# ANNUAL MANAGEMENT REPORT

- Floresteca S/A -

Year 2018

(Jan/18 to Dec18)

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## PROPERTY OVERVIEW

Floresteca S/A is located in the State of Mato Grosso, where it holds16,103.48 hectares of *Tectona Grandis* (Teak) at December 31th 2018, planted on 52,862.74 of leased land, and composed of 22 individual farms planted between 1994 and 2008. The area is detailed on appendix 9.1.

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 TRC Agroflorestal Ltda (TRC) to perform certain management services to FSA per the Management Services and Timber Purchase and Sale Agreement (MSA), put into effect in March of 2017.

The Companies are structured as follows:

- Floresteca S.A (FSA): Management Company
- Floresteca BV: Controlling shareholder of FSA, and channel to the final beneficial owners of the forests.
- TRC Agroflorestal Ltda. (TRC): Management Services Company retained by Floresteca S.A. to perform harvesting, silvicultural and administrative services on the forests;

For simplification purposes, the information is presented on a consolidated basis for all the projects under management by FSA (note: does not consolidate with Floresteca BV). Financial information is presented on a calendar year basis.

# 1 EXECUTIVE SUMMARY

Macroeconomic developments commented in the 3Q2018 Management Report were also factors in 4Q2018. Federal elections for President, 2/3s of the Senate and all congressional seats, as well as state governors and assembly seats, were held on Oct. 7th for the first round and Oct. 28th for the second round, with the campaigns officially beginning August 15th. The BRL was subject to substantial volatility through most of this period, with net valuation vs the USD through the end of the third quarter. Following the second round, with the definition of Jair Bolsonaro as president-elect, the BRL appreciated vs the USD on the basis of speculation on the new government's ability to tackle Brazil's economic problems. The Indian Rupee (INR) appreciated in value vs USD on the back of robust Indian GDP figures, as well as a reduction in the trade tensions between the US and China. These macroeconomic factors combined with the low shipping season from Central American teak suppliers resulted in a stable supplying volume of logs to India from Brazil in the fourth quarter. These factors are discussed in greater detail in the market update in section 5.4.

The forest areas under FSA management received substantially higher rainfall than normal during the first quarter of 2018, and this higher rainfall directly impacted forestry and harvesting activities. The harvesting teams prioritized areas with more export logs during the 1Q2018, with the intention of catching up on the projects with more sawmill volume during the dry season, beginning in 2Q2018. While we had expected to be able to catch up on both harvesting and silvicultural activities in the second half of the year, we ultimately fell short, with a substantial part of the harvest volume slipping into early 2019, and substantially reversing our forecast from the 3rd quarter.

As shown in Figure 1 below, the 2018 actual Operational Net Result was USD 1,911 k versus the USD 2,691 k budgeted or a unfavorable variance of USD 780 k (29%). Sales revenue was higher than budgeted for the year, though substantially below the 3Q year end estimated amount, the result of lower than expected volume from delays in the harvesting schedule, which were nonetheless partially offset by higher sales prices. The main reason for the lower final result vs the budget is due to higher than anticipated overhead and forestry costs.

We present a summary of the main factors which impacted results here:

On the sales side, the overall result was favorable when compared to budget in USD 287 k, due to:

- Volume: was lower than budget by 771 m³, caused by the harvesting delay on Buriti and Bocaina which unfavorably impacted the sales volume in 12 k m³ in 2018 when compared to budget. The work in these areas had started in 4Q2018, but will only be completed in 2019. The volume from these farms was largely offset by higher than planned volumes earlier in the year coming from Cocal, Tenda, Vale Dourado, Silas, Santa Maria do Jauru II and Pimental (11.3 k m³). Greater details about the volumes variation on section 5.1;

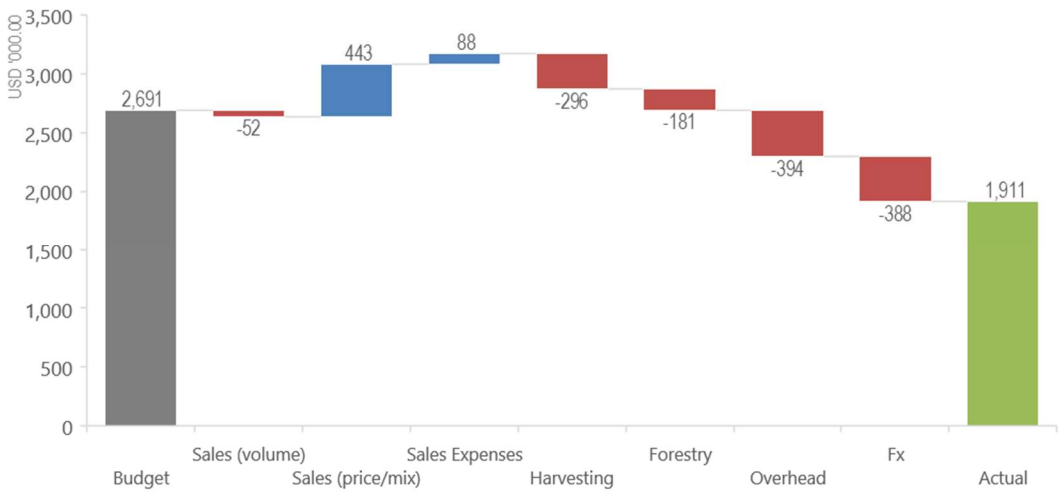
- Price and Mix: a higher weighted average roadside prices had a favorable contribution to budget. The small end diameter logs were conservatively budgeted using the minimum benchmark price, but in fact sold at the average rates. Additionally, the majority of the assortment classes had a higher weighted average than the midpoint used for budgeting. Greater detail about prices is provided in section 5.2;

The others main drivers for this result are:

- Total overhead was was unfavorable to budget by USD 394 k and it has two components:
  - Property Related Costs: Higher than budgeted payroll expenses (USD 137 k), and legal fees (USD 147 k) related to the Rural Property Tax and Legal Advisory;
  - Management fee: as agreed on Management Sevices Timber Sales & Purchase Agreement (MSA) FSA pays BRL 414 per hectare per year under TRC management, and this value is adjusted by Brazilian inflation (IGP-M price index). The adjustment was unintentionally omitted from the 2018 budget, and the adjustment of BRL 324 k (USD 100 k) was only reflected in 4Q2018.
- Harvesting costs were higher than budgeted by USD 296 k as cutting and forwarding activities had lower productivity on Cocal and Buriti. Aditionaly there was higher than expected Social Security Tax (INSS) over harvesting services. See section 6 for harvesting activities details;
- Forestry costs were overbudget (USD 181 k), in due to the purchase in advance of inputs (e.g., herbicides, and fuel) that will be consumed in the next quarter and higher than budgeted cost on operational support staff, equipments, machinery and inputs that support the other activities as for example utlity trucks that provides fuel, water, lubricant oil and etc for enployees and its equipments that are working inside the florest. See section 7 for forestry the main activities details;

To facilitate comparisons, all values in BRL were converted to the USD using the budget fx rate of BRL 3.24/ USD. As the actual fx rate increased over the year from 3.32 in 1Q2018 to 3.87 at the close of 2018, overall results were negatively impacted by this adjustment and shown as a net FX adjustment in the chart.

Figure 1: Year to Date (YTD) Operational Result vs. Budget, main differences (USD, '000s)



# 2 FINANCIAL REPORT

## 2.1 OVERALL FINANCIAL PERFORMANCE

For comparison purposes the actual foreign exchange rate at the end of each quarter (BRL/USD: 3.32 1Q; 3.86 2Q; 4.00 3Q and 3.87 4Q) was adjusted to the budgeted rate (BRL/USD 3.24), with the difference to actual shown as a line item factor.

Table 1: Consolidated Annual Summary

| Budget Item<br>*Values in USD* | 2018<br>FY | 2018<br>Budget |
|---|---|---|
| BRL/USD FX Rate | 3.24 | 3.24 |
| | | |
| Biomass Sales (m³) | 8,882 | 0 |
| Log Sales (m³) | 69,974 | 70,745 |
| | | |
| Revenues | | |
| Biomass | 38,993 | 0 |
| Logs | 10,237,348 | 9,884,637 |
| **Sales Revenues** | **10,276,341** | **9,884,637** |
| | | |
| **Sales Revenues per unit (m³)** | **146.86** | **139.72** |
| | | |
| Production Costs | | |
| Logistics [1] | -10,873 | 0 |
| Taxes on Sales | -256,016 | -358,235 |
| Sales Commission [1] | -3,786 | 0 |
| Harvesting | -1,698,045 | -1,402,376 |
| **Total Costs of Production / Sales** | **-1,968,720** | **-1,760,611** |
| | | |
| **CoP / Sales per unit (m³)** | **-28.14** | **-24.89** |
| | | |
| **Total Net Revenues** | **8,307,621** | **8,124,026** |
| | | |
| **Stumpage Revenue per unit (m³)** | **118.72** | **114.84** |
| | | |
| Operating Expenses | | |
| Forestry Costs | -2,507,834 | -2,326,658 |
| Overhead Costs [2] | -3,500,253 | -3,106,316 |
| Fx gain (loss) to Actual | -388,160 | 0 |
| **Total Operating Expenses** | **-6,396,247** | **-5,432,974** |
| | | |
| **OpEx per unit (ha)** | **-355.66** | **-302.09** |
| | | |
| **Operational Net Result** | **1,911,375** | **2,691,052** |
| | | |
| **Operational Net Result per unit (ha)** | **106.28** | **149.63** |

*Note[1]: Logistics and Sales Commission: The general agreement is to sell logs on roadside terms whereby Logistics and Commissions is at cost of the buyer. In some cases where it is advantageous to do so, however FSA carried the costs of Logistics and Sales Commission and increased the price accordingly;*
*Note[2]: General and administrative cost, including outsourced management services as well as property related expenses.*

*Legend:*
*FY: Full Year;*
*YTD: Year to Date;*
*YEE: Year End Estimated means the actual costs/revenues plus the forecast;*
*COP: Cost of Production;*
*Stumpage: Is the net revenue before logistics, taxes on sales, sales commission and harvesting*

Table 2 shows the cash summary to the full year actual versus budget. The closing cash by the full year was USD 753 k versus USD 8.8 M budgeted.

**Stakeholder distributions** refers to the capital flows (loan repayments) sent/received during the year.

Most of this difference here is due to payments of 2016 and 2017 Harvesting Reports (HR) which were not included in the budget. Greater detail on Harvest Report payments is provided in section 2.3 below. Overall stakeholder distributions total USD 9.0 million in 2018, including FBV expenses, in large part due to the restructuring in process in the Netherlands.

When compared to the 3Q2018 Management Report, the stakeholder distributions increased from USD 7.6 to USD 9.0 million due to distributions made in 4Q2018.

**Financial Expenses**:

For **CapEex** the major change was a credit of USD 250 k related to forest replenishment. More detail on this item is provided in section 2.3 below.

**Capital Expenses** (CapEx) refers to LUD (Land Use Deal) payments to the owners of the land on which the teak forests are planted and forest replenishment credits.

FSA maintains bank accounts in Brazil in BRL, and offshore in USD and EUR, but the functional currency is BRL. Thus all financial transacitions in non BRL currencies are translated at the end of each month to the BRL. In table 2 below the "Increase / (Decrease) from Operations" is stated in actual BRL amounts an the actual FX rate (column 1). However, in column 3, the FY Actual uses the budget FX rate to facilitate comparison. As stated previously, the actual FX rate at year end was BRL 3.875 / USD, which would be a lower USD figure than shown here.

Table 2: Cash Summary

| | BRL | | USD | |
|---|---|---|---|---|
| | FY Actual | FY Budget | FY Actual | FY Budget |
| BRL/USD FX Rate | | | 3.24 | 3.24 |
| Opening Cash | **25,477,959** | **25,477,959** | **7,863,568** | **7,863,568** |
| Stakeholder Distributions | -29,254,908 | -1,944,000 | -9,029,293 | -600,000 |
| Increase / (Decrease) in Financial Exp. [2] | -390,721 | -592,841 | -120,593 | -182,976 |
| Increase / (Decrease) from Operations | 7,840,189 | 7,519,380 | 2,272,205 | 2,320,796 |
| Increase / (Decrease) CapEx | -726,762 | -1,684,926 | -224,309 | -520,039 |
| Income Tax | -26,557 | 0 | -8,197 | 0 |
| Closing Cash | **2,919,199** | **28,775,572** | **753,381** | **8,881,349** |

## 2.2 FULL YEAR RESULTS

Table 3 presents the consolidated Full Year results on an accrual basis.

On the sales side, the overall result was favorable when compared to budget in USD 287 k due to higher weighted average sales price as the small end diameter logs were conservatively budgeted using the minimum benchmark price, however TRC has been paying the average rate. Additionally, the majority of the assortment classes had a higher weighted average than the midpoint used for budgeting. Overall volume had an unfavorable variance of 771 m³ (70,745 m³ vs 69,974m³) due to mainly the volume form Buriti and Bocaina slipping into 2019 (6,143 m³ and 6,388 m³ respectively). Higher volumes coming from Cocal, Tenda, Vale Dourado, Silas, Santa Maria do Jauru II and Pimental (11.7 k m³) done earlier in the year mostly offset the the lower volume from the Buriti and Bocaina farms.

On the cost side, the Overhead was unfavorable to budget by USD 394 k due to:

- Increases in payroll expenses (USD 137 k) Most of this was down to support staff underestimated in the 2018 budget.
- Legal fees (USD 147 k) The main items included expenses related to the FBV restructuring, as well as unforeseen land rental related costs.
- Other third-party services (USD 133 k). The main difference was due to a greater than budgeted inflation adjustment on TRC Administrative Services.

Harvesting activities had lower productivity than budgeted mainly due to Cocal and Buriti. Also, there was higher than expected Social Security Tax (INSS) on harvesting services. See section 6 for harvesting activities details;

Forestry costs were overbudget by USD 181k due the anticipated acquisition of inputs like herbicides and fuel that will be consumed in the next quarter. Operational support (teams providing services for all the separate activities) was also higher than budgeted.

Capital Expenses (CapEx) refers to land rental payments to the owners of the land on which the teak forests are planted and forest replenishment credits. Additionally, FSA received a total amount of BRL 900k related to forest forest replenishment credits, for sales of firewood, from a Mato Grosso state program to foment the use of firewood from sustainable sources. The forest replenishment credits were allocated to netted against other Capex in the Other line on the table below in the Capital Expenditures sectiorn, and were the main reason that Capex was below budget.

## Table 3: Full Year Summary

| Budget Item | 2018 (BRL 0.00) | | | 2018 (USD 0,00) | | |
|---|---|---|---|---|---|---|
| | FY | | | FY | | |
| | Actual | Budget | Var (A-B) | Actual | Budget | Var (A-B) |
| BRL/USD FX Rate | | | - | 3,24 | 3,24 | - |
| Biomass Sales (m³) | 8.882 | 0 | 8.882 | 8.882 | 0 | 8.882 |
| Log Sales (m³) | 69.974 | 70.745 | -771 | 69.974 | 70.745 | -771 |
| Revenues | | | | | | |
| Biomass | 126.337 | 0 | 126.337 | 38.993 | 0 | 38.993 |
| Logs | 33.169.009 | 32.026.224 | 1.142.785 | 10.237.348 | 9.884.637 | 352.711 |
| **Sales Revenues** | **33.295.346** | **32.026.224** | **1.269.122** | **10.276.341** | **9.884.637** | **391.704** |
| **Sales Revenues per unit (m³)** | **475,83** | **452,70** | **23,13** | **146,86** | **139,72** | **7,14** |
| Production Costs | | | | | | |
| Logistics [1] | -35.230 | 0 | -35.230 | -10.873 | 0 | -10.873 |
| Taxes on Sales | -829.491 | -1.160.682 | 331.191 | -256.016 | -358.235 | 102.219 |
| Sales Commission [1] | -12.267 | 0 | -12.267 | -3.786 | 0 | -3.786 |
| Harvesting | -5.501.665 | -4.543.697 | -957.967 | -1.698.045 | -1.402.376 | -295.669 |
| **Total Costs of Production / Sales** | **-6.378.652** | **-5.704.379** | **-674.273** | **-1.968.720** | **-1.760.611** | **-208.109** |
| **CoP / Sales per unit (m³)** | **-91,16** | **-80,63** | **-10,52** | **-28,14** | **-24,89** | **-3,25** |
| **Total Net Revenues** | **26.916.693** | **26.321.845** | **594.848** | **8.307.621** | **8.124.026** | **183.595** |
| **Stumpage Revenue per unit (m³)** | **384,67** | **372,07** | **12,60** | **118,72** | **114,84** | **3,89** |
| Operating Expenses | | | | | | |
| Forestry Costs | -6.481.064 | -7.538.373 | 1.057.309 | -2.000.328 | -2.326.658 | 326.330 |
| Standard Cost to Accrual adj.[4] | -1.644.319 | 0 | -1.644.319 | -507.506 | 0 | -507.506 |
| Overhead Costs | -11.340.819 | -10.064.463 | -1.276.356 | -3.500.253 | -3.106.316 | -393.937 |
| Fx gain (loss) to Actual | 0 | 0 | 0 | -388.160 | 0 | -388.160 |
| **Total Operating Expenses** | **-19.466.202** | **-17.602.837** | **-1.863.365** | **-6.396.247** | **-5.432.974** | **-963.273** |
| **OpEx per unit (ha)** | **-1.082,39** | **-978,78** | **-103,61** | **-355,66** | **-302,09** | **-53,56** |
| **Operational Net Result** | **7.450.491** | **8.719.008** | **-1.268.517** | **1.911.375** | **2.691.052** | **-779.677** |
| **Operational Net Result / (ha)** | **414,28** | **484,81** | **-70,53** | **106,28** | **149,63** | **-43,35** |
| Capital Expenses | | | | | | |
| Facilities | 0 | 0 | 0 | 0 | 0 | 0 |
| Equipment | -34.041 | -173.757 | 139.715 | -10.507 | -53.629 | 43.122 |
| Vehicles | -3.134 | -3.500 | 366 | -967 | -1.080 | 113 |
| Others | -689.587 | -1.507.669 | 818.082 | -212.835 | -465.330 | 252.494 |
| **Total Capital Expenses** | **-726.762** | **-1.684.926** | **958.164** | **-224.309** | **-520.039** | **295.729** |

*[4] Difference between Accrual and "Standard Cost". Accrual values takes place in the month that their correspondent invoices are dated, while the "Standard Cost" is placed by the consumption/ use date. Differences are due to timing.*
*Legend:*

*FY: Full Year;*
*YTD: Year to Date;*
*YEE: Year End Estimated means the actual costs/revenues plus the forecast;*
*COP: Cost of Production;*
*Stumpage: Is the net revenue before logistics, taxes on sales, sales commission and harvesting*

## 2.3 DETAILED CASH REPORT

The closing cash for full year was USD 753 k vs USD 8.8 million budgeted. As commented previously, the orginal budget did not forecast the Stakeholder Distribution payments from the Harvesting Reports. These distributions totalled USD 7.2 million during 2018 regarding payments to SATT and the remainder of USD 1.6 million remitted to fund Floresteca BV's overhead and restructuring in the Netherlands. Disregarding these distributions, operational cash flow would have been USD 9.182 million vs USD 8.881 million budgeted (or 3.3% higher). The values above were adjusted to the budgeted FX rate of 3.24 to match with table 4 below, but the actual figures for Harvest Report payments and Netherlands funding at the prevailing FX rates for the payments totaled USD 6.9 million and EUR 1.2 million respectively.

Table 4: Quarterly Cash Flow 2018

| Budget Item | 2018 (USD 0.00) | | | | | 2018 | Var. (YTD-Budget) |
|---|---|---|---|---|---|---|---|
| *Values in USD* | Q1 | Q2 | Q3 | Q4 | FY | FY | |
| | Actual | Actual | Actual | Actual | YEE | Budget | |
| BRL/USD FX Rate | 3.24 | 3.24 | 3.24 | 3.24 | 3.24 | 3.24 | |
| **Opening Cash** | **7,863,568** | **4,150,149** | **3,819,625** | **2,703,803** | **7,863,568** | **7,863,568** | **0** |
| Biomass Sales (m³) | 0 | 733 | 2,858 | 5,291 | 8,882 | 0 | 8,882 |
| Log Sales (m³) | 17,964 | 16,860 | 19,827 | 15,323 | 69,974 | 70,745 | -771 |
| Revenues | | | | | | | |
| Biomass | 0 | 2,860 | 12,350 | 23,783 | 38,993 | 0 | 38,993 |
| Logs | 2,261,266 | 2,306,058 | 3,244,189 | 2,425,836 | 10,237,348 | 9,884,637 | 352,711 |
| **Sales Revenues** | **2,261,266** | **2,308,918** | **3,256,540** | **2,449,618** | **10,276,341** | **9,884,637** | **391,704** |
| Production Costs | | | | | | | |
| Logistics | -6,272 | 0 | 0 | -4,601 | -10,873 | 0 | -10,873 |
| Taxes on Sales | -62,493 | -62,495 | -69,736 | -61,292 | -256,016 | -358,235 | 102,219 |
| Sales Commission | -3,786 | 0 | 0 | 0 | -3,786 | 0 | -3,786 |
| Harvesting | -517,123 | -439,665 | -368,210 | -373,046 | -1,698,045 | -1,402,376 | -295,669 |
| **Total Costs of Production / Sales** | **-589,674** | **-502,160** | **-437,947** | **-438,939** | **-1,968,720** | **-1,760,611** | **-208,109** |
| **Total Net Revenues** | **1,671,591** | **1,806,757** | **2,818,593** | **2,010,680** | **8,307,621** | **8,124,026** | **183,595** |
| Operating Expenses | | | | | | | |
| Forestry Costs | -305,878 | -584,117 | -746,841 | -363,491 | -2,000,328 | -2,326,658 | 326,330 |
| Standard Cost to Accrual adj. | -250,587 | -85,126 | 93,254 | -265,047 | -507,506 | 0 | -507,506 |
| Overhead Costs | -896,371 | -766,161 | -835,494 | -1,002,227 | -3,500,253 | -3,106,316 | -393,937 |
| Fx gain (loss) to Actual | 1,164 | -22,382 | -299,750 | -67,192 | -388,160 | 0 | -388,160 |
| **Total Operating Expenses** | **-1,451,673** | **-1,457,787** | **-1,788,831** | **-1,697,956** | **-6,396,247** | **-5,432,974** | **-963,273** |
| **Operational Net Result** | **219,919** | **348,971** | **1,029,762** | **312,723** | **1,911,375** | **2,691,052** | **-779,677** |
| Capital Expenses | | | | | | | |
| Equipment | -3,575 | -1,358 | -1,209 | -4,365 | -10,507 | -53,629 | 43,122 |
| Vehicles | 21,759 | 7,099 | -45,257 | 15,432 | -967 | -1,080 | 113 |
| Others | -283,101 | -236,947 | 288,060 | 19,152 | -212,835 | -465,330 | 252,494 |
| **Total Capital Expenses** | **-264,917** | **-231,206** | **241,594** | **30,220** | **-224,309** | **-520,039** | **295,729** |
| Accounts Receivable | -659,991 | 345,151 | -775,425 | 910,470 | -179,795 | -472,015 | 292,219 |
| Other Credits | 0 | 0 | 0 | 52,467 | 52,467 | 0 | 52,467 |
| Accounts Payable | -95,458 | -72,469 | -217,548 | -49,453 | -434,929 | 101,759 | -536,688 |
| Fx gain (loss) to Actual | -8,720 | -45,123 | 541,868 | 435,062 | 923,087 | 0 | 923,087 |
| **Var. Assets and Liabilities (acc. to cash)** | **-764,169** | **227,559** | **-451,106** | **1,348,545** | **360,830** | **-370,256** | **731,086** |
| Leasing/Finame | -36,829 | -38,496 | -27,304 | -32,694 | -135,324 | -172,976 | 37,652 |
| Earnings on investments | 4,169 | 5,201 | 23,763 | 17,192 | 50,325 | 0 | 50,325 |
| Loans/ Bank fees | -3,868 | -3,831 | -1,421 | -26,474 | -35,594 | -10,000 | -25,594 |
| **Financial Movements** | **-36,528** | **-37,126** | **-4,962** | **-41,977** | **-120,593** | **-182,976** | **62,383** |
| Shareholder Contribution / (Repayment) | -2,026,118 | -349,556 | -1,770,790 | -3,674,504 | -7,820,967 | 0 | -7,820,967 |
| Other Transfers | -841,231 | -288,439 | -158,190 | 79,534 | -1,208,326 | -600,000 | -608,326 |
| Income Tax | -374 | -728 | -2,129 | -4,965 | -8,197 | 0 | -8,197 |
| **Cash Transfer / Income Tax** | **-2,867,723** | **-638,722** | **-1,931,110** | **-3,599,935** | **-9,037,489** | **-600,000** | **-8,437,489** |
| **Cash Flow Var.** | **-3,713,419** | **-330,524** | **-1,115,821** | **-1,950,423** | **-7,110,187** | **1,017,782** | **8,127,969** |
| **Closing Cash** | **4,150,149** | **3,819,625** | **2,703,803** | **753,381** | **753,381** | **8,881,349** | **8,127,969** |

*Note: the stakeholder distribution is recognized in this table under Shareholder Contribution (repayment)*

The outstanding Harvest Report payment amounts and provisions are shown in table 5 below in USD:

Table 5: Harvest Report Amounts Paid and Provisions

| Total to Pay | 13,487,428 |
|---|---|
| 2016 HR | 7,841,879 |
| 2017 HR | 5,645,549 |
| Paid through 12/31/2018 | -8,768,500 |
| Provision for Future Payment | 4,718,928 |

### 2.3.1 Estimated Revenues for 2019

As commented above Bocaina and Buriti had part of its harvesting volume delayed and will only be finalized in 2019. We conservatively estimate that the volume from both projects to be harvested in 2019 will be 4,000 m³ for Buriti and 5,000 m³ for Bocaina, or BRL 1,660 k and BRL 3,066 k respectively. The receivables from these sales will be paid starting in April 2019. For reference, in table 6 below we show the estimated cash basis receivables from sales for 2019 (consistent with the 2019 Management Plan).

Table 6: Sales Revenues 2019 Cash Basis

| Sales Revenues 2019 | Q1 | Q2 | Q3 | Q4 | TOTAL |
|---|---|---|---|---|---|
| BRL | 7,718 | 8,851 | 6,747 | 10,900 | **34,217** |
| USD | 2,031 | 2,329 | 1,775 | 2,868 | **9,004** |

Table 7 below presents the sales revenues and volumes for January 2019, and show that FSA had 25% higher sales volume and 29% higher revenues from the addition of the delayed harvesting areas. This means that FSA will anticipate BRL 876 k in its cash receivables in 1Q-2Q2019 when compared to the initial budget estimation.

Table 7: Table Comparison Budget vs Actual January 2019

| | Budget | Actual | Var. |
|---|---|---|---|
| Volume m³ | 7.250 | 9.085 | 25% |
| Sales BRL | 3.016.330,54 | 3.876.771,97 | 29% |
| Sales USD | 793.771,20 | 1.020.203,15 | 29% |

*Note: FX rate BRL/USD 3.8*

# 3 CONSOLIDATED STATEMENT OF ASSETS, LIABILITIES AND EQUITY

FSA financial statements are in the midst of their annual audit, and should be completed by early April, and made available via the FBV website.

# 4 AREA CHANGES

From the initial area position from the beginning of the year, we have finalized harvesting in 1,109.88 ha through the end of 2018. The difference between this amount and the total harvested area shown in the table below is due to the harvesting on areas in process and not yet finalized.

Table 8: Area variations, in hectares, 31/12/2018.

| Project | Year | Initial Area | Harvested | Current Area |
|---|---|---|---|---|
| Buriti | 1994 | 307,91 | 4,77 | 303,14 |
| Cocal | 1996 | 374,88 | 374,88 | 0,00 |
| Tenda | 1996 | 191,42 | 191,42 | 0,00 |
| Paiolandia | 1997 | 297,92 | | 297,92 |
| Paraíso | 1997 | 555,05 | | 555,05 |
| Bocaina | 1998 | 431,65 | 187,13 | 244,52 |
| São José da Canastra | 1998 | 44,62 | | 44,62 |
| Paiolandia | 1998 | 93,95 | | 93,95 |
| São Judas Tadeu | 1998 | 26,76 | | 26,76 |
| Silas | 1998 | 24,41 | 24,41 | 0,00 |
| Vale Dourado | 1998 | 351,68 | 351,68 | 0,00 |
| Araras | 1999 | 98,88 | | 98,88 |
| Bambu | 1999 | 549,07 | | 549,07 |
| Bocaina | 1999 | 108,18 | | 108,18 |
| Cassange | 1999 | 88,49 | | 88,49 |
| Capim Branco | 1999 | 507,87 | | 507,87 |
| Serra das Araras | 1999 | 105,01 | | 105,01 |
| Vale Dourado | 1999 | 48,59 | | 48,59 |
| Bambu | 2000 | 513,83 | | 513,83 |
| Duas Lagoas | 2000 | 1.527,51 | | 1.527,51 |
| Duas Lagoas | 2001 | 1.760,42 | | 1.760,42 |
| São Miguel | 2001 | 97,52 | | 97,52 |
| Barranquinho | 2002 | 970,20 | | 970,20 |
| Cacimba | 2002 | 571,08 | | 571,08 |
| Duas Lagoas | 2002 | 48,41 | | 48,41 |
| São Miguel | 2002 | 5,71 | | 5,71 |
| Santa Maria do Jauru | 2002 | 1.085,18 | | 1.085,18 |
| Barranquinho | 2003 | 12,95 | | 12,95 |
| Cacimba | 2003 | 10,19 | | 10,19 |
| Santa Maria do Jauru | 2003 | 207,87 | | 207,87 |
| Santa Fé | 2003 | 2.562,71 | | 2.562,71 |
| Barranquinho | 2004 | 1.021,00 | | 1.021,00 |
| Terra Santa | 2004 | 1.143,17 | | 1.143,17 |
| Duas Lagoas | 2005 | 207,67 | | 207,67 |
| Duas Lagoas | 2006 | 233,88 | | 233,88 |
| Mutum | 2007 | 539,18 | | 539,18 |
| São José | 2007 | 301,30 | | 301,30 |
| Santa Maria do Jauru II | 2008 | 99,87 | | 99,87 |
| **Total** | | **17.125,99** | **1.134,29** | **15.991,70** |

# 5 LOG SALES

## 5.1 YIELD PER HECTARE

As mentioned in the earliers reports, delays in harvesting operations occured, resulting in slippage in the schedule. This has affected the final harvest in BOC98 and BUR94, with lower volume sold in 2018 (6,388 m³ and 6,143 m³, respectively), as TRC was able to perform just part of the planned area. The unharvested stands have been included to 2019 budget.

The final harvest of COC96, TEN96 and VDO98 resulted in higher volume than budgeted. COC96 budgeted area and volume were underestimated, and during 2018 the entire project area was harvested, resulting in a higher than budgeted volume. VDO volume was close to budget (66.5 vs 69.8 m³/ha).

Regarding TEN96, a higher average commercial volume per tree than forecast resulted increased final yield. The actual average volume is 32.2 m³/ha vs the forecast 23.5 m³/ha. The budget estimates were based on the last inventory information from 2016, which is partially responsible for the underestimation of the growth and expected final yield.

As previously commented, there was volume carried over from 2017 into 2018 (7,3k m³), from Pimental (PIM), Silas (SIL), Cocal 98 (COC) stands that were harvested in 2017. This volume was not budgeted. Table below detail the yield per project, based on volume FYA vs FYB. Santa Maria do Jauru II had non-material sales volume on 2018 (159 m³) as the harvesting team anticipate the 2019 operations in this area a few days prior the closing of the year.

The following tables show the yield per project on absolute (9) and relative (10) basis. The inventory team only measures the area once the harvesting operations on the stand and finalized. The stand area for projects where the harvesting is on-going show the total hectares to be harvested ( "actual" in the third column of each table), however the volume for these projects is not complete. To assist in interpreting the table, we have added a column showing the percent of the area which has been harvest (% of the the Actual area).

Table 9: Log sales per project, 2018 FY volume.

***Total volume (m³) - per diameter class from all length***

| | | Area (ha) | | Production yield (m³) | | Trees Removed | | TOTAL (ACTUAL) | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| % of Actual Area Accomplished | Project | Actual | Budget | Actual | Budget | Actual | Budget | 15-20 cm | 20-25 cm | 25-30 cm | 30-35 cm | 35-40 cm | 40+ cm |
| 100% | VDO1998 | 351,68 | 351,68 | 24.555 | 23.372 | 49.476 | 52.054 | 654 | 4.950 | 9.534 | 3.529 | 4.622 | 1.267 |
| 100% | TEN1996 | 191,42 | 191,42 | 6.158 | 4.500 | 31.832 | 31.242 | 2.305 | 2.719 | 1.061 | 72 | 0 | 0 |
| 53% | BUR1994 | 275,92 | 289,09 | 4.733 | 10.876 | 46.591 | 44.274 | 981 | 2.424 | 893 | 244 | 191 | 0 |
| 100% | COC1996 | 357,75 | 300,74 | 4.897 | 3.500 | 121.927 | 91.052 | 3.117 | 1.392 | 290 | 97 | 0 | 0 |
| 100% | COC1998 | 133,84 | 0,00 | 5.600 | 0 | 18.095 | 0 | 52 | 2.195 | 2.205 | 343 | 781 | 25 |
| 100% | PIM1996 | 64,18 | 0,00 | 420 | 0 | 10.708 | 0 | 0 | 197 | 125 | 75 | 24 | 0 |
| 100% | SIL1998 | 24,40 | 0,00 | 1.343 | 0 | 4.299 | 0 | 305 | 483 | 338 | 217 | 0 | 0 |
| 55% | BOC1998 | 341,21 | 372,71 | 22.109 | 28.497 | 43.375 | 44.356 | 98 | 3.154 | 9.733 | 3.795 | 4.574 | 754 |
| 36% | SMJ2008 | 33,25 | 0,00 | 159 | 0 | 4.299 | 0 | 0 | 159 | 0 | 0 | 0 | 0 |
| **TOTAL** | | **1.773,65** | **1.505,63** | **69.974** | **70.745** | **308.208** | **262.979** | **7.513** | **17.673** | **24.179** | **8.371** | **10.192** | **2.046** |

*Note:: The trees removed are the best estimate at the date of this report issuance.*

Table 10: Production per project, 2018 FY volume per hectare.

***Total volume (m³) per hectare - per diameter class from all length***

| | | Area (ha) | | Production yield (m³) | | Trees Removed | | PER HECTARE (ACTUAL) | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| % of Actual Area Accomplished | Project | Actual | Budget | Actual | Budget | Actual | Budget | 15-20 cm | 20-25 cm | 25-30 cm | 30-35 cm | 35-40 cm | 40+ cm |
| 100% | VDO1998 | 351,68 | 351,68 | 69,82 | 66,46 | 140,69 | 148,02 | 1,86 | 14,07 | 27,11 | 10,03 | 13,14 | 3,60 |
| 100% | TEN1996 | 191,42 | 191,42 | 32,17 | 23,51 | 166,29 | 163,21 | 12,04 | 14,21 | 5,55 | 0,38 | 0,00 | 0,00 |
| 53% | BUR1994 | 275,92 | 289,09 | 17,15 | 37,62 | 168,86 | 153,15 | 3,56 | 8,79 | 3,24 | 0,88 | 0,69 | 0,00 |
| 100% | COC1996 | 357,75 | 300,74 | 13,69 | 11,64 | 340,82 | 302,76 | 8,71 | 3,89 | 0,81 | 0,27 | 0,00 | 0,00 |
| 100% | COC1998 | 133,84 | 0,00 | 41,84 | 0,00 | 135,20 | 0,00 | 0,39 | 16,40 | 16,47 | 2,56 | 5,84 | 0,18 |
| 100% | PIM1996 | 64,18 | 0,00 | 6,55 | 0,00 | 166,84 | 0,00 | 0,00 | 3,07 | 1,94 | 1,16 | 0,38 | 0,00 |
| 100% | SIL1998 | 24,40 | 0,00 | 55,05 | 0,00 | 176,19 | 0,00 | 12,50 | 19,81 | 13,85 | 8,90 | 0,00 | 0,00 |
| 55% | BOC1998 | 341,21 | 372,71 | 64,80 | 76,46 | 127,12 | 119,01 | 0,29 | 9,24 | 28,52 | 11,12 | 13,41 | 2,21 |
| 36% | SMJ2008 | 33,25 | 0,00 | 4,77 | 0,00 | 129,29 | 0,00 | 0,00 | 4,77 | 0,00 | 0,00 | 0,00 | 0,00 |
| **TOTAL** | | **1.773,65** | **1.505,63** | **39,45** | **46,99** | **173,77** | **174,66** | **4,24** | **9,96** | **13,63** | **4,72** | **5,75** | **1,15** |

It is worth mentioning that Pimental (PIM), Silas (SIL), Cocal 98 (COC) and some of Buriti 94 (BUR) stands were partially performed in 2017, but the area accounted for in table 9 and 10 considers the whole stand, which distorts the analysis of the yield per hectare comparisons between projects. Also, as commented earlier, some stands from Bocaina 98 (BOC) were partially performed in 2018, and a this volume will be sold and received in 2019.

## 5.2 ROADSIDE PRICES

The table below shows the volume sold in 2018, compared to the budget. As commented above, the budget conservatively considered the minimum benchmark price (Consufor) for lower diameter (sawmill grade) logs, while the actual prices paid were the benchmark averages. Additionally, the mix of logs for export resulted in higher prices than budgeted.

Table 11: FY Budget vs Actual Volume and Roadside Price

| Diameter Class | Volume YTD (m³) | | RS Price YTD (USD/m³) | |
|---|---|---|---|---|
| | Actual | Budget | Actual | Budget |
| 15-20 cm | 7,513 | 4,105 | 48.0 | 25.6 |
| 20-25 cm | 17,673 | 21,961 | 76.8 | 88.5 |
| 25-30 cm | 24,179 | 29,845 | 148.0 | 157.1 |
| 30-35 cm | 8,371 | 14,834 | 189.5 | 212.2 |
| 35-40 cm | 10,192 | 0 | 267.7 | 0.0 |
| 40+ cm | 2,046 | 0 | 305.8 | 0.0 |
| **Total** | **69,974** | **70,745** | **146.3** | **139.7** |

## 5.3 OVERDUE ACCOUNTS

No overdue accounts through December 31th, 2018.

Per the Management Services and Timber Purchase Agreement, the payment term for sales is 120 days.

## 5.4 TEAK MARKET UPDATE

### 5.4.1 Brazil Economic Overview

The fourth quarter of the calendar year saw a less FX volatility of the BRL and the Indian Rupee (INR) than the previous quarter. For the BRL, this was largely driven by the outcome of federal and state elections in Oct. 28th second round voting. More widely, the BRL appreciated vs the USD on the basis of speculation on the new government's ability to tackle Brazil's economic problems, and also benefited from the reduction of the trade tensions between the USA and China.

**Brazil Federal Elections**

The fourth quarter saw Brazilian federal and state elections final decision on the second round which occurred on Oct. 28th. The far-right candidate Jair Bolsonaro has won the presidential race and the market has been responding positively to the confirmed exit of the left-wing Worker's Party from the presidency (the PT governed Brazil from 2003 until May 2016, under President's Lula (now serving a 12-year jail sentence for corruption) and his chosen successor, Dilma Rousseff, who was impeached).

Before the election's outcome the market had speculated and drove substantial volatility in BRL/ USD FX rates. In large part this reflected a campaign which was remarkably thin on policy discussion of the main economic issues facing Brazil (reforms of federal pensions and taxes, both key parts for structurally balancing the budget, among the most urgent). After the outcome of the elections, speculation on the new government's ability to take care of the Brazilian economic problems was the main driver for the appreciation of the BRL against the USD.

**Trucker Strike**

As reported in the 2Q report, in May Brazil suffered a trucker's strike, which lasted nearly 10 days in total, resulting in a substantial halting of economic activity, largely down to the lack of petrol, whose distribution is mostly done by truckers. Fuel and food supplies only normalized in the first full week of June while supply chains only normalized in mid-July. Field operations were not greatly affected, as stocks of fuel and foodstuffs were sufficient to make it through the most critical period.

The strike was only settled with the Temer Administration agreeing to price floors for freight rates, which most industry observers consider uneconomic. Moreover, many industry groups, including those in the forestry products industry, have challenged the freight price floors in the courts, arguing that they represent an unconstitutional and unjustified intervention in the market, resulting large material increases in operating costs. The government decrees have left much margin for interpretation, for example, the standing of prior existing freight contracts. While these challenges wind their way through the judicial system, the press reports that both companies contracting freight and freight companies / independent truckers were largely ignoring the agreements, in the expectation that something more permanent and viable is established. The topic will likely land on the desk of the winner of the presidential run-off election.

The legislative power has been discussing during the fourth quarter of 2018 towards this issue as the settled freight price floor has been declared unviable by the executive power. No decisions were made

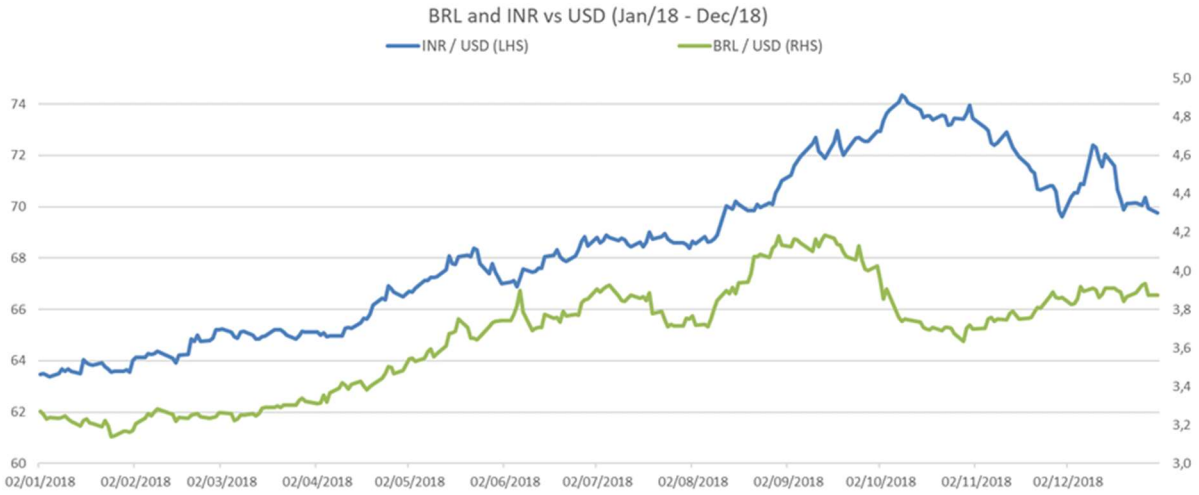
until the moment of this writing and the agreement has still been ignored in contracts between companies and truck drivers.

TRC has been closely monitoring the ongoing negotiations lead by the various industry groups. If the price floor were to effectively be declared legal and binding, the domestic freight rates would increase approximately, and would adversely impact roadside prices.

**BRL Depreciation**

While currencies globally have depreciated vs the USD over the course of the last semester of 2018, in expectation of further base interest rates increases in the US, the BRL has depreciated more than most of the other main EM currencies with a slight recovery in early October, followed by gradual depreciation through the year end. From the year opening to close (Jan. 2nd – Dec. 31st), the BRL had depreciated by 18.5% vs the USD, but including 3.8% BRL appreciation in 4Q.

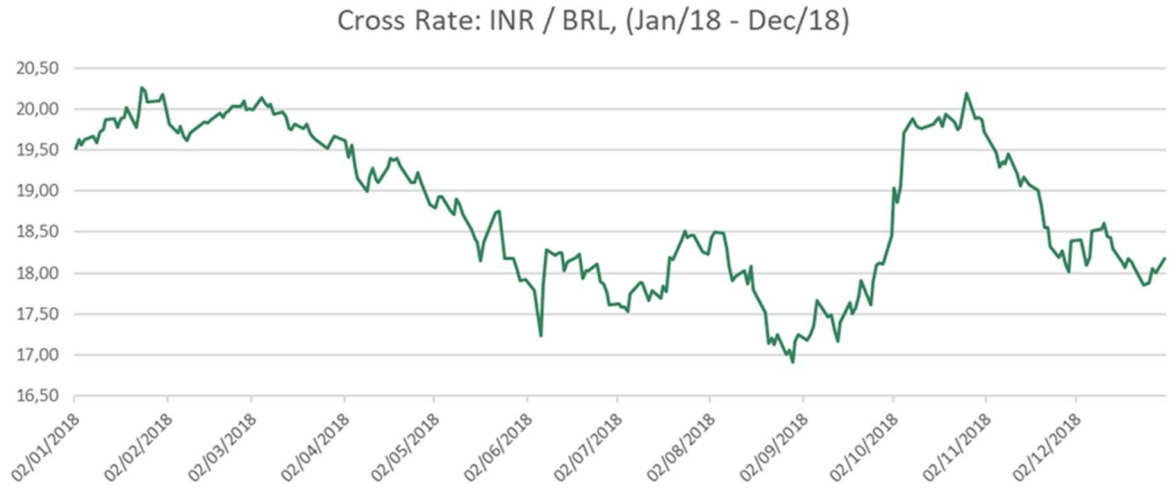
Figure 3: Comparison between BRL/USD and INR/USD, YTD




This fourth quarter BRL appreciation was was the result of speculation on the potential for economic reforms, following the victory of a pro-business candidate in the federal elections. At this writing, with Jair Bolsonaro at the beginning of his mandate, the BRL has appreciated vs the USD. TRC now expects somewhat less volatility in the FX rate through the first months of 2019, though much will depend on the new President's post-election statements and the final formation of the cabinet of Ministers. It bears emphasizing that, in the short term at least, the BRL impacts costs in USD terms, and so impacts roadside results.

Ultimately the relation between the BRL and INR is what matters from a demand standpoint. The INR has also devalued relative to the USD, but through the fourth quarter it has appreciated against the USD by around 4.3%. Overall, the BRL devalued 7.2% vs the INR in the year opening to close, most of which occurred in 2Q2018.

Figure 4: INR/BRL Cross Rate, YTD




### 5.4.2 India Economic Overview

The main market for teak logs, India continues to experience fairly strong growth, reporting 2Q2018 GDP of 7.3% on an annual basis, 0.3% below market expectations of 7.6%. The IMF, World Bank and Moody's have all recently updated their forecasts for India, and signal continued growth in the 7 to 8% range for the next several years, building on 2016 and 2017 growth of 7.1% and 6.7% respectively.

Part of the growth story is down to fiscal stimulus, as the Modi administration looks to fortify its position ahead of next year's elections, with increased focus on public investment, but also including some directed tax relief to electorally significant segments.

The financial sector continues to be a drag on economic activity, in the wake of a banking scandal involving a high-profile jewelry group, responsible for a USD 2.4 billion default to a number of the largest Indian banks. Overall, non-performing loans as a percentage of total financial system assets has continued to grow, reaching 12% in the Reserve Bank of India's most recent accounting. This has resulted in a tightening of credit conditions generally and resulted in less working capital being made available in certain segments, and at higher rates.

Construction investment, which accounts for around 8% of Indian GDP, has been a big focus of the Modi government. It had slowed somewhat in 2016 and 2017, with a buildup of unsold residential units in several the largest cities. In the first quarter of 2018, however, construction began to surge, and the Modi administration is contemplating additional stimulus measures, such as a reduction of the Goods and Services Tax on construction materials, according to local press reports. The administration's Housing for All program entails a number of other measures, aimed at increasing the supply of affordable housing, and should continue to provide stimulus to the sector.

### 5.4.3 Teak Market

CIF prices in India were reduced several times over the course of 2018. The key driver for this has been excess supply from of Central American suppliers, of which notably Panama. The effect of this surge in supply is most concentrated in the lower diameter / girth log grades, the onset of the rainy season in most supplier countries will help to reduce the stock levels in India, however, demand factors reported in last quarter persist, impacting prices:

- INR/USD depreciation: as shown in the previous chart, there has been substantial depreciation of the INR over the year, reaching its peak in October. Until the year end the

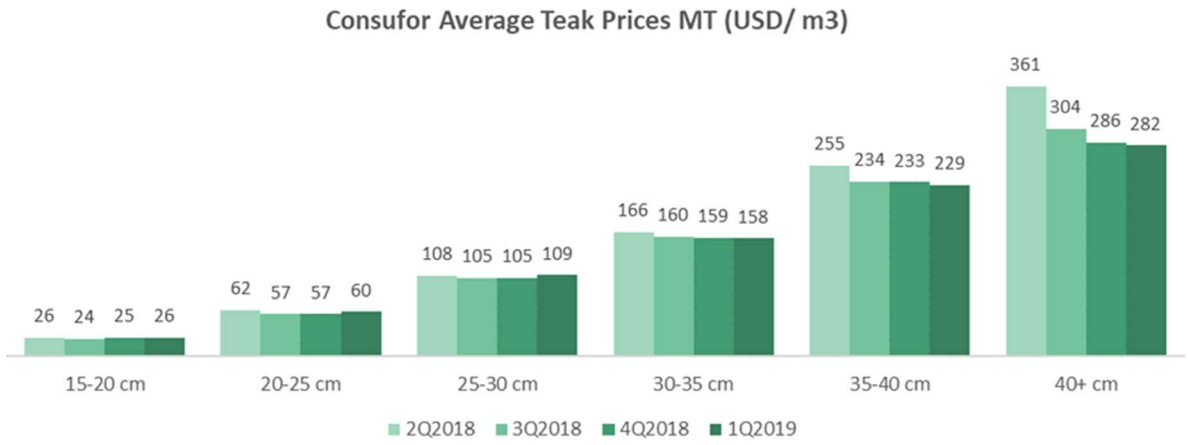
INR has appreciated against the USD relieving to some degree the extra pressure on importers, who sell in INR, and need to pass the higher USD cost on to final buyers. As a new FX rate level is not yet clear, importers are in some cases pricing in the uncertainty;

- The price / FX volatility has moderated, and led to better results in overall market demand through the 4th Quarter, compared to last year;
- Importers continue to face tighter credit criteria with their banks in the wake of the widely reported bank fraud. This has limited demand, and put downward pressure on prices.

### 5.4.4 Roadside Price Benchmarking

TRC has contracted a third-party consultant, Consufor, to assess teak prices in Mato Grosso on a quarterly basis. Consufor interviews companies in the region, its most recent survey consisting of 84 prices samples, and 25 companies (not considering TRC, outliers), weighted by traded volume. Consufor recently indicated that the prices apply to the highest grades (A).

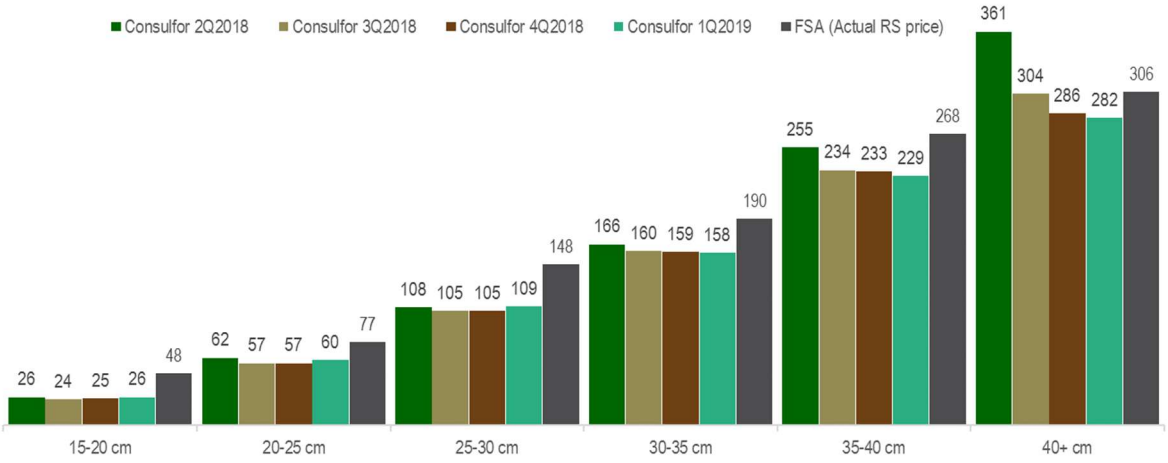
Figure 5: CONSUFOR Average Teak Prices MT (USD/ m3)




Consufor's most recent report was produced in early January of 2019, based on survey data taken in December (shown as 1Q2019 in the chart above). Log prices for diameters between 15-20 cm until 25-30 cm have increased by 4.4% on average, and log prices for diameters above 30-35 cm have slightly decreased by 1.25%. Additionally, even before the trucker strike, the local transportation costs had increased due increased oil prices. Maritime freight costs have also increased with the increase in oil prices pushing up logistics costs, and have a negative impact on local roadside prices as a result.

In Figure 6 below, we compare the prices of logs (all grades and sizes) of the Consufor averages for 2Q2018 until 1Q2019 and those obtained thus far from the FSA properties.

Figure 6: Floresteca S.A. (4Q2018) versus CONSUFOR roadside prices (USD/m³)*




*Note: The diameter classes are determined by the Consufor report, but are not on a fully comparable basis, as TRC log classifications for the sub-25 cm diameters are distinct (16-20cm, 20-23 cm and 23-25 cms). We have used TRC 20-23 cm logs to compare with Consufor 20-25 cm logs, which implies a richer mix / higher price for the Consufor survey estimates. TRC typically seeks to sell the 23-25 cm logs as semi-long or long logs, or together with the 25-30 cm short logs, obtaining better prices.*

Note that the FSA prices are higher than the Consufor prices across all grades, with the exception of the 40+ diameter logs in the 2Q2018. The main reason for the divergence in Floresteca SA log prices vs those of the Consufor 4Q2018 and 1Q2019 price reports are due to the average diameters of Floresteca SA log sales. The while Consufor figures assume the midpoint of the diameter range, whereas the actual average assortments of the Floresteca SA sales can differ from the midpoint. For example, the FSA log sales for logs with 40+ diameters were 40.7 cms on average, whereas the Consufor price was based on a 42.5 cm log. The difference in prices is thus partially down to assortment of lower diameter logs within this class, not to different prices.

| FSA diameter point | |
|---|---|
| 15-20 cm | 18.8 |
| 20-25 cm | 22.0 |
| 25-30cm | 26.8 |
| 30-35 cm | 32.8 |
| 35-40 cm | 37.9 |
| 40+ cm | 40.7 |

# 6 THINNING & HARVESTING

## 6.1 COST OF PRODUCTION

The table below shows the actual versus budget comparison for harvesting (production) cost and sales expenses. The actual cost per cubic meter sold in for the full year was USD 28.1 versus USD 24.9 in the budget, an unfavorable variance of 13%.

Overall harvesting activities and taxes over services were BRL 957,968 higher than budgeted due to:

- Activities: The main variation on activities occurred on Harvesting and Forwarding due to lower productivity on Cocal 96 and Buriti 94, partially offset by Bocaina's better results. Its worth mentioning that the cost budgeted for harvesting activities is based on an average yield.

- Tax: An error in the 2018 budget assumptions, which underestimated the total tax rate on services. Actual taxes were BRL 621 k vs BRL 223 k budgeted, an unfavorable variance of BRL 398 K.

Table 12: Harvesting Cost, per activity:

| | | Budget FY | Actual FY | Var. |
|---|---|---|---|---|
| Tree Selection | BRL | 0 | 50.373 | 50.373 |
| Harvesting | BRL | 1.260.428 | 1.483.440 | 223.012 |
| Forwarding | BRL | 1.966.991 | 2.147.114 | 180.123 |
| Lot Formation | BRL | 669.087 | 656.707 | -12.380 |
| Loading | BRL | 423.233 | 542.621 | 119.388 |
| Tax | BRL | 223.957 | 621.410 | 397.453 |
| **Total** | **BRL** | **4.543.697** | **5.501.665** | **957.967** |
| Sales Expenses | BRL | 1.160.682 | 876.988 | -283.694 |
| Commercial Vol. | m³ | 70.745 | 69.974 | -771 |
| BRL/m³ | | 80,63 | 91,16 | 10,52 |
| BRL/USD rate | | 3,24 | 3,24 | 3,24 |
| USD/m³ | | 24,89 | 28,14 | 3,25 |

Sales related taxes and expenses refers to:

- Sales related taxes and expenses: Federal Taxes (Funrural 2.85% on billing) Social Security Taxes (PIS/COFINS 9.25% on billing);
- Logistics and Sales Commission: Only on actual, a total of BRL 47,497 (USD 14,659). The general agreement is to sell logs on roadside terms whereby Logistics and Commissions is at cost of the buyer. In a few specific cases, however, FSA carried the costs of logistics and sales commissions and increased the price accordingly, as it was more advantageous to do so.

# 7 FORESTRY MANAGEMENT

The figure below shows the budget and actual forest activities for the fourth quarter of 2018 operations. The most relevant activities are commented in the following subsections.

Figure 7: Forestry Operations

| Activity Group (gr.. | un. | St.. | Total Cost (BRL) | Quantity (un.) | Unitary Cost (BRL/un.) |
|---|---|---|---|---|---|
| Fertilization | ha | Budget | 390,0K | 600,0 | 650,0 |
| | | Actual | 466,1K | 601,2 | 775,3 |
| Pruning | ha | Budget | 965,8K | 1.418,0 | 681,1 |
| | | Actual | 561,7K | 1.135,3 | 494,8 |
| Sprout Control | ha | Budget | 682,8K | 1.454,0 | 469,6 |
| | | Actual | 1.288,6K | 1.951,7 | 660,3 |
| Stump Removal & Soil Preparation | ha | Budget | 3.975,0K | 3.440,0 | 1.155,5 |
| | | Actual | 2.874,5K | 2.304,0 | 1.247,6 |

Overall forestry costs were under budget for the year, with total costs of USD 2.0 million for the year versus USD 2.3 million budgeted. There costs of the main specific activities are detailed below:

## 7.1 STUMP REMOVAL & SOIL PREPARATION (LAND CLEANING)

Stump removal and soil preparations (land cleaning) activities are performed after a farm has completed its final harvest, as the land must be cleaned prior to returning it to the landowner. Total cost and area were underbudget as harvesting operations faced some delays at Buriti farm due to unusually severe rains between January and March. Also the rain and higher than expected mechanical maintenance caused delays on Vale Dourado farm, however the land cleaning on both farms will be concluded in 2019. The unitary cost was higher as stump removal is performed before soil preparation, and is the most costly of the two acitivies. When the soil preparation is completed, the total unit cost should be in line with the budget.

## 7.2 SPROUT CONTROL

The unusually intense rainfall during 1Q2018 and thicker and more intense sprouting areas have resulted in higher than budgeted unit costs for sprout control.TRC detected that Santa Fé and Barraquinho areas needed more sprout control than pruning, which also accounted for the higher than budgeted spending.

## 7.3 PRUNING

Total area pruned was smaller than budgeted, due to the unusually high rainfall, and the decision to prioritize sprout control mentioned above. Unit costs were lower than budgeted, as the team was deployed in areas easier to operate.

## 7.4 FERTILIZATION

The total area to be fertilized for 2018 has been finalized (Fazendas São José e Mutum). The total cost for the year was higher than budgeted, as the fertilizer is sold in USD, and the BRL depreciated over the budget FX.

# 8 COMPLIANCE & LEGAL ISSUES

The text that follows provides the historical context and present situation of each outstanding case.

Regarding the last report there were to the following issues:

Paraíso Farm has an update.
Mutum Farm, issues 1 and 2 were updated.

## 8.1 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. FSA has filed final allegations with the court and was informed in July that the judge has nominated an expert for the case. We have filled the requirements for the forensics and information requested by the judge. We expect to have an update in the next quarterly report. On January 22, the expert did on site due diligence on the farm, and is expected to complete and file his findings in February.

## 8.2 MUTUM FARM

**Issue 1**: Mutum farm was invaded by the Landless Movement MST-in 2011. The owner of the property (LHS) filled an order in the court to remove the squatters. The judge ruled in favor of the LHS. Repeatedly the MST has invaded the property motivating the hiring of a security guard. Currently, there are no squatters on the property. The Public Prosecutor`s Office has filled an opinion which did not materially modify the material in the lawsuit. We are waiting for court date and/or final decision.

On September 30, squatters entered the front border of Mutum farm again but caused no damage to the property and operations. Our lawyers prepared and filled all information asking for another authorization from the judge to remove the squatters, and the authorization was granted. The security team was increased.

On January 14, 2019, the squatters left the invaded area by themselves (we subsequently received a court decision to have the squatters forcefully removed, but it has not been necessary). TRC has detected some damage to the property, but we have not been able to fully measure and evaluate their impact. We will report our analysis in the next quarterly report.

**Issue 2**: In 2012 LHS went to court against the National Agriculture Colonization Institute - INCRA, requesting the suspension of an administrative order for the expropriation of the property, alleging that the property was idle/ non-productive. The judge decided to suspend the administrative order. A technical expert subsequently declared that the property is productive. The process is still under review by the judge for final decision. A court date had been scheduled for November 9, 2017, at which time our testimonies were heard to clarify the facts. A final decision from the judge has been issued declaring the property is fully productive and cancelling the administrative process. It is possible for INCRA to appeal, though with the recent change in government this seems less likely.

# 9 APPENDIX

## 9.1 PROPERTIES AREAS BREAKDOWN AT DECEMBER 2018:

| Project | Year | SATT | LUD | Total |
|---|---|---|---|---|
| Buriti | 1994 | 307,91 | | 307,91 |
| Paiolandia | 1997 | 210,44 | 87,48 | 297,92 |
| Paraíso | 1997 | 524,04 | 31,01 | 555,05 |
| Bocaina | 1998 | 351,53 | | 351,53 |
| São José da Canastra | 1998 | 44,62 | | 44,62 |
| Paiolandia | 1998 | 93,95 | | 93,95 |
| São Judas Tadeu | 1998 | 26,76 | | 26,76 |
| Araras | 1999 | 78,30 | 20,58 | 98,88 |
| Bambu | 1999 | 549,07 | | 549,07 |
| Bocaina | 1999 | 108,18 | | 108,18 |
| Cassange | 1999 | 88,49 | | 88,49 |
| Capim Branco | 1999 | 507,87 | | 507,87 |
| Serra das Araras | 1999 | 104,01 | 1,00 | 105,01 |
| Vale Dourado | 1999 | 48,59 | | 48,59 |
| Bambu | 2000 | 476,09 | 37,74 | 513,83 |
| Duas Lagoas | 2000 | 1.527,51 | | 1.527,51 |
| Duas Lagoas | 2001 | 1.760,42 | | 1.760,42 |
| São Miguel | 2001 | 97,52 | | 97,52 |
| Barranquinho | 2002 | 776,15 | 194,05 | 970,20 |
| Cacimba | 2002 | 456,87 | 114,21 | 571,08 |
| Duas Lagoas | 2002 | 48,41 | | 48,41 |
| São Miguel | 2002 | 5,71 | | 5,71 |
| Santa Maria do Jauru | 2002 | 1.085,18 | | 1.085,18 |
| Barranquinho | 2003 | 10,36 | 2,59 | 12,95 |
| Cacimba | 2003 | 8,15 | 2,04 | 10,19 |
| Santa Maria do Jauru | 2003 | 207,87 | | 207,87 |
| Santa Fé | 2003 | 2.562,71 | | 2.562,71 |
| Barranquinho | 2004 | 1.021,00 | | 1.021,00 |
| Terra Santa | 2004 | 1.134,45 | 8,72 | 1.143,17 |
| Duas Lagoas | 2005 | 207,67 | | 207,67 |
| Duas Lagoas | 2006 | 233,88 | | 233,88 |
| Mutum | 2007 | 539,18 | | 539,18 |
| São José | 2007 | 301,30 | | 301,30 |
| Santa Maria do Jauru II | 2008 | 99,87 | | 99,87 |
| **Total** | | **15.604,06** | **499,42** | **16.103,48** |

**LUD refers to "Land Use Deals", and the hectares belonging to the land owners of the projectes on which the teak in planted.*