

Usina Caeté S/A

Financial statements
December 31, 2004 and 2003

(A translation of the original report in Portuguese, as published in Brazil, containing financial statements prepared in accordance with accounting practices adopted in Brazil).

Usina Caeté S/A

Financial statements

December 31, 2004 and 2003

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Independent auditors' report

To
The Board of Directors and Shareholders
Usina Caeté S/A
Maceió - AL

1. We have examined the balance sheets of Usina Caeté S/A, as of December 31, 2004 and 2003, and the related statements of income, changes in shareholders' equity and changes in financial position for the years then ended, which are the responsibility of its management. Our responsibility is to express an opinion on these financial statements.
2. Our examinations were conducted in accordance with auditing standards generally accepted in Brazil and included: (a) planning of the audit work, considering the materiality of the balances, the volume of transactions and the accounting systems and internal accounting controls of the Company; (b) verification, on a test basis, of the evidence and records which support the amounts and accounting information disclosed; and (c) evaluation of the most significant accounting policies and estimates adopted by Company management as well as the presentation of the financial statements taken as a whole.
3. Based on the opinion of its legal advisors, who assessed as likely a favorable final court decision on litigations in process, the Company is recognizing excise tax (IPI) credits, for which the financial statements effects are being disclosed in footnote 14b. In accordance with accounting practices adopted in Brazil, these credits represent contingent gains, which only could have been recognized after a final favorable court decision, with no recourses. Additionally, the Company signed terms of transaction and adhesion aimed to solve state taxes issues, as described in footnote 14c.

4. In our opinion, except for the possible effects of the subjects mentioned in paragraph 3, the aforementioned financial statements present fairly in all material respects, the financial position of Usina Caeté S/A as of December 31, 2004 and 2003, and the results of its operations, changes in shareholders' equity and changes in its financial position for the years then ended, in conformity with accounting practices adopted in Brazil.

March 03, 2005

KPMG Auditores Independentes
CRC-2SP014428/O-6



João Bruno Cruz
Accountant CRC-1SP076600/O-0 S-AL

Usina Caeté S/A

Balance sheets

December 31, 2004 and December 31, 2003

(In thousand of reais)

Assets	2004	2003	Liabilities	2004	2003
Current assets			Current liabilities		
Cash and cash equivalents	5,297	11,463	Accounts payable to suppliers	55,893	33,009
Marketable securities	39,538	44,057 (*)	Bank loans and financing	217,858	156,257
Trade accounts receivable	58,216	63,613	Salaries and charges	12,051	3,903
Inventories	362,155	134,243	Advances from customers	5,340	24,181
Advanced payments to sugar cane suppliers	14,364	28,337 (*)	Taxes and contributions payable	7,374	5,411
Other accounts receivable	5,203	1,655	Income and social contribution taxes	619	2,467
Recoverable taxes	<u>55,549</u>	<u>42,995</u>	Other accounts payable	<u>2,143</u>	<u>764</u>
	<u>540,322</u>	<u>326,363</u>		<u>301,278</u>	<u>225,992</u>
Non current assets			Non current liabilities		
Group companies	5,372	162,749	Bank loans and financing	224,547	134,388
Advanced payments to sugar cane suppliers	19,746	12,144 (*)	Group companies	527	6,851
Judicial deposits	7,502	7,335	Taxes and contributions payable	2,624	2,658
Recoverable taxes	<u>62,759</u>	<u>54,953 (*)</u>	Provision for contingencies	69,571	15,060
	<u>95,379</u>	<u>237,181</u>	Accounts payable	<u>-</u>	<u>1,430</u>
				<u>297,269</u>	<u>160,387</u>
Permanent assets			Shareholders' equity		
Investments	18,013	31,883 (*)	Capital	520,000	400,000
Property, plant and equipment	472,619	350,975	Treasury shares	-	(3,008)
Deferred charges	<u>8,281</u>	<u>9,436</u>	Capital reserves	22,255	35,136
	<u>498,913</u>	<u>392,294</u>	Revenue reserves	2,952	4,563
			Retained earnings (accumulated losses)	<u>(9,140)</u>	<u>132,768</u>
				<u>536,067</u>	<u>569,459</u>
	<u><u>1,134,614</u></u>	<u><u>955,838</u></u>		<u><u>1,134,614</u></u>	<u><u>955,838</u></u>

(*) Balances reclassified for presentation improvements.

See accompanying notes to the financial statements.

Usina Caeté S/A

Statements of income

Year ended December 31, 2004 and December 31, 2003

(In thousand of reais)

	2004	2003
Gross Income		
Sale of goods and services		
Domestic Market	244,786	260,199
Foreign Market	310,673	303,709
Services rendered	<u>8,371</u>	<u>181</u>
	563,830	564,089
Deductions		
Sales taxes	(41,343)	(31,061)
Returns and discounts	<u>(566)</u>	<u>(1,761)</u>
	(41,909)	(32,822)
Net revenues	521,921	531,267
Cost of goods and services sold	<u>(393,817)</u>	<u>(365,044)</u>
Gross profit	128,104	166,223
Operating (expenses) income		
Selling expenses	(54,997)	(45,697)
Administrative and general expenses	(40,037)	(37,696)
Net financial	(6,564)	1,974
Equity in net income of subsidiaries and group companies	(2,036)	1,932
Other operating income	<u>8,533</u>	<u>50,889</u>
	(95,101)	(28,598)
Operating income	<u>33,003</u>	<u>137,625</u>
Nonoperating income	<u>448</u>	<u>712</u>
Net income before income and social contribution taxes	<u>33,451</u>	<u>138,337</u>
Income and social contribution taxes	<u>(12,343)</u>	<u>(47,077)</u>
Net income for the year	<u><u>21,108</u></u>	<u><u>91,260</u></u>
Net income per lot of thousand shares - R\$	<u><u>1,472.07</u></u>	<u><u>6,364.46</u></u>
Number of shares at year-end	<u><u>14,339</u></u>	<u><u>14,339</u></u>

See accompanying notes to the financial statements.

Usina Caeté S/A

Statements of changes in shareholders' equity

Years ended December 31, 2004 and 2003

(In thousand of Reais)

	Capital	Treasury Shares	Capital reserves	Revenue Reserves	Retained earnings	Total
Balances at January 1, 2003	350,000	(3,008)	17,323	2,943	103,448	470,706
Capital increase	50,000			(2,943)	(47,057)	-
Reversion of dividends of treasury shares					128	128
Prior year adjustment					(448)	(448)
Capital reserve arising from income tax exemption incentive			17,813			17,813
Net income for the year					91,260	91,260
Distributions:						
Legal reserve				4,563	(4,563)	-
Dividends					(10,000)	(10,000)
Balances at December 31, 2003	400,000	(3,008)	35,136	4,563	132,768	569,459
Capital increase	120,000		(17,323)	(4,563)	(98,114)	-
Cancellation of common stock		3,008			(3,008)	-
Dividends					(4,000)	(4,000)
Net assets of subsidiary Delta Agrícola Ltda and of the associated company Varrela Agrícola Ltda. merged, as described in footnote 02.				1,897		1,897
Prior year adjustment					2,078	2,078
Adjustment related to constitution of provision for excise tax credits, as described in footnote 14b.					(58,917)	(58,917)
Capital reserve arising from income tax exemption incentive			4,442			4,442
Net income for the year					21,108	21,108
Distributions:						
Legal reserve				1,055	(1,055)	-
Balances at December 31, 2004	<u>520,000</u>	<u>-</u>	<u>22,255</u>	<u>2,952</u>	<u>(9,140)</u>	<u>536,067</u>

See the accompanying notes to the financial statement

Usina Caeté S/A

Statements of changes in financial position

Years ended December 31, 2004 and 2003

(In thousand of reais)

	2004	2003
Sources of funds		
Operations		
Net income for the year	21,108	91,260
Items not affecting working capital		
Monetary variation and interest on long term items	(12,011)	(10,277)
Depreciation and amortization	64,940	38,944
Residual cost on disposal of investment	13,557	1,682
Residual cost on disposal of fixed assets	690	1,557
Loss from capital increase in subsidiary	-	1,981
Equity in net income of subsidiaries and associated companies	2,036	(1,932)
Reversion of provision for contingencies	(9,390)	-
Capital reserve arising from income tax exemption incentive	<u>4,442</u>	<u>17,813</u>
From operations	85,372	141,028
From Shareholders		
Reversion of treasury shares related dividends	-	128
From subsidiary and associated company		
Net assets of subsidiary and associated Companies merged	1,897	-
From third parties		
Increase in noncurrent liabilities	191,217	48,987
Increase in accounts payable - associated company	-	6,851
Decrease in accounts receivable - associated company	157,377	-
Decrease in noncurrent assets	<u>262</u>	<u>10,127</u>
	<u>436,125</u>	<u>207,121</u>
Applications of funds		
Property, plant and equipment	186,118	59,360
Increase in accounts receivable from group company	-	9,365
Decrease in accounts payable from group company	6,324	-
Investments	1,723	19,781
Decrease in noncurrent liabilities	26,614	38,315
Noncurrent assets	15,834	37,234
Prior year adjustment	56,839	448
Dividends	<u>4,000</u>	<u>10,000</u>
	<u>297,452</u>	<u>174,503</u>
Increase in working capital	<u>138,673</u>	<u>32,618</u>
Changes in working capital		
Current assets		
At end of year	540,322	326,363
At beginning of year	<u>326,363</u>	<u>260,610</u>
	<u>213,959</u>	<u>65,753</u>
Current liabilities		
At end of year	301,278	225,992
At beginning of year	<u>225,992</u>	<u>192,857</u>
	<u>75,286</u>	<u>33,135</u>
Increase in working capital	<u>138,673</u>	<u>32,618</u>

See accompanying notes to the financial statements.

Usina Caeté S/A

Notes to the financial statements

Years ended December 31, 2004 and 2003

(In thousand of reais)

1 Operations

The Company is engaged in the production and selling of sugar, alcohol, and other products derived from sugar cane, sugar cane plantation and cultivation, supply of electrical energy, imports and exports and invests in other companies. Most of the consumed raw material (sugar cane) is the Company's own property production.

The Company's production process is spread over in five plants, being three located in the state of Alagoas and two in the state of Minas Gerais.

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

2 Mergers

The General shareholders meeting as of April 29, 2004 approved the merger of net assets of the subsidiary Delta Agrícola Ltda. effective as of April 30, 2004 and the General shareholders meeting as of June 30, 2004 approved the merger of net assets of the associated Varrela Agrícola Ltda. effective as of May 31, 2004, which values are as follows:

	Delta Agrícola Ltda.	Varrela Agrícola Ltda.	Total
Current assets	64,767	51,545	116,312
Non current assets	1,242	26	1,268
Permanent assets	76,967	51,992	128,959
Current liabilities	5,151	5,285	10,436
Non current liabilities	<u>129,652</u>	<u>96,397</u>	<u>226,049</u>
	<u>8,173</u>	<u>1,881</u>	<u>10,054</u>
Elimination of investment for merging purposes	(8,157)	—	(8,157)
Net assets merged	<u>16</u>	<u>1,881</u>	<u>1,897</u>

3 Presentation of the financial statements

The financial statements were prepared in accordance with accounting practices derived from the Brazilian Corporation Law.

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

Description of significant accounting policies

a. Income statement

Income and expenses are recognized on the accrual basis.

Revenue from the sale of goods is recognized in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. Revenue from services rendered is recognized in the income statement in proportion to the stage of completion of the service. Revenue is not recognized if there are significant uncertainties as to its realization.

b. Accounting estimates

The accounting estimates were established on objective and subjective factors, based on management's opinion of the appropriate amount to be recorded in the financial statements. Significant items subject to these estimates and assumptions include the residual value of property, plant and equipment, allowance for doubtful accounts, inventories, deferred income tax assets, provision for contingencies, valuation of derivative instruments, and assets and liabilities related to employees' benefits. The settlement of transactions involving these estimates may result in significantly different amounts due to the lack of precision inherent to the process of their determination. The Company reviews the estimates and assumptions at least once a year.

c. Foreign currency

Monetary assets and liabilities denominated in foreign currencies were translated into reais at the foreign exchange rate ruling at the balance sheet date.

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

d. Current and non-current assets

- **Interest earning bank deposits**

Interest earning bank deposits are recorded at cost plus income accrued up to the balance sheet date.

- **Provision for doubtful accounts**

The provision for doubtful accounts was calculated at an amount considered adequate by management to cover any losses arising on collection of accounts receivable.

- **Inventories**

Inventories are stated at the lower of average acquisition or production cost, less a provision for losses or market value.

The cost of inventories includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured products and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.

The industry off-season maintenance and the cultivation tracts for sugarcane plantations refer to maintenance costs, to be appropriated to the cost of the next crop.

- **Other current and non-current assets**

Presented at the net realization amount.

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

e. Permanent assets

- **Investments**

Investments in subsidiaries and associated companies were valued using the equity method.

Other investments were valued at cost, less a provision for devaluation, when applicable.

- **Property, plant and equipment**

Property, plant and equipment is recorded at the cost of acquisition, formation or construction. Depreciation is provided using the straight-line method at rates described in footnote 10, established by Brazilian fiscal law.

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, including major inspection and overhaul costs, is capitalized. Other subsequent expenditure is capitalized only when it increases the future economic benefits of the item of property, plant and equipment. All other expenditure is recognized in the income statement as an expense as incurred.

- **Deferred charges**

Deferred charges are recorded at purchase and formation cost, less amortization, which is calculated by the straight-line method at rates that consider the useful life of the intangible assets. Deferred charges are recognized only when there is an increase in the economic benefit related to those assets.

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Notes to the financial statements

(In thousand of reais)

f. Current and noncurrent liabilities

Stated at the known amounts or estimated, plus, when applicable, the corresponding charges and / or monetary and exchange variations incurred up to the balance sheet date.

g. Provisions

A provision is recognized in the balance sheet when the Company has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are recorded considering the best estimates of the risk specific to the liability.

h. Income and social contribution taxes

The income and social contribution taxes, current, are based on the effective rates of the income tax and social contribution on net income.

The Company has a fiscal incentive of income tax exemption over the profit of the exploration in its three units located in the State of Alagoas.

The income tax incentive amounts determined for each fiscal year are recognized in the income statement and credited to equity, as a compulsory capital reserve account, for future capital increase.

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

4 Marketable securities

	2004	2003
Fixed-income funds	985	822
Bank Deposit Certificate – income between 98.5% and 106% (98% and 104% in 2003) of the Interbank Deposit Certificate rates.	37,890	42,597
Other	<u>663</u>	<u>638</u>
Total	<u>39,538</u>	<u>44,057</u>

5 Trade accounts receivable

	2004	2003
Domestic customers	18,513	12,503
Foreign customers	<u>40,320</u>	<u>51,875</u>
	58,833	64,378
Provision for doubtful accounts	(617)	(765)
	<u>58,216</u>	<u>63,613</u>

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

6 Inventories

	2004	2003
Finished goods	220,978	118,046
Sugarcane plantations	91,614	-
Soybean agriculture	2,930	-
Industry off-season and sugar cane cultivation maintenance costs	28,363	10,816
Maintenance supplies and others	<u>18,270</u>	<u>5,381</u>
	<u>362,155</u>	<u>134,243</u>

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Notes to the financial statements

(In thousand of reais)

7 Recoverable taxes

	2004		2003	
	Current assets	Non current assets	Current assets	Non current assets
Income tax – IRPJ	28,887	-	29,526	-
Value added tax – ICMS	18,843	4,899	12,827	7,119
Excise tax credit – IPI	-	39,804	-	45,020
Income Tax Withheld at Source – IRRF	-	-	629	-
Employees’ Profit Participation Program – PIS	-	4,962	-	2,814
Social Contribution for Social Security				
Financing - COFINS	-	13,094	-	-
Social security contribution – INSS	7,426	-	-	-
Other taxes	<u>393</u>	<u>-</u>	<u>13</u>	<u>-</u>
	<u>55,549</u>	<u>62,759</u>	<u>42,995</u>	<u>54,953</u>

The excise tax - IPI credit recoverable is being recognized based on court discussions, starting from the fiscal credit taken in the respective tax book.

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Notes to the financial statements

(In thousand of reais)

8 Group companies

The main balances of assets and liabilities as of December 31, 2004 and 2003, as well as the transactions, which influenced the income of the year, related to operations with related parties, result from transactions between the Usina Caeté S/A and its subsidiaries, which were performed under normal market conditions for similar types of operations:

- The associated company SOTAN - Sociedade de Táxi Aéreo do Nordeste Ltda., renders services of aerial transport for the Company. These services amounted R\$ 2,409 (R\$ 2,607 in 2003).
- The sales of chemical products used in the industrial process and fertilizers made by the group Company PROFERTIL - Produtos Químicos e Fertilizantes S.A., for the Company amounted R\$ 14,624 (R\$ 466 in 2003 including only chemical products used in the industrial process).
- The other balances relate the loans, which were performed under normal market conditions.

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Notes to the financial statements

(In thousand of reais)

The balances of the transactions with the group companies are maintained at historical values as follows:

	2004		2003	
	Non current assets	Non current Liabilities	Non current assets	Non current Liabilities
Profertil S.A.	-	-	-	77
Lagense S.A.	-	485	-	6,732
WW Rent	-	42	-	42
Varrela Agrícola Ltda.	-	-	77,012	-
Fábrica da Pedra S.A.	-	-	4,678	-
Sotan Ltda.	5,024	-	240	-
Delta Agrícola Ltda.	-	-	80,583	-
Varrela pecuária Ltda.	212	-	209	-
Others	<u>136</u>	<u>-</u>	<u>27</u>	<u>-</u>
Total	<u>5,372</u>	<u>527</u>	<u>162,749</u>	<u>6,851</u>

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

9 Investments

	2004				2003			
	SOTAN – Sociedade de Táxi Aéreo do Nordeste Ltda.	Varrela Pecuária Ltda.	Delta Agrícola Ltda.	Total	SOTAN – Sociedade de Táxi Aéreo do Nordeste Ltda.	Varrela Pecuária Ltda.	Delta Agrícola Ltda.	Total
Capital	19,100	11,000	7,500	37,600	19,100	11,000	7,500	37,600
Number of shares	1,852,809	20,000	75,000	-	1,852,809	20,000	75,000	-
Investment interest	88.45%	16.13%	99.80%	-	88.45%	18.18%	99.80%	-
Shareholders' equity at December 31	13,713	10,906	8,173	-	16,293	10,964	7,693	-
Book value of investment	14,411	1,993	7,677	24,081	16,438	2,000	5,693	24,131
Loss on capital increase	-	-	-	-	(1,981)	-	-	(1,981)
Equity in net income (loss) of subsidiaries and group companies	(2,282)	(234)	480	(2,036)	(45)	(7)	1,984	1,932
Elimination of investments on merged subsidiaries	-	-	(8,157)	(8,157)	-	-	-	-
Adjusted book value of investments	<u>12,129</u>	<u>1,759</u>	<u>-</u>	<u>13,888</u>	<u>14,412</u>	<u>1,993</u>	<u>7,677</u>	<u>24,082</u>
Property and real state	-	-	-	3,426	-	-	-	7,102
Other investments	-	-	-	699	-	-	-	699
	<u>-</u>	<u>-</u>	<u>-</u>	<u>18,013</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>31,883</u>

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

Based in the General shareholders meeting as of April 29, 2004 the merger of net assets of the subsidiary Delta Agrícola Ltda., has been approved, eliminating the related investment.

10 Property, plant and equipment

	Average depreciation rate (p.a.)	2004			2003
		Cost	Depreciation	Net	Net
Buildings and improvements	4	72,955	(13,618)	59,337	48,706
Installations	10	19,903	(5,486)	14,417	14,962
Machinery and equipment	10	242,606	(82,465)	160,141	166,982
Machinery and agricultural implements	25	55,597	(44,885)	10,712	12,300
Fixtures and fittings	10	3,421	(1,451)	1,970	1,597
Vehicles	20	46,190	(27,327)	18,863	12,380
Computers equipment	20	9,419	(5,948)	3,471	4,081
Apparels and tools	10	5,310	(3,113)	2,197	1,861
Equipment and phone apparels	20	1,627	(1,008)	619	524
Sugarcane plantation	20	155,351	(52,423)	102,928	
Others		188	(59)	129	127
Land		94,523	-	94,523	83,711
Fixed assets in progress		2,946	-	2,946	1,040
Advances to suppliers		<u>366</u>	<u>-</u>	<u>366</u>	<u>2,704</u>
		<u>710,402</u>	<u>(237,783)</u>	<u>472,619</u>	<u>350,975</u>

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

11 Deferred charges

	2004	2003
Preoperating expenses	16,160	16,160
Accumulated amortization	<u>(13,154)</u>	<u>(11,999)</u>
	3,006	4,161
Goodwill on investments	<u>5,275</u>	<u>5,275</u>
	<u>8,281</u>	<u>9,436</u>

a. Preoperating expenses

The preoperating expenses, include start-up costs connected with the Volta Grande unit expansion. These expenses are being amortized over a period of ten years.

b. Goodwill

The premium paid on acquisition (excess of cost over net assets acquired) of the subsidiary Delta Agrícola Ltda., arises from the difference between the market value and the understated historical cost of the land owned by such company.

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

12 Suppliers

	2004	2003
Sugar cane suppliers	14,420	12,870
Others suppliers	<u>41,473</u>	<u>21,569</u>
	<u>55,893</u>	<u>34,439</u>
Current liabilities	<u>(41,473)</u>	<u>(20,139)</u>
Non current liabilities	<u>-</u>	<u>1,430</u>

13 Bank loans and financing

	2004	2003
Foreign currency:		
Exchange variation, plus interest of 1.53% to 6.50% (2.08% to 9% in 2003) p.y.	285,795	147,776
Local currency:		
Interest of 8.00% to 11.5% (8.75% to 12.5% in 2003) p.y. over TJLP	<u>156,610</u>	<u>142,869</u>
	442,405	290,645
Current portion included in current liabilities	<u>(217,858)</u>	<u>(156,257)</u>
	<u>224,547</u>	<u>134,388</u>

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

The long-term installments have the following payment schedule:

Maturity:	2004	2003
2005	-	18,525
2006	35,945	26,577
2007	78,945	27,401
2008	49,188	4,949
2009 up to 2015	<u>60,469</u>	<u>56,936</u>
	<u>224,547</u>	<u>134,388</u>

The loans and financing are guaranteed by collateral security of the financed assets in the amount of R\$ 137,713 (R\$ 91,759 in 2003), promissory notes and management and controlling Company sureties in the amount of R\$ 155,308 (R\$ 69,035 in 2003).

Usina Caeté S/A

Notes to the financial statements

(In thousand of reais)

14 Provision for contingencies

The Company takes part in legal actions and administrative proceeding in various courts of appeals and governmental entities, resulting from the normal course of operations, involving tax, labor, civil and other issues.

- a) Based on information provided by its legal advisors and on analysis of the pending legal demands and labor litigations, based in preceding experience refer the negotiated values, the management constituted provision in an amount considered sufficient to cover possible losses with the actions in course, as follows:

	2004	2003
Social security contribution – INSS over directors remuneration	1,147	1,147
Sugar and Alcohol Institute Contribution Rate – IAA	-	9,259
Excise Tax – IPI	4,383	4,383
Excise Tax Credits – IPI	63,764	-
Others	<u>271</u>	<u>237</u>
	<u>69,571</u>	<u>15,060</u>

- b) Based on its legal advisors' opinion, of a probable final issue with favorable court decision, the Company have been recognized excise tax credits - IPI, classifying as other operating income.

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Notes to the financial statements

(In thousand of reais)

In accordance with contingent gains accounting practices, in December 2004 the Company decided to recognize a provision in the amount of R\$ 63,764 for excise tax credits – IPI, related to non taxable and zero tax rate materials. Out of this amount, R\$ 4,848 was recognized in the statement of income, reversing tax credits taken during the year and R\$ 58,917 was reversed from retained earnings, reducing tax credits taken in prior years. In consequence, shareholder's equity is being presented increased by R\$ 153,084 regarding the credits taken and not provided for (R\$ 212,000 in 2003) and net income for the year 2003 increased by R\$ 61,000.

- c) In August 2004, the Company started negotiations, signing a term of transaction and adhesion aimed to solve state taxes issues. However, the related taxes liability has not been recognized, due to negotiations in connection with certain suspensive conditions involving the issue. The amounts preliminarily determined are still in phase of confirmation, as well as the parceling terms, therefore, remaining the uncertainties regarding the amount to be accrued and the terms for its payment. As a result, the net income for the year and the shareholders equity are subject to these effects.
- d) The Company has other contingencies involving tax issues in the estimated amount of R\$ 31,000 (R\$ 25,000 in 2003). Due to their current stage of these actions, and based on its legal advisors' opinion of a probable favorable court decision, management decided not to recognize a provision for eventual losses in the financial statements.
- e) Based on a final court decision and on its lawyers advice, the Company reversed to income the provision for the law suit related to the liabilities connected with the required contributions to the former Instituto do Açúcar e do Alcool – IAA, in the amount of R\$ 9.390, classified as other operating income.

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15 Income and social contribution taxes

The reconciliation between the tax expense as calculated by the combined statutory rates and the income and social contribution tax expense charged to net income is presented below:

	2004	2003
Net income before income and social contribution taxes	<u>33,451</u>	<u>138,337</u>
Combined statutory rates	34%	34%
Income and social contribution taxes calculated at the statutory rates	11,373	47,035
Permanent additions		
Nondeductible expenses	970	651
Permanent exclusion:		
Nontaxable revenues	<u>-</u>	<u>(609)</u>
Income and social contribution taxes charged to net income	<u>12,343</u>	<u>47,077</u>
Effective tax rates	36%	34%

The amount of R\$ 12,343 (R\$ 47,077 in 2003), includes the income tax incentive exemption on the profit of the exploration, in the amount of R\$ 4,442 (R\$ 17,813 in 2003), as mentioned in the note 3h.

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Notes to the financial statements

(In thousand of reais)

16 Shareholders' equity

a. Capital

The subscribed and paid-in, at December 31, 2004, is of R\$ 520,000 (R\$ 400,000 in 2003), divided in 14,339 nominative ordinary shares with no par value

b. Reserves

Legal reserve

In compliance with article 193 of Law 6404/76, the reserve was recorded at the rate of 5% of the net profit for the year, up to the limit of 20% of the capital.

Capital reserve

Referring to income tax incentive to Company's located in the northeast region of the country, that had recognized the right to income tax exemption, over the exploration profit on the sugar and alcohol activities.

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c. Dividends

The Company's bylaw determines the following destination of profits for each year, after approval by the General Ordinary Shareholders' meeting:

- amount (optional) to be approved by the shareholders' meeting as a fund for installation replacement;
- up to 10% for bonus to management;
- a minimum of 25%, adjusted as determined by the corporate law, for distribution of dividends to the shareholders.

The Company is proposing the distribution of dividends on the net profit for the year for approval by the shareholders as follows:

	2004	2003
Net income for the year	21,108	91,260
Appropriation for legal reserve	<u>(1,055)</u>	<u>(4,563)</u>
Base for calculation of the dividends	20,053	86,697
Statutory dividends	<u>5,013</u>	<u>21,674</u>
Proposed dividends	<u>4,000</u>	<u>10,000</u>

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Notes to the financial statements

(In thousand of reais)

17 Other operating income (net)

	2004	2003
Other operating revenues:		
Excise Tax - IPI – Credits on supply purchases	-	12,594
Excise Tax - IPI – Credits on export sales	-	48,510
Social Security Credit - INSS with court decision – Process 935654-6	6,363	-
Reversal of provision for contingencies – IAA	9,390	-
Tax credits of PIS Law 10.637/02 and of COFINS Law 10.833/03	5,813	3,000
Others	<u>3,690</u>	<u>172</u>
	<u>25,256</u>	<u>64,276</u>
Other operating expenses:		
Social Contribution for Social Security Financing – COFINS	932	3,078
Social Integration Program over other income – PIS	239	1,691
Tax on financial activities – CPMF	3,360	3,120
Value added tax – ICMS – rate difference	1,563	1,148
Loss for capital increase in subsidiary	-	1,981
Value added tax credit - ICMS - consolidation	3,867	-
Reversal of value added tax - ICMS extraordinary credits	3,771	-
Others	<u>2,992</u>	<u>2,369</u>
	<u>16,724</u>	<u>13,387</u>
	<u>8,532</u>	<u>50,889</u>

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Notes to the financial statements

(In thousand of reais)

18 Financial instruments

The estimated realization values of financial assets and liabilities of the Company were determined through information available in the market and appropriate valuation methodologies. However, considerable judgment was required in the interpretation of the market data to estimate of the most adequate realization value. Consequently, the estimates below do not necessarily indicate the values that could be realized in the current exchange market. The use of different market methodologies may have a material effect on the estimated realizable values.

The management of these instruments is done through operating strategies, aimed at liquidity, profitability and security. The control policy consists of permanent follow-up of the rates engaged versus those in force in the market. The Company and its subsidiaries do not invest in derivatives or any other risk assets on a speculative basis.

Credit Risk

The Company's sales policies are closely related with its level of credit risk arising from its normal course of business. The selection and the diversification of its client portfolio and the follow-up of financing terms of sales by business segment are procedures followed by the Company to minimize exposure to eventual risks resulting from the default of its clients.

Price Risk

The volatility of foreign currency exchange rate, market interest rates and prices of commodities are the principal market risks that the Company is exposed to. The sales in the future market and exchange rate variation over the sales price are managed with derivatives securities, which are realized with the exclusive objective to reduce exposure, and not for speculative purposes. The Company has transactions in the future market in the New York Stock Exchange (NYBOT – Coffee Sugar Cocoa Exchange) concerning sugar sale contracts in dollars for future delivery at pre-fixed prices, with various maturities up to October 2005.

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To protect the sugar price in the maturity date of future delivery contracts, the Company is operating in the sugar option market with pre-fixed price in the maturity date of contracts. At December 31, 2004, the position of purchase options and future sold (Call and Put) represents 5,384 ton. of sugar (10,160 ton. in 2003).

Exchange and interest rates risks

The results of the Company and its subsidiaries are susceptible to significant variations arising from financing and loan operations contracted at floating interest rates.

The Company uses derivative financial instruments to protect or reduce the financial costs of the financing operations.

The Company negotiates "swap" contracts based in the variation of pre-fixed interest rates, to protect its sugar sale contracts for future delivery from the foreign currency exchange rate variation. At December 31, 2004, the amount negotiated with those contracts is of approximately US\$ 1,000,000 (US\$ 400,000 in 2003), equivalent to R\$ 2,650 (R\$ 1,156 in 2003), and the unrealized results with these transactions are approximately R\$ 4,000.

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