

# QUARTERLY MANAGEMENT REPORT



- Floresteca S/A -

Calendar Year 2017  
3<sup>rd</sup> Quarter (Jul/17 to Sep/17)

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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.

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.

The information shown herein is on calendar year basis (January to December), although, the forestry activities run on an agricultural year basis (July to June).

## 2. THINNING & HARVESTING

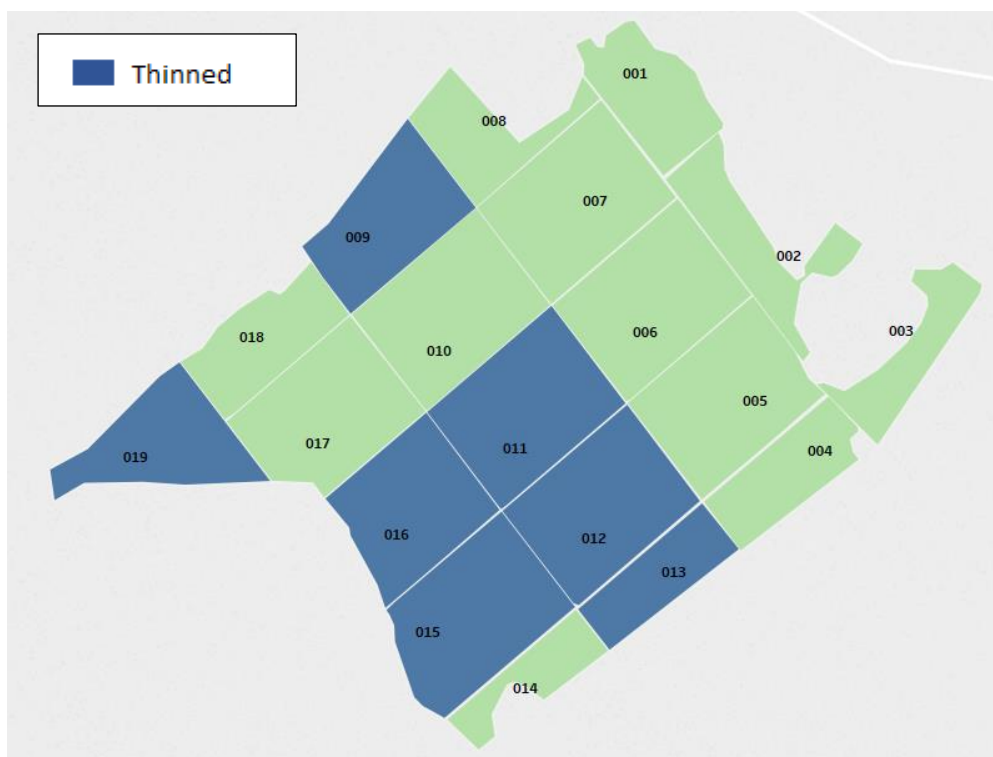
This section segregates activities of thinning from final harvesting.

### 2.1. THINNING ACTIVITIES

In accordance with the 2017 Management Plan the Mutum 2007 (MUT) and São José 2007 (SAJ) farms are to be thinned in 2017. Both areas have reached 18 m<sup>2</sup>/ha of basal area, which indicates they are reaching competition stage. This is the second thinning of these farms and the objective of the operation is to reduce 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 blue, totaling 220 hectares. It represents site class I areas, where growth is higher and, need to be thinned first. The operation on the remaining stands was postponed to the next year due to operational constraints.

Map 1: YTD – Thinning per stand, Mutum 2007



The thinning at the São José farm (map 2) started in February and were 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 in both Mutum and São José are finalized for 2017.

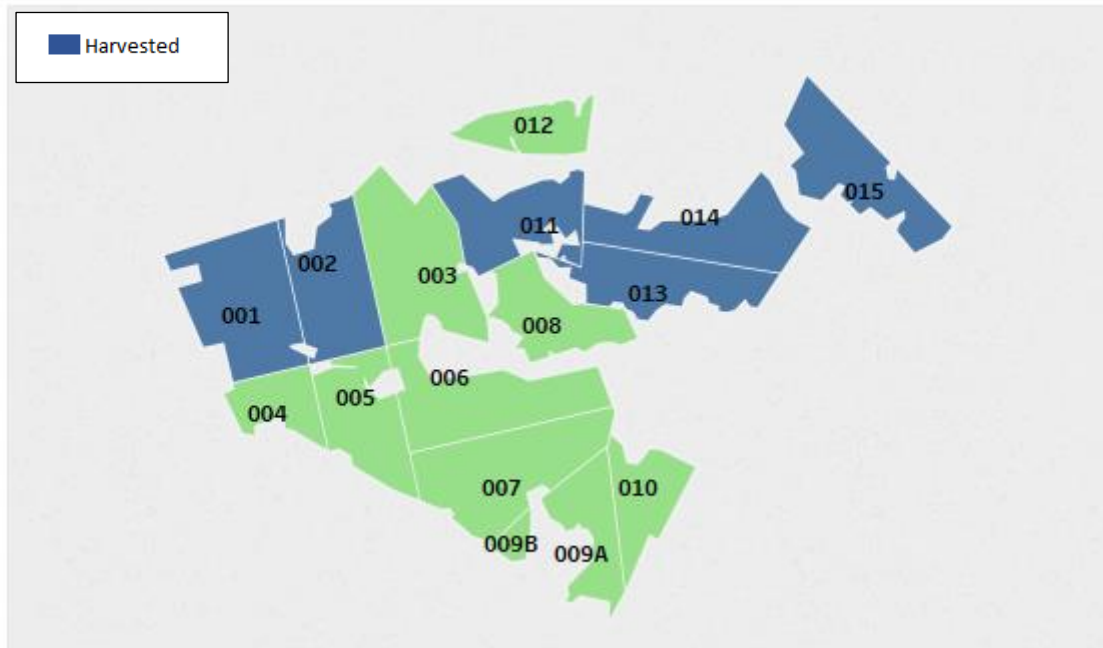
## 2.2. HARVESTING ACTIVITIES

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. This is the most important operation in the lifecycle of the project, as it is when the most valuable timber and most of the revenues are generated.

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.

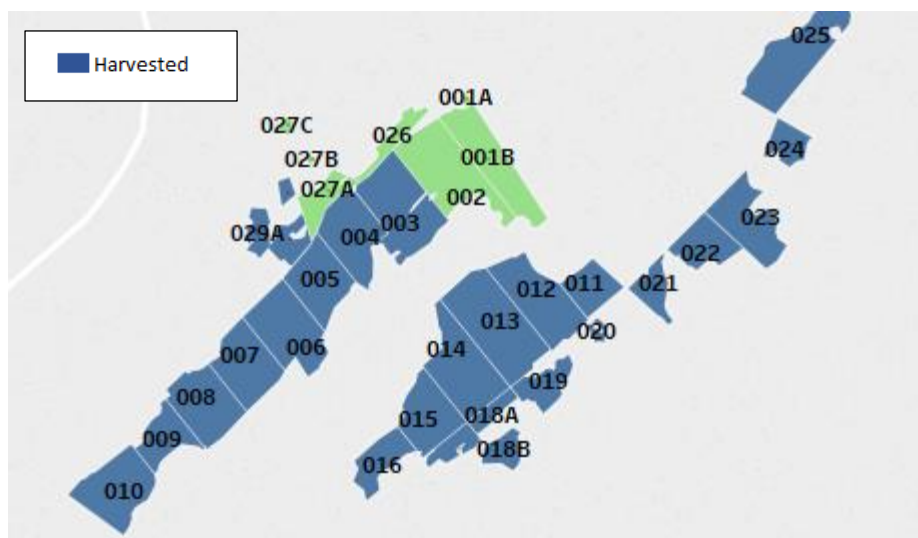
During this quarter, the operation in Pimental meant to be finalized and continuing in Buriti. Both projects are being harvested at the same time, generating a favorable product mix, coming from forests with distinct growth patterns. After finishing Pimental, which should happen in October, we will start harvesting Cocal.

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



The Pimental farm (map 4) had all hectares harvested this year.

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



The stands 001A, 001B, 002, 026, 027, 027A and 027C were performed in 2016.

### 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 until the 3<sup>rd</sup> quarter of 2017.

Table 1 – YTD capital forestry activities, per forest.

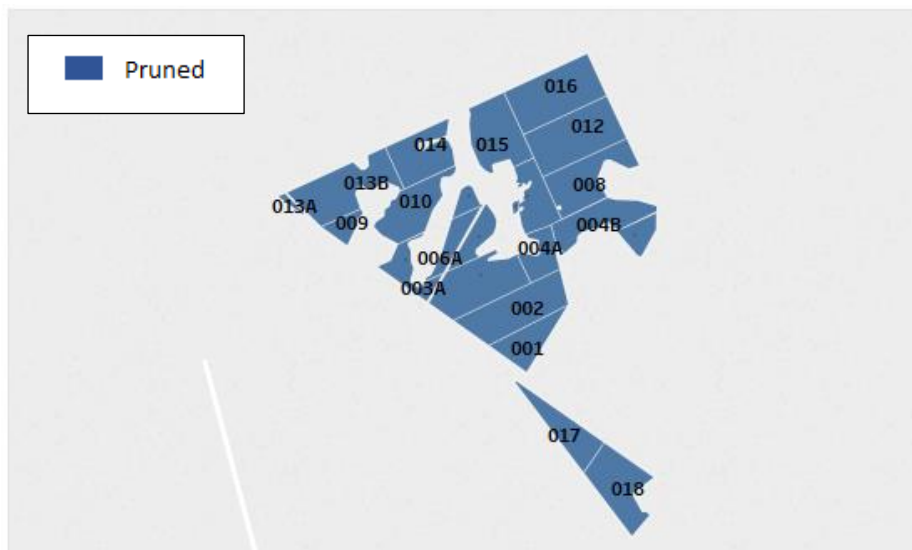
Activity	Project	Unit	Quantity
Pruning	MUT	ha	512,7
	CMB	ha	301,0
	PAR	ha	216,2
	BAR	ha	86,7
	DLG	ha	79,4
	SMJ	ha	54,6
	BAM	ha	52,7
	ARA	ha	41,2
	SER	ha	20,9
	SMJII	ha	17,8
Sprout Control	STF	ha	13,2
	MUT	ha	609,7
	CMB	ha	305,2
	BAR	ha	200,3
	PAR	ha	135,0
	SMJ	ha	131,7
	DLG	ha	103,6
	SMJII	ha	89,9
	BAM	ha	36,5
	SER	ha	21,7
Weed Control	STF	ha	16,6
	PIM	ha	335,3
	PAN	ha	89,0
	SMJ	ha	76,6
	BAR	ha	61,9
	BUR	ha	39,0
	CMB	ha	34,0
IND	ha	31,0	
	PAI	ha	27,0
<b>Total</b>			<b>3740,32</b>

### 3.1. PRUNING

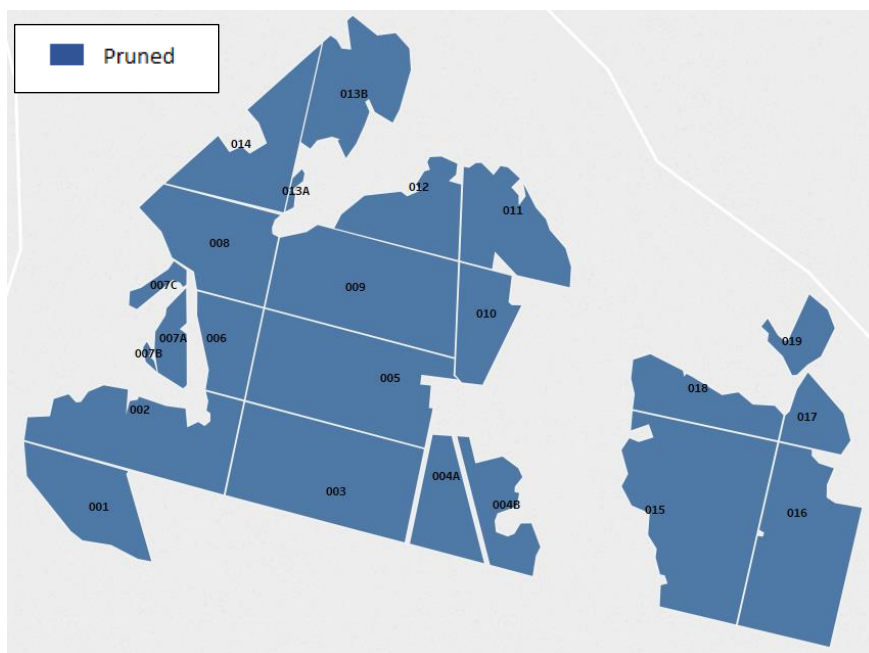
Pruning aims to eliminate the branches of the trees that do not contribute to its growth, as well as to reduce the formation of knots. This activity is very important in the determination of future wood quality, and results in a better shape and marketability of the logs,

The most relevant pruned areas this quarter were in Cacimba and Paraíso farms, finishing all stands, and the younger plantations (2005, 2006) in Duas Lagoas.

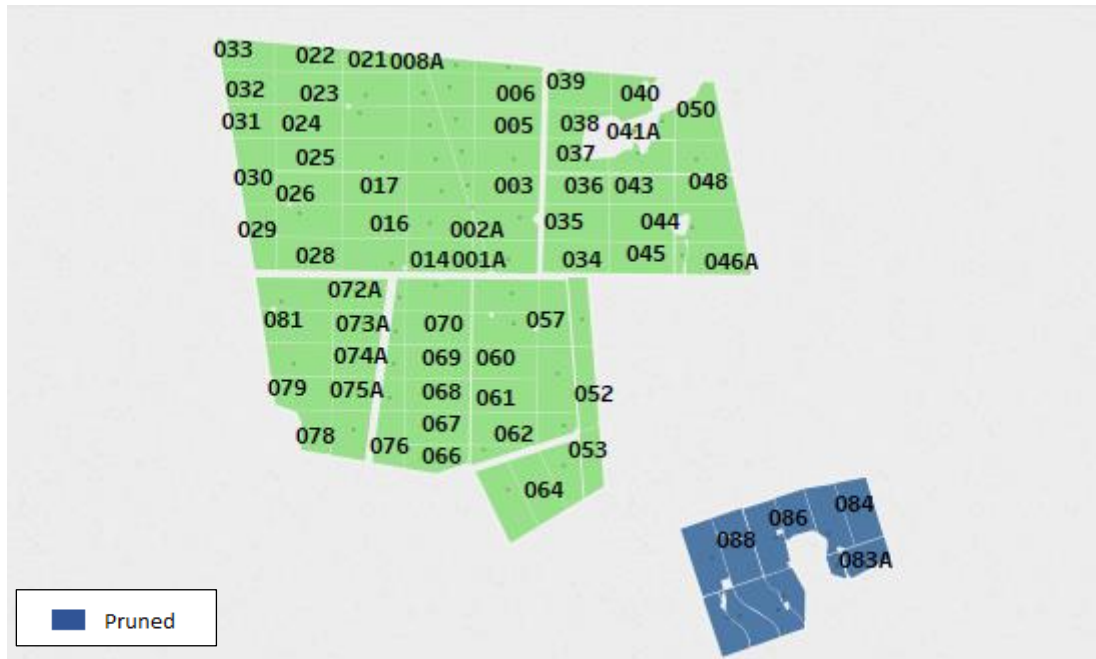
Map 5: YTD Pruning per stand, Cacimba 2002 and 2003.



Map 6: YTD Pruning per stand, Paraíso 1997



Map 7: YTD Pruning per stand, Duas Lagoas 2005 and 2006.

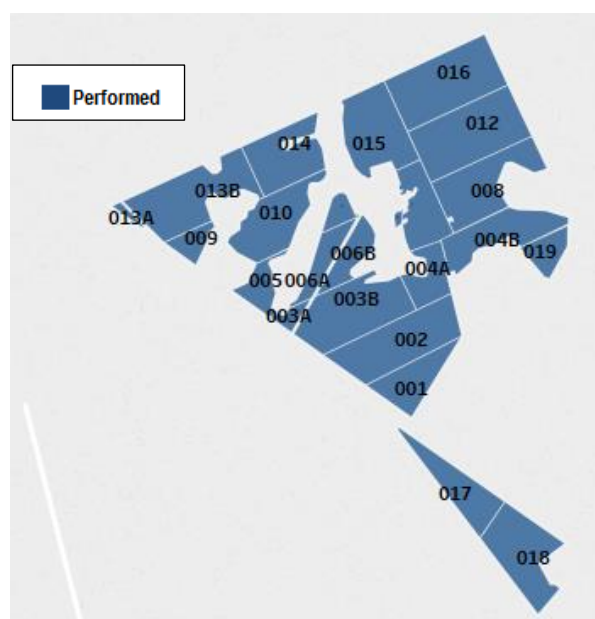


### 3.2. SPROUT CONTROL

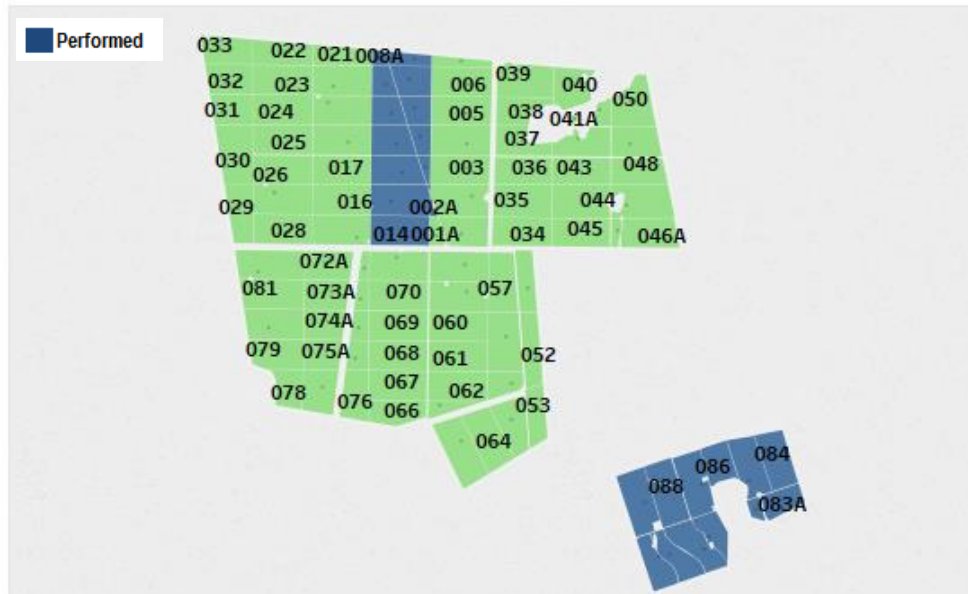
With the opening of the canopy following thinning, the stumps of the removed trees tend to re-sprout and may result in competition with the remaining crop trees. Sprout control involves eliminating sprouts from thinned trees, allowing the remaining trees to grow without additional competition.

The most relevant areas performed are shown below:

Map 8: YTD Sprout Control per stand, Cacimba 2002 and 2003

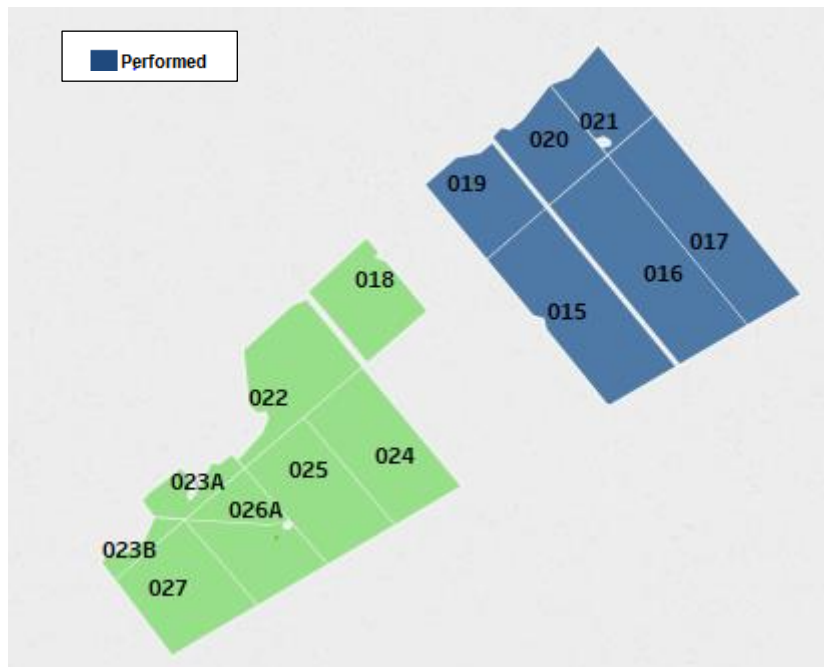


Map 9: YTD Sprout Control per stand, Duas Lagoas



The younger part of the farm (2005 and 2006), on the lower right part of the map, was done completely. On the older part (center of the map), this activity was performed only on the stands with high incidence of stumps sprouting,

Map 10: YTD Sprout Control per stand, BAM 2000



So far, 4 stands in Bambu farm were finished. The operation will be completed, including 1999 stands on the last quarter of this year.

### 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 is normally done manually, and can be chemical (with dorsal spray tanks) or mechanical (hoe and/or sickle). This operation can also be done to clear the understory to facilitate traffic for our field crews inside the forest prior to significant operations. All farms illustrated here below are cases of mowing to improve conditions for the harvesting team.

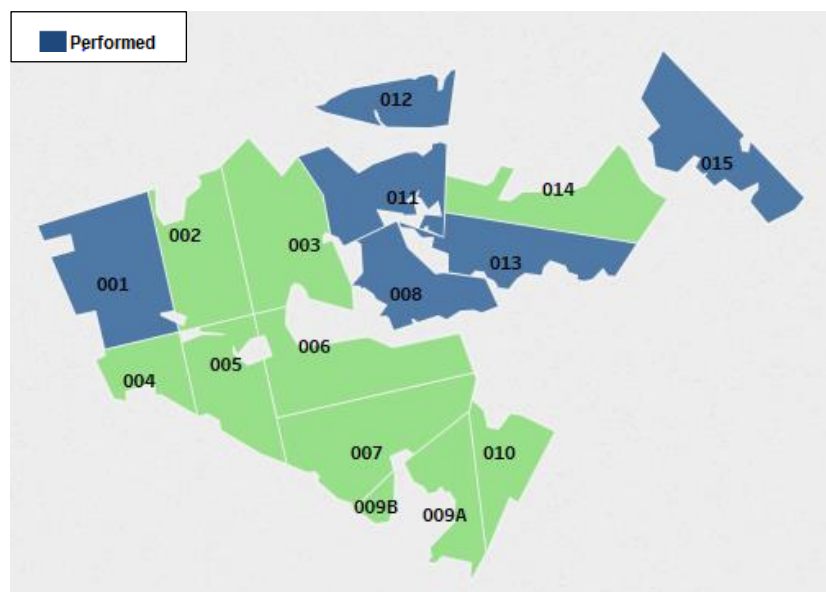
The most relevant areas performed this quarter are presented in detail in the maps hereunder:

Map 11: YTD Weed Control per stand, Pimental 1996



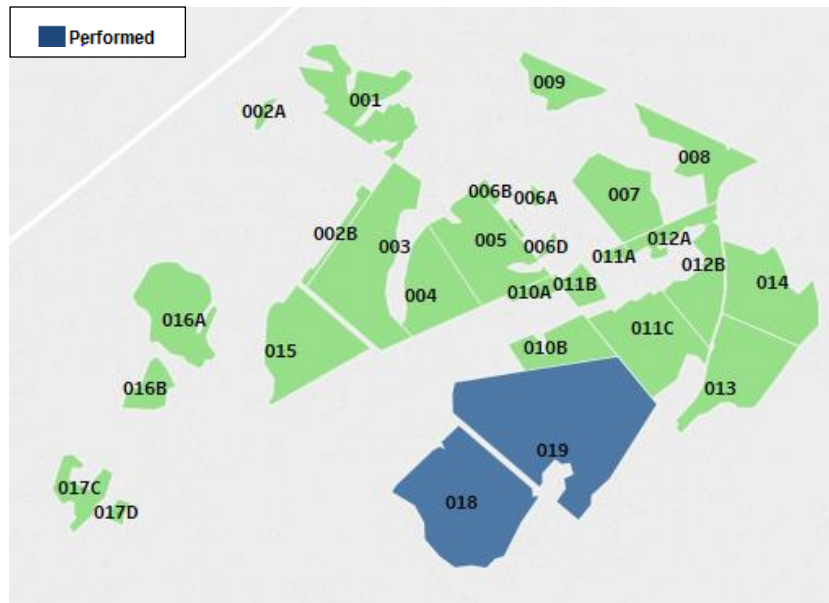
Stands were done prior to final harvesting.

Map 12: YTD Weed Control per stand, Buriti 1994



Stands were done prior to final harvesting.

Map 13: YTD Weed Control per stand, Cocal 1996 and 1998



Stands were done prior to final harvesting, which will begin on the coming quarter.

#### **4. PLANNING AND FOREST DESCRIPTION**

<Intentionally left blank – no changes from the Management Plan 2017>

## 5. LOG SALES

### 5.1. LOG SALES AND HARVESTING COSTS

The Year to Date sold volume equals to 47,260.75 m<sup>3</sup> with a weighted average price (at roadside) of USD 111/m<sup>3</sup>. 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 <sup>3</sup> )	Gross Revenue (USD)			Total	W.A. Price (USD/m <sup>3</sup> )
					Export	Local	Sawmill		
1994	BUR	FC	592,29	4.198,16	141.971,15	1.609,65	133.877,66	<b>277.458,46</b>	66,09
1996	PIM	FC	693,42	30.311,26	3.670.255,96	65.312,41	483.777,32	<b>4.219.345,69</b>	139,20
1995	SIL	FC	582,80	132,03	32.378,93	0,00	0,00	<b>32.378,93</b>	245,24
2004	TST	2T	1.143,17	648,96	70.725,19	0,00	0,00	<b>70.725,19</b>	108,98
1998	COC	FS	133,80	24,26	6.502,48	0,00	0,00	<b>6.502,48</b>	268,00
2007	MUT	2T	539,18	1.891,82	0,00	0,00	109.665,92	<b>109.665,92</b>	57,97
2007	SAJ	2T	301,30	10.054,25	0,00	0,00	541.951,99	<b>541.951,99</b>	53,90
<b>Total</b>			<b>3.985,96</b>	<b>47.260,75</b>	<b>3.921.833,72</b>	<b>66.922,06</b>	<b>1.269.272,89</b>	<b>5.258.028,66</b>	<b>111,26</b>

FC = Final Cut  
 2T = Second thinning  
 FS = Phytosanitary

Gross Revenues = revenues before applicable costs including:

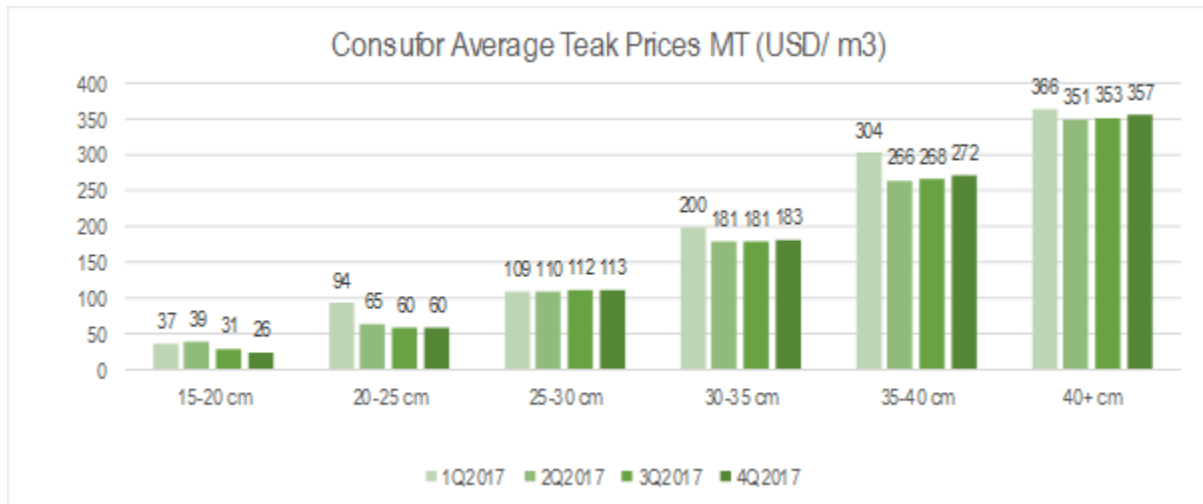
- Harvesting costs FC (cutting, forwarding, making land root free)
- Agreed maintenance and general management fees;
- Incentive fee of 5% to FSA;
- Applicable local taxes.

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 m<sup>3</sup> 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/m<sup>3</sup>)



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. This is large due to the fact that the logs are from thinnings (so have less heartwood, and are accordingly discounted) and compete with logs from Central America which have greater logistics advantages. Most of these logs are sold in the local market to sawmills, as their export would not be economic.

Table 3 – YTD harvesting costs (FX 3.168)

Activity	Actual cost BRL	Actual cost USD
<b>Total</b>	<b>3,868,166</b>	<b>1,221,012</b>
Volume Sold	47,261	47,261
<b>Cost / m<sup>3</sup></b>	<b>81.8</b>	<b>25.8</b>

## 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 with the Usufruct. Following the court decision and after a relatively short disturbance in the work planning, the maintenance teams of FSA were able to resume activities at Paraiso again.

### 6.2. MUTUM FARM

**Issue 1:** 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 2011). The judge ruled in favor of the LHS (in June, 27, 2011). 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, Cáceres-MT. In (March, 28, 2012), the judge decided to suspend INCRA’s administrative procedure. Subsequently, in (January 09, 2015) a technical opinion declared the property as productive. A Court Hearing is scheduled for November 9th, 2017, where FSA’s testimonies will be heard to clarify the facts. After that, the judge will issue a final decision.

### 6.3. EXECUTIVE OFFICER CHANGE

FSA has hired Glenn Peebles III as Vice-President since 1<sup>st</sup> May, 2017 in substitution of Sylvio Coutinho Neto. The latter became member of the non-executive board.

## 7. APPENDIX

### 7.1. PLANTED AREA PER PROJECT AT END 2016

Project	Total Managed	
	Area	SATT
1994 BUR	592,29	592,29
1995 K 8	0	0
1995 SIL	0	0
1996 COC	374,88	374,88
1996 PIM	698,26	698,26
1996 TEM	191,42	191,42
1996 PAI	297,92	210,44
1997 PAR	555,05	512,94
1998 BOC	431,65	426,55
1998 COC	133,84	133,84
1998 PAI	93,95	93,95
1998 CAN	44,62	44,62
1998 STJ	26,76	26,76
1998 SIL	24,41	24,41
1998 VDO	351,68	351,68
1998 ARA	98,88	78,3
1998 BAM	549,07	400,17
1999 BOC	108,18	108,18
1999 CPB	507,87	507,87
1999 CAS	88,49	84,89
1999 SER	105,01	104,01
1999 VDO	48,59	48,59
2000 BAM	513,83	404,24
2000 DLG	1527,51	1527,51
2001 DLG	2136,42	2136,42
2001 SMG	97,52	93,02
2002 BAR	970,2	756,75
2002 CMB	571,08	445,75
2002 DLG	48,41	48,41
2002 SMJ	1085,18	1085,18
2002 SMG	5,71	4,57
2003 BAR	12,95	10,36
2003 CMB	10,19	8,15
2003 STF	2562,71	2493,02
2003 SMJ	207,87	207,87
2004 BAR	1201	1000,51
2004 TST	1143,17	1134,45
2005 DLG	207,67	170,37
2006 DLG	233,88	190,72
2007 MUT	539,18	522,43
2007 SAJ	301,3	290,91
2008 SMJII	99,87	89,88
<b>Total</b>	<b>18798,47</b>	<b>17634,57</b>