



Financial Statements

December 31, 2005 and 2004

CONTENTS

Report of Independent Auditors	I
Audited Financial Statements	
Balance Sheets	II
Statements of Income	III
Statements of Shareholders' Equity	IV
Statements of Changes in Financial Position	V
Notes to Financial Statements	VI

A free translation from Portuguese into English of Report of Independent Auditors on financial statements prepared in accordance with the accounting practices adopted in Brazil

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders Videolar S.A

1. We have audited the balance sheet of Videolar S.A. as of December 31, 2005, and the related statements of income, shareholders' equity and changes in financial position for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements.

2. Except for the matter mentioned in paragraph 3, our audit was conducted in accordance with generally accepted auditing standards in Brazil and included: a) the planning of our work, taking into consideration the materiality of balances, the volume of transactions and the accounting and internal control systems of the Company; b) the examination, on a test basis, of documentary evidence and accounting records supporting the amounts and disclosures in the financial statements; and c) an assessment of the accounting practices used and significant estimates made by management of the Company, as well as an evaluation of the financial statement presentation, taken as a whole.

3. We did not audit the financial statements of the subsidiaries Videolar S.A. Argentina and Transvat Transportadora Ltda. for the year ended December 31, 2005. Accordingly, we were not able to form an opinion on the balances related to these investments as of that date and to the corresponding equity pick-up for the year then ended, based on the shareholders' equity of these subsidiaries, as mentioned in note 6 to the financial statements.

4. The Company recorded contingent assets whose outcome will only be confirmed by the occurrence or not of one or more future events, which are not totally under the control of the Company. As required by the accounting practices adopted in Brazil, these assets could only be recognized when a future event is certain, resulting from situations under the control of the Company's management. Accordingly, as of December 31, 2005, long-term liabilities are understated, shareholders' equity and net income are overstated by approximately R\$18,752 thousand, net of tax effects.

5. In our opinion, except for the adjustments, if any, that might result from the audit of the investments mentioned in paragraph 3, and except for the effects of the adjustment mentioned in paragraph 4, the financial statements referred to in paragraph 1 above present fairly, in all material respects, the financial position of Videolar S.A. as of December 31, 2005, the result of its operations, changes in its shareholders' equity and changes in its financial position for the year then ended in accordance with the accounting practices adopted in Brazil.

6. The financial statements for the year ended December 31, 2004 were audited by us, and our report thereon, dated March 18, 2005, contained an emphasis paragraph related to the matter mentioned in paragraph 3, and a scope limitation to the financial statements for the year ended December 31, 2003, which were not audited by us. Additional audit of transactions and balances as of December 31, 2003 were not sufficient to ensure that these balances would not have significant effects on the statement of income, changes in shareholders' equity and changes in its financial position for 2004.

São Paulo, February 17, 2006

ERNST & YOUNG
Auditores Independentes S.S.
CRC 2SP015199/O-6

LUIZ CARLOS PASSETTI
Accountant CRC 1SP 144343/O-3

BALANCE SHEETS

December 31, 2005 and 2004
(In thousands of reais)

ASSETS	2005	2004
Current assets		
Cash and marketable securities	181,770	97,990
Trade accounts receivable	344,074	324,927
Allowance for doubtful accounts	(11,333)	(11,332)
Receivables from related parties	7,854	1,509
Recoverable taxes	4,398	4,329
Prepaid taxes	18,637	
Inventories	144,365	158,474
Prepaid expenses	610	433
Deferred income and social contribution taxes	2,612	5,788
Other accounts receivable	3,125	6,078
Total current assets	696,112	588,196
Noncurrent assets		
Judicial deposits	6,534	6,837
Receivable from related parties		8,451
Deferred income and social contribution taxes	3,193	2,756
Total noncurrent assets	9,727	18,044
Permanent assets		
Investments	13,183	23,921
Property, plant and equipment	307,898	278,693
Total permanent assets	321,081	302,614
Total assets	1,026,920	908,854

LIABILITIES AND SHAREHOLDER'S EQUITY	2005	2004
Current liabilities		
Loans and financing	13,966	8,157
Trade accounts payable	76,331	8,222
Payroll and related charges	10,844	10,979
Distributed companies (licensors)	325,601	240,959
Taxes and contributions payable	17,725	6,495
Royalties payable	3,256	25,948
Dividends payable	6,456	44,504
Interest on shareholders' equity	784	
Deferred taxes and social contributions	4,426	4,426
Other accounts payable	4,139	13,611
Total current liabilities	463,528	363,301
Noncurrent liabilities		
Deferred income and social contribution taxes	4,755	9,180
Loans and financing	8,911	16,994
Provision for contingencies	9,390	8,314
Total noncurrent liabilities	23,056	34,488
Shareholders' equity		
Capital	114,949	149,525
Capital reserves	323,509	276,155
Revaluation reserves	17,823	26,412
Income reserves	84,055	58,973
Total shareholders' equity	540,336	511,065
Total liabilities and shareholders' equity	1,026,920	908,854

See accompanying notes.

STATEMENTS OF INCOME

December 31, 2005 and 2004
(In thousands of reais, except earnings per share)

	2005	2004
Gross sales	1,303,909	1,150,373
Sales deductions	(167,778)	(167,776)
Net sales	1,136,131	982,597
Cost of goods sold and services	(894,617)	(727,811)
Gross profit	241,515	254,786
Operating expenses		
Administrative/human resources expenses	(19,037)	(16,508)
Selling/logistic expenses	(48,596)	(53,340)
Industrial/technology expenses	(60,996)	(59,724)
Financial income (expenses), net	(2,855)	9,264
Equity pick-up in subsidiaries	(10,738)	(5,874)
Other operating income, net	10,030	17,063
Operating income	109,323	145,668
Non-operating income (loss)	(2,926)	1,559
Income before income and social contribution taxes and employee profit sharing	106,397	147,227
Income and social contribution taxes - current	(40,084)	(60,910)
Income and social contribution taxes - deferred	(2,740)	8,545
Income before employee profit sharing	63,573	94,862
Employee profit sharing	(2,488)	(3,655)
Income before reversal of interest on shareholders' equity	61,085	91,207
Reversal of interest on shareholders' equity	10,559	
Net income for the year	71,644	91,207
Number of outstanding shares at year end	815,907	925,743
Net earnings per share (R\$)	87.81	98.52

See accompanying notes.

STATEMENTS OF SHAREHOLDERS' EQUITY

Years Ended December 31, 2005 and 2004
(In thousands of reais)

	Capital reserves				Income Reserves			Total
	Capital	ICMS Incentive	Income Tax Incentive	Treasury Shares	Revaluation Reserve	Legal Reserve	Retained Earnings	
Balances at December 31, 2003	149,525	265,812			26,413	535	32,181	474,466
Dividends paid related to prior years							(32,181)	(32,181)
Income tax incentive			33,416					33,416
Revaluation reserve adjustment					(1)		11,735	11,734
Purchase of own shares				(23,073)				(23,073)
Net income for the year							91,207	91,207
Allocation of the net income:								
Legal reserve – 2003						59	(59)	
Legal reserve – 2004						4,560	(4,560)	
Proposed and paid dividends							(44,504)	(44,504)
Balances at December 31, 2004	149,525	265,812	33,416	(23,073)	26,412	5,154	53,819	511,065
Dividends paid related to prior years							(42,561)	(42,561)
Income tax incentive			24,281					24,281
Revaluation reserve adjustment					(8,589)		13,014	4,425
Purchase of own shares				(11,503)				(11,503)
Cancellation of treasury shares	(34,576)			34,576				
Net income for the year							71,644	71,644
Allocation of the net income:								
Interest on shareholders' equity							(10,559)	(10,559)
Legal reserve – 2005						3,582	(3,582)	
Proposed dividends							(6,456)	(6,456)
Balances at December 31, 2005	114,949	265,812	57,697		17,823	8,736	75,319	540,336

See accompanying notes.

STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 2005 and 2004

(In thousands of reais)

	2005	2004
WORKING CAPITAL PROVIDED BY:		
Operations:		
Net income for the year	71,644	91,207
Items not affecting working capital:		
Equity pick-up in subsidiaries	10,738	5,874
Deferred income and social contribution taxes	(437)	(2,756)
Provision for contingencies	1,076	3,773
Net book value of property, plant and equipment disposals	26,975	
Depreciation	43,085	52,117
	153,081	150,215
Third parties:		
Income tax incentive	24,281	33,416
Decrease in investments		1,620
Decrease in noncurrent assets	8,754	
Revaluation reserve adjustments		11,734
	186,116	196,985
WORKING CAPITAL USED FOR:		
Dividends paid related to prior years	42,561	32,181
Dividends paid/proposed related to current year	6,456	44,504
Interest on shareholders' equity	10,559	
Purchase of own shares	11,503	23,073
Acquisition of property, plant and equipment	99,265	95,988
Transfer from noncurrent to current liabilities	8,083	11,954
Increase in noncurrent assets		10,834
	178,427	218,534
Total working capital used	178,427	218,534
Increase/(Decrease) in net working capital	7,689	(21,549)
Represented by:		
Current assets:		
At the end of the year	696,112	588,196
At beginning of the year	588,196	482,582
	107,916	105,614
Current liabilities:		
At the end of the year	463,528	363,301
At beginning of the year	363,301	236,138
	100,227	(127,163)
Increase/(Decrease) in net working capital	7,689	(21,549)

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

December 31, 2005 and 2004
(In thousands of reais)

1. OPERATIONS

Videolar was established on June 30, 1988, in the city of Caxias do Sul, where it started the recording and subtitling of VHS tapes, also with a branch in São Paulo, where the translation and subtitling of movies were made. In 1990, the Company moved from Caxias do Sul to São Paulo and opened its plant in Manaus, for the manufacture, production and recording of VHS tapes.

In 1991, the Company began its distribution of recorded tapes to CIC Vídeo (Paramount and Universal) and, in order to improve the services provided to its clients, the Company specialized in entertainment distribution, offering this service to the major Hollywood studios (Buena Vista – Disney, Fox, MGM, Paramount, Sony – Columbia and Warner) and independent distributors of movies (Buttman, Califórnia, Casablanca, Europa, Gol Records, Lktel, LW, Oregon, Playarte, Private, Top Tape and Videofilmes), herein referred to as distributed companies. Videolar also distributes to the phonographic (Warner Music, EMI, Trama, Somlivre) and software (Digerati Comunicações, Editora Pini, Editora DCL, Editora Sol Soft) segments, as well as to the principal Brazilian newspapers.

As it develops these activities, in addition to the manufacture of various media support (CDs, DVDs and Audio and Video Cassette Tapes), the Company seeks to create customized solutions to meet each client's operational and commercial needs, including promotional and institutional campaigns, reduced quantity, differentiated finishes, short delivery timeframes and customized logistic operations.

From the matrix to the final product. From basic inputs to packaging. From production to the delivery to the final client. From billing to the report on rendering of accounts, everything is integrated and accessed through the management system. This is how Videolar operates its complete service chain, applying know-how to each stage of the process in order to always provide maximum satisfaction to its clients.

In addition to manufacturing the media and its respective packaging, Videolar verticalizes the whole process (Authoring, Masterization, Duplication, Replication, Translation, Subtitling, Inventory Control, Storage, Billing, Handling, Distribution Logistic, and After-Sales Service), through a Complete Distribution Service Chain, offering the same level of quality throughout all the stages. That is, everything related to the purchase order by the final client is the responsibility of Videolar. Our clients (distributed companies) monitor the progress of the orders

at every stage, from production to the physical distribution, in Brazil and in the other Latin American countries to which we export goods at the risk and expense of the clients.

In the production of its basic inputs, Videolar started to produce the polystyrene, meeting its own needs and selling the excess to companies engaged in the production of disposables in general (plates, glasses, tableware), foam trays, toys, electric and electronic, packaging in general, entertainment (cases for CD, cassette etc), office materials, laboratory materials etc. The Company also distributes a complete line of blank media, such as magnetic audio tapes, compact disc (CD and CD-ROM), digital versatile disc (DVD and DVD-ROM) and computer floppy discs.

In the provision of services to the distributed companies, Videolar is backed by licensing agreements in which it, in general, transfers the copyrights from the distribution of movies and titles held by them.

In September 2005, Videolar acquired Somlivre.com's assets, originating Videolar.com division. In November 2005, Videolar started electronic commerce operations, which represented a significant expansion of the Company's business, aligned with the strategy of improving the operations related to the provision of services to its corporate clients and final consumers. The new electronic commerce channel is focused exclusively on entertainment products in the formats of CDs, DVDs and blank media.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

The financial statements of the Company were prepared in accordance with accounting derived from Brazilian corporate law (Law 6.404/76) and supplementary provisions.

The principal accounting practices adopted by the Company are described below:

a) Statement of Income

Revenues and expenses are recognized on the accrual basis. Revenue from sale of products is recognized in the statement of income when all risks and rewards of ownership have been transferred to the buyer. No revenue is recognized if there is a significant uncertainty regarding its realization.

b) Cash and marketable securities

Marketable securities are stated at cost, plus earnings income accrued to the balance sheet dates, not exceeding market value.

c) Allowance for doubtful accounts

The allowance for doubtful accounts is recognized at an amount considered sufficient by Management to cover any possible losses on the collection of accounts receivable. Distributed companies' allowance for doubtful accounts is recorded as a reduction to the transfers to be made to the distributed companies.

d) Inventories

Inventories are stated at their average acquisition or production cost, less allowance for losses on obsolete or slow-moving items, not exceeding market value.

e) Investments

Investments in subsidiaries are valued under the equity method, based on the subsidiaries' balance sheet for the same dates. Other permanent investments are recorded at acquisition cost.

f) Property, plant and equipment

These are stated at acquisition, formation or construction cost and monetarily restated until December 31, 1995, plus voluntary revaluation. Depreciation is calculated on an accelerated basis, in accordance with the use of each equipment, as mentioned in Note 7, taking into consideration the useful life of the assets.

g) Rights and obligations

When applicable, they are restated based on exchange and index variations, plus interest, under the agreements in force, in order to reflect the amounts incurred until the balance sheet dates. Exchange gains and losses and monetary variations are recognized in the statement of income for the years.

h) Loans and financing

These are restated based on monetary variations and interest incurred until the balance sheet dates.

i) Income and social contribution taxes

The provisions for income and social contribution taxes are recognized based on rates and taxable income, adjusted in accordance with specific legislation. Deferred income and social contribution taxes are calculated based on temporary differences, considering an expectation of realization within two years.

j) Provisions

Provisions are recognized in the balance sheets whenever the Company has a legal or acquired obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the liability. The provisions are recognized based on the best estimates of the risk involved.

k) Distributed companies (Licensors)

Composed of repass liabilities due to the distributed companies. Under copyright license agreements, the Company duplicates, in VHS, DVDs or CDs, the movies or songs and bill them directly to the clients of their distributed companies, receiving the amount and passing on to licensors the result under the license agreement.

l) Use of estimates

The preparation of financial statements requires Management to make estimates based on assumptions affecting the amounts of assets, liabilities, income and expenses and disclosures in the financial statements. Actual results may differ from these estimates.

m) Earnings per share

Earnings per share are calculated based on the number of shares outstanding at the balance sheet dates.

3. CASH AND MARKETABLE SECURITIES

	2005	2004
Cash and banks	28,463	24,535
Marketable securities	153,306	73,455
	181,770	97,990

Marketable securities refer, substantially, to bank deposit certificates, remunerated at rates ranging from 100% to 100.5% of the Brazilian Interbank Deposit Certificate (CDI).

4. ACCOUNTS RECEIVABLE

	2005	2004
Own domestic receivables	84,032	107,450
Receivables - distributed companies	260,042	217,477
	344,074	324,927

5. INVENTORIES

	2005	2004
Raw materials	69,877	82,114
Work in process	24,262	20,895
Finished goods	43,337	49,515
Printing and packaging material	4,694	3,538
Other materials	4,758	2,857
Allowance for losses	(2,563)	(445)
	144,365	158,474

6. INVESTMENTS IN SUBSIDIARIES (UNAUDITED)

(a) Significant information on the subsidiaries as of December 31, 2005:

Subsidiaries	Number of total shares held	Ownership interest in %	Capital R\$	Shareholder's equity R\$	Subsidiaries loss R\$
Videolar – Garin Argentina	24,150	96.02	19,384	12,510	(5,178)
Transvat Transportadora Ltda.	990	99.00	1,000	671	

(b) Changes in investments:

	Videolar Garin Argentina	Transvat Transportadora Ltda	Other Investments	Total Investments
Balances as of December,31 2004	22,750	671	500	23,921
Equity pick-up in subsidiaries	(10,738)			(10,738)
Balances as of December,31 2005	12,012	671	500	13,183

7. PROPERTY, PLANT AND EQUIPMENT

	Depreciation rate	2005			2004
		Cost	Accumulated depreciation	Net	Net
Properties	4%	68,113	(11,885)	56,227	58,960
Machinery and equipment	10%	417,066	(275,082)	141,984	131,139
Industrial plants	10%	24,843	(10,783)	14,060	22,689
Furniture and fixtures	10%	40,997	(33,104)	7,894	9,585
Molds and tools	10%	24,074	(8,683)	15,390	9,068
Other assets	10% to 20%	31,302	(19,580)	11,721	15,473
Construction in progress		60,621		60,621	31,779
		667,016	(359,119)	307,898	278,693

As of December 31, 1997, the Company performed a revaluation of properties, machinery and equipment, industrial installations and furniture and fixtures, recording R\$131,148 as a credit to revaluation reserve in shareholders' equity. Deferred income tax liability, in the amount of R\$44,590, was recognized by reducing the balance of such reserve. As of December 31, 2005, the balance of the revalued assets, net of accumulated depreciation, amounts to R\$27,004.

8. LOANS AND FINANCING

Agreement	Rates	Collaterals	Limit	12.31.2005	12.31.2004
BNDES	TJLP + 1.2% p.a.	Properties	38,593	17,136	25,151
Export financing					
ACC-BRADESCO	5.01% a 5.53% p.a.	Promissory note	N/A	5,741	
	+				
	Exchange Variation			22,877	25,151

Loans from BNDES (National Bank for Social and Economic Development) were obtained for the expansion of the Company's operating activities. Of the total amount, R\$8,225 is classified in current liabilities (R\$8,157 in 2004), and R\$8,911 is classified in noncurrent liabilities (R\$16,994 in 2004).

Advances on exchange contracts from Banco Bradesco will be used in the exports of polystyrene within 180 days, and are classified in current liabilities.

9. PROVISION FOR CONTINGENCIES

The Company is subject to tax, legal, labor, civil and other contingencies. On a periodic basis, Management reviews the known contingencies, assesses the chances of loss and adjusts the respective provision based on the opinion of its legal counsel and other data available at the balance sheet dates, such as nature of the lawsuits and historic experience.

When applicable, judicial deposits are made to guarantee the lawsuits. These deposits, amounting to R\$6,534 as of December 31, 2005 (R\$6,837 in 2004), are classified in noncurrent assets.

Regarding lawsuits in progress, the contingencies accrued and recorded in noncurrent liabilities are as follows:

	2005	2004
Provision for civil contingencies	523	669
Provision for tax contingencies	6,287	7,423
Provision for labor contingencies	2,067	222
Provision for administrative contingencies	513	
	9,390	8,314

The provision for labor contingencies refers to losses estimated based on the individual analysis of 121 labor claims, mainly related to overtime.

The provision for civil contingencies refers to estimated losses on 140 lawsuits mainly related to commercial disputes.

The provision for tax contingencies refers substantially to the Company's complaint regarding the collection of PIS and COFINS (taxes on revenue) on revenues earned in the Manaus free-trade zone.

10. ICMS TAX INCENTIVES

VIDEOLAR is beneficiary of the following tax incentives granted by the State of Amazonas: ICMS (state VAT) deferral on acquisition of imported inputs; ICMS deferral on sale of intermediate goods to be used in the production process of the industrial plant that is also beneficiary of the same tax incentive; and reduction of the ICMS tax basis on acquisition of certain inputs used in the production process.

11. ROYALTIES PAYABLE

The Company recorded, until December 31, 2004, royalties payable on the use of patents based on contractually due amounts, which provide for the payment of a fixed amount based on the volume of DVDs and CDs sold. Based on the opinion of its legal counsel, according to which these conditions were abusive, the Company filed a lawsuit with the purpose of changing the calculation of these royalties. In 2005, the National Institute of Industrial Property (INPI) issued a certificate of registration establishing that the amount of royalties payable cannot exceed the maximum limit of 5% of the net sales price. Based on this certificate and on the assessment of the lawsuit by its legal counsel, the Company reverted the provision in the amount of approximately R\$22,700, and is paying the royalties under the criteria established by INPI. The provision as of December 31, 2005 includes the amount payable related to December 2005.

12. SHAREHOLDERS' EQUITY

a) Capital

i. As of December 31, 2005, capital is represented by 585,470 (679,424 in 2004) common shares, 169,343 class "A" preferred shares (180,000 in 2004) and 61,094 class "B" preferred shares (66,319 in 2004), totaling 815,907 shares (925,743 in 2004).

ii. Class "B" preferred shares have priority in the payment of minimum dividends of 25%, priority in the reimbursement of capital in case of Company's dissolution, so that no other type and class of shares may be granted higher advantages, participating in all qualified events, such as distribution of profits, including capitalization of available reserves and retained earnings for any reason.

iii. Preferred shares have no voting right at general meetings.

iv. At the Board of Directors meeting held on November 22, 2004, the shareholders ratified the agreement with CCE Investimentos S.A. aimed at exchanging the polystyrene manufactured by the Company for Videolar's shares held by CCE Investimentos S.A. In the year ended December 31, 2005, the Company redeemed R\$11,503 (R\$23,073 in 2004).

v. At the Extraordinary Shareholders Meeting held on December 27, 2005, the shareholders ratified the cancellation of all treasury shares totaling 109,836, with capital reduction in the total amount of the cancelled shares of R\$34,576, which reduced capital from R\$149,525 to R\$114,949.

b) Capital reserves

i. Income tax and ICMS tax incentive

The capital reserve is composed of ICMS (until 2003) and Income Tax (as of 2004) incentives due to the fact that Videolar is located in the Manaus industrial pole, and has projects approved by the Superintendency for the Development of the Amazon (Sudam). The income tax incentive provides a reduction in this tax expense. This tax incentive, calculated based on operating income, is applied to the revenues of the Units in Manaus.

c) Income reserves

i. Legal reserve

The legal reserve is recognized through appropriation of 5% of net income after reversal of interest on capital, pursuant to article 193 of Law No. 6.404/76.

d) Dividends

Under the Company's Bylaws, shareholders are entitled to a mandatory minimum dividend of 25% of net income adjusted under article 202 of the Brazilian Corporate Law.

The minimum mandatory dividend is calculated as follows:

Net income for the year	71,644
Legal reserve	(3,582)
Base income for calculation of the dividend	68,062
Proposed dividend, equivalent to 25% of the base income	17,015
(-) Interest on shareholders' equity	(10,559)
Dividends payable	6,456
Dividend per share – R\$	20.85

According to Management's proposal, mandatory minimum dividends should not be paid, which would enable the Company to continue its investment plans. This proposal is subject to approval by the Extraordinary Shareholders Meeting to be held in 2006.

According to the decision of the Annual Shareholders Meeting held on April 29, 2005, ratified by the Extraordinary Shareholders Meeting of July 18, 2005, the payment of additional dividends in the total amount of R\$42,561 related to prior years was approved.

e) Interest on shareholders' equity

At the Extraordinary Shareholders Meeting held on December 27, 2005, the shareholders approved the payment of interest on capital pursuant to the applicable legal provisions, in the total gross amount of R\$10,559, to be distributed in proportion to the interest held by each shareholder. This amount was paid on December 28, 2005.

13. FINANCIAL INCOME (EXPENSES), NET

	2005	2004
Financial income:		
Interest and gains on marketable securities	17,433	18,650
Exchange rate gains	17,642	10,505
Other	1,534	1,130
	<u>36,609</u>	<u>30,285</u>
Financial expenses:		
Interest on loans	2,354	3,375
Interest on shareholders' equity	10,559	
Discounts granted	3,166	5,133
Bank expenses	912	228
Exchange rate losses	17,097	7,668
CPMF (tax on banking transactions)	4,947	4,319
Other	429	298
	<u>39,464</u>	<u>21,021</u>
Financial income (expenses), net	<u>(2,855)</u>	<u>9,264</u>

14. INCOME AND SOCIAL CONTRIBUTION TAXES

Deferred income and social contribution taxes are recorded to reflect future tax effects attributable to temporary differences between the tax basis of assets and liabilities and their respective book value. Tax credits are recorded based on the expected generation of future taxable income.

The balance recorded in the Company's assets is composed as follows:

	2005	2004
Provision for losses on assets	871	3,737
Provision for contingencies	3,193	2,826
Other temporary differences	1,740	1,981
	<u>5,804</u>	<u>8,544</u>

Deferred income and social contribution tax liabilities were recorded upon recognition of the revaluation reserve on property, plant and equipment, and its realization is based on disposals and depreciation of the revalued assets.

The reconciliation of income and social contribution tax expenses is as follows:

Description	2005	2004
Income after employee profit sharing and before income and social contribution taxes	103,909	143,572
Combined tax rate	34%	34%
Income and social contribution taxes at combined tax rate	(35,329)	(48,814)
Permanent differences:		
Gifts, bonuses and donations		(207)
Equity pick-up on subsidiaries	(3,650)	(1,997)
Nondeductible fines	(128)	(59)
Inventory adjustments	(495)	(580)
Other	(3,222)	(708)
Income and social contribution taxes charged to statement of income	<u>(42,824)</u>	<u>(52,365)</u>
Effective rate	41%	36%
Current income and social contribution taxes	(40,084)	(60,910)
Deferred income and social contribution taxes	(2,740)	8,545
	<u>(42,824)</u>	<u>(52,365)</u>

15. INSURANCE COVERAGE (UNAUDITED)

The Company has insurance coverage for operating risks and other involving property, plant and equipment and inventories.

The insurance amount as of December 31, 2005 and 2004 is considered sufficient by its insurance advisors to cover possible losses.

16. FINANCIAL INSTRUMENTS

The Company performed an evaluation of its accounting assets and liabilities in relation to the market values or actual realization (fair value), based on available information and proper evaluation methodologies for each situation. The interpretation of market data for the selection of the methodology requires considerable judgment and estimate to reach an amount considered adequate for each situation. Accordingly, the estimates presented may not necessarily indicate the amounts that could be obtained in the current market. The use of different hypotheses for calculation of market or fair value may have a material effect on the amounts obtained. The

assets and liabilities presented in this Note were selected due to their materiality. Those instruments whose amounts approximate to fair value and whose risk assessment is not relevant are not mentioned herein.

According to their nature, financial instruments may involve known or unknown risks, being important, in the best judgment, the potential of these risks. Accordingly, there may be risks with or without guarantees depending on circumstantial or legal aspects. The main market risk factors that may affect the Company's business are as follows:

a) Credit risk

The Company's client portfolio is dispersed, and the principal clients do not represent more than 20% of total sales revenue. The Company constantly monitors the level of its accounts receivable through internal controls, which limits the risk of delinquency.

b) Exchange rate risks

The Company's trade accounts payable and liabilities denominated in foreign currency are not significant. The risk related to these liabilities results from exchange rate fluctuations that could increase these liabilities. The Company does not have derivatives to reduce this risk.

c) Contingent risks

Contingent risks are evaluated according to their likelihood of loss as probable, possible or remote. The contingencies considered as probable risk are recorded in liabilities. The details of these risks are presented in Note 9.

d) Marketable securities risks

Marketable securities are mostly carried out at periods lower than three months and the rates substantially reflect usual market conditions as of December 31, 2005 and 2004.

e) Loan risks

Loan transactions are presented in Note 8, and the rates substantially reflect usual market conditions as of December 31, 2005 and 2004.

17. BALANCES AND TRANSACTIONS WITH RELATED PARTIES

Subsidiary	Amounts receivable		Purchases, sales or interest expenses and exchange variation	
	2005	2004	2005	2004
Videolar Argentina	7,854	8,451	2,190	10,474

Related-party transactions are carried out under the conditions agreed to between the parties.

At the Board of Directors Meeting held on September 30, 2005, the Company approved a capital increase to Videolar Rio Grande Argentina in the amount of R\$7,003, with accounts receivable from this subsidiary. Since this corporate act has not yet been approved by the Argentine legislation, the Company maintained this amount in accounts receivable, including the balance of R\$7,854 shown above.

18. EMPLOYEE BENEFITS

The Company does not operate or sponsor any type of pension plan or other post-employment benefit.

According to a labor union agreement, the Company must pay profit sharing to its employees, in case certain performance goals established in the annual planning are met. Considering that these goals will be met, Management recognized a provision for payment of this benefit in the amount of R\$2,488 in 2005 (R\$3,665 in 2004).

Francisco Aurélio Martins

CRC 1SP165.357/O-0 S-AM

Accountant

Diretoria Executiva e Conselho de Administração

Board of Directors and the Administrative Council

Diretoria Executiva

Board of Directors

Lirio Albino Parisotto

Diretor Presidente
President and Chairman of the Board

Carmo Bernardi Caparelli

Diretor de Operações
Operations Director

Tsuguo Takayama

Diretor Administrativo / Financeiro
Administrative / Financial Director

Luiz Roberto Fahl Boaventura

Diretor de Comércio Eletrônico / Recursos Humanos
E-Commerce / H. Resources Director

Valmir Franco

Diretor Industrial
Industrial Director

Elie Waitzberg

Diretor Técnico / de Suprimentos
Technical / Procurement Director

Conselho de Administração

Administrative Council

Lirio Albino Parisotto

Presidente do Conselho
Council Chairman

Philip Wojdyslawski

Tânia Maris Vanin Parisotto