ARACRUZ CELLULOSE S A
Form 20-F
June 30, 2005

# 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** |
| **ý** | **ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004** |
| | **OR** |
| **o** | **TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** |

**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)

**Rua Lauro Müller, 116, 40th floor**

**22299-900 Rio de Janeiro, RJ, Brazil**

(Address of principal executive offices)

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

| **Title of each class:** | **Name of each exchange on which registered:** |
| --- | --- |
| American Depositary Shares (as evidenced by American Depositary Receipts), each representing ten shares of Class B Stock | New York Stock Exchange |

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

**None**

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

**None**

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** |

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 ý No o

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

Item 17 o Item 18 ý

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

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**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. at December 31, 2003 and 2004 and 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 (u 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, approxin 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 generally accepted accounting principles in the United States of America, or U.S. GAAP. Because we exported approximately 98% of our production in 2004 and operate in an industry that uses the U.S. dollar as its currency of reference, our management believes that the U.S. dollar is the most appropriate currency in which to present our financial statements. Accordingly, we decided to present our primary U.S. GAAP 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 our 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.

We publish our financial statements in Brazil in accordance with accounting practices adopted in Brazil, or Brazilian GAAP, which differs in certain significant respects from U.S. GAAP. The principal differences between Brazilian GAAP and U.S. GAAP, as applied to us, are related to disclosure requirements. Our taxes and dividends are determined on the basis of Brazilian GAAP financial statements.

During the first quarter of 2001, in an effort to conform our reporting practices to those commonly used in the industry, we changed the classification of freight costs in the statement of income. As a result of this change, ocean freight and insurance charges, which had previously been classified as a reduction to export sales of eucalyptus pulp, together with inland freight charges, previously classified as selling expenses, are now classified as a component of cost of sales. Additionally, certain administrative expenses were identified as indirectly related to the production process and, beginning January 1, 2001, classified as a component of cost of sales. Historical information herein with respect to 1999 and 2000 was reclassified accordingly. Therefore, some information may differ from the condensed financial statements published elsewhere.

The following table presents our selected financial data as of the dates and for each of the periods indicated. Our U.S. GAAP financial statements as of December 31, 2002, 2003 and 2004 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). The selected financial information at December 31, 2000 and 2001 has been derived from our U.S. GAAP 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, | | | | |
|---|---|---|---|---|---|
| | **2000** | **2001** | **2002** | **2003** | **2004** |
| | (thousands of U.S. dollars, except number of shares and per share amounts) | | | | |
| **Statement of Operations Data** | | | | | |
| ***Operating Revenues*** | | | | | |
| Sales of eucalyptus pulp | | | | | |
| Domestic | $ 43,601 | $ 23,579 | $ 17,126 | $ 42,401 | $ 66,083 |
| Export | 800,634 | 583,365 | 700,622 | 1,056,498 | 1,256,648 |
| Total sales | $ 844,235 | $ 606,944 | $ 717,748 | $ 1,098,899 | $ 1,322,731 |
| Sales taxes and other deductions | (63,240) | (32,589) | (48,765) | (95,829) | (155,618) |
| Net operating revenues | $ 780,995 | $ 574,355 | $ 668,983 | $ 1,003,070 | $ 1,167,113 |
| ***Operating costs and expenses*** | | | | | |
| Cost of sales | $ 412,313 | $ 420,606 | $ 468,875 | $ 592,555 | $ 700,333 |
| Selling | 21,492 | 23,253 | 28,242 | 38,617 | 53,850 |
| Administrative | 22,454 | 22,012 | 22,302 | 22,762 | 31,072 |
| Provision for loss on ICMS credit | | 10,754 | 45,093 | 23,178 | 22,859 |
| (Gain)/Loss and provision for loss sale of property, plant and equipment and spare parts inventories | 4,826 | 9,555 | 1,534 | 4,401 | 6,490 |
| Other, net | 7,152 | 5,252 | 7,434 | 14,383 | (4,141) |
| Total operating costs and expenses | $ 468,237 | $ 491,432 | $ 573,480 | $ 695,896 | $ 810,463 |
| ***Operating income*** | $ 312,758 | $ 82,923 | $ 95,503 | $ 307,174 | $ 356,650 |
| ***Non-operating (income) expenses*** | | | | | |
| Equity in results of affiliated company | $ 1,313 | $ (1,195) | $ (6,076) | $ 6,844 | $ 11,568 |
| Financial income | (64,849) | (54,749) | (61,611) | (43,037) | (56,123) |
| Financing expense | 101,461 | 70,215 | 82,014 | 108,209 | 119,976 |
| Loss (gain) on currency remeasurement, net | (8,812) | 18,029 | (14,888) | (41,955) | (16,197) |
| Other, net | (131) | (214) | (276) | (92) | (67) |
| *Total Non-operating (income) expenses* | $ 28,982 | $ 32,086 | $ (837) | $ 29,969 | $ 59,157 |
| ***Income (loss) before income taxes*** | $ 283,776 | $ 50,837 | $ 96,340 | $ 277,205 | $ 297,493 |
| **Income tax expense (benefit)** | | | | | |
| Current | $ 40,461 | $ 35,722 | $ (23,988) | $ 106,549 | $ 42,746 |
| Deferred | 41,604 | (2,992) | 8,415 | 22,567 | 27,510 |
| Total | $ 82,065 | $ 32,730 | $ (15,573) | $ 129,116 | $ 70,256 |
| ***Net income*** | $ 201,711 | $ 18,107 | $ 111,913 | $ 148,089 | $ 227,237 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| ***Basic and diluted earnings per share(1)*** | | | | | | | | | |
| Class A Stock | $ 0.20 | | $ 0.05 | | $ 0.11 | | $ 0.15 | | $ 0.23 | |
| Class B Stock | 0.20 | | 0.02 | | 0.11 | | 0.15 | | 0.23 | |
| Common Stock | 0.18 | | 0.01 | | 0.10 | | 0.14 | | 0.21 | |
| ***Dividends per share*** | | | | | | | | | | |
| Class A Stock | $ 0.06 | (2) | $ 0.06 | (3) | $ 0.08 | (4) | $ 0.11 | (5) | $ 0.12 | (6) |
| | | | | | | | | | $ 0.09 | (7) |
| Class B Stock | 0.06 | (2) | 0.06 | (3) | 0.08 | (4) | 0.11 | (5) | 0.12 | (6) |
| | | | | | | | | | 0.09 | (7) |
| Common Stock | 0.05 | (2) | 0.06 | (3) | 0.07 | (4) | 0.10 | (5) | 0.11 | (6) |
| | | | | | | | | | 0.08 | (7) |
| ***Weighted-average number of shares outstanding (thousands of shares)*** | | | | | | | | | | |
| Class A Stock | 40,903 | | 40,651 | | 40,395 | | 39,819 | | 38,074 | |
| Class B Stock | 552,889 | | 536,512 | | 536,768 | | 535,969 | | 537,711 | |
| Common Stock | 454,908 | | 454,908 | | 454,908 | | 454,908 | | 454,908 | |
| Total | 1,048,700 | | 1,032,071 | | 1,032,071 | | 1,030,696 | | 1,030,693 | |

(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 April 05, 2000 and paid on April 30, 2000.

(3) Including the dividend declared on March 30, 2001 and paid on April 12, 2001.

(4) Including the dividend declared on April 30, 2002 and paid on May 13, 2002.

(5) Including the dividend declared on April 29, 2003 and paid on May 15, 2003.

(6) Including the dividend declared on April 29, 2004 and paid on May 14, 2004.

(7) Including the interest on stockholders equity declared on October 19, 2004 and November 16, 2004 and paid on November 11, 2004 and December 10, 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

| | At December 31, | | | | |
|---|---|---|---|---|---|
| | 2000 | 2001 | 2002 | 2003 | 2004 |
| | (thousands of U.S. dollars) | | | | |
| ***Balance Sheet Data*** | | | | | |
| Cash and cash equivalents | $ 18,091 | $ 20,125 | $ 25,474 | $ 66,284 | $ 36,474 |
| Other current assets | 261,815 | 215,199 | 250,487 | 390,459 | 384,529 |
| Short-term investments | 323,032 | 405,493 | 248,455 | 285,991 | 412,110 |
| Property, plant and equipment, net | 1,664,322 | 1,913,191 | 2,000,071 | 2,270,369 | 2,133,896 |
| Investment in affiliated company | 79,698 | 80,893 | 87,107 | 382,318 | 480,940 |
| Other assets | 107,500 | 143,296 | 87,220 | 59,012 | 81,709 |
| ***Total assets*** | $ 2,454,458 | $ 2,778,197 | $ 2,698,814 | $ 3,454,433 | $ 3,529,658 |
| Short-term debt | 272,042 | 325,855 | 182,680 | 392,088 | 152,934 |
| Other current liabilities | 55,035 | 99,425 | 55,824 | 121,591 | 121,872 |
| Long-term debt | 278,873 | 537,183 | 611,091 | 979,435 | 1,222,728 |
| Other long-term liabilities | 75,387 | 78,004 | 88,656 | 160,358 | 217,837 |
| Stockholders equity | 1,773,121 | 1,737,730 | 1,760,563 | 1,800,961 | 1,814,287 |
| ***Total liabilities and stockholders equity*** | $ 2,454,458 | $ 2,778,197 | $ 2,698,814 | 3,454,433 | 3,529,658 |

**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 shall 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 ease, on January 15, 1999, the Central Bank allowed the *real* to float freely. On May 31, 2005, the commercial selling rate was R$2.4038 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.

| | Exchange Rate of R$ per US$ | | | |
|---|---|---|---|---|
| **Year ended December 31,** | **Low** | **High** | **Average(1)** | **Year-End** |
| 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 |

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.

| | Exchange Rate of R$ per US$ | |
|---|---|---|
| | **Low** | **High** |
| **Month Ended** | | |
| December 31, 2004 | 2.6544 | 2.7867 |
| January 31, 2005 | 2.6248 | 2.7222 |
| February 28, 2005 | 2.5621 | 2.6320 |
| March 31, 2005 | 2.6011 | 2.7621 |
| April 30, 2005 | 2,5195 | 2,6598 |
| May 31, 2005 | 2,3784 | 2,5146 |

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 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.

At the end of 2002, Brazil elected a new president from the Workers Party, Luís Inácio Lula da Silva, known as Lula. In the period leading up to and following his election, there was substantial uncertainty relating to the policies that the new government would pursue, including the potential implementation of macroeconomic policies that differed significantly from those of the prior administration. This initial uncertainty resulted in a loss of confidence in the Brazilian capital markets with a consequent significant devaluation of the *real*. Up to now, the new government has not departed in any material way from previous and responsible economic and monetary policies, which has caused a subsequent appreciation of the real. Nevertheless, any substantial negative reaction to possible economic or monetary policy changes by the Brazilian government could adversely affect our business, operations and the market price of our preferred shares and ADSs.

***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 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*. On the other hand, any appreciation of the *real* against the U.S .dollar will generally increase operating expenses as expressed in U.S.dollars. If the rate of Brazilian inflation increases more rapidly than the rate of appreciation of the U.S. dollar against the *real*, then our operating expenses may increase in U.S. dollar terms and, assuming constant U.S. dollar sales prices, our profit margins may decrease. As expressed in U.S. dollars *s*, any appreciation of the *real* may produce exchange losses on unhedged debt denominated in reais. On the other hand, any 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, the appreciation of the Real relative to the U.S. dollar was 18.2%. In 2004, the depreciation of the Real relative to the U.S. dollar was 8.1%. From January 1, 2005 through May 31, 2005, the Real appreciated 9.4%.

Devaluations of the *real* relative to the U.S. dollar also create additional inflationary pressures in Brazil that may negatively affect us. They generally curtail access to foreign financial markets and may cause government intervention, including recessionary governmental policies. See Inflation and certain governmental measures to combat inflation may contribute significantly to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets. Devaluations also reduce the U.S. dollar value of distributions and dividends on the ADSs.

***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 control inflation and market speculation about possible future measures, has in the past had significant negative effects on the Brazilian economy. Our operating expenses are substantially denominated in *reais* and tend to increase in value with Brazilian inflation because our suppliers and providers generally increase prices to reflect the depreciation 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, our operating expenses expressed in U.S. dollars may also increase and, assuming constant U.S. dollar sales prices, our profit margins may decrease. In addition, high inflation generally leads to higher domestic interest rates, and, as a result, our 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, 2004 and has, through a subsidiary, advanced approximately 17% 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. 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.

**Developments in the international financial markets, in the future, 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 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$341 billion as of December 31, 2004, and an average monthly trading volume of approximately US$419.7 million in 2004. In comparison, the NYSE had a market capitalization of US$19.8 trillion as of December 31, 2004, and an average monthly trading volume of approximately US$46.1 billion for 2004.

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 47.5% of the aggregate market capitalization of BOVESPA as of December 31, 2004. The top ten stocks in terms of trading volume accounted for approximately 45.3% 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, shipments of BEKP grew by 11%. A more favorable economic situation, strong growth in demand for printing and writing paper, and the increase in the production of tissue paper were the main factors leading to this strong growth. In 2004, the average list price for BEKP (North America delivered) was US$ 559/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 has permitted the implementation of price increase, the average list price for BEKP (North America delivered) in the first quarter of 2005 was US$ 595/t.

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 wood.

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 bleached eucalyptus kraft market pulp, 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 167,800of 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 from the date 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 it has obtained all necessary permits and that all our property was legally acquired 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, recently 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. Our ability to continue to expand successfully through acquisitions or alliances depends on many factors, including the availability of businesses for sale. 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.***

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***

The Company s marketing strategy is to develop long-term relationships with customers that will purchase the Company s production year after year. In 2004, the Company s ten largest customers accounted for approximately 72% of its sales (by volume) and the two largest customers accounted for 44% of the Company s sales (by volume). See Market Overview Markets and Customers . The Company believes that the loss of either of these customers would have a material adverse effect on the Company s results of operations.

***Various other risks could have a material adverse effect on our financial results.***

Our operations are subject to various other risks that affect our forests and manufacturing processes, including fire, port closings, disease and factory explosions. To date, the Company s experience with such hazards has not had a material adverse effect on the Company. However, in the future, such hazards could have a negative effect on the Company s financial results.

# 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 Rua Lauro Müller, 116, 40th floor, 22299-900 Rio de Janeiro, State of Rio de Janeiro, Brazil, and its telephone number is 55-21-3820-8111. Our management has recently decided to relocate our principal office to the city of São Paulo, State of  São Paulo. Such decision is under implementation and is expected to be concluded early in the second half of 2005. 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 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 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 150,000 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, 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 expect to meet approximately 84% of our wood requirements from our own eucalyptus forests.

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. As of March 31, 2005, a total of US$824 million had been 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 is forecasted at 360,000 tons of pulp, half of it (180,000 tons) going to the Company. Of this amount, the Company expects to sell about 130,000 tons in 2005, with the balance being used to build inventory. In

2006, with the initial learning phase completed, the plant should attain full capacity. Transportation of the pulp from the Belmonte terminal in Bahia to the Portocel port terminal, in the state of Espírito Santo, a distance of approximately 450 km, will be carried out using sea-barges

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. See Business Guaíba Unit .

**Capital Expenditures**

The Company s capital expenditures for 2004, 2003 and 2002 were US$94.5 million, US$118.7 million and US$260.7 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, | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2004 | | | 2003 | | 2002 | |
| | (in US$ millions) | | | | | | |
| Fiberline C Expansion Project | | | | US$ | 55.8 | US$ | 185.3 |
| Siviculture and other forestry investments | US$ | 52.7 | | | 41.4 | | 39.5 |
| Forests (includes land purchase) | | 15.4 | | | 10.1 | | 15.4 |
| Improvements/industrial investments | | 20.9 | | | 3.2 | | 9.4 |
| Other | | 5.5 | | | 8.2 | | 10.8 |
| Total | US$ | 94.5 | | US$ | 118.7 | US$ | 260.7 |

The US$160.8 million decrease in capital expenditures in 2002 compared to 2001 were primarily due to investments in the Fiberline C Expansion Project.

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$3.2 million was devoted to ongoing industrial investments, US$51.5 million was devoted to silviculture and other forestry investments and US$8.2 million was devoted to other projects.

During the year 2004, we invested approximately US$94.5 million, of which US$68.1 million was devoted to silviculture and other forestry investments, US$17.9 million was devoted to ongoing industrial investments, US$3.0 million was devoted to Guaíba Unit optimization and US$5.5 million was devoted to other projects.

During 2005, the Company expects to invest approximately US$132 million relates 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.

During 2004, we produced approximately 2,497,000 tons of BEKP, a 11% increase from 2003 when we had produced approximately 2,250,000 tons of BEKP, which was a 36% increase as compared to 2002 when it had produced approximately 1,656,000 tons of bleached eucalyptus pulp. Pulp sales for 2004 were approximately 2,450,000 tons, a 14% increase as compared to 2,149,000 in 2003, which had represented a 36% increase when compared to 2002 pulp sales of 1,585,000 tons. Export pulp sales in both the years 2003 and 2004 were approximately 98% of total sales. See Markets and Customers and Competition.

From 1979 to 2004 the Aracruz s pulp production volume had a compound annual growth rate of 9.1% p.a., and the Company expects to reach in 2006 a total pulp production volume of 3,060,000 tons (including 50% of Veracel pulp production volume).

Our production facilities at Barra do Riacho unit consist of a eucalyptus pulp mill which has three production lines (Fiberlines A, B and C). The Fiberlines A and B have each two bleaching, drying and a total of five baling lines for both Fiberlines. The Fiberline C which began production in May 2002 has one bleaching line, one drying line and three baling lines. We also have a pulp mill in our Guaíba Unit which has a single production unit with one bleaching line, one drying line and one baling lines. The Guaiba Unit industrial facilities are currently being upgraded with the purpose of increasing its production capacity. See Business Overview - Guaiba Unit .

We own approximately 414,600 hectares of forest and other land in the States of Espírito Santo, Bahia, Minas Gerais and Rio Grande do Sul, of which over 252,400 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, of which 51% are owned by us. The Guaiba Unit is located approximately 160 nautical miles from the Rio Grande port and the pulp is transported from the mill thereto by barge through the lake Lagoa dos Patos. See History and Development of Aracruz above.

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 planting processes,
- the comparatively short harvest cycle of our trees, and
- lower energy and chemical costs.

During 2004, we were able to meet almost approximately 62% 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 97% of our electrical energy requirements, mainly from by-products of our pulp production process, and recycle the greater part of the chemicals used at the Units. See Raw Materials Energy.

**Business Strategy**

The key elements of our mission statement are:

Leveraging our competence in renewable forestry uses,

Developing products that add value for our customers,

Creating development opportunities for our employees, and

Observing the principles of sustainable development.

In 2004, 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 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 nominal production capacity of approximately 400,000 tons of bleached eucalyptus market pulp and 40,000 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.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.

*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 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 and those presenting the best adaptation to Aracruz s environmental conditions will be used on a large scale as of 2005. 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. Improve 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 2004, coastal shipping delivered 13% of the total wood consumed at the Barra do Riacho Unit. With the entry into service of another tug and barge next year, the annual shipping capacity is expected to reach 3.4 million tons, representing 42% of total wood transportation. Each barge has a wood-carrying capacity of 5,000 tons. As well as optimizing transport costs, their use eliminated some 40,000 truck journeys along the BR 101 highway in 2004, 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.

*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.

**Fiberline C Expansion Project**

The Fiberline C, our third pulp operational unit, began operations at the end of May 2002, after being completed in 17 months (two months ahead of schedule) at a lower cost than originally budgeted.

With nominal capacity of 700,000 tons per year as of December 31, 2003, the cost of the new line was US$477 million (net of ICMS tax). The volume of production during year 2004 by the Fiberline C totaled 780,000 tons, an increase of 11% over nominal capacity. In January 2005, the facility reached a monthly production record of 72,078 tons.

The new production volume resulting from the Fiberline C Expansion Project required an increase in our forest base of approximately 65,200 hectares of eucalyptus plantations, which were acquired between June 2000 and December 2004 through separate transactions. Additionally, in September 2002, Bahia Sul and we 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 us of forestry assets comprising approximately 40,000 hectares of gross lands that include around 28,000 hectares of eucalyptus-planted forests.

In order to meet the expected increase in production arising from the Fiberline C Expansion Project, we built a port facility in Caravelas, State of Bahia, and expanded our port facility in Barra do Riacho, State of Espírito Santo.

**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.

Under both stock purchase and sale agreements, we have agreed to indemnify the relevant counterparty for certain liabilities and/or damages which such counterparty may incur as a result of a breach by us of the representations and warranties or a default by us under a covenant under those agreements.

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. The mill will have a nominal capacity of 900,000 tons per year, and the overall investment is budgeted at US$1.24 billion Veracel will be 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 is expected to consist of 50% equity and 50% 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, 2004 the outstanding amount of such indebtedness guaranteed by the Company was approximately US$251.6 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 requires 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 were contracted mostly from Brazilian suppliers.

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 Original Veracel Shareholders Agreement, which sets 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. The Original 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 Original Veracel Shareholders Agreement. The Original Veracel Shareholders Agreement will terminate automatically if the ownership by any of the Veracel Shareholders of common shares of Veracel exceeds 50%. The Original Veracel Shareholders Agreement provides that Veracel will at all times during its term have a board of directors comprised of five members, of which (i) two will be elected from individuals appointed by Stora Enso, (ii) two will be elected from individuals appointed by us and (iii) one will be elected from individuals appointed by Odebrecht. 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 Original 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 other than (i) prior to the decision to build Veracel s pulp mill, or the Implementation Decision, and (ii) if the Implementation Decision is made, after the second anniversary of the start-up of Veracel s pulp mill. We each have a right of first refusal if the other party wishes to transfer all of its common shares of Veracel before the Implementation Decision. Under the Original Veracel Shareholders Agreement, Odebrecht may not transfer any of its common shares of Veracel other than (i) on or prior to December 31, 2002, if there has been no Implementation Decision, (ii) following the Implementation Decision, (iii) after the start-up date of Veracel s pulp mill (if it is built) or (iv) after the second anniversary of the start-up of Veracel s pulp mill (if it is built), provided that, in the case of the conditions described in (i), (ii) and (iii), Odebrecht will have the right to transfer all of its common shares of Veracel to the other shareholders of Veracel, for different prices, in accordance with the terms set forth in the Veracel Shareholders Agreement. Any of the Veracel Shareholders may transfer its common shares of Veracel to an affiliate, subject to certain limitations, or with the prior written consent of each of the other Veracel Shareholders. The Original 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 Original 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 Original 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.

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 Original Veracel Shareholders Agreement was amended. According to the amended agreement, or the Veracel Shareholders Agreement, the board of directors of Veracel is to be comprised of four members, of whom two will be elected from individuals appointed by Stora Enso, and two will be elected from individuals appointed by us. The Original Veracel Shareholders Agreement provides 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 Original Veracel Shareholders Agreement. The Original Veracel Shareholders Agreement governs the management and operation of Veracel.

**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 400,000 tons of BEKP and 40,000 tons of printing and writing paper, equipped with advanced environmental protection resources. The Guaíba Unit has approximately 65,787 hectares of forest and other land and 8,287 hectares of plantations are kept in association with third parties. The average distance of the wood supply to the mill is approximately 85 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 involving an investment of US$34 million. The project will improve product quality, reduce costs and increase production by 30.000 tons per year.

***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., or 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 started sales 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, 2005, 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.

The initial impact of this agreement was to increase Lyptus® sawn wood exports from 4.2% in 2001 to 10.6% in 2002, in addition to 47,223$m^2$ of Lyptus® flooring. In 2002 and 2003, 15% and 23,5%, respectively, of total production was exported. In 2004, 30% of total production was exported, and export sales accounted for 61% 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 5 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 committed for 2005.

**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, also 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 1994 to 2004. Over the same ten-year period, the annual rate of growth in demand for bleached eucalyptus pulp was estimated at 6.9%, while the annual rate of growth in demand for hardwood pulp during the same period was estimated at 4.6% and the market for softwood for the same period was estimated at a 2.5% 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 44% in 2004) primarily due to its high quality, and because of properties, such as its softness, opacity and printability.

***International Markets***

From 1992 to 2004, the worldwide production capacity of bleached hardwood kraft market pulp is estimated to have grown an average of approximately 4.3% per year, from 13.2 million tons to 22 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 3.9 million tons from 2000 to 2004. 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. 