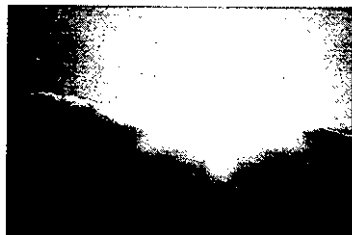
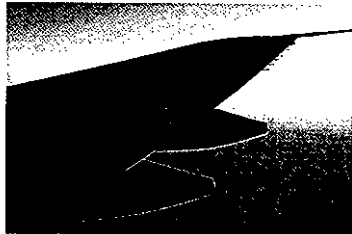
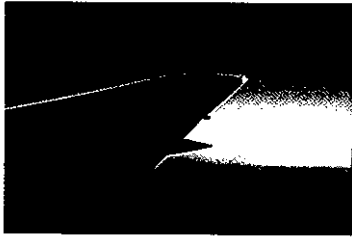


"VARIG", S.A. (Viação Aérea Rio-Grandense)  
A BRAZILIAN Publicly HELD Company Founded May 7, 1927  
CGC No. 92.772.821/0001-64



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\$18.00  
003534



# *I*NDEX

<i>1</i> VARIG IN 1994 .....	6
<i>2</i> MARKET AND BUSINESS ENVIRONMENT .....	8
<i>3</i> TRAFFIC AND FLEET .....	12
<i>4</i> ORGANIZATION AND HUMAN RESOURCES .....	14
<i>5</i> ECONOMIC-FINANCIAL ASPECTS .....	16
<i>6</i> OUTLOOK .....	18
<i>A</i> CKNOWLEDGEMENTS .....	20
<i>O</i> FFICERS AND BOARD OF DIRECTORS .....	22
<i>B</i> RANCHES AND OFFICES - BRAZIL .....	24
<i>B</i> RANCHES AND OFFICES - OVERSEAS .....	26



# *1* VARIG IN 1994



Sunrise in Brasília

1.1 This past year was noteworthy for several important milestones in the history of both VARIG and Brazil. Our Company underwent major operational, administrative and financial restructuring. The crowning achievement of this process was the return to operational profitability after a series of deficit-ridden years. In terms of directly measurable progress, the restructuring plan — which management has constantly disclosed and clarified to stockholders and the market alike — had the following effects:

- attainment of balanced cash flow, through renegotiation of aircraft leasing contracts, lengthening of the debt profile and simultaneous reduction of interest charges on the latter;
- headcount reduction of 3,586 over the course of the year;
- cutback in the number of departments and hierarchical levels;
- closing of 39 off-line offices (3 more are being deactivated);
- elimination of excess fleet capacity, through the return of three B-747-400 and one B-737-300 aircraft and the withdrawal of five B-747-Combis from regular service;
- cancellation and alteration of routes, in order to match supply and demand while, at the same time, making more economical use of flight equipment.

This far-reaching project further envisages these following forthcoming developments:

- redesign of commercial and operating processes;
- outsourcing of catering operations;
- continuation of efforts to make productivity levels match or even surpass industry benchmarks, a goal already achieved in certain areas;
- enhancement and updating of IT and telecommunications facilities to state-of-the art industry levels.

With respect to Brazil, VARIG was fortunate to count on major beneficial external factors. 1994 will be remembered as the year in which our nation finally managed to implement a successful economic stabilization plan. This one was quite different from past attempts, first of all in that it was transparent: it was widely debated with representatives of all elements of Brazilian society before it was transformed into law; secondly, it was solidly grounded: there were no shock therapy treatments, no short-lived manipulations. By drastically reducing the erosion of the purchasing power of salaried employees, the government's Real Plan accelerated the economic recovery process to such an extent that monetary authorities had to keep a close watch on consumer demand, which was threatening to get out of hand in certain sectors.

1.2 At the corporate level, several chapters of VARIG's corporate statutes were altered in order to meet the requirements of the modern business world and provide greater flexibility in capital markets. Along the same line, the stockholders decided at their November 8, 1994 meeting to open up the Board of Directors to participation by experienced business leaders from outside the Company, which has been benefiting from their valuable contributions since then.

1.3 It should also be mentioned that VARIG's controlling stockholder, the Ruben Berta Foundation (which celebrates its 50th anniversary on December 7, 1995), is modernizing its administrative structure. Changes in its bylaws were approved on February 18, 1995, the main one being creation of a Board of Trustees comprised of 7 members to be elected by the entity's highest body, the Deliberative Council. The latter is made up of around 300 members, all of them Company employees.



## 2 MARKET AND BUSINESS ENVIRONMENT



Sunrise in Porto Alegre

2.1 Worldwide demand by market segment was as follows (expressed as percentages of passenger kilometers and of metric tons per kilometer of cargo flown, respectively):

<u>ROUTES</u>	<u>DEMAND BY SEGMENT (%)</u>	
	<u>PASSENGER</u>	<u>CARGO</u>
Domestic.....	26.5	24.8
International.....	73.5	75.2
TOTAL.....	100.0	100.0

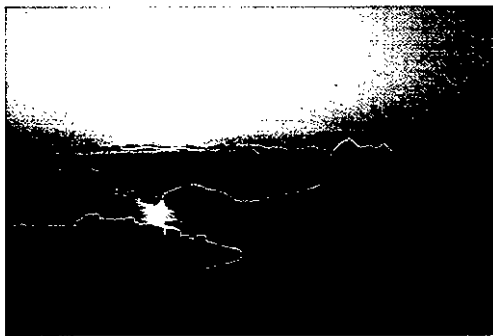
INTERNATIONAL MARKETS  
(By Region)

North America (U.S.A./Canada).....	16.4	36.1
Europe.....	28.3	25.1
Asia.....	16.0	7.1
Latin America.....	12.5	6.8
Africa.....	0.3	0.1
TOTAL.....	73.5	75.2

2.2 Despite continued keen competition in the world aviation industry, VARIG managed once again to enjoy healthy shares in the various markets where it competes, as shown below:

<u>MARKETS</u>	<u>NUMBER OF COMPETITORS</u>	<u>VARIG's % SHARE (Passenger market)</u>
North America (U.S.A./Canada).....	12	33
Europe.....	14	45
Asia.....	3	45
Latin America.....	20	50
Africa.....	2	67
Domestic.....	2	53





Sunrise in Rio de Janeiro

2.3 Our domestic and international route network regularly serves 42 cities in Brazil and another 31 cities in 23 countries around the globe, distributed throughout the three Americas, Europe, Asia and Africa. As of December 31, 1993, our non-duplicated routes totaled 433,652 km, compared with 469,805 km the previous year. The major changes in our operating network during 1994 are as follows:

- Inauguration of daily service on the Rio-São Paulo-Atlanta route.
- Restructuring and streamlining of our flight grid to boost productivity. As a result, operations in 13 locations-2 in Brazil and 11 overseas-were discontinued.

2.4 A wide-ranging cooperation agreement was signed and implemented between VARIG and Delta Airlines, which permitted VARIG to strengthen its competitive position in the North American market. Our flights between Brazil and United States are now operated together with Delta on a code-sharing basis. The two companies' flight grids interconnect in Atlanta, which allows immediate flights linking Brazil with 200 cities in the United States in both directions.

2.5 Due to their convenience and benefits, the following cooperation agreements signed with other airlines continue in effect:

- Ecuatoriana and LACSA: joint flights linking Brazil, Ecuador and Costa Rica. These connections, which had been operated by VARIG since inauguration, were taken over by LACSA's aircraft from November 1994 on;
- Japan Air Lines (JAL): code-sharing operation linking Brazil with Tokyo and Nagoya;
- Scandinavian Airlines System (SAS): code-sharing operation linking Scandinavia with Brazil;
- Lufthansa: code-sharing operation linking Brazil with Germany.

2.6 The VARIG Mileage Program SMILES was implemented and has been accruing benefits for frequent users of our services since January of 1994. By year end, it had more than 100,000 associated users.

2.7 As part of the Company's administrative restructuring process, our network of branches and offices was adjusted to the realities of present-day commercial aviation. At present, VARIG operates 309 branches and sales outlets, 123 in Brazil and 186 abroad.



## 3 TRAFFIC AND FLEET

3.1 The following statistics show traffic volumes in 1993 and 1994. As part of the Company's operational reorganization plan, available seat kilometers were reduced with a view to returning lines to profitability. The impact of this is directly reflected in the notable increases in passenger load factors. Revenue cargo kilometers likewise were considerably up over previous years; this area will receive the additional attention it deserves in the overall context of the Company's business.

<u>TRAFFIC STATISTICS</u>	<u>1994</u>	<u>1993</u>	<u>CHANGE (%)</u>
<b>HOURS FLOWN</b>			
International.....	127,422	124,516	2.3
Domestic.....	126,983	129,531	-2.0
Total.....	254,405	254,047	0.1
<b>KILOMETERS FLOWN (Millions)</b>			
Internacional.....	104	101	3.0
Doméstico.....	86	88	-2.3
Total.....	190	189	0.5
<b>PASSENGER CARRIED</b>			
International.....	3,306,022	3,095,823	6.8
Domestic.....	5,936,812	6,064,409	-2.1
Total.....	9,242,834	9,160,232	0.9
<b>AVAILABLE SEAT KILOMETERS (Millions)</b>			
International.....	25,115	25,609	-1.9
Domestic.....	9,603	10,323	-7.0
Total.....	34,718	35,932	-3.4
<b>REVENUE PASSENGER KILOMETERS (Millions)</b>			
International.....	16,863	16,003	5.4
Domestic.....	6,075	6,128	-0.9
Total.....	22,938	22,131	3.6
<b>PASSENGER LOAD FACTOR (%)</b>			
International.....	67	62	5 p.p.
Domestic.....	63	59	4 p.p.
Total.....	66	62	4 p.p.
<b>REVENUE CARGO KM (Millions of metric tons)</b>			
International.....	905	805	12.4
Domestic.....	298	291	2.4
Total.....	1,203	1,096	9.8

3.2 The following table details the VARIG fleet as of December 31, 1993, with breakdown of average hours-per-day utilization during the year for each type of aircraft:

AIRCRAFT TYPE	AIRCRAFT IN USE ON DECEMBER 31, 1994	AVERAGE DAILY UTILIZATION RATE
B-747-300 (PASSENGER).....	3	12.60
B-747-300 (COMBI).....	2	6.96*
B-747-200B (COMBI).....	3	5.49*
MD-11.....	6	12.07
DC-10-30 (PASSENGER).....	7	6.26*
DC-10-30 (CARGO).....	2	8.99
B-767-300ER.....	4	12.29
B-767-200ER.....	6	10.45
B-727-100 (CARGO).....	5	5.31
B-737-300.....	25	7.94
B-737-200.....	17	7.53
Passengers aircraft.....	73	8.76
Cargo aircraft.....	7	6.36
Total Fleet.....	80	8.55

\* Low average utilization was due to removal of these types of flight equipment from service, as part of the overall fleet restructuring plan.

Average fleet age was 10.9 years in December, 1994.

Further in regard to utilization, it is important to note that the above amounts represent annual utilization rates with high growth trends, indicating that streamlining measures are paying off.

3.3 VARIG's fleet underwent the following changes in 1994:

- phasing in of two MD-11 aircraft in January;
- deactivation and re-exportation of three B-747-400 units;
- return of one B-747-200B and one DC-10-30 aircraft, which had been rented to Aerolineas Argentinas and LAPSA, respectively;
- lease of a DC-10-30 aircraft to PLUNA on a wet lease basis, not included in the VARIG fleet listed in the table in item 3.2 above; and
- return of a B-737-300 aircraft at the end of an operating lease contract in October 1994.

## 4 ORGANIZATION AND HUMAN RESOURCES

---



Sunrise in São Paulo

4.1 One of the main targets achieved in 1994 was the reduction of departments and hierarchical levels after careful analysis of our operating and administrative processes. Besides reducing costs, as already reflected in results, this has led to significant improvements in the processes themselves. In short, we have become a leaner and more adaptive organization

4.2 The increasingly stiffer competition in all areas of commercial aviation has reinforced the importance of constantly enhancing the excellent quality of Company services as perceived by our customers.

In this regard, VARIG has gone into much greater depth in surveying the satisfaction levels of its customers — passengers, cargo shippers, travel and cargo agents, in order to identify the extent to which their expectations are being met. Based on this data, we can leverage the enhancement steps in effect in the various sectors of our organization.

4.3 Human resources training and development investments totaled US\$ 14.7 million in 1994. Courses were given to 24,425 participants from all Company areas.

These funds went mainly to technical training, with special emphasis on front-line employees.

At the managerial level, Training and Development efforts focused on developing team players in tune with the latest management techniques. This culminated in a broad program, currently being executed in conjunction with renowned institutions and involving US\$ 1 million in investments for 1995.

4.4 In the area of on-the-job safety and health, investments were made to ensure periodic medical exams for employees and to purchase individual protective equipment. Also, preventive and corrective measures were taken to deal with any environmental conditions which could be detected by routine technical inspections and might be detrimental to employee health.

4.5 The continuation of the downsizing process included retirement incentive programs, including early retirements. Some services not directly linked to our core business were outsourced. All told, our work force was reduced by 3,586 in 1994.

	1994	1993
	Employees %	Employees %
Ground personnel	14,539 (68.8%)	16,994 (68.8%)
Crew members	4,948 (23.5%)	5,669 (23.0%)
Personnel abroad	1,618 (7.7%)	2,028 (8.2%)
Total staff	<u>21,105 (100.0%)</u>	<u>24,691 (100.0%)</u>

4.6 The headcount reduction offset increased wage costs derived from the government's Real Plan and, therefore, prevented personnel expenses from increasing over the previous year.

4.7 Through the Ruben Berta Foundation, our employees enjoy benefits such as subsidized meals, medical/dental care and opportunities to participate in cultural, sporting and recreational activities.



## 5 ECONOMIC-FINANCIAL ASPECTS

5.1 Analysis of the 1994 financial statements indicates that, compared to the previous year:

- flight operating profit rose 122% over 1993, although this still represents only a fraction of the Company's potential;
- also increasing substantially was book stockholders' equity — up 167%;
- our current ratio nearly doubled, from 0.44 (December 1993) to 0.80 (December 1994).

5.2 We first should stress that our improved profitability derives from a combination of substantial cost reductions and marked revenue increases, the latter the result of improved load factors and yields. Even so, we also have to consider that such trends were not evenly distributed over the year; indeed, they only had a considerable impact in the fourth quarter. This aspect is important in projecting performance for the coming years, when we will reap the combined benefits of internal restructuring and increased demand.

5.3 Due to their materiality, three key financial statement figures deserve highlighting:

- net financial expenses of R\$ 221 million;
- R\$ 440 million in translation gains; and
- non-operating loss of R\$ 145 million.

The first figure indicates that for most of 1994 we continued to feel the weight of interest charges. The full benefits of the debt rescheduling will be felt as from 1995.

The net foreign currency gains, caused by devaluation of the US Dollar against the Real in the second half of 1994, represent a partial reversal of losses of the same nature that were the norm for many years running and were largely responsible for the losses reported in our financial statements.

The non-operating loss was largely due to the sale-leaseback operation involving six Boeing 767-200 aircraft and should be understood as part of the cost of our overall restructuring project. Further details on fleet reduction are to be found in Section 4 of the Report of Management.

5.4 It is reasonable to predict that the Real will be gradually devalued vis à vis the US Dollar during 1995/1996. This may result in reabsorption of the foreign currency translation gains, or at least part of them. In our specific case, however, we cannot overlook the existence of a partial offsetting mechanism. This is because 65% of our flight revenues are in Dollars. That is to say, if a loss arises from any devaluation of the Real in relation to the Dollar, there will be a symmetrical gain in revenues from tickets sold in the latter currency.

5.5 As regards book stockholders' equity, we should stress that the credit mentioned in Note 19 to the financial statements has not been recorded in the balance sheet. This credit alone is equivalent to 330% of net assets as of December 31, 1994. Although the situation in the courts leaves no room for doubt as to the realization of this credit, a conservative accounting approach indicates that it should not be recognized in the financial statements until such time as realization is imminent.

5.6 A major factor contributing to the improved current ratio was the lengthening of our debt profile (note the rise in long-term liabilities), in conjunction with the contraction of our Dollar commitments upon translation to Reais. The practical effect of improved liquidity is already discernible in the Cash and Cash Equivalents account, which rose 90% in 1994.

The numbers below demonstrate the better distribution of liabilities in relation to **working capital**: (in millions of Reais)

	<u>12/31/94</u>	<u>12/31/93</u>
Short-term	261.9	533.5
Long-term	508.8	228.4
Total	<u>770.7</u>	<u>761.9</u>

In this case, although the total amount of the debt remained virtually unaltered, there was marked improvement insofar as the respective profile is concerned. Short-term debt was reduced and long-term amortization stretched out.

As explained in the notes to the financial statements, the average amortization lifespan of **aircraft financing debt**, totaling US\$ 1,285 million, was lengthened so that the new profile is perfectly commensurate with the Company's cash-flow.

5.7 Shares of VARIG ON (registered common) and PN (registered preferred) stock are traded on all Brazilian stock exchanges. On the São Paulo stock exchange (Bovespa), our main market, a total of 110 million shares of VARIG stock were traded in 1994, 2,040,000 common and 107,960,000 preferred. In the wake of the change in currency, implementation of the Real Plan and low inflation as from July, 1994, our preferred shares rose 350% in the second half, one of the best-performing stocks in Brazil for the period.

5.8 The Extraordinary Stockholders Meeting held August 24, 1994, approved a reverse split of shares of capital stock in the proportion of 10 to 1, due to the change in the nation's currency. The Company's Capital Stock thus totaled R\$ 39,923,910.00 as of December 31, 1994, comprised of 61,856,129 shares without par value, of which 35,448,793 are common and 26,407,336 are preferred.

Book value of each share was R\$ 4.41 as of December 31, 1994, while market value was R\$ 2.80.

5.9 As explained in Note 14.4 - Dividends, in spite of the net income for the year, distributable income, as computed in accordance with the Brazilian Corporation Law, is negative. This is principally due to offsetting of previous years' losses. Accordingly, the Company will not pay dividends out of 1994 net income.



## 6 OUTLOOK



Sunrise in Nordeste

6.1 There are reliable indications that 1994 marked the turnaround for the world's commercial aviation sector. The heavy losses incurred in the four previous years are now past history. The early 1990s were the period in which the accumulated losses posted by IATA affiliated carriers on international routes exceeded US\$ 15 billion. According to preliminary IATA data, in 1994 there was a 10% increase in passengers and cargo carried, at the same time as available seat kilometers rose a mere 5%. It is therefore estimated that airlines the world over had a positive year on balance for the first time since 1989; the preliminary aggregate figure is a profit of US\$ 1 billion. However much macroeconomic aspects may have contributed to this turnaround, there were other key factors besides. These included the stiff adjustment programs which all the leading carriers, with few exceptions, underwent in relation to fleet, personnel, airfares and, above all, customer service quality. This last is proving to be the leading competitive advantage at present.

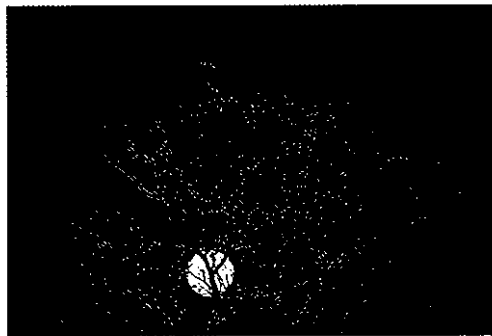
6.2 At the Company level, continuity of the restructuring plan outlined in Section I of this Report is our main concern at the moment. Our aims are to consolidate the advances already made, carry out the planned subsequent steps and regain economic-financial stability. The latter was the priority announced in the closing of our previous Annual Report. Along this line, the first vital step was taken in December. This consisted of a public issue of R\$ 130 million in share-convertible debentures, R\$ 96 million of which is being funded by BNDESpar, the subsidiary of the Brazilian Development Bank. The immediate objective of this issue was to consolidate all of our debts to Brazilian banks at a considerably reduced cost. The medium-term objective, however, is a capital increase through conversion of these securities, with a view to diminishing the sizeable gap existing today between VARIG's net worth (R\$ 273 million) and the weight of an undertaking that — measured in total assets or sales potential — amounts to around R\$ 2.8 billion.

6.3 Looking at the Brazilian scenario, we have additional reasons to be optimistic, since the new government's plans of action will lead to sustainable growth and better income distribution. This is a very favorable framework for our industry, as it will induce an enduring and long-awaited enlargement of our customer base.



## *A*CKNOWLEDGEMENTS

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Sunrise in Pantanal

Everybody knows that 1994 was a year of profound changes and solid achievements for VARIG, the fruition of a great deal of effort, hard work and sacrifice.

It behooves us, therefore, to mention all of those who played a decisive role in attaining these results.

We wish to especially thank General Electric, McDonnell-Douglas and all our international creditors, whose cooperation was fundamental for restructuring our fleet and demonstrating confidence in our future. Also deserving special mention are the Brazilian Development Bank (BNDES), Banco do Brasil and the nation's private banks, government authorities and consulting institutions, for their continued support for our restructuring. Naturally, we cannot fail to express our appreciation to our customers who, by continuing to honor us with their preference, inspire us to constantly improve our services.

Gratitude is likewise owed to the public and the media for the many expressions of solidarity, understanding and encouragement we have been fortunate to receive.

We must further mention Brazil's aviation authorities, who deserve our thanks for the wise guidance and decisive support that were fundamental to the success of our negotiating efforts.

Special thanks go as well to the departing members of the Board of Directors — Edgard Nascimento de Araujo, Antônio José Schittini Pinto, Eduardo Camargo Neves, Götz Georg Herzfeldt and Oswaldo Trigueiros Jr. - whose contributions were vital to the progress made by our organization.

Finally, a word of heartfelt gratitude and recognition to our personnel, whose work, dedication, understanding and spirit of sacrifice were of fundamental importance. The level of collaboration shown demonstrates that the entire VARIG family intuitively knew that only by sticking together through tough times would we be able to face and overcome the temporary difficulties which we now gratefully bid farewell. We are proud of this, yet at the same time we wish to reaffirm how essential it is for everyone to contribute towards furtherance of our quality enhancement process on a longer-term horizon. In a modern company, this — after all is said and done — should be a permanent mission.

Porto Alegre, February 24, 1995.



### **Officers**

Rubel Thomas - *President and Chief Executive Officer*

Joaquim Fernandes dos Santos - *Vice-President Director*

Walterson Fontoura Caravajal - *Vice-President Director*

Carlos Willy Engels - *Vice-President Director*

Carlos Ebner Neto - *Financial Director*

Edacir Luiz Tombini - *Director of On-Board Service*

João Luis Bernes de Sousa - *Marketing Director*

Nelson Hillcoat Riet Corrêa - *Director of Flight Operations*

Paulo Enrique Moraes Coco - *Director of Sales and Services*

Paulo Lopes Gallindo - *Director of Engineering and Maintenance*

### **Board of Directors**

Rubel Thomas - *Chairman*

Joaquim Fernandes dos Santos - *Vice-Chairman*

Aguinaldo de Mello Junqueira Filho

Arnoldo Souza de Oliveira

Harro Fouquet

Ingo Plöger

Lino Pereira

Nelson de Sampaio Bastos

Wilson Nélío Brumer

## *B*RANCHES AND OFFICES - BRAZIL

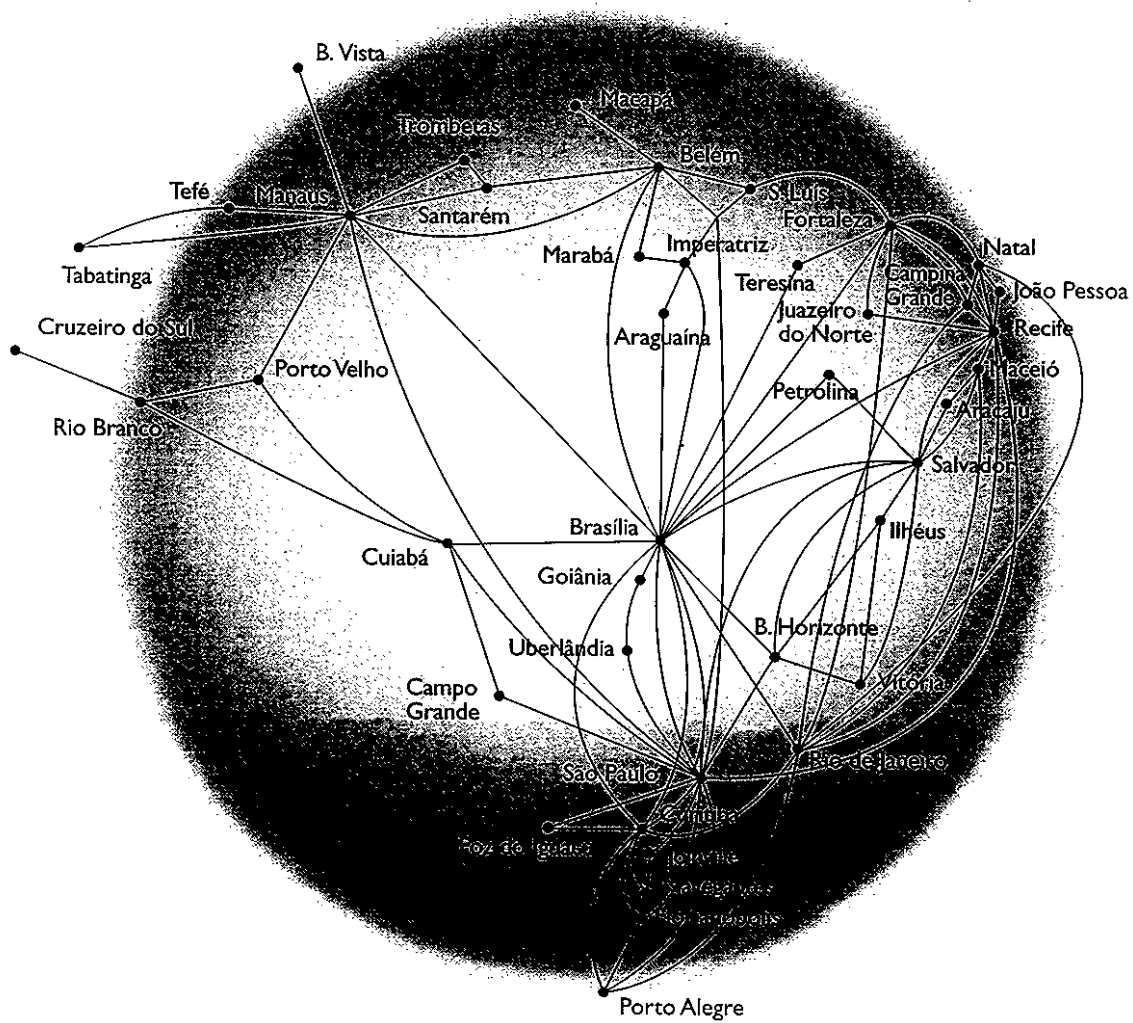
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Alagoinhas  
Anápolis  
Aracaju  
Araguaína  
Araxá  
Assis Brasil  
Atibaia  
Bagé  
Bauru  
Belém  
Belo Horizonte  
Benjamin Constant  
Blumenau  
Boa Vista  
Brasília  
Brusque  
Cachoeira do Sul  
Cachoeiro do Itapemirim  
Camaçari  
Campina Grande  
Campinas  
Campo Bom  
Campo Grande  
Campos  
Carajás  
Carazinho  
Caruaru  
Cascavel  
Cataguases  
Caxias do Sul  
Chapecó  
Colatina  
Cotia  
Criciúma  
Cruz Alta  
Cruzeiro do Sul  
Cuiabá  
Curitiba  
Divinópolis  
Duque de Caxias

Erexim  
Farrapos  
Florianópolis  
Fortaleza  
Foz do Iguaçu  
Franca  
Francisco Beltrão  
Goiânia  
Guajará-Mirim  
Guarulhos  
Ijuí  
Ilhéus  
Imperatriz  
Itabuna  
Itajaí  
Jaraguá do Sul  
João Pessoa  
Joinville  
Juazeiro do Norte  
Juiz de Fora  
Lages  
Lajeado  
Londrina  
Macaé  
Macapá  
Maceió  
Mairiporã  
Manaus  
Marabá  
Maringá  
Mogi das Cruzes  
Montenegro  
Mossoró  
Natal  
Nova Iguaçu  
Osasco  
Paranaguá  
Passo Fundo  
Pelotas  
Petrópolis

Petrópolis  
Ponta Grossa  
Porto Alegre  
Recife  
Ribeirão Preto  
Rio Branco  
Rio de Janeiro  
Rio Grande  
Rio Verde  
Salvador  
Santa Maria  
Santana do Livramento  
Santarém  
Santo André  
Santo Ângelo  
Santos  
São Bernardo do Campo  
São Caetano do Sul  
São Carlos  
São Gonçalo  
São Gonçalo do Amarante  
São José dos Campos  
São Leopoldo  
São Luís  
São Paulo  
Sete Lagoas  
Sorocaba  
Tabatinga  
Tefé  
Teresina  
Teresópolis  
Tijucá  
Três Rios  
Uberaba  
Uberlândia  
Uruguaiana  
Viçosa  
Vila Maria  
Vila Mariana  
Vila Velha  
Vitória

# Domestic Routes



## *B*RANCHES AND OFFICES - OVERSEAS

### EUROPE (54)

Amsterdam  
Athens  
Barcelona  
Bari  
Berlim  
Bilbao  
Bologna  
Bordeaux  
Brussels  
Budapest  
Catania  
Cyprus  
Cologne  
Copenhagen

### Düsseldorf

Stockholm  
Florence  
Frankfurt  
Geneva  
Genoa  
Hamburg  
Helsinki  
Lisbon  
Livorno  
London  
Luxembourg  
Lyon  
Madrid  
Marseilles

### Messina

Milão  
Munich  
Naples  
Nice  
Nuremberg  
Oslo  
Palermo  
Paris  
Porto  
Prague  
Puteaux  
Rome  
Ruzhany  
Sliema

### Sofia

Stuttgart  
Terni  
Turin  
Valencia  
Verona  
Vienna  
Vigo  
Warsaw  
Zurich

### Atlanta

Barranquilla  
Baymon  
Boca Raton  
Bogota  
Boston  
Bucamaranga  
Buenos Aires  
Cancun  
Caracas  
Chaco

### Concepción

Cordoba  
Cuenca  
Curaçao  
Denver  
Guadalajara

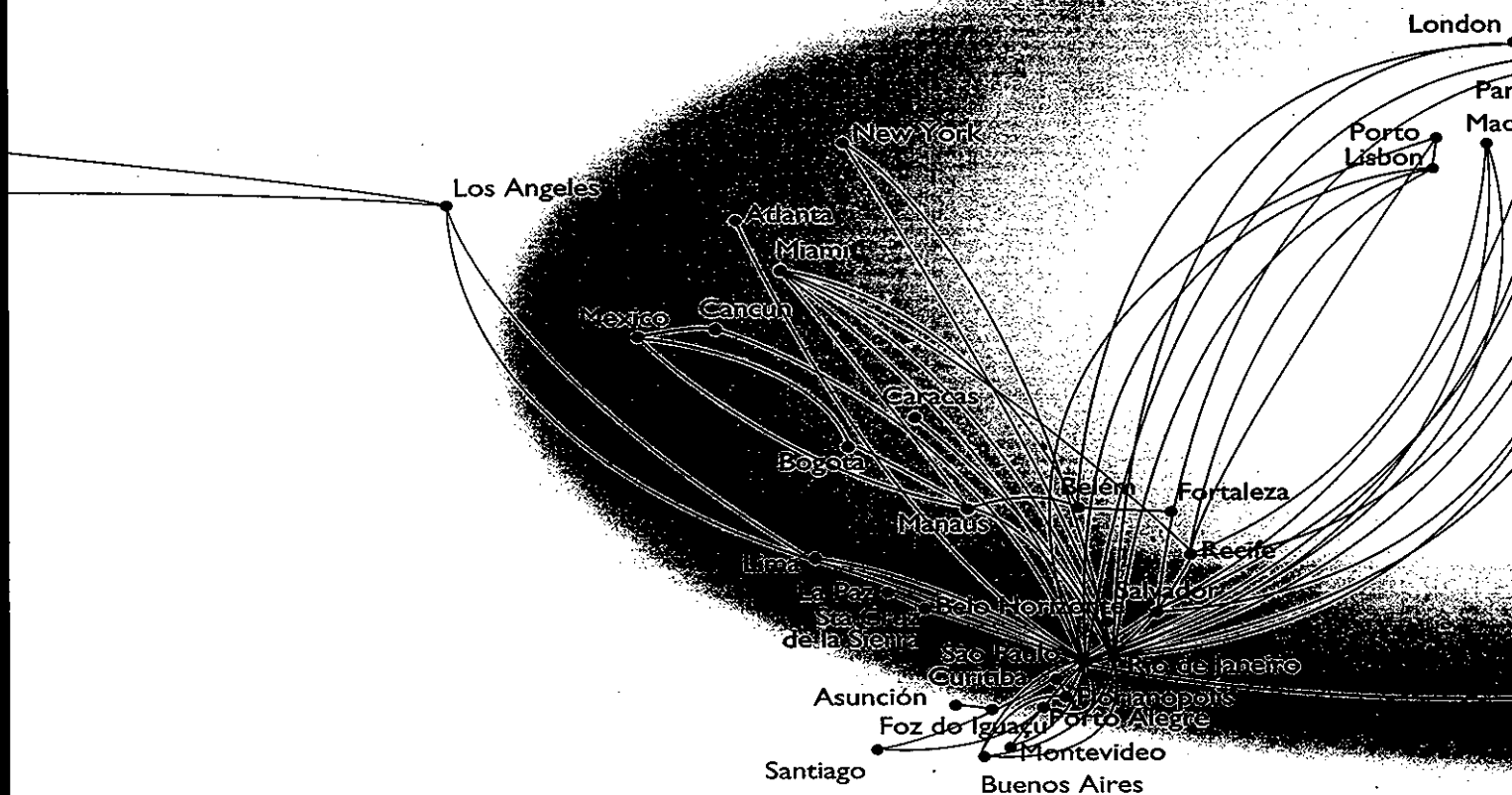
### AMERICAS (81)

Antofagasta  
Arequipa  
Asunción

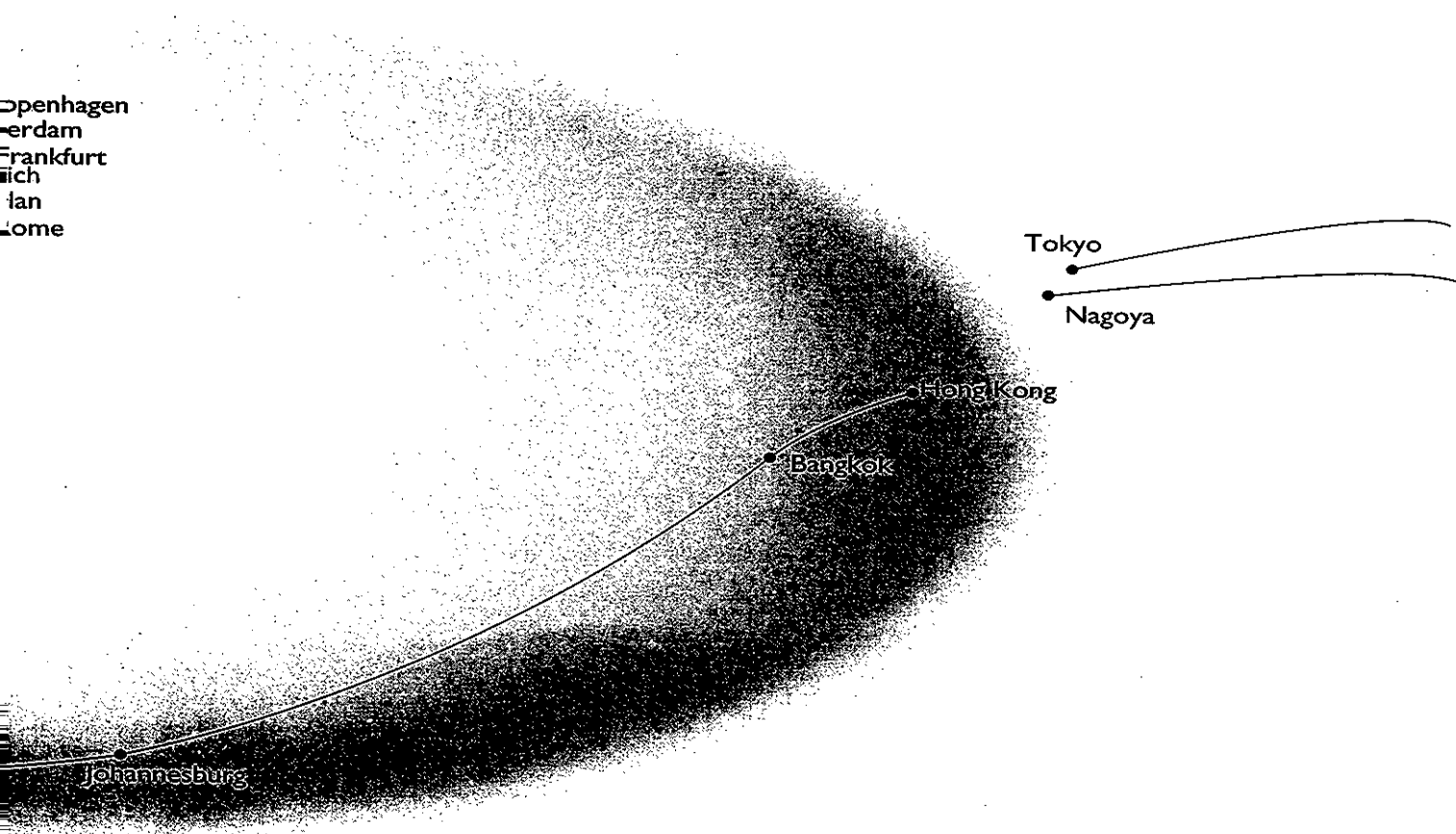
### Chicago

Ciudad del Leste  
Cochabamba  
Colonia

### International Routes



Guayaquil	Monterey	San Salvador	Amman	Manila	Harcourt
Guatemala	Montevideo	Sta. Cruz de la Sierra	Baghdad	Nagoya	Ibadan
Haedo City	Montreal	Santa Fe	Bangkok	Naha	Iliha do Sal
Honolulu	New Orleans	Santiago	Beirut	New Delhi	Johannesburg
Houston	New York	Santo Domingo	Bombay	Okinawa	Luanda
Junín	Orlando	Seattle	Singapore	Osaka	Mauritius
La Paz	Osorno	Tegucigalpa	Colombo	Seoul	Moroni
La Plata	Panama	Temuco	Daman	Taipei	Port Louis
Lima	Pereira	Toronto	Damascus	Tel-Aviv	Salisbury
Los Angeles	Philadelphia	Trujillo	Doha	Tokyo	St. Denis
Managua	Puerto Ordaz	Tucumán	Dubai		Tunisia
Manta	Puntarenas	Valencia	Fukuoka	AFRICA (19)	
Mar del Plata	Quito	Valparaíso	Hong Kong	Addis Ababa	OCEANIA (1)
Maracaibo	Río Negro	Vancouver	Istanbul	Blantyre-Limbe	Sydney
Medellín	Rivera	Vera Cruz	Jakarta	Cape Verde Islands	
Mendoza	Rosário	Yucatan	Jeddah	Cairo	
Mercedes	Salto	Washington	Jounieh	Casablanca	
Mexico	San Francisco		Karachi	Capetown	
Miami	San Jose	ASIA (31)	Kuala-Lumpur	Djibouti	
Minas	San Martin	Abu Dhabi	Kuwait	Harare	



# *B*ALANCE SHEETS

DECEMBER 31, 1994 AND 1993.

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## BALANCE SHEETS

for the years ended December 31, 1994 and 1993

(in thousands of Reais)

### ASSETS

	Notes	In December, 1994 currency	
		1994	1993
<b>CURRENT:</b>			
Cash and Cash Equivalents.....		104,156	55,188
Accounts Receivable			
Customers.....		283,450	201,340
Brazilian Government.....		11,727	12,506
Other Airlines.....		20,233	8,333
Subsidiaries and Associated Companies.....	( 9)	7,645	12,011
Other Receivables.....		12,526	39,554
Less: Allowance for Doubtful Accounts.....		( 2,846)	( 1,870)
<b>Total Accounts Receivable</b> .....		332,735	271,874
Special Deposits.....	( 4)	32,792	44,846
Maintenance and Operating Supplies.....	( 3)	102,373	130,335
Advances to Suppliers.....		43,538	19,922
Prepaid Expenses.....		30,445	37,193
<b>TOTAL CURRENT ASSETS</b> .....		<u>646,039</u>	<u>559,358</u>
<b>LONG-TERM ASSETS:</b>			
Subsidiaries and Associated Companies.....	( 9)	38,606	16,156
Special Deposits.....	( 4)	37,666	136,550
Other.....		31,100	19,971
<b>TOTAL LONG-TERM ASSETS</b> .....		<u>107,372</u>	<u>172,677</u>
<b>PERMANENT ASSETS:</b>			
Investments			
Subsidiaries.....	( 5)	136,502	142,121
Other Investments.....		12,351	2,539
<b>Total Investments</b> .....		148,853	144,660
Property and Equipment			
Property and Equipment.....	( 6)	3,007,014	2,811,113
Less: Accumulated Depreciation.....	( 6)	( 1,117,592)	(1,076,094)
Flight Equipment - Lease Contracts.....		-	211,808
Work in Progress.....	( 7)	18,901	34,815
<b>Total Property and Equipment</b> .....		1,908,323	1,981,642
Deferred Charges			
Amortizable Expenses.....	( 8)	29,910	31,370
Less: Accumulated Amortization.....	( 8)	( 17,093)	( 17,021)
<b>Total Deferred Charges</b> .....		12,817	14,349
<b>ATIVO PERMANENT ASSETS</b> .....		<u>2,069,993</u>	<u>2,140,651</u>
<b>TOTAL ASSETS</b> .....		<u><b>2,823,404</b></u>	<u><b>2,872,686</b></u>

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

## LIABILITIES AND STOCKHOLDERS' EQUITY

		In December, 1994 currency	
	Notes	1994	1993
<b>CURRENT:</b>			
Suppliers.....		54,050	65,876
Loans and Financings.....	( 10)	261,936	533,513
Lease Agreements.....	( 11)	91,595	175,183
Debentures.....	( 13)	34,724	-
Accrued Interest.....		26,294	85,492
Fees and Contributions.....		66,610	134,540
Wages and Salaries.....		24,070	24,167
Payable to Other Airlines.....		5,166	5,017
Accounts Payable.....		36,061	47,964
Unearned Transportation Revenues.....		144,706	134,674
Provisions for:			
Labor Contingencies.....		54,587	63,896
Flight Equipment Overhaul.....		7,623	8,740
<b>TOTAL CURRENT LIABILITIES</b> .....		<b>807,422</b>	<b>1,279,062</b>
<b>LONG-TERM LIABILITIES</b>			
Loans and Financings.....	( 10)	508,823	228,396
Lease Agreements.....	( 11)	1,193,597	1,202,955
Debentures.....	( 13)	8,026	41,562
Accrued Interest.....		25,913	9,432
Subsidiaries and Associated Companies.....	( 9)	6,510	8,057
Accounts Payable.....		46	758
<b>TOTAL LONG-TERM LIABILITIES</b> .....		<b>1,742,915</b>	<b>1,491,160</b>
<b>STOCKHOLDERS' EQUITY:</b>			
Paid-in Capital Stock			
Paid-in Capital Stock.....	( 14)	39,924	1,583
Monetary Restatement of Paid-in Capital Stock.....	( 14)	361,413	399,754
<b>Total Paid-in Capital Stock</b> .....		<b>401,337</b>	<b>401,337</b>
Capital Increase Subject to Approval.....		25,419	25,419
Revaluation Reserves			
Property and Equipment.....	( 14)	26,190	100,815
Investments.....	( 14)	7,093	11,555
<b>Total Revaluation Reserves</b> .....		<b>33,283</b>	<b>112,370</b>
Retained Earnings (Deficit).....	( 14)	(186,972)	(436,662)
<b>TOTAL STOCKHOLDERS' EQUITY</b> .....		<b>273,067</b>	<b>102,464</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b> .....		<b>2,823,404</b>	<b>2,872,686</b>

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



# STATEMENTS OF INCOME

For the years ended December 31, 1994 and 1993

(in thousands of Reais except for per share data)

	Notes	In December, 1994 currency	
		1994	1993
<b>Operating Revenues</b>			
Flight Revenues.....		2,825,558	2,911,124
Less: Valued-Added Tax (ICMS).....		(43,470)	(80,002)
Other .....		63,443	99,372
Total Operating Revenues.....		2,845,531	2,930,494
Less: Taxes on Revenues - COFINS .....		(19,636)	(21,048)
Net Operating Revenues.....		2,825,895	2,909,446
<b>Operating Costs</b>			
Flight Operations.....		(1,642,656)	(1,705,919)
Other Operating Costs.....		(53,361)	(40,724)
Depreciation Aggregated to Service Costs.....		(66,795)	(89,762)
Depreciation of Leased Equipment.....		(117,312)	(98,282)
		(1,880,124)	(1,934,687)
<b>GROSS PROFIT</b> .....		945,771	974,759
Commercial Expenses.....		(697,288)	(777,924)
General Expenses			
Directors and Counsellors Salaries.....		(2,863)	(3,353)
Administrative Expenses.....		(153,481)	(151,982)
		(156,344)	(155,335)
<b>FLIGHT OPERATING PROFIT</b> .....		92,139	41,500
<b>Net Financial Income (Expenses)</b>			
Financial Income.....		53,667	59,617
Financial Expenses.....		(177,944)	(165,655)
Interest on Long-Term Debt for Flight Equipment.....		(96,501)	(97,687)
		(220,778)	(203,725)
Gains (Losses) on Foreign Currency Assets and Liabilities.....	(15)	439,638	(139,105)
Income from Investments			
Income from Investments in Subsidiaries and Associated Companies.....	(5)	8,055	2,434
Dividends and Income from Other Investments.....		4	17
		8,059	2,451
<b>Gains (Losses) on Non-Interest Monetary Items</b> .....	(16)	(3,776)	(15,752)
<b>Operating Income (Loss)</b> .....		315,282	(314,631)
<b>Non-Operating Income (Loss)</b> .....	(17)	(144,679)	41,294
<b>NET INCOME (Loss) FOR THE YEAR</b> .....		170,603	(273,337)
<b>NET INCOME (Loss) PER SHARE</b> .....		2,76	(0,44)

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

# STATEMENTS OF CHANGES IN FINANCIAL POSITION

for the years ended December 31, 1994 and 1993

(in thousands of Reais)

	In December, 1994 currency	
	1994	1993
<b>SOURCES:</b>		
Operations:		
Net Income (Loss) for the Year.....	170,603	(273,337)
Depreciation and Amortization.....	105,253	124,843
Depreciation - Leased Equipment.....	117,312	98,282
Equity in Subsidiaries.....	(8,055)	(2,434)
Gains (Losses) on Long-Term Assets.....	16,172	21,063
Net Book Value of Property and Equipment Sold.....	356,426	31,669
Gains (Losses) on Long-Term Liabilities.....	(411,403)	132,896
Net Book Value of Investments.....	10,569	400
Capital Losses.....	7,069	847
	<u>363,946</u>	<u>134,229</u>
Shareholders and Third Parties:		
Long-Term Financings.....	1,013,835	209,379
Reduction of Long-Term Liabilities.....	49,132	-
<b>Total Sources</b> .....	<u>1,426,913</u>	<u>343,608</u>
<b>USES:</b>		
Increase in Permanent Assets		
Investments.....	13,775	1,019
Property and Equipment.....	710,340	305,425
Deferred Charges.....	5,609	5,859
	<u>729,724</u>	<u>312,303</u>
Increase in Long-Term Assets.....	-	22,321
Reduction of Long-Term Debt.....	138,868	98,545
<b>Total Uses</b> .....	<u>868,592</u>	<u>433,169</u>
Changes in Net Working Capital.....	<u>558,321</u>	<u>(89,561)</u>
	<u>1,426,913</u>	<u>343,608</u>
<b>REPRESENTED BY:</b>		
Current Assets		
At End of Year.....	646,039	559,358
At Beginning of Year.....	559,358	523,558
	<u>86,681</u>	<u>35,800</u>
Current Liabilities		
At End of Year.....	(807,422)	(1,279,062)
At Beginning of Year.....	(1,279,062)	(1,153,701)
	<u>471,640</u>	<u>(125,361)</u>
Changes in Net Working Capital.....	<u>558,321</u>	<u>(89,561)</u>

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

# STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

For the years ended december 31, 1994 and 1993

(in thousands of Reais)

HISTÓRICO	Paid-in Capital Stock	Capital to be Homologated	Revaluation Reserves		Retained Earnings (Deficit)	Total
			Property and Equipment	Investments		
A - BALANCES AS OF DECEMBER 31, 1992	401,337	-	133,342	13,333	(193,084)	354,928
- Capital increase (Extraordinary Stockholders Meeting of October 15, 1993) .....	-	25,419	-	-	-	25,419
- Equity adjustments relating to prior years .....	-	-	-	-	(4,546)	(4,546)
- Realization of revaluation reserves - Property and Equipment .....	-	-	(32,527)	-	32,527	-
- Realization of revaluation reserves - Investments .....	-	-	-	(1,778)	1,778	-
- Net loss for the year .....	-	-	-	-	(273,337)	(273,337)
B - BALANCES AS OF DECEMBER 31, 1993	401,337	25,419	100,815	11,555	(436,662)	102,464
- Realization of revaluation reserves - Property and Equipment .....	-	-	(74,625)	-	74,625	-
- Realization of revaluation reserves - Investments .....	-	-	-	(4,462)	4,462	-
- Net income for the year .....	-	-	-	-	170,603	170,603
C - BALANCES AS OF DECEMBER 31, 1994	<u>401,337</u>	<u>25,419</u>	<u>26,190</u>	<u>7,093</u>	<u>(186,972)</u>	<u>273,067</u>

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

# NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 1994

## **1. BUSINESS OF THE COMPANY**

The main business of the Company is operating passenger, cargo, baggage and mail air transport services over both domestic and international routes, under government concessions or licences, and rendering related services to third parties.

## **2. PRESENTATION OF THE FINANCIAL STATEMENTS**

In order to upgrade the quality of information provided to investors and to the general public, and in accordance with instructions issued by the Brazilian Securities and Exchange Commission (CVM), the Company presents only Financial Statements inflation indexed by reference to units of constant purchasing power. This is because Income for the Year and the Shareholders' Equity as of December 31, 1994 so reported are the same as those reported in the Financial Statements presented in accordance with inflation indexing prescribed by Brazilian Corporation Law.

The Financial Statements related to the previous year were translated into Reais and monetarily restated to December 1994 currency.

The amounts presented in the Notes to Financial Statements have likewise been monetarily restated to December 1994 currency.

## **2.1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **a) Effects of inflation**

The effects of the loss of the purchasing power of Brazilian currency on equity components have been recognized in results for the year based on the change in the nominal value of the Fiscal Reference Unit (UFIR) over the year. Inflation income determined in accordance with Brazilian Corporation Law has been reclassified to the respective income statement accounts to which it relates.

### **b) Denomination of foreign currency or index-linked amounts**

Current and noncurrent assets and current and long-term liabilities denominated in foreign currencies or otherwise index-linked are determined by reference to the appropriate exchange rates and other indices in effect at the balance sheet date.

### **c) Allowance for doubtful accounts**

The allowance for doubtful accounts is based on historical experience and is considered sufficient to cover any losses expected upon realization.

### **d) Maintenance and Operating Supplies**

The Spare Parts and Sundry Materials and the Work in Progress Inventories are stated at acquisition or production cost, inflation-indexed as discussed in Note 2.1.a., which is lower than replacement cost. The Imports in Progress are stated at costs incurred through the balance sheet date.

### **e) Property and Equipment**

The Company's own equipment and equipment under purchase leases are stated at monetarily restated acquisition cost, except for flight equipment revalued in October of 1988 and monetarily restated from that date on.

Depreciation is computed by the straight-line method at the rates shown in Note 6, with no residual value.

### **f) Provisions**

The Provision for Flight Equipment Overhaul is computed based on the hours flown and covers future equipment overhaul costs, except for latest generation equipment, the overhaul costs of which are recognized as incurred.

### **g) Adjustments to present value**

Current amounts receivable and payable have been adjusted to present value, based on rates disclosed by the Brazilian Association of Investment Banks (ANBID).

## h) Revenue recognition

Sales are recorded as a Current Liability - "Unearned Transportation Revenues" - until such time as the transportation services are provided, at which point they are transferred to income statement as revenue earned.

## 3. MAINTENANCE AND OPERATING SUPPLIES

	R\$ thousand	
	12/31/94	12/31/93
- Spare parts and sundry materials.....	73,202	116,521
- Work in progress.....	8,470	10,438
- Importation in progress.....	20,701	3,376
	<u>102,373</u>	<u>130,335</u>

The monetarily restated portion of the above balances corresponds to R\$ 64,463 thousand (R\$ 112,090 thousand as of December 31, 1993).

## 4. SPECIAL DEPOSITS

	R\$ thousand			1993 Total
	Short-Term	1994 Long-Term	Total	
- As guarantee for lease contracts (Security Deposits and Maintenance Deposits)				
Nissho Iwai Corp. - Japan .....	1,397	-	1,397	35,873
International Lease Finance Corp. - USA.....	-	5,180	5,180	18,986
Ansett Worldwide Aviation - USA.....	-	482	482	1,919
Harrington Ltd. - USA.....	11,321	-	11,321	18,676
G.P.A. Group - Ireland.....	-	6,573	6,573	9,918
C. Itoh Co. Ltd. - Japan.....	2,258	-	2,258	13,594
Bavaria Flug Gesellschaft - Germany.....	-	6,184	6,184	7,081
Orix Ouro Corp. - Cayman.....	-	763	763	3,640
SL - VRG Ltd. - Cayman.....	-	844	844	3,542
Other Deposits.....	620	1,268	1,888	13,234
	<u>15,596</u>	<u>21,294</u>	<u>36,890</u>	<u>126,463</u>
- As guarantee for aircraft manufacture (Progress Payments)				
The Boeing Co. - USA.....	6,508	5,566	12,074	22,297
Mc Donnell Douglas - USA.....	-	508	508	22,865
Less: Advances Received				
Marubeni - USA.....	-	-	-	(28,378)
	<u>6,508</u>	<u>6,074</u>	<u>12,582</u>	<u>16,784</u>
- Other Deposits.....	<u>10,688</u>	<u>10,298</u>	<u>20,986</u>	<u>38,149</u>
	<u>32,792</u>	<u>37,666</u>	<u>70,458</u>	<u>181,396</u>

In view of the financial restructuring of leasing contracts during 1994, part of the lease contract guarantee deposits was used to reduce past due amounts under the said contracts.

## 5. SUBSIDIARIES AND ASSOCIATED COMPANIES

VARIG's investments in its subsidiaries and associated companies are accounted for under the equity method. Details on these investments are as follows as of December 31, 1994:

	R\$ thousand				R\$ thousand		
	Share- holders' Equity	Income (Loss) for the year	Share of Capital		Adjusted Book Value	1994 Equity Income (Loss)	1993 Adjusted Book Value
			Total	Voting			
Cia. Tropical de Hotéis.....	31,829	(1,597)	89,85	96,02	28,599	(1,435)	33,333
Cia, Tropical de Hotéis da Amazônia.....	32,540	(8,233)	64,57	80,78	21,011	(5,316)	26,327
Expressão Brasileira de Propaganda Ltda.....	-	-	-	-	-	(106)	2,379(a)
ÍCARO Editora Ltda.....	601	(361)	19,57	19,57	118	(71)	187
Banco VARIG S.A.....	12,402	(6,585)	46,67	24,24	5,788	(3,073)	8,902
SATA Serv. Auxiliares de Transp. Aéreo S.A.....	15,946	1,762	99,36	99,36	15,844	1,751	13,202
RIO-SUL Serv. Aéreos Regionais S.A.....	54,101	18,632	96,78	96,69	52,360	18,032	44,366
VARIG Agropecuária S.A....	49,927	(5,436)	21,24	21,24	10,606	(1,155)	11,649
InterLocadora S.A.....	792	(402)	91,46	91,46	725	(367)	1,092
Other Companies.....					1,451	(205)	684
					<u>136,502</u>	<u>8,055</u>	<u>142,121</u>

(a) Investment sold in October 1994 for R\$ 4,167 thousand.

Intercompany transactions are carried out on normal market terms. Revenues and expenses arising from such transactions are immaterial. Resulting balances are shown in Note 9.

## 6. PROPERTY AND EQUIPMENT

	R\$ thousand				
	12/31/94		12/31/93		
	Restated Amount	Restated Depreciation	Restated Amount	Restated Depreciation	(a) Rate % per year
Own Equipment					
- Flight Equipment					
B-727/100.....	44,065	(44,065)	36,397	(35,831)	20,0
B-737/200.....	203,521	(159,795)	226,985	(155,358)	7,1 and 16,6
DC-10/30.....	-	-	166,297	(80,494)	
737/747/767/DC&-c. 10 engines.....	88,020	(39,842)	50,931	(19,126)	5,8
Spare and repair parts.....	208,011	(94,172)	214,140	(90,935)	(b)
- Training Equipment (Planes and Simulators)...	63,148	(31,487)	63,274	(26,427)	10,0
- Ground Equipment.....	191,146	(141,137)	190,556	(130,799)	10,0
- Vehicles.....	12,766	(11,626)	14,372	(12,762)	20,0
- Real Estate.....	307,109	(142,944)	294,008	(130,827)	4,0 and 5,0
Total Own Equipment.....	1,117,786	(665,068)	1,256,960	(682,559)	
Purchase Leases					
- Flight Equipment					
B-737/200.....	23,486	(21,637)	-	-	7,1 and 16,6
B-737/300.....	398,863	(29,666)	130,790	(13,943)	5,0 and 6,6
DC-10/30.....	271,295	(145,219)	143,145	(49,570)	9,5 and 16,6
B-747/200.....	228,060	(107,062)	227,425	(89,733)	8,3
B-747/300.....	259,588	(94,139)	259,335	(78,884)	5,8
B-767/200 ER.....	-	-	494,122	(135,801)	
B-767/300.....	135,450	(4,570)	-	-	6,5 and 6,6
MD-11.....	541,703	(37,306)	260,950	(11,936)	5,0
B-767 - 747/400 engines.....	17,880	(1,006)	25,483	(3,543)	
- Training Equipment - Simulators.....	12,903	(11,919)	12,903	(10,125)	14,2
Total Purchase Leases.....	1,889,228	(452,524)	1,554,153	(393,535)	
Total Property and Equipment.....	3,007,014	(1,117,592)	2,811,113	(1,076,094)	

(a) Depreciation is calculated in accordance with the service life of the equipment, which, in the case of flight equipment, is based on an appraisal report of October 1988.

(b) Depreciated at the same rate as the equipment to which they are related.

### 6.1 The following changes in property and equipment in 1994 deserve mention:

	R\$ thousand
- Purchase of two MD-11 aircraft (purchase lease).....	269,152
- Transformation of operating lease into financial lease for eleven B-737-300 aircraft.....	268,058
- Transformation of operating lease into financial lease for two B-767-300 aircraft.....	116,419
- Write-off of six B-767-200 aircraft and two engines.....	(324,872)

Besides these alterations, it is important to highlight sale-leaseback operations involving two B-737-200 and two DC-10-30 aircraft, which residual values were transferred to flight equipment - leasing.

**6.2** As a result of the flight equipment revaluation made in October of 1988, depreciation expense and cost of assets written off in the respective amounts of R\$ 18,473 thousand and R\$ 56,152 thousand were charged to results of 1994 operations. Property and equipment as of December 31, 1994, includes R\$ 93,502 thousand representing the uplift of assets from restated cost to their revalued amounts; this uplift will be amortized in the results of operations of future years when realized through depreciation or sale.  
The resulting revaluation reserve has been reduced by losses incurred in the year of revaluation and, consequently, is lower than the related uplift in Property and Equipment by R\$ 67,312 thousand as of December 31, 1994.

**6.3** In accordance with article 2 of Law 8200/91, depreciation expense and cost of assets written off, in the respective amounts of CR\$ 5,160 thousand and CR\$ 1,446 thousand, were charged to results of 1993 operations. An amount of CR\$ 46,715 thousand out of the total reappraised amount remains under Property and Equipment and will be recorded in the results of operations of future years when realized through depreciation or sale.

## 7. WORK IN PROGRESS

	R\$ thousand	
	12/31/94	12/31/93
- Technical and operational infrastructure		
Physical plant - Rio de Janeiro.....	-	15,616
Purchase of real estate - Brasília.....	14,453	14,042
Building improvements - Brazil.....	1,084	427
- Purchase and manufacture of data processing equipment.....	863	793
- Ground support equipment.....	206	466
- Purchase of Brazilian/foreign real estate.....	356	367
- Standardization of aircraft.....	1,783	2,093
- Other fixed assets in progress.....	156	201
	<u>18,901</u>	<u>34,815</u>

## 8. DEFERRED CHARGES - AMORTIZABLE EXPENSES

	R\$ thousand			
	Monetarily restated original amounts		Monetarily restated amortizations	
	12/31/94	12/31/93	12/31/94	12/31/93
- On-board service equipment.....	291	199	(154)	(100)
- Leasehold improvements (a).....	3,555	3,506	(2,806)	(2,279)
- Expenses incurred in putting new flight/ground equipment into service (b).....	26,064	27,665	(14,133)	(14,642)
	<u>29,910</u>	<u>31,370</u>	<u>(17,093)</u>	<u>(17,021)</u>

(a) Amortizable expenses over term of lease or service life.

(b) Preoperating expenses, such as for training of crew and technical personnel, institutional advertising, standardization, test flights, etc., amortizable at a rate of 10% p.a. starting when equipment enters into service.

## 9. INTERCOMPANY TRANSACTIONS - SUBSIDIARIES AND ASSOCIATED COMPANIES

Amounts classified as Current refer to normal market transactions. Amounts classified as Noncurrent refer to mutual loans, earning interest at market rates.

## 9.1 Current

	R\$ thousand	
	Assets	
	12/31/94	12/31/93
Cia. Tropical de Hotéis.....	281	279
SATA Serv. Auxiliares de Transporte Aéreo S.A.....	2,189	2,627
RIO-SUL Serviços Aéreos Regionais S.A.....	1,558	1,156
Fundação Ruben Berta.....	3,022	6,120
Others.....	595	1,829
	<u>7,645</u>	<u>12,011</u>

## 9.2 Noncurrent

	R\$ thousand			
	Assets		Liabilities	
	12/31/94	12/31/93	12/31/94	12/31/93
Soc. Brasileira de Turismo Aéreo-Rotatur Ltda.....	-	-	119	28
RIO-SUL Serv. Aéreos Regionais S.A.....	-	-	6,391	8,029
InterLocadora S.A.....	19,556	6,721	-	-
VARIG Agropecuária S.A.....	1,529	2,325	-	-
Cia. Tropical de Hotéis.....	13,610	7,110	-	-
Caterair do Brasil S.A.....	1,761	-	-	-
SPR Empreendimentos e Participações.....	2,150	-	-	-
	<u>38,606</u>	<u>16,156</u>	<u>6,510</u>	<u>8,057</u>

## 10. WORKING CAPITAL LOANS AND FINANCING

	R\$ thousand			
	1994		1993	
	Short-Term	Long-Term	Total	Total
Working capital loans and financing.....	145,808	144,910	290,718	359,203
Lines of credit:				
Brazil.....	801	13,934(a)	14,735	67,040
Abroad.....	5,689	-	5,689	18,060
Financing of supplies.....	5,872	3,170	9,042	27,350
Financed imports.....	6,698	24,857	31,555	39,456
Financing of taxes and levies.....	72,646	306,925	379,571	199,082
Financing of fuel purchases.....	18,008	5,685	23,693(b)	18,154
Financings related to property and equipment.....	275	36	311	4,896
Others.....	6,139	9,306	15,445	28,668
	<u>261,936</u>	<u>508,823</u>	<u>770,759</u>	<u>761,909</u>

(a) Balance of guaranteed account maintained at Banco Nacional. See item "a" of Note 10.1.

(b) Financing related to Petrobrás and Shell fuel billings, monthly payments and interest calculated based on CETIP rate.

Interest incurred and not due is classified as Current and Long-Term Liabilities, depending on the respective maturity dates, under "Accrued Interest".

## 10.1 Working capital loans

		R\$ thousand				
		1994				
		Short-Term	Long-Term	Total	1993 Total	Final maturity
Brazil						
- Banco Nacional.....		-	5,017	5,017	18,645	
- Banco Rural.....		-	13,073	13,073	8,703	
- Bamerindus.....		-	9,200	9,200	11,921	
- Bradesco.....		-	7,487	7,487	9,243	
- Banerj.....		7,468	-	7,468	1,549	
- Unibanco.....		-	8,922	8,922	11,920	
- Banco Inter-Atlântico.....		1,816	5,048	6,864	9,526	
- Banco Pontual.....		-	5,104	5,104	488	
- Others (22 institutions).....		6,564	23,521	30,085	101,108	
		15,848	77,372(a)	93,220	173,103	
Abroad						
- Nissho Iwai Corp. - Japan (JY\$ 4 billion)		16,778	16,778	33,556(b)	63,295	DEC/96
- Banco do Brasil - USA (US\$ 69 million)		58,339	-	58,339(b)	23,841	
- Banespa - USA (US\$ 24 million)		20,304	-	20,304	34,570	
- Brazilian American Merchant Bank - USA (US\$ 100 million)						
Less: Discount (US\$ 40 million)						
Net (US\$ 60 million)		-	50,760	50,760(c)	-	DEC/2012
- Others (10 institutions)		34,539	-	34,539	64,394	
		129,960	67,538	197,498	186,100	
		145,808	144,910	290,718	359,203	

(a) Amount classified as Long-Term Liabilities, since it is related to the issue of debentures in November 1994. Although they fell due in January/February 1995, such loans were settled by the issue of debentures in compensation for guarantees provided by creditors;

(b) Loans guaranteed by sales in Japan, Argentina and Italy, with variable interest rates in accordance with LIBOR;

(c) Loans for an 18-year period with a 5-year grace period for payment of the principal. Interest calculated based on LIBOR plus a spread of 3.5% per year, due semi-annually. As a consequence of the sale operation of DCBs - Debt Conversion Bonds, a discount equivalent to US\$ 40 million was obtained on these loans, to be accrued to results over the loan amortization term. Real estate properties in Brasília and Manaus and all shares owned in RIO-SUL, SATA, Cia. Tropical de Hotéis and in Cia. Tropical de Hotéis da Amazônia were included as guarantees for these operations.

## 10.2 Financing of Materials

	R\$ thousand				
	1994			1993 Total	Final maturity
	Short-Term	Long-Term	Total		
- International Lease Fiance Corp.					
- USA (US\$ 4.4 millions) .....	3,722	-	3,722(a)	14,400	DEC/95
- Tombo Aviation - USA (US\$ 6.3 millions)...	2,150	3,170	5,320(b)	12,950	MAR/96
	5,872	3,170	9,042	27,350	

(a) Monthly payments with fixed interest rate of 9.9% per year

(b) Quarterly payments with variable interest rates in accordance with LIBOR plus spread of 2.5% per year

### 10.3 Financings of Taxes, Levies and Social Security and Pension Fund Contributions

	R\$ thousand				
	1994			1993	Final
	Short-Term	Long-Term	Total	Total	maturity
- INSS .....	51,640	161,141	212,781 (a)	123,303	JUL/2001
- COFINS .....	3,119	12,047	15,166 (b)	-	AUG/2002
- ICMS .....	10,759	1,989	12,748 (c)	2,418	
- INFRAERO - Airport taxes .....	7,128	52,213	59,341 (d)	-	NOV/2002
- Instituto Aerus de Seguridade Social .....	-	79,535	79,535 (e)	73,361	JAN/99
	<u>72,646</u>	<u>306,925</u>	<u>379,571</u>	<u>199,082</u>	

(a) Company's share of Social Security contributions - due through August 1994; to be paid in installments from 24 to 90 months and bearing interest at 1% per month;

(b) Contributions related to COFINS levy from June 1993 to March 1994; to be paid in installments over a maximum of 80 months and bearing interest at 1% per month;

(c) Value-Added Tax (ICMS) on air transportation services up to July 1994; to be paid in installments under agreements reached with the respective state governments. Payments have now been suspended by decision of the Federal Supreme Court;

(d) Airport taxes due up to June 1994; to be paid to INFRAERO in installments over a 96-month period, and bearing interest at 1% per month;

(e) Contributions due to AERUS will be divided into installments in January 1996 and then be payable as from February 1996 in 36 monthly installments and bearing interest at 1% per month.

## II. LEASE AGREEMENTS

	R\$ thousand	
	12/31/94	12/31/93
Flight Equipment .....	1,153,734	1,146,572
Ground/Training Equipment .....	7,740	19,758
Refinancings .....	123,718	-
Leasing Contracts .....	-	211,808
	<u>1,285,192</u>	<u>1,378,138</u>
Analyzed between:		
Short-Term .....	91,595	175,183
Long-Term .....	1,193,597	1,202,955

Interest incurred and not due is reported under Current Liabilities as "Accrued Interest".

## 11.1 Flight Equipment

R\$ thousand					
		1994			Last due date
		Short-Term	Long-Term	Total	
(a) - Orient Leasing Co. and Others - Japan (JY\$ 19.1 billion)		-	160,069	160,069	201,288
(b) - Nissho Iwai Corp. and Others - Japan (JY\$ 20.8 billion)		8,057	165,930	173,987	229,100
(c) - Nissho Iwai Corp. - Japan (US\$ 666 thousand)		563	-	563	3,797
(d) - Nissho Iwai Corp. - Japan (US\$ 130.9 million)		4,415	106,303	110,718	-
(e) - Citibank - USA (US\$ 9.7 million)		1,368	6,842	8,210	13,233
(f) - Citibank - USA (US\$ 30.4 million)		3,428	22,286	25,714	-
(g) - Wilmington Trust Co. - USA (US\$ 50.5 million)		2,741	39,973	42,714	63,730
(h) - Wilmington Trust Co. - USA (US\$ 178.6 million)		2,742	148,390	151,132	241,928
(i) - Wilmington Trust Co. - USA (US\$ 15.8 million)		-	13,349	13,349	23,841
(j) - Wilmington Trust Co. - USA (US\$ 201.2 million)		2,609	167,591	170,200	-
- Wilmington Trust Co. - USA.....		-	-	-	263,544
(k) - G.P.A. Group - Ireland (US\$ 24.8 million)		941	20,030	20,971	31,893
(l) - G.P.A. Group - Ireland (US\$ 50.3 million)		3,766	38,803	42,569	69,270
(m) - Harrington Ltd. - USA (US\$ 89.5 million)		6,304	69,415	75,719	-
(n) - Harrington Ltd. - USA (US\$ 2.2 million)		1,230	615	1,845	-
(o) - General Electric Capital Corp - USA (US\$ 13.3 million)		-	11,251	11,251	-
(p) - Bavaria Flug Gesellschaft - Germany (US\$ 52.8 million)		1,167	43,533	44,700	-
(q) - Mitsui Corp. - Japan (US\$ 52.4 million)		2,158	42,114	44,272	-
(r) - Orix Ouro Corp. - Cayman (US\$ 25.9 million)		709	21,193	21,902	-
(s) - SL VGR Ltd. - Brazil (US\$ 26.4 million)		646	21,713	22,359	-
(t) - BCN Leasing - Brazil (US\$ 2.7 million)		1,210	1,079	2,289	1,032
(u) - BCN Leasing - Brazil (US\$ 3.0 million)		2,588	-	2,588	3,647
(v) - Pontual Leasing - Brazil (US\$ 4.5 million)		2,538	1,269	3,807	-
(w) - Safra Leasing - Brazil (US\$ 3.3 million)		452	2,354	2,806	-
- Westdeutsche - USA.....		-	-	-	269
		<u>49,632</u>	<u>1,104,102</u>	<u>1,153,734</u>	<u>1,146,572</u>

- a)** Three B-747/200B aircraft, on a 15 year lease starting December 1982, with an option to purchase at the end of the lease term for JY\$ 600. The outstanding balance is to be amortized as from January, 1996 on terms to be defined in December, 1995. Interest is paid quarterly at a fixed rate of 9.15% p.a.
- b)** Two B-747/300 aircraft leased in December 1985 for 15 years, with an option to purchase at the end of the lease term for JY\$ 400. Fixed interest charges at the rate of 9.0% p.a. are payable semi-annually up to March, 1995 and quarterly after that date.
- c)** Two CF6-80-C2 B6F engines leased in February 1990 from Nissho Iwai Corp. for 5 years, amounting to US\$ 10.9 million, with an option to purchase at the end of the lease term for US\$ 50.00. Installments are quarterly and bear interest of LIBOR plus 1.5% p.a..
- d)** Two B-767-300 aircraft leased in October 1989, converted into a financial lease in November 1994, with a purchase option at the end of the lease term for US\$ 200.00 and remaining period of 11 years. Installments are quarterly and bear interest of LIBOR plus 1.5% p.a..

- e) Four engines leased in July, 1992 from Citibank for an original 5-year period and a purchase option at the end of the lease term, for US\$ 100.00. After renegotiation of the contract, payments became monthly, beginning in July 1995 and ending in June 1998. Installments are paid monthly and bear annual interest at LIBOR plus 4.0%.
- f) Two DC-10 aircraft in November 1994 on the basis of a sale-leaseback transaction for a period of 5 years, with an option to purchase at the end of the lease term for the market price. Installments are payable monthly and bear annual interest of LIBOR plus 2.87% p.a. and 4% p.a., also paid monthly.
- g) Two B-737/300 aircraft leased in December 1991 from Wilmington Trust Co. - USA for 12 years, with payments totaling US\$ 63.2 million and purchase option at the end of the lease term for US\$ 200.00. Payments are quarterly; interest is at 8.31% p.a.
- h) Two MD-11 aircraft leased in December 14, 1992 from Wilmington Trust Co. - USA for 12 years, with purchase option at the end of the lease term for US\$ 200.00. Payments are made quarterly and bear variable interest of 0.4% to 3.15% p.a. over quarterly LIBOR and fixed interest of 7.28% p.a. Installments due/to be due from April 1994 to July 1995 are being borne by the guarantor of the transaction and will be covered by a specific amortization scheme.
- i) One DC-10 aircraft on the basis of a 2-year sale-leaseback transaction with Wilmington Trust Co. - USA in December 1993 and with an original 2-year term. After being renegotiated, the term was extended to November 1997 and quarterly amortizations will begin in May 1996. Interest is calculated based on LIBOR plus 4% p.a. and is paid monthly.
- j) Two MD-11 aircraft leased in December 1993 for 12 years, with an option to purchase at the end of the lease term for US\$ 200.00. Payments are made quarterly and bear variable interest in accordance with LIBOR. Installments due/to be due from April 1994 to July 1995 are being borne by the guarantor of the transaction and will be covered by a specific amortization scheme.
- k) One B-737/300 aircraft leased in April 1992 for 10 years, with purchase option at the end of the lease term for U.S.\$ 2.5 million. Installments are payable monthly in US\$; is at interest of 10.0042% p.a..
- l) Two DC-10/30 cargo aircraft leased in April, 1992 on the basis of a sale-leaseback transaction for a period of 6 years, with option to purchase at the residual value of US\$ 17.5 million. Installments are payable monthly; interest is at 10.7433% p.a.
- m) Five B-737-300 aircraft leased in November 1988 converted into financial lease in February 1994, with a seven-year term, with a purchase option at the end of the lease (US\$ 30.6 million) and monthly amortization. Interest at LIBOR plus 1.5% p.a. is being paid monthly.
- n) Two CF6 engines leased in May 1994 for 2 years, with purchase option at the end of the lease term (US\$ 1.00) and monthly amortization. Interest at LIBOR is paid monthly.
- o) Two CF6 engines leased in October 1994 for 10 years, with an option to purchase at the end of the lease term (US\$ 1.00), payable monthly from May 1996 on. Interest at LIBOR plus 4% p.a. is payable monthly from the beginning of the contract.
- p) Two B-737-300 aircraft leased in July 1992, converted into financial lease in March 1994, with a purchase option at the end of the lease term (US\$ 2.00) and remaining term of 8 years. Payments will be made monthly from September 1995 on and interest, at a fixed rate of 10% p.a., will also be paid monthly from that date on.

- q) Two B-737-300 aircraft leased in November 1990, converted into financial lease in December 1994, with a purchase option at the end of the lease term (US\$ 200.00) and remaining term of 12 years. Amortization of principal and interest (LIBOR plus 1.1250% p.a.) is payable quarterly.
- r) One B-737-300 aircraft leased in July 1991, converted into financial lease in December 1994, with a purchase option at the end of the lease term (US\$ 12.7 million) and remaining term of seven years. Payments are made semi-annually at fixed charges of 10.64% p.a.
- s) One B-737-300 aircraft leased in July 1991, converted into financial lease in December 1994, with a purchase option at the end of the lease term (US\$ 13.8 million) and remaining term of seven years. Payments are made semi-annually; interest is fixed at 10.64% p.a.
- t) Three CF6 engines leased in September 1993 on a sale-leaseback basis for 3 years, with a purchase option at the end of the lease (US\$ 42 thousand) and quarterly payment terms.
- u) One B-737-200 aircraft leased in August 1992 on a sale-leaseback basis for 2 years, with a purchase option at the end of the lease term (US\$ 3,059 thousand).
- v) Three CF6 engines leased in March 1994 on a sale-leaseback basis for 2 years and semi-annual payments.
- w. One B-737-200 aircraft leased in June 1994 on a sale-leaseback basis for 3 years.

## 11.2 Ground/Training Equipment

		R\$ thousand				
		1994				
		Short-Term	Long-Term	Total	1993 Total	Last Due Date
- Tokio Leasing S.A.	- Brazil (US\$ 251 thousand)	213	-	213	899	FEB/95
- Norchen Leasing S.A.	- Brazil (US\$ 264 thousand)	223	-	223	942	MAY/95
- Franlease S.A.	- Brazil (US\$ 369 thousand)	312	-	312	880	AUG/95
- IBM Leasing	- Brazil.....	4,776	1,759	6,535	15,345	JAN/97
- Others .....		368	89	457	1,692	
		5,892	1,848	7,740	19,758	

### 11.3 Refinancings

	R\$ thousand			Last Due Date
	1994			
	Short-Term	Long-Term	Total	
- Financial Leases				
(a) Orient Leasing Co. and Others - Japan (JY\$ 590 million)....	4,952	-	4,952	DEC/95
(b) Wilmington Trust Co. - USA (US\$ 16.2 million)....	-	13,746	13,746	JUL/2005
(c) Wilmington Trust Co. - USA (US\$ 17.4 million)....	3,489	11,227	14,716	OCT/97
(d) First Security Bank of Utah - USA (US\$ 28 million)....	-	23,688	23,688	NOV/2005
(e) GPA Group - USA (US\$ 9.8 million)....	1,834	6,476	8,310	SEP/98
(e) GPA Group - USA (US\$ 9.8 million)....	1,008	-	1,008	DEC/95
(f) Bavaria Flug Gesellschaft - Germany (US\$ 1.2 million)....	847	3,648	4,495	OCT/97
Others.....	12,130	58,785	70,915	
- Operating Leases				
(g) Pegasus Capital Corp. - USA (US\$ 2.4 million)....	667	1,332	1,999	OCT/98
(g) Global Aircraft Leasing Ltd. - Cayman (US\$ 3.0 million)....	981	1,523	2,504	JAN/99
(g) PK Airfinance - USA (US\$ 2.8 million)....	875	1,532	2,407	JAN/99
(g) Ansett Worldwide Aviation - USA (US\$ 3.9 million)....	1,538	1,736	3,274	OCT/99
(g) Bavaria Flug Gesellschaft - Germany (US\$ 7.3 million)....	3,309	2,883	6,192	SEP/99
(g) GPA Group - Ireland (US\$ 3.7 million)....	3,118	-	3,118	DEC/95
(g) International Lease Finance Corp. - USA (US\$ 39.4 million)....	13,453	19,856	33,309	MAY/2003
	23,941	28,862	52,803	
	36,071	87,647	123,718	

- a)** Interest due in June 1994 (JYE 872.8 million), financed in 18 monthly installments starting in July 1994 and bearing interest at 9.15% p.a. (Note 11.1 item "a");
- b)** Installments of the principal due (US\$ 16.2 million) on contracts for four MD-11 aircraft, borne by the guarantor of the transaction (Mc Donnell Douglas), to be amortized as from 2005. Interest of LIBOR plus 4% p.a. will be charged on the outstanding balance of the debt, be payable quarterly;
- c)** Overdue interest (US\$ 17.4 million) related to contracts for four MD-11 aircraft, borne by the guarantor of the operation (Mc Donnell Douglas), to be amortized as from July 1995 in 10 quarterly installments. Interest of LIBOR plus 4% p.a. will be due on the outstanding balance of debt, and will be payable quarterly;
- d)** Outstanding balance of debt (US\$ 26.9 million) and interest (US\$ 1.1 million) on series "D" of the contracts for four MD-11 aircraft signed with Wilmington Trust, refinanced by the First Bank of Utah for 11 years. Payments will be made monthly beginning in June, 1996. Interest will be also paid monthly based on a rate of LIBOR plus 4% p.a.;

- e) Installments of the principal and interest due on lease contracts from March to June, 1994, which were refinanced with the lessor over 54 monthly payments. Interest will also be paid monthly based on a fixed rate of LIBOR plus 8% p.a.;
- f) Interest due from March to June 1994 on lease contract (item "p" of Note 11.1), and refinanced in 18 monthly installments, with interest at 8% p.a.;
- g) Amounts of operating lease that were not paid and were refinanced by creditors for average terms of 18 to 60 months; monthly payments and interest calculated either at fixed rates of 8% p.a. or LIBOR plus 4% p.a.

#### 11.4 The 1993 lease contracts are broken down as follows:

	R\$ Mil
International Lease Finance Corp.....	176,379(a)
Orix Ouro Corp.....	17,445(b)
SL VRG Ltd.....	17,984(b)
	<u>211,808</u>

(a) Contract converted into operating lease in 1994;

(b) Contract converted into financial lease ("Purchase leasing") in 1994.

## 12. OPERATING LEASES

The Company has operating lease commitments for the following aircraft:

Lessor	Equipment		Contract		Monthly Cost	US\$ thousand		
	Quant.	Type	Beginning	End		Balance 12/31/94	Distribution (Term)	
							Short	Long
Bavaria Flug Gesellschaft - Germany.....	2	B-737/300	APR/91	MAR/99	445	22,699	5,341	17,358
	2	B-737/300	OCT/90	OCT/98	489	22,501	5,870	16,631
	2	B-737/300	AUG/91	SEP/99	511	29,126	6,132	22,994
Ansett Worldwide Aviation - USA.....	1	B-737/300	MAY/90	APR/98	253	10,104	3,031	7,073
	2	B-737/300	NOV/91	OCT/99	501	29,580	6,014	23,566
International Lease Finance Corp. - USA.....	3	B-747/300	APR/94	APR/99	2,390	124,280	28,680	95,600
	2	B-737/300	OCT/91	OCT/96	572	12,584	6,864	5,720
GPA Group - Ireland.....	2	MD-11	NOV/91	NOV/96	1,790	40,279	21,487	18,792
C. Itoh Co. Ltd - Japan.....	2	B-767/300	SEP/94	MAR/98	560(a)(b)	44,880	12,480	32,400
Mitsui Corp - Japan.....	2	B-737/300	DEC/90	NOV/95	555(a)	6,659	6,659	-
	1	DC-10/30	JUN/91	JUN/96	441(a)	7,943	5,295	2,648
Pegasus Capital Corp - USA	1	DC-10/30	SEP/90	OCT/98	317	14,567	3,800	10,767
Global Aircraft Leasing Ltd - Cayman.....	1	DC-10/30	DEC/90	JAN/99	328	16,070	3,936	12,134
PK Airfinance - USA.....	1	DC-10/30	JAN/91	JAN/99	329	16,136	3,952	12,184
Aircraft 46.941 Inc. - USA.	1	DC-10/30	MAY/91	MAY/96	500	8,500	6,000	2,500
B-767 - Leasing, Inc. - USA	6	B-767-200	NOV/94	OCT/2009	1,830(c)	363,672	21,960	341,712

a) Average monthly cost, varying according to the LIBOR plus a spread of 1.5% p.a.

b) After May 1995, average cost is US\$ 1,100 thousand per month.

- c) After January 1996, average cost is US\$ 2,034 thousand per month.

The operating leases are neither recorded in Property and Equipment nor in Short- and Long-Term Liabilities because they do not have purchase options and therefore they are not considered acquisitions.

The balances as of December 31, 1994, which correspond to commitments of the Company, are amortized monthly and charged to results of operations for the year under the heading Flight Operations, in view of the utilization of the respective equipment.

### 13. DEBENTURES

	R\$ thousand	
	1994	1993
3rd Issue.....	42,279	41,562
4th Issue.....	471	-
	<u>42,750</u>	<u>41,562</u>
Analyzed between:		
Short-Term.....	34,724	-
Long-Term.....	8,026	41,562

- 13.1** The Extraordinary Shareholders Meeting held on September 11, 1990, approved the issue on October 1, 1990 of 130,000 debentures with par value equivalent to 1,000 BTNF (Brazilian Treasury Fiscal Notes), each divided into two series of 65,000 debentures each.

Since February 1, 1991, when the BTNF was abolished by government decree, the debentures have been restated according to the Brazilian managed prime rate - the TRD (Daily Reference Rate).

The maturity dates of the first and second series are October 1, 1995 and March 1, 1996, respectively, and they bear interest of 12% p.a. The debenture agreement also establishes a renegotiation procedure to adjust periodically the interest rates to market rates (premiums). Premiums are calculated in accordance with criteria established in the debenture agreement. The maturity dates of the next series are June 1 and July 1, 1995, respectively. The remaining renegotiations will be carried out in periods to be defined by the Board of Directors, at which time the Company agrees that it will buy back any outstanding debentures from debenture-holders who do not accept the renegotiation terms.

Below is a summary of the balance sheet position of these debentures as of December 31, 1994:

	Quantity	R\$ thousand		Renegotiation Period
		Restated Amount	Renegotiated Interest and Premium (b)	
1st series.....	65,000	44,399	2,205	June 1, 1994 to June 1, 1995
	(14,164)(a)	(9,675)	(480)	
	<u>50,836</u>	<u>34,724</u>	<u>1,725</u>	
2nd series.....	65,000	44,399	3,786	July 1, 1994 to July 1, 1995
	(53,940)(a)	(36,844)	(3,142)	
	<u>11,060</u>	<u>7,555</u>	<u>644</u>	
		<u>42,279</u>	<u>2,369(b)</u>	

(a) Debentures in Treasury

(b) Interest and premium accruals are recorded under the heading "Current Liabilities - Accrued Interest".

**13.2** The Extraordinary Shareholders Meeting held on November 17, 1994, approved the issue of 130,000 debentures with par value equivalent to R\$ 1,000.00, divided into three series with the following characteristics:

- 1st series: 25,000 debentures convertible into common shares;
- 2nd series: 71,000 debentures convertible into preferred shares;
- 3rd series: 34,000 debentures convertible into preferred shares.

The debentures covered by this issue are restated (inflation indexed) based on the variation in the Consumer Price Index (IPC-r), and bear interest of 12% p.a. plus a premium, all payable annually. The debentures are to be amortized in 3 consecutive annual installments as from November, 1997, or at the option of the debenture-holder, may be converted into shares of the Company at any time up to the final due date, in accordance with the following schedule:

Period	Quantity of Shares per Debenture
Up to October 31, 1995.....	385
From November 1, 1995 to October 31, 1996.....	308
From November 1, 1996 to October 31, 1997.....	254
From November 1, 1997 to October 31, 1998.....	178
From November 1, 1998 to October 31, 1999.....	102

The 1st and 2nd series debentures are guaranteed by the Company's banking creditor under a private agreement. The subscription value of these debentures was used to pay off loans to these institutions in January 1995. As of December 31, 1994, 447 debentures were subscribed, with the remainder being fully subscribed by January 27, 1995..

## **14. STOCKHOLDERS' EQUITY**

### **14.1 Paid-in capital stock**

The Company's paid-in capital stock, totalling R\$ 39,923,910.00, is divided into 61,856,129 shares with no par value. Of this total number of shares, 35,448,793 are common shares and the remaining 26,407,336 are preferred non-voting shares.

The principal corporate acts during the year were as follows:

- a) Annual and Extraordinary General Stockholders Meetings were held on April 28, 1994 and, among other decisions, approved an increase in the Company's capital stock from Cr\$ 4,353,217;366.27 to Cr\$ 109,790,777,264.45 through incorporation of monetary restatement reserves into capital stock in the amount of Cr\$ 105,437,559,898.18, without issue of new shares. Also, the Extraordinary Stockholders Meeting held on October 15, 1993 approved the following decisions.
  - Capital increase through use of credits hold by the Ruben Berta Foundation in the Company, at the same time authorizing the Board of Directors to decide on opening up the subscription period again at an appropriate occasion;
  - Changes in the Corporate Statutes authorizing the Board of Directors to decide on capital increases, without prior approval of the Annual Stockholders Meeting, up to the limit of 858,438,552 common shares and 639,487,934 preferred shares, due heed being paid to applicable legal provisions and shareholder preference rights.
- b) A General Preferred Stockholders Meeting was held on August 24, 1994 and approved modification in the split between common and preferred shares.

On the same date, financial statements for the period ended June 30, 1994 and changes in the Corporate Statutes were approved at an Extraordinary General Stockholders Meeting, including chiefly:

- Capital stock was increased to R\$ 39,923,910.00 (translation into Reais) and the quantity of shares to 61,856,129, of which 35,448,793 are common shares and 26,407,336 preferred shares;
- Issue of preferred shares without voting rights, up to the limit determined by law (2/3 of total shares);
- Authorization for the Board of Directors to decide on capital increases, without changes in Corporate statutes, up to the limit of 150,000,000 shares.

- c) An Extraordinary General Stockholders Meeting was held on November 8, 1994 and approved the election of members of the Board of Directors.
- d) An Extraordinary General Stockholders Meeting was held on November 17, 1994 and approved the issue of Debentures (Note 13.2).

#### 14.2 Reserves

In accordance with the Brazilian Corporation Law 6.404/76 and the Corporate Statutes, the Company set up a capital stock monetary restatement reserve, which can be capitalized at the next Annual General Stockholders Meeting.

#### 14.3 Revaluation reserve

The revaluation of flight equipment was approved in October of 1988 (Note 6.2). As allowed by Instruction no. 197 issued by the Brazilian Securities & Exchange Commission (CVM) on January 19, 1993, the Company chose not to reclassify part of the revaluation reserves to Special Monetary Restatement reserve (Article 2, Law 8.200/91, as established by CVM Instruction no. 189/92).

The remaining balance of the revaluation reserve as of December 31, 1994 corresponds to the total of the reserve.

#### 14.4 Dividends

The following is the calculation of the adjusted net loss for dividend distribution purposes, as prescribed by the Brazilian Corporation Law:

	R\$ thousand
Net income for the year.....	170,603
Plus: Realization of revaluation reserves.....	79,087
Less: Deficit (accumulated losses).....	(436,662)
Adjusted loss for the year.....	<u>(186,972)</u>

### 15. NET GAINS (LOSSES) ON FOREIGN CURRENCY ASSETS AND LIABILITIES

These amounts correspond to the amount by which exchange gains and losses on foreign currency assets and liabilities differ from the results of applying Brazilian inflation indices to the net amounts of these assets and liabilities.

Major items are:

	R\$ thousand	
	1994	1993
Net profit (loss) on fixed assets financings.....	86,309	(68,181)
- Financings in Japanese Yen.....	343,399	(41,066)
- Financings in US Dollars and other currencies.....	429,708	(109,247)
	9,930	(29,858)
Net profit (loss) from other liabilities and assets in foreign currency.....	<u>439,638</u>	<u>(139,105)</u>

It is important to highlight that two elements contributed to the marked gains in foreign currency, especially those generated by fixed asset financings:

a. Losses on translation of our debts in Japanese Yen, since this currency appreciated in relation to the US Dollar, impacting VARIG by around US\$ 43.5 million (R\$ 36,803 thousand);

b. Gains resulting from US Dollar devaluation in relation to the Real - especially in the second half of 1994 - plus the decrease in purchasing power of the Brazilian currency, which, in total, represents 40% of the US Dollar devaluation in relation to UFIR. This generated gains of R\$ 466,511 thousand.

It should be observed that such net gains are merely bookkeeping entries and impact cash flow only when the corresponding loans are paid.

## 16. GAINS (LOSSES) ON DEFLATION OF INTEREST BEARING BALANCE SHEET ITEMS TO PRESENT VALUE

16.1 The deflation adjustments to present value charged to results of operations for 1994 and 1993 were as follows:

	R\$ thousand	
	1994	1993
- Customers and accounts receivable and unearned transportation revenues.....	(1,557)	(102)
- Suppliers.....	(31)	1,300
- Others.....	-	(558)
	<u>(1,588)</u>	<u>640</u>

The nominal values of transactions which included interest charges were reduced to their net present values by reference to the ANBID (average interest) rate in effect on the transaction dates.

16.2 In the Statements of Income, expressed in currency of Constant Purchasing Power, gains or losses on monetary items and deflation adjustments to present value have been reclassified to the respective accounts to which they relate. This reclassification is broken down as follows:

	R\$				
	Corporate legislation	Full restatement before reclassification	Reclassifications		Constant purchasing power
			Net profit (loss) from monetary items	Adjustments at present value	
- Net operating revenues.....	1,762,353	2,795,010	32,408	(1,523)	2,825,895
- Operating expenses.....	(1,208,625)	(2,097,719)	217,626	(31)	(1,880,124)
- Commercial expenses.....	(410,389)	(698,454)	1,166	-	(697,288)
- Administrative expenses.....	(98,478)	(164,666)	8,322	-	(156,344)
- Net financial income (expenses).....	(711,591)	(1,392,926)	1,172,113	35(b)	(220,778)
- Net exchange loss on assets and liabilities in other currencies.....	-	(3,523,741)	3,963,379	-	439,638
- Income from investments.....	8,058	8,059	-	-	8,059
- Gains (losses).....	-	5,425,670	(5,429,446)	-	(3,776)(a)
- Adjustments to present value.....	(448)	(1,588)	69	1,519	-
- Non-operating income.....	(153,631)	(179,042)	34,363	-	(144,679)
- Inflation indexing result.....	983,354	-	-	-	-
Income for the year.....	<u>170,603</u>	<u>170,603</u>	<u>-</u>	<u>-</u>	<u>170,603</u>

(a) Gains (losses) detailed as follows:	
- Subsidiary and associated companies.....	(13,821)
- Other credits.....	(9,905)
- Collection on behalf of third parties.....	819
- Accounts payable.....	11,727
- Other payables.....	7,404
	<u>(3,776)</u>

(b) Net commercial financial charges for the year, which correspond to the difference between the interest charges effectively included in the nominal value of transactions and ANBID interest rates.

## 17. NON-OPERATING INCOME (LOSS)

We highlight the following net results of the main events which occurred in 1994:

	R\$ thousand
- Penalties on return of aircraft (B-747-400).....	(26,031)
- Result of write-off of six B-767-200 aircraft and 2 engines.....	(102,530)
- Fines on installment payment of levies and contributions.....	(8,324)
- Other non-operating results.....	(7,794)
	<u>(144,679)</u>

## 18. TAXES

### 18.1 Value-added tax on goods and services (ICMS)

In view of the tax changes instituted by the Federal Constitution in October of 1988, the States of the Brazilian Federation approved collection of ICMS on domestic air passenger and cargo transport as from May, 1989 on the basis of the national tax conference (CONFAZ 66/88). The Special Presumed Credit rate is 9% for all of Brazil except for the States of São Paulo, Rio Grande do Sul and Paraná, where the rate is 8%.

Collection of such value-added tax was suspended under a restraining order as from July, 1994. This resulted from a preliminary injunction granted in that month by the Federal Supreme Court in response to a Direct Unconstitutionality Suit filed by the nation's Attorney General. This suit was in turn based on a suit of the same nature filed by the Brazilian Airline Companies Association (SNEA). This decision suspended the administrative ruling which had ordered the collection of the ICMS on airline transportation services in Brazil.

According to our legal advisers, the restraining order means that ICMS will not be levied on Company operations until such time as a final decision is reached.

### 18.2 Social Investment Fund (FINSOCIAL)

The rate of the FINSOCIAL (Social Investment Fund) levy was increased during the period from October, 1988 to March of 1992. On the basis of a decision by the Federal Supreme Court on December 16, 1992, the legal grounds for such increases were judged unconstitutional.

In a decision on our suit at the lowest court level, it was decided that legislation subsequent to the 1988 Federal Constitution is unconstitutional. According to our legal counsel, this means the levy in question may be calculated based on Income Tax effectively due rather than on billings. Therefore, the amounts paid during this period are being considered as tax credits, offset monthly with other levies of the same nature.

### 18.3 Social Integration Program (PIS)

The Company has also filed suit to challenge the government's collecting the Social Integration Program (PIS) levy on Operating Revenues. Although a court decision has not yet been reached, legal counsel advise that as this levy on companies that render services is unconstitutional, and consequently it is not due. Therefore, the amounts collected after 1988 in the amount of R\$ 26.2 million are being considered as tax credits to Other Operating Revenues in the Statements of Income.

#### 18.4 Income Tax and Social Contribution

In light of the deficit accumulated from prior years, neither Income Tax nor the Social Contribution levy are due. Tax losses for the year ended December 31, 1994, amounting to R\$ 414,178 thousand, will be offset against future taxable income.

#### 19. CONTINGENT CREDITS

Through its legal counsel VARIG has filed suit for reimbursement by the government of an insufficiency of domestic fare tariffs in effect from 1986 through 1991. The amount filed for, approximately US\$ 900 million, is based on route concession agreements and, although favorable decisions have already been made in similar cases, the Company has chosen not to record such contingent credits in its financial statements. This will be done when a favorable decision is obtained.

#### 20. AERUS EMPLOYEE PENSION FUND

The Instituto Aerus de Seguridade Social (Aerus Social Security Institute) is an employee pension fund which provides supplementary retirement benefits to airline employees in Brazil.

In order to finance its activities on the basis of actuarial calculations, contributions are paid by employees and sponsoring companies, which in the Company's case amounted to 10.1% of salaries, in a total of R\$ 40,333 thousand for the year ended December 31, 1994.

According to the financial statements of Instituto Aerus de Seguridade Social, supported by the respective actuarial calculations and the report of independent accountants, the mathematical reserves representing liabilities for benefits granted or to be granted, in the amount of R\$ 774,890 thousand as of December 31, 1994, are covered by the plan's assets. Therefore, there are no contingencies to be recognized by the sponsors.

#### 21. INSURANCE

The Company maintains insurance policies in amounts considered sufficient to cover potential risks to its assets and/or liabilities, broken down as follows as of December 31, 1994:

Type	Object	Insured amount R\$ thousand
- Aviation	- Aircraft (engines, airframe), flight simulators, spare parts	3,521,153
- Fire	- Buildings and contracts	274,319
- Ground liability	- Comprehensive (cargo, passengers and other)	851,183
- Sundry Risks	- Valuables and equipment	13,677
- Life and personal accident	- All employees	168

#### 22. CONTINGENT ACCOUNTS

Liens, pledges, guarantees, insured risks, contracts and similar items are broken down as follows as of December 31, 1994:

	R\$ thousand
Insured risks .....	4,660,500
Severance pay (FGTS) .....	139
Guarantees provided to third parties .....	3,922
Spare parts on consignment .....	1,859
Guarantees obtained from third parties .....	32
Finance leases .....	

#### 23. SUBSEQUENT EVENT

**23.1** On March 6, 1995 the Federal Government issued a series of economic-financial measures, in order to maintain and consolidate price stability, chief among them exchange rate flexibility. This note is being included as this report is being published, although item 5.4 of the Report of Management, dated February 24, 1995, already mentions the possibility of future exchange rate flexibility.

## **OFFICERS BOARD OF DIRECTORS**

Rubel Thomas  
*President and Chief Executive Office*

Joaquim Fernandes dos Santos  
*Vice-President Director*

Walterson Fontoura Caravajal  
*Vice-President Director*

Carlos Willy Engels  
*Vice-President Director*

Carlos Ebner Neto  
*Financial Director*

Edacir Luiz Tombini  
*Director of On-Board Service*

João Luis Bernes de Sousa  
*Marketing Director*

Nelson Hillcoat Riet Corrêa  
*Director of Flight Operations*

Paulo Enrique Moraes Coco  
*Director of Sales and Services*

Paulo Lopes Gallindo  
*Director of Engineering and Maintenance*

Rubel Thomas  
*Chairman*

Joaquim Fernandes dos Santos  
*Vice-Chairman*

Aguinaldo de Mello Junqueira Filho

Arnoldo Souza de Oliveira

Harro Fouquet

Ingo Plöger

Lino Pereira

Nelson de Sampaio Bastos

Wilson Nélío Brumer

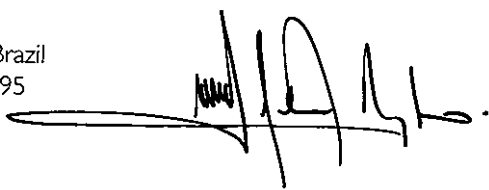
Yutaka Imagawa  
*Accountant*  
C.R.C. - SP 150,334/S/RS  
C.P.F. 053,663,658-04

## REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders and Board of Directors  
"VARIG", S.A. (Viação Aérea Rio-Grandense)

1. We have audited the accompanying balance sheets of "VARIG", S.A. (Viação Aérea Rio-Grandense) as of December 31, 1994 and 1993, and the related statements of income, changes in stockholders' equity and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.
2. We conducted our audits in accordance with auditing standards generally accepted in Brazil. Those standards required that we: a) plan our work considering the materiality of balances, volume of transactions and the Company's system of internal accounting control; b) examine, on a test basis, evidence supporting the amounts and disclosures in the financial statements; and c) assess the accounting principles used and significant estimates made by management, as well as evaluate the overall financial statement presentation.
3. In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of "VARIG", S.A. (Viação Aérea Rio-Grandense) as of December 31, 1994 and 1993, and the results of its operations and the changes in its stockholders' equity and financial position for the years then ended, in accordance with accounting principles generally accepted in Brazil.
4. As discussed in the Annual Report of Management, during 1994 the Company underwent major operational, administrative and financial restructuring, which included, among other measures, balancing the cash flow through renegotiation of aircraft leasing contracts, lengthening of the debt profile and simultaneous reduction of interest charges on the latter, as well as of the fleet of aircraft, routes and headcount, which led to improved operating results. Even so, the reestablishment of the Company's economic-financial balance, intrinsic to its self-sustaining continuity, will depend, apart from the constant effort for maximization of profit and cash flow, on the success of the several measures taken by Management. The financial statements for the year ended December 31, 1994 were prepared in accordance with accounting principles generally accepted in Brazil, assuming that the Company will continue operating as a going concern.

São Paulo, Brazil  
March-9, 1995



**Coopers  
& Lybrand**

Coopers & Lybrand  
Biedermann, Bordasch  
Independent Auditors  
C.R.C. - SP 8599

Roberto Wagner Promenzio  
Senior Partner  
Accountant CRC-SP 88.438 S/RS

## **REPORT OF AUDIT COMMITTEE ON THE 1994 FINANCIAL STATEMENTS**

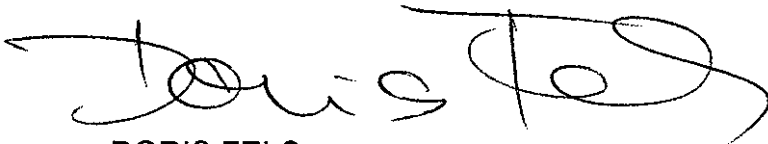
Pursuant to its legal and statutory powers and duties, the Audit Committee of "VARIG", S.A. (Viação Aérea Rio-Grandense) met on this date to examine the 68th Annual Report of the Company's management on the accompanying Financial Statements, encompassing the Balance Sheet, Statements of Income and Changes in Stockholders' Equity and Financial Position, as well as the respective Notes thereto, for the year ended December 31, 1994.

Based on our examination, analysis of monthly balance sheet and information obtained from Company departments, as well as the Report of Independent Accountants, it is our opinion that the said Financial Statements reflect the Company's financial position and the results of its operations and, therefore, we believe that they should be approved by the Annual General Stockholders Meeting.

Porto Alegre, March 10, 1995

Celso Lima Araújo  
Horst Gunte Axthelm  
Roberto Bier da Silva  
Izidoro Polacow  
Arnaldo Sandall Pires  
Emílio Otto Kaminski

This is to certify that the foregoing translation  
which was submitted to me for certification is  
a true translation (extract) of the German  
document




DORIS FELS  
Sworn Translator

25 July 1995

Hiermit wird bescheinigt, daß die *vor* stehende  
Unterschrift von *der* beim Landgericht Köln zuge-  
~~lassen~~ für den Oberlandesgerichtsbezirk Köln er-  
mächtigten Übersetzerin, *die* mit der Anfertigung  
von Übersetzungen in die *englische* Sprache  
betraut ist, herrührt.

Köln, den 27. Juli 1995

Der Präsident des Amtsgerichts

  
(Dr. Wohlenich)

