

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

LIVRARIA E PAPELARIA SARAIVA S.A.

BALANCE SHEETS AS OF DECEMBER 31, 2006 AND 2005

(In thousands of Brazilian reais - R\$)

| <u>ASSETS</u> | <u>Note</u> | <u>2006</u> | <u>2005</u> | <u>LIABILITIES AND SHAREHOLDERS' EQUITY</u> | <u>Note</u> | <u>2006</u> | <u>2005</u> |
|---|-------------|----------------|----------------|--|-------------|----------------|----------------|
| CURRENT ASSETS | | | | CURRENT LIABILITIES | | | |
| Cash and cash equivalents | 4 | 11,910 | 11,553 | Trade accounts payable | | 60,403 | 50,203 |
| Trade accounts receivable | 5 | 56,247 | 31,872 | Financing | 8 | 1,360 | 2,324 |
| Inventories | | 52,088 | 40,378 | Accrued vacation and related charges | | 2,850 | 2,539 |
| Recoverable taxes | | 404 | 113 | Taxes payable | 13 | 3,628 | 3,499 |
| Deferred income and social contribution taxes | 11 | 3,644 | 4,853 | Provision for income and social contribution taxes | | 145 | 3,135 |
| Loans to parent company | 9 | - | 11,446 | Dividends | 14 | 1,574 | - |
| Other receivables | | 415 | 127 | Other payables | | 6,598 | 4,534 |
| Prepaid expenses | | 90 | 84 | Total current liabilities | | <u>76,558</u> | <u>66,234</u> |
| Total current assets | | <u>124,798</u> | <u>100,426</u> | | | | |
| | | | | NONCURRENT LIABILITIES | | | |
| NONCURRENT ASSETS | | | | Financing | 8 | 4,182 | 1,081 |
| Deferred income and social contribution taxes | 11 | 5,008 | 6,032 | Loans from parent company | 9 | 5,008 | - |
| Escrow deposits | | 805 | 524 | Reserve for contingencies | 12 | 1,617 | 1,549 |
| | | 5,813 | 6,556 | Taxes payable | 13 | 5,014 | 6,413 |
| Investments | | 147 | 135 | Total noncurrent liabilities | | <u>15,821</u> | <u>9,043</u> |
| Property and equipment | 6 | 17,686 | 17,843 | SHAREHOLDERS' EQUITY | | | |
| Intangible assets | 6 | 1,682 | 2,081 | Capital | 14 | 51,210 | 51,210 |
| Deferred charges | 7 | 705 | 926 | Capital reserves | | 2,190 | 2,190 |
| Total noncurrent assets | | 26,033 | 27,541 | Profit reserves | | 5,052 | - |
| | | | | Accumulated deficit | | - | (710) |
| | | | | Total shareholders' equity | | <u>58,452</u> | <u>52,690</u> |
| TOTAL ASSETS | | <u>150,831</u> | <u>127,967</u> | TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | | <u>150,831</u> | <u>127,967</u> |

The accompanying notes are an integral part of these financial statements.

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

LIVRARIA E PAPELARIA SARAIVA S.A.

STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(In thousands of Brazilian reais - R\$, except earnings per share)

| | <u>Note</u> | <u>2006</u> | <u>2005</u> |
|--|-------------|------------------|-----------------|
| GROSS REVENUE FROM SALES | | 352,202 | 281,306 |
| DEDUCTIONS FROM GROSS REVENUE | | | |
| Sales taxes (ICMS, PIS, Cofins and ISS) | | (36,086) | (28,191) |
| NET OPERATING REVENUE | | <u>316,116</u> | <u>253,115</u> |
| COST OF SALES AND SERVICES | | (200,772) | (154,277) |
| GROSS PROFIT | | <u>115,344</u> | <u>98,838</u> |
| OPERATING EXPENSES | | | |
| Selling expenses | | (78,522) | (68,444) |
| General and administrative expenses | | (14,745) | (12,584) |
| Management fees | | (1,864) | (1,353) |
| Depreciation and amortization | | (4,950) | (4,865) |
| Other operating expenses, net | | <u>(1,227)</u> | <u>(474)</u> |
| | | <u>(101,308)</u> | <u>(87,720)</u> |
| INCOME FROM OPERATIONS BEFORE FINANCIAL INCOME (EXPENSES) | | <u>14,036</u> | <u>11,118</u> |
| FINANCIAL INCOME (EXPENSES) | | | |
| Financial income | | 923 | 2,174 |
| Financial expenses | | <u>(3,213)</u> | <u>(3,053)</u> |
| | | <u>(2,290)</u> | <u>(879)</u> |
| INCOME FROM OPERATIONS | | <u>11,746</u> | <u>10,239</u> |
| NONOPERATING EXPENSES, NET | | (703) | (194) |
| INCOME BEFORE INCOME AND SOCIAL CONTRIBUTION TAXES | | <u>11,043</u> | <u>10,045</u> |
| INCOME AND SOCIAL CONTRIBUTION TAXES | | | |
| Current | 11 | (1,412) | (4,927) |
| Deferred | 11 | (2,233) | 1,628 |
| INCOME BEFORE MANAGEMENT PROFIT SHARING | | <u>7,398</u> | <u>6,746</u> |
| MANAGEMENT PROFIT SHARING | | (736) | (674) |
| NET INCOME | | <u>6,662</u> | <u>6,072</u> |
| EARNINGS PER SHARE - R\$ | | <u>0.12</u> | <u>0.11</u> |
| NUMBER OF SHARES OUTSTANDING AT THE BALANCE SHEET DATE (IN THOUSANDS) | | <u>57,540</u> | <u>57,540</u> |

The accompanying notes are an integral part of these financial statements.

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LIVRARIA E PAPELARIA SARAIVA S.A.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

(In thousands of Brazilian reais - R\$, except dividend per share)

| | Note | Capital | Capital reserves | Profit reserves | Retained earnings (accumulated deficit) | Total |
|--|------|---------------|------------------|-----------------|---|---------------|
| BALANCES AS OF DECEMBER 31, 2004 | | 51,210 | 2,190 | - | (6,782) | 46,618 |
| Net income | | - | - | - | 6,072 | 6,072 |
| BALANCES AS OF DECEMBER 31, 2005 | | <u>51,210</u> | <u>2,190</u> | <u>-</u> | <u>(710)</u> | <u>52,690</u> |
| Prior year adjustments - reversal of management profit sharing provision | 14 | - | - | - | 674 | 674 |
| Net income | | - | - | - | 6,662 | 6,662 |
| Legal reserve | 14 | - | - | 331 | (331) | - |
| Transfer to profit reserves | | - | - | 4,721 | (4,721) | - |
| Mandatory minimum dividend - R\$0.027355 per share | 14 | - | - | - | (1,574) | (1,574) |
| BALANCES AS OF DECEMBER 31, 2006 | | <u>51,210</u> | <u>2,190</u> | <u>5,052</u> | <u>-</u> | <u>58,452</u> |

The accompanying notes are an integral part of these financial statements.

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

LIVRARIA E PAPELARIA SARAIVA S.A.

STATEMENTS OF CHANGES IN FINANCIAL POSITION
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(In thousands of Brazilian reais - R\$)

| | <u>Note</u> | <u>2006</u> | <u>2005</u> |
|--|-------------|---------------|---------------|
| SOURCES OF FUNDS | | | |
| From operations: | | | |
| Net income | | 6,662 | 6,072 |
| Items not affecting working capital: | | | |
| Depreciation and amortization | | 5,172 | 5,161 |
| Net book value of property and equipment written off | | 731 | 438 |
| Deferred income and social contribution taxes - noncurrent | 11 | 1,024 | 2,026 |
| Financial charges and exchange and monetary variation on noncurrent assets and liabilities | | 1,249 | 818 |
| Provision for investment losses | | 48 | - |
| | | <u>14,886</u> | <u>14,515</u> |
| From third parties: | | | |
| Financing | 8 | 4,427 | - |
| Loans from parent company | 9 | 4,341 | - |
| Increase in noncurrent liabilities | | - | 107 |
| Prior year adjustments - reversal of provision for management profit sharing | 15 | 674 | - |
| Total sources | | <u>24,328</u> | <u>14,622</u> |
| USES OF FUNDS | | | |
| Purchase of property and equipment and intangible assets | | 5,126 | 5,314 |
| Transfer from noncurrent to current liabilities | | 3,224 | 4,559 |
| Increase in noncurrent assets | | 140 | 598 |
| Decrease in noncurrent liabilities | | 216 | - |
| Dividends | 14 | 1,574 | - |
| Total uses | | <u>10,280</u> | <u>10,471</u> |
| INCREASE IN WORKING CAPITAL | | <u>14,048</u> | <u>4,151</u> |
| REPRESENTED BY | | | |
| Current assets | | 24,372 | 30,301 |
| Current liabilities | | 10,324 | 26,150 |
| INCREASE IN WORKING CAPITAL | | <u>14,048</u> | <u>4,151</u> |

The accompanying notes are an integral part of these financial statements.

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LIVRARIA E PAPELARIA SARAIVA S.A.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(Amounts in thousands of Brazilian reais - R\$, unless otherwise stated)

1. OPERATIONS

Livraria e Papelaria Saraiva S.A. (the “Company”) is primarily engaged in retail sale of books, DVDs, music, stationery, and computer and electric-electronic products. Distribution is conducted through an Internet-based sales platform and a chain of 30 stores, of which 15 are megastores and 15 are conventional stores.

2. PRESENTATION OF FINANCIAL STATEMENTS

The financial statements have been prepared and are presented in conformity with Brazilian accounting practices and provisions of the Brazilian Corporate Law. These financial statements reflect the changes introduced by Accounting Standard and Procedure (NPC) No. 27, “Presentation and Disclosures”, and NPC No. 22, “Provisions, Liabilities, Contingent Liabilities and Contingent Assets”, both issued by the Brazilian Institute of Independent Auditors (IBRACON) on October 3, 2005. The financial statements for the year ended December 31, 2005 were adjusted to the aforementioned accounting standards to allow comparability with the current year. The main changes resulting from applying these standards are as follows:

- Presentation of the group “Noncurrent” in assets and liabilities.
- Presentation of the account “Intangible assets”, classified in the group “Noncurrent assets”.
- Reclassification of escrow deposits, previously classified in assets, to liabilities as a reduction of the account “Reserve for contingencies”, when applicable.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of deferred tax assets and liabilities, provisions and contingent liabilities, considering the best available evidence and assumptions at the balance sheet dates. Actual results could differ from those estimates.

3. SIGNIFICANT ACCOUNTING PRACTICES

a) Current and noncurrent assets

- Temporary cash investments

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 cost, less provision for write-down to market value, when market value is lower.

- Other noncurrent assets

Stated at net realizable value.

- Investments

Stated at cost, less a valuation allowance.

- Property and equipment and intangible assets

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

- Deferred charges

Stated at cost, less amortization, and include preoperating costs and expenses incurred before the start-up of the stores opened through 2001. Beginning 2002, expenses incurred before the start-up of new stores are recorded directly in income.

Deferred charges are amortized over five years or according to the provisions of the properties' lease contract, beginning upon the start-up of the stores.

b) Current and noncurrent liabilities

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

c) Income and social contribution taxes

Taxes on income 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 noncurrent assets and current and noncurrent liabilities, as stated in Note 11, to reflect future tax effects on temporary differences between the carrying amount and the tax basis of assets and liabilities, and tax loss carryforwards.

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

d) Earnings per share

Calculated based on the number of shares outstanding at the balance sheet dates.

4. CASH AND CASH EQUIVALENTS

| | <u>2006</u> | <u>2005</u> |
|-------------------------------------|---------------|---------------|
| Cash and banks | 8,902 | 1,491 |
| Bank certificates of deposit (CDBs) | <u>3,008</u> | <u>10,062</u> |
| | <u>11,910</u> | <u>11,553</u> |

5. TRADE ACCOUNTS RECEIVABLE

| | <u>2006</u> | <u>2005</u> |
|---------------------------------|---------------|---------------|
| Credit cards | 55,219 | 31,101 |
| Checks receivable | 807 | 932 |
| Other | 595 | 230 |
| Allowance for doubtful accounts | <u>(374)</u> | <u>(391)</u> |
| | <u>56,247</u> | <u>31,872</u> |

6. PROPERTY AND EQUIPMENT AND INTANGIBLE ASSETS

| | Annual depreciation/ amortization rate - % | 2006 Cost | 2006 Accumulated depreciation/ amortization | 2006 Net | 2005 Net |
|--|---|---------------|--|---------------|---------------|
| Property and equipment: | | | | | |
| Land | - | 3 | - | 3 | 3 |
| Buildings and constructions | 4 | 1,441 | (629) | 812 | 869 |
| Furniture, fixtures and installations | 10 | 49,398 | (37,900) | 11,498 | 12,765 |
| Vehicles | 20 | 544 | (151) | 393 | 38 |
| IT equipment | 20 | 10,632 | (7,624) | 3,008 | 3,391 |
| Advances to suppliers | - | 1,972 | - | 1,972 | 230 |
| Other | - | - | - | - | 547 |
| | | <u>63,990</u> | <u>(46,304)</u> | <u>17,686</u> | <u>17,843</u> |
| Intangible assets: | | | | | |
| Goodwill | 20 | 12,414 | (11,337) | 1,077 | 1,502 |
| Software | 20 | 1,467 | (929) | 538 | 512 |
| Trademarks and patents | - | 67 | - | 67 | 67 |
| | | <u>13,948</u> | <u>(12,266)</u> | <u>1,682</u> | <u>2,081</u> |

7. DEFERRED CHARGES

| | <u>2006</u> | <u>2005</u> |
|--------------------------|----------------|----------------|
| Preoperating costs | 10,299 | 10,299 |
| Accumulated amortization | <u>(9,594)</u> | <u>(9,373)</u> |
| | <u>705</u> | <u>926</u> |

8. FINANCING

| | <u>2006</u> | <u>2005</u> |
|--|-------------|-------------|
| In local currency - BNDES (a) - FINEM (b): | | |
| Current | 1,360 | 2,324 |
| Noncurrent | 4,182 | 1,081 |

(a) BNDES - National Bank for Economic and Social Development

(b) FINEM - Financing for Projects

The noncurrent portion matures as follows:

| | <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>Total</u> |
|-------|--------------|--------------|-------------|--------------|
| BNDES | <u>1,722</u> | <u>1,476</u> | <u>984</u> | <u>4,182</u> |

On November 14, 2006, a credit facility agreement was entered into with the BNDES for investment to open 11 stores, renovation and modernization of 19 stores and centralization of logistics operations in the municipality of São Paulo. The credit facility in the amount of R\$22,087 is divided into three subloans, and the first release was made on December 22, 2006, in the amount of R\$4,427. The financing is fully collateralized by the parent company, and the principal is subject to annual interest of 3.1% plus the long-term interest rate (TJLP).

Other financing from the BNDES - FINEM was allocated for investments in megastores and modernization of conventional stores and is fully collateralized by the parent company. The principal is subject to annual interest between 3% and 3.5% plus the TJLP.

9. RELATED-PARTY TRANSACTIONS

Related-party transactions include purchases, sales and intercompany loans. Loans granted to the parent company in 2005 were fully received in June 2006, and financial income related to interest in the amount of R\$127, equivalent to 100% of the interbank deposit rate (CDI) variation, was recorded. Loans obtained from the parent company in 2006 have indeterminate maturity and generate financial expenses related to interest equivalent to 101% of the CDI variation.

Loans payable to the parent company - recorded in noncurrent liabilities:

| | <u>2006</u> |
|--------------------------|--------------|
| Loans contracted in 2006 | 4,341 |
| Financial expenses | <u>667</u> |
| Balance payable | <u>5,008</u> |

The main balances and transactions with related parties are as follows:

| | <u>2006</u> | <u>2005</u> |
|---|-------------|-------------|
| Balances: | | |
| Assets: | | |
| Trade accounts receivable (current) | 6 | - |
| Loans to the parent company - loan agreement (current) | - | 11,446 |
| Liabilities: | | |
| Trade accounts payable (current) | 3,916 | 1,041 |
| Loans from the parent company - loan agreement (noncurrent) | 5,008 | - |
| Transactions: | | |
| Sale of products | 55 | 25 |
| Purchase of products | 12,627 | 9,174 |
| Financial income | 127 | 629 |
| Financial expenses | 667 | - |

10. LOYALTY PROGRAM - SARAIVA PLUS

The Company has a customer loyalty program ("Saraiva Plus") whereby purchases made by customers in stores and the Company's website earn points that can be discounted in future purchases. Accumulated points, net of redemptions, are accrued considering redemption estimates. As of December 31, 2006, the Company has a provision for the loyalty program in the amount of R\$2,683 (R\$1,108 as of December 31, 2005) recorded under the caption "Other payables".

11. INCOME AND SOCIAL CONTRIBUTION TAXES

a) Deferred

Deferred income and social contribution taxes are derived from:

| | <u>2006</u> | <u>2005</u> |
|---|--------------|--------------|
| Current assets- | | |
| Temporary differences (provision for trade accounts payable and loyalty program) | <u>3,644</u> | <u>4,853</u> |
| Noncurrent assets: | | |
| Reserve for contingencies (including lawsuits involving income and social contribution taxes) | 4,621 | 5,009 |
| Tax loss carryforwards | <u>387</u> | <u>1,023</u> |
| | <u>5,008</u> | <u>6,032</u> |

Based on the expectation of future taxable income and positive cash flows discounted to present value, the Company maintained in its financial statements the deferred tax asset.

In the event of a definitive decision on the lawsuits, the Company's deferred tax asset is expected to be realized as follows:

| <u>Balance sheet date</u> | <u>Realization of deferred tax asset</u> |
|---------------------------|--|
| December 31, 2007 | 5,404 |
| December 31, 2008 | <u>3,248</u> |
| | <u>8,652</u> |

b) Expense reconciliation

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

| | <u>2006</u> | <u>2005</u> |
|--|----------------|----------------|
| Income before taxes on income | 11,043 | 10,045 |
| Combined tax rate | <u>34%</u> | <u>34%</u> |
| Taxes computed at the combined tax rate | (3,756) | (3,415) |
| Permanent additions - nondeductible expenses | (41) | (57) |
| Permanent deductions | 66 | 61 |
| Other items | <u>86</u> | <u>112</u> |
| | <u>(3,645)</u> | <u>(3,299)</u> |
| Income and social contribution taxes: | | |
| Current | (1,412) | (4,927) |
| Deferred | <u>(2,233)</u> | <u>1,628</u> |
| | <u>(3,645)</u> | <u>(3,299)</u> |
| Effective tax rate on adjusted net income | <u>33.0%</u> | <u>32.8%</u> |

12. RESERVE FOR CONTINGENCIES

The Company is challenging in court certain aspects related to Federal taxes, such as taxes on revenue (PIS and Cofins), income tax (IR) and social contribution tax (CSLL), as follows:

| | <u>2006</u> | <u>2005</u> |
|---|----------------|----------------|
| PIS/Cofins - increase in tax basis and rate increase | 8,775 | 8,992 |
| IR/CSLL - "Plano Real" (economic plan) - Law No. 8,880/94 | 1,617 | 1,533 |
| Escrow deposits | <u>(8,775)</u> | <u>(8,976)</u> |
| | <u>1,617</u> | <u>1,549</u> |

13. TAXES PAYABLE

| | <u>2006</u> | <u>2005</u> |
|------------------------|--------------|--------------|
| IR and CSLL (*) | 6,837 | 8,123 |
| ICMS (State VAT) | 1,648 | 1,271 |
| PIS/Cofins | 67 | 463 |
| Other | <u>90</u> | <u>46</u> |
| | <u>8,642</u> | <u>9,912</u> |
| Current liabilities | 3,628 | 3,499 |
| Noncurrent liabilities | <u>5,014</u> | <u>6,413</u> |
| | <u>8,642</u> | <u>9,912</u> |

(*) Request filed with the National Treasury Attorney General in October 2005 for the installment payment of the accrued amounts related to lawsuits brought to discuss the effects of IR and CSLL arising from “Plano Real” - Law No. 8,880/94.

14. SHAREHOLDERS' EQUITY

a) Capital

Fully paid-up capital as of December 31, 2006 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.

b) Dividends

Mandatory dividends were calculated as follows:

| | |
|--|-----------------|
| Net income for the year | 6,662 |
| Absorption of the accumulated deficit balance | (710) |
| Prior year adjustment | <u>674</u> |
| Net income after absorption of accumulated deficit | 6,626 |
| Legal reserve | <u>(331)</u> |
| Adjusted net income | <u>6,295</u> |
| Mandatory minimum dividend - 25% | <u>1,574</u> |
| Earnings per share - R\$ | <u>0.027355</u> |

c) Prior year adjustment

As per a resolution of the Annual Shareholders' Meeting held on April 27, 2006, the Company's management profit sharing for the year ended December 31, 2005, in the amount of R\$674, was not approved and was adjusted against the account “Retained earnings” in 2006.

15. FINANCIAL INSTRUMENTS

The carrying amounts and fair values of the financial instruments recorded in the balance sheet as of December 31, 2006 are as follows:

| <u>Description</u> | <u>Carrying amount</u> | <u>Fair value</u> |
|-----------------------------|------------------------|-------------------|
| Cash and cash equivalents | 11,910 | 11,910 |
| Financing in local currency | 5,542 | 5,542 |

Criteria, assumptions and limitations used in calculating fair values are as follows:

a) Cash and cash equivalents

Cash and cash equivalents are represented by unrestricted bank deposits and highly-liquid investments.

b) Financing

The carrying amounts of financing correspond to funds obtained from the BNDES. The fair values of this financing do not differ significantly from the carrying amounts as of December 31, 2006.

c) Limitations

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

d) Derivatives

The Company did not conduct derivative transactions in 2006.

e) Market risks

Inventory obsolescence risk discontinued products and new technologies may lead to excess and obsolete inventories. To minimize these conditions, the Company periodically monitors inventory levels and takes necessary action for realization.

16. INSURANCE

As of December 31, 2006, the Company has insurance coverage against fire and sundry risks for fixed assets and inventories, in amounts considered sufficient to cover potential losses.