

(Convenience Translation into English from the Original Previously Issued in Portuguese)

LIVRARIA E PAPELARIA SARAIVA S.A.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003
(Amounts in thousands of Brazilian reais - R\$, unless otherwise indicated)

1. OPERATIONS

Livraria e Papelaria Saraiva S.A. (the "Company") is primarily engaged in the sale of books, stationery, audio and video products, periodicals and multimedia products. Sales and distribution are through the Internet and 30 stores, of which 14 are megastores and 16 are conventional stores.

2. PRESENTATION OF FINANCIAL STATEMENTS

The financial statements have been prepared in accordance with Brazilian accounting practices, procedures adopted by the Parent Company, Saraiva S.A. Livreiros Editores, and standards established by the Brazilian Securities Commission (CVM).

3. SIGNIFICANT ACCOUNTING PRACTICES

a) Current and long-term assets

- Cash equivalents

Stated at cost plus income earned through the balance sheet dates.

- Allowance for doubtful accounts

Recorded in an amount considered sufficient to cover potential losses on the realization of trade accounts receivable. Uncollectible receivables are charged directly to income.

- Inventories

Stated at average acquisition or production cost, which does not exceed realizable value.

- Other current and long-term assets

Stated at net realizable value.

b) Permanent assets

- Investments

Stated at cost, less a valuation allowance.

- Property and equipment

Recorded at acquisition or construction cost, plus monetary restatement through December 31, 1995. Depreciation is computed under the straight-line method based on the useful lives of the assets.

- Deferred charges

Stated at cost and refers to preoperating expenses associated with commercial assignment and expenses incurred prior to the start-up of new stores. Preoperating expenses are amortized over five years or over the terms of the lease contracts, beginning upon the start-up of the stores.

c) Current and long-term liabilities

Stated at known or estimated amounts plus charges, monetary and/or exchange variations incurred through the balance sheet dates, if applicable.

d) Income and social contribution taxes

Taxes on net income (loss) include current and deferred amounts.

Income tax is calculated at the rate of 15% on taxable income plus a 10% surtax, and social contribution tax is calculated at the rate of 9% on taxable income.

Deferred income and social contribution taxes are recorded in current and long-term assets, as stated in Note 9, to reflect future tax effects on temporary differences between the reported amounts of assets and liabilities and their tax bases, and tax loss carryforwards.

Deferred tax assets are based on expected future taxable income at the tax rates in effect at yearend, and are reviewed annually and adjusted to reflect any substantial change in expected profits.

e) Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

4. TRADE ACCOUNTS RECEIVABLE

	<u>2004</u>	<u>2003</u>
Credit cards	20,736	17,705
Checks receivable	1,335	1,528
Other	190	154
Allowance for doubtful accounts	<u>(490)</u>	<u>(457)</u>
	<u>21,771</u>	<u>18,930</u>

5. PROPERTY AND EQUIPMENT

	Annual	2004		2003	
	depreciation	Cost	Accumulated	Net book	Net book
	rate - %		depreciation	value	value
Buildings	4	1,897	(737)	1,160	1,236
Furniture and fixtures and installations	10	45,322	(33,363)	11,959	14,551
Vehicles	20	157	(94)	63	93
Software and IT equipment	20	15,264	(11,197)	4,067	5,294
Land	-	3	-	3	3
Advances to suppliers	-	101	-	101	435
Other	-	624	-	624	635
		<u>63,368</u>	<u>(45,391)</u>	<u>17,977</u>	<u>22,247</u>

6. DEFERRED CHARGES

	2004	2003
Commercial assignment and preoperating expenses	22,713	22,713
Accumulated amortization	<u>(19,555)</u>	<u>(18,271)</u>
	<u>3,158</u>	<u>4,442</u>

7. LOANS AND FINANCING

	2004	2003
Current-		
Financing in local currency-		
BNDES - FINEM	3,112	3,364
Long term-		
Financing in local currency-		
BNDES - FINEM	3,273	5,819

BNDES - National Bank for Economic and Social Development

FINEM - Enterprises Financing

Maturities of long-term debt are as follows:

	2006	2007	2008	Total
Financing	<u>2.230</u>	<u>810</u>	<u>233</u>	<u>3.273</u>

Financing from the BNDES - FINEM was used for investment in megastores and modernization of conventional stores, and is 100% guaranteed by the Parent Company. The principal of the financing is subject to interest of 3% to 3.5%, plus TJLP (long-term interest rate).

The Company obtained a new financing from BNDES - FINEM, in the amount of R\$382.

8. RELATED PARTIES

Transactions with related parties include purchase and sale operations and loan agreements, and were made under usual market conditions. Loans granted to the Parent Company, Saraiva S.A. Livreiros Editores, will be received in 2005, as stated in the loan agreement.

	<u>2004</u>	<u>2003</u>
Balance:		
Current assets:		
Accounts receivable	-	3
Loans	11,736	-
Current liabilities-		
Accounts payable	16	3,762
Transactions:		
Sales of products	22	39
Purchases of products	8,212	9,874

9. DEFERRED INCOME AND SOCIAL CONTRIBUTION TAXES

Deferred income and social contribution taxes arise from:

	<u>2004</u>	<u>2003</u>
Current assets-		
Other temporary differences	<u>1,199</u>	<u>481</u>
Long-term assets:		
Reserve for contingencies	4,876	4,638
Tax loss carryforwards	<u>3,182</u>	<u>2,794</u>
	<u>8,058</u>	<u>7,432</u>

Reconciliation of the tax expense calculated by applying the combined tax rate and the tax expense charged to income is as follows:

	<u>2004</u>	<u>2003</u>
Loss before taxes on income	(4,202)	(2,314)
Combined tax rate	<u>34%</u>	<u>34%</u>
Taxes computed at the combined tax rate	1,429	787
Permanent additions- Nondeductible expenses	(84)	(41)
Other items	<u>(1)</u>	<u>18</u>
	<u>1,344</u>	<u>764</u>
Income and social contribution taxes:		
Current	-	(102)
Deferred	<u>1,344</u>	<u>866</u>
	<u>1,344</u>	<u>764</u>
Effective tax rate	<u>32%</u>	<u>33%</u>

In conformity with the procedures adopted by the Parent Company regarding CVM requirements and based on the expectation of future taxable income and positive cash flows discounted to present value, pursuant to CVM Instruction No. 371/02, the Company maintained in its financial statements the deferred tax asset.

Considering the final resolution of the lawsuits, the estimate of realization of the deferred tax asset is 95% until 2007 and the remaining 5% in 2008, as follows:

	<u>Realization of deferred tax asset</u>	<u>Deferred tax asset</u>
Balance of deferred tax asset as of December 31, 2004	-	9,257
December 31, 2005	2,305	6,952
December 31, 2006	4,131	2,821
December 31, 2007	2,366	455
December 31, 2008	455	-

10. RESERVE FOR CONTINGENCIES

The Company is challenging in court the constitutionality of federal taxes, such as PIS and COFINS (taxes on revenue), IR (income tax) and CSLL (social contribution tax). Escrow deposits were made for the PIS/COFINS lawsuit, which are recorded in a specific account in long-term assets.

The contingent liability is composed of:

	<u>2004</u>	<u>2003</u>
PIS/COFINS - expansion of tax basis and rate increase	8,885	8,780
IR/CSLL - "Plano Real" (economic plan) - Law No. 8,880/94	<u>9,376</u>	<u>8,783</u>
	<u>18,261</u>	<u>17,563</u>

11. SHAREHOLDERS' EQUITY

Fully paid-up capital as of December 31, 2004 is R\$51,210, represented by 57,539,843 common shares with par value of R\$0.89.

All shares are entitled to a minimum dividend equivalent to 25% of adjusted net income for each year.

12. FINANCIAL INSTRUMENTS

The carrying amounts and fair values of the financial instruments recorded in the balance sheet as of December 31, 2004 are as follows:

	<u>Carrying amount</u>	<u>Fair value</u>
Cash and cash equivalents	1,846	1,846
Loans in local currency	6,385	6,385

Criteria, assumptions and limitations used in calculating fair values:

a) Cash and cash equivalents

Represented by bank deposits.

b) Loans and financing

The carrying amounts of loans and financing correspond to financing from BNDES. The fair values of such financing do not differ significantly from the carrying amounts as of December 31, 2004.

c) Limitations

The fair values were estimated at a specific time, based on relevant market information. Changes in assumptions can significantly affect those estimates.

d) Derivatives

The Company has not conducted derivative transactions in 2004.

13. INSURANCE

As of December 31, 2004, the Company had insurance coverage against fire and sundry risks for fixed assets and inventories, in amounts considered sufficient to cover potential losses.
