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BRAZIL OPERATING GROUP
QUARTERLY PROGRESS REPORT
MARCH 1989

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2/5/89 JB

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BRAZIL OPERATING GROUP
QUARTERLY PROGRESS REPORT
MARCH 1989

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2/5/89

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BRAZIL OPERATING GROUP
QUARTERLY PROGRESS REPORT- MARCH/89 US$MN

YEAR TO DATE				ESTIMATE FOR YEAR		
3.80	11.62657	754.01	EXCHANGE RATE	3.80	11.62657	754.01
TIMATE CTUAL	+/- BUDGET	+/- LAST YEAR		ESTIMATE	+/- BUDGET	+/- LAST YEAR
			GROSS TURNOVER			
179.4	121.5	101.1	Tobacco	1.267.5	157.9	283.1
7.7	4.2	4.2	Paper	58.0	3.4	6.4
3.4	1.3	1.7	Fruit Juice	34.3	-6.1	3.6
0.4	0.1	0.3	Other	3.1	-0.2	1.1
- 2.9	-1.2	-1.4	Intra Group Sales	-22.0	1.1	-1.2
188.0	125.9	105.9	TOTAL	1.340.9	156.1	293.0
			NET TURNOVER			
45.2	27.7	24.6	Tobacco	368.0	-12.4	37.5
6.2	3.4	3.4	Paper	47.0	3.4	6.0
3.0	1.2	1.5	Fruit Juice	30.2	-5.3	2.6
0.4	0.1	0.3	Other	2.9	-0.3	1.0
-2.2	-0.7	-1.0	Intra Group Sales	-17.4	2.1	-1.5
52.6	31.7	28.8	TOTAL	430.7	-12.5	45.6
			TRADING PROFIT			
7.0	8.5	4.0	Tobacco	31.3	-17.5	3.3
2.3	1.3	1.3	Paper	16.2	1.4	-1.3
0.5	-0.1	0.4	Fruit Juice	5.4	-7.1	-0.6
-1.2	-0.6	-0.2	Other	-6.3	-3.6	-0.3
-0.2	0.1	0.1	Intra Group Sales	-4.0	0.2	0.6
8.4	- 9.2	5.6	TOTAL	42.6	-26.6	1.7
			SHARE OF ASSOC.PROFITS			
-	-	-	- Aracruz	16.3	6.3	-6.4
-	-	-	. Polo	1.0	0.7	0.8
34.2	22.0	19.9	INVESTMENT INCOME	213.8	18.7	20.3
0.2	0.2	-0.1	INTEREST PAID	1.4	0.8	-0.8
42.4	31.0	25.6	PROFIT BEFORE TAX	272.3	-1.7	17.2
13.3	11.1	9.1	Taxation: Own Group	77.6	4.6	39.2
			Associates	4.6	-0.6	2.5
29.1	19.9	16.5	PROFIT AFTER TAX	190.1	-5.7	-24.5
7.4	4.7	4.1	MINORITIES	49.2	-2.2	- 5.9
21.7	15.2	12.4	ATTRIBUTABLE PROFITS	140.9	-3.5	-18.6

ADING PROFIT/NET TURNOVER - %

	Estimate	Budget
Tobacco	8	12
Paper	34	33
Fruit Juice	17	35
Other	-	-
TOTAL	9	15

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BRAZIL OPERATING GROUP

QUARTERLY PROGRESS REPORT

MARCH 1989

INTRODUCTORY NOTE

The Summer Plan, since its launching in mid-January, was understood as a stabilization program with a limited horizon and essentially in line with an attempt to stop the hyperinflationary process, together with the political target of setting a more adequate cenario for the presidential elections in November. The usual freeze of prices and exchange were put together with high interest rates and the slow down of wages, in addition to the initial removal of the complex indexation system which has been present for more than 2 decades in the Brazilian economy.

The initial intention of the Federal Government to promote fiscal austerity, including cutting down public expenditures and the dismissal of non-effective public servants, was not in fact materialized, in part due to Congress actions blocking the major austerity measures proposed by the President. In addition, the high interest rates paid by the Government in the first three months of the Plan have considerably aggravated the public deficit for 1989, which is now being estimated at not less than 7% of GDP against the previous 2% target. The overall concern with the public debt is growing to a considerable extent, as it is being now understood that the financial burden of this process will have to be paid or financed by the future Government.

The second half of April was chosen as the starting point of the formal adjustments to the Summer Plan, including the first exchange devaluation, the gradual and limited unfreeze of prices, the definition of a new wage policy and the reintroduction of the indexation. Under these circunstances the annual inflation of 462% (monthly indexes below 10% up to June and growing from 11% to 20% in the second half of 1989) considered for Souza Cruz financial planning can be considered realistic. The economic indicators issued in mid-March for the preparation of QPR I are as follows:

	1988	1989	
	ACTUAL	BUDGET	QPR I
GDP (% Annual Growth)	-0.3	3.0	zero
Inflation (% Dec/Dec)	934	1501	462
Exchange			
Revaluation (% Dec/Dec)	955	1501	402
Rate NCZ$/US$ (31st Dec)	0.75655	11.62657	3.80
Monetary Correction (%Dec/Dec)	816	1501	377*

* excluding December inflation = 298

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Of course, economic risks like a higher growth of inflation and a new economic shock are still present, but the major risk currently identified of not achieving the planned results would be related to the assumption of the monetary correction, as far as the economic indexes are concerned. Our working assumption was that this rate would follow the level of inflation within the same month (the most likely hypothesis by the time the basic assumptions were defined). However, as of today, due to the Government's cash problems, the alternative of defining the rate of monetary correction at the level of the previous month's inflation is the one likely to be adopted. We have therefore introduced a contingency reserve on top of our income tax liability amounting to US$ 5.0 MN, thus reducing the Brazil Operating Group PAT by the same extent.

OVERALL RESULTS

THREE MONTHS 1989 TO MARCH

The profit after tax for the first quarter is being estimated at US$29.1 MN against a budgeted figure of US$9.2 MN. The major reason for such a variance is related to the year-end exchange rate in QPR I substantially below budget (3.80 versus 11.627), which can be identified by comparing the corresponding NCZ$ figures (millions):

Budget	-	107.0	(9.2 x 11.627)
QPR I	-	110.6	(29.1 x 3.80)

This can be better understood by considering that inflation in the first quarter reached 87%, not far from the 100% level budgeted for the period.

In addition, tobacco trading profit was favourably affected by the 55% price increase in January (against 26% budgeted), as well as lower variable costs and operating expenses. Income Tax, on the other hand, is unfavourable due to the improved and taxable results mainly in CCSC and CSCIC (higher investment income).

FULL YEAR 1989

The overall trading profit for the Group, estimated at US$42.6 MN in QPR I, is US$26.6 MN below the revised budget mainly due to the Social Contribution - amounting to US$14.8 MN - now charged to Trading Profit (instead of taxation), given that this liability was defined as not related to income tax. The effects on the business segments in QPR I are:

	US$ MN
TOBACCO	11.3
PAPER	0.8
FRUIT JUICE	0.1
OTHER	2.6
	14.8

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The other major reasons by segments are as follows:

In Tobacco, the remaining unfavourable variance of US$6.2 MN is mainly explained by the assumption of 1% reduction in the manufacturers' margin as from May (partially) and fully in July, which is being considered due to the high price increases that would be necessary to compensate the impact of the higher ICM (17% to 25%) on Federal tax revenues.

In Paper, the remaining positive variance of US$2.2 MN is mainly related to the elimination in the QPR I of OTN indexation on IPI payments, now not likely to occur.

In Fruit Juice, the remaining negative variance amounts to US$7.0 MN, of which US$5.3 MN comes from Maguary. The assumed 22% reduction in Maguary's (budgeted) sales volume, reflecting the recessive conditions in the straight juice market after the Summer Plan, is the major reason for such a difference. The unfavourable variance of US$1.7 MN in Suvalan follows from lower sales in the domestic market.

In Share of Associates, the positive variance of US$7.0 MN essentially reflects the better operating results from Aracruz, mainly from higher export prices, on the average US$15/ton above budget. Another favourable factor is the higher investment income generated in Brazil after the Summer Plan.

The Investment Income, now estimated at US$213.8 MN, is US$18.7 MN ahead of budget, due to a set of favourable conditions such as:

- The high interest rates prevailing after the Summer Plan, were kept for a longer than expected period of time (previous guesses were not considering such high real rates in March and April).

- The delay in payments related to leaf purchases, amplified by farmer's protests and late deliveries, produced a very favourable cash flow.

Taxation shows a negative variance of US$4.0 MN, which in fact should be regarded as a negative variance of US$18.8 MN considering that the Social Contribution was treated as taxation in the budget exercise. Such an increase in taxation, which includes a US$5.0 MN contingency reserve for the likely change in the monetary correction procedure, is highly concentrated at CSCIC - some US$ 8.3 MN - and is obviously related to the higher than budgeted investment income (in CCSC and S.C.Trading as well).

The resulting Profit after Tax is now US$190.1 MN, which is US$5.7MN below the revised budget.

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TOBACCO

CCSC

The factors which mostly affect cigarettes demand in Brazil - inflation, price increases and consumers purchasing power - behaved quite unusually in this first quarter of 1989.

Inflation has been frontally attacked in its symptoms by the "Summer Plan", which at least broke for some time hyper inflation expectations. A quite substantial price increase of 55% was obtained a few days before Summer Plan was announced and since then no other price increases were granted, but a solid basis was built with January's increase, which levered cash to a totally unpredictable level and allowed the Company to easily caravan through the first quarter.

Consumers confidence inevitably rose with prospects of lower inflation and also with subsequent injections of purchasing power via salary readjustments, lower personal taxation and abnormal gains in the financial market (for the higher income bracket individuals).

The results were then sales slightly below Co. Plan forecast, but at considerably higher prices - as the impacts of the 55% price increase were peacefully absorbed in the middle of the turmoil of the Summer Plan introduction. Market share reached 78% in March.

Competitors activities remained agressive, with RJR once again breaking the rules of another attempt of industry agreement, with Philip Morris static at their 8% s.o.m. National competitors were the winners in the quarter, reaching a market share above 4% due to the disappearance of a previously strong marketing device: sales at old prices after price increases, RJR's preferred lever.

Souza Cruz remained alert to all possibilities of gaining share, protecting a declining Hollywood on one side but also strenghtening Belmont on the opposite extreme of the market, in addition to taking adequate care of the mid market brands such as the growing Free and the useful Plaza, which helps to parachute Hollywood down traders. A promising Lucky Strike and the innovation launches of Capri and Barclay continue to be carefully monitored, with the first of them cautiously oriented towards the permanent objective of combating Marlboro.

Volume expectations for QPR I have been kept in line with Co. Plan, around 122 billion pieces for Souza Cruz' 79% of the total market, which is good in view of the low January sales which followed December very strong market performance.

Cigarette exports are now forecasted to increase to 2.1 billion as a consequence of the Cyprus deal, on top of a strong performance in CCSC traditional South American Aruba-based markets (mainly Colombia).

Souza Cruz

Leaf export estimates have been reviewed one million kg up to 56,000 t due to favourable market conditions, with price estimates slightly reduced to US$ 3.15/kg (average), which is likely to compound in a turnover level similar to that of Co. Plan.

Financial results estimates for the year have now been totally altered due to the great number of assumptions changed, although the total variation is US$ 0.4 MN unfavourable:

Variances	US$ MN
Net Turnover	78.2 F
Contribution	14.6 F
F & Semi Variables	25.9 U
	11.3 U
Net Investment Income	9.7 F
Taxation	1.5 U
	3.1 U
Other Effects (net)	2.7 F
TOTAL VARIATION	0.4 U

(U) unfavourable

Price increases have been estimated to take place as from May in line with the change in taxation (increasing ICMS, reducing IPI) and following the trend of previous month inflation, as below:

		Real Gain	Previous Inflation
January	55.71 (actual)		
May	7.10	7.10%	-
June	24.91	7.10%	9% + 7%
July	14.12	4.70%	9%
August	11.00	20.0%	.
September	14.00		.
October	15.00		.
November	16.50		.
December	17.50		.
TOTAL YEAR	373.54%		

As a conservative assumption (recommendable in those uncertain times in this country), it was assumed a loss of 1% of the manufacturers' margin in the above mentioned process of tax changes.

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TABASA

QPR I results are expected to be close to budget, in spite of the 5% expected reduction in leaf purchases, partly due to increased competition from other exporters. Exports in 1989 are now estimated to be 7% ahead of budget, implying in a 40% reduction in domestic sales (Souza Cruz).

Currently the major problem faced by Tabasa is related to the farmers' frustration with respect to the price agreement with buyers, which so far has been the reason for some unexpected shifts of their deliveries to competitors and may eventually induce to a lower registration for the next crop. The setting of leaf price conditions for 1990 will have to be analysed with a great deal of care.

Trading results in QPR I are ahead of budget, reflecting both the favourable impact of the higher proportion of exports at contribution level and the fact that operating expenses are being kept below budget, allowing an adequate compensation for the reduction in the overall sales volume.

PAPER

PIRAHY

The Brazilian paper industry in the first quarter faced a considerable recession, which has affected Pirahy's sales to the domestic market and allowed a significant increase in exports. The same picture is being considered in QPR I, with the total volume for 1989 kept at the budget level, but with a reduction of 6.8 thousand tons in the domestic market being fully offset by a corresponding increase in exports.

QPR I forecasts continue to indicate a satisfactory performance - improved by the elimination of the OTN indexation on IPI payments assumed on budget - and Pirahy's contribution to Group results is now expected to be higher than budgeted.

FRUIT JUICE

MAGUARY

The QPR I forecasts indicate considerable changes over budget figures, in view of the negative effects of the Summer Plan on Maguary's performance. The overall sales for 1989 are now estimated to be substantially below budget, with a 27% drop in exports (mainly related to a shortage of pineapple and to deteriorated international prices for passion fruit juice) and a 22% reduction in the volume of domestic sales.

Souza Cruz

The major reason for the lower domestic sales is a 23% reduction in the straight juices market, where Maguary has registered a minor share increase from 46% to 47%. Coconut sales are being considered at 53% of the budget target, due to a shortage of the fruit and the resulting escalation of coconut costs, which lead to a temporary suspension of sales that would become unprofitable at these cost levels.

Operating results are being considerably affected by the unfavourable variance of volume, without any real reduction in operating expenses (which are in line with budget on a current dollar basis). Net profit, on the other hand, was positively affected by the postponement to December of the US$8.0 MN capitalization which had been budgeted for April.

SUVALAN

The strategic plan for Suvalan reflects its leadership in the domestic segment of fruit concentrates and its capability to achieve premium prices in the world export market.

Suvalan's overall volume in QPRI is slightly lower than budget, reflecting mainly the grape crop being smaller than expected. Internal prices are frozen, but export grape prices are still better than budget.

The lower turnover in QPRI reflects the recession which followed the Government's economic plan, and the downwards trend on the international prices of orange concentrate. Fixed expenses are in line with budget and trading profit is close to target. Cash flow is far more favourable than expected and, mainly due to that, the profit after tax is considerably better than budgeted.

SHARE OF ASSOCIATES

ARACRUZ

Following the international trend prevailing since 1986, export prices of pulp continue to grow. For the second quarter, North American prices are reaching the level of US$780/ton. and prices in Europe are now close to US$760/ton. Demand is expected to remain strong and, in keeping with this cenario, the QPR I assumption for export prices considered an increase of US$20/ton. in Europe and of US$15/ton. in North America.

In the domestic market, due to the price freeze determined by the Summer Plan, prices are now substantially below export levels (the QPR I assumes a difference of NCZ$165/ton from FOB export prices to Europe). As a result of such a gap, Aracruz is planning to reduce deliveries to the domestic clients from the 25% budget share to 23%, as considered in QPR I. Due to the weakness of the domestic market, such a reduction is not likely to create any serious problems to the non-integrated paper makers in Brazil.

QPR I projections indicate better than budgeted results, reflecting an improved operating performance related to higher export prices and investment income ahead of budget, due both to the high interest rates in the first quarter and to the favourable cash flow in the period (expenses with the expansion project below forecasts is the major explaining factor).

The expansion project is progressing satisfactorily and the start up of the new factory is still expected for March 91. The total cost of the project should not exceed US$1.1 billion and the high level of cash generation by Aracruz may reduce or even eliminate the requirement of shareholders' funds.

POLO

The first quarter of the year was marked by unfavourable market conditions and considerable difficulties to sustain Polo's policy of keeping the real level of its selling prices. In spite of that, and of considerable increase in raw material costs earlier in the quarter, results are in line with budget.

For the remaining of the year, some degree of recovery in the domestic market is being expected by Polo's management and their forecasts indicate an overall volume for the year slightly over budget, with a minor reduction in domestic sales being fully offset by an increase in exports.

During 1989, Polo will face two major problems: to bring the efficiency level of its 4th line (started in 1988) to a satisfactory standard and to cope adequately with Votorantin's commercial actions after the start up of their 2nd line, planned to take place during May. Polo's strategy will be directed to keep their current 59% market share, which was translated in QPR I by a 5% real loss in selling prices in May.

In spite of the impact of such problems in operating results, the QPR I forecasts indicate a profit after tax ahead of budget, due to an improved cash flow related to better working capital management, further helped by a lower level of inflation.

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DIVIDENDS

The second 1989 dividend remittance (due in August) is now estimated to reach US$ 17.5 MN and the first remittance of 1989 (due in March) is being forecasted at US$29.8 MN. Therefore, the current estimate of net dividends out of 1989 profits amounts to US$47.3 MN against a revised budget forecast of US$31.2 MN.

Dividend estimates were based on a 45% distribution of CSCIC profits, plus monetary correction to the month of payment. The high dividends foreseen for the 1989 fiscal year are derived from the high investment income generated after the Summer Plan, on top of the 55% price increase granted in January and the cash gains from the delay in leaf payments by CCSC.

CONCLUSION

By the time the QPR I was being concluded, the Federal Government announced its decision to limit price increases to the level of inflation and of granting such increases with a 3 month minimum interval. Therefore the major risks facing the current plan are definitely related to the assumption of cigarette price increases and structure. This poses the serious threat of not having the 20% of real gains (assumed for the period of May to July) and also of getting a delayed recovery of the inflation indexes. Secondly, with respect to the assumption that the reduction of the IPI will follow the same timing of the increase in ICM (17% to 25% progressively with 3%/3%/2% from May to July).

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