

# S Financial Statements



# Report of independent registered public accounting firm

To the Board of Directors and Shareholders  
Votorantim Celulose e Papel S.A.

In our opinion, based on our audits and the report of other auditors, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Votorantim Celulose e Papel S.A. and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements as at and for the year ended December 31, 2005 and 2004, of Aracruz Celulose S.A., an affiliate, the investment in which totaled US\$ 262 million and US\$ 243 million respectively and for which the equity in earnings of affiliate, included in net income, totaled US\$ 42 million and US\$ 28 million for the years then ended. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Aracruz Celulose S.A., is based solely on the report of the other auditors. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

São Paulo, January 17, 2006

PricewaterhouseCoopers  
Auditores Independentes

# Consolidated balance sheets at december 31

In millions of U.S. dollars, except number of shares

Assets	2005	2004
<b>Current assets</b>		
Cash and cash equivalents	261	151
Held-to-maturity securities	-	69
Available for sale securities	446	-
Trade accounts receivable, net	212	175
Inventories	157	130
Recoverable taxes	57	49
Deferred income tax	7	-
Other	24	13
	1,164	587
Investment in affiliates, including goodwill	596	249
Property, plant and equipment, net	1,758	1,443
<b>Other assets</b>		
Held-to-maturity securities	-	209
Unrealized gains from cross currency interest rate swaps	-	47
Recoverable taxes	31	32
Deferred income tax	89	43
Judicial deposits	87	26
Other	6	8
	213	365
	3,731	2,644
<b>Liabilities and shareholders' equity</b>		
<b>Current liabilities</b>		
Trade payables	64	45
Short-term debt	132	79
Current portion of long-term debt	79	297
Unrealized loss from currency interest rate swaps	6	-
Payroll, profit sharing and related charges	20	15
Income taxes	-	18
Taxes payable	21	8
Interest attributable to capital payable	103	-
Other	20	11
	445	473
<b>Long-term liabilities</b>		
Long-term debt	1,285	569
Unrealized loss from currency interest rate swaps	71	-
Accrued liabilities for legal proceedings	172	104
Post-retirement benefits	21	-
	1,549	673
<b>Commitments and contingencies (Note 14)</b>		
<b>Shareholders' equity</b>		
Preferred shares, no par value, 280,000,000 shares authorized, 85,911,046 shares issued and outstanding	785	785
Common shares, no par value, 140,000,000 shares authorized, 105,702,452 shares issued and outstanding	1,053	1,053
Additional paid-in capital	29	29
Treasury shares, at cost, 2005 - 1,081,500 preferred shares; 2004 - 157,200 preferred shares	(13)	(2)
Appropriated retained earnings	72	60
Unappropriated retained earnings	487	440
Accumulated other comprehensive deficit		
Cumulative translation adjustments	(687)	(867)
Net unrealized gains on available for sale securities	11	-
	1,737	1,498
	3,731	2,644

The accompanying notes are an integral part of the consolidated financial statements.

# Consolidated statements of income

In millions of U.S. dollars, except number of shares

	2005	2004	2003
Net operating revenue			
Domestic sales (net of sales taxes: 2005 - US\$ 183; 2004 - US\$ 119 and 2003 - US\$ 123)	564	512	443
Export sales (including related party sales: 2003 - US\$ 58)	566	498	373
	1,130	1,010	816
Operating costs and expenses			
Cost of sales	654	518	421
Selling and marketing	138	121	82
General and administrative	55	40	33
Other operating expenses, net	36	6	12
	883	685	548
Operating income	247	325	268
Non-operating income (expense)			
Financial income	79	40	65
Financial expense	(119)	(69)	(71)
Foreign exchange gain (loss) and unrealized gain (loss) on swaps, net	(5)	12	(14)
	(45)	(17)	(20)
Income before taxes on income and equity in affiliates	202	308	248
Current income tax expense			
Domestic	(45)	(47)	(37)
Foreign	(6)	(6)	(3)
Deferred income tax benefit	59	17	17
Income before equity in affiliates	210	272	225
Equity in earnings of affiliates	54	31	19
Net income	264	303	244
Net income applicable to preferred shares	124	143	115
Net income applicable to common shares	140	160	129
Net income	264	303	244
Basic and diluted earnings - in U.S. dollars			
Per preferred share or ADS	1.46	1.67	1.34
Per common share	1.33	1.51	1.22
Weighted average number of shares outstanding (thousand)			
Preferred	85,451	85,773	85,510
Common	105,702	105,702	105,702

The accompanying notes are an integral part of the consolidated financial statements.

# Consolidated statements of cash flows

In millions of U.S. dollars

	2005	2004	2003
<b>Cash flows from operating activities</b>			
Net income	264	303	244
Adjustments to reconcile net income to cash provided by operating activities			
Foreign exchange (gain) loss and unrealized (gain) loss on swaps, net	5	(12)	14
Equity in earning of affiliates	(54)	(31)	(19)
Deferred income tax	(59)	(17)	(17)
Depreciation and depletion	117	89	72
Loss on disposal of property, plant and equipment	9	5	7
Decrease (increase) in assets			
Trade accounts receivable	(4)	(17)	5
Inventories	(6)	(21)	(28)
Other assets	(38)	(15)	(3)
Increase (decrease) in liabilities			
Decrease in liabilities	(11)	(29)	(37)
<b>Net cash provided by operating activities</b>	<b>223</b>	<b>255</b>	<b>238</b>
<b>Cash flows from investing activities</b>			
Held-to-maturity securities purchased, net of proceeds on sale	6	48	55
Available for sale securities purchased, net of proceeds on sale and matured securities	(110)	-	-
Acquisition of an interest in affiliate (Note 4 (a))	(275)	-	-
Interest attributable to capital and dividends received	11	22	13
Acquisition of property, plant and equipment	(247)	(218)	(165)
<b>Net cash used in investing activities</b>	<b>(615)</b>	<b>(148)</b>	<b>(97)</b>
<b>Cash flows from financing activities</b>			
Short-term debt	55	42	(23)
Long-term debt			
Third parties			
Borrowings	869	347	364
Repayments	(324)	(558)	(420)
Related parties			
Borrowings	43	46	163
Repayments	(39)	(30)	(8)
Treasury shares			
Acquisition	(12)	(2)	-
Sales	1	1	3
Dividends paid	(88)	(104)	(40)
<b>Net cash provided by (used in) financing activities</b>	<b>505</b>	<b>(258)</b>	<b>39</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>(3)</b>	<b>12</b>	<b>20</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>110</b>	<b>(139)</b>	<b>200</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>151</b>	<b>290</b>	<b>90</b>
<b>Cash and cash equivalents at end of year</b>	<b>261</b>	<b>151</b>	<b>290</b>
<b>Supplemental cash flow information</b>			
Cash paid during the year for			
Income tax	43	34	31
Interest	65	61	59
<b>Non-cash transactions</b>			
Acquisition of property, plant and equipment financed by suppliers	-	-	2

The accompanying notes are an integral part of the consolidated financial statements.

# Consolidated statements of changes in shareholders' equity

In millions of U.S. dollars, except number of shares

	2005	2004	2003
<b>Preferred shares</b>			
At beginning of year	785	553	553
Transferred from unappropriated retained earnings	-	232	-
At end of year	785	785	553
<b>Common shares</b>			
At beginning and end of year	1,053	767	767
Transferred from unappropriated retained earnings	-	286	-
At end of year	1,053	1,053	767
<b>Additional paid-in-capital</b>			
At beginning of year	29	29	24
Gain on sale of treasury shares	-	-	5
At end of year	29	29	29
<b>Treasury shares</b>			
At beginning of year	(2)	(1)	(4)
Preferred shares sold (2005 - 126,400; 2004 - 114,500 and 2003 - 713,600)	1	1	3
Preferred shares purchased (2005 - 1,050,700; 2004 - 263,800)	(12)	(2)	-
At end of year	(13)	(2)	(1)
<b>Appropriated retained earnings</b>			
At beginning of year	60	46	31
Transferred from unappropriated retained earnings	12	14	15
At end of year	72	60	46
<b>Unappropriated retained earnings</b>			
At beginning of year	440	773	584
Net income	264	303	244
Transferred to preferred shares	-	(232)	-
Transferred to common shares	-	(286)	-
Transferred to appropriated retained earnings	(12)	(14)	(15)
Dividends and interest attributed to capital			
Preferred	(97)	(49)	(19)
Common	(108)	(55)	(21)
At end of year	487	440	773
<b>Cumulative translation adjustments</b>			
At beginning of year	(867)	(981)	(1,187)
Gain for the year	180	114	206
At end of year	(687)	(867)	(981)
<b>Net unrealized gains on available for sale securities</b>			
At beginning of year (2004 and 2003 in affiliates)	-	(1)	(1)
Transferred to results of operations (retained earnings)	-	1	-
Gain for the year, net of tax of US\$ 6	11	-	-
At end of year	11	-	(1)
<b>Shareholders' equity at end of year</b>	<b>1,737</b>	<b>1,498</b>	<b>1,185</b>
<b>Comprehensive income</b>			
Net income	264	303	244
Unrealized gains on available for sale securities	11	-	-
Translation adjustments	180	114	206
<b>Comprehensive income</b>	<b>455</b>	<b>417</b>	<b>450</b>

The accompanying notes are an integral part of the consolidated financial statements.

# Notes to the consolidated financial statements

In millions of U.S. dollars, unless otherwise stated

## Operations

Votorantim Celulose e Papel S.A. and its subsidiaries (the “Company”, “VCP” or “we”) is a limited liability company constituted in accordance with the laws of the Federative Republic of Brazil and headquartered in the state of São Paulo.

We produce eucalyptus pulp which we use in our own integrated paper manufacturing facilities or, to a lesser extent, sell in the domestic and foreign markets. We also have forestry operations which produce the pulp wood required for our production. Our business has experienced, and is likely to continue to experience, cycles relating to available industry capacity and general industry economic conditions. Our sales (volumes and prices) are affected by such conditions which are beyond our control. We are a member of the Votorantim Group, which has other interests in Brazil and abroad, principally in cement, metallurgy, agribusiness, chemicals and financial services.

Our preferred shares are traded on the São Paulo Stock Exchange under the symbol “VCPA4.” Our American Depositary Shares (“ADSs”) are traded on the New York Stock Exchange under the symbol “VCP”. Each ADS represents one of our preferred shares.

## Significant accounting policies

### Basis of presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”), which differ in certain respects from the accounting principles applied by the Company in its financial statements prepared in accordance with accounting practices generally accepted in Brazil (“Brazilian GAAP”) as filed with the Comissão de Valores Mobiliários (Brazilian Securities Commission or “CVM”), or for other statutory purposes in Brazil.

### Translation of financial statements

We transact the majority of our business in Brazilian Reais (R\$) and, therefore, have adopted the Brazilian Real as the functional currency and have selected the United States dollar as our reporting currency. The U.S. dollar amounts for all years presented have been translated from Reais amounts in accordance with the criteria set forth in Statement of Financial Accounting Standards (“SFAS”) 52, “Foreign Currency Translation”. Assets and liabilities are translated from the functional currency to the reporting currency using the official exchange rates reported by the Brazilian Central Bank at the balance sheet date (December 31, 2005 - US\$ 1.00 : R\$ 2.3407; December 31, 2004 - US\$ 1.00 : R\$ 2.6544; December 31, 2003 - US\$ 1.00 : R\$ 2.8892).

Revenue, expenses and gains and losses are translated from the functional currency to the reporting currency using the monthly weighted-average exchange rates for the year. Capital accounts are recorded at historical exchange rates. Translation gains and losses are recorded in the Cumulative Translation Adjustments account (“CTA”) in shareholders’ equity.

### Principles of consolidation

Our consolidated financial statements include the accounts of VCP and our directly and indirectly controlled subsidiaries: VCP Exportadora e Participações Ltda. (“VEP”), VCP Florestal Ltda. (merged into VCP on January 1, 2005), St. Helen Holding III B.V., Normus Empreendimentos e Participações Ltda., Newark Financial Inc. (“Newark”), VCP Overseas Holding KFT, VCP North America Inc. (United States) and VCP Trading N.V. (Netherlands Antilles), all of which are wholly owned. Significant intercompany accounts and transactions have been eliminated in the consolidation. The 12.35% owned equity investee, Aracruz Celulose S.A. (“Aracruz”), in which we acquired our interest during 2001 and our 50 % owned equity investees, Voto - Votorantim Overseas Trading Operations N.V. (“VOTO”), Voto - Votorantim Overseas Trading Operations II Limited. (“VOTO II”) and Voto - Votorantim Overseas Trading Operations IV Limited. (“VOTO IV”) respectively, are accounted for using the equity method.

On March 31, 2005, Ripasa Participações S.A. (“Ripar”) a joint venture in which we own 50%, acquired a 46.06% interest in the total capital and 77.59 % interest in the voting capital of Ripasa S.A. Celulose e Papel (“Ripasa”), a Brazilian pulp and paper producer. We account for our interest in Ripar using the equity method of accounting.

## Cash and cash equivalents

We consider all highly liquid investments with a maturity at acquisition of three months or less to be cash equivalents.

## Available for sale securities

We consider debt securities as available for sale securities when we intend to sell the securities before its maturity. Available for sale securities are presented based on quoted market prices and the unrealized gain or loss, net of taxes, is recorded in shareholders’ equity until the maturity or sale date, when the gain or loss is transferred to the financial income in the statement of income.

## Held-to-maturity investments

We consider debt securities as held-to-maturity when we intend and have the ability to hold the securities to maturity. Held-to-maturity securities are carried at cost plus accrued income which is included in financial income in the statement of income

## Inventories

Inventories, including timber, are stated at average acquisition or production cost, which is lower than market.

## Investment in affiliates, including goodwill

Investments in affiliates in which we have the ability to exercise significant influence over the operating and financial policies are accounted for under the equity method.

Goodwill as well as other intangible assets with indefinite lives is tested annually for impairment.

## Property, plant and equipment

Property, plant and equipment are stated at cost of acquisition or construction, including interest during the construction period. Expenditures which materially extend the useful lives of the existing facilities and equipment are capitalized. We depreciate property, plant and equipment using the straight-line method at rates we judge to be compatible with the useful lives, principally 25 years for plant and equipment, 10 years for furniture and fixtures and five years for vehicles. Depletion of forests is computed on the unit-of-production method, based on the volume of timber harvested in each period. Software costs capitalized are amortized on a straight-line basis over five years.

Forest development costs, primarily project implementation costs (preparation of soil, planting, pest control and clearing etc.) and on-going development costs are capitalized as incurred. As a result of improvements in forest management techniques, including genetic improvement in trees, we harvest and replant our forests approximately every seven years. Capitalized costs are expensed at the time of each harvest.

We review our property, plant and equipment for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset or group of assets may not be recoverable on the basis of undiscounted future cash flows. The reviews are carried out at the lowest level of groups of assets to which we are able to attribute identifiable future cash flows. Asset groups are forestry projects or production facilities for paper and pulp. We adjust the net book value of the underlying assets if the sum of the expected future cash flows is less than book value. These reviews to date have not indicated the need to recognize any impairment.

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## Income taxes

Brazilian taxes on income consist of federal income and social contribution taxes, the latter being a federal tax based on adjusted taxable income determined under Brazilian tax regulations. There are no taxes levied by state or local authorities on income in Brazil.

For the purposes of these financial statements, we have applied SFAS 109 "Accounting for Income Taxes", for all periods presented. The effect of adjustments made to reflect the requirements of US GAAP as well as the differences between the tax basis of non-monetary assets have been recognized as temporary differences for the purpose of recording deferred income taxes.

Current and non-current deferred tax assets and liabilities are presented separately.

## Revenues and expenses

We recognize revenue and associated costs of sales at the time our products are delivered to our customers or when title and associated risks pass to our customers. Revenue is recorded net of sales returns of US\$ 7 in 2005 (US\$ 6 in 2004 and US\$ 8 in 2003). Our customers that purchase on credit agree to payment terms that effectively include finance charges. The finance charge on each sale is the difference between the amount the customer agrees to pay at the due date and the cash sale price. The finance charges are recognized over the payment period and are included in financial income. Recognition of revenue for our two segments and for domestic and export sales is based on the following principles:

### Paper – domestic market

Sales are either on cash or credit terms (normally 30, 60, 90 days) or through our vendor program. Credit sales receivables are discounted to present values as our price list is dependent on the length of credit granted. Revenue is recognized when the customer takes delivery of the product either upon delivery to the customer's carrier (FOB) or premises (CIF). Sales through our vendor program are made to certain of our pre-qualifying domestic customers, and represented approximately 22% of our domestic sales in 2005 (2004 - 21%; 2003 - 22%). Under the vendor program, the customer agrees to pay the bank and the bank in turn pays us on behalf of the customer for the purchase price of the product. We guarantee full repayment of the loan for which the maximum allowable term for payment is generally 180 days, though in the case of a few customers, we extend the term to 360 days.

We estimate that for 2005, 2004 and 2003, an average of approximately 2% of our total number of regular domestic customers (approximately 22%, 21% and 22%, respectively, of total domestic sales value) obtained our guarantee for their loans.

### Paper – export market

Export orders are normally met by own or third party warehouses located close to strategic markets. These sales are recognized when products are delivered to the carrier and risks have passed to the customer, that is, the Company delivers the goods, cleared for export to the carrier nominated by the buyer at the named place. CIF and FOB terms determine timing of revenue recognition.

### Pulp – domestic market

In 2005 none of our customers qualified for sales through our vendor program (2004 - none; 2003 - one), credit terms of up to 270 days were extended by the bank. Remaining sales are primarily under credit terms which do not exceed 30 days. Revenue recognition is consistent with that applied to paper sales.

### Pulp – export market

All export orders are normally satisfied by own or third party warehouses located close to strategic markets. These sales are recognized when products are delivered to the carrier and risks have passed to the customer. Exports to Asia are on a cost and freight basis with a named port of destination.

Research and development expenses are charged to expense as incurred and totaled approximately US\$ 1 in each of 2005, 2004 and 2003. Start-up expenses of new facilities and restructuring charges are also directly expensed.

Shipping and handling costs are charged to selling and marketing expenses and totaled approximately US\$ 75, US\$ 76 and US\$ 52 in 2005, 2004 and 2003, respectively.

## Comprehensive income

We report comprehensive income in accordance with SFAS 130, "Reporting Comprehensive Income", and have elected to present this in the Statement of changes in shareholders' equity. In our case, comprehensive income comprises the results of our operations, the translation adjustments included in the CTA component of shareholders' equity and the changes in the fair value of available for sale securities.

## Earnings per share

In conformity with SFAS 128, "Earnings per Share", we have presented earnings per share for each class of shares, taking into account that the preferred shares are entitled to a dividend 10% greater than that paid to the common shares. The computation has been made as if the net income for each period will be fully distributed. Earnings may be capitalized or otherwise appropriated; consequently such earnings would no longer be available as dividends. Therefore, there is no assurance that preferred shareholders will receive a 10% premium on undistributed earnings. We may also pay dividends through interest attributed to capital in accordance with our by-laws.

Following the reverse stock split of our shares and ADSs on October 18, 2004 (Note 16), we retroactively adjusted all shares and ADS data to take account of the reverse split.

## Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Estimates are used for, but not limited to: accounting for allowance for doubtful accounts, selection of depreciable lives of assets, asset impairments, tax valuation allowances, contingencies and other similar evaluations. Actual results could differ from those estimates.

## Employee benefits and other related matters

In March 2000 we launched a defined contribution plan which provides pension and post-retirement benefits (Note 19). We also contribute to the Government pension, welfare and redundancy plans on behalf of our employees and these contributions are expensed as incurred. Most of our employees are members of unions, with which we enter into collective-bargaining arrangements annually. The liability for future compensation for employee vacations is accrued as earned.

We adopt SFAS 106, "Employers' Accounting for Post-retirement Benefits Other than Pensions", which requires a provision for the costs of post-retirement benefits expected to be paid to current, former or inactive employees upon retirement. Expenses relating to benefits we provide to our current employees are expensed as incurred whereas those relating to retired employees (current as well as expected in the future) and their dependents are accounted for in accordance with SFAS 106.

## Environmental matters

Our production facilities and forestry operations are subject to a number of environmental risks which we seek to mitigate by strict operating procedures and investments in pollution control equipment and systems. Ongoing environmental compliance expenditures are expensed as incurred and new equipment and systems are capitalized. We believe that no provision for losses related to environmental matters is currently required based on prevailing laws and regulations in Brazil.

## Recently issued accounting pronouncements

The Financial Accounting Standards Board (“FASB”) recently issued a number of Statements of Financial Accounting Standards and interpretations; neither of the standards or interpretations described below had or are expected to have a material impact on the financial position and results of operations of the Company.

In November 2004, the FASB issued SFAS 151, Inventory Costs an amendment of ARB 43, Chapter 4, which addresses inventory pricing. This statement clarifies the accounting for abnormal amounts of idle facility expenses, freight, handling costs, and spoilage. Under previous guidance, paragraph 5 of ARB 43, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs that are considered to be “so abnormal” are treated as current period charges. This statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of “so abnormal.” In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of this Statement shall be effective prospectively for inventory costs incurred during fiscal years beginning after June 15, 2005.

In December 2004, the FASB issued SFAS 153, “Exchanges of Nonmonetary Assets - an amendment of APB 29”, to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS 153 is effective for nonmonetary assets exchanges occurring in fiscal periods beginning after June 15, 2005.

In March 2005, the FASB issued FASB Interpretation 47, “Accounting for Conditional Asset Retirement Obligations”. This statement requires companies to recognize a liability for the fair value of a legal obligation to perform asset retirement obligations that are conditional on a future event if the amount can be reasonably estimated. This statement becomes effective on December 31, 2005. Management has previously evaluated the application of FASB Statement 143 to its operations and concluded that no material effects would be expected. Management will consider this Interpretation from 2005 in the event a conditional asset retirement obligation arises.

In June 2005, the FASB issued SFAS 154, “Accounting Changes and Error Corrections, a replacement of APB 20 and FASB Statement 3”. SFAS 154 requires retrospective application to financial statements of prior periods for changes in accounting principles as if such principles had always been used. The cumulative effect of the change is reflected in the carrying value of assets and liabilities as of the first period presented and the offsetting adjustments are recorded to opening retained earnings. This statement is effective January 1, 2006. The Company will apply this statement as of January 1, 2006 as such changes in accounting principles occur.

In July 2005, the FASB issued FSP no. APB 18-1, “Accounting By an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for Under The Equity Method in Accordance with APB Opinion 18 Upon a Loss of Significant Influence”, which requires that when equity method accounting ceases upon the loss of significant influence of an investee, the investor’s proportionate share of the investee’s other comprehensive income should be offset against the carrying value of the investment. To the extent this results in a negative carrying value, the investor should adjust the carrying value to zero and record the residual balance through earnings. The Company will apply this Statement in the fiscal period beginning January 1, 2006 as the need arises.

In November 2005, the FASB issued FSP FAS 115-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments”, which outlines a three-step model for identifying investment impairments in debt and equity securities within the scope of Statement 115 and cost-method investments. The three steps involve (i) determining whether the investment is impaired, (ii) evaluating whether the impairment is other-than-temporary, and (iii) if the impairment is other-than-temporary, recognizing an impairment loss. The FSP carries forward the disclosure requirements of issue 03-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.” The Company will begin applying this guidance as of January 1, 2006 as circumstances arise.

# Acquisition of affiliates

## Ripasa

On November 10, 2004, we signed an agreement to acquire an interest in Ripasa through a venture with Suzano Bahia Sul Papel e Celulose S.A. ("Suzano"). The agreement was consummated on March 31, 2005 when Ripar was constituted by VCP and Suzano upon each contributing US\$ 275 in exchange for equal shareholder rights and responsibilities, including equal direct and indirect holdings in the capital of Ripasa. On March 31, 2005, Ripar acquired and paid for 129,676,966 common shares and 41,050,819 preferred shares of Ripasa, representing 77.59% of the voting share capital and 46.06% of the total stock, the reais equivalent, at that date, of US\$ 550.

Pursuant to the November 10, 2004 agreement, VCP and Suzano have a call option to acquire 37,449,084 common shares and 12,388,719 preferred shares of Ripasa, representing 22.41% of the voting stock and 13.45% of the total stock for a twelve-month period starting on the fifth anniversary of the closing date, for the reais equivalent, at that date, of US\$ 160 plus interest. The shareholders of Ripasa who are party to the agreement have a put option which may require Ripar to acquire all their common and preferred shares during a period of five years from the closing date. The shareholder agreement between VCP and Suzano provides for certain rights of first refusal in relation to their respective interest in Ripar.

On July 20, 2005, the Boards of Directors of VCP, Suzano and Ripasa, approved the corporate restructuring that would allow Ripasa's minority shareholders to exchange their interests in Ripasa for VCP and Suzano stock, in equal parts. The restructuring involves two phases: (i) the merger of Ripasa into Ripar and (ii) the distribution of assets to VCP and Suzano, in equal parts. The restructuring will be submitted for approval at the general meetings of the respective companies. At the completion of the restructuring, Ripasa's minority shareholders will become shareholders in VCP and Suzano, in accordance with the Protocol and Justification of Share Merger and Distribution ("Protocol") that VCP, Suzano, Ripasa and Ripar executed on July 20, 2005.

This transaction is being analyzed by Brazilian antitrust authorities and is subject to their review and approval.

On August 29, 2005, the Extraordinary General Meeting of Ripasa, which had been called to discuss the proposal, was suspended through an injunction without any decisions having been taken. The companies are pursuing legal measures to assure the shareholders meeting is reconvened, as soon as possible, with the objective of implementing the restructuring program.

Our share of the distributable retained earnings of Ripasa is restricted to the equivalent of US\$ 9 at December 31, 2005.

## Aracruz

On October 3, 2001, Newark acquired 127,506,457 common shares of Aracruz, representing 28.00% of the voting share capital and 12.35% of the total stock of Aracruz, for US\$ 370, when we became a member of the controlling group of Aracruz, together with the Lorentzen and Safra Group, (each member owning 28% of the voting shares and with three seats on the board of directors), and BNDESPAR (with 12.5% of the voting shares and one seat on the board of directors). The excess of the cost of our investment in Aracruz over our portion of the underlying fair value of the net assets amounted to US\$ 155.

Our share of the distributable retained earnings of Aracruz is restricted to the equivalent of US\$ 35 at December 31, 2005. Dividends and interest attributable to capital received from Aracruz during 2005, totaled US\$ 11 (2004 totaled US\$ 22).

A goodwill impairment provision was determined based on the market price of US\$ 18.56 for the Aracruz ADRs on December 31, 2002, of US\$ 136 (gross of deferred income tax effects of US\$ 46) and was charged directly to income. The deferred tax effect is included in "Deferred income tax benefit". At December 31, 2005, Aracruz ADSs traded at US\$ 40.01.

## Income taxes

Income taxes in Brazil include federal income tax and social contribution. The composite tax rate on adjusted taxable income is 34%. From 2001 to 2004 we elected to calculate and pay our income taxes based on the provisions of REFIS (an estimated tax basis which is based on a percentage of net sales adjusted by financial income and other income). As from 2005, taxes on income are based on adjusted taxable income determined under Brazilian tax regulations.

### Income tax analysis

The statutory rate applied to income before taxes is reconciled to income tax expense as follows:

	2005	2004	2003
Income before income taxes	202	308	248
Income tax expense at statutory tax rate - 34%	(69)	(105)	(84)
Reconciliation of statutory to effective rate			
Effect of REFIS election	-	69	61
Benefit from interest attributable to capital	42	-	-
Difference in foreign income tax rates and other permanent differences	35	-	-
Income tax (expense) benefit	8	(36)	(23)

### Analysis of deferred tax balances

	2005	2004
Deferred tax assets		
Tax loss carryforwards	7	13
Tax effects on impairment of Aracruz (Note 4 (b))	46	46
Cross currency interest rate swap contracts	30	-
Post-retirement benefits	7	-
Provisions	28	7
Others	1	1
Total deferred tax assets	119	67
Deferred tax liabilities		
Accelerated depreciation and US GAAP adjustments	(17)	(17)
Cross currency interest rate swap contracts	-	(7)
Tax effect on unrealized gains on available for sale securities	(6)	-
Total deferred tax liabilities	(23)	(24)
Net deferred tax assets	96	43
Less: current portion	(7)	-
Non-current portion	89	43

We recognize deferred tax assets and liabilities based on the temporary differences between the financial statement carrying amounts and the tax basis of assets and liabilities. If we or one of our subsidiaries operate at a loss or are unable to generate sufficient future taxable income, or if there is a material change in the actual effective tax rates or time period over which the underlying temporary differences become taxable or deductible, we evaluate the need to establish a valuation allowance against all or a significant portion of our deferred tax assets resulting in an increase in our effective tax rate.

## Securities

	Available for sale 2005	Held-to-maturity 2004
In reais		
Securities	207	-
Foreign Government Bonds	54	41
Credit linked notes	30	-
In U.S. dollars		
Brazilian Government Bonds	155	223
VOTO III	-	14
<b>Total - current and non-current</b>	<b>446</b>	<b>278</b>
Maturity periods		2005
Due in less than one year		237
Due in one to five years		209
		446

Due to requirements to fund future investments in our operations and the acquisition shares of Ripasa, we reviewed the classification of the entire security portfolio classified as held-to-maturity in the second quarter of 2005. At the time we invested in these securities, and in each reporting period through that date, our intention had been to hold them through maturity. As a result of our review, we reclassified the full portfolio to the 'available for sale'. Upon the transfer, securities were adjusted to their fair values and the difference between the carrying amounts of the securities at the date of transfer and their fair value as of such date was recognized, net of the related tax effects, in "Net unrealized gains on available for sale securities" directly in shareholders' equity.

## Trade accounts receivable

	2005	2004
Domestic receivables	124	101
Export receivables, denominated in U.S. dollars	95	79
Allowance for doubtful accounts	(7)	(5)
	212	175

No single customer represented more than 10% of our trade accounts receivables balance or net sales.

## Inventories

	2005	2004
Finished products	64	57
Work in process	8	7
Raw materials and supplies	82	63
Imports in transit and other	3	3
	157	130

## Property, plant and equipment

	2005	2004
Land	155	114
Buildings	138	113
Machinery, equipment and installations	1,393	1,136
Forests	315	272
Other	174	156
Construction in progress	93	78
	2,268	1,869
Accumulated depreciation and depletion	(510)	(426)
	1,758	1,443

Interest capitalized on construction in progress in each of the periods was: 2005 - US\$ 5; 2004 - US\$ 4 and 2003 - US\$ 7.

## Short-term debt

Short-term debt represents commitments under recourse provisions to honor export receivables transferred to banks accounted for as secured borrowings (ACEs), bearing an annual average interest rate of 4.6% at December 31, 2005 (2004 - 2.4%). Historically, we have not incurred significant losses in connection with such recourse provisions.

## Long-term debt

	Interest rate December 31, 2005	2005	2004
Third parties			
In U.S. dollars			
Export credits (prepayment)	5.95	936	444
Syndicated bank loan		-	88
Others		1	3
Total third parties		937	535
Related parties			
In U.S. dollars			
VOTO II loan		-	125
VOTO III loan	7.88	41	47
VOTO IV loan	7.75	201	-
In reais			
Banco Nacional de Desenvolvimento Econômico e Social ("BNDES")			
TJLP	13.11	158	132
UMBNEDES	12.86	27	27
Total related parties		427	331
Total debt		1,364	866
Less: current portion		(79)	(297)
Long-term portion		1,285	569

-LIBOR (London Interbank Offered Rate) at December 31, 2005 was 4.63% p.a. (2004 - 2.78%).

-TJLP ("Taxa de juros de longo prazo"), a long-term interest rate fixed quarterly by the Brazilian Central Bank.

At December 31, 2005 and 2004, the TJLP was 9.75% p. a.

-The UMBNEDES is a weighted average exchange variation on basket of currencies, predominantly U.S. dollars, held by BNDES.

## Export credits

In July 2005, we signed an Export Prepayment contract with Banco Santander Central Hispano London Branch for US\$ 100 at LIBOR plus 1.58%. Payments are due through 2012 in instalments to match export shipments. The financings are guaranteed by export contracts

In May 2005, we signed an Export Prepayment contract with ING Bank N.V. and Bayerische Hypo und Vercinsbank for US\$ 50 at LIBOR plus 1.5% and US\$ 100 at LIBOR plus 1.49%, respectively. Payments are due through 2012 in installments to match export shipments. The financings are guaranteed by export contracts.

In March 2005, we signed an Export Prepayment Agreement with a pool of banks in the aggregate amount of US\$ 300 at LIBOR plus 1.63%. Payments are due through 2012 in installment to match export shipments. We utilized US\$ 275 to finance the acquisition of our investment in Ripasa and the financings are guaranteed by export contracts by the borrowers, VCP and VEP. VCP is the primary obligor and has unconditionally and irrevocably agreed that if payments are not made, VCP will pay the lenders, which are ABN Amro Bank, Banco Santander Central Hispano and BNP Paribás, such outstanding amounts at the due date.

In May and July 2004, we signed an Export Prepayment Agreement and an Offshore Facility Agreement with a pool of banks in the aggregate amount of US\$ 350 at LIBOR plus 2.00% due through 2011 in installments to match export shipments. The funds were released in 2004. The financings are guaranteed by export contracts by the borrowers, which are VEP and VCP Trading N.V. VCP is the primary obligor and has unconditionally and irrevocably, agreed that if the borrowers fail to make any payments, we will pay to the lenders, which are ABN Amro Bank N.V., Banco Santander Central Hispano and Banco Bradesco S.A., such outstanding amounts at the due date.

## Syndicated bank loan

In October 2001, our wholly owned subsidiary VEP, through its wholly owned subsidiary Newark, received a bridge financing of US\$ 370 to finance the acquisition of our interest in Aracruz. In May 2002, Newark raised US\$ 380 in a credit agreement with ABN AMRO Bank N.V, which it used to pay in full the bridge financing and to make certain payments in connection with the credit agreement. The loan was fully repaid in May 2005.

## VOTO II loan

In July 2003, together with Votorantim Participações (“VPAR”), our ultimate controlling shareholder, we jointly formed VOTO II, a 50% owned affiliated company based in the Cayman Islands, for the sole purpose of raising funds. VOTO II issued US\$ 250, 5.75% Bonds due in June 2005 in the international market, under Regulation S and on-lent US\$ 125 to each of St. Helen III (our consolidated subsidiary) and St. Helen II (owned by VPAR). Together with VPAR and Cimento Rio Branco S.A., a company also under common control of our shareholder VPAR, we are the guarantors for this operation. The loan was fully repaid by St. Helen III to VOTO II on June 27, 2005 with the proceeds of the loan from VOTO IV described below.

## VOTO III Loan

In January 2004, VPAR formed VOTO III, a company based in the Cayman Islands, for the sole purpose of raising funds. VOTO III issued US\$ 300, 7.875% Bonds due 2014 in the international market. We received 15% of the total amount issued or US\$ 45 for which we are the guarantors.

## VOTO IV loan

On June 24, 2005 VOTO IV, a wholly-owned subsidiary of VPAR, issued US\$ 400, 7.75% Fixed Rate Notes due 2020 in the international market, under Rule 144A and Regulation S. VCP is a guarantor of 50% of the debt issued by VOTO IV and in turn received US\$ 200 of the proceeds. On September 6, 2005, we acquired a 50% interests in VOTO IV and together with VPAR we are the guarantors for this operation. From the proceeds of US\$ 200, US\$ 125 was used by St. Helen III to repay the debt incurred with VOTO II.

## BNDES

On May 20, 2005, we signed a financing agreement with BNDES for a total equivalent to US\$ 93 for the purpose of financing acquisition of timberlands. Part of the loan, equivalent to US\$ 79, bears interest at TJLP plus 4.5% per annum. The remaining balance is indexed to the UMBNDES plus 4.5% per annum and carries annual interest of 12.64%. This financing will mature in July 2015. VCP has drawn down US\$ 42 to date.

## Other guarantees

The BNDES loans are secured by property, plant and equipment and a lien on certain land and personal guarantees of an owner of VPAR.

## Long-term debt maturities

At December 31, 2005, the long-term position of long-term debt maturities is as follows:

2007	39
2008	97
2009	198
2010	501
After 2011	450
	1,285

## Covenants

We are subject to a number of material affirmative and negative covenants including, among others: limitations on our ability to incur debt; limitations on the existence of liens on our properties; limitations on transactions with related parties, which generally must be on terms no less favorable than those that could be obtained in a comparable arm's-length transaction; and maintenance of certain financial ratios calculated based on Brazilian GAAP.

## Related parties

Balances and transactions with related parties are as follows:

	Nature and business purpose of transactions	2005	2004
Cash, cash equivalents and held-to-maturity investments	Surplus cash funds invested with Group financial institutions		
Votorantim Group			
Banco Votorantim S.A.		576	336
VOTO III bonds		-	14
Unrealized gains (losses) from cross currency interest rate swaps	Arising from swap contract transactions in which the Group financial institution acts as counter-party		
Votorantim Group	Loans from related parties		
Banco Votorantim S.A.		(54)	27
Long-term loans from related parties			
Votorantim Group			
VOTO II		-	125
VOTO III		41	47
VOTO IV		201	-
BNDES (shareholder)		185	159
Suppliers from related parties	Purchases of wood, pulp and paper		
Ripasa		12	-

Revenue, income and expenses from transactions with related parties were as follows:

	2005	2004	2003
Export sales revenue	-	-	65
Financial income	52	35	17
Financial expenses	115	53	51

Export sales revenue primarily relates to sales made to Votorantrade N.V.; financial income arises from loans made to related parties and investments made in Banco Votorantim S.A.; and financial expenses represent mainly losses on cross currency interest rate swaps, including their respective fair values.

## Financial instruments

We primarily use cross currency interest rate swap contracts and Brazilian Government bonds indexed to the U.S. dollar to hedge our U.S. dollar denominated debt. By entering into these contracts or purchasing Brazilian Government bonds, we partially protect ourselves from the effects of unfavorable exchange movements. Accordingly, if the Real devalues against the U.S. dollar and results in a foreign exchange loss, we are at least in part protected by an offsetting gain from the swap contracts.

We used the following methods and assumptions in estimating the fair value disclosures of our financial instruments:

- . Held-to-maturity investments: the fair value of our held-to-maturity investments were estimated based on market rates for securities with similar terms and maturities.
- . Long-term and short-term debt: the fair values of our long-term debt were estimated based on available quoted rates for loans of substantially similar terms and maturities.

The fair values of our cross currency interest rate swap contracts were estimated based on quoted market prices of comparable contracts. At December 31, 2005 and 2004 the notional amounts of our outstanding cross currency interest rate swap contracts were US\$ 564 and US\$ 259, respectively and their fair values of US\$ 34 and US\$ 55, respectively. The actual cash settlements on the contracts occur at times specified in each agreement.

The carrying amounts and fair values of our financial instruments at December 31 were as follows:

	Carrying amount	2005 Fair value	Carrying amount	2004 Fair value
Cash and cash equivalents	261	261	151	151
Held-to-maturity securities				
VOTO III bonds	-	-	14	15
Brazilian Government Bonds denominated in U.S. dollars	-	-	223	313
Foreign Government Bonds denominated in reais	-	-	41	41
Available for sale securities				
Securities tradable	207	207	-	-
Brazilian Government Bonds denominated in U.S. dollars	155	155	-	-
Credit linked notes	30	30	-	-
Foreign Government Bonds denominated in reais	54	54	-	-
Unrealized gains (losses) from cross currency interest rate swaps	(77)	(77)	47	47
Short-term debt	132	132	79	79
Long-term debt	1,364	1,371	866	873

## Commitments and contingencies

We are party to certain legal proceedings in Brazil arising in the normal course of business, and have made provisions when we believe that we can reasonably estimate probable losses. In connection with some of these proceedings we have made deposits (in "Other assets") which will only be released to us upon a judgment in our favor. The position of such provisions for tax and other litigation and deposits is as follows:

	Deposits	2005 Provisions	Deposits	2004 Provisions
Tax-related	83	157	24	93
Labor-related	4	11	2	7
Civil-related	-	4	-	4
	87	172	26	104

The activity in our provision account was as follows:

	2005	2004	2003
At beginning of year	104	56	27
Provisions for new legal proceedings	54	45	23
Translation adjustment	14	5	6
Amounts paid to settle litigation	-	(2)	-
At end of year	172	104	56

## Tax-related

In 1999, we filed a lawsuit challenging the 1% increase in the COFINS tax rate (from 2% to 3%), a tax on revenues. Although we have obtained a legal injunction, based on advice from our legal counsel and reflecting rulings by the Federal Supreme Court, we accrued US\$ 55 relating to this claim, from 2002 through 2004. In December 2005 we made a judicial deposit of US\$ 55 following an unfavorable decision of the Supreme Court. During 2005, we recorded an additional US\$ 21 related to the 1% increase in the COFINS tax rate.

During 2002, we filed a lawsuit challenging the inclusion of the ICMS (Value-added sales tax) in the computation basis for the COFINS tax, relating the period from 1996 to 2003, as well as our deductibility of recoverable ICMS originated from raw material used for tax exempt paper products. We have accrued and deposited US\$ 26 relating to this claim.

In 1996, we filed a judicial claim to assure our right to the deductibility of inflation-indexed depreciation (an uplift of 70%) arising from a government economic stabilization program in January 1989. We obtained a favorable decision enabling the partial deduction of an uplift of 43%. Based on advice from our legal counsel, we have accrued US\$ 7 relating to this claim.

## Other unprovided possible losses

VCP is party to a substantial number of other legal proceedings in the normal course of its business involving possible risk of loss, in addition to the lawsuits and administrative proceedings discussed above.

Management does not believe that such legal proceedings will, individually or in the aggregate, have a material adverse affect on our business, results of operations or financial condition, and therefore, no provisions have been recorded based on management's assessment of the probability of loss.

These possible losses, at December 31, are as follows:

	2005	2004
Tax-related	112	21
Civil-related	13	11
Labor-related	11	8
	136	40

## Sale of affiliate

In 1999, we sold our 51% interest in Indústria de Papel de Salto Ltda. Under the terms of the sale, we have indemnified the purchaser against certain losses in excess of amounts recorded limited to US\$ 6 through 2007. No amounts have been paid under this indemnification 2005 and we believe such amounts if ultimately paid, if any, will not be significant.

## Commitments

We do not maintain insurance for our forests; rather, our policy is to self-insure against fire, disease and other risks to our forests. We have taken measures to mitigate these risks, but any losses from damage outside of our control would be for our own account.

We provide guarantees to banks, not in excess of 180 days, although in exceptional cases, this is extended to 360 days, which finance sales to certain of our selected customers. We recognize revenue on these sales at the time our products are delivered which is the time we transfer title to our customers. Under the vendor program we are the secondary obligor to the bank and monitor the amount due from the customer to the bank. We periodically review the adequacy of our allowance for estimated losses and adjust our allowance accordingly. At December 31, 2005, customer guarantees provided by us totaled US\$ 57, including interest (US\$ 71 at December 31, 2004). Our guarantees are usually secured by the personal guarantee of the customer's owner.

We lease timberlands under operating leases from other companies of the Votorantim Group as a source for raw material for our products. The leases, most of which commenced in 1991, are typically for a term of 21 years. Lease payments, equal to 30% of the market value of the timber harvested on the property, are payable after each harvest. We guarantee to the lessor a minimum harvest payment. Payments under these operating leases were US\$ 2 in 2005 and US\$ 1 in 2004 and 2003.

We have commitments for capital expenditures amounting to US\$48 at December 31, 2005.

We have long-term "Take-or-Pay" contracts with suppliers of chemical products for periods from 1 to 13 years. The contractual obligations in connection with such contracts are US\$ 35 per year.

The following is a summary of guarantees issued to other companies of the Votorantim Group:

Primary obligor	Obligations	Beneficiary	Outstanding guarantee amount	
			2005	2004
VOTO I	US\$ 400 notes issuance	Noteholders and the trustee		200
VOTO II	US\$ 250 notes issuance	Noteholders and the trustee		125
VOTO III	US\$ 300 notes issuance	Noteholders and the trustee	45	45
VOTO IV	US\$ 400 notes issuance	Noteholders and the trustee	200	

## Segment information

The following information about segments is based upon information used by our senior management to assess the performance of our operating segments and decide on the allocation of resources. This approach is required by SFAS 131, "Disclosure about Segments of an Enterprise and Related Information", and has been applied for all periods presented. Our paper and pulp operations are based solely in Brazil. Intersegment revenues are accounted for at amounts which approximate those that would be obtained in a sale to third parties.

The accounting policies underlying the financial information provided for the segments are based on Brazilian GAAP. We evaluate segment performance information generated from the statutory accounting records, except for the effects of our affiliates Aracruz and Ripar which are proportionally consolidated in our Brazilian GAAP financial statements but are not included in information used by our senior management to assess the performance of our segments. The local currency information related to statement of income data has been translated to U.S. dollars, for convenience purposes, at the average rate of each year presented. The information as at the balance sheet dates has been translated at the respective year-end exchange rates.

	2005	2004	2003
Net operating revenue - Brazilian GAAP			
Pulp	440	385	276
Paper	704	634	557
Reconciling item to US GAAP			
Pulp	(1)		(1)
Paper	(13)	(9)	(16)
Total net operating revenue - US GAAP	1,130	1,010	816
Intersegment sales of pulp to paper segment	249	214	196
Net operating revenue before intersegment sales eliminations - US GAAP	1,379	1,224	1,012
Depreciation and depletion expense - Brazilian GAAP			
Pulp	89	69	61
Paper	31	23	17
Reconciling items to US GAAP			
Pulp	(2)	(2)	(5)
Paper	(1)	(1)	(1)
Depreciation and depletion expense - US GAAP	117	89	72

There are certain differences between the methodologies we use to determine the operating profit shown in the following table and operating profit reported in our US GAAP statement of income. For segment reporting purposes we defer start-up costs of new facilities and amortize them against operating profit over the subsequent 10 years. We allocate depreciation to segments based on property, plant and equipment amounts which have been indexed for inflation, rather than the historical real amounts. Also, we depreciated our machinery, equipment and installations over 10 years up to December 31, 1996 and over 25 years thereafter. These differences are reconciled as follows:

	2005	2004	2003
Segment operating income - Brazilian GAAP			
Pulp	155	177	137
Paper	113	150	127
Operating income under Brazilian GAAP	268	327	264
Reconciling items to US GAAP			
Depreciation and amortization expense			
Pulp	2	2	5
Paper	1	1	1
Start-up costs			
Pulp	-	-	(1)
Paper	-	-	-
Other adjustments			
Pulp	(10)	1	(1)
Paper	(14)	(6)	-
Total pulp	147	180	140
Total paper	100	145	128
Operating income - US GAAP	247	325	268
Segment assets			
Pulp	1,167	943	
Paper	513	433	
Total segment assets per Brazilian GAAP	1,680	1,376	

	2005	2004	2003
Reconciling items to US GAAP			
Pulp	44	41	
Paper	34	26	
Total pulp	1,211	984	
Total paper	547	459	
Property, plant and equipment - US GAAP	1,758	1,443	
Capital expenditures per Brazilian GAAP			
Pulp	188	178	119
Paper	54	36	39
Reconciling items to US GAAP			
Capitalized interest			
Pulp	4	3	5
Paper	1	1	2
Total capitalized interest	5	4	7
Total pulp	192	181	124
Total paper	55	37	41
Capital expenditures - US GAAP	247	218	165

## Export sales by region

The following table includes our sales made directly to unaffiliated customers (the final customers) as well as our sales made to Votorantrade N.V. and related parties (also a member of the Votorantim Group) to the final customers.

	2005		2004		2003	
	Paper	Pulp	Paper	Pulp	Paper	Pulp
Europe	50	243	45	164	39	109
Middle East and Asia	10	120	9	150	9	94
North America	54	39	53	37	46	38
South America, other than Brazil	44	-	33	-	25	-
Africa	5	1	4	3	13	-
	163	403	144	354	132	241

## Shareholders' equity

Our by-laws require that we pay a dividend to our common and preferred shareholders of at least 25% of our annual net distributable income determined in accordance with Brazilian Corporate Law. Preferred shareholders are entitled to receive a dividend per share 10% higher than that paid to common shareholders. In 2005, 2004 and 2003 we paid dividends in excess of the mandatory amount.

The preferred shareholders may not vote at shareholders meetings but have priority in repayment of their capital, in the case of liquidation.

In accordance with the Brazilian Corporate Law and our by-laws we are required to make annual appropriations to certain reserves ("Appropriated retained earnings"). These comprise mainly (a) 5% of the net income in our statutory accounts which must be transferred to a legal reserve until such reserve reaches 20% of our share capital and (b) appropriation of an amount equal to income tax rebates available for investments in certain underdeveloped regions of Brazil to an investment incentive reserve. The legal and investment incentives reserves cannot be used to distribute dividends to our shareholders.

Brazilian law permits the payment of dividends only in "reais", limited to the unappropriated retained earnings in our financial statements prepared in accordance with Brazilian GAAP.

Brazilian companies are permitted to pay limited amounts of interest attributable to capital to shareholders and treat such payments as an expense for Brazilian income and social contribution tax purposes. This notional interest distribution is treated for accounting purposes as a deduction from shareholders' equity in a manner similar to a dividend. Interest attributable to capital is treated as a dividend for purposes of the mandatory dividend payable. A 15% tax is withheld and paid by upon credit of the interest.

The devaluation of the Real impacts the amount available for distribution when measured in U.S. dollars. Amounts reported as available for distribution in our statutory accounting records prepared under Brazilian GAAP will decrease or increase when measured in U.S. dollars as the real depreciates or appreciates, respectively, against the U.S. dollar. The devaluation of the real results in net foreign exchange losses which are included in the statement of income determined under Brazilian GAAP and which reduces the amount of unappropriated earnings available for distribution. At December 31, 2005, we had unappropriated retained earnings of R\$ 1,469 million (2004 - R\$ 1,224 million) in our statutory books, equivalent, at the exchange rate at December 31, 2005, to US\$ 628 (2004 - US\$ 461).

Dividends paid per shares in U.S. dollars were as follows:

	2005	2004	2003
Preferred	0.45	0.58	0.22
Common	0.41	0.52	0.20

On December 3, 2003, the Board of Directors approved a change in VCP's dividend policy. Under the new policy, VCP intends to pay dividends and/or interest attributable to capital based on 60% of "free cash flow". Free cash flow is expected to be an amount equal to "EBITDA" (defined as operating profit excluding net financial income (expense), amortization, depreciation and depletion and equity gain (loss) of affiliate) minus changes in working capital, minus income tax and social contribution effectively paid by VCP and minus capital expenditures and will be based upon VCP's financial statements prepared in accordance with Brazilian GAAP.

On October 18, 2004, the Extraordinary General Meeting approved the following proposals:

- increase of subscribed capital stock, from US\$ 1,320 to US\$ 1,838, by means of capitalization of part of unappropriated retained earnings without issue of new shares;
- a reverse stock split dividing the entire subscribed capital of the Company, by 200 resulting in 191,613,498 shares, of which 105,702,452 are shares of common stock and 85,911,046 are shares of preferred stock;
- a reverse split of our American Depositary Shares - ADSs traded on the New York Stock Exchange, each of which had previously represented 500 preferred shares, to represent one preferred share per ADS.

We have retroactively adjusted all shares and ADS data to take account of the reverse split.

## Concentration of credit risk

We are potentially subject to credit risk with respect to our cash equivalents, held-to-maturity investments, available for sales securities, trade receivables, guarantees provided to banks which finance our customers, and derivative contracts. We limit our risk associated with cash equivalents, held-to-maturity investments and available for sales securities by placing our investments with highly rated financial institutions and we only take out derivative contracts with financially sound counter-parties. With respect to trade receivables and guarantees, provided to banks financing our customers, we perform initial and ongoing credit evaluations of our customers and, when deemed necessary, obtain collateral or letters of credit to protect our interests. Additionally, most of our export sales to the USA and Europe are secured by letters of credit. We establish an allowance for doubtful accounts against receivables we believe will not be fully collected.

## Financial income and financial expense

	2005	2004	2003
<b>Financial income</b>			
Interest income on cash equivalents	32	39	21
Realized and unrealized gain on held-to-maturity securities available for sale securities	13	15	27
Interest income on credit sales	22	-	-
Other (including taxes)	7	4	2
	5	(18)	15
	79	40	65
<b>Financial expenses</b>			
Interest and charges on U.S. dollar debt	62	39	53
Interest and charges on Real debt	16	16	15
Indexation and interest charges on contingencies	17	-	-
Tax on checking accounts - CPMF	10	7	6
Other	14	7	(3)
	119	69	71

## Retirement benefits

### Defined contribution plan

In March 2000 we began co-sponsoring a multi-employer defined contribution plan of the Votorantim Group which is available to all of our employees. For employees below a certain income level we match the employee's contribution limited to 1.5% of the employee's compensation. For employees above that income level we match the employee's contribution up to 6% of the employee's compensation. At our option we may also make additional contributions. Our contributions vest in varying percentages depending on the employee's years of service and will fully vest upon the employee's retirement, death or disability, provided the employee has at least one year of service. Our contributions were US\$ 2 in 2005, US\$ 2 in 2004 and US\$ 1 in 2003.

### Post-retirement benefits

The actuarial liability relates to our proportion of the costs of a hospital facility we share with co-sponsors. Although the not-for-profit hospital is funded by multiple-employers, it has no separate assets and costs are apportioned among the sponsors based on usage. No liability had been recorded prior to 2005. Contributions paid to the hospital in the year ended December 31, 2005 and 2004 amounted to US\$ 1.

Based on the report of our independent actuary, the accumulated post-retirement benefit obligation and accrued benefit cost (no plan assets) was US\$ 21.

	Percentage
<b>Weighted-average assumptions as of December 31, 2005</b>	
Discount rate	8.5
Health care cost trend on covered changes	3.0
	US\$
<b>Components of net periodic benefit cost for 2006</b>	
Interest cost	2
Total net periodic benefit cost (benefit)	2

It has been assumed, for measurement purposes, that health care cost trends for 2006 will not be considerably different from 2005. Our actuaries are unable to project the direction and pattern of changes in the assumed trend rates, the ultimate trend rates, nor can they estimate when the rates are expected to be achieved. A one-percentage-point change in assumed health care cost trend rates would have the following effects in 2005 (all other assumptions have been held constant):

	One-percentage-point increase	One-percentage-point decrease
<b>Sensitivity of retiree welfare results</b>		
On total service and interest cost components	0.3	(0.3)
On post-retirement benefit obligation	2.0	(2.0)



