

Aracruz Celulose S.A.
Consolidated Financial Statements at
December 31, 1999 and 2000 and
Report of Independent Accountants

Report of Independent Accountants

To the Board of Directors and Stockholders of
Aracruz Celulose S.A.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of cash flows and of changes in stockholders' equity, expressed in United States dollars, present fairly, in all material respects, the financial position of Aracruz Celulose S.A. and its subsidiaries at December 31, 1999 and 2000 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America. These consolidated financial statements are the responsibility of the management of Aracruz Celulose S.A.; our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers
Auditores Independentes

Vitória, Brazil
January 12, 2001

Aracruz Celulose S.A.

Consolidated Balance Sheets

Expressed in thousands of United States dollars
(except number of shares)

	<u>December 31,</u>			<u>December 31,</u>	
Assets	<u>1999</u>	<u>2000</u>	Liabilities and stockholders' equity	<u>1999</u>	<u>2000</u>
Current assets			Current liabilities		
Cash and cash equivalents	312.590	18.091	Suppliers	21.158	29.310
Debt securities available-for-sale	189.480	323.032	Payroll and related charges	8.753	11.036
Accounts receivable, net			Income and other taxes	7.356	13.416
Related party	5.892	9.530	Current portion of long-term debt		
Other	78.085	84.536	Related party	65.044	60.251
Inventories, net	69.639	80.976	Other	288.572	45.035
Deferred income tax, net	6.488	6.736	Short-term borrowings - export financing and	102.368	157.693
Recoverable income and other taxes	22.323	72.081	Accrued finance charges	17.668	9.063
Prepaid expenses and other current assets	<u>8.462</u>	<u>7.956</u>	Other accruals	<u>2.907</u>	<u>1.273</u>
	<u>692.959</u>	<u>602.938</u>		<u>513.826</u>	<u>327.077</u>
Property, plant and equipment, net	<u>1.702.747</u>	<u>1.664.322</u>	Long-term liabilities		
Investment in affiliated company		<u>79.698</u>	Long-term debt		
Other assets			Related party	175.593	109.367
Advances to suppliers	15.993	16.659	Other	216.761	169.506
Deposits for tax assessments	21.181	20.329	Tax assessments and litigation contingencies	36.883	68.910
Deferred income tax, net	49.473	7.163	Other	<u>4.255</u>	<u>6.115</u>
Recoverable income taxes	114.430	54.868		<u>433.492</u>	<u>353.898</u>
Other	<u>4.270</u>	<u>8.481</u>	Commitments and contingencies (Note 16)		
	<u>205.297</u>	<u>100.673</u>	Minority interest	<u>373</u>	<u>362</u>

Aracruz Celulose S.A.

Consolidated Statements of Income

Expressed in thousands of United States dollars
(except number of shares and per-share amounts)

	Year ended December 31,		
	1998	1999	2000
	Reclassified Note 1		
Operating revenues			
Sales of eucalyptus pulp			
Domestic	38,449	33,796	43,601
Export	462,163	550,729	751,900
	500,612	584,525	795,501
Sales taxes and other deductions	(39,490)	(43,459)	(63,240)
Net operating revenues	461,122	541,066	732,261
Operating costs and expenses			
Cost of sales	349,621	311,190	344,515
Selling	34,231	32,626	28,390
Administrative	47,238	29,849	34,620
Other, net	28,188	33,060	11,978
	459,278	406,725	419,503
Operating income	1,844	134,341	312,758
Non-operating (income) expenses			
Equity in results of affiliated company			1,313
Financial income	(104,840)	(100,692)	(64,849)
Financial expenses	120,955	120,336	101,461
Loss (gain) on currency remeasurement, net	7,780	7,454	(8,812)
Other, net	65	(146)	(120)
	23,960	26,952	28,993
Income (loss) before income taxes and minority interest and	(22,116)	107,389	283,765
Income tax expense (benefit)			
Current	(9,573)	8,980	40,461
Deferred	(15,733)	7,699	41,604
	(25,306)	16,679	82,065
Minority interest in losses of subsidiary	257	63	11
Net income for the year	3,447	90,773	201,711

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Consolidated Statements of Income

Expressed in thousands of United States dollars
(except number of shares and per-share amounts)

(Continued)

	<u>Year ended December 31,</u>		
	<u>1998</u>	<u>1999</u>	<u>2000</u>
Basic and diluted earnings per share			
Class A preferred stock	0.09	0.09	0.20
Class B preferred stock	0.00	0.09	0.20
Common stock	0.00	0.08	0.18
Weighted-average number of shares outstanding (thousands)			
Class A preferred stock	41,007	40,979	40,903
Class B preferred stock	564,374	553,279	552,889
Common stock	454,908	454,908	454,908

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

Aracruz Celulose S.A.

Consolidated Statements of Cash Flows

Expressed in thousands of United States dollars

	<u>Year ended December 31,</u>		
	<u>1998</u>	<u>1999</u>	<u>2000</u>
Cash flows from operating activities			
Net income	3,447	90,773	201,711
Adjustments to reconcile net income to cash provided by operating activities:			
Non-cash items			
Depreciation and depletion	152,803	158,829	167,960
Equity in results of affiliated company			1,313
Provision for impairment of property, plant and equipment	12,098	1,573	
Deferred income tax	(15,733)	7,699	41,604
Loss (gain) on currency remeasurement	7,780	7,454	(8,812)
Provision for contingencies	700		
Loss on sale of equipment	3,775	23,864	1,643
Other		648	
Decrease (increase) in assets			
Accounts receivable, net	4,943	(16,000)	(11,226)
Inventories, net	(580)	13,303	(11,337)
Interest receivable on debt securities	(14,685)	11,606	(36,398)
Recoverable income taxes	(54,488)	(14,015)	(1,047)
Other	12,821	(2,734)	(890)
Increase (decrease) in liabilities			
Suppliers	(19,145)	4,429	7,788
Payroll and related charges	272	(4,021)	3,458
Income and other taxes and litigation contingencies	(4,747)	18,888	45,323
Accrued finance charges	1,244	(11,739)	(8,381)
Other	(1,993)	(1,898)	407
Net cash provided by operating activities	<u>88,512</u>	<u>288,659</u>	<u>393,116</u>
Cash flows from investing activities			
Debt securities		509,108	(96,165)
Proceeds from sale of equipment	2,420	61,871	677
Acquisition of Terra Plana Agropecuária Ltda and Veracel Celulose S.A.			(101,215)
Additions to property, plant and equipment	<u>(88,306)</u>	<u>(56,467)</u>	<u>(118,152)</u>
Net cash provided by (used in) investing activities	<u>(85,886)</u>	<u>514,512</u>	<u>(314,855)</u>

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Consolidated Statements of Cash Flows

Expressed in thousands of United States dollars

(Continued)

	<u>Year ended December 31,</u>		
	<u>1998</u>	<u>1999</u>	<u>2000</u>
Cash flows from financing activities			
Short-term debt, net	171,832	(403,105)	57,134
Long-term debt			
Issuances			
Related parties	59,939	2,703	
Other	209,216	78,400	
Repayments			
Related parties	(41,564)	(52,020)	(62,699)
Other	(229,595)	(231,654)	(289,085)
Bank deposits, as compensating balances	4,442	1,195	2,589
Treasury stock acquired	(26,400)		(22,718)
Dividends paid	(24,388)	(18,196)	(57,963)
	<u>123,482</u>	<u>(622,677)</u>	<u>(372,742)</u>
Net cash provided by (used in) financing activities			
Effect of changes in exchange rates on cash and cash equivalents	(1,960)	(19,790)	(18)
Increase (decrease) in cash and cash equivalents	124,148	160,704	(294,499)
Cash and cash equivalents, beginning of year	<u>27,738</u>	<u>151,886</u>	<u>312,590</u>
Cash and cash equivalents, end of year	<u>151,886</u>	<u>312,590</u>	<u>18,091</u>
Supplementary cash flow information			
Financial charges paid	<u>117,014</u>	<u>138,309</u>	<u>69,303</u>
Income taxes paid, including escrow deposits for tax assessments	<u>329</u>	<u>19</u>	<u>20</u>
Withholding income tax on financial income	<u>99,629</u>	<u>64,909</u>	<u>25,825</u>

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

Aracruz Celulose S.A.

Consolidated Statements of Changes in Stockholders' Equity

Expressed in thousands of United States dollars

(except number of shares and per-share amounts)

	Year ended December 31					
	1998		1999		2000	
	Shares	U.S.\$	Shares	U.S.\$	Shares	U.S.\$
Share Capital						
Preferred stock - Class A						
Balance, January 1	41,042,246	33,547	41,042,246	33,547	40,941,849	33,465
Conversion to Class B stock			(100,397)	(82)	(12,299)	(10)
Balance, December 31	41,042,246	33,547	40,941,849	33,465	40,929,550	33,455
Preferred stock - Class B						
Balance, January 1	581,486,768	580,949	581,486,768	580,949	581,587,165	581,031
Conversion from Class A stock			100,397	82	12,299	10
Balance, December 31	581,486,768	580,949	581,587,165	581,031	581,599,464	581,041
Common stock						
Balance, January 1 and December 31	455,390,699	297,265	455,390,699	297,265	455,390,699	297,265
Treasury stock						
Balance, January 1	(6,921,707)	(8,689)	(28,753,707)	(35,089)	(28,753,707)	(35,089)
Treasury stock acquired	(21,832,000)	(26,400)			(17,095,000)	(22,718)
Balance, December 31	(28,753,707)	(35,089)	(28,753,707)	(35,089)	(45,848,707)	(57,807)
Total share capital	1,049,166,006	876,672	1,049,166,006	876,672	1,032,071,006	853,954

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Consolidated Statements of Changes in Stockholders' Equity Expressed in thousands of United States dollars (except number of shares and per-share amounts)

(Continued)

	Year ended December 31,					
	1998		1999		2000	
	Shares	U.S.\$	Shares	U.S.\$	Shares	U.S.\$
Balance brought forward	1,049,166,006	876,672	1,049,166,006	876,672	1,032,071,006	853,954
Net unrealized gain (loss) on available-for-sale securities						
Balance, January 1				(11,177)		514
Unrealized gain (loss) on available-for-sale securities, net of reclassification adjustments		(16,420)		17,236		988
Tax effect on above		5,243		(5,545)		(407)
Balance, December 31		(11,177)		514		1,095
Appropriated retained earnings						
Unrealized income reserve						
Balance, January 1		19,687		8,572		9,016
Transfer from (to) unappropriated retained earnings		(11,115)		444		(9,016)
Balance, December 31		8,572		9,016		
Investments reserve						
Balance, January 1		376,362		313,942		143,917
Transfer from (to) unappropriated retained earnings		(62,420)		(170,025)		138,558
Balance, December 31		313,942		143,917		282,475
Fiscal incentive reserve						
Balance, January 1		97				
Transfer to share capital		(97)				
Balance, December 31						
Legal reserve						
Balance, January 1		66,801		66,801		50,492
Transfer from (to) unappropriated retained earnings				(16,309)		7,283
Balance, December 31		66,801		50,492		57,775
Total appropriated retained earnings		389,315		203,425		340,250
Balance carried forward	1,049,166,006	1,254,810	1,049,166,006	1,080,611	1,032,071,006	1,195,299

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Consolidated Statements of Changes in Stockholders' Equity

Expressed in thousands of United States dollars

(except number of shares and per-share amounts)

(Continued)

	Year ended December 31,					
	1998		1999		2000	
	Shares	U.S.\$	Shares	U.S.\$	Shares	U.S.\$
Balance brought forward	<u>1,049,166,006</u>	<u>1,254,810</u>	<u>1,049,166,006</u>	<u>1,080,611</u>	<u>1,032,071,006</u>	<u>1,195,299</u>
Unappropriated retained earnings						
Balance, January 1		259,822		312,354		572,701
Net income for the year		3,447		90,773		201,711
Cash dividends (per share: 1998 - U.S.\$ 0.09 to Class A preferred stock and U.S.\$ 0.02 to both Class B preferred and common stock; 1999 - U.S.\$ 0.06 to Class A preferred stock and U.S.\$ 0.01 to both Class B preferred and common stock; 2000 - U.S.\$ 0.06 to both Class A preferred and Class B preferred stock and U.S.\$ 0.05 to common stock)		(24,450)		(16,316)		(59,765)
Transfer from (to) reserves		<u>73,535</u>		<u>185,890</u>		<u>(136,825)</u>
Balance, December 31		<u>312,354</u>		<u>572,701</u>		<u>577,822</u>
Total stockholders' equity	<u>1,049,166,006</u>	<u>1,567,164</u>	<u>1,049,166,006</u>	<u>1,653,312</u>	<u>1,032,071,006</u>	<u>1,773,121</u>
Comprehensive income (loss) is comprised as follows:						
Net income for the year		3,447		90,773		201,711
Net unrealized gain (loss) on available-for-sale securities						
Unrealized gain (loss) arising during the year		(11,177)		12,340		581
Less: reclassification adjustments for losses included in net income				<u>(649)</u>		
		<u>(11,177)</u>		<u>11,691</u>		<u>581</u>
Total comprehensive income (loss)		<u>(7,730)</u>		<u>102,464</u>		<u>202,292</u>

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

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Notes to Consolidated Financial Statements

Expressed in thousands of United States dollars
(unless otherwise stated)

1 Summary of significant accounting policies

The consolidated financial statements of Aracruz Celulose S.A. and its subsidiaries (the Company) have been prepared in conformity with accounting principles generally accepted in the United States of America ("US GAAP"), which require management 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; actual results may vary from estimates.

(a) Basis of presentation

The consolidated financial statements have been prepared in accordance with US GAAP, which differ in certain respects from the Brazilian accounting principles applied by the Company in its statutory financial statements prepared in accordance with Brazilian corporate legislation.

The Company has reported in U.S. dollars since 1994 when the U.S. Securities and Exchange Commission permitted foreign registrants to report in U.S. dollars rather than in the currency of the country in which they are incorporated. The U.S. dollar amounts have been remeasured from Brazilian reais (R\$) in accordance with the criteria set forth in Statement of Financial Accounting Standards N° 52 - "Foreign Currency Translation" ("SFAS 52"). The Board of Directors and management have historically considered the U.S. dollar as the Company's functional currency as this has been, and remains in their opinion, the currency in which it principally operates as well as being the Company's primary unit of economic measure. Accordingly, the Company's management has concluded that the Company's functional currency is and will continue to be the U.S. dollar.

On January 13 and 15, 1999, certain significant changes occurred in the exchange rate policy until then adopted by the Brazilian government, which resulted in the elimination of certain exchange controls, previously carried out by means of a system of trading bands, when the Central Bank decided to no longer intervene in the foreign exchange markets. Following this decision and the markets' reaction, the Real devalued to U.S.\$ 1: R\$ 1.7890 at December 31, 1999 from U.S.\$ 1: R\$ 1.2087 at December 31, 1998 (U.S.\$ 1: R\$ 1.9554 at December 31, 2000).

Gains and losses resulting from the remeasurement of the financial statements, as well as those resulting from foreign currency transactions, have been recognized in the statements of income. The impact of the devaluation of the Real on the Company's monetary assets and liabilities in

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2000 was a net gain of U.S.\$ 8.8 million (U.S.\$ 7.5 million loss in 1999 and U.S.\$ 7.8 million loss in 1998).

Stockholders' equity included in the consolidated financial statements presented herein differs from that included in the Company's statutory accounting records as a result of the variations in the U.S. dollar exchange rate, the indexation mandated over the years up to December 31, 1995 for statutory financial statements and adjustments made to reflect the requirements of US GAAP.

(b) Basis of consolidation

The financial statements of majority-owned subsidiaries have been consolidated, and all significant intercompany accounts and transactions have been eliminated. Accordingly, the following companies were consolidated: Aracruz Trading S.A., Aracruz Celulose (USA) Inc., Portocel – Terminal Especializado de Barra do Riacho S.A., Mucuri Agroflorestal S.A., Aracruz Produtos de Madeira S.A., Aracruz Empreendimentos S/C Ltda. and Terra Plana Agropecuária Ltda..

(c) Cash and cash equivalents

Cash and cash equivalents represent cash, bank accounts and short-term financial investments with a ready market and maturities when purchased of 90 days or less, and are stated at the lower of cost plus accrued interest or market value.

(d) Concentration of risk

Financial instruments which potentially subject the Company to concentrations of credit and performance risk are cash and cash equivalents, debt securities and trade accounts receivable. The Company limits its credit and performance risk associated with cash and cash equivalents by placing its investments with highly rated financial institutions and in very short-term securities, and the Company's debt securities are principally comprised of U.S. dollar denominated notes which are issued and guaranteed as to principal and interest by the Brazilian government. An allowance for doubtful accounts is established to the extent the Company's trade receivables are estimated not to be fully collectible.

The Company's pulp sales are made substantially to the paper industry; consequently, its performance is dependent upon that industry's worldwide demand for pulp and the related supply, as well as fluctuations in the market price for pulp which can be significant.

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Expressed in thousands of United States dollars
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(e) Inventories

Inventories are stated at the lower of the average cost of purchase or production, and replacement or realizable values. Cost is determined principally on the average-cost method.

(f) Investments in affiliated companies and debt securities available-for-sale

(i) Investments in affiliated companies

The Company uses the equity method of accounting for all long-term investments for which it owns between 20% and 50% of the investee's voting stock and/or has the ability to exercise significant influence over operating and financial policies of the investee. The equity method requires periodic adjustments to the investment account to recognize the Company's proportionate share in the investee's results, reduced by receipt of investee dividends and amortization of goodwill.

(ii) Debt securities available-for-sale

In accordance with SFAS 115 - "Accounting for Certain Investments in Debt and Equity Securities", the Company's investments in securities are classified in accordance with their nature and management's intentions. Available-for-sale debt securities are carried at cost plus accrued interest, adjusted to market value. Any unrealized gains or losses, net of taxes, are excluded from income and recognized as a separate component of stockholders' equity until realized.

(g) Property, plant and equipment

Timber resources are stated at cost, less accumulated depletion. Tree development costs and forest maintenance costs are capitalized. Depletion is determined on the unit-of-production basis, excluding from the amount to be depleted the portion of tree-development costs that benefits future harvests; such costs are deferred and included in the cost of those harvests.

Other property, plant and equipment are recorded at cost, including interest incurred on financing during the construction period of major new facilities. Interest on local currency borrowings is determined as that part of the total finance cost incurred on borrowings net of the foreign currency translation adjustments arising on such borrowings, and, on foreign currency borrowings (including those denominated in U.S. dollars), at the contractual interest rates. Depreciation is computed on the straight-line basis at rates which take into consideration the useful lives of the assets, principally an average of 25 years for buildings, 10 years for

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Notes to Consolidated Financial Statements

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(unless otherwise stated)

improvements and installations, and 4 to 25 years for machinery and equipment and other assets.

(h) Environmental costs

Expenditures relating to ongoing programs for compliance with environmental regulations are generally expensed but may be capitalized under certain circumstances. Capitalization is considered appropriate when the expenditures relate to the acquisition and installation of pollution control equipment. These ongoing programs are designed to minimize the environmental impact of the Company's pulp-producing activities.

(i) Recoverability of long-lived assets

In accordance with SFAS 121 – “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of”, management reviews long-lived assets, primarily property, plant and equipment to be held and used in the business, for the purposes 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. At December 31, 1998 and 1999 the Company recorded provisions of U.S.\$ 12.1 million and U.S.\$ 1.6 million, respectively, for impairment related to plant and equipment expected to be discontinued. The Company did not record a provision for impairment in 2000.

(j) Employee retirement and postemployment benefits

The cost of the retirement benefits plans is accrued currently. Employee postretirement and postemployment benefits as defined by SFAS 106 - “Employers’ Accounting for Postretirement Benefits other than Pensions” and SFAS 112 - “Employers’ Accounting for Postemployment Benefits”, respectively, are not significant. The Company is required by law to provide severance benefits to employees terminated without just cause. No significant amounts were accrued at December 31, 1999 and 2000, since future severance costs are not reasonably estimable.

(k) Compensated absences

The liability for employees' future vacation compensation is accrued as vacation vests during the year.

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(unless otherwise stated)

(l) Revenues and expenses

Revenues arise from annual and long-term contracts and from spot sales and are recognized when products are invoiced. Expenses and costs are accrued as incurred.

(m) Accounting for derivatives and hedging activities

The Company maintains an overall risk management strategy to minimize significant unplanned fluctuations caused by foreign exchange rate volatility. The Company may enter into forward foreign exchange contracts to protect against exchange-rate movements affecting its non-US dollar denominated export accounts receivable. Additionally, the Company may enter into foreign currency swaps and foreign currency options to manage risk in administering the Company's cash and cash equivalents portfolio. Finally, the Company may enter into contracts to protect against exchange-rate movements affecting its non-US dollar denominated export accounts payable and indebtedness. Market-value gains and losses on these contracts are recognized in income currently, offsetting foreign exchange gains and losses arising on the accounts receivable and cash equivalent balances.

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 133 - Accounting for Derivative Financial Instruments and Hedging Activities (SFAS 133), as amended by SFAS 137 and SFAS 138. These standards are effective for the Company as from January 1, 2001. FAS 133, as amended, requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether the derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction. For fair value hedge transactions, in which the Company is hedging changes in the fair value of an asset, liability or firm commitment, changes in the fair value of the derivative instrument will generally be offset in the income statement by changes in the hedged item's fair value. For cash-flow hedge transactions in which the Company is hedging the variability of cash flows related to a variable-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative instrument will be reported in other comprehensive income. The gains and losses on the derivative instrument that are reported in other comprehensive income will be reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges will be recognized in current period earnings.

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Management estimates that, due to the limited number of unsettled derivative instruments as of December 31, 2000, the adoption of FAS 133, as amended, as of January 1, 2001 will not have a significant effect on the Company's results of operations or its financial position.

(n) **Income taxes**

The Company has adopted SFAS 109 - "Accounting for Income Taxes" for all years presented. Accordingly, the Company recognizes (i) the benefits of tax loss carryforwards available to be offset against future taxable income and (ii) deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the tax bases and financial reporting bases of assets and liabilities, as well as on the effects of adjustments made to reflect the requirements of US GAAP. A valuation allowance is provided to reduce deferred tax assets when management considers that realization is not reasonably assured.

(o) **Basic and diluted earnings per share**

Basic and diluted earnings per share are computed by dividing net income by the weighted average number of all classes of shares outstanding during the year, net of treasury stock, after taking into consideration the dividend provisions applicable to Class A preferred and Class B preferred stocks, assuming that all earnings for the year are fully distributed. There were no dilutive securities outstanding in 1998, 1999 and 2000.

(p) **Comprehensive income**

The Company has disclosed comprehensive income as part of the Statement of Changes in Stockholders' Equity, in compliance with SFAS 130 - "Reporting Comprehensive Income".

2 **Sale of the "Electrochemical Plant"**

On September 27, 1999, the Company formed Aracruz Eletroquímica Ltda., a wholly-owned subsidiary, and transferred to the subsidiary certain equipment comprising an "electrochemical plant", at its net book value of U.S.\$ 82.6 million, as payment of capital subscribed.

On December 17, 1999, Aracruz Eletroquímica Ltda. issued debt securities in the international market ("Fixed rate notes") in the amount of U.S.\$ 58 million. In addition, at that date, the subsidiary was split and cash in the amount of U.S.\$ 54.9 million was retained by the twin subsidiary Aracruz Empreendimentos S/C Ltda., also wholly-owned, incorporated on December 6, 1999.

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Aracruz Eletroquímica Ltda., which retained the electrochemical plant assets and the liability for the notes, with a net equity of U.S.\$ 27.7 million, was then sold for U.S.\$ 6.1 million, on December 17, 1999, to CanadianOxy Chemicals Holding Ltd., a Canadian group. The loss on sale of the plant of U.S.\$ 21.6 million (U.S.\$ 13.6 million net of taxes), was recorded in "Other operating costs and expenses".

Pursuant to a contract signed by the Company and the acquirors of the electrochemical plant, the Company will purchase future production from the plant. See discussion of "take-or-pay" contract in Note 16 (b).

3 Acquisition of Terra Plana Agropecuária Ltda

On June 1, 2000 the Company acquired Terra Plana Agropecuária Ltda ("Terra") for U.S.\$ 20,204. The acquisition has been accounted for using the purchase method of accounting. The net assets of Terra are comprised solely of land, and at September 30, 2000 the Company has allocated the purchase price to land (U.S.\$ 13,169) and goodwill (U.S.\$ 7,035), based upon estimates of the fair value of the land. Goodwill will be amortized on a straight-line basis over 7 years, which the Company believes is the estimated benefit period.

4 Investment in Veracel Celulose S.A.

On October 10, 2000, the Company acquired a 45% interest in Veracel Celulose S.A. (Veracel) for U.S.\$ 81,011. Veracel is currently in the pre-operational stage, growing eucalyptus plantations in the state of Bahia in Brazil. Stora Enso OYJ and Odebrecht S.A. own the remaining 45% and 10%, respectively. At the end of 2002, the Company and Stora Enso will jointly decide, based upon prevailing market conditions, whether to proceed with a planned construction of Veracel's own green field.

Upon closing of the purchase agreement, the Company and Veracel entered into a three-year wood supply contract to provide wood for the Company's mill expansion currently in progress. Under terms of the contract, beginning in 2002 Veracel will supply up to 3.85 million cubic meters of wood at U.S.\$ 40.50 per cubic meter.

The Company accounts for its investment in Veracel using the equity method of accounting. At December 31, 2000 the Company's investment in Veracel included goodwill of U.S.\$ 15,583, which will be amortized over a period up to 7 years. Amortization is expected to commence in 2002, which corresponds to the estimated beginning of the period the Company believes it will benefit from its investment. For the year ended December 31, 2000, the Company recognized equity earnings of U.S.\$ 1,313.

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5 Income taxes

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 are presented as follows:

	Year ended December 31 - %		
	1998	1999	2000
Federal income tax rate	25.0	25.0	25.0
Social contribution (*)	8.0	8.0 to 12.0	9.0 to 12.0
Composite tax rate	33.0	33.0 to 37.0	34.0 to 37.0

(*) Pursuant to a provisional measure, the social contribution rate was increased to 12% for the period May 1, 1999 to January 31, 2000 and was reduced to 9% for the period February 1, 2000 to December 31, 2000. The social contribution rate will continue to be 9% until December 31, 2002 and will be reduced to 8% again effective January 1, 2003. Because provisional measures are valid only for 30 days unless approved by the Congress, the enacted rate continues to be 8% in accordance with the provisions of SFAS 109. Therefore, this rate was used to calculate deferred taxes at December 31, 2000 and 1999.

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The amounts reported as income tax expense (benefit) in the consolidated statements of income are reconciled to the statutory rates as follows:

	<u>Year ended December 31,</u>		
	<u>1998</u>	<u>1999</u>	<u>2000</u>
Income (loss) before income taxes and minority interest	<u>(22,116)</u>	<u>107,389</u>	<u>283,765</u>
Federal income tax and social contribution at statutory rates	(7,298)	39,734	93,642
Adjustments to derive effective tax rate:			
Effects of differences in remeasurement from reais to U.S. dollars, using historical exchange rates and indexing for tax purposes:			
Translation effect for the period	(5,716)	(14,797)	(4,688)
Depreciation on difference in asset basis	1,074	29,025	22,406
Valuation allowance (reversal)			
Operations in Brazil	(4,168)	(38,924)	(5,394)
Operations outside Brazil	(4,389)	2,617	(29,737)
Effects of changes in tax rates for 1999		(1,116)	
Social contribution recovered, net of federal income tax effect of U.S.\$ 2,601 (see Note 16 (a) (iv))	(7,806)		
Other permanent items	<u>2,997</u>	<u>140</u>	<u>5,836</u>
Income tax expense (benefit) per consolidated statement of income	<u>(25,306)</u>	<u>16,679</u>	<u>82,065</u>

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The major components of the deferred tax accounts in the balance sheet are as follows:

	<u>December 31,</u>	
	<u>1999</u>	<u>2000</u>
Assets		
Tax loss carryforwards		
Operations in Brazil	22,777	63
Operations outside Brazil	32,211	2,474
Depreciation - book over tax	10,961	
Expenses not currently deductible	22,235	7,100
Others	6,488	6,736
Valuation allowance	<u>(38,761)</u>	<u>(2,474)</u>
	55,911	13,899
Current assets	<u>6,488</u>	<u>6,736</u>
Long-term assets	<u>49,423</u>	<u>7,163</u>

Although realization of net deferred tax assets is not assured, management believes that, except where a valuation allowance has been provided, such realization is more likely than not to occur. The amount of the deferred tax asset considered realizable could, however, be reduced if estimates of future taxable income during the tax loss carryforwards period are reduced. Tax loss carryforwards do not expire and are available to offset against future taxable income limited to 30% of taxable income in any individual year.

In addition, at December 31, 2000, the Company had recoverable taxes in the total amount of U.S.\$ 126,949, relating mainly to the withholding income tax on financial income (U.S.\$ 63,974), which can be offset with future income tax payable, and to the value-added tax credits (U.S.\$ 41,056) for which management is studying alternatives of recovery with the Government of the Espírito Santo State.

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6 Cash and cash equivalents

	<u>December 31,</u>	
	<u>1999</u>	<u>2000</u>
Brazilian reais	13,934	704
United States dollars	288,743	15,768
Other European currencies	<u>9,913</u>	<u>1,619</u>
	<u>312,590</u>	<u>18,091</u>

Cash equivalents in Reais represent principally short-term investments in certificates of deposit placed with major financial institutions in Brazil. The amount invested in United States dollars at December 31, 1999 consists of participations in an investment fund whose assets are basically denominated in U.S. dollar. The amount invested in United States dollars at December 31, 2000 consist primarily of time deposits with prime financial institutions.

7 Debt securities available-for-sale

The Company's debt securities available-for-sale are comprised of Notas do Tesouro Nacional ("National Treasury Notes") Series D, and Notas do Banco Central ("Central Bank Bonds") Series E, which are issued and guaranteed by the Brazilian Federal Government. These securities have maturity dates ranging from May 2001 to June 2004.

During the first half of 1999 the Company sold National Treasury Notes for an amount of U.S. \$ 80,313, realizing losses of U.S. \$648, net of taxes, calculated on an identified security basis. The realized loss that had been previously recorded as a component of other cumulative comprehensive income in stockholders' equity was classified as financial expense in the statement of income. Additionally, in accordance with the maturity schedule of the National Treasury Notes, U.S. \$94,398 were redeemed in September 1999 and partially reinvested.

During October and November of 2000, National Treasury Notes with a value of U.S. \$ 119,768 matured and the Company partially reinvested proceeds of U.S. \$34,924 into Central Bank Bonds, Series E with a maturity date in June 2004.

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At December 31, 2000, the fair value of the Company's debt securities available for sale amounted to U.S. \$323,032 (1999 – U.S. \$189,480), with an unrealized gain, net of tax, of U.S. \$1,095 recorded as a component of other cumulative comprehensive income.

8 Accounts receivable, net

	<u>December 31,</u>	
	<u>1999</u>	<u>2000</u>
Customers - pulp sales		
Domestic	6,999	8,149
Export	71,074	80,887
Advances to suppliers	1,223	3,432
Other	<u>5,171</u>	<u>2,044</u>
	84,467	95,512
Allowance for doubtful accounts	<u>(490)</u>	<u>(446)</u>
Total, net	<u><u>83,977</u></u>	<u><u>94,066</u></u>

At December 31, 2000, one customer accounted for 30% of total customer receivables (1999 - two customers accounted for 37%) and no other accounted for more than 10%.

Export receivables are denominated in the following currencies:

	<u>December 31,</u>	
	<u>1999</u>	<u>2000</u>
United States dollars	41,416	77,439
European currency units - EURO	29,399	3,448
British pounds	<u>259</u>	<u> </u>
	<u><u>71,074</u></u>	<u><u>80,887</u></u>

Export receivables in currencies other than U.S. dollars are swapped into U.S. dollars through forward foreign exchange contracts as discussed in Note 17.

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9 Inventories, net

	<u>December 31,</u>	
	<u>1999</u>	<u>2000</u>
Finished products	24,054	34,151
Work in process	853	824
Timber	3,181	5,737
Raw materials	7,694	10,731
Spare parts and maintenance supplies, less allowance for loss of U.S.\$ 4,841 (1999 – U.S.\$ 3,522)	<u>33,857</u>	<u>29,533</u>
	<u><u>69,639</u></u>	<u><u>80,976</u></u>

Spare parts include parts which, when utilized, are expected to extend the useful lives of plant and equipment and will be capitalized.

10 Property, plant and equipment

	<u>December 31, 1999</u>			<u>December 31, 2000</u>		
	<u>Cost</u>	<u>Accumulated depreciation</u>	<u>Net</u>	<u>Cost</u>	<u>Accumulated depreciation</u>	<u>Net</u>
Land	134,581		134,581	178,192		178,192
Timber resources	454,491	296,038	158,453	482,164	327,680	154,484
Buildings, improvements, and installations	462,092	244,295	217,797	467,231	264,275	202,959
Equipment	1,842,545	759,931	1,082,614	1,831,744	830,576	1,001,168
Information tecnology equipment	41,572	24,635	16,937	41,898	28,082	13,816
Other	<u>135,444</u>	<u>76,620</u>	<u>58,824</u>	<u>144,617</u>	<u>95,331</u>	<u>49,287</u>

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	3,070,725	1,401,519	1,669,206	3,145,849	1,545,943	1,599,906
Construction in progress	<u>33,541</u>	<u> </u>	<u>33,541</u>	<u>64,416</u>	<u> </u>	<u>64,416</u>
Total	<u>3,104,266</u>	<u>1,401,519</u>	<u>1,702,747</u>	<u>3,210,265</u>	<u>1,545,943</u>	<u>1,664,322</u>

During the second quarter of 2000, the Company commissioned a technical report from engineering experts in order to align, for accounting purposes, the remaining useful life of the plant assets to their prospective economical use. Based on that report, which considered aspects such as the useful economic life established by the assets' manufacturers, the Company's maintenance standards and the general conditions of use and conservation, management concluded that the Company should depreciate its industrial assets at higher annual rates to reflect the actual wear of the assets by their use. Accordingly, as a result of this change, which was effective April 1, 2000, the depreciation charge for the year ended December 31, 2000 increased by U.S.\$ 17.8 million. For the year ended December 31, 2000 U.S.\$ 15.6 million, respectively, was charged against cost of sales, net income was reduced by U.S.\$ 10.5 million, respectively, and earnings per share were reduced by U.S.\$.02 per Class A and B shares U.S.\$.02 per common share for the year ended December 31, 2000. Assets acquired in the future will be depreciated at the same rates as those determined in the technical report, taking into consideration the nature of the assets.

11 Short-term borrowings

The Company's short-term borrowings are principally from commercial banks for export financing and are substantially denominated in U.S. dollars. Average annual interest rates at December 31, 1999 and 2000 were, respectively, 8.2% and 7.4%.

At December 31, 2000, U.S.\$ 125,203 of short-term borrowings fall due within 90 days, U.S.\$ 29,440 from 91 to 180 days and U.S.\$ 3,050 from 181 to 365 days.

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12 Long-term debt

	<u>December 31,</u>	
	<u>1999</u>	<u>2000</u>
Denominated in Brazilian currency - term loans with varying interest rates: principally the "Long-term Interest Rate" (TJLP) plus 5.5% to 11.5% (1999 - 5.5% to 11.5%), due 2000 to 2006	<u>162,330</u>	<u>117,464</u>
Denominated in foreign currencies		
Term loans - 9.26% to 12.37% (1999 - 8.45% to 12.23%), due 2001 to 2004	193,354	136,640
Securitization of receivables - 7.98% (1999 - 7.98% to 9.89%) due 2001 to 2002	69,572	39,547
Import financing - 6.56% to 7.31% (1999 - 5.55% to 7.08%), due 2001 to 2007	40,197	34,227
Import financing - LIBOR plus 1.4%, due 2001 to 2004	73,167	56,281
Pre-export financing - 1999 - 5.54% to 10.7%, due 2000	<u>207,350</u>	<u> </u>
	<u>583,640</u>	<u>266,695</u>
Total	745,970	384,159
Less current maturities	<u>353,616</u>	<u>105,286</u>
	<u>392,354</u>	<u>278,873</u>

In January 1994, the Company issued U.S.\$ 120 million of 10.375% unsecured notes (the "Notes") maturing 2002. The Notes were redeemable on January 31, 1997 at 94.527% of face value if redeemed at the option of the Company, or at 93.710% of face value if redeemed at the option of the bondholder. On January 31, 1997, the terms of the Notes were remarketed and amended, through a purchase and resale operation under which they were redeemed at 94.527% of their face value and reissued at 104.75% of face value on the same date. The gain on the redemption was recognized currently in financial income in 1997 while the premium on reissuance is being amortized over the remaining term of the Notes. Interest, fees and commissions on the Notes are exempt from Brazilian withholding tax. However, should the instruments be redeemed prior to their original final maturities, the Company will be obligated to pay such tax on both past and future payments at rates from 12.5% through 15%, depending upon the country to which such payments are remitted.

In November 1994, the Company, through Aracruz Trading S.A. entered into a U.S.\$ 100 million Euro-Commercial Paper program, guaranteed by the Company, with maturities through 1997 and with interest negotiated as each tranche is released. The Company has drawn down and repaid several tranches under this program. On September 2, 1998, renewal of this

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program was approved by the Brazilian Central Bank for a 3-year term, in conjunction with an increase in the amount from U.S.\$ 100 million to U.S.\$ 200 million. The Company did not draw down on this facility during 2000.

In February 1995, the Company, through Aracruz Trading S.A., signed a financing agreement with a special-purpose entity (SPE) under which such entity received from a trust and advanced to the Company, as a first phase of a U.S.\$ 200 million program, U.S.\$ 50 million, representing funds received by the trust through the private placement of trust certificates. In return, the Company securitizes the financing by selling to the SPE its current and future accounts receivable from designated customers. Concurrently, the SPE has assigned its right, title and interest on the certificates to the trust. Each month such collections in excess of contractual funding requirements are transferred to the Company. The financing bears fixed annual interest of 9.89% and has been fully repaid. The net proceeds were transferred to Aracruz Celulose S.A. as advances for future purchases of pulp. In July 1995, the Company completed the remaining U.S.\$ 150 million phase of the securitization program, which has been structured similarly to the first phase described above. This second phase comprehends U.S.\$ 38 million of five-year certificates with interest equal to one-month LIBOR plus 1.75%, which were fully redeemed during 1997, and U.S.\$ 112 million of seven-year certificates, with interest of 7.98%, and repayments beginning, respectively, in December 1996 and June 1999, with monthly interest payments which began in July 1995. In August 1995, Aracruz Trading S.A., a wholly-owned subsidiary of the Company, used the funds to purchase the full amount of an issue of US\$ 150 million of Aracruz Celulose S.A.'s unsecured 9% notes, due August 2003; accordingly these amounts have been offset against each other in the consolidated financial statements.

During 1998, the Company, through Aracruz Trading S.A., entered into a U.S.\$ 65 million long-term debt, with maturities from September 2000 to November 2000. This debt was fully paid at each maturity date during the year 2000.

At December 31, 2000, the Company had outstanding debt with the Banco Nacional de Desenvolvimento Econômico e Social - BNDES, a stockholder, in an amount equivalent to U.S.\$ 170 million (1999 - U.S.\$ 241 million) maturing up to 2006; local currency loans bear interest at varying rates based on the TJLP plus 5.5% to 11.5% and foreign currency loans are linked to a basket of foreign currencies. The loans are secured by liens on the Company's property, plant and equipment and on its timber resources.

At December 31, 2000, the Company had in treasury and available for resale all of its debentures (approximately U.S.\$ 140 million at December 31, 2000 values) issued in 1982 and 1990, which were repurchased in the market in 1992.

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The long-term portion of the Company's debt at December 31, 2000 becomes due in the following years:

2002	196,045
2003	46,363
2004	17,935
2005	7,274
2006 and thereafter	<u>11,256</u>
Total	<u><u>278,873</u></u>

13 Stockholders' equity

The Company's principal common stockholders and their common stock ownership interests, either direct or indirect, are as follows: Arapar S.A. (a Company associated with the Chairman of the Board of the Company), S.O.D.E.P.A. - Sociedade de Empreendimentos, Publicidade e Participação S.A. (SODEPA) (an affiliate of Banco Safra S.A.), and Mondi International for 28% each; Banco Nacional de Desenvolvimento Econômico e Social - BNDES for 12.5%. At December 31, 1999 and 2000, SODEPA and the Banco Nacional de Desenvolvimento Econômico e Social - BNDES also owned preferred stocks which in total amounted to 16.4% and 23.5%, respectively, of the total preferred stocks.

Class A preferred stock may be converted into Class B preferred stock at any time at the option of the stockholder. Preferred stock does not have voting rights but has priority in the return of capital in the event the Company is liquidated. Stock dividends payable to Class A preferred stockholders are effected through issuance of Class B preferred stock. Class A preferred stock has priority in the distribution of a minimum annual cash dividend equivalent to 6% of the related capital. Additionally, in order to comply with Law 9457/97, the Company's By-laws were changed to grant Class B preferred stock the right to receive an annual dividend in an amount that is 10% greater than dividends paid to common stockholders ("Dividend Ratio"); earnings, if any, in excess of the Class A preferred stock minimum dividend will be distributed as dividends to Class B preferred stock and common stock, up to the equivalent on a per-share basis to those paid to Class A preferred stock, while maintaining the Dividend Ratio between Class B preferred stock and common stock. Any earnings remaining for distribution thereafter are shared ratably among Class A preferred, Class B preferred and common stocks while maintaining the Dividend Ratio between Class A and Class B preferred stock and common stock. In the event that Class A preferred stock is not paid dividends for three consecutive years, holders of that stock are entitled to voting rights until the dividends in arrears for those three years are paid.

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Basic and diluted earnings per share ("EPS") as of December 31, 1998, 1999 and 2000, as presented in the Company's statement of income, have been calculated on the above basis taking into consideration the Dividend Ratio between Class A and Class B preferred stock and common stock. However, the per share amounts have been rounded to two decimal places. The following presents the earnings per share calculations:

	<u>1998</u>	<u>1999</u>	<u>2000</u>
Net income	3,447	90,773	201,711
Less priority Class A preferred stock dividends	(3,561)	(2,429)	(2,219)
Less Class B preferred stock and common stock dividends up to the Class A preferred stock dividends on a per-share basis while maintaining the Dividend Ratio	<u>114</u>	<u>(57,308)</u>	<u>(52,429)</u>
Remaining net income to be equally allocated to Class A and Class B preferred stock and common stock while maintaining the Dividend Ratio		<u>31,036</u>	<u>147,063</u>
Weighted average number of shares outstanding (thousands)			
Class A preferred	41,007	40,979	40,903
Class B preferred	564,374	553,279	552,889
Common	454,908	454,908	454,908
Basic and diluted earnings per share			
Class A preferred	0.09	0.09	0.20
Class B preferred	0.00	0.09	0.20
Common	0.00	0.08	0.18

Brazilian law permits the payment of cash dividends only from retained earnings and certain reserves registered in the Company's statutory accounting records. At December 31, 2000, after considering appropriated retained earnings which can be transferred to unappropriated retained earnings, the earnings and reserves available for distribution as dividends, upon approval by the Company's stockholders, amounted to the equivalent of U.S.\$ 239 million.

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Retained earnings that represent unrealized income (principally inflationary income recognized up to December 31, 1995 in the Company's statutory financial statements) are transferred to unrealized income reserve and are transferred back to retained earnings as financial resources become available for dividend distribution.

The investments reserve represents discretionary appropriations, ratified by the stockholders, for plant expansion and other capital projects, the amount of which is based on an approved capital budget presented by management. After completion of the projects, the Company may elect to retain the appropriations until the stockholders vote to transfer all or a portion of the reserve to capital or to retained earnings, from which a cash dividend may then be paid.

The fiscal incentive reserve results from an option to invest a portion of income tax otherwise payable in the acquisition of capital stock of companies undertaking specified government-approved projects. The amount so applied is credited to non-operating income and subsequently appropriated from retained earnings to this reserve.

The legal reserve results from appropriations from retained earnings of 5% of annual net income recorded in the statutory accounting records. Such appropriations are required until the balance reaches 20% of the balance of capital stock, based on the statutory accounting records. At December 31, 2000, such capital stock was R\$ 1,855 million and the balance in the legal reserve was R\$ 113 million.

The fiscal incentive and legal reserves may be used to increase capital and to absorb losses, but are not available for distribution as cash dividends.

14 Pension plans

The Company sponsors a retirement plan covering substantially all of its employees. Prior to May 1, 1992, the program ("Plan 1") consisted of a final-pay, defined-benefit pension plan with benefits based on years of service and salary so as to complement the government social security benefits. As of May 1, 1992, a new program ("Plan 2") was created under which the retirement benefits were based principally on defined-contribution accumulations and the disability and death benefits were based on a defined-benefits formula. On attaining retirement, participants could either opt for a defined monthly retirement benefit or withdraw a capital sum, both determined on the basis of the contributions accumulated relating to the participant. Substantially, all active employees elected to transfer to Plan 2 while the retired employees remained in Plan 1.

In September 1998, the Company implemented another plan ("Plan ARUS"), which automatically replaced Plan 2, with retirement benefits based solely on defined contribution accumulations. Upon implementation of Plan ARUS, each participant was assigned an

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individual account with his/her accumulated benefit at the date of implementation; also, the option for a defined monthly retirement benefit provided under Plan 2 was eliminated.

The net effect of U.S.\$ 1,395 resulting from the transfer of the benefit obligation and related assets from Plan 2 to Plan ARUS was accounted for as a settlement gain in accordance with SFAS 88 - "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits", and credited to income for the year ended December 31, 1998.

The Company and eligible employees make monthly contributions under the plan to a private, government-approved pension fund, whose sponsors are Aracruz Celulose S.A. and its subsidiary companies and whose board of administrators is composed principally of officers of Aracruz Celulose S.A. Contributions by employees to the new plan are optional. The fund owns and administers (or places with a trustee) its investments and other assets, which comprise, principally, bank certificates of deposit, investments funds, marketable equity securities and real estate.

Contributions made by the Company to the plan amounted to U.S.\$ 1,211, U.S.\$ 1,266 and U.S.\$ 1,183 in 1998, 1999 and 2000, respectively, and represented the annual pension expense of the Company for this plan.

After the implementation of Plan 2, and its subsequent substitution by Plan ARUS, few participants remained in the defined-benefit plan (Plan 1), and it no longer represents a significant liability for the Fund. Accordingly, the Company's management considers that it is no longer necessary to disclose the plan's funded status and other information required by SFAS 132 - "Employers' Disclosures about Pensions and Other Postretirement Benefits".

15 Employee benefits

In addition to the pension plans, the Company makes monthly contributions, based on total payroll, to government pension, social security and severance indemnity plans and such payments are expensed as incurred. Also, certain severance payments are due on dismissal of employees, principally notice of one month's salary and a severance payment calculated at 40% of the accumulated contributions made to the government severance indemnity plan on behalf of the employee. Based on current operating plans management does not expect that amounts of future severance indemnities will be material.

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16 Commitments and contingencies

(a) Contingencies

(i) Labor Proceedings

The Company has been involved in legal proceedings with labor unions in respect of wage adjustments to incorporate inflation for the period February 16, 1990 through March 15, 1990. Such suits, however, have been denied by the Superior Labor Court, based on rulings by the Federal Supreme Court.

The Company has received an unfavorable judgment in respect of a suit brought by certain industrial employees represented by their union, claiming additional compensation for alleged hazardous conditions at the mill. The Court's decision established a framework for computing the amount of liability. Five other collective suits of the same nature have their respective technical expertise proceedings concluded although not yet decided by the local court. At December 31, 2000, the Company had recorded a provision for eventual losses, based on the Court's computation framework and existing labor jurisprudence, in the amount of U.S.\$ 16,849 regarding these claims, and deposited U.S.\$ 4,180 in an escrow account.

(ii) Administrative Proceedings

The Company has been involved in an administrative claim regarding the enlargement of Indian reservations in an area owned by the Company. In April 1998, the Indian communities signed two Terms of Settlement recognizing the legitimacy of the Ministry of Justice Edicts 193, 194 and 195, dated March 6, 1998, that restricted expansion of the reservation to 2,571 hectares of land belonging to the Company. Additionally, the Company committed itself to a financial aid program to be implemented through social, agricultural, educational, shelter and health projects, up to an amount of approximately R\$ 13.5 million (equivalent to U.S.\$ 6.9 million at December 31, 2000), to be disbursed within a twenty-year period, conditioned to the accomplishment of certain obligations by the Indian communities.

If the Indian communities breach any of their obligations, Aracruz will be released from the obligations defined by the Terms of Settlement. Decrees approving the enlargement of the Indian reservations have extinguished the aforementioned administrative claim. As of December 31, 2000, the Company had donated to the Indian Associations approximately R\$ 2.6 million (U.S.\$ 1.8 million) (U.S. \$ 445 in 2000) under the Terms of Settlement.

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(iii) Fiscal Proceedings

In March 1997, the Company received notification from the INSS (the Brazilian Social Security System) relating to the value of housing allowances paid to certain employees over a period of several years. At December 31, 2000, the Company is contesting this notification and has placed approximately U.S.\$ 9,942 in an escrow account to cover this claim. Based on the opinion of its legal advisors, the Company's management does not believe that the ultimate resolution of this matter will have a material adverse impact on the Company, and accordingly, no provision has been made therefor.

(iv) Income tax and social contribution related to the Plano Verão

In December 1994, the Company petitioned the Tribunal Regional Federal da 2ª região (the "Tribunal") to include in the determination of income tax and social contribution the IPC difference in January 1989 of 70.28%. The Tribunal subsequently accepted the use of 42.72%. Beginning in the third quarter of 2000 with the substantial utilization of the Company's net operating losses in Brazil, the Company began remitting income tax using the 42.72% deduction and has included a provision for contingencies of U.S.\$ 20,362.

(v) PIS and COFINS contributions

The Company is questioning in Court certain changes in the rates and rules for the calculation of the PIS and COFINS contributions determined by Law 9718/98. The Company recorded a provision in the amount of U.S.\$ 26,981 in relation to these contributions, which it believes is sufficient to cover any possible loss which could arise from this case.

(vi) Others

The Company has, based on the advice of its legal counsel, recorded additional provisions in the amount of U.S.\$ 4,690 relating to several other legal disputes and has also made deposits in the amount of U.S.\$ 6,003 in escrow accounts.

(b) "Take-or-pay" contract

In connection with the sale of the electrochemical plant (see Note 2), the Company and CanadianOxy Chemicals Holding Ltd. (CXY) entered into a long-term contract for chemical products supply. The contract includes clauses of performance incentives such as sharing of productivity gains, preference prices and "take-or-pay", by which the Company is committed to acquire from the electrochemical plant purchased by CXY a volume of chemical products conservatively projected for the next 6 years. Volumes purchased by the Company in addition to the minimum agreed for a given year may be compensated with lower volumes acquired in subsequent years. For the take-or-pay quantities, the Company will pay unit prices which equal cost plus margin as determined in the contract.

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(c) Compliance with Regulations

The Company's forestry and manufacturing operations are subject to both Federal and State government environmental regulations. The Company's management believes that it is in compliance, in all material respects, with all applicable environmental regulations.

17 Derivative Instruments, Hedging and Risk Management Activities

The Company is engaged in the exportation of market pulp to various markets throughout the world. Management considers the Company's functional currency to be the U.S. dollar and approximately 22% of the Company's indebtedness was Real-denominated, consisting of loans bearing interest at variable rates. These activities expose the Company to credit and foreign currency fluctuation risks, as well as risks associated with the effects of changes in floating interest rates. The Company maintains an overall risk management strategy to minimize significant unplanned fluctuations caused by foreign exchange rate volatility.

The Company's Treasury assesses, at least on a weekly basis, macroeconomic issues and the implications of these issues on the Company's financial performance. The Treasury reports to the Chief Financial Officer. The responsibilities of the Treasury includes the proposal of the Company's corporate risk management policy and its implementation, and the evaluation of the effectiveness of the Company's overall risk management strategy.

The Company may use derivative and non-derivative instruments to implement its overall risk management strategy. However, by using derivative instruments, the Company exposes itself to credit and market risk. Credit risk is the failure of a counterparty to perform under the terms of the derivative contract. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates, currency exchange rates, or commodity prices. The Company addresses credit risk by restricting the counterparties to such derivative financial instruments to major financial institutions. Market risk is managed by the Treasury. The Company does not hold or issue financial instruments for trading purposes.

(a) Foreign Currency Risk Management

The Company's foreign currency risk management strategy may use derivative instruments to protect against foreign exchange rate volatility, which may impair the value of certain of the Company's assets. The Company may use foreign currency forward-exchange contracts, foreign currency swaps and forward currency options contracts to implement this strategy.

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At December 31, 2000, the Company had entered into five forward foreign-exchange contracts to protect its foreign currency denominated accounts receivable and bank balances against exchange rate movements in the aggregate amount of EUR 3,103 thousand (1999 – EUR 23,840 thousand), equivalent in aggregate to U.S.\$ 2,885 (1999 – U.S.\$ 24,173). The contracts expire in January, February and March 2001. The Company realized a net loss in 2000 associated with its forward foreign exchange contracts of U.S.\$ 227 (1999 – U.S.\$ 144).

Additionally, the Company has been investing substantially all of its financial resources in long-term U.S. dollar denominated or U.S. dollar indexed available-for-sale debt securities to protect against the exchange risk of a devaluation of the Brazilian real in relation to the U.S. dollar.

(b) Interest Rate Risk Management

The Company's strategy for interest rate management has been to maintain a diversified portfolio of interest rates in order to optimize cost and volatility. The Company's interest rate risk management strategy may use derivative instruments to reduce earnings fluctuations attributable to interest rate volatility. The Company may use interest rate swaps to implement this strategy. At December 31, 2000 the Company had no outstanding interest rate swap contracts.

(c) Commodity Price Risk Management

The Company is exposed to commodity price risks through the fluctuation of pulp prices. The Company currently does not utilize derivative financial instruments to manage its exposure to fluctuations in commodity prices, but may utilize them in the future.

18 Nonderivative financial instruments

Fair value - the Company considers that the carrying amount of its financial instruments generally approximates fair market value. Fair value have been determined as follows:

Cash - the carrying amount of cash is a reasonable estimate of its fair value.

Cash equivalents and short-term investments and bank deposits - cash equivalents are represented, principally, by short-term investments. Their fair value, and that of other bank deposits not meeting the definition of cash equivalents, were estimated using the rates currently offered for deposits of similar remaining maturities.

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Debt securities - the fair value of the Company's debt securities was estimated by obtaining quotes from major financial institutions and brokers.

Short-term debt and long-term debt - interest rates that are currently available to the Company for issuance of debt with similar terms and remaining maturities are used to estimate fair value. The Company's financial structure does not require any substitution of such financing or the contracting of similar fundings.

The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required in interpreting market data to develop the estimates of fair value.

19 Geographical information

The Company's exports from Brazil, classified by geographic destination, are as follows:

	Year ended December 31,		
	1998	1999	2000
North America	181,439	252,078	267,859
Europe	193,608	194,640	368,992
Asia	83,472	94,847	109,122
Other	<u>3,644</u>	<u>9,164</u>	<u>5,927</u>
Total	<u>462,163</u>	<u>550,729</u>	<u>751,900</u>

Sales to one unaffiliated customer represented 25% of net sales in 2000, sales to one unaffiliated customer represented 26% in 1999 and 2 unaffiliated customers represented 30% in 1998. Sales to no other individual customers represented more than 10% of net sales.

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20 Related parties

Transactions with related parties resulted in the following balance sheet and income statement balances:

	<u>December 31,</u>			
	<u>1999</u>		<u>2000</u>	
	<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>
Balance sheet				
Current assets				
Cash and cash equivalents	35		2	
Accounts receivable	5,892		9,530	
Current liabilities – suppliers				
Long-term debt (including current portion and accrued finance charges)		<u>242,847</u>		<u>171,133</u>
	<u>5,927</u>	<u>242,847</u>	<u>9,532</u>	<u>171,133</u>

	<u>Year ended December 31,</u>					
	<u>1998</u>		<u>1999</u>		<u>2000</u>	
	<u>Income</u>	<u>Expense</u>	<u>Income</u>	<u>Expense</u>	<u>Income</u>	<u>Expense</u>
Income statement						
Operating revenues	34,108		36,855		44,555	
Financial expenses		<u>25,304</u>		<u>78,168</u>		<u>14,152</u>
	<u>34,108</u>	<u>25,304</u>	<u>36,855</u>	<u>78,168</u>	<u>44,555</u>	<u>14,152</u>

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21 Supplementary information - Valuation and qualifying accounts

<u>Description</u>	<u>Balance at beginning of year</u>	<u>Additions Charged to Costs and Expenses</u>	<u>Deductions credited to costs and expenses</u>	<u>Balance at end of year</u>
2000				
Allowances deducted from related balance sheet accounts:				
Accounts receivable	490		44	446
Inventories	3.522	1.319		4.841
Investments (other assets - other)	801			801
Property, plant and equipment, net	20.164		20.164	
Deferred income tax	38.761		36.287	2.474
1999				
Allowances deducted from related balance sheet accounts:				
Accounts receivable	112	400	22	490
Inventories	3.522			3.522
Investments (other assets - other)	802		1	801
Property, plant and equipment, net	18.591	1.573		20.164
Deferred income tax	75.068		36.307	38.761
1998				
Allowances deducted from related balance sheet accounts:				
Accounts receivable	122		10	112
Inventories	3.485	1.664	1.627	3.522
Investments (other assets - other)	802			802
Property, plant and equipment, net	6.500	12.098	7	18.591
Deferred income tax	83,625		8,557	75,068

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