

ANNUAL MANAGEMENT REPORT



- Floresteca S/A -

Calendar Year 2017
Annual Report

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1. PROPERTY SUMMARY

Floresteca S/A is located in the State of Mato Grosso, where it manages 17,634.57 hectares of *Tectona Grandis* (Teak), planted on 52,862.74 of leased land, and composed of 23 individual farms planted between 1994 and 2008. At year end of 2017, the hectares under management totaled 16,956.75, as a result of harvesting activity over the course of the year. The hectares per farm are shown in appendix I of this report.

The management objective is to maximize the production of high quality teak round logs for hardwood markets.

With the object of gaining long term cost-efficiency and flexibility and securing the highest standards of professionalism in teak plantation management, Floresteca S/A (FSA) has engaged Teak Resource Company S/A (TRC) to perform certain management services to FSA per the Management Services and Timber Purchase and Sale Agreement (MSA), put in effect in March of 2017.

2. THINNING & HARVESTING

This section segregates activities of thinning from final harvesting.

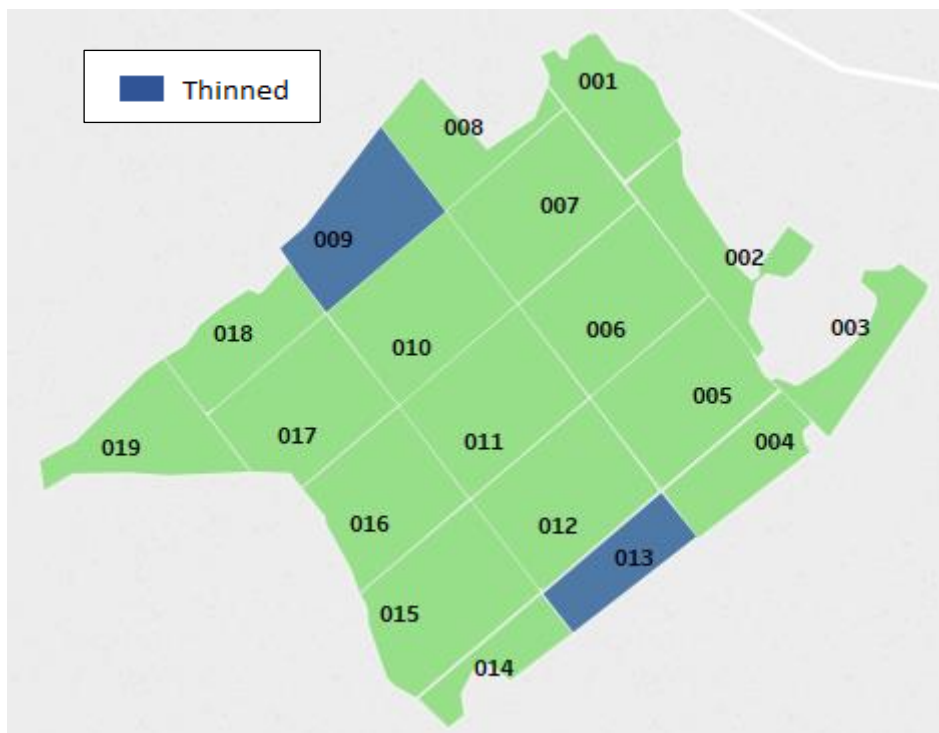
2.1. THINNING ACTIVITIES

In accordance with the 2017 Management Plan the Mutum 2007 (MUT) and São José 2007 (SAJ) farms were to be thinned in 2017. Both areas reached 18 m²/ha of basal area, which indicates they have reached the competition stage. This was the second thinning of these farms and reduced the number of trees per hectare from 430 to 250.

Due to operational constraints, the thinning operation in Mutum began one month earlier than planned, starting in December 2016, and was finished in mid-January of 2017. The map below presents the stands thinned in 2017 in blue. Together with the area done still in 2016, the operation totaled 220 hectares, all site class I areas, where growth is highest and needed to be thinned first.

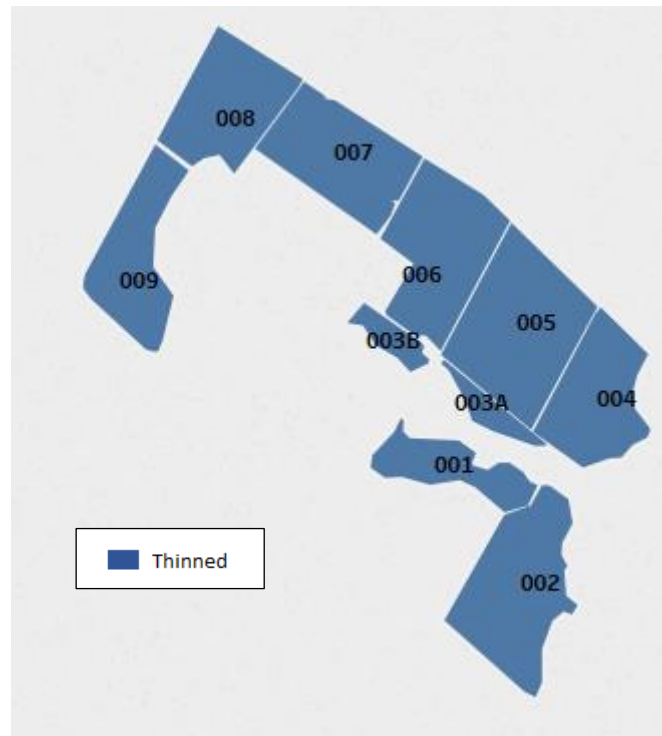
There was no thinning in the remaining areas during the fourth quarter of 2017 and there is no thinning forecasted for Q1 2018 on any project, per the 2018-19 FSA Management Plan

Map 1: YTD – Thinning per stand, Mutum 2007



The thinning at the São José farm (map 2) started in February and was completed during 1S2017.

Map 2: YTD – Thinning per stand, São José 2007



All production from the thinning on these farms was sold as short logs (2.3m). Only logs above 18 cm at the small end have commercial value to be exported or processed in a sawmill. Below 18cm, the logs only have value as firewood, and are left on site, where they may be sold when dry, and depending on market demand for biomass energy. Production at both Mutum and São José were finalized over the course of 2017.

2.2. HARVESTING ACTIVITIES

Final harvesting is the most important operation in the lifecycle of a project, as it is when the most valuable timber and most of the revenues are generated. Floresteca started the final harvest on some of the oldest projects in June 2015. By the end of 2016, the Silas and K_8 projects had been harvested completely, while the operation at Pimental began in September 2016.

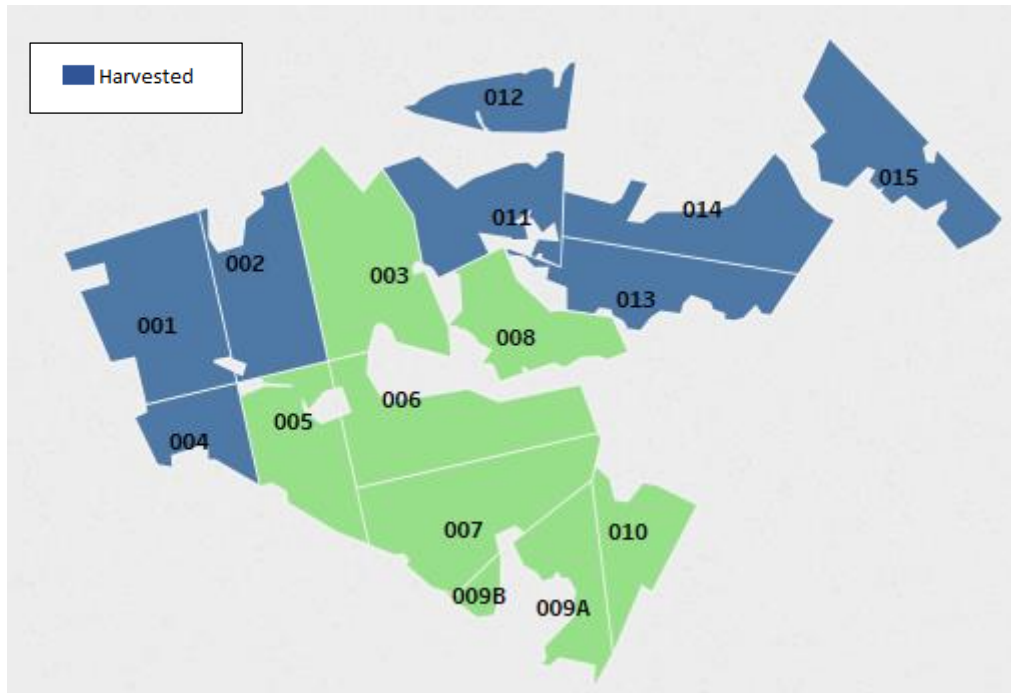
The selection of which areas to be harvested is done through an optimization process, which considers the expected future growth and revenues for different harvesting age alternatives, while respecting important operational and market constraints.

The Pimental project was completed in the fourth quarter of 2017 and Buriti final harvesting continued in 4Q2017 as per the third quarter management report. The final cut of the Cocal project began in the second half of September, and continued throughout the fourth quarter of 2017.

The final cut of the Vale Dourado, and Tenda projects, and continuation of Cocal is expected to occur during the first and second quarters of 2018. The Buriti project presents significant operational challenges

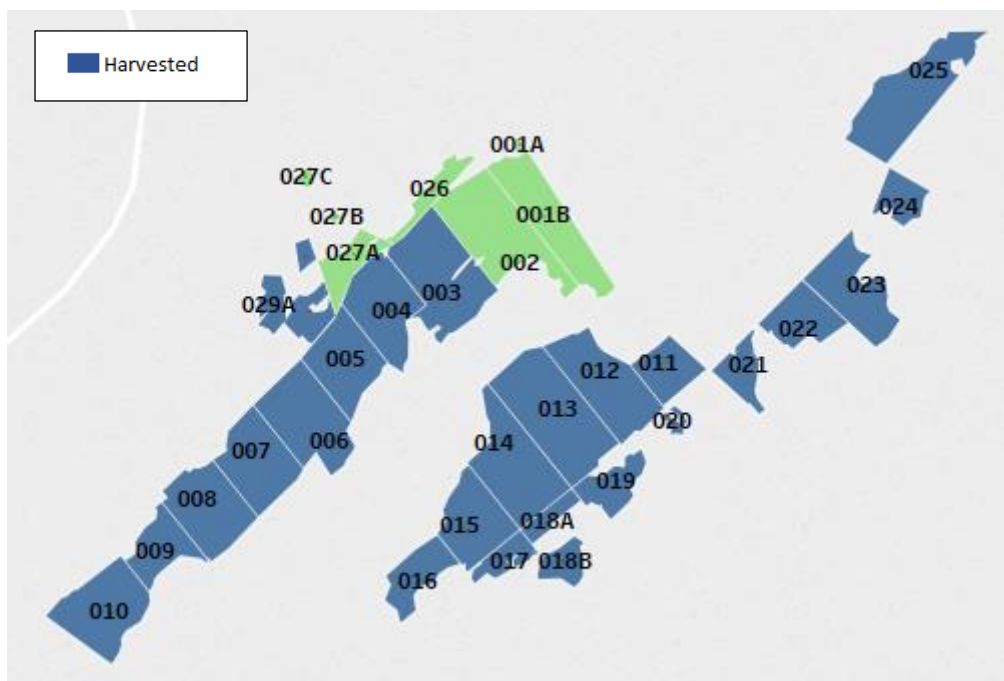
during the rainy season, and has been paused. Final harvest is expected to resume at Buriti form 2Q or3Q of 2018, subject to weather and other conditions.

Map 3: YTD – Final Cut per stand, Buriti 1994



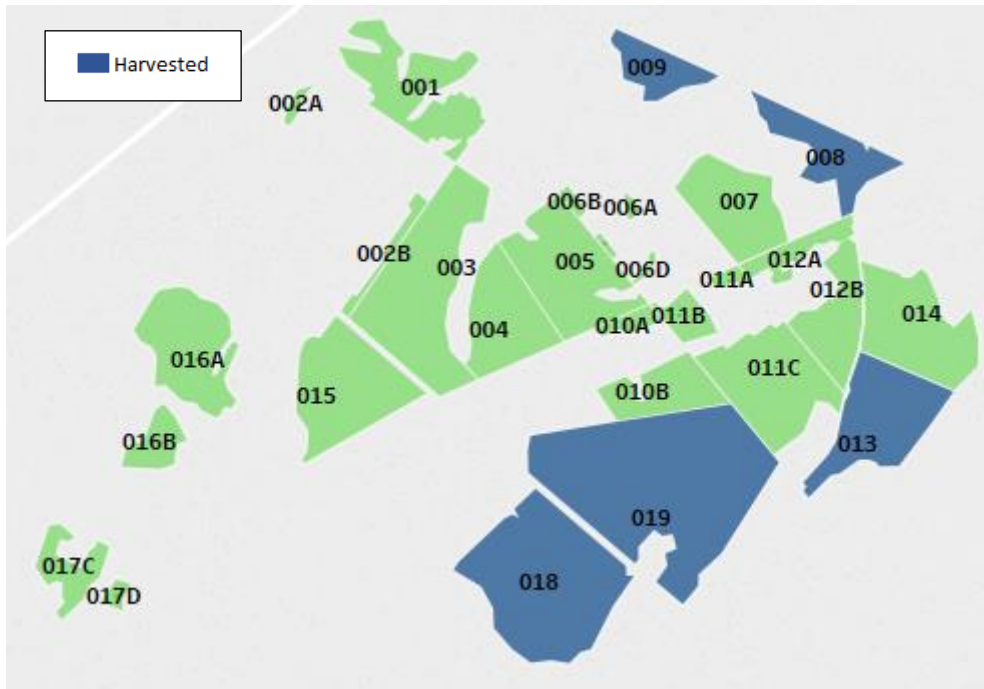
The remaining stands will be harvested during the 2nd quarter of 2018.

Map 4: YTD – Final Cut per stand, Pimental 1996



The Pimental stands 001A, 001B, 002, 026, 027A, 027B and 027C were felled in 2016. All stands have been totally felled, but there are still some wood lots on roadside waiting to dry and loaded at the close of this report, and will be invoiced in 2018.

Map 5: YTD – Final Cut per Stand, Cocal 1996 and 1998



Cocal stands 018 and 019 were felled between October and November of 2017. Most of the wood has already been sold, but a small portion of their production will be carried into 2018. The other stands were started in December and the whole project should be harvested in the first quarter of 2018.

3. FORESTRY MANAGEMENT

The maintenance and general management fees agreed between Floresteca S.A. and SATT are USD 4,500 for a 20-year rotation project and USD 6,375 for a 25-year rotation project (Agreed Fees) for all activities after year 8. Most of the maintenance and general management activities have been outsourced to TRC through the Management Services Agreement put in place in March 2017, to lower the per hectare costs for FSA, (TRC operates at a larger scale, as it also provides services to additional international clients, as well as possessing specialized know-how in teak plantation management). The combined costs for maintenance and general management by Floresteca S.A. and TRC are capped at the Agreed Fees level.

The main groups of silvicultural activities are pruning, sprout control and weed control, which will be described hereunder. Table 1 below shows the activities performed and number of hectares on which they were performed for each individual farm during 2017.

Table 1 – YTD main forestry activities, per project.

Activity	Project	Unit.	Quantity
Pruning	MUT	ha	512,8
	CMB	ha	301,0
	BAM	ha	216,6
	PAR	ha	216,2
	DLG	ha	177,3
	BAR	ha	86,7
	SMJ	ha	54,6
	ARA	ha	41,2
	PAI	ha	37,2
	SER	ha	20,9
	TST	ha	20,2
	SMJII	ha	17,8
	STF	ha	13,2
Subtotal			1715,7
Sprout Control	MUT	ha	609,7
	CMB	ha	305,2
	BAM	ha	235,7
	BAR	ha	200,3
	DLG	ha	159,2
	PAR	ha	137,4
	SMJ	ha	131,7
	SMJII	ha	89,9
	PAI	ha	40,0
	SER	ha	21,7
	TST	ha	20,2
	STF	ha	16,6
	Subtotal		
Weed Control	PIM	ha	347,3
	PAN	ha	91,0
	SMJ	ha	76,6
	BAR	ha	61,9
	VDO	ha	54,4
	BUR	ha	44,0
	CMB	ha	34,0
	PAI	ha	27,0
	COC	ha	18,0
Subtotal			754,2
Total			4437,5

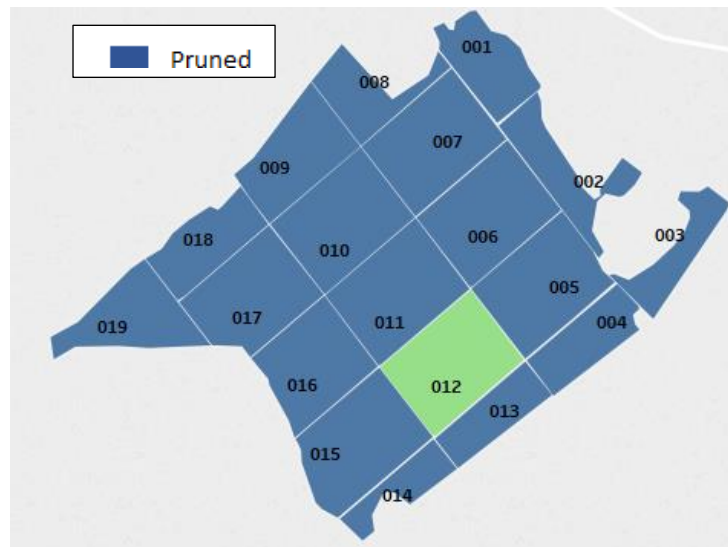
In the following sections, we present details for each activity during the last quarter of 2017.

3.1. PRUNING

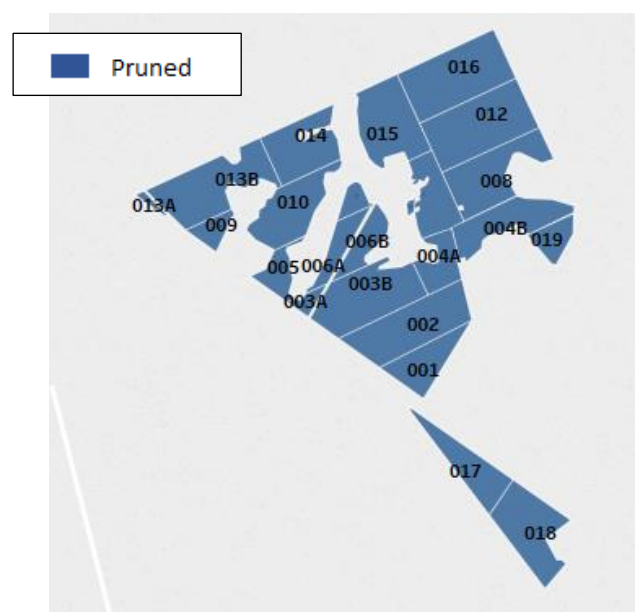
Pruning aims to eliminate the lower branches of the trees that do not contribute to their growth and may cause harm to trunk formation or knots in the wood. This activity is very important in the determination of future wood quality, and results in a better shape and marketability of the logs,

During this last quarter, pruning was done along the boundaries of the stands in of Bambu, São Judas Tadeu, Duas Lagoas and Paiolândia. We focused on the perimeter of the stands (first 7 planted rows) because these trees receive more sunlight, and consequently tend to grow more lower branches than trees in the interior of the forests.

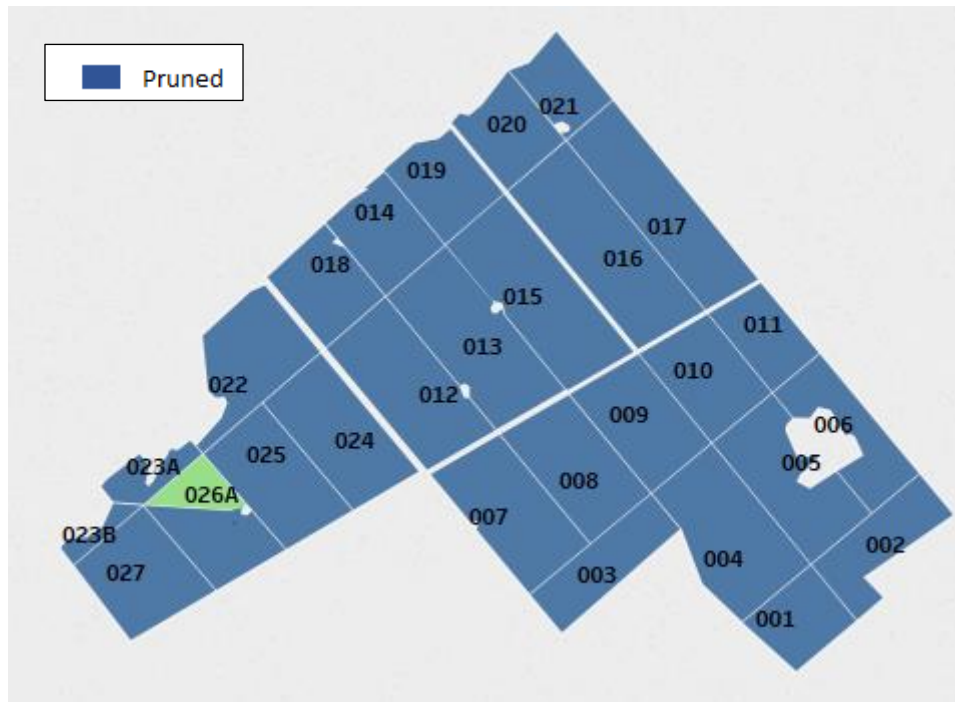
Map 6: YTD Pruning per stand, Mutum 2007



Map 7: YTD Pruning per stand, Cacimba 2002 and 2003

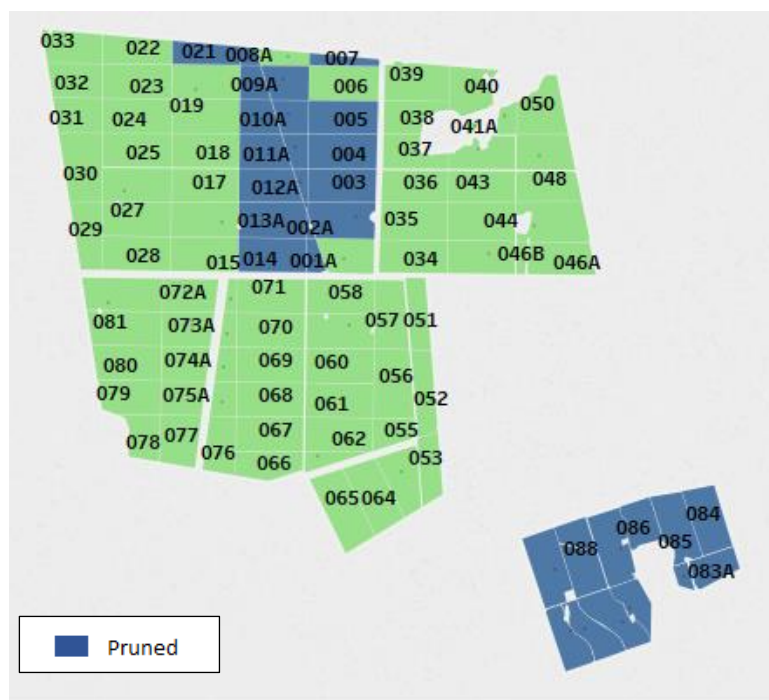


Map 8: YTD Pruning per stand, Bambu 1999 and 2000



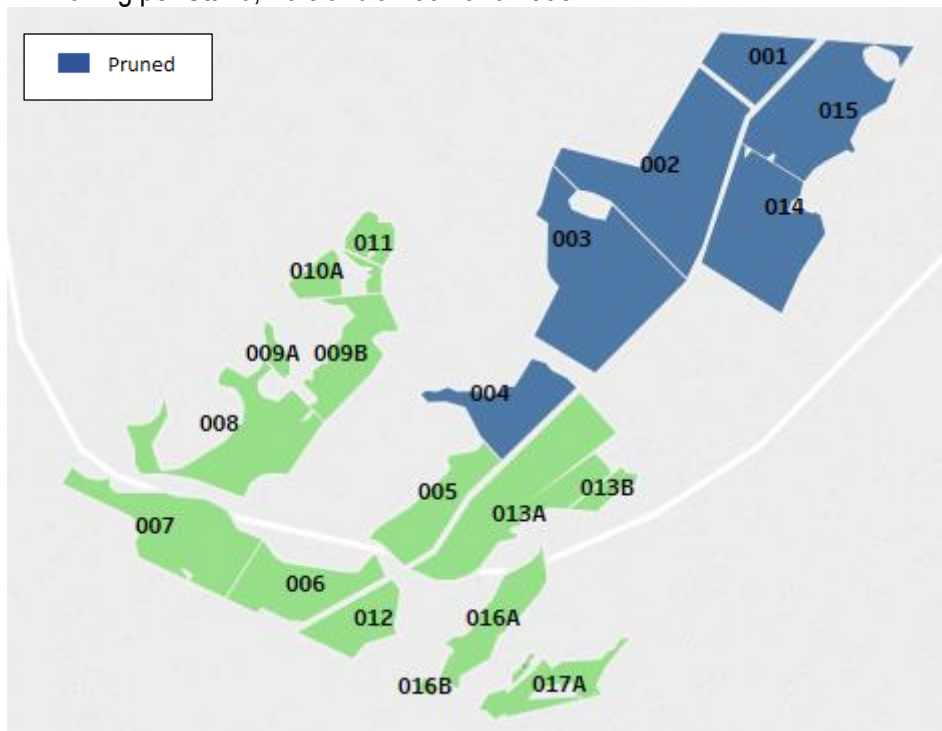
The Bambu farm has finalized its pruning, as the remaining green stand was pruned in the prior quarter.

Map 9: YTD Pruning per stand, Duas Lagoas 2000, 2001, 2002, 2005 and 2006.



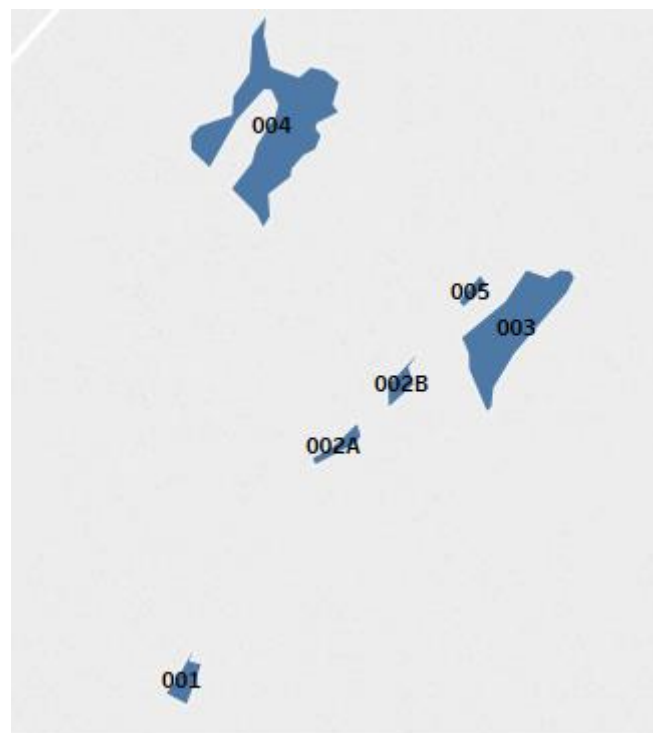
Pruning at Duas Lagoas is ongoing and should be finished in the first quarter of 2018.

Map 10: YTD Pruning per Stand, Paiolândia 1997 and 1998



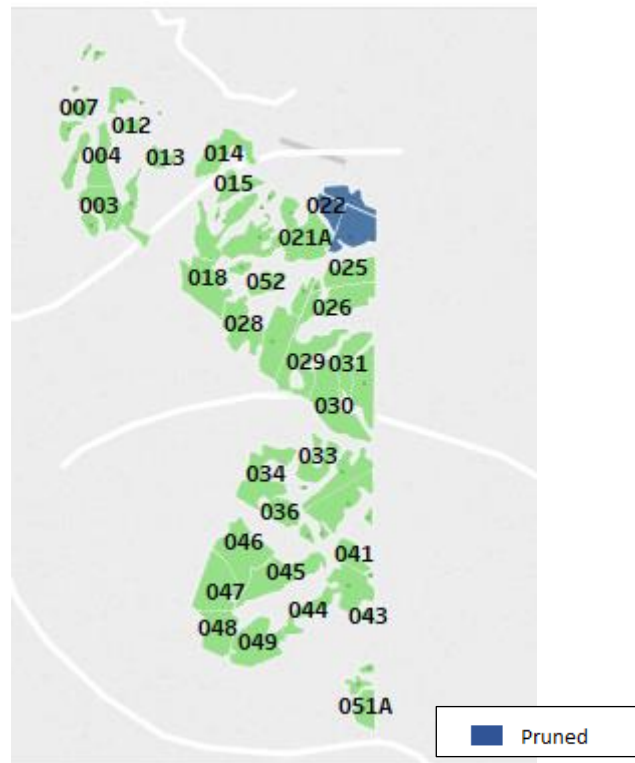
We started pruning the best growing areas of Paiolândia, where branching is more likely to develop. The rest of the project will be done during the first quarter of 2018.

Map 11: YTD Pruning per Stand, São Judas Tadeu 1998



All stands in São Judas Tadeu were pruned during September and October 2017.

Map 12: YTD Pruning per Stand, Terra Santa 2004



A few stands at Terra Santa were done to take advantage of an idle crew that was working on a neighboring farm. The rest of the farm is planned to be done from August to October 2018.

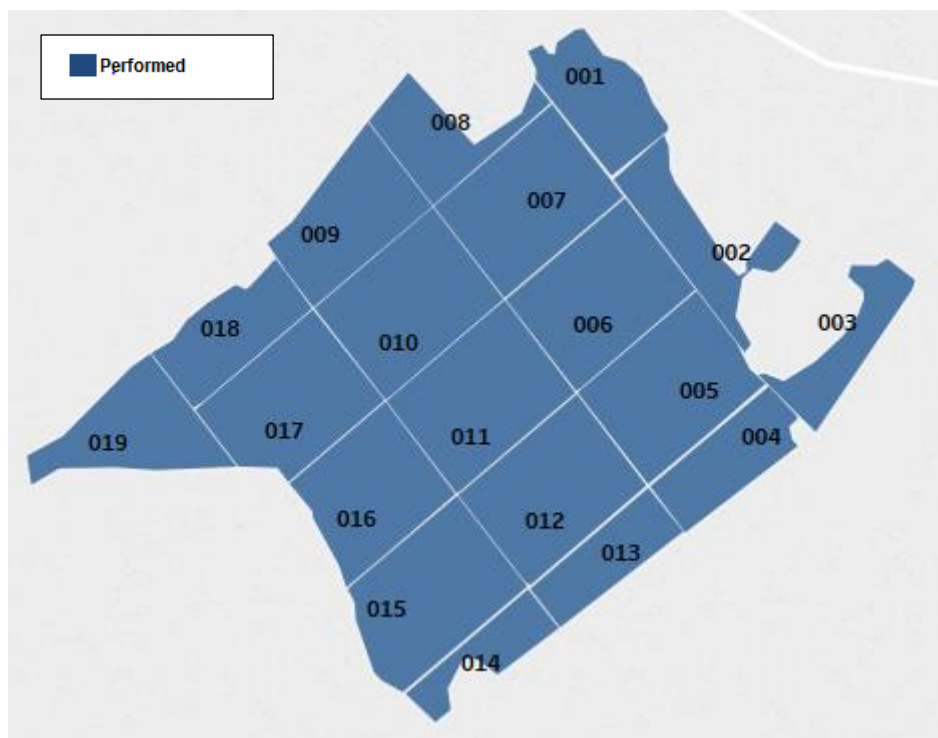
3.2. SPROUT CONTROL

With the opening of the canopy following thinning, the stumps of the removed trees tend to re-sprout and may result in competition with the remaining crop trees. Sprout control involves eliminating sprouts from thinned trees, allowing the remaining trees to grow without additional competition.

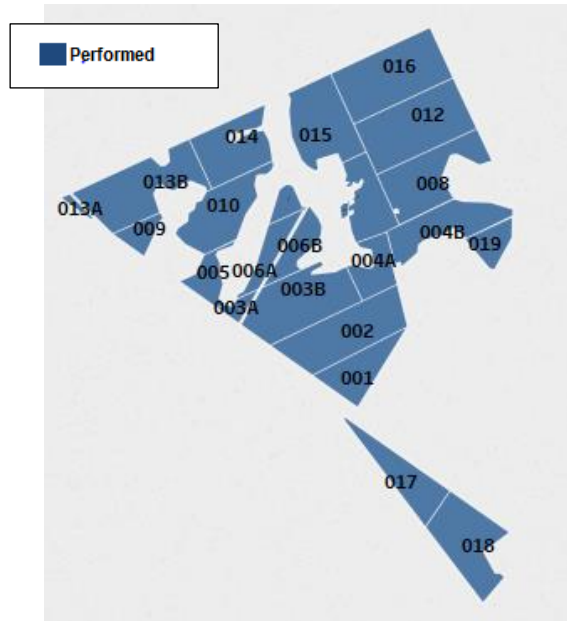
The most relevant areas where sprout control was done are shown in the remainder of this section.

Sprout control was also done along the boundaries of stands in Bambu, Paiolândia and Duas Lagoas, for the same reason mentioned in the pruning section, as the greater sunlight hitting these areas leads to more vigorous growth of stump sprouts.

Map 13: Sprout Control, Mutum 2007

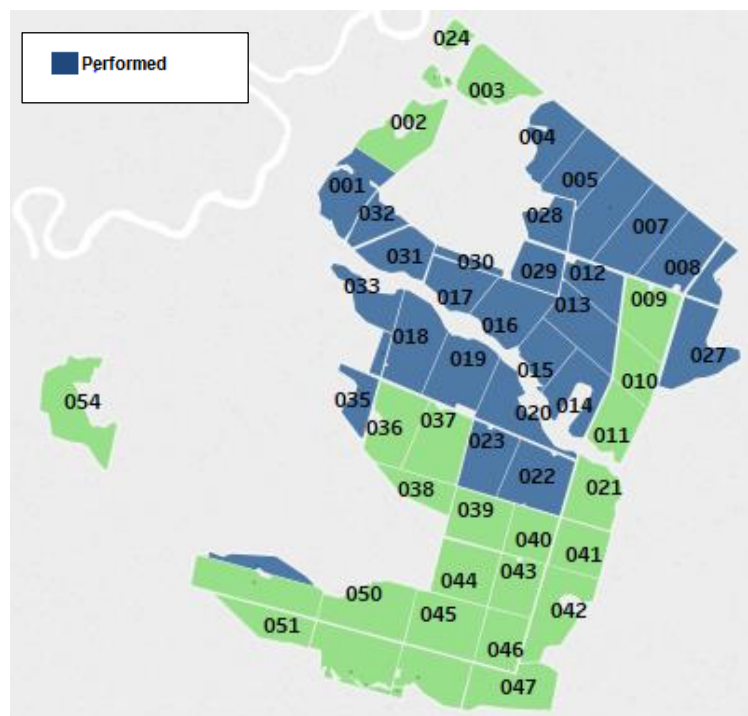


Map 14: Sprout Control, Cacimba 2002 and 2003



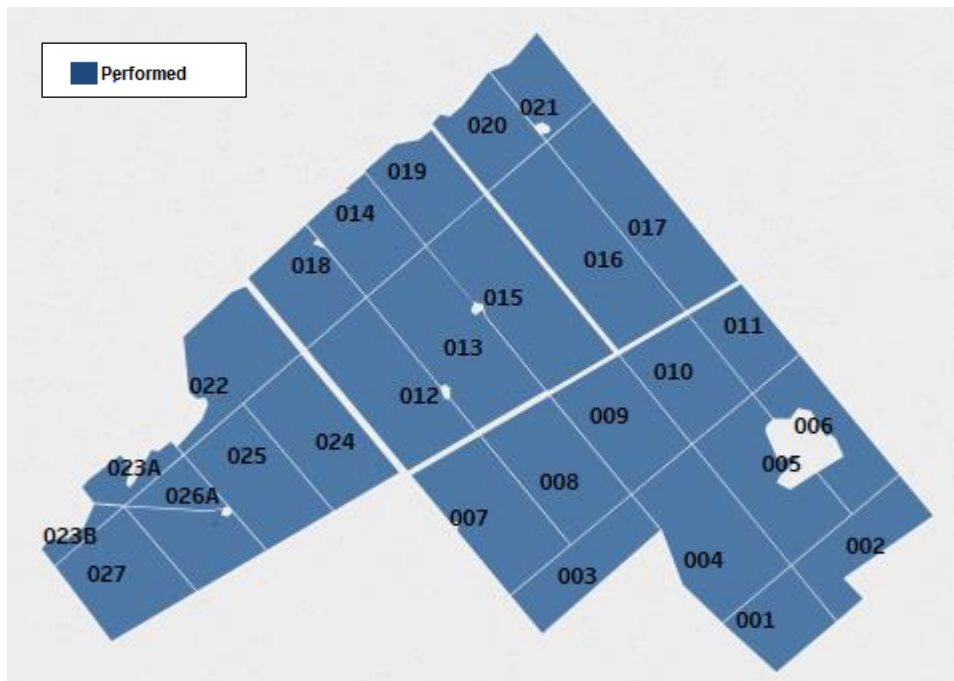
The whole projects were executed from June to August 2017.

Map 15: Sprout Control, Barranquinho 2002, 2003 and 2004.



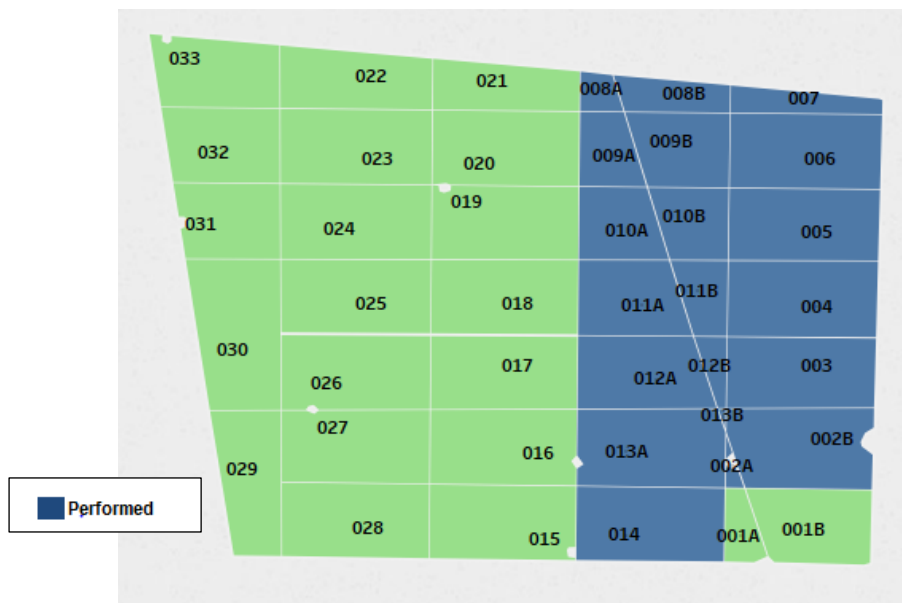
We completed the operation started in August 2016 by March 2017, with just a small portion of the project (stands 036, 037, 038, 039, 041 and 044) not being executed. They are planned to be done in 2018.

Map 16: Sprout Control, Bambu 1999 and 2000.



The work in this farm was performed from September to December 2018.

Map 17: Sprout Control, Duas Lagoas 2000.



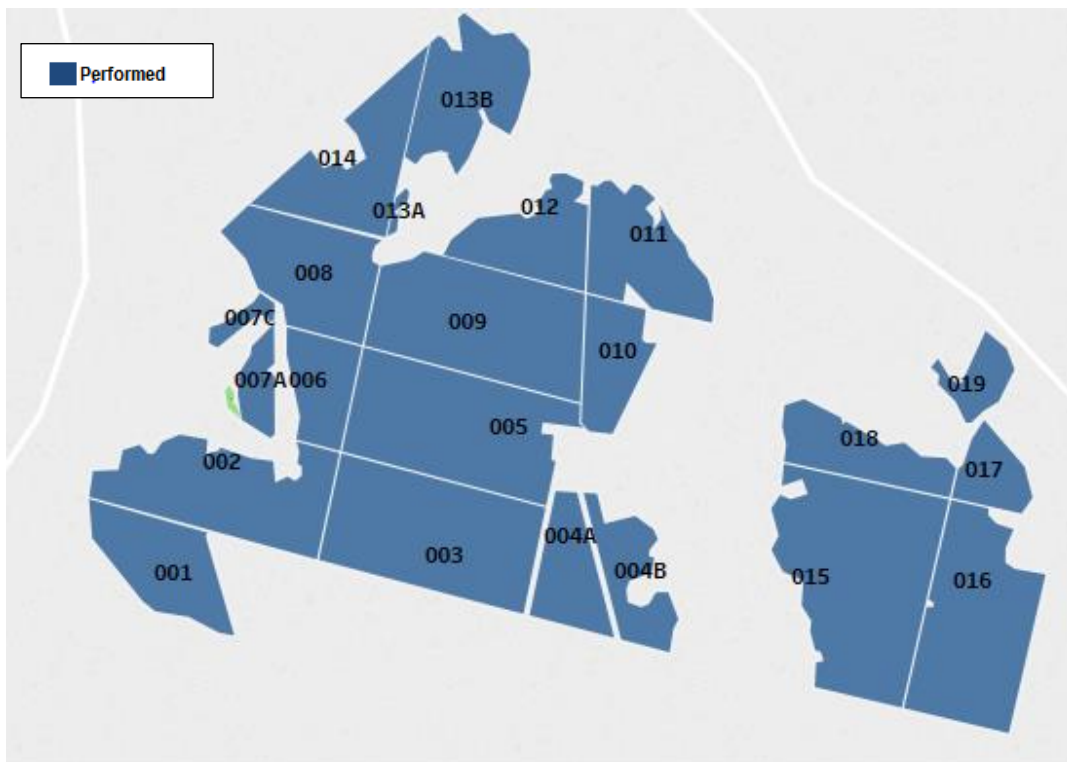
Sprout control is still ongoing at Duas Lagoas and should be finished in the first quarter of 2018.

Map 18: Sprout Control, Paiolândia 1997 and 1998



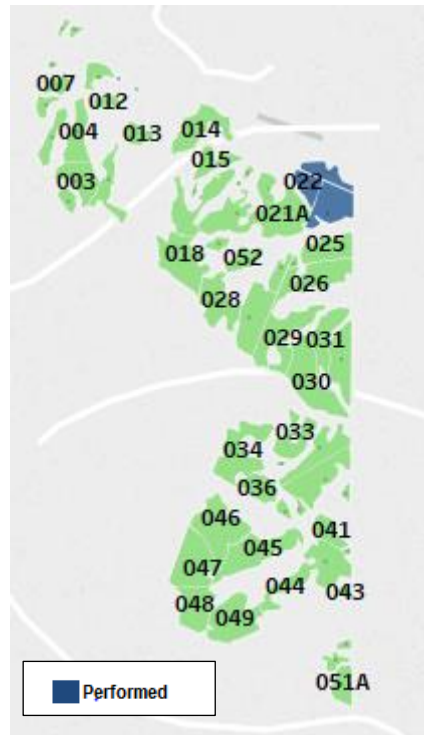
At Paiolândia, sprout control was started in the best stands, but the rest of the farm will be done in the first quarter of 2018.

Map 19: Sprout Control, Paraíso 1997.



Sprout control was done on Paraíso farm in June 2017.

Map 20: YTD Sprout Control, Terra Santa 2004.



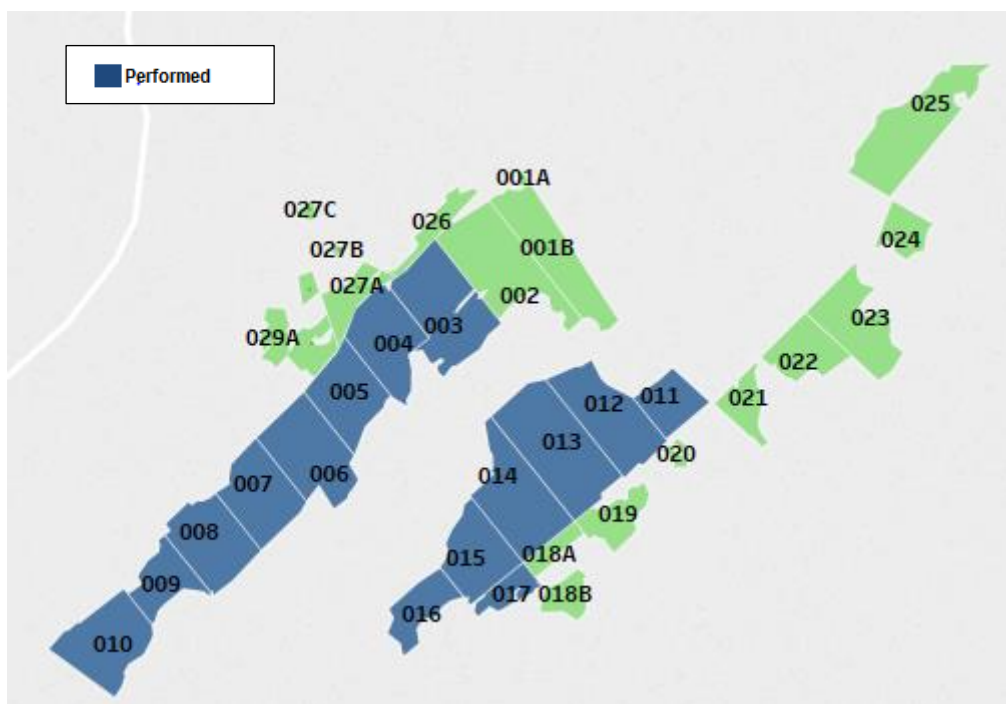
As with the pruning, only 3 stands of Terra Santa had sprout control done, taking advantage of an idle crew that was working on a neighboring farm. The remainder of the farm will be done in 2018 from August to October.

3.3. WEED CONTROL

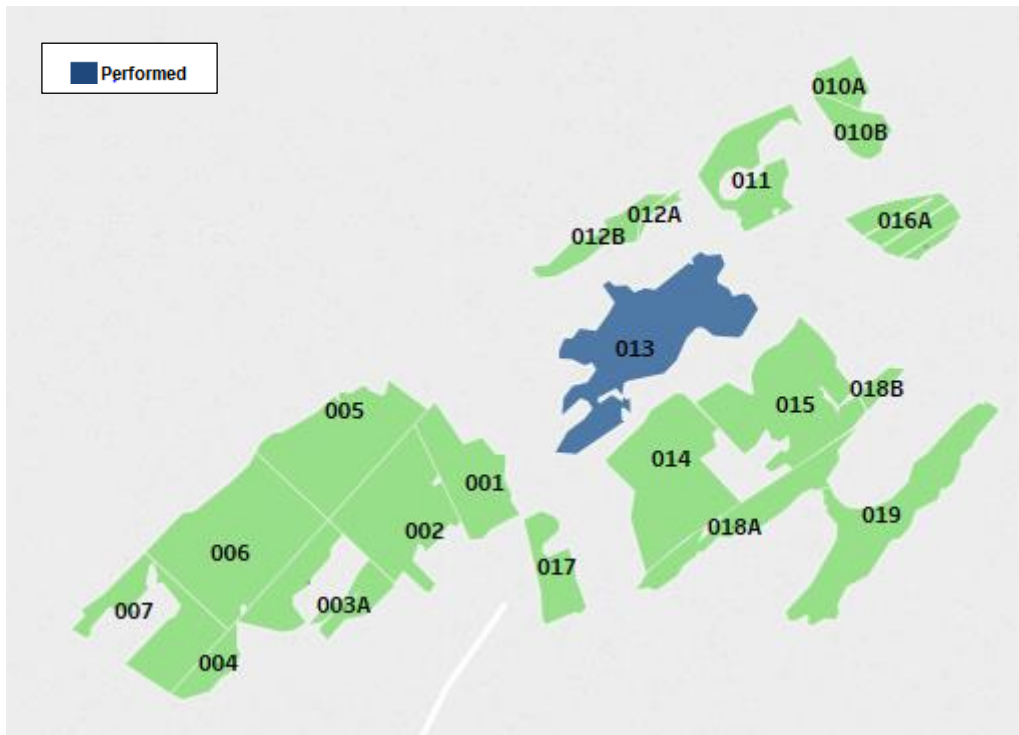
Weed control consists in the prevention of infestations of invasive plants to avoid competition for resources, such as sunlight, nutrients and water. The activity can be done manually, using chemicals (with dorsal spray tanks) or mechanically to cut or remove the weeds. This operation can also be done to clear the underbrush to facilitate traffic for our field crews inside the forest prior to significant operations. The most relevant areas performed this quarter are presented in detail in the maps in this section.

The mechanized mowing was performed prior to the start of the final cut in all areas presented below, to improve harvesting performance and make working conditions of the crew safer on the cleaner ground. It was carried out on the Buriti, Cocal and Vale Dourado projects.

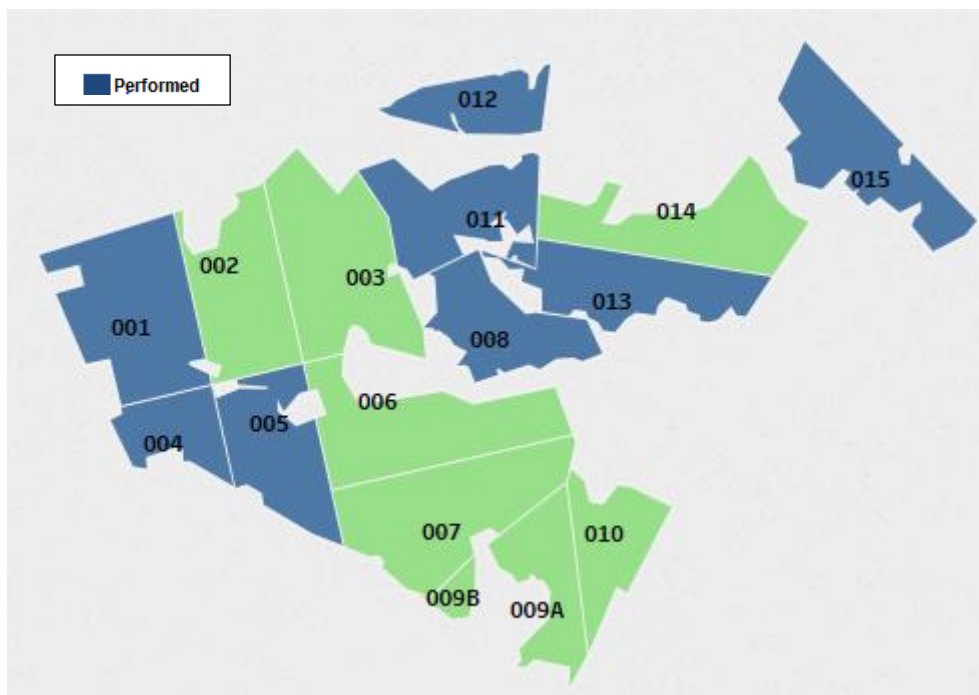
Map 21: YTD Weed Control per stand, Pimental 1996



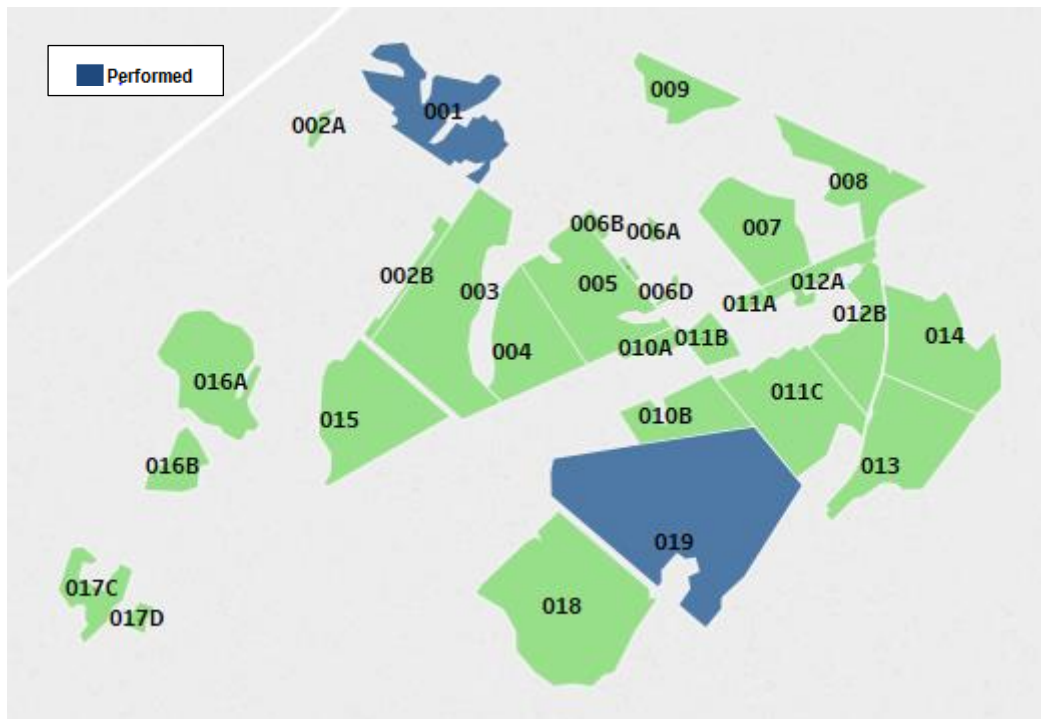
Map 22: YTD Weed Control per stand, Vale Dourado 1998 and 1999



Map 23: YTD Weed Control per stand, Buriti 1994



Map 24: YTD Weed Control per stand, Cocal 1996 and 1998



4. PLANNING AND FOREST DESCRIPTION

On the tables below we present the list of projects that are eligible for harvesting and thinning in 2018, per the FSA Management Plan for 2018-19. It is important to note that the harvesting schedule can be changed due to weather, market and operational constraints that may occur over the course of the year. More detail about the decision to work on these projects can be found in the Management Plan document.

THINNING VOLUMES (m ³)													
PROJECT	SITE CLASS	AREA (HA)	8-16.	16-18.	18-20.	20-23.	23-25.	25-30.	30-35.	35-40.	40+	Total	m ³ /ha
2002CMB	S1	234,7	1.875,7	950,3	1.201,9	1.913,8	1.272,8	2.914,5	854,8	22,0	0,0	11.005,8	46,9
TOTAL		234,7	1.875,7	950,3	1.201,9	1.913,8	1.272,8	2.914,5	854,8	22,0	0,0	11.005,8	46,9

FINAL HARVEST VOLUMES (m ³)													
PROJECT	SITE CLASS	AREA (HA)	8-16.	16-18.	18-20.	20-23.	23-25.	25-30.	30-35.	35-40.	40+	Total	m ³ /ha
1994BUR	S2	81,8	883,7	447,6	567,4	893,2	599,5	1.365,9	414,5	15,9	0,0	3.856,4	47,1
1994BUR	S3	211,7	2.462,7	1.236,6	1.488,9	2.015,3	1.287,3	2.131,5	295,0	2,3	0,0	7.220,4	34,1
1996COC	S3	374,9	9.305,5	3.192,4	2.542,8	1.223,7	199,0	91,3	0,7	0,0	0,0	4.057,6	10,8
1996TEN	S3	191,4	2.020,2	1.034,2	1.271,4	1.790,9	1.211,2	2.280,2	471,8	11,5	0,0	7.037,0	36,8
1997PAI	S1	115,9	1.410,6	545,4	908,1	1.519,8	1.379,0	3.688,5	2.668,5	1.033,1	78,2	11.275,3	97,3
1997PAI	S2	66,8	761,7	343,7	510,2	859,2	703,3	1.751,1	1.122,5	216,3	2,5	5.165,0	77,4
1997PAI	S3	115,3	2.330,8	829,6	713,3	707,6	285,5	222,5	6,6	0,0	0,0	1.935,5	16,8
1997PAR	S2	80,9	1.655,1	837,3	1.012,9	1.341,7	910,0	1.383,8	249,0	4,9	0,0	4.902,3	60,6
1997PAR	S3	474,1	9.279,8	4.134,7	4.757,1	5.811,6	2.814,0	1.480,6	6,9	0,0	0,0	14.870,3	31,4
1998BOC	S1	393,8	4.976,8	514,9	1.178,6	2.957,9	2.913,6	9.979,4	10.100,1	8.201,3	4.929,1	40.260,0	102,2
1998BOC	S2	37,9	329,5	119,6	207,7	347,6	326,0	893,8	664,4	297,7	25,5	2.762,7	73,0
1998PAI	S1	59,3	604,0	212,7	373,8	629,9	594,1	1.643,1	1.232,0	582,8	58,0	5.113,7	86,3
1998PAI	S2	34,7	432,9	224,2	273,9	385,5	251,6	505,7	66,3	0,0	0,0	1.483,0	42,8
1998VDO	S1	202,2	2.677,1	249,8	586,9	1.540,1	1.515,7	5.262,0	5.418,1	4.462,6	2.761,4	21.546,6	106,5
1998VDO	S2	149,4	1.742,7	857,8	1.113,5	1.681,1	1.206,1	2.635,0	1.015,2	192,0	9,1	7.852,1	52,5
TOTAL		2.590,0	40.873,0	14.780,6	17.506,6	23.705,2	16.195,8	35.314,5	23.731,6	15.020,4	7.863,7	139.337,9	53,8

5. LOG SALES

5.1. LOG SALES AND HARVESTING COSTS

The Year to Date log sales volume was 58,818,80 m³, at a weighted average price (at roadside) of USD 115,01/m³. Resulting total gross roadside revenue was USD 6.764 million, with the majority of revenue from export log sales. The time difference from forwarding to sales is at least of 30 days for drying and loading.

Table 2 – YTD Sales (volume & values)

Planting Year	Project	Intervention	Total Area (ha)	Volume Sold (m ³)	Gross Revenue (USD)				W.A. Price (USD/m ³)
					Export	Local	Sawmill	Total	
1994	BUR	FC	592,29	6.739,21	323.316,68	1.609,65	207.321,34	532.247,67	78,98
1996	PIM	FC	693,42	36.450,45	4.366.469,66	10.132,36	495.381,87	4.871.983,89	133,66
1995	SIL	FC	582,80	132,03	35.026,21	-2.647,28	0,00	32.378,93	245,24
2004	TST	2T	1.143,17	648,96	70.725,19	0,00	0,00	70.725,19	108,98
1998	COC	FC	133,80	4.202,37	505.853,89	0,00	136.258,39	642.112,28	152,80
2007	MUT	2T	539,18	1.891,82	0,00	0,00	109.665,92	109.665,92	57,97
2007	SAJ	2T	301,30	8.653,20	0,00	0,00	487.311,04	487.311,04	56,32
1998	VDO	FC	351,68	100,76	0,00	0,00	18.439,08	18.439,08	183,00
Total			4.337,64	58.818,80	5.301.391,64	9.094,73	1.454.377,64	6.764.864,01	115,01

FC = Final Cut

2T = Second thinning

Gross Revenues = revenues before applicable costs including:

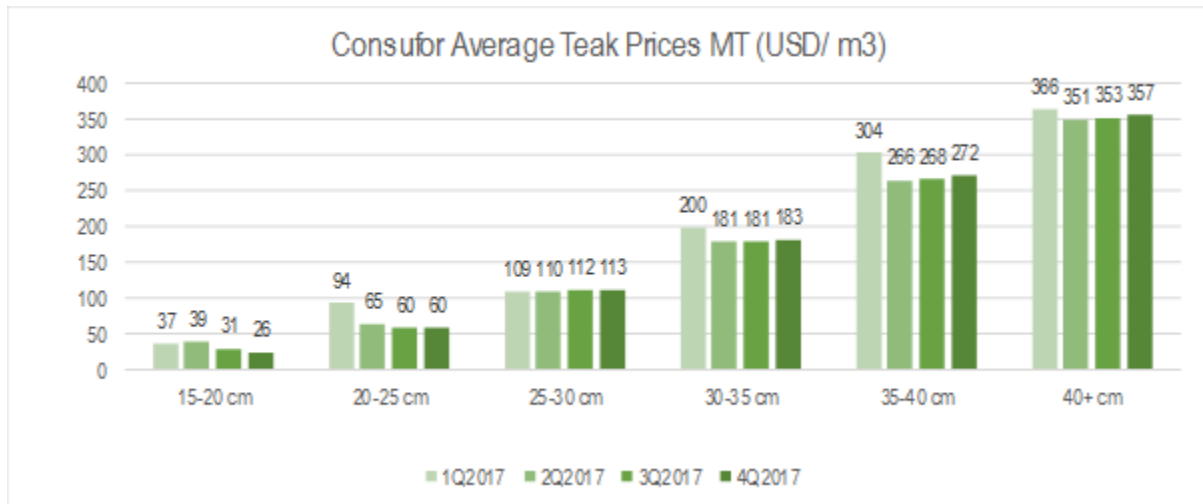
- Harvesting costs FC (cutting, forwarding, making land root free)
- Agreed maintenance and general management fees;
- Incentive fee of 5% to FSA;
- Applicable local taxes.

W.A. Price = Weighted Average for the price of sales, equals to the total revenue divided by the total volume sold.

The considerable variation observed in the weighted average prices per m³ reflects both the mix and timing of the harvesting operations occurring year to date. In projects like SIL and PIM, for example, where final cuts are occurring, unit prices are higher, with a greater share of large diameter logs, whereas at MUT and SAJ, where second thinning are taking place, unit prices are lower, reflecting mostly smaller diameter logs. It should be also noted that the revenue and price figures shown here are partial and reflect activity in the current year only. Final gross revenue and average prices per project take into consideration all revenues over the life of each project.

Log prices are determined based on roadside prices in Mato Grosso. As the market for teak logs is largely private and fragmented, Floresteca has contracted Consufor, an independent forestry services firm, to provide a benchmark roadside pricing report for teak log sales in the Mato Grosso region. The reports are done quarterly, the latest of which dated October 2017. All were based on based on a sample of respondents, most which are forest owners, but also included some sawmills and traders. Below we show the prices for all quarters (prevailing at the beginning of each period):

Figure 1: CONSUFOR average Teak Prices in Mato Grosso (USD/m³)



Prices of larger diameter logs (most of which represent later thinnings and final harvest logs, have remained steadier, with some appreciation in the largest diameter grades (following a drop in 2Q vs Q1 2017).

Note that logs below 25 cms in diameter have experienced price compression over the course of 2017. These thinning logs have less heartwood, and are accordingly discounted, and compete with logs from Central America which have logistics advantages. Most of these logs are sold in the local market to sawmills, as their export would not be economic.

Table 3 – 2017 harvesting costs (FX 3,3080)

Activity	Actual cost BRL	Actual cost USD
Total	5.698.483	1.722.637
Volume Sold	58.819	58.819
Cost / m³	96,9	29,3

6. COMPLIANCE & LEGAL ISSUES

6.1. PARAISO FARM

Issue 1: Floresteca has received a legal challenge by Mr. Antonio Frigieri, the owner of the Paraíso Farm (“plaintiff”), in a declaratory procedure, requesting the end of the usufruct rights with immediate effect. After being subpoenaed by the Mato Grosso State Court, which held that the plantation area was considered abandoned, the court issued a preliminary decision in August 2016 granting land possession to the plaintiff. However, the preliminary decision did not consider the Usufruct Agreement void, and Floresteca challenged the preliminary decision in the Mato Grosso Superior Court. In May 2017, the Superior Court reversed the initial decision in favor of Floresteca, who has been granted the right to continue under the Usufruct Agreement. Following the court decision and after a relatively short disturbance in the work planning, the maintenance teams of FSA resumed activities at Paraiso.

6.2. MUTUM FARM

Issue 1: The Mutum farm was invaded by the MST Landless Movement -in 2011. The owner of the property (LHS) filed a court order to remove the squatters in the same year. The judge ruled in favor of LHS on June 27, 2011. However, the MST has repeatedly invaded the property over time, motivating the hiring of a private security guard.

Issue 2: In 2012, the National Agrarian Reform Institute -INCRA, initiated an administrative process aimed at the expropriation of the property, alleging that the property was not being used productively. In (March 27, 2012) LHS filed for a withdrawal of the process in the Federal Court, at Cáceres-MT. On March 28, 2012, the judge decided to suspend INCRA’s administrative procedure. Subsequently, on January 09, 2015, a technical opinion declared the property as productive. A Court Hearing was held on November 9th, 2017, where FSA’s testimonies were heard to clarify the facts. The judge is expected to issue a final decision over the course of 2018.

7. APPENDIX

7.1. PLANTED AREA PER PROJECT AT END OF 2016

Project		Total Managed		
		Area	Harvested	SATT
1994	BUR	592,29	43,76	548,53
1995	K-8	331,91	331,91	0
1995	SIL	582,8	582,8	0
1996	COC	374,88	0	374,88
1996	PIM	693,42	629,24	64,2
1996	TEM	191,42	0	191,42
1996	PAI	297,92	0	210,44
1997	PAR	555,05	0	512,94
1998	BOC	431,65	0	426,55
1998	COC	133,84	0	133,84
1998	PAI	93,95	0	93,95
1998	CAN	44,62	0	44,62
1998	STJ	26,76	0	26,76
1998	SIL	24,41	0	24,41
1998	VDO	351,68	0	351,68
1998	ARA	98,88	0	78,3
1998	BAM	549,07	0	400,17
1999	BOC	108,18	0	108,18
1999	CPB	507,87	0	507,87
1999	CAS	88,49	0	84,89
1999	SER	105,01	0	104,01
1999	VDO	48,59	0	48,59
2000	BAM	513,83	0	404,24
2000	DLG	1527,51	0	1527,51
2001	DLG	2136,42	0	2136,42
2001	SMG	97,52	0	93,02
2002	BAR	970,2	0	756,75
2002	CMB	571,08	0	445,75
2002	DLG	48,41	0	48,41
2002	SMJ	1085,18	0	1085,18
2002	SMG	5,71	0	4,57
2003	BAR	12,95	0	10,36
2003	CMB	10,19	0	8,15
2003	STF	2562,71	0	2493,02
2003	SMJ	207,87	0	207,87
2004	BAR	1201	0	1000,51
2004	TST	1143,17	0	1134,45
2005	DLG	207,67	0	170,37
2006	DLG	233,88	0	190,72
2007	MUT	539,18	0	522,43
2007	SAJ	301,3	0	290,91
2008	SMJII	99,87	0	89,88
Total		19708,34	1587,71	16956,75