided by short-term financing totaled P\$ 116 million in 2004, primarily from foreign trade financing, compared to P\$ 168 million of cash used in short-term financing in 2003.

Description of Indebtedness

Most of the financial debt and a significant portion of the debt of its main affiliates are denominated in U.S. dollars.

As of December 31, 2004, the total indebtedness, excluding proportional consolidation of companies under joint control, was P\$ 5,949 million, of which P\$ 4,802 million was long-term indebtedness. As of December 31, 2004, the short-term indebtedness totaled P\$ 1,147 million, of which P\$ 859 million represents the current portion of long-term obligations and P\$ 278 million represents the short-term indebtedness with financial institutions under loan agreements and foreign trade financing.

The long-term debt primarily consists of corporate notes. The Company maintain a global corporate note program due May 2008, for a principal amount at any time outstanding of US\$ 2.5 billion or its equivalent in any currency. This program was authorized under Certificate N. 202 dated May 4, 1998, Certificate N. 290 dated July 3, 2002 and Certificate N. 296 dated September 6, 2003. As of December 31, 2004, notes in an aggregate principal amount of US\$ 1,569 million were outstanding under this program.

The program was rated at A+(arg) and raBBB+ by Fitch Argentina Calificadora de Riesgo S.A. and Standard & Poor's International Ratings, LLC, Argentina, respectively. On an international basis, Fitch Rating Ltd, Standard & Poor's Rating Services and Moody's Investor Services Inc. have assigned the program a credit rating of B+, B- and Caa1 respectively.

Notes under the program are not subject to acceleration in the event the credit ratings are downgraded.

A small portion of the long-term debt consists of loans granted by the International Finance Corporation in order to finance capital expenditures in Venezuela, the construction of Innova plants in Brazil, foreign trade financing operations and bank loans obtained by other foreign subsidiaries

The following is our debt maturity profile as of December 31, 2004:

	1 year	2 years	3 years	4 years	5 years	6 o r m o r e years
Millions of Pesos	1,147	621	1,345	229	602	2,005

Cross default covenants

Class F, G, H, I, N, Q and R notes include cross default covenants, whereby the Trustee, as instructed by the noteholders representing at least 25% of the related outstanding capital, shall declare all the amounts owed due and payable, if any debt of the Company or its significant subsidiaries is not settled upon the maturity date, provided that those due and unpaid amounts exceed the higher of US\$25 million or 1% of Petrobras Energía s shareholders equity upon those maturities, and that the default has not been defeated or cured within 30 days after the Company has been served notice of the default.

Class K and M notes include cross default covenants, whereby the Trustee, as instructed by the noteholders representing at least the majority of the related outstanding capital, shall declare all of the amounts owed due and payable, if any debt of the Company or its significant subsidiaries is not settled upon the maturity date, provided that those due and unpaid amounts exceed the higher of US\$15 million or 1% of Petrobras Energía s shareholders equity upon those maturities.

Class C notes, as well as certain loan agreements, include cross default covenants, whereby the Trustee or the creditor bank, as appropriate, shall declare all the amounts owed as due and payable, if any debt of the Company is not settled upon the maturity date, provided that those due and unpaid amounts exceed US\$10 million or 1% of our shareholders equity in relative terms, upon those maturities.

Covenants

In relation to the issuance of Class K and M notes and medium-term credit instruments (the refinanced financial debt), while some portion of the debt remains unpaid, the Company shall be subject to compliance with a series of restrictions and obligations, which include, among others, the following:

- a) Restrictions on liens: Petrobras Energía shall not create, except for a limited number of exceptions, any lien upon the whole or any part of its assets and its current or future income, including any right to earn income, unless it grants identical security interests to the refinanced financial debt.
- b) Restrictions on the payment of dividends: Petrobras Energía shall not distribute dividends prior to December 31, 2004, in cash exceeding US\$ 650,000. Such dividends shall be exclusively allocated to the payment of certain administrative expenses. After this date and through October 2007, the aggregate amount paid shall not exceed 50% of the excess cash (cash provided by operating activities less aggregate capital expenditures allowed, up to the amount of actual capital expenditures, less financial debt repaid) for the immediately preceding fiscal year.
- c) Restrictions on capital expenditures: Petrobras Energía shall not make any capital expenditures, including the amount of debt incurred in relation thereto, in excess of US\$425 million in 2005 and US\$475 million in 2006 and 2007. These limits shall be increased through: (i) proceeds from the sale of capital assets, (ii) 50% of the excess cash from the preceding fiscal year, (iii) contributed capital for capital increases, subordinated debt and investment project finance, and (iv) 50% of cash provided by new debt, issuance the aggregate dividends paid shall decrease the limit of capital expenditures.
- d) Restrictions on the incurrence of additional debt: Petrobras Energía shall not incur any financial debt as long as, after the estimation thereof, the ratio of: (A) consolidated financial debt, and (B) consolidated EBITDA (defined as gross profit less administrative, selling and exploration expenses, plus depreciation and amortization, dividends and advisory services collected) exceeds 3.5. This restriction shall not be applicable to subordinated debt, debt resulting from investment project finance and that incurred to settle the existing debt.
- e) Restrictions on consolidated financial debt (excluding subordinated debt): The consolidated financial debt to consolidated EBITDA ratio shall not be greater than 3.0 as from 2005 through 2007. For interim periods, the restriction will be weighted considering the period of four consecutive quarters prior to the end of the quarter.
- f) Restrictions on EBITDA to Interest ratio: EBITDA to Interest ratio shall not be lower than 3.0 as from 2005 through 2007. For interim periods, the restriction will be weighted considering the period of four consecutive quarters prior to the end of the quarter.
- g) Restrictions on debt maturity profile: at any time Petrobras Energía's short term financial debt shall not exceed an amount equal to US\$ 650 million.
- h) Export obligation: Exports and export collections to total principal services ratio (principal repayments plus accrued interest) for Series K shall be higher than 1.25 and 1.10 respectively.
- i) Mandatory financial debt redemption: Within a term not exceeding 120 days as from fiscal year end, Petrobras Energía shall mandatorily redeem on a pro rata basis a portion of the refinanced financial debt of up to 50% of the excess cash during such fiscal year. In addition, proceeds from the sale of assets, excluding those that constitute the business purpose, not reinvested within 360 days, and the 50% of the cash proceeds from new debt, shall be used to prepay the refinanced financial debt.

FUTURE CAPITAL REQUIREMENTS

In 2005, the Company expects to make investments for approximately US\$550 million. Though this level of investments also includes investments of about US\$100 million relating to EG3, PAR and PSF (See Corporate Reorganization), it ratifies sustained growth in recent fiscal years and business growth and expansion targets contemplated in the Business Plan.

The Company's 2005 Business Plan will primarily focus on the Oil and Gas Exploration and Production segment, with special emphasis on operations in Argentina, Venezuela and Ecuador. Projected investments in this segment will be in line with the goal of increasing reserves and production, as a crucial step in securing the Company's sustainable growth.

In Argentina, efforts will continue at the Neuquén Basin to develop oil reserves through well drilling and expansion of the relevant surface facilities. As regards gas production, construction works will start for El Mangrullo field, owned by PSF, to become operational in 2006. At the Austral Basin, drilling expenditures will be mainly directed toward development and delimitation of oil reserves. The Plan contemplates construction of a treatment plant to increase the quality of crude oil produced. In addition, interconnection works will be performed for the development of gas reserves, with the subsequent increase in the Basin available sales potential.

In Venezuela, the 2005 budget contemplates the development of producing reservoirs, with a special focus on drilling and lifting improvement activities. In addition, efforts will be made to enhance facilities to secure profitable production under applicable safety and environmental standards.

In Ecuador, development of Block 18 will continue through drilling of producing wells, construction of a treatment plant and infrastructure works for crude oil transportation. In Block 31, development of the Apaika Nenke field is foreseen through the construction of the pier and access area. In addition, construction works are estimated to start in connection with the crude oil treatment and water injection plants and the oil pipeline to transport crude oil to OCP.

In Peru, the capital expenditure program contemplates execution of drilling and secondary recovery projects aimed at developing reserves and increasing the recovery factor. In addition, the program contemplates execution of optimization projects for the recovery of production and reduction in operating costs.

In the Refining segment, we will continue developing the retail commercial network. In this regard, investments are foreseen to increase the number of gas stations and simultaneously move forward in the process of reidentification with Petrobras brand, with a view to consolidating its image and sustained growth in customer satisfaction ratings. In

addition, investments are foreseen to improve efficiency and operating reliability of refineries and expand logistics infrastructure.

In the Petrochemicals business segment, investments will be made to consolidate the Company's leadership in the fertilizer and styrenic businesses and expand product offering.

The Company estimates that its capital investment requirements, financial debt payment obligations and working capital will be financed by cash from operations and, to a lesser extent, by new debt financings and possible divestments.

Our 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 enforceability of Argentine and foreign regulations, the economic situation prevailing in Argentina and the Mercosur region and the evolution of the exchange rate.

CORPORATE GOVERNANCE

Corporate Governance refers to a set of policies, systems, standards and procedures regulating the Company's management and development.

The Corporate Governance best practices provide the adequate framework to support organizational objectives, where the roles and responsibilities of the main players and their interaction are defined, securing the alignment, balance and respect of the interests of all shareholders and any other public involved (shareholders, employees, clients, vendors and the community in general).

Ethics in the conduct of business, transparency in the relationship with target publics and trustworthiness of the financial information generated by the company are the main pillars of the management practices on which the Company's Corporate Governance philosophy is built.

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