

Our objectives

Consistent with our commitment to all three aspects of sustainable development, we at Precious Woods strive to create economic, social and environmental added-value in all of our business activities. The practice of responsible forestry in tropical regions, focusing on the long-term preservation of forest resources, represents a unique opportunity to achieve this goal.

Global deforestation continues to advance. Over the last ten years around 2% of the Earth's forest cover has been lost. The tropical forests of Latin America and Africa are particularly affected. Brazil alone loses an average of approximately 20 000 km² of forest every year, an area equivalent to around half the size of Switzerland.

The destruction of the rainforest continuously depletes an important natural resource upon which the majority of the population in rural tropical areas depend. In addition, deforestation is responsible for approximately one-fifth of annual global greenhouse gas emissions and also represents a serious threat to biodiversity.

It is Precious Woods' aim to contribute to the permanent preservation of tropical forests by sustainable management of both natural forest and plantations and the marketing of the products these provide. By developing and marketing non-timber products – including emission rights – we also encourage innovation and extend the opportunities to create value from tropical forests. We are firmly convinced that the sustainable use of these forests is the best way to protect them.

Sustainability as our core business

Most companies' environmental commitment is limited to reducing the impact of their products and production processes on the environment and to restricting their consumption of resources. As a forestry business operating in the tropics, Precious Woods by contrast is able to contribute directly towards the conservation of natural resources and the improvement of the environment. When Precious Woods reforests land in Central America, unproductive pastures – which were originally covered with forest – are converted back into forest. This promotes biological diversity and also sequesters

CO₂. The sustainable use of forests in the Amazon region protects endangered, species-rich forest areas from being cleared for agricultural purposes and prevents the associated release of carbon dioxide. In addition, significantly more jobs are created by the sustainable forestry industry than would be the case if these lands were cleared for extensive cattle ranging or used by the mechanised plantation industry.

For Precious Woods sustainability is much more than a production criterion to minimise any harmful effects our operations may have on the environment or the social conditions in the countries where we operate. Conducting our business activities in a sustainable manner is literally our core business.

Defining Sustainability

The concept of sustainability has been defined in many different ways. We use the term in accordance with the definition of the World Business Council on Sustainable Development. Inherent in this definition is the idea that sustainable development simultaneously strives to achieve economic success, provide ecological benefits and contribute towards social justice. Thus, it is not only the financial bottom line that counts. For sustainability-driven companies, performance is measured in terms of a triple bottom line.



By producing valuable hardwoods and non-timber forest products in a sustainable manner...



... we protect tropical forests...



... and improve the socio-economic conditions.

Market opportunities

Our efforts to protect tropical forests by producing valuable hardwoods and non-timber forest products while contributing to the improvement of the socio-economic conditions in the producer countries clearly set us apart from most of our competitors. Precious Woods is convinced that beyond contributing to the positive development of the environment and society, our approach provides a competitive edge creating significant market opportunities. These are based on our capability to differentiate our business and products from those of our competitors, but even more so by instigating a fundamental change in the way tropical timber markets currently operate, providing the impetus for the introduction of a new set of sustainability-focused rules.

The challenges of sustainability

Achieving a balance in the day-to-day life of a company between the three pillars of sustainability – economic, environmental and social objectives – can often present a major challenge. Our recent experiences in Brazil demonstrate that conflicts can arise between the separate

objectives when we had to change the manufacturing program and cut back on staff due to steeply rising costs. From a social perspective this move was highly undesirable, but for the survival of the company it was essential. In the meantime we have largely overcome these difficulties. In the case of the Central American reforestations we also have to balance conflicting interests very carefully. From a purely ecological point of view it would always be preferable to plant indigenous tree species instead of teak which is an Asian species. For the time being however, it is only possible to develop a reliable business model on the basis of teak combined with a smaller proportion of indigenous species.

These and other examples illustrate that in developing countries – and not only in these countries – managing a company committed to the principles of sustainable development “correctly” can, in practice, be a very challenging task. Accomplishing this successfully requires thorough, first-hand knowledge of the forests’ ecology and the socio-economic conditions of local communities, together with the ability to integrate this

knowledge into economically successful business practices.

Group review

2006 was shaped by four major developments. First, the full-year consolidation of the trading company, Precious Woods Europe, led to a marked increase in turnover. Second, the Precious Woods Group achieved its first significant revenues from the sale of emission rights. Third, the Brazilian operations once again suffered substantial losses related to restructuring costs, and the workforce had to be reduced. Finally, timber prices rose worldwide. This led to improved fourth quarter operating results, including those achieved by Precious Woods' Brazilian subsidiaries. The overall result falls short of the optimistic forecast we made at the beginning of 2006 but is significantly above our somewhat pessimistic, mid-year predictions.

Income statement

The integration of Precious Woods Europe and the first ever sale of emission rights led to a huge jump in revenue. Sales of timber and electricity increased from USD 15.31 million to USD 43.15 million. Including the revenue from emission rights and the gain in fair value of the plantations in

Central America, total revenue almost tripled, from USD 20.62 million to USD 59.93 million. Although the Brazilian subsidiaries once again suffered heavy, extraordinary losses in the first semester and further exceptional write-offs were necessary the Precious Woods Group achieved a positive operating result in 2006, in contrast to the prior year. Together with the positive financial result, this led to a net profit of USD 5.31 million, compared with a prior year loss of USD 7.46 million and a USD 3.33 million profit in 2004. The exceptional charges incurred in Brazil, which were related to previous years, negatively impacted the Group result by approximately USD 8 million.

Operating cash flow

In 2006 a considerable share of expenditures were cash neutral. Neither the sharp increase in depreciation due to acquisitions, nor the stock valuation adjustments related to the restructuring process at Precious Woods Amazon impacted cash flow. On the other hand, particularly revenues from the emission rights which were not sold in the reporting year, were also cash flow neutral. As a result, operating cash flow in the

amount of 8.92 million USD was significantly higher than net result. Regarding current assets, somewhat more working capital was tied up in inventories while trade and other payables increased and short term borrowings were reduced. At USD 4.72 million, the level of investment in property, plant and equipment in 2006 was such that all the necessary capital expenditures could be financed entirely by the operating cash flow generated in the same period.

Balance sheet

Precious Woods did not make any significant acquisitions in 2006. The net increase in non-current assets in the amount of USD 12.52 million is mainly attributable to the increase in fair value of the biological assets in Central America, to the increase in plant, property and equipment as well as to exchange rate effects. Total net current assets remained practically unchanged compared to the prior year. In spite of the reduction in stocks of timber and wood products, the value of inventories increased by USD 1.58 million, due to higher timber prices and the new inventory of emission rights available for sale. With shareholders' equity (less mino-



The integration of Precious Woods Europe led to a jump in turnover.



By acquiring a minority stake in NST, Precious Woods has laid the foundation for an expansion into the Democratic Republic of Congo.

ity interest) accounting for 85% (2005: 83%) of total assets, the Group remains heavily equity-financed.

Africa projects

At the time of the Annual General Meeting of 20 May 2006, Precious Woods expected that the contract relating to the Congo participation would soon be finalised. However, changes in the institutional environment prompted us to reassess the risks involved. This reassessment focused exclusively on the country risk and did not pertain to our partner companies as such.

In view of the new risk situation, we did not go ahead with the initial investment as originally planned. In the winter of 2006/2007, however, Precious Woods reached an agreement with its partners on a new investment contract which was signed at the end of March 2007. According to this contract, Precious Woods will participate in a capital increase conducted by the Liechtenstein-based holding company, Nord-südtimber (NST), and thus provide the NST group with fresh funds. The fresh capital will be used by the

group's subsidiaries in the Democratic Republic of Congo to finance investments in logistics and new production capacity. This will lay the foundation for further growth and create new opportunities for employment. At the end of March, Precious Woods became – with a stake of less than 10% – a shareholder of NST. This move enables us to become thoroughly acquainted with the NST group of companies and also allows us to follow political developments in the DRC at close hand, with the result that in a few years' time we will be able to make a competent assessment of the situation.

The investment agreement includes an option to raise our stake in NST substantially at a later date. The investment in NST secures Precious Woods a potential share in a few years' time of one of the world's most outstanding and extensive forest resources. The number of large forest concessions available, the industrial base, distribution network and NST's long tradition (dating back to 1955), together with the excellent mix of species all present us with tremendous opportunities. Should Precious Woods exercise its option to

increase its participation, this could be the decisive growth driver for the decade from 2010 to 2020. Precious Woods will contribute its own wealth of experience and network of business relationships in order to play a positive and influential role through the large NST forestry group – which already employs over 4 000 people – in the development of a socially responsible and ecologically sustainable forestry industry in the Congo Basin. The NST subsidiaries already have a large project team in place preparing forest management plans in order to fulfil one of the important prerequisites for certification by the FSC.

Concurrent with the negotiations with NST, Precious Woods also evaluated an expansion opportunity in Gabon during the year under review. In this case, the company concerned has some 700 employees and a concession covering 600 000 ha of forest. At the time of going to press, negotiations were in an advanced stage but not completed.



The Precious Woods Group sold its first emission rights from reforestations in Costa Rica.



Emission rights from the power plant project in Itacoatiara were issued by the UN climate change agency and a large portion of them was sold by the end of the year.

The Carbon & Energy division

Our Carbon & Energy division experienced a number of significant successes in the reporting year. In March 2006, Precious Woods succeeded in selling its first ever emission rights. These originated from the reforestation projects in Costa Rica and had been verified and registered as Carbon Financial Instruments on the Chicago Climate Exchange (CCX). With this transaction Precious Woods became the first forestry company worldwide to sell emission rights from reforestations via the CCX.

In September we achieved a further notable success. The United Nations Climate Agency (UNFCCC) issued 512 385 Certified Emission Rights (CERS) generated by the replacement of diesel with renewable biomass at the power plant near Itacoatiara and the prevention of methane emissions. These were the first CERs based on biomass from FSC-certified forest management operations and at the same time the highest number of CERs to have been issued up to then to a Latin America-based project. A large portion of these emission rights were sold to a buyer in the over-the-counter market.

With the sale of CO₂ certificates (CERs and CFIs) representing a total of 684 000 tons of carbon dioxide, the generation of emission rights has finally become established as an additional pillar of Precious Woods' business model. The revenue from emission reduction activities amounted to USD 11.39 million. The amount was particularly high in 2006 because it included the proceeds from rights that had been generated in previous years, but which were registered for the first time and approved for sale only in 2006. In Europe the market for Kyoto-compatible emission rights was extremely volatile. The prices for certificates traded in phase I (2005–2007) of the European Emissions Trading Scheme (EU ETS) increased from just a few euros per ton in 2004 to over 30 euros per ton at the beginning of 2006. Towards the end of the year they dropped to below two euros. The prices for phase II fluctuated between 33 and 13 euros. Future prices for emission rights will largely depend on the emissions reduction targets set by the political authorities. The market volatility seen in 2006 was mainly attributable to the fact that the carbon reduction targets had been set so low in phase I that

very little effort was required to meet them. Most participants in the market assume that stricter reduction targets will be imposed in future, which is why the prices for tradable emission rights in the second phase are expected to stabilize.

Compared with the prior year, electricity production at the power plant in Itacoatiara decreased by 11% from 54 276 MWh to 48 128 MWh. This was due to a decline in demand owing to the economic situation and the closure of a number of industrial operations (including our own veneer factory) in Itacoatiara.



The Brazilian operations once again suffered substantial losses related to restructuring and the workforce had to be reduced.



During the reporting year we expanded the scope of our environmental and social data collection.

Sustainability facts and figures

Precious Woods' approach to sustainable forest management goes beyond environmental responsibility and attaches equal importance to social considerations. We collect environmental and social data from all our locations, which allows us to compare statistics across the group over a period of several years and at the same time helps us identify potential for improvement.

Environmental performance

All the production and trading companies of the Precious Woods Group have been certified by the FSC or are in the process of being certified. Certification is carried out by the following FSC-accredited certifiers: SmartWood, Société Générale de Surveillance (SGS) and Skal. Precious Woods Brazil and Precious Woods Central America sell exclusively FSC-certified timber. In 2006 the proportion of FSC timber sold by Precious Woods Europe rose from 62% to 66%.

Energy and water consumption

The environmental performance indicators show that by far the major portion of the energy Precious Woods consumes comes from fossil

fuels. At 69%, diesel (used in forest operations and in internal transportation) accounts for the largest share of our energy consumption. At present we do not keep statistics on our water consumption because most of it comes from our own springs and the water from these sources cannot be accurately quantified. All of Precious Woods' operations are located in areas where water is plentiful. Moreover, the plantations in Costa Rica are not artificially irrigated.

Emissions

Precious Woods' CO₂ emissions in 2006 amounted to 7 800 tons, of which 79% result from the combustion of diesel fuel. By comparison, Precious Woods annually prevents the emission of around 1 million metric tons of CO₂ by protecting forests in the Amazon Basin (assuming an average annual rate of deforestation of 0.35%). At present this ecosystem service is not sold to third parties.

Employees

Compared to the previous year, the number of people employed by the Precious Woods Group in 2006 fell by 10% to 1 608 employees. This was due to the reduction in staff at

Precious Woods Amazon. At Precious Woods' Central American operations on the other hand, staff numbers rose by 33.5%. Along with these changes there was also an increase in the proportion of women employed. Across the group women accounted for 7.5% of employees (2005: 6.8%) and in administration/finance for 33.3% (23%).

Industrial accidents

Overall the number of accidents per 1 000 employees increased. This is mainly due to the adoption in 2006 of a new method of recording data which also takes minor accidents into account. An injury is counted as an accident as soon as it leads to the loss of a day's work. Every serious accident is thoroughly investigated to clarify whether any modifications to working practices, facilities or safety regulations are necessary in order to prevent the occurrence of accidents in the future.

Training

We place great importance on the initial and further training of our employees. For Precious Woods, improving occupational safety and the quality of work are prime con-



In 2006, Precious Woods continued to focus on the continuous improvement of occupational safety and the quality of work.

cerns. Half of the initial and further training sessions took place in the forest and a quarter at the industrial and logistics facilities.

Donations

In Brazil and Central America Precious Woods supports health, educational and environmental projects which take account of local needs and existing infrastructure. About 80% of the donations consist of financial assistance and 20% are "in kind" (i.e. goods and services.)

Visitors

Every year several hundred interested people visit Precious Woods' operations in Brazil and Central America to learn about the practical aspects of sustainable forest management and reforestation. The visitors include students (31%), the local population (16.5%), representatives of the media (2.5%) and a number of other interested parties (50%).

Environmental and social key performance indicators

Environment	2006	2005
Environmental performance		
Reforestation (total area in ha)	6 273	5 788
Forest protection (total area in ha) ¹	528 840	528 614
Reduction of GHG emissions (in metric tons) ²	851 385	0
Production of renewable energy (in GJ) ³	138 600	75 000
FSC share of timber sales	71%	100%
Energy consumption and emissions		
Fossil fuel consumption (in GJ)	95 500	92 000
Electricity consumption (in GJ)	26 000	29 000
CO ₂ -emissions (in metric tons) ⁴	7 800	7 500
Employment		
Employees		
Number of employees (yearly average) ⁵	1 608	1 784
Brazil	1 065	1 323
Central America	434	359
Europe	55	–
Carbon & Energy	45	44
Corporate	9	8
Women	7.5%	6.8%
Rate of employee turnover	3.3%	–
Personnel costs (in USD)	18 051 155	8 812 650
Health & safety		
Number of employees recorded for statistics ⁶	1 389	1 630
Accidents at work	241	218
Days lost due to accidents	1 301	1 642
Accidents per 1 000 employees	174	134
Fatal accidents at work	1	2
Training		
Training hours	7 000	5 700
Training hours per employee	4.4	3.3
Society		
Donations⁷		
Healthcare (in USD)	28 550	–
Education (in USD)	7 150	–
Environment & business development (in USD)	8 100	–
Visitors		
Number of visitors	674	966

¹ This area comprises the forest base in Brazil (2006: 524 700 ha) and the existing forest in Central America (2006: 4 140 ha)

² Greenhouse gas reductions (measured in tons of CO₂ equivalents) which were either certified by the UNFCCC as Certified Emission Rights (CERs) or registered on the Chicago Climate Exchange (CCX) as Carbon Financial Instruments (CFIs) and issued in the year 2006.

³ The 2005 figure refers only to the amount of energy generated for the period following the acquisition of the woodchip-fired power plant in Itacoatiara by Precious Woods (i.e. from June to December 2005).

⁴ The share of emissions from electricity consumption was calculated using the specific conversion factors for the different countries issued by the International Energy Agency (IEA).

⁵ Employee figures are stated as the equivalent number of full-time staff.

⁶ The accident figures for Nicaragua are not included as these were not collected until fourth quarter 2006. The accident figures for Precious Woods Europe are included for the first time.

⁷ Donations had been calculated for the first time in 2006.