

ARACRUZ CELLULOSE S A
Form 20-F
June 19, 2006

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 20-F

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the Fiscal Year Ended December 31, 2005

OR

TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report ..

Commission File No. 1-11005

ARACRUZ CELULOSE S.A.

(Exact name of Registrant as specified in its charter)

Aracruz Cellulose

(Translation of Registrant's name into English)

Federative Republic of Brazil

(Jurisdiction of incorporation or organization)

**Av. Brigadeiro Faria Lima, 2277, 4th floor
01452-000 São Paulo, SP, Brazil**

(Address of principal executive offices)

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

Title of each class:

American Depositary Shares (as evidenced by American Depositary Receipts),
each representing ten shares of
Class B Stock

Name of each exchange on which registered:

New York Stock Exchange

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Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

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

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

455,390,699	Shares of Common Stock
38,022,178	Shares of Class A Stock
539,141,243	Shares of Class B Stock

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

Yes No

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer Accelerated filer Non-accelerated filer

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

Item 17 Item 18

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

Yes No

Please send copies of notices and communications from the Securities and Exchange Commission to:

Ross Kaufman
Greenberg Traurig LLP
Met Life Building
200 Park Avenue
New York, NY 10166

TABLE OF CONTENTS

<u>PART I</u>	
<u>ITEM 1.</u>	<u>IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS</u>
<u>ITEM 2.</u>	<u>OFFER STATISTICS AND EXPECTED TIMETABLE</u>
<u>ITEM 3.</u>	<u>KEY INFORMATION</u>
<u>ITEM 4.</u>	<u>INFORMATION ON ARACRUZ</u>
<u>ITEM 5.</u>	<u>OPERATING AND FINANCIAL REVIEW AND PROSPECTS</u>
<u>ITEM 6.</u>	<u>DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES</u>
<u>ITEM 7.</u>	<u>MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS</u>
<u>ITEM 8.</u>	<u>FINANCIAL INFORMATION</u>
<u>ITEM 9.</u>	<u>THE OFFER AND LISTING</u>
<u>ITEM 10.</u>	<u>ADDITIONAL INFORMATION</u>
<u>ITEM 11.</u>	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>
<u>ITEM 12.</u>	<u>DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u>
<u>PART II</u>	
<u>ITEM 13.</u>	<u>DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u>
<u>ITEM 14.</u>	<u>MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u>
<u>ITEM 15.</u>	<u>CONTROLS AND PROCEDURES</u>
<u>ITEM 16.</u>	<u>RESERVED</u>
<u>Item 16A. Audit committee financial expert</u>	
<u>Item 16B. Code of Ethics</u>	
<u>Item 16C. Principal Accountant Fees and Services</u>	
<u>Item 16D. Exemptions from the listing Standards for Audit Committees</u>	
<u>Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers</u>	
<u>PART III</u>	
<u>ITEM 17.</u>	<u>FINANCIAL STATEMENTS</u>
<u>ITEM 18.</u>	<u>FINANCIAL STATEMENTS</u>
<u>ITEM 19.</u>	<u>EXHIBITS</u>

INTRODUCTION

Unless otherwise specified, all references in this annual report to:

- U.S. dollars, \$ or US\$ are to United States dollars;
- *reais*, *real* or R\$ are to Brazilian *reais*, the official currency of Brazil;
- Brazilian government are to the federal government of the Federative Republic of Brazil;
- consolidated financial statements are to the Consolidated Financial Statements of Aracruz Celulose S.A. as of December 31, 2004 and 2005 and, for the three years ended December 31, 2005, the corresponding Report of Independent Registered Public Accounting Firm;
- the Company, Aracruz, we, us and our are to Aracruz Celulose S.A. and its consolidated subsidiaries (the context otherwise requires);
- our preferred shares and our common shares are to our authorized and outstanding preferred stock and common stock, respectively;
- Class A Stock and Class B Stock are to our non-voting preferred stock class A (*ações preferenciais classe A*) and non-voting preferred stock class B (*ações preferenciais classe B*), respectively, which together are referred to as the Preferred Shares; and
- tons are to metric tons of 1,000 kilograms each.

As used in this annual report, one hectare equals approximately 2.471 acres, one kilogram equals approximately 2.2 pounds and one kilometer equals approximately 0.621 miles.

Unless otherwise indicated,

- all references in this annual report to percentages, tons and U.S. dollar or *real* amounts of pulp are to market pulp ; and
- amounts in *reais* stated at a particular date and followed by U.S. dollar equivalents have been converted using the *reais* to U.S. dollars commercial selling rate in effect on such date.

FORWARD-LOOKING STATEMENTS

This annual report contains statements which constitute forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Certain such forward-looking statements can be identified by the use of forward-looking terminology such as believe, expect, may, are expected to, will, will allow, will continue, will likely result, should, would be, seek, approximately, project, estimate or anticipate, or similar expressions or the negative thereof or other variations thereof of comparable terminology, or by discussions of strategy, plans or intentions. In addition, all information included herein with respect to future operations, financial condition, financial performance or other financial or statistical matters constitute forward-looking statements. Those forward-looking statements are necessarily dependent on assumptions, data or methods that may be incorrect or imprecise and that may not be realized. Such statements appear in a number of places in this annual report, including, without limitation, the information set forth under the headings Item 3D. Risk Factors, Item 4B. Business Overview and Item 5. Operating and Financial Review and Prospects, and include statements regarding our intent, belief or current expectations or those of our directors or our executive officers with respect to:

- general economic, political and business conditions, both in Brazil and in our principal export markets,
- the declaration or payment of dividends,
- our direction and future operation,
- the implementation of our principal operating strategies, including our potential participation in acquisition or joint venture transactions or other investment opportunities,
- the implementation of our financing strategy and capital expenditure plans,
- the development of solid wood products, or
- the factors or trends affecting the pulp and paper market (including its cyclical nature and our financial condition or results of operations).

Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those in the forward-looking statements, as a result of various factors. We do not undertake, and specifically disclaim, any obligation to update any forward-looking statements, which speak only as of the date hereof.

We make statements in this annual report about our competitive position and market share in, and the market size of, the pulp industry. We have made these statements on the basis of statistics and other information from third-party sources that we believe are reliable. We derive this third-party information principally from reports published by the International Pulp Statistical Committee, which includes the American Forest Paper Association, the Canadian Pulp & Paper Association, the Finnish Forest Industry Federation and the Brazilian Pulp and Paper Association, or Bracelpa, and reports published by Hawkins Wright Ltd., or Hawkins Wright. Although we have no reason to believe that any of this information or these reports is inaccurate in any material respect, we have not independently verified the competitive position, market share, market size or market growth data provided by third parties or by industry or general publications.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP. Because we exported substantially all of our production in 2005, operate in an industry that uses the U.S. dollar as its currency of reference and this is the currency in which cash is primary generated and expended, representing the economic environment in which the Company conducts its operations, our management believes that the U.S. dollar is the Company's functional currency and the most appropriate currency in which to present our consolidated financial statements. Accordingly, we decided to present our primary U.S. GAAP consolidated financial statements in U.S. dollars beginning in 1994. For this purpose, amounts in Brazilian currency for all periods presented have been remeasured into U.S. dollars in accordance with the methodology set forth in Statement of Financial Accounting Standards No. 52, or SFAS 52.

During 1997, the 36-month cumulative rate of inflation in Brazil fell below the 100% threshold, and our management determined the Brazilian economy to have ceased being a highly inflationary economy as of the fourth quarter of 1997. Accordingly, our management reevaluated our economic profile and operations and determined that the U.S. dollar should remain as our functional currency, in accordance with the criteria established by SFAS 52. Our transition from a highly inflationary environment to a non-highly inflationary accounting environment as of and from January 1, 1998, had no financial reporting effect on our results of operations and financial position, because our reporting currency (which has been, since 1994, the U.S. dollar) was also our functional currency under highly inflationary conditions according to SFAS 52.

Pursuant to SFAS 52 as it applies to us, inventories, property, plant and equipment, accumulated depreciation and stockholders' equity are remeasured at historical rates of exchange, and other assets and liabilities denominated in *reais* are remeasured at period-end rates. Export sales invoiced in currencies other than the U.S. dollar are remeasured at the applicable exchange rate on the date of sale. Cost of sales, depreciation and other expenses relating to assets remeasured at historical exchange rates are calculated based on the U.S. dollar values of such assets, and other statement of operations accounts are remeasured at the rate prevailing on the date of the charge or credit to income.

The following table presents our selected financial data as of the dates and for each of the periods indicated. Our U.S. GAAP consolidated financial statements as of December 31, 2003, 2004 and 2005 appear elsewhere herein, together with the reports of the Independent Registered Public Accounting Firms, PriceWaterhouseCoopers Auditores Independentes, Rio de Janeiro, Brazil (2002 and 2003) and Deloitte Touche Tohmatsu Auditores Independentes Rio de Janeiro, Brazil (2004 and 2005). The selected financial information at December 31, 2001 and 2002 has been derived from our U.S. GAAP consolidated financial statements, not included in this annual report. The selected financial data should be read in conjunction with Item 5. Operating and Financial Review and Prospects.

	For the year ended December 31,									
	2001		2002		2003		2004		2005	
	(thousands of U.S. dollars, except number of shares and per share amounts)									
Statement of Operations Data										
Operating Revenues										
Sales of eucalyptus pulp										
Domestic	\$	23,579	\$	17,126	\$	42,401	\$	66,083	\$	62,019
Export		583,365		700,622		1,056,498		1,256,648		1,469,646
Total sales	\$	606,944	\$	717,748	\$	1,098,899	\$	1,322,731	\$	1,531,665
Sales taxes and other deductions		(32,589)		(48,765)		(95,829)		(155,618)		(186,432)
Net operating revenues	\$	574,355	\$	668,983	\$	1,003,070	\$	1,167,113	\$	1,345,233
Operating costs and expenses										
Cost of sales	\$	420,606	\$	468,875	\$	592,555	\$	700,333	\$	783,578
Selling		23,253		28,242		38,617		53,850		64,430
Administrative		22,012		22,302		22,762		31,072		33,820
Provision for loss on ICMS credit		10,754		45,093		23,178		22,859		7,440
Other, net		14,807		8,968		18,784		2,349		8,873
Total operating costs and expenses	\$	491,432	\$	573,480	\$	695,896	\$	810,463	\$	898,141
Operating income	\$	82,923	\$	95,503	\$	307,174	\$	356,650	\$	447,092
Non-operating (income) expenses										
Financial income		(54,749)		(61,611)		(43,037)		(56,123)		(125,439)
Financing expense		70,215		82,014		108,209		119,976		137,276
Loss (gain) on currency remeasurement, net		18,029		(14,888)		(41,955)		(16,197)		(21,386)
Other, net		(171)		(212)		(129)		(76)		(778)
Total Non-operating (income) expenses	\$	33,324	\$	5,303	\$	23,088	\$	47,580	\$	(10,327)
Income before income taxes, minority interest and equity in results of affiliated companies	\$	49,599	\$	90,200	\$	284,086	\$	309,070	\$	457,419
Income tax expense (benefit)										
Current	\$	35,722	\$	(23,988)	\$	106,549	\$	42,746	\$	71,086
Deferred		(2,992)		8,415		22,567		27,510		1,142
Total	\$	32,730	\$	(15,573)	\$	129,116	\$	70,256	\$	72,228
Minority interest	\$	43	\$	64	\$	(37)	\$	(9)	\$	(31)
Equity in results of affiliated companies	\$	1,195	\$	6,076	\$	(6,844)	\$	(11,568)	\$	(44,062)
Net income	\$	18,107	\$	111,913	\$	148,089	\$	227,237	\$	341,098
Basic and diluted earnings per share(1)										
Class A Stock	\$	0.05	\$	0.11	\$	0.15	\$	0.23	\$	0.34
Class B Stock		0.02		0.11		0.15		0.23		0.34
Common Stock		0.01		0.10		0.14		0.21		0.31

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<i>Dividends per share</i>													
Class A Stock	\$	0.06	(2)	\$	0.08	(3)	\$	0.11	(4)	\$	0.12(5), \$0.09(6)	\$	0.06(7), \$0.13(8)
Class B Stock		0.06	(2)		0.08	(3)		0.11	(4)		0.12(5), 0.09(6)		0.06(7), 0.13(8)
Common Stock		0.06	(2)		0.07	(3)		0.10	(4)		0.11(5), 0.08(6)		0.05(7), 0.12(8)
<i>Weighted-average number of shares outstanding (thousands of shares)</i>													
Class A Stock		40,651			40,395			39,819			38,074		38,022
Class B Stock		536,512			536,768			535,969			537,711		537,739
Common Stock		454,908			454,908			454,908			454,908		454,908
Total		1,032,071			1,032,071			1,030,696			1,030,693		1,030,669

(1) Holders of Class B Stock have no dividend preference. Holders of Class A Stock are entitled to an annual preferential dividend.

(2) Including the dividend declared on March 30, 2001.

(3) Including the dividend declared on April 30, 2002.

(4) Including the dividend declared on April 29, 2003.

(5) Including the dividend declared on April 29, 2004.

(6) Including the interest on stockholders' equity declared on October 19, 2004 and November 16, 2004, respectively. The interest on stockholders' equity were attributed to the Compulsory Dividend relating to the year 2004, which were declared on April 29, 2005.

(7) Including the dividend declared on April 29, 2005.

(8) Including the interest on stockholders' equity declared on April 19, 2005, May 19, 2005, June 20, 2005 and December 20, 2005, respectively. The interest on stockholders' equity were attributed to the Compulsory Dividend relating to the year 2005, which were declared on April 28, 2006.

	At December 31,				
	2001	2002	2003	2004	2005
	(thousands of U.S. dollars)				
Balance Sheet Data					
Cash and cash equivalents	\$ 20,125	\$ 25,474	\$ 66,284	\$ 36,474	\$ 34,114
Short-term investments	405,493	248,455	285,991	412,110	521,613
Other current assets	215,199	250,487	390,459	384,529	539,078
Property, plant and equipment, net	1,913,191	2,000,071	2,270,369	2,133,896	2,068,547
Investment in affiliated company	80,893	87,107	382,318	480,940	505,975
Other non-current assets	143,296	87,220	59,012	81,709	94,678
Total assets	\$ 2,778,197	\$ 2,698,814	\$ 3,454,433	\$ 3,529,658	\$ 3,764,005
Short-term debt	325,855	182,680	392,088	152,934	292,018
Other current liabilities	99,425	55,824	121,591	121,872	193,147
Long-term debt	537,183	611,091	979,435	1,222,728	1,010,285
Other long-term liabilities	78,004	88,656	160,358	217,837	304,132
Stock capital	853,954	909,476	909,473	909,473	909,122
Stockholders' equity	883,776	851,087	891,488	904,814	1,055,301
Total liabilities and stockholders' equity	\$ 2,778,197	\$ 2,698,814	3,454,433	3,529,658	3,764,005

Exchange Rates

The purchase and sale of foreign currency in Brazil is subject to governmental control. As of March 4th, 2005 the two then existing foreign exchange markets - the free rate foreign exchange market, also known as the commercial market; and the floating rate foreign exchange market - were unified to become one single foreign exchange market (the Foreign Exchange Market). Transactions in the Foreign Exchange Market are required to comply with the provisions set forth in the Resolution 3,265 and the regulations established by the Central Bank of Brazil.

The Foreign Exchange Market includes purchase and sale transactions of foreign currency and gold-based foreign exchange trades carried out by institutions authorized to operate on the Foreign Exchange Market by the Central Bank of Brazil. From March 1995 through January 1999, the Central Bank allowed the gradual devaluation of the *real* against the U.S. dollar, pursuant to an exchange rate policy that established a band within which the *real*/U.S. dollar exchange rate could fluctuate.

Responding to pressure on the *real*, on January 13, 1999, the Central Bank widened the foreign exchange rate band. Because the pressure on the *real* did not cease, on January 15, 1999, the Central Bank allowed the *real* to float freely. On May, 2006, the commercial selling rate was R\$2.3005 per US\$1.00. Since January, 1999 the real exchange rate has been having an erratic trend, where the exchange rate is determined by demand and supply currency flows.

The following table shows the commercial selling rate for U.S. dollars for the periods and dates indicated.

Year ended December 31,	Exchange Rate of R\$ per US\$			Year-End
	Low	High	Average(1)	
1999	1.2078	2.1647	1.8158	1.7890
2000	1.7234	1.9847	1.8295	1.9554
2001	1.9357	2.8007	2.3420	2.3204
2002	2.2709	3.9552	2.9309	3.5333
2003	2.8219	3.6623	3.0715	2.8892
2004	2.6544	3.2051	2.8639	2.6544
2005	2.1633	2.7621	2.4125	2.3407

Source: Central Bank, PTAX. PTAX is the average of the exchange rates negotiated in the commercial rate market on a given day.

(1) Represents the average of the exchange rates (PTAX) on the last day of each month during the relevant period.

Month Ended	Exchange Rate of R\$ per US\$	
	Low	High
December 31, 2005	2.1800	2.3735
January 31, 2006	2.2116	2.3460
February 28, 2006	2.1177	2.2217
March 31, 2006	2.1067	2.2238
April 30, 2006	2.0892	2.1542
May 31, 2006	2.0586	2.3711

Source: Central Bank, PTAX. PTAX is the average of the exchange rates negotiated in the commercial rate market on a given day.

We pay cash dividends and make other cash distributions with respect to the Class B Stock in *reais*. Accordingly, exchange rate fluctuations may affect the U.S. dollar amounts received by holders of ADSs on conversion by the depositary of our ADSs, or the Depositary, of such distributions into U.S. dollars for payment to holders of ADSs. For additional information, see Item 10D. Exchange Controls. For information on dividends, see Item 8A. Consolidated Statements and Other Financial Information Dividend Policy and Dividends.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Risk Factors Relating to Brazil

Brazilian political and economic conditions have a direct impact on our business and the market price of our preferred shares and ADSs.

The Brazilian economy has been characterized by volatile economic cycles. In addition, the Brazilian government frequently, and occasionally drastically, intervenes in the Brazilian economy. The Brazilian government has often changed monetary, taxation, credit, tariff and other policies to influence the course of Brazil's economy. For example, the Brazilian government has the authority, when a serious imbalance in Brazil's balance of payments occurs, to impose restrictions on the remittance to foreign investors of the proceeds of their investments in Brazil, and on the conversion of Brazilian currency into foreign currencies. The Company's business, financial condition

8

and results of operations may be adversely affected by changes in policy including tariffs, exchange controls and other matters, as well as factors such as:

- currency fluctuations,
- inflation,
- price instability,
- interest rates,
- tax policy, and
- other political, diplomatic, social and economic developments in or affecting Brazil.

Rapid changes in Brazilian political and economic conditions that have already occurred and that might continue will require the Company's continued emphasis on assessing the risks associated with its activities and adjusting its business and operating strategy. Future developments in Brazilian government policies or in the Brazilian economy, over which the Company has no control, may reduce demand for the Company's products in Brazil, and adversely affect the Company's business, financial condition and results of operations.

The year 2005 was characterized by high interest rates, with the main objective of controlling inflation rates, and also by the continuous appreciation of the Real. The high interest rates that started to decrease in September 2005, contributed to the weak growth of Brazil in 2005, around 2%.

The following table shows the SELIC (Sistema Especial de Liquidação e de Custódia) interest rate per month for the dates indicated.

January, 2005	1,48%
February, 2005	1,38%
March, 2005	1,22%
April, 2005	1,53%
May, 2005	1,41%
June, 2005	1,50%
July, 2005	1,59%
August, 2005	1,51%
September, 2005	1,66%
October, 2005	1,50%
November, 2005	1,41%
December, 2005	1,38%
January, 2006	1,47%

February, 2006	1,43%
March, 2006	1,15%
April, 2006	1,42%
May, 2006	1,08%

Exchange rate instability may adversely affect our financial condition and results of operations and the market price of our preferred shares and ADSs.

Because a portion of our expenses and a significant portion of our assets and liabilities are denominated in *reais* and we have U.S. dollar-denominated revenues, debt and other liabilities, we may be adversely affected by foreign exchange rate volatility. See Selected Financial Data Exchange Rates.

Our operating cash expenses are substantially denominated in *reais* and will generally decrease, as expressed in U.S. dollars, as a result of any devaluation of the *real*. If the rate of Brazilian inflation increases more rapidly than the rate of appreciation of the U.S. dollar against the *real*, then, as expressed in U.S. dollars, our operating expenses may increase and (assuming constant U.S. dollar sales prices), our profit margins decrease. In addition, any significant devaluation of the *real* may produce exchange gains on unhedged debt denominated in *reais*.

In 2002, the depreciation of the *real* relative to the U.S. dollar totaled 52%, due in part to the continued economic and political uncertainties in emerging markets and the global economic slowdown. In 2003 Brazil started a new cycle of Real appreciation relatively to the U.S. dollar and the rate in that year was 18.2%. In 2004 the appreciation of the Real relative to U.S. dollar was 8.1% and in 2005 the Real appreciated 11,8%, representing an accumulated appreciation of 33,7% since the beginning of 2003.

Inflation and certain governmental measures to control inflation may contribute significantly to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets.

Brazil has historically experienced extremely high rates of inflation. Inflation itself, as well as certain governmental measures to combat inflation and public speculation about possible future measures, has in the past had significant negative effects on the Brazilian economy. The Company's cash operating expenses are substantially denominated in Reais and tend to increase with Brazilian inflation because its suppliers and providers generally increase prices to reflect the depreciation of the value of the currency. As expressed in U.S. dollars, however, these increases are typically offset at least in part by the effect of the appreciation of the U.S. dollar against the Real. If the rate of Brazilian inflation increases more rapidly than the rate of appreciation of the U.S. dollar, then, as expressed in U.S. dollars, operating expenses may increase and (assuming constant U.S. dollar sales prices) profit margins decrease. In addition, high inflation generally leads to higher domestic interest rates, and as a result the Company's costs of Real-denominated debt may increase. See Item 5. Operating and Financial Review and Prospects Brazilian Economic Environment.

We may be impacted by governmental actions affecting the Brazilian markets and economy.

The Brazilian government has exercised and continues to exercise substantial influence over many aspects of the private sector. The Brazilian government owns or controls many companies, including some of the largest in Brazil. For example, Banco Nacional de Desenvolvimento Econômico e Social BNDES, which is owned by the Brazilian government, indirectly owned approximately 12.5% of our common stock as of December 31, 2005 and has, through a subsidiary, advanced approximately 20% of our total consolidated indebtedness as of such date. See Item 7B. Related Party Transactions.

Developments in other emerging markets may adversely affect the market price of our preferred shares and ADSs

The Brazilian securities markets are, to varying degrees, influenced by economic and market conditions in other emerging market countries, especially those in Latin America. Although economic conditions are different in each country, investors' reaction to developments in one country can have an effect on the securities of issuers in other countries, including Brazil. Developments or conditions in other emerging market countries have, at times, significantly affected the availability of credit in the Brazilian economy and resulted in considerable outflows of funds and declines in the amount of foreign currency invested in Brazil.

For example, in 2001 after a prolonged recession followed by political instability, the Argentine government announced that it would no longer continue to service its public debt. In order to address the deteriorating economic and social conditions, the Argentine government abandoned its decade-old fixed dollar-peso exchange rate, allowing the peso to float to market rate levels. In 2002, the Argentine peso experienced a 237% devaluation against the U.S. dollar. The situation in Argentina, one of Brazil's largest trading partners, negatively affected investors' perceptions of Brazilian securities.

Similar developments in the international financial markets, in the future, especially in Latin America, may adversely affect the Company's financial condition and its ability to raise capital when needed. There can be no assurance that the Brazilian securities markets will not continue to be affected negatively by events elsewhere, especially in emerging markets, or that such events will not adversely affect the value of the Company's preferred shares or ADS.

Risks Relating to our Preferred Shares and ADSs

Exchange controls and restrictions on remittances abroad may adversely affect holders of ADSs.

You may be adversely affected by the imposition of restrictions on the remittance to foreign investors of the proceeds of their investments in Brazil and the conversion of *reais* into foreign currencies. The Brazilian government imposed remittance restrictions for a number of months in 1989 and early 1990. These restrictions would hinder or prevent the conversion of dividends, distributions or the proceeds from any sale of our preferred shares into U.S. dollars and remitting the U.S. dollars abroad. We cannot ensure that the Brazilian government will not take similar measures in the future. See Item 10D. Exchange Controls. Holders of the ADSs could be adversely affected by delays in, or a refusal to grant, any required Brazilian governmental approval for conversion of *real* payments and remittances abroad in respect of the shares of Class B Stock underlying the ADSs. In such case, the Depositary will hold the *reais* it cannot convert for the account of the ADS holders who have not been paid.

Exchanging ADSs for the underlying Class B Stock may have unfavorable consequences.

The Brazilian custodian for our Class B Stock, or the Custodian, must obtain an electronic certificate of registration from the Central Bank to remit U.S. dollars abroad for payments of dividends, any other cash distributions, or upon the disposition of the shares and sales proceeds related thereto. If you decide to exchange your ADSs for the underlying Class B Stock, you will be entitled to continue to rely for five business days from the date of the exchange on the ADS Depositary's electronic certificate of registration. Thereafter, you may not be able to obtain and remit U.S. dollars abroad upon the disposition of the Class B Stock, or distributions relating to the Class B Stock, unless you obtain your own electronic certificate of registration pursuant to Resolution No. 2,689, of January 26, 2000, of the National Monetary Council, known as Resolution 2,689, which entitles foreign investors to buy and sell on the São Paulo stock exchange. If you do not obtain a certificate of registration under Resolution 2,689, you may not be able to obtain and remit abroad U.S. dollars or other foreign currencies upon the disposition of Class B Stock or distributions with respect thereto, and you will generally be subject to less favorable tax treatment on gains with respect to the Class B Stock. If you attempt to obtain your own electronic certificate of registration, you may incur expenses or suffer significant delays in the application process. Obtaining an electronic certificate of registration involves generating significant documentation, including completing and filing various electronic forms with the Central Bank and the *Comissão de Valores Mobiliários*, or the CVM. These expenses or delays could adversely impact your ability to remit dividends or distributions relating to the Class B Stock or the return of your capital outside of Brazil.

in a timely manner. If you decide to exchange your Class B Stock back into

11

ADSs once you have registered your investment in the Class B Stock, you may deposit your Class B Stock with the Custodian and rely on the Depositary's certificate of registration, subject to certain conditions. See Item 10D. Exchange Controls. We cannot assure you that the Depositary's certificate of registration or any certificate of foreign capital registration obtained by you may not be affected by future legislative or other regulatory changes, or that additional Brazilian restrictions applicable to you, the disposition of the underlying Class B Stock or the repatriation of the proceeds from disposition could not be imposed in the future.

The relative volatility and illiquidity of the Brazilian securities markets may adversely affect holders of ADSs.

Investments in securities, such as the Class B Stock or the ADSs, of issuers from emerging market countries including Brazil involve a higher degree of risk than investing in securities of issuers from more developed countries.

The Brazilian securities market is substantially smaller, less liquid, more concentrated and more volatile than major securities markets in the United States. These features may substantially limit holders' ability to sell the preferred shares underlying the ADSs at a price and time at which holders wish to do so. The São Paulo Stock Exchange (*Bolsa de Valores de São Paulo*), or BOVESPA, the main Brazilian stock exchange, had a market capitalization of approximately US\$482 billion as of December 31, 2005, and an average daily trading volume of approximately US\$667 million in 2005. In comparison, the NYSE had a market capitalization of US\$21.4 trillion as of December 31, 2005, and an average daily trading volume of approximately US\$56.1 billion for 2005.

There is also significantly greater concentration in the Brazilian securities market than in major securities markets in the United States. The ten largest companies in terms of market capitalization represented approximately 30% of the aggregate market capitalization of BOVESPA as of December 31, 2005. The top ten stocks in terms of trading volume accounted for approximately 51.3% of all shares traded on BOVESPA.

Because we are subject to specific rules and regulations as a Brazilian company, holders of our ADSs have fewer and less well defined shareholders' rights than investors in U.S. companies.

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

Although Brazilian law imposes restrictions on insider trading and price manipulation, the Brazilian securities markets are not as highly regulated and supervised as the securities markets in the United States or certain other jurisdictions. For example, certain provisions of the U.S. Sarbanes-Oxley Act of 2002 that apply to U.S. companies do not apply to us. In addition, rules and policies against self-dealing and regarding the preservation of shareholder interests may be less well developed and enforced in Brazil than in the United States, potentially disadvantaging holders of our preferred shares and ADSs. When compared to Delaware general corporation law, the Brazilian corporate law and practice have less detailed and less well established rules and judicial precedents relating to the review of management decisions under duty of care and duty of loyalty standards in the context of corporate restructurings, transactions with related parties and sale-of-business transactions. In addition, shareholders must hold 5% of the outstanding share capital of a corporation to have the necessary standing to bring shareholders' derivative suits. Shareholders ordinarily do not have standing to bring a class action.

Also, in accordance with Brazilian corporate law and our by-laws, holders of our preferred shares, and therefore of our ADSs, are not entitled to vote at meetings of our shareholders except in limited circumstances. See Item 10B. Memorandum and Articles of Association.

You may not be able to exercise preemptive rights.

You may not be able to exercise the preemptive rights relating to the Class B Stock underlying the ADSs unless a registration statement under the Securities Act is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement with respect to the shares relating to these preemptive rights, and we cannot assure investors that we will file any such registration statement. Unless we file a registration statement or an exemption from registration applies, investors may receive only the net proceeds from the sale of their preemptive rights by the Depositary, or if the preemptive rights cannot be sold, they will be allowed to lapse.

We are incorporated under the laws of Brazil. All of our directors and executive officers, and the experts named in this annual report, reside outside the U.S. Substantially all of our assets, and our directors and officers assets and such experts assets are located outside the U.S. As a result, it may not be possible for investors to effect service of process within the U.S. upon us or our directors, executive officers or such experts, or to enforce against them or us, judgments obtained in U.S. courts based upon the civil liability provisions of the federal securities laws of the U.S. In addition, we have been advised by our Brazilian counsel, that there is doubt that the courts of Brazil will enforce against us, our officers, directors and experts named herein, judgments obtained in the U.S. based upon the civil liability provisions of the federal securities laws of the U.S. or will enter judgments in original actions brought in Brazilian courts based upon the federal securities laws of the U.S.

Risk Factors Relating to Aracruz and the Pulp Industry

The market prices for our products are cyclical.

The prices we are able to obtain for our pulp depend on prevailing world prices for market pulp. Worldwide pulp prices have historically been cyclical, subject to significant fluctuations over short periods of time, due to a number of factors, including:

- worldwide demand for pulp products,
- worldwide production capacity,
- the strategies adopted by major pulp producers, and
- the availability of substitutes for our products.

All of these factors are beyond our control. After reaching a peak in the middle of 1995, market pulp prices continued to fall through the first quarter of 1999, due primarily to a significant drop in demand, although market prices began to increase beginning in the second quarter of 1999 and continued to increase through the second half of 1999 and early 2000. In the second half of 2000, market prices of pulp were flat for the whole period. Weak demand and excess inventories in the hands of pulp producers caused eucalyptus pulp list prices to fall at the end of March 2001. Market conditions remained difficult through 2002, with Europe being the most challenging market. In 2002 the average list price of BEKP in North America decreased 8% compared to the average list price in 2001; this was primarily due to the slowdown in the growth of the major economies which began in 2001 that continued to negatively impact the global demand for paper throughout 2002. Global product availability was limited due to pulp production curtailments as a result of inventory adjustments, maintenance and bad weather conditions in the Northern Hemisphere. At the same time, pulp demand remained relatively stable in the majority of the markets, except in Asia and especially in China, where demand was above levels of the previous year. Consequently, global pulp inventories were driven down to below the historic level. In 2003, shipments of BEKP increased the most when compared to other grades. From January to November 2003, deliveries grew 14%, mainly to Asia and Western Europe. This compares with relatively flat shipments of northern hardwood and a 9% decline in southern hardwood. Over the course of the fourth quarter, an increase of approximately 300,000 tons in the aggregate stocks (5.5 million tons at the end of December) put pressure on pulp prices, resulting in a \$10-\$20/ton erosion of list prices in December. In 2003 the average list price for BEKP was US\$ 540/t. In 2004, the average list price for BEKP (North America delivered) was US\$ 563/t. Demand for BEKP continued strong through the first quarter of 2005 as

expected, with shipments registering an increase of 7% until February 2005. This strong demand permitted the implementation of price increases, the average list price for BEKP (North America delivered) in the first quarter of 2005 was US\$ 595/t. In 2005 the international climate was favorable, marked by continued Chinese economic growth and improved economic performance of the United States, Europe and Japan. The price of most commodities increased, including pulp. The average list price for BEKP delivered to North America in 2005 was US\$ 625/t, 11% above the 2004 level.

A sensitivity analysis shows that the highest price levels realized in 2005 added approximately US\$115 million in net revenue this year, compared to 2004.

In the first quarter of 2006, the average list price for BEKP (North America delivered) was US\$ 649/t.

Discounts from list prices are frequently granted by sellers to significant purchasers. It is possible that market prices for pulp will decline in the future, or that there will not be sufficient demand for the Company's products to enable it to operate its production facilities in an economical manner.

The Company has long term supply contracts with various customers and no assurance can be given that the prices for pulp or paper will stabilize or not decline further in the future, or that demand for the Company's products will not decline in the future. As a result, no assurance can be given that the Company will be able to operate its production facilities in a profitable manner in the future. The Company's results of operations would be materially adversely affected if the price of its product were to decline significantly. See also Item 4B. Business Overview Market Overview.

We face significant competition, which may adversely affect our market share.

The pulp industry is highly competitive. In the international pulp markets, we compete with larger competitors that have greater financial strength, higher production capacities and access to cheaper sources of capital.

In addition, most markets are served by several suppliers, often from different countries. Many factors influence our competitive position, including plant efficiencies and operating rates in relation to our competitors, and the availability, quality and cost of wood, energy, chemicals and labor. To the extent that pulp from other hardwoods can be substituted for the more expensive BEKP, we also compete with producers in the broader segment of the pulp market. Some of our competitors in this market have greater financial, marketing and other resources, larger customer bases and greater breadth of product offerings than we do. If we are unable to remain competitive with these producers in the future, our market share may be adversely affected. See Item 4B. Business Overview Competition.

We may be adversely affected by the imposition and enforcement of more stringent environmental regulations that would require us to spend additional funds.

The Company is subject to stringent environmental laws and regulations in Brazil on the national, state and local levels. Changes in environmental laws and regulations or changes in the policy of enforcement of existing environmental laws and regulations could adversely affect it. The Company's operations are supervised by governmental agencies that are responsible for the implementation of pollution control laws and policies. These agencies could take action against the Company if it failed to comply with applicable environmental regulations. These actions could include the imposition of fines and revocation of licenses and concessions.

Although changes in laws and regulations apply only prospectively under Brazilian law, it is possible that the relevant legislatures and/or governmental agencies will impose additional regulations or seek a more stringent interpretation of existing laws and regulations that would require the Company to spend additional funds on environmental matters or limit the Company's ability to operate as it currently does. In addition, such actions by such governmental bodies could impose additional costs to be borne by the Company when it renews existing licenses or applies for new ones.

Actions by federal or state legislature may adversely affect our operations.

In September 2001, the legislature of the State of Espírito Santo, where we own approximately 168,500 of forest and other land, passed a law temporarily restricting the plantation of eucalyptus forests for purposes of pulp production within the State. In June 2002, this law was declared to be unconstitutional by a provisional decision of the Brazilian Federal Supreme Court, and injunctive relief was granted in response to suits brought by the National Confederation of Industry and by the National Brazilian Confederation of Agriculture and Cattle Raising. The Company believes that such provisional decision will be upheld by the court's definitive decision on the merits. However, there can be no assurance that such definitive decision will be favorable to the Company or that similar laws will not be enacted that would impose a limitation or restriction on plantation of eucalyptus or that would affect our licenses or permits.

On March 13, 2002, the Espírito Santo legislative assembly created an investigating commission (*Comissão Parlamentar de Inquérito*) to investigate the legality of our permits and the acquisition of our properties, since we began our operations in Espírito Santo. As the procedures in the investigation were not concluded within the prescribed time period for such a type of investigation, the commission was terminated without issuing a final report. The Company is confident that all its permits and acquisition documents are strictly in accordance with all laws and regulations. However, we cannot be certain that a governmental entity will not initiate similar or other investigations in the future that would cause us to incur significant expense and divert management's attention.

In May 2003 the Human Rights Commission of the Brazilian House of Representatives (*Câmara dos Deputados*) created a Working Group to discuss the alleged violation of economic, social, cultural and environmental rights in the eucalyptus plantations in the State of Espírito Santo. Among other issues, several complaints involving the Company were discussed. Representatives of the Company participated in a Public Hearing and presented to the Commission extensive reports, information, evidence, technical studies and governmental and judicial decisions that demonstrate that the complaints were unjustified. The Working Group was terminated without issuing a final report. However, the Company cannot be certain that a governmental entity will not initiate similar or other investigations in the future that would cause the Company to incur significant expense and divert management's attention.

If we are unable to manage potential problems and risks related to acquisitions and alliances, our business and growth prospects may suffer. Some of our competitors may be better positioned to acquire other pulp and paper businesses.

The Company, as part of its business strategy, made a major acquisition by purchasing Riocell and may acquire other businesses in Brazil or elsewhere. In addition, the Company has made a significant joint venture investment in Veracel and may enter into other similar arrangements or alliances with third parties. Our management is unable to predict whether or when any prospective acquisitions or alliances will occur, or the likelihood of a material transaction being completed on favorable terms and conditions. Our ability to continue to expand successfully through acquisitions or alliances depends on many factors, including the availability to identify acquisitions and negotiate, finance and close transactions. Acquisitions and similar joint ventures or other arrangements have significant risks:

- we could fail to successfully integrate the operations, services and products of any acquired company;
- we could fail to select the best partners or fail to effectively plan and manage any alliance strategy;
- the acquisitions could increase our costs;
- our management's attention could be diverted from other business concerns; and
- we could lose key employees of the acquired company.

Our failure to integrate any new businesses or manage our investment in Veracel or any new alliances successfully could adversely affect our business and financial performance. Furthermore, the world pulp industry is undergoing consolidation, and many companies compete for acquisition and alliance opportunities in our industry. Some of our competitors have greater financial and other resources than we do. This may reduce the likelihood that we will be successful in completing acquisitions and alliances necessary for the expansion of our business or cause such acquisition or alliances to be possible only on less favorable terms. In addition, any major acquisition we consider may be subject to regulatory approval. We may not be successful in obtaining required regulatory approvals on a timely basis or at all.

We are controlled by a few shareholders, what can cause impasse on certain decisions.

Approximately 96.5% of our voting stock is owned by four principal shareholders, who have the ability to control the election of our board of directors and our direction and future operations, including decisions regarding acquisitions and other business opportunities, the declaration of dividends in excess of the requirements under our by-laws and Brazilian corporate law, and the issuance of additional shares and other securities. See Item 7A. Major Shareholders.

Dependence on Few Customers and the Loss of any of them can Cause a Significant Impact over our Operations

The Company's marketing strategy is to develop long-term relationships with customers that will purchase the Company's production year after year. In 2005, the Company's three largest customers accounted for approximately 54% of its sales (by volume). See Market Overview Markets and Customers. The Company believes that the loss of any of these customers would have a material adverse effect on the Company's results of operations.

ITEM 4. INFORMATION ON ARACRUZ

A. History and Development of Aracruz

We conduct our operations under our legal and commercial name, Aracruz Celulose S.A. We are a corporation (*sociedade anônima*), with unlimited duration, organized under the laws of the Federative Republic of Brazil. As a Brazilian corporation, we operate under the provisions of the Brazilian corporate law. Our headquarters and main operating unit are located at Rodovia Aracruz - Barra do Riacho, Kilometer 25, Municipality of Aracruz, State of Espírito Santo, Brazil, and its telephone number is 55-27-3270-2122. Our principal office is located at Av. Brigadeiro Faria Lima, 2277, 4th floor, 01452-000 São Paulo, State of São Paulo, Brazil, and our telephone number is 55-11-3301-4111. Our agent for service of process in the United States is CT Corporation, 111 Eighth Avenue, New York, NY 10011. We maintain an Internet website at www.aracruz.com.br. Information contained on our website is not part of, or incorporated by reference into, this annual report.

Aracruz Florestal S.A., or AFSA, our predecessor, was incorporated in 1967, for an unlimited duration, to plant eucalyptus forests. AFSA became a subsidiary of Aracruz in 1972 when Aracruz was incorporated, and on July 20, 1993, AFSA was merged into Aracruz.

We commenced pulp production operations in September 1978, using a single production line (*Fiberline A*) with a nominal production capacity (i.e., the production capacity for which the mill was designed) of approximately 400,000 tons of pulp per year. In early 1991, we completed an expansion plan, known as the 1991 Expansion Project, which added a second production line (*Fiberline B*). This increased the nominal capacity of the Barra do Riacho Unit to approximately 1,025,000 tons per year. In 1994, we increased our effective production capacity to 1,070,000 tons through system upgrades and productivity gains. From October 1995 to December 1998, we implemented the Modernization Project, which increased the Barra do Riacho Unit nominal capacity to 1,240,000 tons per year, as well as our production efficiency.

We own 51% of Portocel Terminal Especializado de Barra do Riacho S.A., the company that operates the port terminal of Barra do Riacho, since January 1985. The remaining 49% of Portocel is owned by Celulose Nipo-

Brasileira S.A. - CENIBRA, another pulp manufacturer and one of our competitors. From the privatization of the port terminal in 1985 until 2005 Portocel increased its storage capacity from 45,000 to 157,000 tons.

In 1997 we acquired all ownership interests of Gutchess International Inc. in Tecflor Industrial S.A. (currently known as Aracruz Produtos de Madeira S.A., or APM), a joint venture between Gutchess International Inc. and we created in 1997 for the production of solid wood products. In October 2004 we sold two thirds of our shares in APM to Weyerhaeuser do Brasil Participações Ltda., a subsidiary of Weyerhaeuser Corporation. APM's domestic sales policy remained unaltered and its overseas sales continued to be Weyerhaeuser's responsibility. We currently own one third of the shares of APM. See Business Overview Aracruz Produtos de Madeira.

In June 2000, our board of directors approved another expansion of the nominal production capacity of the Barra do Riacho Unit by 700,000 tons per year, known as the Fiberline C Expansion Project. The Fiberline C Expansion Project involved the addition of a new pulp line and certain other modifications to existing equipment at the Unit in order to further improve our cost-effectiveness. Construction began in the second semester of 2000, and the plant began operations at the end of May 2002, reaching full capacity in 2003. See Business Overview Fiberline C Expansion Project. The production volume resulting from the Fiberline C Expansion Project required an increase in the Company's forest base of approximately 65,200 hectares of eucalyptus plantations. To meet this demand, in June 2000, the Company acquired Terra Plana Agropecuária Ltda., with assets comprised of 19,000 hectares of land appropriate for planting eucalyptus trees. From July 2000 through December 31, 2001, the Company acquired approximately 44,000 additional hectares of land in a number of separate transactions. Additionally, in September 2002, Bahia Sul and the Company signed, jointly with Companhia Vale do Rio Doce and its wholly owned subsidiary, Florestas Rio Doce S/A, a contract for the acquisition of equal stakes by Bahia Sul and the Company of forest assets comprising approximately 40,000 hectares of lands and eucalyptus-planted forests. The Company also entered into a three-year wood supply contract for with Veracel to provide a total of up to 3.85 million cubic meters wood for the Fiberline C Expansion Project until the new plantations reach maturity for harvesting. This contract terminated in the first half of 2004. During 2004, we were able to meet approximately 62% of our wood fiber requirements from our own eucalyptus forests. In 2005 we met approximately 90% of our wood requirements from our own eucalyptus forests. In 2006 we expect to meet approximately 95% of our wood requirements from our own eucalyptus forests.

During 2005, the Barra do Riacho Unit gradually reduced the need to purchase wood from the market and, in 2006, will resume being self-sufficient in wood supply.

Our board of directors approved in December 2005 another investment at the Barra do Riacho Unit known as Barra do Riacho Unit optimization. The project will improve the technology and performance in the pulp production process, introducing flexibility to adapt the pulp to different market requirements. These improvements will be made by modifying and/or replacing equipment at Fiberlines A, B and C, leading to a sustainable increase in nominal capacity of 200,000 tons/year. The plant investment is estimated at \$192 million, or \$960/ton, with 80% of the items produced domestically and 20% imported. Implementation is forecasted to commence in the first half of 2006 and should be concluded in the third quarter of 2007 (around 18 months), with full capacity (of 2.3 million tons/year) being attained within a period of 36 months, in increments of 130,000 tons in 2007; 50,000 tons in 2008; and 20,000 tons in 2009, totaling 200,000 tons.

On October 10, 2000, we acquired a 45% stake in Veracel, a joint venture to grow eucalyptus trees on plantations and to build a pulp mill. On January 31, 2003, the Company acquired an additional 5% stake in Veracel, bringing its total stake to 50%. The remaining 50% interest in Veracel is owned by Stora Enso OYJ (*Stora Enso*). Veracel grows eucalyptus on plantations in the State of Bahia, which has diversified the sources of the Company's supply of wood for the Barra do Riacho Unit. This equity investment in Veracel achieved two objectives: (i) a guaranteed supply of wood for the Fiberline C Expansion Project during the first three years of the new production unit's operation and (ii) the opportunity to expand the Company's business in the future from an operational base in Bahia that can potentially replicate its accomplishments in the State of Espírito Santo. In May 2003, the Company and its joint venture partner decided to invest an additional US\$940 million in Veracel to build a 900,000-ton capacity mill (the *Veracel Mill*) for the production of BEKP in the State of Bahia. Construction of the Veracel Mill was started at the beginning of the second half of 2003, and the mill start up was in May 2005. A total of US\$1.24 billion was committed to the project.

The Veracel pulp mill, from the cornerstone to the start-up at the beginning of May 2005, took 22 months to be completed. The mill has a nominal production capacity of 900,000 tons per year of bleached eucalyptus pulp. The output of the new plant will be sold in its entirety to the controlling shareholders, in the same proportion as their shareholdings (50% each). Production in 2005 was 467,872 tons of pulp, 291,574 being assigned to the Company. On November 6, 2005, the Veracel pulp mill officially attained its design capacity. The so called learning curve phase was considered completed after the mill had produced for 30 consecutive days at an average output of 2,543 tons per day. This was achieved 174 days after the mill's start-up. The quality curve had already been achieved in June, when a level of over 97% of prime grade product had been continuously recorded for a period of 30 days. Both accomplishments represent world records for a greenfield pulp mill and are two major achievements in the successful development of the Veracel project.

The Veracel mill is expected to have the world's lowest production cost for bleached eucalyptus market pulp, due to its modern equipment, low average forestry operations radius (50 km) and high forest productivity, and will be one of the largest single-line pulp production facilities of its type in the world. The project makes use of modern equipment, control systems and processes to preserve the quality of the environment.

Because of its location - distant from large urban centers - Veracel's mill will contribute to the creation of jobs and income in a region where there are currently few opportunities. During the construction phase of the project, up to 12,000 direct and indirect jobs were generated. See Business Overview Acquisition of Veracel and Note 4 to the consolidated financial statements.

On May 30, 2003, the Company acquired all of the capital stock of Riocell S.A. (*Riocell*), a major producer of BEKP, from Klabin S.A. for an adjusted purchase price of US\$567 million. Riocell owned and operated a mill (the *Riocell Mill*) with a capacity of approximately 400,000 tons per annum and owned approximately 40,000 hectares of eucalyptus plantations. On January 7, 2004, Riocell was merged into the Company and the Riocell Mill and related forestry assets are now operated as the Company's Guaíba Unit. On September 15, 2004 the Company announced the Guaíba Unit optimization. The systems involved in the modernization of the Guaíba Unit went into operation in November 2005, just as planned, and achieved their performance targets. The optimization project will allow additional production of 30,000 tons in 2006, bringing the Guaíba Unit's nominal capacity to 430,000 tons/year. See Business Guaíba Unit.

Capital Expenditures

The Company's capital expenditures for 2005, 2004 and 2003 were US\$ 147.9 million, US\$94.5 million and US\$118.7 million, respectively.

The table below sets forth a breakdown of our most significant capital expenditures for the periods indicated:

	For the years ended December 31,		
	2005	2004	2003
	(in US\$ millions)		
Fiberline C Expansion Project			US\$55.8
Silviculture (Forest) and other forestry investments (includes land purchase)	US\$71.4	US\$68.1	51.5
Improvements/industrial investments	66.8	20.9	3.2
Other	9.7	5.5	8.2
Total	US\$147.9	US\$94.5	US\$118.7

During the year 2003, we invested approximately US\$118.7 million, of which US\$55.8 million was devoted to the Fiberline C Expansion Project, US\$41.4 million to forest, US\$10.1 million to other forestry investments, US\$3.2 million to ongoing industrial investments, and US\$8.2 million to other projects.

During the year 2004, we invested approximately US\$94.5 million, of which US\$52.7 million was devoted to forest, US\$8.9 million to land purchases, US\$6.5 million to other forestry investments, US\$17.9 million to ongoing industrial investments, US\$3.0 million to Guaíba Unit optimization and US\$5.5 million to other projects.

During the year 2005, we invested approximately US\$147.9 million, of which US\$65.2 million was devoted to forest, US\$2.4 million to land purchases, US\$3.8 million to other forestry investments, US\$40.1 million to ongoing industrial investments, US\$26.7 million to Guaíba Unit optimization and US\$9.7 million to other projects.

During 2006, the Company expects to invest approximately US\$212 million related to industrial, forestry and other investments. Funding for these investments will derive mostly from the Company's own cash generation.

B. Business Overview

General

We are the world's largest producer of bleached hardwood kraft market pulp. We produce eucalyptus pulp, which is a high-quality variety of hardwood pulp used by paper manufacturers to produce a wide range of products, including premium tissue, printing and writing papers, liquid packaging board and specialty papers. Eucalyptus pulp's distinguishing characteristics are its softness, opacity, porosity, and suitability for printing. Market pulp is the pulp sold to producers of paper products, as opposed to pulp produced by an integrated paper producer, for use in paper production facilities. Kraft pulp is pulp produced in a chemical process using sulphate.

We (comprising the Barra do Riacho Unit and the Guaíba Unit) produced approximately 2,552,000 (2,786,000 including Veracel's pulp production) tons of bleached eucalyptus kraft pulp (**BEKP**) in 2005, a 12% increase compared to 2004, representing approximately 12% of the total worldwide production capacity of hardwood market pulp and 26% of the worldwide production capacity of BEKP during 2005. In 2005, eucalyptus accounted for approximately 47% of the total worldwide production capacity of BEKP. In 2005 and 2004, sales to customers located outside Brazil, especially in North America, Western Europe and Asia, accounted for approximately 98% of our sales volume. See Market Overview Markets and Customers and Competition .

In 2005, we sold US\$1,345.2 million of eucalyptus pulp compared to US\$1,167.1 million in 2004 and US\$1,003.1 million in 2003.

From 1979 to 2005 our pulp production volume had a compound annual growth rate of 9.1% per annum and it expects to reach a total pulp production volume of 3,020,000 tons (including 50% of Veracel's pulp production) in 2006.

In December 1999, we moved our headquarters from Rio de Janeiro to the Municipality of Aracruz, in the Brazilian coastal State of Espírito Santo, where part of the Company's production facilities is located. In 2005 we moved our executive offices from Rio de Janeiro to São Paulo, where we maintain our financing, administrative and trading activities. Our production facilities consist of the Barra do Riacho Unit in Espírito Santo State, which has three production units each with two bleaching, drying and baling lines, and the Guaíba Unit, located in the municipality of Guaíba, State of Rio Grande do Sul, where we operate a high-tech mill with capacity to produce approximately 430,000 tons of BEKP. Our production facilities are equipped with advanced environmental protection resources.

We own approximately 429,252 hectares of forest and other land in the Brazilian states of Espírito Santo, Bahia, Minas Gerais and Rio Grande do Sul of which over 260,802 hectares are planted with eucalyptus forests. The Barra do Riacho Unit is located approximately 1.5 kilometers from the port facilities at Barra do Riacho, which are 51% owned by us.

We believe that we are one of the lowest-cost producers of bleached kraft market pulp in the world. Our low production costs relative to some of our competitors are due to a number of factors, including:

- economies of scale,
- advanced forestry techniques in managing the processes of planting,
- growing and harvesting of its trees,
- a comparatively short harvest cycle of its trees, and
- lower energy and chemical costs.

During 2005, we were able to meet almost 90% of our wood fiber requirements from our own eucalyptus forests. Climate and soil conditions in Brazil enable us to harvest our eucalyptus trees in only seven years after plantation, while harvest cycles for other types of hardwood trees in the southern United States, Canada and Scandinavia can range from 25 to 70 years. Harvest cycles for our principal non-Brazilian competitors in the eucalyptus pulp market, which are located in Spain, Portugal and Chile, are approximately eight to ten years. See Raw Materials Wood and Competition . We internally produce approximately 104% and 91%, in Barra do Riacho and Guaiba Units, respectively, of our electrical energy requirements, mainly from by-products of its pulp production process, and recycles the greater part of the chemicals used at the Units. See Raw Materials Energy.

Business Strategy

The key elements of our mission statement are:

- generating a superior return to our shareholders,
- offering products and services that add value for our customers,
- leveraging our competence in renewable forestry uses,
- creating development opportunities for our employees, and
- observing the principles of sustainable development.

In 2005, the Company made progress in the implementation of its strategy of combining sustainable growth with continuous efforts to boost operational excellence. Our strategic objective is to substantially increase Aracruz's share of the global hardwood pulp market over the coming years and to continue to be one of the lowest cost producers in the sector, adding value for shareholders and other stakeholders.

The following ongoing and approved projects implement our business strategy:

- *Economies of scale resulting from new capacity increases.* Following the Modernization of Fiberlines A and B, and the Excellence Project, both carried out in 1998, which improved Aracruz's operational efficiency and enabled the Company to reduce costs, and the Fiberline C Expansion Project, which in the middle of 2002 increased our nominal production capacity to over 2,000,000 tons per year, Aracruz continued to deliver growth through the acquisition from Klabin S.A., in 2003, of Riocell, with its updated nominal production capacity of approximately 430,000 tons of bleached eucalyptus market pulp and 50,000 tons of printing and writing paper, and through the Veracel project, a pulp mill for the production of bleached eucalyptus kraft market pulp in Eunápolis, in the state of Bahia, with a nominal capacity of 900,000 tons per year, which started up in May 2005. In mid 2004, Aracruz Board of Directors approved the Guaiba Unit optimization project, which improved operational efficiency and enabled the Unit to increase its nominal capacity from 400,000 to 430,00 tons per year. Those Projects rely on our technology advances and benefits from our existing overhead and management structure, which has absorbed the new activity

without significant additional fixed costs. These enhancements will enable us to reduce pulp costs and improve quality levels in the new production unit. Following the same value

20

drive, the company approved in 2005 the Barra do Riacho Unit optimization project that will increase the nominal capacity of the 3 existing Fiberlines in 200,000 tons.

- *Improvements in forestry technology using advanced genetic techniques, which will result in an increase in the forest yield.* As a result of the ongoing forest improvement program, we planted new eucalyptus clones in 2004 and 2005 that display greater pulp potential productivity per hectare as well as wood quality that is better suited to the requirements of our customers. The performance of these clones was monitored throughout the year 2005, confirming they are superior to the ones belonging to the previous generation. We made progress in forest sustainability, especially regarding the most effective use of water and nutrients, soil conservation and maintenance of biodiversity.
- *Optimization of transportation logistics.* Transportation of wood to the mills comprises a large portion of the cost of our pulp production. Improvements in transportation logistics and costs are a priority for the Company. At the end of 2002, we improved the logistics of our rail transportation. We also launched our Multimodal Transportation Systems Maritime and Rail , the main objective of which is to enhance logistics and further integrate our Mill-Port-Forest system. In 2005, coastal shipping delivered 17% of the total wood consumed at the Barra do Riacho Unit. With the entry into service in October, 2005 of another tug and barge, the annual shipping capacity is expected to reach 3.1 million tons in 2006, representing 46% of total wood transportation. Each barge has a wood-carrying capacity of approximately 5,000 tons. As well as optimizing transport costs, their use eliminated some 26,500 truck journeys along the BR 101 highway in 2005, reducing traffic on the road and cutting emissions of greenhouse gases as a result of lower fossil fuel consumption.
- *Improve business process management with state-of-the-art information technology in order to improve efficiency and reduce costs.* We use mySAP.com(R) platform supplied by SAP to control, simplify and integrate our business process within all our sites and also to implement connectivity with our customers and suppliers. We are currently making improvements in all our applicable systems in order to comply with Sarbanes-Oxley demands. We have also started to implement in 2005 BPMS - Business Process Management System.
- *Increase of competitiveness.* The competitiveness of our business operations, combined with our significant cash generation capabilities, has led us to evaluate from time to time various future strategic alternatives, including further increase of current pulp operations either through acquisitions or expansion of existing capacity, and/or further acquisitions of additional forests.
- *Enterprise risk management (ERM).* The Company is developing its Sustainability Plan, which comprises ERM, a wide and structured long term approach of the main corporate risks of the company. Following the best practices of Corporate Governance, the Company seeks to have full control of its main financial and intangible corporate risks. The methodology used by the Company is considered an evolution of impact and probability regarding financial and intangibles corporate risks.

Acquisition of Veracel

On October 10, 2000, we entered into two stock purchase and sale agreements pursuant to which we acquired a 45% stake in Veracel, a joint venture between Stora Enso OYJ and Odebrecht to grow and manage eucalyptus plantations and to build a pulp mill. One agreement, for the amount of approximately US\$72 million, was entered between the Company and Odebrecht for the acquisition of 40% of the total outstanding capital stock of Veracel. The other agreement, for the amount of approximately US\$9 million, was entered between the Company and Stora Enso Treasury Amsterdam B.V. for the acquisition of an additional 5% of the total outstanding capital stock of Veracel. On January 31, 2003, Odebrecht sold its 10% stake in Veracel to Stora Enso OYJ and us. We acquired shares representing 5% of the total outstanding capital stock of Veracel for US\$9.7 million, resulting in 50% stake for each shareholder. This equity investment in Veracel achieved two objectives: (i) a guaranteed supply

of wood for the Fiberline C Expansion Project during the first three years of the new production unit's operation and (ii) the opportunity to grow our business in the future from an operational base in Bahia that can potentially replicate our accomplishments in the State of Espírito Santo.

In May 2003, Stora Enso and we approved the construction of Veracel's pulp mill for the production of BEKP in Eunápolis, in the State of Bahia ("**Veracel Project** "). The mill was projected to have a nominal capacity of 900,000 tons per year and the overall investment was budgeted at US\$1.30 billion. Veracel operations started in May, 2005 and reached full capacity 174 days after at beginning of November, setting a new world record for learning curve achievement. During 2005 Veracel produced 467,872 tons of pulp and it is expected to produce 920,000 tons in 2006, becoming one of the largest and most advanced single-line pulp mill in the world.

The Veracel Project has obtained commitments for long-term direct funding from development banks in the amount of approximately US\$650 million, being US\$500 million from BNDES and US\$150 million from the European Investment Bank (EIB) and the Nordic Investment Bank (NIB). The funding of the Veracel Project consists of 5% internal cash generation, 42% equity and 53% loans from Brazilian and international development agencies. The Company is a several guarantor of 50% of the indebtedness incurred by Veracel, including indebtedness in connection with the financing of the Veracel Project. Stora Enso is a several guarantor of the other 50% of such indebtedness. At December 31, 2005 the outstanding amount of such indebtedness guaranteed by the Company was approximately US\$398.2 million.

The construction of the mill was started at the beginning of the second half of 2003, and the operational start-up was in May 2005. The project was carried out under an EPC (Engineering, Procurement and Construction) concept and required the prior implementation of a qualification program to enable the local workforce to take part in the construction of the pulp mill. The equipment and services necessary for the project have been contracted mostly from Brazilian suppliers. The implementation of the Veracel project was also successfully concluded, establishing two other global marks: the installation of the project in 22 months and the effective construction of the mill, concluded in 17 months.

In connection with the acquisition of the 45% equity participation in Veracel, on October 10, 2000, we, Stora Enso and Odebrecht, together known as the Veracel Shareholders, and Veracel entered into a shareholders' agreement, or the Veracel Shareholders' Agreement, which set forth, among other things, certain agreements among the parties with respect to the management and operation of Veracel and the transfer of the common shares of Veracel. In connection with the further acquisition by us and by Stora Enso, on equal basis, of the stake then held by Odebrecht in Veracel on January 31, 2003 and as a consequence of the Implementation Decision adopted by the remaining shareholders, the Veracel Shareholders' Agreement was amended. The amended Veracel Shareholders' Agreement has a term of 20 years from its date and can be automatically extended for successive 20-year terms thereafter unless notice is given by any party to the Veracel Shareholders' Agreement. The Veracel Shareholders' Agreement will terminate automatically if the ownership by any of the Veracel Shareholders of common shares of Veracel exceeds 50%. The Veracel Shareholders' Agreement provides that Veracel will at all times during its term have a board of directors comprised of 6 (six) members, of which (i) 3 (three) will be elected from individuals appointed by Stora Enso and, (ii) 3 (three) will be elected from individuals appointed by us. The directors elected by us (acting jointly) and the directors elected by Stora Enso (acting jointly) will each have the right, without any action by any other directors, to request the removal of any incumbent officer of Veracel. The Veracel Shareholders' Agreement also provides that neither we nor Stora Enso may transfer (which includes the creation of liens) any of their respective common shares of Veracel to non-affiliated entities other than after the second anniversary of the start-up of Veracel's pulp mill. Either of the Veracel Shareholders may transfer its common shares of Veracel to an affiliate, subject to certain limitations. The Veracel Shareholders' Agreement also requires that each person or entity who acquires shares of Veracel pursuant to the provisions thereof become a party to such agreement. The Veracel Shareholders' Agreement provides that, under certain circumstances, the Veracel Shareholders may be required to make capital contributions to Veracel, on a *pro rata* basis. The Veracel Shareholders' Agreement also provides that we, so long as neither we nor any of our subsidiaries is a shareholder of Veracel, shall not acquire (or caused to be acquired) any interest in real property in Veracel. The same covenant applies to Veracel with respect to real property in our core area.

The Veracel Shareholders' Agreement provides further that if any of the shareholders, known as the Defaulting Shareholder, fails to comply with any of its obligations regarding Veracel's funding needs in connection

with the business plan, the Investment Plan and Capital Contributions, the other shareholder (the Calling Shareholder) shall have the right to require the Defaulting Shareholder to transfer all (but not less than all) of its shares to the Calling Shareholder at a discounted market value calculated according to the provisions of the Veracel Shareholders Agreement.

Guaíba Unit

On June 30, 2003 the Company announced that it had acquired Riocell S.A. (*Riocell*) from Klabin S.A., which operated the Riocell Mill situated in Guaíba, Rio Grande do Sul, in the south of Brazil, for an adjusted purchase price of US\$567 million. As a consequence, Riocell was included in the Financial Information of the Company at and for the year ended December 31, 2003 included herein. On January 7, 2004, Riocell was merged into the Company and is now operated as the Guaíba Unit of the Company.

The nominal production capacity of the Guaíba Unit is approximately 430,000 tons of BEKP and 50,000 tons of printing and writing paper, equipped with advanced environmental protection resources. The Guaíba Unit has approximately 73,808 hectares of forest and other land and 6,559 hectares of plantations are kept in association with third parties. The average distance of the wood supply to the mill is approximately 82 kilometers.

The Guaíba unit is now fully integrated into Aracruz: human resources, information technology, systems and processes. Several synergies were obtained mainly in logistics, sales and operations.

During the second half of 2004, the project to upgrade the Guaíba Unit's industrial facilities was approved. The systems involved in the modernization of the Guaíba Unit went into operation in November 2005, improving production capacity in the Guaíba Unit from 400,000 tons to 430,000 tons of BEKP. The overall investment amounted to US\$ 29.7 million and the initial results are running well considering production, quality, environment and costs.

Aracruz Produtos de Madeira

As part of our earlier strategy of diversification into other forest product businesses, we established a joint venture with the Gutchess International group of the United States in 1997 to create a new company, Tecflor Industrial S.A., for the production of solid wood products. In 1998, we acquired all ownership interests of Gutchess International Inc. in Tecflor Industrial S.A., now called Aracruz Produtos de Madeira S.A., (*APM*), which then became our wholly owned subsidiary. APM's high-tech hardwood lumber sawmill, which is located in the State of Bahia, was commissioned in the first quarter of 1999 and sales of its producing began during the third quarter of 1999. APM manufactures and markets Lyptus®, a new concept renewable, high-grade hardwood lumber produced using eucalyptus trees, computer-optimized sawing technology and advanced drying and finishing processes. The sawmill has a nominal production capacity of 44,000 cubic meters per year. As of April 30, 2006, APM had nominated 11 sales representatives in major furniture markets in Brazil and was supplying an industrial customer base of nearly 150 manufacturers.

Having consolidated the production process and trained its workforce during the preceding two years, in 2001 APM sought to expand the presence of its Lyptus® brand of high-quality sawn wood in domestic and international markets while ensuring that its quality standards were maintained. In 2001, APM established a commercial partnership with the U.S.-based Weyerhaeuser Co., or Weyco, one of the largest forestry companies in the world, for the exclusive distribution of Lyptus® in the North American markets. This new partnership arrangement gave APM access to over 70 Weyco points of sale in the U.S. and Canada, increasing the presence of Lyptus® in one of the largest markets in the world for high-quality hardwood. The first shipments to Weyco took place in the months of May and August 2001. We have expanded the 2001 agreement with Weyco of the U.S. to extend sales of Lyptus® to the European and Asian markets, thus assuring the presence of the product in over 100 points of distribution in those regions.

In 2003, 2004 and 2005, 23,5%, 30% and 40% respectively, of total production was exported. In 2004 and 2005, export sales accounted for 61% and 65%, respectively, of the revenues of APM.

Consistent with the strategies set forth above, in October 2004 we sold two thirds of our shares in APM to Weyerhaeuser do Brasil Participações Ltda., a subsidiary of Weyco, for a total purchase price of US\$ 18,6 million. We currently own one third of the shares of APM and have certain voting rights as set forth in APM Shareholders Agreement.

The Board of Directors of APM approved in February 2004 a five year business plan, which comprises the expansion of the sawmill nominal production capacity to 95,000 cubic meters per year and investments in the amount of up to US\$ 10,3 million, of which US\$ 1,35 million have been invested in 2005. The investment in 2006 is budgeted at US\$ 550,000.00.

Barra do Riacho Unit Optimization Project

Barra do Riacho Unit began its operations in 1978 with a nominal capacity of 400,000 tons in Fiberline A. In 1991 throughout the duplication of capacity, the Fiberline B started operations with an additional of 525.000 tons. In 2002 our third line, Fiberline C, was started with a nominal capacity of 700.000 tons. During the last 27 years, throughout many debottlenecking and modernization projects, Barra do Riacho Unit achieved a total production capacity of 2,130,000 tons per year.

The Barra do Riacho Unit optimization project will improve the technology and performance in the pulp production process, introducing flexibility to adapt the pulp to different market requirements. These improvements will be made by modifying and/or replacing equipments at Fiberlines A, B and C leading to a sustainable increase in nominal capacity of 200,000 tons per year.

The plant investment is estimated at US\$ 192 million, or US\$ 960 /ton, with 80% of the items produced domestically and 20% imported. Land purchase will not be needed. The incremental wood volume will be provided basically by (1) reduction in average age of current forestry base and (2) forestry productivity on increase throughout forestry management implemented in 1999.

Implementation commenced in the first half of 2006 and should be concluded in the third quarter of 2007 (around 18 months), with full capacity (of 2.3 million tons/year) being attained within a period of 36 months, in increments of 130,000 tons in 2007, 50,000 tons in 2008 and 20,000 tons in 2009, totaling 200,000 tons.

Market Overview

General

Wood pulp is the principal raw material used in manufacturing paper and paperboard. Whether or not a specific type of wood pulp is suitable for a particular end use depends on the type of wood used to make the pulp, as well as the process used to transform the wood into pulp. Hardwood pulp is produced using hardwood trees, such as oak, eucalyptus, aspen, birch and acacia trees. Hardwood pulp has short fibers and is generally better suited for manufacturing coated and uncoated printing and writing papers, tissue and specialty papers. Softwood pulp is produced using softwood trees, such as pines. It has long fibers and is generally used to add strength to the paper. We do not produce softwood pulp.

The pulp manufacturing process also can determine a pulp's suitability for particular end-uses. Chemical pulp refers to pulp made using chemical processes to dissolve the lignin and other organic materials holding the wood fibers together. Among the various chemical processes, the most common is the kraft process, which is used by us to produce our pulp. The kraft process helps to maintain the inherent strength of the wood fibers and thus produces a pulp especially well suited for manufacturing printing and writing papers, specialty papers and tissue papers. Pulp producers may sell their pulp in the worldwide market or use it internally to manufacture various types of papers.

Bleached pulp is used for a variety of purposes, including printing and writing papers, specialty papers and tissues. Unbleached pulp, which is brown in color, is used in the production of wrapping papers, corrugated containers and other paper and cardboard transportation materials.

As a result of the variety of wood types and processes used to produce pulp, which have evolved significantly over time, the pulp market has become increasingly specialized in terms of technical characteristics. Many of the physical and chemical properties most valued by printing and writing paper manufacturers and other bleached pulp consumers, such as opacity and brightness, are exhibited by hardwood and, particularly, eucalyptus pulp. In addition, the increasing specialization of paper manufacturers has resulted in many such manufacturers developing their own customized mix of pulp inputs (known as furnish), for use in their paper manufacturing. Furthermore, as more paper manufacturers have come to appreciate the technical characteristics of hardwood pulp and to rely on a significant hardwood pulp component in their furnish, the market for hardwood pulp has grown more rapidly than the market for softwood pulp. Within the hardwood segment, bleached eucalyptus kraft market pulp has demonstrated the highest annual rate of growth in demand from 1995 to 2005. Over the same ten-year period, the annual rate of growth in demand for bleached eucalyptus pulp was estimated at 6.8%, while the annual rate of growth in demand for hardwood pulp during the same period was estimated at 4.5% and the market for softwood for the same period was estimated at a 2.8% annual rate.

Eucalyptus is only one of many types of hardwood used to make pulp. Eucalyptus trees generally grow straight and have few branches. This allows for dense growth, easy harvesting and less need for pruning. Since 1980, eucalyptus kraft market pulp has steadily increased as a percentage of the total worldwide production of bleached hardwood kraft market pulp (from 29% in 1980 to approximately 43% in 2005) primarily due to its high quality, and because of properties, such as its softness, opacity and printability.

International Markets

From 1992 to 2005, the worldwide production capacity of bleached hardwood kraft market pulp is estimated to have grown an average of approximately 4.2% per year, from 13.2 million tons to 23 million tons. The start-up of new or expanded production facilities has increased the total worldwide capacity for bleached hardwood kraft market pulp by approximately 4.7 million tons from 2000 to 2005. Worldwide demand for bleached hardwood kraft market pulp is strongly influenced by the demand for paper and board products, which correlates to world GDP growth. Demand for bleached hardwood kraft market pulp has grown in recent years, increasing from 11.5 million tons in 1992 to 20.8 million tons in 2005. Consumption of market pulp is concentrated mainly in Europe, North America and Asia.

The charts below show the demand for bleached hardwood by region:

	Total Bleached Hardwood Demand By Region									
	2002		2003		2004		2005			
	Tons	% total	tons	% total	tons	% total	tons	% total		
NORTH AMERICA	2.750.000	15	2.725.000	14	2.730.000	13	2.875.000	14		
EUROPE	7.915.000	43	8.485.000	43	9.010.000	43	9.150.000	43		
ASIA	6.830.000	37	7.530.000	39	8.205.000	39	8.255.000	39		
TOTAL WORLD	18.340.000		19.545.000		20.810.000		21.115.000			

Aracruz Sales and Market Share By Region												
	2002		2003		2004		2005					
	Tons	%Share*	tons	%Share	tons	%Share	tons	%Share	tons	%Share		
NORTH AMERICA	623.000	23	%	690.000	25	%	833.000	31	%	909.000	32	%
EUROPE	637.000	8	%	765.000	9	%	1.004.000	11	%	1.004.000	11	%
ASIA	280.000	4	%	470.000	6	%	540.000	7	%	510.000	6	%

The market pulp industry is highly competitive and is also sensitive to changes in industry capacity, producer inventories and cyclical changes in the world's economies, all of which may significantly affect pulp prices and thereby our profitability. The price of pulp generally increases as economies expand around the world. Strong demand during most of the 1980s caused the market price per ton of bleached eucalyptus kraft market pulp delivered in the United States by us to peak in 1989 at US\$775 per ton. A global recessionary environment and a substantial increase in worldwide pulp supply during the early 1990s led to a sharp decline in the prices of market pulp, reaching US\$410 per ton in December 1993, the lowest price level since 1983. Prices began to increase in the second quarter of 1999 through the second half of 1999. In 1999, the average price per ton of bleached eucalyptus kraft market pulp delivered in the United States was US\$522, an increase of approximately 1.3% as compared to 1998. In 2000, prices continued increasing during the first half of the year, led mainly by the strong demand in Europe. However, in the second half of 2000, prices remained stable. The average price per ton of bleached eucalyptus kraft market pulp delivered in the United States was US\$665, an increase of approximately 27% as compared to 1999.

While the Company's volume of pulp sales during 2002 was higher than in 2001 or 2000, the price of pulp declined throughout 2002. The Company's average list price decreased 8.2% in 2002 compared with the average in 2001, primarily due to the slowdown in the growth of the major economies, which began in 2001 and continued to negatively impact the global demand for paper throughout 2002.

The high level of the world pulp inventories witnessed at the beginning of the year caused prices to fall to their lowest levels by the end of the first quarter of 2002. From then on, the recovery in demand, coupled with expectations of renewed growth in the world economy during the second half of 2002 and underpinned by improved control over supply, prompted consecutive increases in the price of eucalyptus pulp, which reached US\$510 per ton delivered to the United States in the third quarter of 2002.

Despite the satisfactory performance of the main consumer markets, high quality tissue and printing and writing papers, the price of pulp still was depressed throughout 2003.

In the beginning of 2004 prices were still under pressure, but with the pick up of paper demand and adequate inventories, prices were able to reach its peak by June and July at US\$ 595 (North America delivered). In the middle of third quarter the absence of the Chinese buyers in the market once more depressed prices which ended 2004 at US\$555 North America delivered.

The increase in demand in 2005, combined with pulp mill closures have permitted the implementation of price increase in the year which reached list price of US\$ 635 per ton (North America delivered) in April and sustained itself throughout the year.

The following chart shows, for the periods indicated, average annual prices for BEKP produced by us as compared to northern hardwood (NBHK) and southern hardwood (SBHK) prices:

**BEKP -NBHK - SBHK List Prices
North America Delivered (US\$/ton)**

(Note: prices are expressed as simple arithmetic average for the year)

Sources: For all eucalyptus pulp prices and for 2000 southern and northern hardwood pulp prices, the Company's databank; for 2001 northern and southern hardwood pulp prices, Hawkins Wright 2001; for 1988-99 southern and northern hardwood pulp prices, Hawkins Wright, November 2000. For 2002, 2003, 2004 and 2005 eucalyptus prices, the Company's databank, and for southern and northern hardwood pulp prices, Hawkins Wright, December 2002, 2003, 2004 and 2005.

Domestic Market

In 2005, we supplied approximately 40,000 tons of the aggregate domestic demand for bleached eucalyptus kraft market pulp, compared to 50,000 tons in 2004. In 2004, we supplied approximately 50,000 tons of the aggregate domestic demand for bleached eucalyptus kraft market pulp, compared to 36,000 tons in 2003. Demand for bleached hardwood kraft market pulp in Brazil decreased from 530,740 tons in 1998 to 511,760 tons in 1999, due to the adverse economic situation in Brazil during most of 1999. See Item 5. Operating and Financial Review and Prospects Brazilian Economic Environment. However, in 2000, the Brazilian economic scenario improved and the demand for bleached hardwood kraft market pulp reached 517,000 tons, an increase of 1% compared to 1999. In 2001, the demand for bleached hardwood kraft market pulp reached 489,000 tons, a 5% decrease compared to 2000, primarily due to the energy rationing in Brazil, which had a negative impact on paper production. In 2002, the demand for bleached hardwood kraft market pulp reached 512,000 tons, a 5% increase compared to 2001, primarily due to the paper production growth, mainly on the tissue segment (8.4%). In 2003 demand grew by 2% compared to 2002, reaching 520,579 tons, reflecting an increase in the tissue and printing and writing segments. In 2004 demand remained almost flat reaching 518,742 tons, still reflecting a positive scenario in the paper segment which started in 2003. In 2005 total domestic market demand for bleached hardwood kraft reached 564,789 tons, resulting in an increase of 9% over 2004. The increase in tissue demand and the stability of the printing writing market contributed to this result.

The six largest Brazilian producers of bleached hardwood kraft market pulp are:

- Aracruz Celulose S.A.,

- Celulose Nipo-Brasileira S.A., or CENIBRA,
- Votorantim Celulose e Papel S.A.,
- Suzano Bahia Sul Papel e Celulose S.A.,
- Jarí Celulose S.A., and
- Lwarcel Celulose e Papel

Together the six largest Brazilian producers accounted for 71% of total domestic sales in 2005, with us accounting for 7% of total domestic sales. Our domestic sales volume of bleached hardwood kraft market pulp was 2% of its total sales volume in 2002, 2003, 2004 and 2005 as compared to 3% in 2001, as a result of our increase in sales in international markets and other producers increasing their own share of the Brazilian market. See Competition. Although domestic pulp prices are affected to a certain degree by general economic conditions in Brazil, domestic pulp prices have been, and are expected to continue to be, correlated with international pulp prices.

Eucalyptus Forests

At December 31, 2005, we owned approximately 429,252 hectares of forest and other land in the Brazilian States of Espírito Santo, Bahia, Minas Gerais and Rio Grande do Sul, of which over 260,802 hectares are planted with eucalyptus forests. The average distance from our forest areas currently in use to the mills at Barra do Riacho Unit is 207 kilometers, while this distance at Guaíba Unit is 82 kilometers. Because of the cost of transportation, the average distance from the forest to the mill has an important effect on our cost structure, and we have sought to reduce the distance in various ways, including by accelerating the substitution of cloned trees with higher productivity near the mills, as discussed in

Raw Materials Wood. We are always evaluating opportunities for acquiring land with forest closer to the mills in order to reduce the distance, and the associated costs, of hauling wood between the forest and the mills as well as any system of logistics that could reduce the cost of transportation, such as transportation by barges using our port facility in the state of Bahia. See Business Strategy. Of the 429,252 hectares owned by us, approximately 260,802 hectares are currently used for the planting of trees to supply pulp production and solid wood production, approximately 139,177 hectares are reserved for preservation, approximately 18,383 hectares have been used in the construction of roads and the remainder is used for research and development and other activities. Brazilian law requires that 20% of our land, at any given time, either remain uncultivated with eucalyptus trees or planted with indigenous species.

Throughout 2005, one of our principal objectives was to increase the Forestry Partners Program, for the establishment of new plantations to ensure the future supply of wood for our mills. During 2005, we established approximately 14,000 additional hectares of eucalyptus plantation through this program.

At Barra do Riacho Unit we have a tree nursery capable of producing approximately 40 million seedlings per year and a research facility are located nearby as well. At Guaíba Unit our tree nursery was capable of producing 10 million in 2005 and there is an expectation of expansion in 2006 to up to 30 million.

In 2005, we supplied 9.5 million cubic meter wood to our pulp mills, of which 8.3 million cubic meter came from our own eucalyptus forests and 1.3 million cubic meters of wood were purchased from the market, including approximately 277,000 cubic meters purchased through the Forestry Partners Program.

The Company pioneered the use of cloned seedlings from rooted cuttings, a method also known as vegetative propagation, to carry out large-scale planting of eucalyptus trees. This method of cloning results in trees whose fibers are extremely homogeneous, which the Company believes results in a more streamlined industrial process and higher quality pulp. Today, approximately 89% of the Company's eucalyptus forests are grown from this type of seedling. Rather than growing from seeds, clones are the offspring of asexual propagation. By means of this type of generation, the descendant receives the entire genetic code of the original tree. Accordingly, the risk of disease and pests can be lessened by choosing parent trees better adapted to the region. Other benefits of

vegetative propagation include significantly lower bark per cubic meter of wood and self-pruning trees with fewer branches.

Raw Materials

Wood

We rely exclusively on eucalyptus trees to meet our pulp wood requirements. Eucalyptus is a short-fibered hardwood that grows back from the stump after being cut, with each tree capable of regenerating twice. Eucalyptus trees are among the fastest growing trees in the world. Climate and soil conditions in Brazil allow for approximately seven-year eucalyptus tree harvest rotations as compared to eight to ten-year harvest rotations in Spain, Portugal and Chile. As part of our growth strategy, it has sought to eliminate the need for external sources of wood and to maximize both the yield and quality of fiber grown on our timberlands through advanced forestry and tree-cloning techniques.

In 2003, we supplied most of our 7.4 million cubic meter wood requirements from our own eucalyptus forests in the State of Espírito Santo and in the southernmost region of the State of Bahia. During the same period, we also purchased 2.7 million cubic meters of wood, which is equivalent to 37% of our wood consumption, of which approximately 623,000 cubic meters were purchased through the Forestry Partners Program.

Through the development of cloned trees selected on the basis of certain characteristics, we were able to reduce our wood consumption per ton of pulp produced from 3.9 solid cubic meters under bark in 1985 to 3.5 solid cubic meters in 2005. The optimal time to harvest our trees is six to seven years from the time of planting.

Energy

Reducing our need for outside sources of energy and chemicals is an important component of our low-cost production strategy. At the Barra do Riacho Unit approximately 98% of our electrical energy needs in each of the years 2004 and 2005 were met by burning by-products generated from the pulp production process compared with 79% in 1999. At the Guaíba Unit approximately 89% and 91.5% of our electrical energy in 2004 and 2005, respectively, were generated internally using methods similar to the ones used in Barra do Riacho Unit and generation from coal. The remainder of our energy needs was met through purchases of electricity, fuel oil and natural gas from third sources.

Chemicals

We use several chemicals in the pulp bleaching process. Until December 1999, we maintained and operated an electrochemical plant on the same site as the mill at Barra do Riacho Unit to produce some of the chemicals used in the pulp bleaching process, specifically chlorine, caustic soda and sodium chlorate.

On December 16, 1999, we entered into a series of transactions with Canadianoxy Chemicals Ltd. for the transfer of our electrochemical plant to a subsidiary of Nexen Inc., or Nexen, a Canadian company formerly known as Canadian Occidental Petroleum, for approximately US\$61 million. Nexen, with head offices in Calgary, Canada, is a major producer of sodium chlorate. Its principal shareholder is Occidental Petroleum Corporation, which owns approximately 80% of its share capital. The transfer closed on December 17, 1999. The sale of the electrochemical plant, located adjacent to the mill in Barra do Riacho Unit, is part of our strategy to concentrate on our core business, transferring the production of chemicals to a specialized producer. We built the plant during the construction of the pulp mill in 1979 and subsequently expanded the plant in 1991. At the time of the sale, the electrochemical plant had the capacity to produce approximately 36,000 tons per year of sodium chlorate, 36,000 tons per year of caustic soda and 32,000 tons per year of chlorine. The plant also produces hydrochloric acid and sodium hypochlorite (liquid bleach).

Under the terms of the purchase agreement, we have agreed to indemnify Nexen for certain liabilities relating to: (i) the manufacturing of electrochemical products prior to the sale, (ii) any legal proceedings that relate to the manufacture of the electrochemical products in which the basis of the claim occurred prior to the sale and (iii)

any misrepresentation by us in connection with the purchase agreement. Our indemnity obligations expire, with respect to tax, labor, product liability and environmental matters, upon the passage of the relevant statute of limitations, which depends on the relevant Brazilian legislation.

As part of the sale of the electrochemical plant, we and two subsidiaries of Nexen entered into a successively renewable contract for the reciprocal supply of raw materials, services and products over a 25-year period. The agreement obligates us to provide a continuous supply of raw materials, primarily water and steam, to the electrochemical plant, and the plant to provide bleaching chemicals to us, at competitive prices. The agreement includes clauses of performance incentives, such as sharing of productivity gains, preference prices and take-or-pay obligations pursuant to which we are committed to purchase from the electrochemical plant a volume of chemical products projected for six years from the date of the agreement. If, in a given year, we purchase volumes of chemical products in excess of the minimum agreed to volume, our obligations to purchase may be reduced in subsequent years. For the take-or-pay quantities, we will pay unit prices which equal cost plus a margin as determined in the contract. The agreement also may not be assigned by a party without the consent of the other party and includes provisions relating to: (i) the extension of the agreement for an additional 10-year period upon the agreement of both parties not less than two years prior to the expiration of the initial 25-year term, (ii) the suspension of service by each party, (iii) the termination of service and (iv) the termination of the agreement by a party upon 18 months' notice that such party intends to permanently cease operation at its facility. In the event of termination of the agreement or a proposed sale by Nexen, the agreement provides that we have the right of first negotiation for the acquisition of the electrochemical plant. As a result of the sale, we no longer have responsibility for the electrochemical plant and, accordingly, any interruption of the operations of the electrochemical plant could require us to seek alternative sources in the market for certain chemicals essential to our production of pulp.

The chemicals used in the pulp bleaching process in the Guaíba Unit, specially chlorine, caustic soda, sodium chlorate, hydrochloric acid and chlorine dioxide, are also produced in an electrochemical plant located on site. The nominal capacities of such electrochemical plant are, respectively, 23,605 ton/year of caustic soda, 20,949 ton/year of chlorine, 9,900 ton/year of sodium chlorate, 9,000 ton/year of hydrochloric acid and 5,760 ton/year of chlorine dioxide.

Water

Water is required in the pulp production process and in the cultivation of seedlings. Water is primarily provided by several rivers, which feed into a 35 million cubic meter reservoir on the mill site in Barra do Riacho Unit. In the Guaíba Unit the water is provided by the Guaíba River, beside the mill. The reservoir in the Barra do Riacho Unit holds enough water to supply the mill's needs for a five-year period in the event of a drought (based on statistical information regarding periods of very low rainfall). In the Barra do Riacho Unit wastewater undergoes a two-stage purification treatment process before it flows into the ocean, and in Guaíba Unit we have a four stage purification process before it flows into the Guaíba River.

Beginning in the latter half of 1998, the State of Espírito Santo experienced a severe drought which reduced our water supply and caused us to pursue alternative long-term sources of water to meet our current operating needs as well as any foreseeable expansion plans. As a result, in May 1999, we, together with the municipal governments of Aracruz and Linhares, a neighboring city, began a project of public interest to obtain water from the Rio Doce river through an existing system of canals and rivers. The project was completed in June 1999 and now provides water for the local communities and for the industrial and chemical districts of the Municipality of Aracruz as well as for irrigation of agricultural activities in the northern region of the State of Espírito Santo. During 2000 and the beginning of 2001, we made the necessary adjustments in the mill to receive the water supply from Rio Doce. The project was approved by federal, state and local authorities. Despite the low average rainfall during 2003, the use of water from the Rio Doce river enabled us to obtain all of our water supply requirements. In 2004 due to high average rainfall, we decided to temporarily close our Rio Doce river access. In 2005 the mill sometimes needed to use the water from Rio Doce due to maintenance of the river access.

The Units

Our principal pulp mill, located in the State of Espírito Santo, is the largest bleached hardwood kraft market pulp production facility in the world. From 1991 to 1998, we successfully increased this mill's nominal capacity

from 1,025,000 tons of pulp per year to 1,240,000 tons of pulp per year. This mill's third production unit, known as the Fiberline C Expansion Project, began production in May 2002, increasing the nominal production capacity of the mill to approximately 2,000,000 tons of pulp per year.

We also have a pulp mill in our Guaíba Unit which production capacity is of approximately 430,000 tons of BEKP per year, after full implementation of the project to upgrade the Guaíba Unit's industrial facilities. - See B - Business Overview - Guaíba Unit .

The Company's total production in 2005 was 2,552,000 (comprising the Barra do Riacho Unit and the Guaíba Unit) and 2,786,000 tons including 50% of Veracel's pulp production (versus 2,497,000 tons in 2004), representing approximately 12% of the total worldwide bleached hardwood kraft market pulp production capacity. In 1994, we increased our effective production capacity to 1,070,000 tons through system upgrades and productivity gains. From 1995 to 1999, we invested in the Modernization Project in Barra do Riacho Unit, increasing the nominal production capacity of that mill to 1,240,000 tons of pulp per year. After the Fiberline C Expansion Project the nominal capacity of the Barra do Riacho Unit increased to 2,000,000 tons. The total production of that mill in 2002 was 1,656,000 tons (1,272,000 tons in 2001), 2,031,000 tons in 2003, 2,093,000 tons in 2004 and 2,134,000 tons in 2005, representing approximately 10% of the total worldwide bleached hardwood kraft market pulp production capacity.

The production facilities in the State of Espírito Santo and Rio Grande do Sul consist of large receiving yards for the logs, debarking, chipping and digesting equipment, packaging, warehousing facilities and a fully computerized control system that continuously monitors the entire production process. The Barra do Riacho Unit and the Guaíba Unit mills' pulp systems have, respectively, five steam turbines and three steam turbines, and generators that provide a continuous power supply for that system. Fuel for the generation of steam is mainly provided by waste products from the pulp production process. External backup power supplies are also available on sites. In Barra do Riacho Unit a tree nursery capable of producing approximately 40 million seedlings per year and a research facility are located nearby. At Guaíba Unit our tree nursery was capable of producing 10 million in 2005 and there is an expectation of expansion in 2006 to up to 30 million. The Barra do Riacho Unit electrochemical plant, which was transferred in December 1999 to Nexen and that provides most of the chemicals used in the pulp bleaching process, is located within the boundaries of the production facility. The Guaíba Unit also has an electrochemical plant located within its boundaries. For a discussion of the sale of our electrochemical plant to Nexen, see Raw Materials Chemicals.

Pulp Production

When operating at full capacity, the Barra do Riacho Unit mill can process over 23,000 solid cubic meters of timber each day and the Guaíba Unit mill can process 6,700 solid cubic meters of timber each day. The logs are either debarked in the forest or debarked at the mills using tumbling drums and then cut into chips, which are transferred by conveyors system to the digesters where they are mixed with chemicals and heated under pressure. During this chemical cooking process, the lignin and cellulose are separated. Once removed, the lignin is used as fuel to produce steam and electrical energy for the milling process. The used chemicals are removed at various stages of the production process and recycled within the plant. The cellulose fibers are then washed, bleached using bleaching chemicals (which are produced on site), filtered, pressed and dried. The dried pulp is then cut into sheets, packed into bales and transported by truck to domestic destinations, for exportation. Barra do Riacho Unit is served by a private port which is administered by Portocel (a company where we own 51% of the stocks) located approximately 1.5 kilometers from the mill, for shipments abroad. At Guaíba Unit a barge terminal is located in the Guaíba River, beside the mill, and the pulp is transported by barges to Rio Grande Port for shipment abroad. See Transportation.

In 2005 we have produced two types of pulp:

- Standard Pulp (only in Barra do Riacho Unit); and
- ECF Pulp.

Standard Pulp is pulp bleached with regular levels of chlorine. Standard Pulp is in high demand in North America and Asia. Although most of the production is represented by ECF Pulp, the production of Standard Pulp is still relevant because there is high demand for such pulp. During 2005, we produced approximately 2,500 tons of Standard Pulp, as compared to 36,792 in 2004 and 79,536 in 2003. ECF Pulp, or Elemental Chlorine Free Pulp, is pulp bleached with lower levels of chlorine. ECF Pulp is in high demand in Europe, where our customers have preferred pulp that is bleached with little or no chlorine due to the environmental concerns relating to the pulp production process, particularly the bleaching process (although recently we have detected a shift in environmental concerns away from the bleaching process to forestry management and efficient control). We first produced ECF Pulp in November 1990. During the period from 1991 to 1994, we equipped the Barra do Riacho Unit mill so that it would have the capacity to produce enough ECF Pulp to meet the growing demand for ECF Pulp. From 1993 to 1997, we produced 75% ECF pulp. Commencing in 1998, with the completion of the Modernization Project, we were to produce 100% ECF pulp. See The Units. During 2005, approximately 100% of Barra do Riacho Unit production, or 2,132,018 tons, was comprised of ECF Pulp as compared to 2,050,218 tons during 2004 and 1,860,060 tons during 2003. During 2005 the production of ECF in Guaíba Unit was approximately 417,000 tons as compared to 401,000 tons in 2004.

Transportation

Wood from the forest areas is transported by truck and by sea barges (owned by independent contractors) to the mills for processing into pulp. The average distance from our forest areas currently in use to the mills at Barra do Riacho Unit is 207 kilometers, while this distance at Guaíba Unit is 82 kilometers.

The pulp produced for export at Barra do Riacho mill is transported by truck from the mill to the port of Barra do Riacho (Portocel), which is located approximately 1.5 kilometers from the mill site. This port is used to hold and load pulp and provides us with convenient access to ocean transport vessels. The port is a modern facility that currently has the capacity to handle approximately 4,090,000 tons of pulp per year. The port includes a warehouse capable of holding approximately 157,000 tons of pulp.

We own 51% of Portocel, the company that operates the port of Barra do Riacho. The remaining 49% of Portocel is owned by CENIBRA, another pulp manufacturer and one of our competitors. We do not own any ships for transportation of our pulp.

Our integrated, coastal wood shipment project was completed in December 2002. It involves a system of sea-going barges and tugboats and two port terminals that link the extreme south of Bahia to the north of Espírito Santo. The port complex of Portocel, adjacent to the mill at Barra do Riacho Unit, receives wood from plantations in southern Bahia via an alternative transportation system that is more efficient than truck-based highway shipments. The first phase of the operation between Caravelas and Portocel, with annual capacity for transporting 1.7 million cubic meters of wood, began at the end of 2002.

Another improvement to our wood transportation operations was the construction and start-up of a nearly 4km-long rail spur used for unloading wood shipments directly at the mill's yard. This improvement is important to optimize the receiving process of the wood that comes from North of Minas Gerais and other areas within the state of Espírito Santo.

At the Guaíba mill, the pulp is exported through the port of Rio Grande. The pulp is transported by barge through the lake Lagoa dos Patos and the distance from the mill to the port is 160 nautical miles. To load the barges there is a terminal facility integrated to the mill.

Markets and Customers

Our principal markets are in North America, Europe, Asia and Brazil. Our export sales are performed through our foreign subsidiaries in Hungary and Panama. See - Organizational Structure - Significant Subsidiaries . The relative geographic distribution of our sales by volume and percentages of total production were as set forth below:

Aracruz Sales and Market Share By Region												
	2001		2002		2003		2004		2005		1Q 2006	
	Tons	% of total	Tons	% of total	Tons	% of total	Tons	% of total	Tons	% of total	Tons	% of total
Europe	475.3	37 %	637.0	40 %	813.7	38 %	1,014.4	41 %	1,122.4	43 %	291.2	39 %
North America	479.8	37 %	623.2	39 %	767.8	36 %	831.3	34 %	909.2	35 %	248.2	33 %
Asia	306.2	23 %	280.1	18 %	509.0	23 %	533.1	22 %	510.8	20 %	192.4	26 %
Latin America	3.6	0 %	17.6	1 %	21.4	1 %	21.6	1 %	8.4	1 %	2.2	0 %
Total Exports	1,264.9	97 %	1,557.9	98 %	2,119.9	98 %	2,400.4	98 %	2,550.8	98 %	734	99 %
Brazil	36.4	3 %	27.0	2 %	37.1	2 %	49.6	2 %	39.7	2 %	10.2	1 %
Total	1,301.3	100 %	1,584.9	100 %	2,149.0	100 %	2,450.0	100 %	2,590.6	100 %	744.2	100 %

The average net prices per ton of eucalyptus pulp for 2001, 2002, 2003, 2004, 2005 and the first quarter of 2006 were US\$438, US\$418, US\$453, US\$458, US\$497, US\$508, respectively.

In 2005, 2004 and 2003 approximately 2% of our sales volume was sold in the domestic market. One of our marketing strategies is to develop long-term relationships with customers that will purchase our production year after year. Stable long-term relationships permit us to reduce our marketing expenses, to better understand our customers' needs, and to take advantage of our competitive strengths, including the consistency of our pulp and our efficient logistic and technical support to our clients. In 2005, our three largest customers accounted for approximately 54% of its sales, by volume. In 2004 and 2003, our ten largest customers accounted for approximately 72% and 75% of our sales, respectively, and for those years our two largest customers accounted for approximately 44% and 46% of our sales, by volume, respectively. These customers include leading North American tissue manufacturers and leading global manufacturers of printing and writing paper. In 2003, 2004 and 2005, demand for our pulp has been in line with our production capacity; however, we cannot guarantee that such balance between demand and production capacity will happen in the future. We believe that the loss of any of these customers could have a material adverse effect on our results of operations. We have long-term sales contracts with some of our customers, including several of our largest customers. These contracts generally provide for sales of specified amounts of pulp at prices announced from time to time by us, which are in line with the prevailing market prices for pulp sold to customers in the geographic area of the purchaser under the contract. Early termination is provided for in the contracts in the event of a material breach, the insolvency of one of the parties or force majeure events of extended duration. Certain sales contracts include provisions that permit us to reduce the quantities to be shipped if sales to the purchaser and our affiliates would exceed a specified percentage of our annual production capacity.

We have sought to diversify our sales among different market segments, such as consumer products (for example, tissue paper), specialty papers and high quality printing and writing papers. Producers of these products, as opposed to producers of commodity papers, value the consistency of our pulp as well as the reliability of our service.

The following table shows the breakdown by end uses of our pulp production in 2001, 2002, 2003, 2004 and 2005.

	2001	2002	2003	2004	2005
Tissue	51 %	57 %	55 %	55 %	57 %
Printing, and Writing Paper	28	29	26	22	22
Specialty Papers(1)	20	13	18	22	21
Cartonboard	1	1	1	1	
	100 %	100 %	100 %	100 %	100 %

(1) Includes liquid packaging board, carbonless paper, base paper for laminated paper and coated wood-free specialties.

Competition

While we compete with other producers of bleached hardwood kraft market pulp, our most direct competitors are other producers of eucalyptus pulp due to the special characteristics of this fiber. To a lesser degree, all producers of hardwood pulp compete with producers of softwood pulp and with other raw materials, such as recycled paper.

Competition is based primarily on quality (particularly consistency of product), service, price and reliability. We and other Brazilian eucalyptus pulp producers have significant cost advantages over producers in other regions. See Raw Materials Wood. We, however, do not generally compete on the basis of price alone. Instead, we emphasize quality, reliability and stable long-term relationships with customers.

If demand for recycled paper increases in the future, demand for pulp could be adversely affected. While no assurance can be given, we believe that increases in demand for recycled paper would not materially affect our results of operations, at least in the near future, because (i) it is more costly to produce recycled paper using current technology due to the high costs of sorting out wastes and de-inking the recycled fiber, and (ii) customers are predominantly manufacturers of higher-quality paper products such as premium tissue paper, coated papers and specialty papers, which are less likely to use recycled fibers for their products.

Bleached Eucalyptus Kraft Market Pulp (BEKP)

We are the largest producer and exporter of bleached eucalyptus kraft market pulp in the world. Our main competitors in this market are located in Brazil, Portugal, Chile and Spain and are listed by country (without any priority as to order) in the following table:

Producer	Country
CENIBRA	Brazil
Suzano Bahia Sul Celulose S.A.	Brazil
Jari Celulose S.A.	Brazil
Votorantim Celulose e Papel S.A.	Brazil
Empresa de Celulose e Papel de Portugal SGPS, S.A. (Portucel)	Portugal
Celulose Beira Industrial S.A.	Portugal
CMPC Papeles S.A.	Chile
Celulosa Arauco y Constitución SA.	Chile
Empresa Nacional de Celulosas S.A.	Spain
Grupo Rottneros (Miranda mill)	Spain

Management estimates that the five major producers of bleached eucalyptus kraft market pulp in the world (i.e., Aracruz, CENIBRA, Empresa Nacional de Celulosas S.A., Suzano Bahia Sula Celulose S.A., and Votorantim Celulose e Papel S.A) currently account for 58% of the total world production capacity of bleached eucalyptus kraft market pulp. Management estimates that in 2005, we accounted for 25% of the world production capacity of bleached eucalyptus kraft market pulp, 5% of the world production capacity of chemical market pulp and 10% of the world production capacity of bleached hardwood kraft market pulp.

Bleached Hardwood Kraft Market Pulp

To the extent that pulp from other hardwoods can be substituted for the slightly more expensive bleached eucalyptus kraft pulp, we also compete with producers of pulp from other hardwoods. Such competition is based more on cost and less on quality or suitability of the pulp for use in higher quality paper products. Although bleached hardwood kraft market pulp is produced in most regions of the world, the dominant producers are located in North America, Latin America, Western Europe and the Scandinavian countries (Finland, Norway and Sweden), which in 2005 are estimated to have accounted for 70% in the aggregate, and 19%, 30%, 13% and 8%, respectively, of the world's total bleached hardwood kraft market pulp production capacity. Producers in the United States

sold approximately, 2,347,000 tons during 2003, 2,352,000 in 2004 and 2,156,000 tons in 2005 while Brazilian producers sold approximately 4,767,000 tons, 5,237,000 and 5,611,922 tons respectively, in such periods. Several of our competitors in this market are larger than we are and may have greater economic and other resources than we do.

Worldwide production capacity for bleached hardwood kraft market pulp grew approximately 4.1% per year from 1995 to 2005, totaling 22.7 million tons, and is expected to grow at an annual rate of 5.8% during the period of 2005 to 2009 (or approximately 5.8 million tons in total during this period). Approximately 85% of this growth in capacity is expected to occur in Latin America, where bleached eucalyptus kraft market pulp capacity is expected to grow from approximately 6.9 million tons in 2005 to approximately 11.8 million tons in 2009. Worldwide demand for bleached hardwood kraft market pulp is expected to grow by 2.8% per year from 2005 through 2009, adding 3.0 million tons to the current demand.

Environmental and Other Regulatory Matters

Our mill and forestry operations are subject to federal, state and local laws, regulations and permit requirements relating to the protection of the environment. Law No. 6,938, dated August 31, 1981 established strict liability for environmental damage, mechanisms for enforcement of environmental standards and licensing requirements for activities that are effectively or potentially damaging to the environment. Environmental laws and regulations also govern the conduct of forest operations and the protection of Brazilian fauna and flora. A violation of environmental laws and regulations may result in fines and penalties which may be material. Law No. 9,605, dated February 12, 1998 provides that individuals or entities whose conduct or activities cause harm to the environment are subject to criminal and administrative sanctions and are liable for any costs to repair the damages resulting from such harm. Criminal sanctions for individuals and entities that commit environmental crimes range from fines to imprisonment (individuals) or dissolution (legal entities). In addition, Law No. 9,605 also establishes that the corporate structure of a company may be disregarded if the structure impedes the recovery for harm caused to the environment. We are not aware of any successful assertion of claims against shareholders under this provision of Law No. 9,605.

The States of Espírito Santo and Rio Grande do Sul require local manufacturing concerns to obtain various permits including operating permits for manufacturing facilities. Pursuant to state laws, state authorities are empowered to regulate a company's operations by prescribing company-specific environmental standards in such company's operating permit. The operating permits require that we maintain certain emissions, effluent and waste disposal standards.

On February 10, 1998, the State of Espírito Santo issued to us a two-year operating permit for Fiberlines A and B at Barra do Riacho Unit, which was renewed for an additional five years commencing on February 10, 2000. On July 01, 2002 the State of Espírito Santo issued to us a four-year operating permit for Fiberline C at Barra do Riacho Unit, valid until July 2006. Nevertheless, on May 06, 2005 the State of Espírito Santo issued to us a unified four-year operating permit for Barra do Riacho Unit (Fiberlines A, B and C), which is valid until May 2009. During 2002, supplemental environmental licenses were obtained for Fiberline C Expansion Project relating to our industrial installations.

On June 20, 2005 the State of Rio Grande do Sul issued to us an operating permit for Guafba Unit, valid until June 2009.

Beginning in March 1997, we became subject to an environmental audit every three years in the State Espírito Santo. The audit is conducted by subcontracted auditors, approved by the Environmental Secretary of the State of Espírito Santo, or SEAMA. The audit was not carried out in 2000, since SEAMA has not published the result of the 1997 audit. The 2000 audit was conducted in June 2001. The most recent audit was conducted in November 2004. In the State Rio Grande do Sul we became subject to an environmental audit every year, since the year 2002. The audit is conducted by subcontracted auditors, approved by the Brazilian Environmental Institute, or IBAMA. The audit has been regularly carried since 2002 and the most recent audit was conducted in October 2005.

Our forestry activities are regulated by the Brazilian federal government and the governments of the States of Espírito Santo, Minas Gerais, Bahia and Rio Grande do Sul. Our operating permit for our forest operations in Espírito Santo was renewed for a six-year period commencing on October 4, 2004. Since 2000, the Company has obtained from the environmental state agencies from the states Espírito Santo, Minas Gerais and Bahia 33

implementation and operational permits for implanting 307 projects accounting for 63,831 hectares of eucalyptus plantations. The remaining area is going to have operational permits during 2006. The terms and conditions for the issuance of forest operating permits in the state Rio Grande do Sul were already defined by the local environmental state agency and we are engaged in this process so as to obtain our relevant forest operating permits in Rio Grande do Sul in due course.

We also entered into contracts with farmers in the State of Espírito Santo, Minas Gerais, Bahia and Rio Grande do Sul pursuant to which the farmers have agreed to grow trees for sale to us. See Eucalyptus Forests . Regarding our operating permit for the Forestry Partners Program, the licensing process for renewing it is under negotiation and we expect to conclude it during 2006.

Plantings may be undertaken only pursuant to a plan presented to and approved by the appropriate governmental authorities. In accordance with federal law, at least 20% of our landholdings, at any given time, must be preserved uncultivated or planted with indigenous species. We currently exceed this requirement, since such land accounts for approximately 32% of our total landholdings. In September 2001, the legislature of the State of Espírito Santo, where we own approximately 168,500 hectares of forest and other land, passed a law temporarily restricting the plantation of eucalyptus forests for purposes of pulp production within that State. This law was declared to be unconstitutional by a provisional decision of the Brazilian Supreme Federal Court and injunctive relief was granted in response to suits brought by the National Confederation of Industry and by the National Confederations of Acquisitions and Cattle Raising. The Company believes that such provisional decision will be upheld by the court's definitive decision on the merits. However, there can be no assurance that such definitive decision will be favorable to the Company nor that other similar laws will not be enacted that would impose a limitation or restriction on plantation of eucalyptus or that would affect our licenses or permits.

On March 13, 2002 the State of Espírito Santo legislative assembly created an investigating commission (*Comissão Parlamentar de Inquérito*) to investigate the legality of our permits and the acquisition of our properties since we began operating in the State of Espírito Santo. As the investigative procedures were not concluded within the prescribed term for such type of investigation, the commission was terminated without issuing a conclusive report. We are confident that all our permits and acquisition documents are strictly in accordance with all laws and regulations.

We believe that we are in compliance in all material respects with all applicable environmental regulations. In addition, environmental considerations are fundamental to our development of new technologies. Our integrated pest management relies on biological control of pests and diseases. Soil and plant nutrients are continuously monitored to guarantee an adequate balance. At the Units, methods for the evaluation of environmental effects of effluents on receiving detriments have been developed and used. The origins of pulp and effluent toxicity have been studied, considering all possible sources, from the raw material (wood) to bleaching effluents. In addition, environmental quality is considered in the development of new technologies and products. Pulp products are continuously evaluated in terms of their possible effects on the quality of effluents in our customers' paper machines as well.

In 1996, the State of Bahia granted us a permit for the location of APM, the sawmill company of which we currently hold 1/3 (one third) of the shares, APM. In 1998, the State of Bahia granted an operating permit for APM, valid until August 2003. In June 2003, the State of Bahia renewed APM's operating permit, valid until June 2007. See Business Strategy.

As part of the licensing process in connection with the Fiberline C Expansion Project, we contracted independent consultants to prepare the required environmental impact assessment reports. Those reports were discussed in public hearings (two in Bahia and one in Espírito Santo) in 2000 as well as during six public meetings with communities in both states. There was ample discussion at each meeting of the environmental and social questions involved. The results of the discussions were taken into consideration by the government regulatory agencies in their technical analyses and their subsequent approval of the permits.

We also obtained 307 projects permits for forest plantations, of which 59 were incorporated in operating licenses issued by the Espírito Santo Agriculture, Cattle-Raising and Forest Protection Institute (IDAF), 216 were

projects incorporated in installation licenses issued by the Bahia Environmental Resources Center (CRA-BA) and 17 projects approved for operating licenses by the Minas Gerais State Forestry Institute (IEF-MG).

In October 2003, the Bureau Veritas Quality International (BVQI) approved CERFLOR (the Brazilian System of Forest Certification) certification of 95,300 hectares covering all of the Company's own plantations in the State of Bahia. The certificate emitted by INMETRO (National Institute of Metrology) was received in March 2004. We initiated this certification process in August 2003, including pre-audit, initial audit and a certification audits. The certification audit was publicized through local radio stations and newspapers as well as the sending out of letters to more than 600 persons or entities. Five public meetings were held in respect of the Certification, with the presence of more than 300 persons. In October 2004 the first annual monitoring audit for the maintenance of CERFLOR certification in Bahia took place. The certification was maintained and a new public report was made available to the general public on the internet.

The CERFLOR Certification for plantations in Espírito Santo State (93,501 hectares) was approved by BVQI in June 2005. The certification process was initiated in November 2004 with the realization of six public meetings and an initial audit. The certification audit was held in January 2005. The audit report was made available for the public on the internet for 90 days. The certificate emitted by INMETRO (National Institute of Metrology) was also received in June 2005.

In October 2005, we had the second annual monitoring audit for the maintenance of CERFLOR certification in Bahia and the first annual monitoring audit for the maintenance of CERFLOR certification in Espírito Santo State. In September 2005, we started the CERFLOR Certification for plantations in Minas Gerais State (6,179 hectares). Two public meetings were held in respect of this Certification, with the presence of more than 100 persons. We expect to receive the certificate emitted by INMETRO (National Institute of Metrology) during the first semester of 2006.

As of May 23, 2006, all of the Company's own plantation areas in the State of Rio Grande do Sul (Guaíba Unit) were certified by the Forestry Stewardship Council (FSC), totaling 58,219 hectares.

In December 2005, an audit for CERFLOR Certification was performed in our Guaíba Unit, including 47,907 ha of forest plantations. Four public meetings were held and the CERFLOR certificate is expected to be issued by INMETRO (National Institute of Metrology) in the first semester of 2006.

In October 2005 CERFLOR Certification has gained international endorsement through the Programme for the Endorsement of Forest Certification Schemes - PEFC Council, the global assessment organization for forest certification systems. Such endorsement attests that CERFLOR certification is an independent proof that the Company's certified plantations are subject to sustainable forest management preserving the ecological, social and economical functions of forests.

Insurance

We believe that our insurance coverage of our production facilities and forests is in line with Brazilian market and international pulp industry standards.

Our forests are fully covered by insurance. The insurance limit was set at US\$ 22 million for each of the three main forest areas based on the historically low rates of loss and the large spread of the risk.

In 2003, the Company received the Highly Protected Risk (HPR) seal of approval from FM Global. The certification, which is renowned worldwide in the field of insurance, attests to the Company's low risk of interruption of its operations as result of an industrial accident. The Company is the first Brazilian company to earn the certificate from FM Global, the world's largest property risk insurance company and leader in the field of risk management and loss prevention.

In 2005, following the same pattern and principals of the Company's risk management practices, Veracel was also granted the HPR seal of approval from FM Global, confirming the low levels of risk in its operations.

C. Organizational Structure

Significant Subsidiaries

Our operations are conducted by Aracruz Celulose S.A., as the controlling and principal operating company. The following table sets forth the significant subsidiaries owned directly or indirectly by us and our ownership interest in each of them as of December 31, 2005:

	As of December 31, 2005			
	Total Capital		Voting	
	(in percentages)		(in percentages)	
Portocel Terminal Especializado de Barra do Riacho S.A.(1)	51	%	51	%
Mucuri Agroflorestral S.A.(1)	100	%	100	%
Aracruz Produtos de Madeira S.A. (formerly named Tecflor Industrial S.A.)(1) (8)	33,33	%	33,33	%
Veracel Celulose S.A.(1) (8)	50	%	50	%
Aracruz Trading S.A.(2)	100	%	100	%
Aracruz Celulose (USA), Inc.(3)	100	%	100	%
Aracruz (Europe) S.A.(4)	100	%	100	%
Aracruz Trading Hungary Ltd.(5)	100	%	100	%
Riocell Trade (6)	100	%	100	%
Ara Pulp - Com. de Importação e Exportação, Unipessoal Ltda(7)	100	%	100	%
Arcel Finance Limited (9)	SPE		SPE	

(1) Incorporated in Brazil.

(2) Incorporated in the Republic of Panama.

(3) Incorporated in the United States under the laws of the State of Delaware.

(4) Incorporated in Switzerland.

(5) Incorporated in Hungary

(6) Incorporated in England

(7) Incorporated in Portugal

(8) Accounted as per the equity method.

(9) See notes 1 (b) and 10 to the consolidated financial statements.

D. Property, Plant and Equipment

In December 1999, we moved our headquarters from Rio de Janeiro to the City of Aracruz in the Brazilian coastal State of Espírito Santo, where our main production unit is located. We maintain offices in São Paulo for our financing, administrative and trading activities.

Our principal production facilities consist of a eucalyptus pulp mill located in Aracruz, State of Espírito Santo, which has three production units, each with three production lines. When operating at full capacity, this mill can process over 23,000 solid cubic meters of timber each day. We also have one mill in Guaíba, State of Rio Grande do Sul that has one production unit, with one production line. When operating at full capacity, this mill can process over 6,700 solid cubic meters of timber each day.

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As of December 31, 2005, we had an aggregate principal amount outstanding of approximately US\$1.681 billion under certain loans granted to us by BNDES, which loans are secured by liens on our industrial site in the Municipality of Aracruz. See Item 7B. Related Party Transactions.

We own approximately 429,252 hectares of land in the Brazilian States of Espírito Santo, Bahia, Minas Gerais and Rio Grande do Sul, of which approximately 260,802 are planted eucalyptus forests. See Business Overview Eucalyptus Forests. The pulp mill in Barra do Riacho Unit is located approximately 1.5 kilometers from the port facilities at Barra do Riacho, of which 51% are owned by us. We have a terminal facility integrated to the Guaíba Unit mill that is used to load the barges that transport the pulp to Rio Grande port.

See Environmental and Other Regulatory Matters for the environmental rules and regulations affecting our operations.

38

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis should be read in conjunction with our consolidated financial statements, including the respective notes thereto, included elsewhere in this annual report, and in conjunction with the discussion of the method of presentation of financial information under Item 3.

Overview

We are the world's largest producer of bleached hardwood kraft market pulp. During 2005, we produced approximately 2,552,000 tons of BEKP (2,786,000 tons including 50% of Veracel's pulp production), a 12% increase from 2004, when we had produced approximately 2,497,000 tons of BEKP, which was a 11% increase as compared to 2003 when we had produced approximately 2,250,000 tons of bleached eucalyptus pulp. Pulp sales for 2005 were approximately 2,605,000 tons, a 6% increase as compared to 2,450,000 in 2004, which had represented a 14% increase when compared to 2003 pulp sales of 2,149,000 tons. Export pulp sales in 2005 were approximately 98% of total sales. Export pulp sales for the year 2004 were approximately 98% of total sales.

In 2005, the Company sold US\$1,345.2 million of eucalyptus pulp compared to US\$1,167.1 million in 2004, US\$1,003.1 million in 2003.

The Company's volume and price of pulp sales during 2005 were higher than in 2004. The Company's average list price increased by approximately 12% in 2005 compared with the average in 2004.

The primary factors affecting our results of operations are:

- prevailing world market prices for pulp;
- the amount of pulp produced and sold by us;
- our costs of production, which primarily consist of the costs of materials (primarily wood and chemicals) and depreciation; and
- the relationship between the *real*, the currency in which approximately 50% of our cash operating cost and expenses (operating expenses net of depreciation and amortization of property, plant and equipment and net of forest depletion) are incurred, and foreign currencies, principally the U.S. dollar, in which more than 95% of our sales are made. See **Brazilian Economic Environment** Effects of Inflation and Currency Exchange Fluctuations.

The prices that we are able to obtain for our pulp depend upon prevailing world market prices, which historically have been cyclical, with prices subject to significant fluctuations over relatively short periods of time. See **Item 4B. Business Overview** Market Overview International Markets.

We believe that we are one of the lowest cost producers of bleached kraft market pulp in the world. Our relatively low production costs are due to economies of scale, advanced forestry techniques, a comparatively short regional harvest rotation and low energy and chemical costs. See **Item 4B. Business Overview** General.

Recently Issued Accounting Pronouncements under U.S. GAAP

In November 2004, the FASB issued SFAS No. 151, **Inventory Costs—an Amendment of ARB No. 43**. The Statement clarifies that abnormal amounts of idle facility expenses, freight, handling costs, and spoilage should be recognized as current period charges and not include as part of inventory cost. This Statement also 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 apply prospectively and are effective for inventory costs incurred by the Company after December 31, 2005. The Company will adopt this Statement as of January 1, 2006. The impact of adopting these new rules is dependent on events that could occur in future periods, and as such, an estimate of the impact cannot be determined until the event occurs in future periods.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*, an amendment of APB No. 29, *Accounting for Nonmonetary Transaction*. This Statement amends Opinion 29 to eliminate the exception from fair value accounting 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. The Statement specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date this Statement is issued. Retroactive application is not permitted. Management will adopt this Statement as of January 1, 2006 and will apply its standards in the event exchanges of nonmonetary assets occur after such date.

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 (1) determining whether the investment is impaired, (2) evaluating whether the impairment is other-than-temporary, and (3) if the impairment is other-than-temporary, recognizing an impairment loss.

The FSP carries forward the disclosure requirements of EITF 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.

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 No. 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 June 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections, a Replacement of APB Opinion No. 20 and FASB Statement No. 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 March 2005, the FASB issued FASB Interpretation No. 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 No. 143 to its operations and concluded that no material effects would be expected. Management considered this Interpretation in 2005 and concluded that no conditional asset retirement obligations currently exists.

In February 2006, the FASB issued SFAS No. 155 *Accounting for Certain Hybrid Financial Instruments*. SFAS No. 155 amends FASB Statements No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS

155 resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets.

SFAS 155:

- a. Permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation;
- b. Clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133;
- c. Establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation
- d. Clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives;
- e. Amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The impact of adopting this new rules is dependent on events that could occur in future periods, and as such, an estimate of the impact cannot be determined until the event occurs in future periods.

In March 2006, the FASB issued SFAS No. 156 Accounting for Servicing of Financial Assets. SFAS 156 amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, that establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. SFAS 156 amends Statement 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. SFAS 156 permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. Under this Statement, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. By electing that option, an entity may simplify its accounting because this Statement permits income statement recognition of the potential offsetting changes in fair value of those servicing assets and servicing liabilities and derivative instruments in the same accounting period. An entity shall adopt this Statement as of the beginning of its first fiscal year that begins after September 15, 2006. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year.

The impact of adopting this new rules is dependent on events that could occur in future periods, and as such, an estimate of the impact cannot be determined until the event occurs in future periods.

Discussion of Critical Accounting Policies and Estimates

In connection with the preparation of the financial statements included in this annual report, we have relied on estimates and assumptions derived from historical experience and various other factors that we deemed reasonable and relevant. We are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses during the reporting periods and require the disclosure of contingent assets and liabilities as of the date of the financial statements. The Company's consolidated financial statements therefore include estimates concerning such matters as the selection of useful lives of property, plant and equipment, provisions necessary for asset impairments, contingent liabilities, employee postretirement benefits and other similar evaluations. Although we review these estimates and assumptions in the ordinary course of business, the portrayal of our financial condition and results of operation often requires our management to make judgments regarding the

effects of matters that are inherently uncertain on the carrying value of our assets and liabilities. Actual results may differ from those estimated under different variables, assumptions or conditions. Note 1 of the Consolidated Financial Statements includes a summary of the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements. In order to provide an understanding about how management forms its judgments about future events, including the variables and assumptions underlying the estimates, and the sensitivity of those judgments to different variables and conditions, we have included below a brief discussion of the more significant accounting policies and methods used by us.

Legal Contingencies

We are currently involved in certain legal proceedings. As discussed in note 16 to our financial statements, we have accrued our estimate of the probable costs for the resolution of these claims. This estimate has been developed in consultation with outside legal counsel handling our defense in these matters and is based upon an analysis of potential results, assuming a combination of litigation and settlement strategies. We do not believe these proceedings will have a material adverse effect on our financial position. It is possible, however, that future results of operations could be materially affected by changes in our assumptions and the effectiveness of our strategies with respect to these proceedings. It is possible, however, that future results of operation could be materially affected by changes in our assumptions and the effectiveness of our strategies with respect to these proceedings.

Impairment testing of goodwill

The Company annually evaluates the carrying value of goodwill, for impairment calculation purposes, during and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. Such circumstances could include, but are not limited to: (1) a significant adverse change in legal factors or in business climate, (2) unanticipated competition, or (3) an adverse action or assessment by a regulator. When evaluating whether goodwill is impaired, the Company compares the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. The fair value of the reporting unit is estimated using a discounted cash flows approach. If the carrying amount of the reporting unit exceeds its fair value, then the amount of the impairment loss must be measured. The impairment loss would be calculated by comparing the implied fair value of reporting unit goodwill to its carrying amount. In calculating the implied fair value of reporting unit goodwill, the fair value of the reporting unit is allocated to all of the other assets and liabilities of that unit based on their fair values. The excess of the fair value of a reporting unit over the amount assigned to its other assets and liabilities is the implied fair value of goodwill. An impairment loss would be recognized when the carrying amount of goodwill exceeds its implied fair value. The Company's evaluation of goodwill completed during the year resulted in no impairment losses.

Recoverability of long-lived assets

Management reviews long-lived assets to be held and used in the Company's business activities, for the purpose of determining and measuring impairment on a recurring basis or when events or changes in circumstances indicate that the carrying value of an asset or group of assets may not be recoverable. Write-down of the carrying value of assets or groups of assets is made if and when appropriate in accordance with Statement of Financial Accounting Standards N° 144, Accounting for the Impairment or Disposal of Long-Lived Assets, or SFAS 144. SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. In accordance with SFAS 144, the carrying value of long-lived asset is considered impaired when the anticipated undiscounted cash flow from such asset is separately identifiable and is less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the assets. Fair value is determined primarily by using a discounted cash flow analysis.

Useful lives of property, plant and equipment

Adopted depreciation rates are based on estimated useful lives of the underlying assets, derived from historical information available to the Company, as well as known industry trends. The Company describes the depreciation rates it applies to its property, plant and equipment in Note 1(h) to its consolidated financial statements. If we reduce the remaining useful lives of our property, plant and equipment, increasing our rates in 10% depreciation expense will increase in approximately US\$ 21million.

Brazilian Economic Environment

The Brazilian economy has been characterized by volatile economic cycles. Since the introduction of Real as a Brazilian currency in July 1994, the Central Bank adopted tight monetary policy as a necessary measure to ensure the country continues to control inflation. Therefore, a more stable economic environment is clearly being observed. After January 1999, when the Central Bank adopted the free flotation of the Dollar exchange rates, the internal interest rates started to be the main tool for inflation control, and the central bank started to act preventively and most of the time was successful in bringing inflation back in line or little bit higher with targets.

The Brazilian economy has also been characterized by frequent and occasionally drastic intervention by the Brazilian government. The Brazilian government has often changed monetary, taxation, credit, tariff and other policies to influence the course of Brazil's economy. For example, the Brazilian government has the authority, when a serious imbalance in Brazil's balance of payment occurs, to impose restrictions on the remittance to foreign investors of the proceeds of their investments in Brazil, and on the conversion of Brazilian currency into foreign currencies. Changes in monetary, taxation, credit, tariff and other policies could adversely affect our business, as could inflation, currency and interest rate fluctuations, social instability and other political, economic or diplomatic developments, as well as the Brazilian government's response to such developments.

Rapid changes in Brazilian political and economic conditions that have already occurred and that might continue will require continued emphasis on assessing the risks associated with our activities and adjusting our business and operating strategy. Future developments in Brazilian government policies, including changes in the current policy and incentives adopted for financing the export of Brazilian goods, or in the Brazilian economy, over which we have no control, may materially adversely affect our business. See Item 3D. Risk Factors Risk Factors Relating to Brazil.

Brazilian economic conditions may be affected negatively by events elsewhere, especially in emerging markets. For instance, the Argentine government's default on certain of its debt obligations, the devaluation of the Argentine peso and terrorist attacks such as those of September 11, 2001 present causes for concern relating to Brazil's economic stability. Instability in the Brazilian financial markets caused by developments in the international financial markets may adversely affect our financial condition and, specifically, our ability to raise capital when needed and the market price of the preferred shares and ADSs. See Item 3D. Risk Factors Risk Factors Relating to Brazil.

The tax reform approved a few years ago by the Brazilian government has resulted in Law No. 10,833/03, extending to Brazil's Social Security Financing Contribution (*Contribuição para o Financiamento da Seguridade Social* - COFINS) the non-cumulative regime already mandatory since 2002 for contributions made to Social Integration Program (*Programa de Integração Social e de Formação do Patrimônio do Servidor Público* - PIS/PASEP), as per Law No. 10,637/02. Law No. 10,833/03 also provided an increase in the tax rate for COFINS now at 7.6% on revenues of Brazilian companies in general (the rate was formerly 3%). Although the tax (PIS/COFINS) is not assessed on export transactions, the Company as a result of the non-cumulative regime, presented a PIS and COFINS credit position, lowering the tax burden for the fiscal year ended in 2004, notwithstanding the increase in tax rates. In June 2005, Brazilian government edited a Provisional Measure known as *MP do Bem*, meaning that the proposal contained some good measures for the economy, such as suspending the collection of PIS and COFINS in the acquisition of new machines and equipment (allocated to the company's fixed assets) by preponderantly exporting companies and granting various types of tax incentives for technological innovation. This Provisional Measure has been converted into Law No. 11,196 in November 2005. According to the definition in Law No. 11,196, the Company is a preponderantly exporting company and as such may reduce the tax burden on future investments in new machines and equipment acquired as fixed assets, benefiting from the suspension in the collection of PIS and COFINS.

As from August 2, 2004, PIS and COFINS rates were reduced to zero in relation to financial revenues obtained by legal entities subject to the non-cumulative regime (essentially large companies), exception made for financial revenues deriving from interest on net equity and hedge transactions. As from April 1, 2005, financial revenues from hedge transactions were included within such zero percent rate.

Effects of Inflation and Currency Exchange Fluctuations

Until July 1994, Brazil had for many years experienced high and generally unpredictable rates of inflation and steady devaluation of its currency relative to the U.S. dollar. The following table sets forth Brazilian inflation as measured by the *Indice Geral de Preço-Mercado*, the General Market Price Index or IGP-M, and the devaluation of Brazilian currency against the U.S. dollar for the periods shown:

	2000	2001	2002	2003	2004	2005
Inflation (General Market Price Index)	9.8%	10.4%	25.3%	8.7%	12.4%	1.21%
Devaluation (R\$ v. US\$)	9.3%	18.7%	52.3%	(18.2%)	(8.1%)	(11.8%)

Inflation and exchange rate variations have had, and may continue to have, substantial effects on our financial condition and results of operations.

Inflation and exchange rate variations affect our monetary assets and liabilities denominated in *reais*. The value of such assets and liabilities as expressed in U.S. dollars declines when the *real* devalues against the U.S. dollar and increases when the *real* appreciates. In addition, many financial instruments denominated in *reais* are indexed for inflation. In periods of devaluation of the *real*, we report (a) a remeasurement loss on *real*-denominated monetary assets, which is offset, at least in part, by monetary indexation of *real*-denominated financial instruments and (b) a remeasurement gain on *real*-denominated monetary liabilities, which is offset, at least in part, by the monetary indexation of *real*-denominated financial instruments.

At December 31, 2005, approximately 94% of our cash and cash equivalents and short-term investments were invested in Real denominated deposits and financial assets. See Liquidity and Capital Resources Financial Strategy.

A. Operating Results

Results of Operations for the Year Ended December 31, 2005 Compared with the Year Ended December 31, 2004

The table below shows the Company's income statements for the years 2003, 2004 and 2005:

Income statement	US\$ thousands		
	2003	2004	2005
Operating revenues			
Sales of eucalyptus pulp			
Domestic	42,401	66,083	62,019
Export	1,056,498	1,256,648	1,469,646
Total sales	1,098,899	1,322,731	1,531,665
Sales taxes and other deductions	(95,829)	(155,618)	(186,432)
Net operating revenues	1,003,070	1,167,113	1,345,233
Operating Costs and expenses			
Cost of sales	592,555	700,333	783,578
Selling	38,617	53,850	64,430
Administrative	22,762	31,072	33,820
Provision for loss on ICMS credit	23,178	22,859	7,440
Other, net	18,784	2,349	8,873

Total operating Costs and expenses	695,896	810,463	898,141
Operating income	307,174	356,650	447,092
Non-operating (income) expenses			
Financial income	(43,037)	(56,123)	(125,439)
Financial expenses	108,209	119,976	137,276
Gain on currency remeasurement, net	(41,955)	(16,197)	(21,386)
Other, net	(129)	(76)	(778)
Total non-operating (income) expenses	23,088	47,580	(10,327)
Income before income taxes, minority interest and equity in results of affiliated companies	284,086	309,070	457,419
Income tax expense	129,116	70,256	72,228
Minority interest	(37)	(9)	(31)
Equity in results of affiliated companies	(6,844)	(11,568)	(44,062)
Net income	148,089	227,237	341,098

Net operating revenues in 2005 were US\$1,345.2 million, US\$178.1 million higher than last year, mainly as a result of higher pulp sales volume (\$64.3 million) due to the purchase of pulp produced by Veracel, beginning in May 2005, and higher pulp prices (\$114.6 million) due to a favorable condition between supply and demand of BEKP.

In 2005 total cost of pulp, paper and sawn wood sales totaled \$783.6 million, compared to \$700.3 million in 2004. The cost of pulp sales in 2005 was \$754.3 million, compared to \$666.3 million in the previous year, mainly due to higher sales volumes. Pulp production cost per ton in 2005 was \$246, compared to \$228 in the previous year, mainly due to Brazilian currency appreciation against the U.S. dollar.

Sales and distribution expenses were \$64.4 million, \$10.6 million higher than in the previous year, mainly due to a 6% higher sales volume, changes in the geographical sales mix, and higher terminal expenses, as a result of the purchase of pulp produced by Veracel, beginning in May 2005.

Administrative expenses were \$33.8 million, \$2.7 million higher than in 2004, mainly due to the local currency's appreciation against the Dollar and \$2.5 million of non-recurring expenses (moving administrative offices from Rio de Janeiro to São Paulo), partially offset mainly by lower legal fees.

Other operating expenses came to \$8.9 million, \$6.6 million higher than in the previous year, mainly due to a higher provision for fines relating to tax contingencies of US\$ 6.7 million and \$6.4 million of tax credits for PIS/Cofins on depreciation, partially offset by the non-cash impact of a \$ 5.1 million accounting loss from the sale of 2/3 ownership in Aracruz Produtos de Madeira S.A (APM), which took place in October, 2004.

Provision for loss on ICMS credits was \$7.4 million, \$15.5 million lower than in the previous year, as a result of successful negotiations with the tax authorities, pursuant to which the company's right to offset certain ICMS liabilities with accumulated credits was recognized, thus bringing this pending issue to a definitive conclusion.

The Financial and Currency remeasurement results amounted to \$9.5 million of financial income, compared to \$47.7 million of financial expenses in the previous year, mainly due to increased financial income and a higher currency re-measurement gain, offset by higher financial expense (see chart below).

The increase in interest on financing was mainly due to a 2% increase in the average balance of gross debt in 2005 compared to 2004. The increased financial income was mainly due to gains on derivative transactions

against the local currency (R\$), which also covered the 50% hedging needs of Veracel's balance sheet exposure (Aracruz's equity interest).

(US\$ million)	2005	2004
Financial Expenses	137.3	120.0
Interest on financing	99.3	93.8
Taxes (PIS/COFINS and CPMF)	4.1	11.9
Interest on fiscal contingency provisions	31.0	12.2
Other	2.9	2.1
Financial Income	(125.4)	(56.1)
Currency remeasurement	(21.4)	(16.2)

In 2005, the Brazilian currency (R\$) appreciated 11.8% against the US dollar, compared to an appreciation of 8.1% in the previous year. The closing exchange rate on December 31, 2005 was R\$2.3407 per US dollar.

Income taxes in Brazil comprise federal income tax and social contribution (which is an additional federal income tax). The statutory rates applicable for federal income tax and social contribution for the years ended December 31, 2003, 2004 and 2005 are presented as follows:

Federal income tax rate	25.0%
Social contribution (*)	9.0%
Composite tax rate	34.0%

Income tax and social contribution amounted to an expense of \$72.2 million, against \$70.3 million in the previous year. Tax charges are calculated based on the Brazilian GAAP results, and consequently influenced by the exchange rate variation's effect on monetary assets and liabilities denominated in US dollars. The positive impact of the exchange rate variation for 2005 on the Brazilian GAAP results was higher than in the previous year, in a total amount of US\$15.3 million. The taxes were also reduced in 2005 as a result of payments of Interest on Shareholders' Equity, which are deductible for tax purposes.

The amounts reported as income tax expense in the consolidated statements of income are reconciled to the statutory rates - See Note 4.1 to our 2005 Consolidated Financial Statements.

As a result of all of the above-described factors, net income in 2005 totaled US\$341.1 million, compared to US\$227.2 million in 2004.

Results of Operations for the Year Ended December 31, 2004 Compared with the Year Ended December 31, 2003

The table below shows the Company's income statement for the years 2003 and 2004:

Income statement	US\$ thousands	
	2003	2004
Operating revenues		
Sales of eucalyptus pulp		
Domestic	42,401	66,083
Export	1,056,498	1,256,648
Total sales	1,098,899	1,322,731
Sales taxes and other deductions	(95,829)	(155,618)
Net operating revenues	1,003,070	1,167,113
Operating Costs and expenses		
Cost of sales	592,555	700,333
Selling	38,617	53,850
Administrative	22,762	31,072
Provision for loss on ICMS credit	23,178	22,859
Other, net	18,784	2,349
Total operating Costs and expenses	695,896	810,463
Operating income	307,174	356,650
Non-operating (income) expenses		
Financial income	(43,037)	(56,123)
Financial expenses	108,209	119,976
Gain on currency remeasurement, net	(41,955)	(16,197)
Other, net	(129)	(76)
Total non-operating (income) expenses	23,088	47,580
Income before income taxes, minority interest and equity in results of affiliated companies	284,086	309,070
Income tax expense	129,116	70,256
Minority interest	(37)	(9)
Equity in results of affiliated companies	(6,844)	(11,568)
Net income	148,089	227,237

Net operating revenues in 2004 were US\$1,167.1 million, US\$164.0 million higher than 2003, mainly as a result of higher pulp sales volume (\$136.4 million), higher pulp prices (\$10.6 million) and higher paper sales (\$17.6 million).

In 2004 total cost of pulp, paper and sawn wood sales totaled \$700.3 million, compared to \$592.6 million in 2003. The cost of pulp sales in 2004 was \$666.3 million, compared to \$569.2 million in the previous year, mainly due to higher sales volumes. Production cost per ton in 2004 was \$228, compared to \$226 in the previous year, mainly due to higher chemical cost and packaging, sustainment projects related to the maintenance of productive capacity and Brazilian currency appreciation against the US dollar.

Sales and distribution expenses were \$53.8 million, \$15.2 million higher than in the previous year, mainly due to a 14% higher sales volume as a result of the acquisition of Riocell from the Klabin group in mid 2003, changes in the geographical sales mix, and higher terminal expenses.

Administrative expenses were \$31.1 million, \$8.3 million higher than in 2003, mainly due to greater services expenses, such as consulting services and legal fees, and the local currency's appreciation against the dollar.

Other operating expenses came to \$2.3 million, \$16.5 million lower than in the previous year, mainly due to a lower provision for fines relating to tax contingencies, of \$9.0 million; a lower allowance for doubtful accounts, of \$1.8 million; smaller losses on the sale of obsolete spare parts, of \$1.5 million; lower fixed asset write-offs, of \$1.5 million; and \$6.4 million of tax credits for PIS/Cofins on depreciation, partially offset by the non-cash impact of a \$ 5.1 million accounting loss from the sale of 2/3 ownership in Aracruz Produtos de Madeira S.A (APM), which took place in October, 2004.

The Financial and Currency remeasurement results amounted to \$47.7 million, \$24.5 million higher than in the previous year, mainly due to increased financial expenses and a lower currency remeasurement gain, partially offset by increased financial income (see chart below).

The increase in interest on financing was mainly due to a 16% increase in the average balance of gross debt in 2004 compared to 2003. The increased financial income was mainly due to gains on derivative financial instruments against the local currency (R\$), which also covered the 50% hedging needs of Veracel's balance sheet exposure (Aracruz's equity interest).

(US\$ million)	2004	2003
Financial Expenses	120.0	108.2
Interest on financing	93.8	79.4
Taxes (PIS/COFINS and CPMF)	11.9	24.4
Interest on fiscal contingency provisions	12.2	15.6
Other	2.1	(11.2)
Financial Income	(56.1)	(43.0)
Currency remeasurement	(16.2)	(42.0)

In 2004, the Brazilian currency (R\$) appreciated 8.1% against the US dollar, compared to an appreciation of 18.2% in the previous year. The closing exchange rate on December 31, 2004 was R\$2.6544 per US dollar.

Income taxes in Brazil comprise federal income tax and social contribution (which is an additional federal income tax). The statutory rates applicable for federal income tax and social contribution for the years ended December 31, 2002, 2003 and 2004 are presented as follows:

Federal corporate income tax rate	25.0% (1)
Social contribution on profits	9.0%
Composite tax rate	34.0% (1)

(1) The federal corporate income tax is levied on profits of Brazilian companies at the rate of 15%; the amount of profits exceeding a certain amount established by law in a given period (currently R\$240,000 per year) is subject to a 10% surcharge. The maximum corporate income tax rate is therefore 25% and the maximum composite tax rate is 34%.

Income tax and social contribution amounted to an expense of \$70.3 million, against \$129.1 million in the previous year. Tax charges are calculated based on the Brazilian GAAP results, and consequently influenced by the

exchange rate variation's effect on monetary assets and liabilities denominated in US dollars. The positive impact of the exchange rate variation for 2004 on the Brazilian GAAP results was lower than in the previous year. The taxes were also reduced in 2004 as a result of payments of Interest on Shareholders' Equity, which are deductible for tax purposes.

The amounts reported as income tax expense in the consolidated statements of income are reconciled to the statutory rates - See Note 4.1 to our 2004 Consolidated Financial Statements.

As a result of all of the above-described factors, net income in 2004 totaled US\$227.2 million, compared to US\$148.1 million in 2003.

B. Liquidity and Capital Resources

Liquidity

The Company's primary sources of liquidity have historically been cash flows from operating and financing activities. The Company's management believes these sources will continue to be the principal ways in which it will meet its anticipated cash flow needs.

The Company's material cash requirements include the following:

- the servicing of its indebtedness; and
- capital expenditures.

At December 31, 2005, we had cash, cash equivalents and short-term investments of US\$558.0 million, an increase of US\$107.8 million from US\$450.2 million at December 31, 2004. The equivalent of US\$524.1 million was invested in local currency instruments and US\$33.9 million was invested abroad, mostly in U.S. dollar time deposits with leading financial institutions.

Cash Flows

Operating Activities

Cash flow provided by operating activities was US\$445.7 million for the year ended December 31, 2005, as compared to US\$367.5 million for the year ended December 31, 2004 and US\$336.4 million for the year ended December 31, 2003. This increase in operating cash flow is mainly due to the increase in the volume and sales price of products sold.

Investing Activities

Cash flow used in investment activities amounted to US\$214.2 million for the year ended December 31, 2005, US\$188.2 million for the year ended December 31, 2004 and US\$716.1 million for the year ended December 31, 2003. This variation is principally due to the acquisition of Riocell from Klabin in 2003, in the value of US\$563.2 million, compared to relatively stable capital expenditures during 2004 and 2005. All those years included equity contributions to the Veracel project that has started up in May 2005, in the amounts of US\$110.2 million, US\$99.0 million and US\$67.0 million, respectively.

Financing Activities

Cash flow used in financing activities was US\$233.2 million for the year ended December 31, 2005 and US\$212.2 million for the year ended December 31, 2004 mainly due to dividend and interest on stockholders' equity paid, and specifically in the year 2005 to a lesser extent due to debt amortization. For the year ended December 31, 2003, cash flow provided by financing activities was US\$421.9 million due to new long-term funding used for the acquisition of Riocell.

The Company paid dividends and interest attributed to shareholders' equity in the amount of US\$139.4 million, US\$198.7 million and US\$109.3 million, in 2005, 2004 and 2003, respectively.

The Company's working capital is sufficient for the Company's present requirements.

Indebtedness

At December 31, 2005, the Company had total debt outstanding of US\$1,302.3 million, a decrease of 5.3% over total debt outstanding at December 31, 2004 of US\$1,375.7 million. Such decrease was due to the normal course of debt amortization.

The breakdown of the Company's total debt outstanding at December 31, 2004 and December 31, 2005 is set forth in the table below:

	At December 31,	
	2004	2005
	<i>(millions of U.S. dollars)</i>	
SHORT-TERM DEBT		
Current portion of long-term debt		
Local currency	43.2	50.9
Foreign currency	98.1	153.5
Short-term debt instruments		
Local currency	3.8	2.1
Foreign currency (ACC/ACE)	0	78.4
Accrued finance charges		
Local currency	1.0	0.9
Foreign currency	6.9	6.2
Subtotal	153.0	292.0
LONG-TERM DEBT		
Local currency	148.5	172.6
Foreign currency	1,074.2	837.7
Subtotal	1,222.7	1,010.3
TOTAL DEBT	1,375.7	1,302.3

At December 31, 2005, the Company's outstanding debt in local currency totaled US\$226.5 million and was comprised primarily of loan agreements with Banco Nacional de Desenvolvimento Econômico e Social - BNDES. BNDES is one of the major shareholders of the Company.

At December 31, 2005, our outstanding debt exclusive of accrued interest was approximately US\$792.1 million based on fixed interest rates, US\$239.3 million based on LIBOR, US\$40.2 million based on a currency basket and US\$223.6 million based on TJLP.

We do not have any significant financial covenant under our debt instruments that may substantially affect our operations or financial condition.

At December 31, 2005, our long-term debt maturities were as follows:

	Maturing in									
	2007		2008		2009		2010		2011 and beyond	Total
Long-term debt										
(in millions of US\$)	234.6		220.3		140.8		143.6		271.0	1,010.3

Our short-term debt consists primarily of trade financing in the form of export sales advances, or ACC, discounted export accounts receivables, or ACE, and prepayments for exports all denominated in foreign currency. ACC and ACE are forms of financing available from Brazilian financial institutions or Brazilian branches of foreign financial institutions at a fixed rate with a maturity of up to 360 days prior to shipment of pulp for export, in the case of ACC, and with a maturity of up to 180 days after shipment of pulp for export, in the case of ACE. Prepayments for exports are a form of financing available from importers or foreign financial institutions at a fixed rate with maturity of either up to 180 days or more than one year, in each case prior to the shipment. As of December 31, 2005 the outstanding principal amount of such short-term trade financing was US\$ 78.4 million at an average annual interest rate of 4.1%.

Our long-term debt consists primarily of U.S. dollar-denominated debt issued outside Brazil in the amount of US\$991.2 million at December 31, 2005 (as compared to US\$ 1,172.3 million at December 31, 2004) and loans from BNDES, one of our principal shareholders, denominated in Reais and in foreign currencies. At December 31, 2005, the Company had loans from BNDES with an aggregate principal amount outstanding of R\$617.5 million (US\$263.8 million) (as compared to R\$620.9 million (US\$233.9 million) at December 31, 2004), which represented approximately 20% of our total indebtedness at such date. At December 31, 2005, of the total aggregate principal amount of the BNDES debt, US\$223.6 million was denominated in Reais and adjusted by the Taxa de Juros de Longo Prazo (the Long-term Interest Rate or *TJLP*), and US\$40.2 million was adjusted by a currency basket.

Financing Agreements

In February 2002, the Company, through Aracruz Trading S.A., signed a financing agreement with a special-purpose entity (SPE) under which such entity received and advanced to the Company US\$ 250 million, as an issuance of Senior Secured Export Notes. In August 2003, a second tranche of Senior Secured Export Notes was issued, in the amount of US\$ 400 million under the same securitization program established in February 2002. In May 2004, a third tranche of Senior Secured Export Notes was issued, in the amount of US\$ 175 million under the same securitization program. In return, the Company securitized the financing by selling to the SPE 95% of its current and future export accounts receivables. In June 2003 this obligation was reduced to 80% of such receivables. In February 2004, Aracruz Trading Hungary Ltd. was included in the securitization program, in addition to Aracruz Trading S.A. Each month the collections in excess of contractual funding requirements are transferred to Aracruz Trading S.A and Aracruz Trading Hungary Ltd. The table below summarizes the terms of the three tranches under the securitization programs:

Tranche	Original line of credit	Annual charges	Due date	Outstanding balance (principal amounts)	
				December 2004	December 2005
February 2002	250,000	5.984%	March/2009	208,500	158,460
August 2003	400,000	7.048%	September/2011	400,000	378,120
May 2004	175,000	6.361%	May/2012	175,000	175,000
	825,000			783,500	711,580

In December 2004, the Company signed a US\$ 50 million loan agreement with International Finance Corporation (IFC), the private sector arm of the World Bank Group. The loan had a floating interest rate based on

LIBOR, semi-annual payments starting in December 2007 and final maturity in 2014. As of December 31, 2005 the outstanding principal amount was US\$ 50 million with an annual interest rate of 7.42%. This loan was prepaid on April 12, 2006, without any gain or loss on the prepayment.

On February 21, 2006 the Company called the senior secured notes maturing 2009 under the securitization for redemption in full. Such redemption was paid on March 23, 2006.

On March 1, 2006 Arcel Finance Ltd. launched a tender offer for any and all of the outstanding notes maturing 2011 and 2012. A total of US\$176.4 million outstanding principal amount of the notes maturing 2011 and US\$58 million outstanding principal amount of the notes maturing 2012 were tendered, and settlement of the purchase price therefor was made on March 14, 2006.

The Company is a several guarantor of 50% of the indebtedness incurred by Veracel in connection with the financing of the Veracel Project. Stora Enso is a several guarantor of the other 50% of such indebtedness. At December 31, 2005 the outstanding amount of such indebtedness guaranteed by the Company was approximately US\$63.5 million.

Financial Strategy

In the past, a major element of our cash management strategy was to take advantage of the interest rate differential available in Brazil only to exporting companies. Funds obtained through lower cost trade financing were invested, together with cash flow from operations, in Brazilian financial instruments at a generally higher yield. Our ability to generate profits from this arbitraging activity has been reduced as a result of the declining interest rates in Brazil as well as from the change in its financial strategy in 1997.

Brazilian companies have limited sources of long-term debt financing denominated in Reais, and we do not intend to incur short-term debt denominated in Reais due to the higher associated costs. At December 31, 2005, 83% of the our total indebtedness was denominated in foreign currencies, as compared to 86% at the end of 2004. Although our access to debt financing denominated in foreign currencies, beyond pre-export and receivables financing, may also be limited, we believe that we have access to a sufficient number of financing sources to meet our needs without resorting to expensive short-term Real-denominated financing.

Because we operate internationally, we are exposed to market risks from changes in foreign exchange and interest rates. To protect against these market risks, we from time to time enter into forward foreign exchange contracts and interest-rate swap agreements. We may be exposed to counterparty credit risk in the event of nonperformance by the counterparties to the forward exchange-rate contracts and the interest-rate-swap agreements. We believe that an event of nonperformance by our counterparties is unlikely to occur due to our credit risk policies.

The Company is subject to some limits on its to access international capital markets due to the non-investment grade sovereign risk rating of the Republic of Brazil. Also, Brazilian companies have as a structural condition limited sources of long-term debt financing denominated in Reais beyond the credit lines provided by BNDES. To fund its investments and to manage liquidity risk the Company's strategy has been to develop international long term funding sources and structures and to manage its debt profile in order to maintain adequate financial ratios established in the Financial Policy, approved by the Board, including maintaining an adequate average maturity of its debt. The Company believes that it already has access to sufficient financing sources to meet its needs, especially after achieving Investment Grade in the global scale rating from Standard & Poor's, meaning that the Company's credit risk is considered largely uncorrelated to the country's risk.

The guidelines for the Company's financial investments policies are:

- investments in fixed income obligations of the Brazilian federal government are subject to the following requirements:
- for external debt (Bradies and Globes) the maximum term shall be 60 months;

- for local debt (NTN, LFT, NTN-C) the maximum term shall be 24 months;
- investments in fixed income obligations of the foreign governments and multilateral agencies are limited to 50% of the total of cash investments;
- investments in corporate debt instruments are subject to the following requirements:
 - the corporation must have a minimum rating of A- or equivalent from the top rating agencies; and the maximum investment is limited to the lesser of (i) 20% of the total cash holdings, and (ii) 10% of the debt instrument per issue amount and (iii) US\$ 20 million;
- The duration of the total balance of financial investments in corporate debt cannot exceed 24 months;
- investments in bank instruments are subject to the following requirements:
 - the bank must have a minimum rating of BBB+ or equivalent from the top rating agencies; and for that rating, the maximum investment per bank is limited to the lesser of (i) 10% of the total cash holdings, and (ii) 5% of the bank's net worth and (iii) US\$ 50 million;
 - for banks with a rating above BBB+ , the maximum investment per bank is limited to the lesser of (i) 20% of the total cash holdings, and (ii) 10% of the bank's net worth.

In the year 2005, the company's financial management distinguished itself in managing to absorb much of the foreign exchange impact on cash flow, principally through the use of financial derivatives. This financial management was the result of a Board approved financial policy that determined specific criteria and indicators for the management of liquidity, market and credit risks, in arbitrage and other opportunities, besides the derivative financial instruments. The financial policy also defined prudent limits for these operations, based on best corporate governance practices.

In the year of 2005, derivative financial instruments results (dollar future contracts) showed a gain of \$29.2 million, reducing part of the negative impact that the Real appreciation caused in the Company's results

Dividends

Subject to certain exceptions, we are required, according to our by-laws and under Brazilian corporate law to pay a minimum annual dividend equal to 25% of its Adjusted Net Income which is represented by the net income for the year less appropriation of the above mentioned legal reserve. In addition, we may pay interim dividends either based on our net income for any period within our fiscal year or from retained earnings or certain other revenue reserves established in prior years. We also use interest on shareholders' equity as a means of paying a dividend to our shareholders. The interest on shareholders' equity to be distributed by us is calculated by applying the Long-term Interest Rate (TJLP), on the Shareholders' Equity for the fiscal year, a set out in the Brazilian Corporate Law.

Capital Expenditures

The Company's capital expenditures for 2005, 2004 and 2003 were US\$ 147.9 million, US\$94.5 million and US\$118.7 million, respectively.

The table below sets forth a breakdown of our most significant capital expenditures for the periods indicated:

	For the years ended December 31,		
	2005	2004	2003
	(in US\$ millions)		
Fiberline C Expansion Project			US\$55.8
Silviculture (Forest) and other forestry investments (includes land purchase)	US\$71.4	US\$68.1	51.5
Improvements/industrial investments	66.8	20.9	3.2
Other	9.7	5.5	8.2
Total	US\$147.9	US\$94.5	US\$118.7

During the year 2003, we invested approximately US\$118.7 million, of which US\$55.8 million was devoted to the Fiberline C Expansion Project, US\$41.4 million to forest, US\$10.1 million to other forestry investments, US\$3.2 million to ongoing industrial investments, and US\$8.2 million to other projects.