# Financial Statements

## Carta Goiás Indústria e Comércio de Papéis S.A.

December 31, 2016 and 2015
with Independent Auditor’s Report

**Carta Goiás Indústria e Comércio de Papéis S.A.**

Financial statements

December 31, 2016 and 2015

Contents

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**A free translation from Portuguese into English of Independent Auditor's Report on Individual and Consolidated Financial Statements prepared in Brazilian currency in accordance with accounting practices adopted in Brazil and International Financial Reporting Standards (IFRS), issued by International Accounting Standards Board (IASB)**

# Independent auditor's report on financial statements

The
To the Shareholders, board of directors and officers of
**Carta Goiás Indústria e Comércio de Papéis S.A.**
Niterói - RJ

## Opinion

We have audited the accompanying individual and consolidated financial statements of Carta Goiás Indústria e Comércio de Papéis S.A. ("Company"), identified as Company and Consolidated, respectively, which comprise the statement of financial position as at December 31, 2016, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the individual and consolidated financial statements present fairly, in all material respects, the individual and consolidated financial position of Carta Goiás Indústria e Comércio de Papéis S.A. as at December 31, 2016, its individual and consolidated financial performance and individual and consolidated cash flows for the year then ended, in accordance with accounting practices adopted in Brazil and in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

## Basis for opinion

We conducted our audit in accordance with Brazilian and International Standards on Auditing. Our responsibilities, under those standards, are further described in the "Auditor's responsibilities for the audit of financial statements" section of our report. We are independent of the Company in accordance with the relevant requirements that are relevant to our audit of the financial statements set forth in the Code of Professional Ethics for Accountants, the professional standards issued by Brazil's National Association of State Boards of Accountancy (CFC) and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Responsibilities of management and those charged with governance for the financial statements**

Management is responsible for the preparation and fair presentation of the individual and consolidated financial statements in accordance with accounting practices adopted in Brazil, and in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the individual and consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless management either intends to liquidate the Company and its subsidiaries or to cease operations, or has no other realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

**Auditor's responsibilities for the audit of financial statements**

Our objectives are to obtain reasonable assurance about whether the individual and consolidated financial statements as a whole are free of material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Brazilian and International Standards on Auditing will always detect material misstatements when they exist. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

As part of the audit conducted in accordance with Brazilian and International Standards on Auditing, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess risks of material misstatements of the individual and consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions or misrepresentations, or the override of internal control

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's and its subsidiaries' internal controls.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of the management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's and its subsidiaries' ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the individual and consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or future conditions may cause the Company and its subsidiaries to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the individual and consolidated financial statements represent the corresponding transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Rio de Janeiro, February 24, 2017.

ERNST & YOUNG
Auditores Independentes S.S.
CRC-2SP015199/F-6

Fernando Alberto S. Magalhães
Accountant CRC-1SP133169/O-0

# Carta Goiás Indústria e Comércio de Papéis S.A.

Statements of financial position
At December 31, 2016 and 2015
(In thousands of reais)

| | | Company | | Consolidated | |
|---|---|---|---|---|---|
| | Note | 2016 | 2015 | 2016 | 2015 |
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | 4 | **22,744** | 27,941 | **23,039** | 28,237 |
| Restricted short-term investments | 4 | **3,948** | 3,650 | **3,948** | 3,650 |
| Trade accounts receivable | 5 | **93,863** | 73,894 | **93,863** | 73,894 |
| Inventories | 6 | **40,526** | 33,717 | **40,526** | 33,717 |
| Taxes recoverable | 7 | **52,988** | 46,114 | **52,988** | 46,114 |
| Advances to suppliers | | **10,710** | 9,392 | **10,710** | 9,392 |
| Other current assets | | **2,281** | 1,788 | **2,281** | 1,788 |
| | | **227,060** | 196,496 | **227,355** | 196,792 |
| Noncurrent assets | | | | | |
| Derivative financial instruments | 9 | **-** | 24 | **-** | 24 |
| Taxes recoverable | 7 | **12,255** | - | **12,255** | - |
| Deferred income tax and social contribution taxes | 17 | **2,871** | - | **2,871** | - |
| Other receivables | | **1,168** | 1,883 | **1,168** | 1,883 |
| Investments | 8 | **7,660** | 8,018 | **-** | - |
| Property, plant and equipment | 10 | **403,892** | 311,814 | **451,450** | 360,524 |
| Intangible assets | 10 | **1,147** | 786 | **1,147** | 785 |
| | | **428,993** | 322,525 | **468,891** | 363,216 |
| Total assets | | **656,053** | 519,021 | **696,246** | 560,008 |
| | | | | | |
| Liabilities and equity | | | | | |
| Current liabilities | | | | | |
| Trade accounts payable | 11 | **81,339** | 74,699 | **81,339** | 74,699 |
| Loans and financing | 12 | **90,482** | 60,203 | **90,482** | 60,203 |
| Derivative financial instruments | 9 | **5,380** | - | **5,380** | - |
| Taxes, charges and contributions | 13 | **6,261** | 5,431 | **6,261** | 5,431 |
| Labor and social security liabilities | 14 | **10,654** | 8,956 | **10,654** | 8,956 |
| Taxes payable in installments | 15 | **1,172** | 3,536 | **1,172** | 3,536 |
| Dividends payable | 18 | **-** | 2,479 | **-** | 2,479 |
| Advances from customers | | **4,839** | 8,105 | **4,839** | 8,105 |
| Tax incentives | | **438** | 270 | **438** | 270 |
| | | **200,565** | 163,679 | **200,565** | 163,679 |
| Noncurrent liabilities | | | | | |
| Accounts payable | | **15,357** | 14,400 | **15,357** | 14,400 |
| Loans and financing | 12 | **186,861** | 153,298 | **186,861** | 153,298 |
| Derivative financial instruments | 9 | **4,149** | - | **4,149** | - |
| Deferred government grant - donation | 10 | **5,984** | - | **35,984** | 30,000 |
| Provision for contingencies | 16 | **13,817** | 17,799 | **13,817** | 17,799 |
| Tax in installments | 15 | **11,329** | 13,295 | **11,329** | 13,295 |
| Deferred income tax and social contribution taxes | 17 | **-** | 3,609 | **3,857** | 7,963 |
| | | **237,497** | 202,401 | **271,354** | 236,755 |
| Equity | 18 | | | | |
| Capital | | **96,289** | 96,289 | **96,289** | 96,289 |
| Equity adjustments | | **49,112** | 54,249 | **49,112** | 54,249 |
| Legal reserve | | **5,643** | 2,403 | **5,643** | 2,403 |
| Reserve for grants | | **66,947** | - | **66,947** | - |
| | | **217,991** | 152,941 | **217,991** | 152,941 |
| Noncontrolling interest | | **-** | - | **6,336** | 6,633 |
| | | | | | |
| Total equity | | **217,991** | 152,941 | **224,327** | 159,574 |
| Total liabilities and equity | | **656,053** | 519,021 | **696,246** | 560,008 |

See accompanying notes.

## Carta Goiás Indústria e Comércio de Papéis S.A.

Income statements
Years ended December 31, 2016 and 2015
(In thousands of reais)

| | | Company | | Consolidated | |
|---|---|---|---|---|---|
| | Note | 2016 | 2015 | 2016 | 2015 |
| Net operating revenue | 19 | **679,062** | 542,523 | **679,062** | 542,523 |
| Cost of goods sold | 20 | **(396,896)** | (326,879) | **(396,896)** | (326,879) |
| Gross profit | | **282,166** | 215,644 | **282,166** | 215,644 |
| Operating income (expenses) | | | | | |
| Selling and logistics expenses | 21 | **(144,342)** | (107,708) | **(144,342)** | (107,708) |
| General and administrative expenses | 22 | **(46,367)** | (37,530) | **(47,517)** | (38,453) |
| Equity pickup | 8 | **(605)** | (291) | **-** | - |
| Other operating income, net | 23 | **13,896** | 24,854 | **13,896** | 25,147 |
| | | **(177,418)** | (120,675) | **(177,963)** | (121,014) |
| Income before financial income (expenses) and income taxes | | **104,748** | 94,969 | **104,203** | 94,630 |
| Financial income (expenses) | | | | | |
| Financial expenses | 24 | **(59,816)** | (48,016) | **(59,818)** | (48,016) |
| Financial income | 24 | **13,392** | 3,173 | **13,392** | 3,173 |
| | | **(46,424)** | (44,843) | **(46,426)** | (44,843) |
| Income before income taxes | | **58,324** | 50,126 | **57,777** | 49,787 |
| Income tax | 17 | **4,789** | (1,514) | **4,823** | (1,441) |
| Social contribution tax | 17 | **1,690** | (547) | **1,702** | (521) |
| Net income for the year | | **64,803** | 48,065 | **64,302** | 47,825 |
| Attributable to shareholders | | | | | |
| Controlling shareholders | | **-** | - | **64,803** | 48,065 |
| Noncontrolling shareholders | | **-** | - | **(501)** | (240) |
| Number of shares | | **96,289,235** | 96,289,235 | **-** | - |
| Earnings per share | | **0.65** | 0.50 | **-** | - |

See accompanying notes.

## Carta Goiás Indústria e Comércio de Papéis S.A.

Statements of comprehensive income
Years ended December 31, 2016 and 2015
(In thousands of reais)

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Net income for the year | **64,803** | 48,065 | **64,302** | 47,825 |
| Other comprehensive income | | | | |
| Realization of revaluation reserves and equity adjustment, net of taxes | **(5,384)** | (2,003) | **(5,384)** | (2,003) |
| Total comprehensive income for the year | **59,419** | 46,062 | **58,918** | 45,822 |

See accompanying notes.

# Carta Goiás Indústria e Comércio de Papéis S.A.

Statements of changes in equity
Years ended December 31, 2016 and 2015
(In thousands of reais)

| | Capital | Equity adjustment | Legal reserve | Reserve for grants | Accumulated losses | Equity attributable to controlling shareholders | Noncontrolling interest | Total equity |
|---|---|---|---|---|---|---|---|---|
| Balances at December 31, 2014 | 96,289 | 56,252 | - | 37,525 | (82,711) | 107,355 | 6,873 | 114,228 |
| Realization of equity adjustments, net of taxes | - | (2,003) | - | - | 2,003 | - | - | - |
| Absorption of accumulated losses with grants from prior years | - | - | - | (37,525) | 37,525 | - | - | - |
| Net income for the year | - | - | - | - | 48,065 | 48,065 | (240) | 47,825 |
| Allocation of income | | | | | | | | |
| Set-up of legal reserve | - | - | 2,403 | - | (2,403) | - | - | - |
| Allocation of reserve for grants (Note 18.b) | - | - | - | 39,886 | (39,886) | - | - | - |
| Absorption of accumulated losses with grants from prior years (Note 18.b) | - | - | - | (39,886) | 39,886 | - | - | - |
| Proposed dividends (Note 18.d) | - | - | - | - | (2,479) | (2,479) | - | (2,479) |
| **Balances at December 31, 2015** | **96,289** | **54,249** | **2,403** | **-** | **-** | **152,941** | **6,633** | **159,574** |
| Realization of equity adjustments, net of taxes | **-** | **(5,384)** | **-** | **-** | **(5,384)** | **-** | **-** | **-** |
| Subsidiary reserve - Carta Industrial | **-** | **247** | | | **-** | **247** | **204** | **451** |
| Net income for the year | **-** | **-** | **-** | **-** | **64,803** | **64,803** | **(501)** | **64,302** |
| Allocation of income | | | | | | | | |
| Set-up of legal reserve | **-** | **-** | **3,240** | **-** | **(3,240)** | **-** | **-** | **-** |
| Allocation of reserve for grants (Note 18.b) | **-** | **-** | **-** | **64,343** | **(64,343)** | **-** | **-** | **-** |
| Restablishment of reserve for grants (Note 18.b) | **-** | **-** | **-** | **2,604** | **(2,604)** | **-** | **-** | **-** |
| **Balances at December 31, 2016** | **96,289** | **49,112** | **5,643** | **66,947** | **-** | **217,991** | **6,336** | **224,327** |

See accompanying notes.

# Carta Goiás Indústria e Comércio de Papéis S.A.

Cash flow statements
Years ended December 31, 2016 and 2015
(In thousands of reais)

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Cash flows from operating activities | | | | |
| Income for the year before income and social contribution taxes | **58,324** | 50,126 | **57,777** | 49,787 |
| Adjustments to reconcile P&L to cash provided by operating activities | | | | |
| Allowance for doubtful accounts | **(100)** | (754) | **(100)** | (754) |
| Provision for contingencies | **(3,982)** | (12,826) | **(3,982)** | (12,826) |
| Depreciation and amortization | **20,808** | 20,108 | **21,959** | 21,032 |
| Loss on write-off of property, plant and equipment | **120** | 93 | **120** | 93 |
| Unrealized interest, commissions and exchange gain (loss) on loans | **28,185** | 30,887 | **28,185** | 30,887 |
| Unrealized derivative transaction losses | **11,128** | 1,568 | **11,128** | 1,568 |
| Equity pickup | **605** | 291 | **-** | - |
| | **115,088** | 89,493 | **115,087** | 89,787 |
| (Increase) decrease in assets and increase (decrease) in liabilities | | | | |
| Trade accounts receivable | **(19,869)** | (18,153) | **(19,869)** | (18,153) |
| Inventories | **(6,809)** | (4,862) | **(6,809)** | (4,862) |
| Advances granted | **(1,318)** | (5,144) | **(1,318)** | (5,144) |
| Taxes recoverable | **(19,129)** | (18,100) | **(19,129)** | (18,100) |
| Other current assets | **(494)** | 257 | **(494)** | 257 |
| Judicial deposits | **715** | 1,042 | **715** | 1,042 |
| Trade accounts payable | **7,597** | 43,827 | **7,597** | 43,827 |
| Taxes and contributions payable | **830** | (2,903) | **830** | (2,903) |
| Labor and social security liabilities | **1,698** | 1,265 | **1,698** | 1,265 |
| Receivables from customers | **(3,266)** | 543 | **(3,266)** | 543 |
| Tax in installments | **(4,330)** | (3,497) | **(4,330)** | (3,497) |
| Other liabilities | **-** | (182) | **-** | (182) |
| Cash and cash equivalents generated by operating activities | **70,713** | 83,586 | **70,712** | 83,880 |
| | | | | |
| Cash and cash equivalents flows from investing activities | | | | |
| Receivable - investment/Tax Incentive Program Fomentar - Goiás State | **168** | (1,033) | **168** | (1,033) |
| Acquisition of PP&E items, net | **(36,453)** | (16,413) | **(36,453)** | (16,414) |
| Incentives received | **5,984** | - | **5,984** | - |
| Short-term investments | **(298)** | (3,650) | **(298)** | (3,650) |
| Cash and cash equivalents used in investing activities | **(30,599)** | (21,096) | **(30,599)** | (21,097) |
| | | | | |
| Cash and cash equivalents flows from financing activities | | | | |
| Loans and financing raised | **62,733** | 121,366 | **62,733** | 121,366 |
| Repayment of loans and financing | **(68,615)** | (126,043) | **(68,615)** | (126,043) |
| Settlement of transactions with derivatives | **(1,575)** | - | **(1,575)** | - |
| Dividend payment | **(2,479)** | - | **(2,479)** | - |
| Interest and foreign exchange gains (losses) on loans and financing | **(35,375)** | (33,686) | **(35,375)** | (33,686) |
| Cash and cash equivalents used in financing activities | **(45,311)** | (38,363) | **(45,311)** | (38,363) |
| | | | | |
| Net increase (decrease) in cash and cash equivalents | **(5,197)** | 24,127 | **(5,198)** | 24,420 |
| Cash and cash equivalents at beginning of year | **27,941** | 3,814 | **28,237** | 3,817 |
| Cash and cash equivalents at end of year | **22,744** | 27,941 | **23,039** | 28,237 |
| | | | | |
| Non-cash transactions | | | | |
| Acquisition of PP&E item through financing | **76,914** | 20,057 | **76,914** | 20,057 |

See accompanying notes.

## 1. Operations

a) Operations of Company and subsidiary

Carta Goiás Indústria e Comércio de Papéis S.A. (“Carta Goiás” or “Company”) was organized on March 3, 2000 and is mainly engaged in the manufacturing, selling, distribution and transportation of paper products, cardboard, toilet paper, paper napkin, paper towel, tissue, disposable diaper, sanitary napkin and toiletries.

Carta Goiás has plants in Anápolis - Goiás State, and São Gonçalo - Rio de Janeiro State, as well as branches in Olinda - Pernambuco State, Salvador - Bahia State and Sumaré - São Paulo State. Additionally, at the financial statements reporting date, the Company had begun construction for its new manufacturing unit in Piraí - Rio de Janeiro State.

During the first quarter of 2016, a new paper conversion line and a new and modern machinery for the manufacture of diapers started operating.

In 2016, in addition to the referred equipment, Carta Goiás developed its own expansion plan through the following main projects: (i) acquisition of machinery for the manufacture of paper rolls in amounting to 10 million Euros, net of taxes (MP6), in facilities of the manufacturing unit of Anápolis - Goiás State, whose commercial operations are expected to begin January 2018; (ii) acquisition of machinery for the manufacture or paper napkins amounting to approximately 3 million US dollars, net of taxes, to be installed in Anápolis - Goiás State in the first half of 2017; (iii) acquisition of three machines for the manufacture of diapers for approximately R$42,000 , the first of which is expected to be commercially operating in the first quarter of 2017; (iv) acquisition of a two-ply paper conversion line; and (v) construction of a manufacturing unit in the city of Piraí, Rio de Janeiro State, with the objective of making room, especially, for the expansion of the manufacture of baby and adult diapers; wet wipes and paper conversion, whose first machines will start commercial operations in the second half of 2017.

Total advances to suppliers for the achievement of the aforementioned projects and supplementary projects amounts to approximately R$52,154 at December 31, 2016, including amounts disbursed directly by financial institutions.

In addition, Carta Goiás owns the controlling interest of Carta Industrial Produtos de Higiene e Limpeza S.A. (“Carta Industrial”), holding 54,7256% interest in its capital. Carta Industrial is headquartered in Anápolis - Goiás State and has an branch in Aracruz - Espírito Santo State. The remaining 45.2744% capital interest of Carta Industrial is held by Carta Fabril S.A., parent company of Carta Goiás.

## 1. **Operations** (Continued)

b) Financial position

Carta Industrial has industrial equipment in Anápolis, Goiás State, and land in Aracruz, Espírito Santo State. This land is intended to the development of the project for expansion of the Company's production capacity, called Aracruz Project (see Note 10).

At December 31, 2016, the Company recorded net working capital of R$26,495 (Consolidated - working capital surplus of R$39,045). Net working capital recorded at December 31, 2015 amounted to R$26,790 (Consolidated - R$33,113).

Similarly to December 31, 2015, this surplus is the result of the continuing improvement of the Company capital structure, combined with operating efficiency measures. The Company's current financial position gives it a solid base for its strategic planning for the next years, especially as regards new investments in production, resulting in increase in its market share. As mentioned in item "a" above, beginning of in-house production of wet wipes, currently manufactured by third parties, is expected for 2017.

Management is implementing several actions to improve the Company's financial and economic situation, such as: (i) taking out of credit transactions with longer terms and grace period for principal; (ii) better operating efficiency and increase in productivity; and (iii) review and diversification of product lines. Accordingly, in March 2016, Carta Fabril Group started manufacturing and trading the "Baby Looney Tunes" diapers, a product that increases the portfolio quality of Carta Fabril Group.

## 2. Presentation and preparation of individual and consolidated financial statements

a) Going concern

Management evaluated the Company's ability to continue as going concern and is convinced that the Company has the necessary resources to continue as a going concern in the future. Additionally, management has no knowledge of any material uncertainty that may raise significant doubts as to its ability to continue as a going concern. Therefore, the individual and consolidated financial statements were prepared based on the going concern principle.

## 2. Presentation and preparation of individual and consolidated financial statements (Continued)

b) Statement of compliance

The financial statements (individual and consolidated) are the responsibility of management and were prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and in accordance with the accounting practices adopted in Brazil.

The main accounting policies applied in the preparation of these financial statements are defined in Note 3. These policies have been consistently applied in the respective years.

The completion of these consolidated financial statements preparation was authorized by the Company management on February 24, 2017.

c) Consolidation criteria

The consolidated financial statements include the financial statements of Carta Goiás and Carta Industrial, both controlled by the same shareholders.

All intercompany transactions, balances, revenues and expenses are fully eliminated in the individual and consolidated financial statements.

The year coincides for all companies included in the individual and consolidated financial statements, as well as the accounting policies adopted for their financial statements.

d) Functional and reporting currency

The transactions and balances in the Company's individual and consolidated financial statements are presented in Brazilian Reais, the main currency of the economic environment where the Company operates ("functional currency").

Transactions in foreign currencies are translated into the functional currency at the exchange rates prevailing on the transaction or valuation dates, when the items are remeasured. Exchange gains and losses stemming from the settlement of these transactions and translation at the exchange rate at year-end, referring to monetary assets and liabilities in foreign currency, are recognized in the income statement as exchange gains or losses.

## 3. Significant accounting policies

The significant accounting policies used to prepare the individual and consolidated financial statements are described below.

a) Cash and cash equivalents

Cash, banks and cash equivalents include cash, bank checking accounts and high-liquidity investments incurring low risk of fluctuation in market value, that are kept for the purpose of meeting the Company's short-term commitments. For an asset to be qualified as cash equivalent, it needs to be readily convertible into a known amount of cash and should be subject to insignificant risk of changes in value. Accordingly, an investment normally qualifies as cash equivalent when it is redeemable in the short term, for instance, within three months or less as from the investment date. These investments are valued at cost plus interest up to the balance sheet date and marked to market, and their earnings or loss are recorded in P&L for the year.

b) Financial instruments - initial recognition and subsequent measurement

Financial assets are initially classified as financial assets at fair value through profit or loss, loans and receivables, investments held to maturity, financial assets available for sale or derivatives classified as effective hedging instruments, as applicable. Financial assets are recognized initially at fair value plus, in the case of financial assets not recognized at fair value through profit or loss, transaction costs directly attributable to their acquisition.

When the Company is unable to trade these financial assets as a consequence of market inactivity, and management's intention of selling them in the near future changes significantly, the Company has the option to reclassify these financial assets in certain circumstances. This evaluation does not affect any financial assets at fair value through profit or loss using the fair value option upon presentation.

The main financial assets recognized by the Company are cash and cash equivalents and trade accounts receivable.

Financial liabilities are classified among the categories below, according to the nature of the financial instruments taken out or issued:

i. Financial liabilities measured at fair value through profit or loss include derivatives. They are measured at fair value at each statement of financial position closing date. Interest, monetary restatement, foreign exchange gains or losses and differences arising from fair value measurement, where applicable, are recognized in the income statement. Derivatives taken out to hedge currency and interest rate (swap) risks are recognized at fair value against P&L, in accordance with the criteria described in Note 9.

## 3. Significant accounting policies (Continued)

b) Financial instruments - initial recognition and subsequent measurement (Continued)

ii. Other financial liabilities: correspond mainly to trade accounts payable and loans. After initial recognition, loans and financing subject to interest are subsequently measured at amortized cost, under the effective interest rate method. Gains and losses are recognized in the income statement when liabilities are derecognized, and over the amortization process by using the effective interest rate method.

iii. Derecognition (write-off): A financial liability is derecognized when the obligation thereunder is discharged, cancelled or has expired. When an existing financial liability is replaced with another of the same lender under substantially different terms, or the terms of an existing liability are significantly changed, such replacement or change is treated as a derecognition of the original liability and recognition of a new one, and the difference in the corresponding book values is recognized in the income statement.

The main financial liabilities recognized by the Company are trade accounts payable and loans and financing.

c) Trade accounts receivable

Trade accounts receivable correspond to trade accounts receivables for sale of goods in the ordinary course of the Company’s businesses. If the collection period is equivalent to one year or less, the accounts receivable are classified in current assets. Otherwise, they are stated as noncurrent assets.

Trade accounts receivable are initially recognized at present value, less allowance for doubtful accounts. The allowance for doubtful accounts is set up when there is an objective evidence that the Company will not be able to collect all the amounts owed to it in conformity with the original accounts receivable terms, and is analyzed individually. The value of the allowance is the difference between the book value and the recoverable amount.

d) Inventories

Inventories are stated at the lower of cost or net realizable value. The cost is determined by using the average cost method.

The historical costs are computed based on the average cost method and include all the expenses incurred to take the inventories to their current location and condition. They include import duties, freight and logistics costs, and any other costs attributable to acquisition.

## 3. Significant accounting policies (Continued)

d) Inventories (Continued)

The net realizable value is the estimated selling price in the ordinary course of business, minus any estimated cost to complete and to sell the goods. Imports in transit are stated at the accumulated cost of each import.

The provisions for inventories, where applicable, are set up based on slow-moving and obsolete inventory items, or items that are not expected to be realized.

e) Property, plant and equipment

PP&E items are recorded at acquisition, formation or construction cost, and adjusted to the deemed cost due to the adoption of CPC 27 – Property, plant and equipment, less accumulated depreciation and adjustments to their recoverable value, where applicable. The depreciation or amortization is calculated by the straight-line method, based on the rates below.

Gains and losses in disposals are determined by comparing the value of disposal with book value, and are recognized in “Other operating income (expenses), net” in the income statement.

Repair and maintenance expenses are allocated to income or loss over the period they are incurred. The cost of major renovations is included in the asset's carrying amount, when it is likely that future economic rewards exceeding the initially measured performance standard for the existing asset will flow to the Company. Major renovations are depreciated over the remaining useful life of the related asset.

Land is not depreciated. Depreciation of other assets is calculated by the straight-line method to allocate their costs to their net book value throughout their estimated useful life.

f) Impairment of non-financial assets

The assets subject to depreciation are tested for impairment whenever events or chances in circumstances indicate that their carrying value may not be recoverable. An impairment loss is recognized at the amount by which the asset's carrying amount exceeds its recoverable amount. Recoverable amount is the higher of an asset’s fair value less costs to sell and its value in use.

## 3. Significant accounting policies (Continued)

f) Impairment of non-financial assets (Continued)

In estimating the value in use of an asset, estimated future cash flows are discounted to present value, using a pre-tax discount rate that reflects the weighted average cost of capital (WACC) for the industry in which the cash-generating unit operates. The net selling price is determined considering, whenever possible, firm sale contracts on an arm's length basis, between knowledgeable, willing parties, adjusted by costs to sell the asset, or, in the absence of a firm sale contract, based on the observable market price in an active market, or on the price of the most recent transaction involving similar assets.

Non-financial assets that suffered impairment are reviewed subsequently for a possible reversal of impairment at the reporting date.

g) Trade accounts payable

Trade accounts payable are obligations payable for goods or services acquired from suppliers in the ordinary course of business, and are classified as current liabilities if payment is due within one year or less. Accounts payable are otherwise stated as noncurrent liabilities. They are actually recognized at the corresponding billing amount (fair value).

h) Judicial deposits

Judicial deposits are monetarily restated and recorded in noncurrent assets.

i) Loans

Loans taken out are initially recognized at fair value when funds are received, net of transaction costs. They are subsequently stated at amortized cost, i.e. plus charges and interest proportional to the period incurred (on a “pro rata temporis” basis). Any difference between the funds raised (net of transaction costs) and the total amount repayable is recognized in the income statement over the period the loans remain outstanding, using the effective interest rate method.

If the settlement period is one year or less, loans are classified under current liabilities. Otherwise, they are stated as noncurrent liabilities.

## 3. Significant accounting policies (Continued)

j) Government grants

Government grants are recognized when there is reasonable certainty that the benefit will be received and that all the related conditions will be met.

When the benefit refers to an expense item, it is systematically recognized as revenue over the grant period in relation to the costs that the benefit intends to offset. When the benefit refers to an asset, it is recognized as deferred revenue and allocated to income or loss at equal amounts over the expected useful life of the corresponding item.

k) Provisions

Provisions for contingencies (labor, civil, social security and tax) are recognized when the Company has a present, legal or constructive obligation as a result of past events and it is probable that an outflow of funds will be required to settle the obligation and a reliable estimate of the amount can be made.

The Company is a party to several judicial and administrative proceedings. The provision for contingencies is set up for legal claims for which an outflow of funds will probably be required to settle the contingency and a reliable estimate can be made. Assessment of the likelihood of loss includes analysis of available evidence, the hierarchy of laws, available case law, the most recent court rulings and their relevance to the legal system, as well as the opinion of external legal advisors. Provisions are reviewed and adjusted considering changes in existing circumstances, such as the applicable statutes of limitation, tax audit conclusions, or additional exposures identified based on new matters or court rulings.

Other provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the obligation due to passage of time is recognized as a financial expense.

l) Income and social contribution taxes and other taxes

Sales revenues are subject to the State Value-Added Tax (ICMS), Federal Value-Added Tax (IPI), Contribution Tax on Gross Revenue for Social Integration Program (PIS), and Contribution Tax on Gross Revenue for Social Security Financing (COFINS), at statutory rates, and the respective amounts are stated as sales deductions in the income statement.

## 3. Significant accounting policies (Continued)

l) Income and social contribution taxes and other taxes (Continued)

Current tax assets and liabilities for the last and prior years are measured at the estimated amount recoverable from or payable to tax authorities. Income and social contribution taxes are calculated based on income or loss for the year, adjusted by the additions and exclusions provided for by the effective tax legislation.

Deferred income and social contribution tax assets are recognized on income and social contribution tax losses and temporary differences between the tax base of assets and liabilities and their carrying values. Deferred income and social contribution tax assets are recognized only to the extent that future taxable income is likely to be available, against which temporary differences may be used.

Deferred tax liabilities refer to (i) tax on equity adjustment of assets at deemed cost conducted in 2010, which is realized in income or loss proportionally to the depreciation of the asset adjusted at deemed cost; (ii) taxable temporary differences arising mainly from the recording of depreciation of assets calculated at rates that differ from those estimated by tax authorities, as provided for by the effective tax legislation.

Deferred tax assets and liabilities are stated net if there is a legal or contractual right to offset tax assets against tax liabilities and the deferred taxes are related to the same taxable entity and subject to the same tax authority. Consequently, management presented a deferred income and social contribution tax asset balance net of liabilities balance.

m) Revenue recognition

Revenue is recognized to the extent that economic benefits are likely to flow to the Company and as long as such revenue may be fairly measured:

i. *Interest income*

Interest income is recognized by the straight-line method based on time and effective interest rate on the outstanding principal, and the effective interest rate discounting exactly estimated future cash flow receipts over the financial asset estimated life vis-à-vis the initial net book value of this asset.

## 3. Significant accounting policies (Continued)

m) Revenue recognition (Continued)

ii. *Revenue from sale of products and goods*

Revenue from sale of products and goods is recognized in the income statement when all the risks and rewards of ownership of the product are transferred to buyer; the amount of revenue can be reliably measured; and it is probable that future economic benefits will flow to the Company. Revenue is not recognized if there is a significant uncertainty as to its realization.

Revenue comprises the fair value of the consideration received or receivable for selling products and goods over the ordinary course of the Company activities. Revenue is stated net of taxes, returns, rebates and discounts. Net revenue also includes revenue from ICMS grants (Note 18.b).

n) Accounting judgment, estimates and assumptions

The preparation of financial statements in accordance with the International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB) and in accordance with the accounting practices adopted in Brazil require that management uses judgment, estimates and assumptions that affect the amounts of revenues, expenses, assets and liabilities reported in the financial statements and the related notes. Significant items subject to these estimates and assumptions include the economic useful life and the net book value of the PP&E items, allowance for doubtful accounts, provision for contingencies, impairment of assets and fair value of financial instruments. The use of estimates and judgments is complex and takes into consideration several assumptions and projections; consequently, the settlement of transactions may result in amounts other than the estimated amounts. The Company reviews its estimates and assumptions on an annual basis.

o) Standards and interpretations not yet in force

· *IFRS 9 Financial Instruments (Effective from January 1, 2018)*

Its ultimate purpose is to replace IAS 39. Significant changes expected are: (i) all financial assets must be initially measured at fair value; (ii) the standard classifies all financial assets into: amortized cost and fair value; and (iii) the concept of embedded derivatives ceased to exist.

## 3. Significant accounting policies (Continued)

o) <u>Standards and interpretations not yet in force</u> (Continued)

· *IFRS 15 - Revenue from Contracts with Customers (Effective from January 1, 2018)*

The new standard on Revenue will supersede all current requirements for revenue recognition, under the IFRS terms. Either a full or modified retrospective adoption is required for annual periods beginning on or after January 1, 2018, with early adoption permitted. Its purpose is to provide clear steps for revenue recognition and streamline the process of preparation of financial statements.

· *IFRS 16 Leases (Effective from January 1, 2019)*

The new standard establishes principles for both the customer (the lessee) and the supplier (the lessor) on the provision of relevant information regarding the leases so the lease transactions are faithfully recorded in the financial statements. To achieve this objective, the lessee is required to recognize the assets and liabilities arising from a lease agreement.

· *Amendments to IFRS 10 and IAS 28 Investment entity - Applying the Consolidation Exception*

The amendments to IFRS 10 clarify that the exemption from preparing consolidated financial statements applies to the parent company that is a subsidiary of an investment entity, when the investment entity measures all its subsidiaries at fair value. Among other clarifications, it is established that a non-investment entity will be able to retain, when applying the equity method, the fair value measurement through P&L used by its investments.

· *IAS 7 Statement of Cash Flows - Amendments to IAS 7 (Effective from January 1, 2017)*

The amendments require that an entity provides disclosures that allow the users of the financial statements to assess changes in liabilities arising from financing activities, including both the changes arising from cash flows and the non-cash changes. Entities that are first-time adopters of the amendment are not required to provide comparative information relating to prior periods.

(In thousands of reais)

## 3. Significant accounting policies (Continued)

o) Standards and interpretations not yet in force (Continued)

- *IAS 12 Income Taxes - Amendments to IAS 1 (Effective from January 1, 2017)*

  The amendments clarify that an entity must consider if the tax law restricts the sources of taxable profit against which the entity may make deductions on the reversal of that deductible temporary difference. In addition, the amendments provide guidance on how the entity should determine future taxable profits and explain the circumstances in which the taxable profit may include the recovery of certain assets for amounts higher than their book value.

Management is evaluating the total impact from adoption of aforementioned standards and interpretations.

## 4. Cash and cash equivalents and restricted short-term investments

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Cash and banks | **7,122** | 12,822 | **7,417** | 13,118 |
| Cash equivalentes | **15,622** | 15,119 | **15,622** | 15,119 |
| | **22,744** | 27,941 | **23,039** | 28,237 |

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Restricted short-term investments | **3,948** | 3,650 | **3,948** | 3,650 |
| | **3,948** | 3,650 | **3,948** | 3,650 |

(In thousands of reais)

## 4. Cash and cash equivalents and restricted short-term investments (Continued)

The cash equivalents balance primarily includes short-term investments in prime banks, redeemable within 90 days, and subject to yield of 100% of the Interbank Deposit Certificate (CDI) variation.

Restricted short-term investments collateralize loans taken out for working capital purposes, with yield of 98% of CDI variation.

## 5. Trade accounts receivable

| | Company and Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| Falling due | **88,579** | 70,925 |
| Overdue | | |
| 1 to 30 days | **3,845** | 1,688 |
| 31 to 60 days | **602** | 379 |
| 61 to 90 days | **271** | 290 |
| 91 to 180 days | **566** | 612 |
| Over 180 days | **1,132** | 1,232 |
| (-) Allowance for doubtful accounts | **(1,132)** | (1,232) |
| Trade notes receivable | **93,863** | 73,894 |

A part of trade notes receivable were offered as collateral of loans and financing taken out from banks. At December 31, 2016, such collaterals totaled R$79,199 (R$62,066 at December 31, 2015).

Management set up an allowance for doubtful accounts based on an analysis of overdue balances, in order to identify those balances that are unlikely to be received, and an allowance is set up for receivables whose realization is not expected.

Changes in allowance for doubtful accounts are as follows:

| | Company and Consolidated | |
|---|---|---|
| **Changes in ADA** | **2016** | **2015** |
| Balance at beginning of year | **(1,232)** | (1,986) |
| Setting up of allowance (Note 21) | **(861)** | (815) |
| Recovery of notes | **961** | 1,569 |
| Balance at the end of year | **(1,132)** | (1,232) |

(In thousands of reais)

## 6. Inventories

| | Company and Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| Finished products | **15,214** | 10,295 |
| Work-in-process | **2,582** | 5,201 |
| Raw materials | **8,312** | 8,288 |
| Packaging | **4,982** | 3,402 |
| Maintenance and supply materials | **8,142** | 6,531 |
| Material held by third parties | **1,294** | - |
| | **40,526** | 33,717 |

## 7. Taxes recoverable

| | Company and Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| IPI (a) | **12,492** | 6,970 |
| PIS (b) | **6,988** | 7,084 |
| COFINS (b) | **36,002** | 24,410 |
| Income and social contribution taxes (IRPJ and CSLL) (c) | **4,622** | 4,622 |
| ICMS Goiás – Revenue Procedures Nos. 1208/2015 and 1269/16 (d) | **4,077** | 1,024 |
| Other | **1,062** | 2,004 |
| | **65,243** | 46,114 |
| | | |
| Current | **52,988** | 46,114 |
| Noncurrent | **12,255** | - |

(a) The IPI balance refers to tax credit taken out in the purchase of raw materials abroad. The balance has been used to offset other federal taxes.

(b) PIS and COFINS credits were implemented by Law No. 12839 of July 9, 2013, which reduces to zero the tax rates levied on revenue from sales in the domestic market of goods included in the basket of food staples. Currently, the Company has been using the balances to offset federal taxes and requested the refund of balances that were not offset. Of the refund requests filed, R$ 2,969 was offset with installments in October of 2016 and approximately R$6,616 have already been reviewed and deferred by the Brazilian IRS and are currently in the final stages of processing in the referred to agency. Tax credits should be used in part to settle federal installments early, in accordance with the legislation in force, and the remaining balance will be reimbursed to Carta Goiás. The Company management expects that the amounts whose refund request was filed more than a year ago be reimbursed in the following months.

(c) IRPJ and CSLL refer to prepayments to be offset with taxes payable in the subsequent years.

(d) Prepayments made in the State of Goiás under Revenue Procedures No. 1208/2015 (effective through February 2016) and No. 1269/16 (published on March 30, 2016) amounting to R$2,112, which will be offset beginning January 2017 at the monthly amount of R$ 88, according to articles 5 and 6 of Revenue Procedure No. 1269/2016 until December 2018.

(In thousands of reais)

## 8. Investments

a) Significant information on investees

The ownership interest in Carta Industrial is recorded under the equity method and the Company shareholding structure is as follows:

| | 2016 | 2015 |
|---|---|---|
| Direct interest | **54.7256%** | 54.7256% |
| Equity | **13,996** | 14,651 |
| Loss for the year | **(1,106)** | (531) |
| Total assets | **47,853** | 49,005 |

The capital of Carta Industrial is composed of 12,077,220 common shares.

b) Changes in investments

| | 2016 | 2015 |
|---|---|---|
| Balance at beginning of year | **8,018** | 8,309 |
| Equity pickup | **(605)** | (291) |
| Subsidiary reserve - Carta Industrial | **247** | - |
| Balance at the end of year | **7,660** | 8,018 |

(In thousands of reais)

## 8. **Investments** (Continued)

c) Summary of statements of financial position and income statements

The summaries of financial statements of companies included in the consolidated financial statements and the amounts adjusted in the consolidation process at December 31, 2016 and 2015 are as follows:

| | December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Carta Goiás | Carta Industrial | Total | Eliminations | Consolidated financial statements |
| Statement of financial position | | | | | |
| Assets | | | | | |
| Current assets | 239,315 | 295 | 239,610 | - | 239,610 |
| Noncurrent assets | | | | | |
| Other | 4,039 | - | 4,039 | - | 4,039 |
| Investments | 7,660 | - | 7,660 | (7,660) | - |
| Property, plant and equipment | 403,892 | 47,558 | 451,450 | - | 451,450 |
| Intangible assets | 1,147 | - | 1,147 | - | 1,147 |
| Total assets | 656,053 | 47,853 | 703,906 | (7,660) | 696,246 |
| Liabilities and equity | | | | | |
| Current liabilities | 200,565 | - | 200,565 | - | 200,565 |
| Noncurrent liabilities | | | | | |
| Loans and financing | 186,861 | - | 186,861 | - | 186,861 |
| Other | 50,636 | 33,857 | 84,493 | - | 84,493 |
| Equity | | | | | |
| Capital | 96,289 | 12,077 | 108,366 | (12,077) | 96,289 |
| Equity adjustments | 49,112 | 7,488 | 56,600 | (7,488) | 49,112 |
| Legal reserve | 5,643 | - | 5,643 | - | 5,643 |
| Reserve for grants | 66,947 | - | 66,947 | - | 66,947 |
| Accumulated losses | - | (5,569) | (5,569) | 5,569 | - |
| Noncontrolling interests | - | - | - | 6,336 | 6,336 |
| Total equity | 217,991 | 13,996 | 231,987 | (7,660) | 224,327 |
| Total liabilities and equity | 656,053 | 47,853 | 703,906 | (7,660) | 696,246 |
| Income statements | | | | | |
| Net operating revenue | 679,062 | - | 679,062 | - | 679,062 |
| Cost | (396,896) | - | (396,896) | - | (396,896) |
| Operating expenses, net | (177,418) | (1,150) | (178,568) | 605 | (177,963) |
| Financial income (expenses) | (46,424) | (2) | (46,426) | - | (46,426) |
| Income and social contribution taxes (IRPJ and CSLL) | 6,479 | 46 | 6,525 | - | 6,525 |
| Net income (loss) for the year | 64,803 | (1,106) | 63,697 | 605 | 64,302 |
| Attributable to shareholders | | | | | |
| Controlling shareholders | - | - | - | - | 64,803 |
| Noncontrolling shareholders | - | - | - | - | (501) |

(In thousands of reais)

## 8. **Investments** (Continued)

c) Summary of statement of financial position and income statements (Continued)

| | December 31, 2015 | | | | |
|---|---|---|---|---|---|
| | **Carta Goiás** | **Carta Industrial** | **Total** | **Eliminations** | **Consolidated financial statements** |
| Statement of financial position | | | | | |
| Assets | | | | | |
| Current assets | 196,496 | 296 | 196,792 | - | 196,792 |
| Noncurrent assets | | | | | |
| Other | 1,907 | - | 1,907 | - | 1,907 |
| Investments | 8,018 | - | 8,018 | (8,018) | - |
| Property, plant and equipment | 311,815 | 48,709 | 360,524 | - | 360,524 |
| Intangible assets | 785 | - | 785 | - | 785 |
| Total assets | 519,021 | 49,005 | 568,026 | (8,018) | 560,008 |
| Liabilities and equity | | | | | |
| Current liabilities | 163,679 | - | 163,679 | - | 163,679 |
| Noncurrent liabilities | | | | | |
| Loans and financing | 153,298 | - | 153,298 | - | 153,298 |
| Other | 49,103 | 34,354 | 83,457 | - | 83,457 |
| Equity | | | | | |
| Capital | 96,289 | 12,077 | 108,366 | (12,077) | 96,289 |
| Equity adjustments | 54,249 | 8,453 | 62,702 | (8,453) | 54,249 |
| Legal reserve | 2,403 | - | 2,403 | - | 2,403 |
| Accumulated losses | - | (5,879) | (5,879) | 5,879 | - |
| Noncontrolling interests | - | - | - | 6,633 | 6,633 |
| Total equity | 152,941 | 14,651 | 167,592 | (8,018) | 159,574 |
| Total liabilities and equity | 519,021 | 49,005 | 568,026 | (8,018) | 560,008 |
| Income statements | | | | | |
| Net operating revenue | 542,523 | - | 542,523 | - | 542,523 |
| Cost | (326,879) | - | (326,879) | - | (326,879) |
| Operating expenses, net | (120,675) | (630) | (121,305) | 291 | (121,014) |
| Financial income (expenses) | (44,843) | - | (44,843) | - | (44,843) |
| IRPJ and CSLL | (2,061) | 99 | (1,962) | - | (1,962) |
| Net income (loss) for the year | 48,065 | (531) | 47,534 | 291 | 47,825 |
| Attributable to shareholders: | | | | | |
| Controlling shareholders | - | - | - | - | 48,065 |
| Noncontrolling shareholders | - | - | - | - | (240) |

## 9. Derivative financial instruments

a) Policies, objectives and hedge accounting

The Company maintains derivative financial instruments managed through the definition of strategies and risk monitoring.

The derivative instruments taken out by the Company are intended to hedge its transactions against the risks of fluctuations in foreign exchange rates in certain loans in foreign currency, and are not used for speculative purposes.

Derivatives are initially recognized at fair value on the date when an agreement is entered into, and are subsequently remeasured at fair value through profit or loss at the end of each year.

The Company formally assigned the transactions subject to hedge accounting to derivative financial instruments, in order to hedge loans denominated in foreign currency, documenting:

- Hedge relationship.
- The Company's risk management objective and strategy in contracting the hedge transaction.
- Identification of financial instrument.
- Hedging object or transaction.
- Nature of the hedged risk.
- Description of hedge relationship.
- Prospective statement of the hedge effectiveness.

The expected effectiveness is higher than the one defined in the hedge accounting standard (80% and 125%), since the initial flows are 100% hedged by swap in the total amounts, maturities and terms of the hedged object. Fair value changes in any of these derivative instruments are immediately recognized in the income statement under "Financial income (expenses)".

The Company applies the Marked-to-Market (MtM) method to measure the market value of its instruments. MtM consists of computing future amounts based on the agreed-upon conditions and determining the present value base on market curves extracted from the São Paulo Securities, Commodities & Futures Exchange (BM&FBOVESPA).

The Company decided to set up a fair value hedge for the above-described object, for certain long-term financing agreements, in order to hedge currency risk and denominate the transaction in Reais (R$), at the interest rates applied in the domestic market.

(In thousands of reais)

## 9. Derivative financial instruments (Continued)

a) Policies, objectives and hedge accounting (Continued)

The hedging instrument chosen is a derivative transaction, through currency and interest rate swap. Swaps were taken out at the same amounts of the hedged loans and with maturities identical to those of financing agreements.

b) Hedging transactions portfolio

Derivative financial instruments were taken out from prime financial institutions in Brazil.

At December 31, 2016, the derivatives portfolio can be summarized by the tables below:

(i) Contracts subject to hedge accounting – Company and Consolidated:

| Hedged item | Counterparty of principal | Notional value |
|---|---|---|
| Exchange rate and change of index | Banco Citibank | **16,471** |
| Exchange rate and change of index | Banco Citibank | **3,294** |
| Exchange rate and change of index | Banco Citibank | **6,173** |
| Exchange rate and change of index | Banco Citibank | **20,058** |
| | | **45,996** |

The above-described swap transactions are pegged to hedged financing agreements and mature on a quarterly basis, their final due date falling between August and November 2020.

(ii) Short-term contracts (Finimp) not subject to hedge accounting – Company and Consolidated:

| Hedged item | Counterparty of principal | Notional value |
|---|---|---|
| Exchange rate and change of index | Banco Citibank | **2,106** |
| Exchange rate and change of index | Banco Citibank | **1,636** |
| | | **3,742** |

(In thousands of reais)

## 9. Derivative financial instruments (Continued)

c) Breakdown of derivative transactions at December 31, 2016:

(i) Contracts subject to hedge accounting - Company and Consolidated:

| | Notional value | Fair value | Instrument yield curve | Gains/ (losses) in P&L |
|---|---|---|---|---|
| Long position | | | | |
| Foreign currency | 45,996 | 41,355 | 40,025 | (1,330) |
| Short position | | | | |
| Index - CDI | (45,996) | (50,884) | (47,151) | (3,733) |
| Total | - | (9,529) | (7,126) | (2,403) |
| Financing subject to hedge accounting, market value adjustments | (45,996) | (41,355) | (40,025) | (1,330) |
| Net effect on P&L | | | | (3,733) |

Derivative transactions’ gains and losses are recognized in the income statement, considering the fair value of these instruments and the yield curve variation.

The provision for unrealized gains and/or losses is recognized in the “Derivative financial instruments” account, under Assets or Liabilities, in the statement of financial position, as the case may be, having "Financial income (expenses)” as a matching entry.

Changes in the financing fair value are recognized under “Loans and financing”, having "Financial income (expenses)” as a matching entry.

(ii) Short-term agreements not subject to hedge accounting - Finimp - Company and Consolidated:

| | Notional value | Fair value |
|---|---|---|
| Long position | | |
| Foreign currency | 3,742 | 3,997 |
| Short position | | |
| Index - CDI | (3,742) | (3,810) |
| Total | - | 187 |

Derivative transactions’ gains and losses are recognized in the income statement, considering the fair value of these instruments.

(In thousands of reais)

## 10. Property, plant and equipment and intangible assets

| Cost | Company | | | | |
|---|---|---|---|---|---|
| | 12/31/2014 | Acqusitions | Disposals | Transfers | 12/31/2015 |
| Machinery and equipment | 304,216 | 1,611 | (164) | 5,125 | 310,788 |
| Construction in progress | 10,451 | 16,401 | - | (9,109) | 17,743 |
| Buildings | 51,174 | 3,836 | - | 644 | 55,654 |
| Vehicles | 22,119 | 3,636 | - | 3,316 | 29,071 |
| Land | 12,326 | 5,393 | - | - | 17,719 |
| Building facilities | 13,838 | 3,599 | - | 24 | 17,461 |
| Construction work | 8,551 | 906 | - | - | 9,457 |
| IT equipment | 1,915 | 173 | - | - | 2,088 |
| Furniture and fixtures | 1,375 | 208 | - | - | 1,583 |
| Other | 48 | 8 | - | - | 56 |
| Total | 426,013 | 35,771 | (164) | - | 461,620 |

| Accumulated depreciation | 12/31/2014 | Acquisitions | Disposals | Transfers | 12/31/2015 |
|---|---|---|---|---|---|
| Machinery and equipment | (110,862) | (10,879) | 71 | - | (121,670) |
| Buildings | (5,388) | (4,001) | - | - | (9,389) |
| Vehicles | (6,551) | (3,001) | - | - | (9,552) |
| Building facilities | (3,520) | (1,701) | - | - | (5,221) |
| Construction work | (2,584) | (320) | - | - | (2,904) |
| IT equipment | (394) | (22) | - | - | (416) |
| Furniture and fixtures | (557) | (97) | - | - | (654) |
| Total | (129,856) | (20,021) | 71 | - | (149,806) |
| Net book value | 296,157 | 15,750 | (93) | - | 311,814 |

| Cost | 12/31/2015 | Acquisitions | Disposals | Transfers | 12/31/2016 |
|---|---|---|---|---|---|
| Machinery and equipment | 310,788 | **1,747** | **(565)** | **22,950** | **334,920** |
| Construction in progress | 17,743 | **98,940** | **-** | **(26,401)** | **90,282** |
| Buildings | 55,654 | **-** | **-** | **50** | **55,704** |
| Vehicles | 29,071 | **1,454** | **-** | **-** | **30,525** |
| Land | 17,719 | **9,834** | **-** | **-** | **27,553** |
| Building facilities | 17,461 | **76** | **-** | **1,723** | **19,260** |
| Construction work | 9,457 | **69** | **-** | **1,652** | **11,178** |
| IT equipment | 2,088 | **498** | **-** | **10** | **2,596** |
| Furniture and fixtures | 1,583 | **236** | **-** | **16** | **1,835** |
| Other | 56 | **3** | **-** | **-** | **59** |
| Total | 461,620 | **112,857** | **(565)** | **-** | **573,912** |

(In thousands of reais)

## 10. Property, plant and equipment and intangible assets (Continued)

| Accumulated depreciation | Company | | | | |
|---|---|---|---|---|---|
| | 12/31/2015 | Acquisitions | Disposals | Transfers | 12/31/2016 |
| Machinery and equipment | (121,670) | **(14,446)** | **447** | **-** | **(135,669)** |
| Buildings | (9,389) | **(1,207)** | **-** | **-** | **(10,596)** |
| Vehicles | (9,552) | **(3,313)** | **-** | **-** | **(12,865)** |
| Building facilities | (5,221) | **(1,035)** | **-** | **-** | **(6,256)** |
| Construction work | (2,904) | **(383)** | **-** | **-** | **(3,287)** |
| IT equipment | (416) | **(161)** | **-** | **-** | **(577)** |
| Furniture and fixtures | (654) | **(114)** | **-** | **-** | **(768)** |
| Other | - | **(2)** | **-** | **-** | **(2)** |
| Total | (149,806) | **(20,661)** | **447** | **-** | **(170,020)** |
| **Net book value** | 311,814 | **92,196** | **(118)** | **-** | **403,892** |

| Cost | Consolidated | | | | |
|---|---|---|---|---|---|
| | 12/31/2014 | Acquisitions | Disposals | Transfers | 12/31/2015 |
| Machinery and equipment | 323,270 | 1,611 | (164) | 5,125 | 329,842 |
| Construction in progress | 10,451 | 16,401 | - | (9,109) | 17,743 |
| Buildings | 61,766 | 3,836 | - | 644 | 66,246 |
| Vehicles | 22,119 | 3,636 | - | 3,316 | 29,071 |
| Land | 42,326 | 5,393 | - | - | 47,719 |
| Building facilities | 13,838 | 3,599 | - | 24 | 17,461 |
| Construction work | 8,551 | 906 | - | - | 9,457 |
| IT equipment | 1,915 | 173 | - | - | 2,088 |
| Furniture and fixtures | 1,375 | 208 | - | - | 1,583 |
| Other | 48 | 8 | - | - | 56 |
| Total | 485,659 | 35,771 | (164) | - | 521,266 |

| Accumulated depreciation | 12/31/2014 | Acquisitions | Disposals | Transfers | 12/31/2015 |
|---|---|---|---|---|---|
| Machinery and equipment | (119,922) | (11,614) | 71 | - | (131,465) |
| Buildings | (6,340) | (4,190) | - | - | (10,530) |
| Vehicles | (6,551) | (3,001) | - | - | (9,552) |
| Building facilities | (3,520) | (1,701) | - | - | (5,221) |
| Construction work | (2,584) | (320) | - | - | (2,904) |
| IT equipment | (394) | (22) | - | - | (416) |
| Furniture and fixtures | (557) | (97) | - | - | (654) |
| Total | (139,868) | (20,945) | 71 | - | (160,742) |
| Net book value | 345,791 | 14,826 | (93) | - | 360,524 |

(In thousands of reais)

## 10. Property, plant and equipment and intangible assets (Continued)

| | Consolidated | | | | |
|---|---|---|---|---|---|
| **Cost** | **12/31/2015** | **Acquisitions** | **Disposals** | **Transfers** | **12/31/2016** |
| Machinery and equipment | 329,842 | **1,747** | **(565)** | **22,950** | **353,971** |
| Construction in progress | 17,743 | **98,940** | **-** | **(26,401)** | **90,282** |
| Buildings | 66,246 | **-** | **-** | **50** | **66,296** |
| Vehicles | 29,071 | **1,454** | **-** | **-** | **30,525** |
| Land | 47,719 | **9,834** | **-** | **-** | **57,553** |
| Building facilities | 17,461 | **76** | **-** | **1,723** | **19,260** |
| Construction work | 9,457 | **69** | **-** | **1,652** | **11,178** |
| IT equipment | 2,088 | **498** | **-** | **10** | **2,596** |
| Furniture and fixtures | 1,583 | **236** | **-** | **16** | **1,835** |
| Other | 56 | **3** | **-** | **-** | **59** |
| Total | 521,266 | **112,857** | **(565)** | **-** | **633,555** |

| **Accumulated depreciation** | **12/31/2015** | **Acquistions** | **Disposals** | **Transfers** | **12/31/2016** |
|---|---|---|---|---|---|
| Machinery and equipment | (131,465) | **(15,390)** | **447** | **-** | **(146,408)** |
| Buildings | (10,530) | **(1,412)** | **-** | **-** | **(11,942)** |
| Vehicles | (9,552) | **(3,313)** | **-** | **-** | **(12,865)** |
| Building facilities | (5,221) | **(1,035)** | **-** | **-** | **(6,256)** |
| Construction work | (2,904) | **(383)** | **-** | **-** | **(3,287)** |
| IT equipment | (416) | **(161)** | **-** | **-** | **(577)** |
| Furniture and fixtures | (654) | **(114)** | **-** | **-** | **(768)** |
| Other | - | **(2)** | **-** | **-** | **(2)** |
| Total | (160,742) | **(21,810)** | **447** | **-** | **(182,105)** |
| **Net book value** | 360,524 | **91,047** | **(118)** | **-** | **451,450** |

| | Company and Consolidated | | |
|---|---|---|---|
| **Cost** | **12/31/2014** | **Acquisitions** | **12/31/2015** |
| Software | 289 | 704 | 993 |
| Total | 289 | 704 | 993 |

| **Accumulated amortization** | **12/31/2014** | **Acquisitions** | **12/31/2015** |
|---|---|---|---|
| Software | (120) | (87) | (207) |
| Total | (120) | (87) | (207) |
| Net book value | 169 | 617 | 786 |

(In thousands of reais)

## 10. Property, plant and equipment and intangible assets (Continued)

| | Company and Consolidated | | |
|---|---|---|---|
| **Cost** | **12/31/2015** | **Acquisitions** | **12/31/2016** |
| Software | 993 | **510** | **1,503** |
| Total | 993 | **510** | **1,503** |

| **Accumulated amortization** | **12/31/2015** | **Acquisitions** | **12/31/2016** |
|---|---|---|---|
| Software | (207) | **(149)** | **(356)** |
| Total | (207) | **(149)** | **(356)** |
| Net book value | 786 | **361** | **1,147** |

On November 23, 2012, Carta Industrial received a government grant from Aracruz Municipality, through the donation of a 550,000 square-meter plot of land, where a new plant will be built. On July 15, 2016, Carta Goiás received a government grant from Piraí Municipality, through the donation of a 121,437 square meter plot of land, where a new plant will be built. Based on the assessment reports prepared by specialists, the fair value of these assets was set at R$30,000 for the plot of land in Aracruz and R$5,948 for the plot of land in Piraí. According to Brazilian accounting standards - CPC 07 - Government Grants and Assistance - the plots of land were recorded under property, plant and equipment against a deferred revenue, classified under noncurrent liabilities.

In August 2014, the subsidiary obtained the Local Installation Permit and is currently obtaining additional permits to prepare the area for the project development in Aracruz. In addition, in October 2014, Carta Industrial signed the INVEST-ES 352/2014 Agreement, which guarantees ICMS tax incentives to the company for the implementation and operation of the Aracruz Project. In 2015, the cleaning works in the 550,000 square-meter plot of land began, with removal of vegetation and preparation of the area.

The total balance of Construction in progress held by the Company (Company and Consolidated) refers to:

| | **12/31/2016** | **12/31/2015** |
|---|---|---|
| Paper machines | **28,375** | - |
| Diaper machines | **25,448** | 2,726 |
| Manufacturing plants | **15,345** | 3,736 |
| Conversion machines | **6,479** | 9,600 |
| Buildings | **6,905** | - |
| Vehicles | **216** | - |
| Wet wipes machines | **207** | - |
| Other assets | **7,307** | 1,681 |
| Total | **90,282** | 17,743 |

(In thousands of reais)

## 10. Property, plant and equipment and intangible assets (Continued)

The depreciation of assets, except for land, is calculated using the straight-line method to allocate their costs to their net book value throughout their estimated useful life, as follows:

| | Average annual depreciation rate % |
|---|---|
| Buildings | **2** |
| Construction work | **4** |
| Facilities | **5** |
| Machinery and equipment | **5** |
| Vehicles | **12** |
| Furniture and fixtures | **7** |
| IT equipment | **8** |
| Software | **15** |

Part of the PP&E items were offered as collateral for bank loans and financing, as described in Note 12.

## 11. Trade accounts payable

| | Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| Trade accounts payable - domestic | **76,654** | 71,431 |
| Trade accounts payable - foreign | **4,685** | 3,268 |
| | **81,339** | 74,699 |

The balances in foreign currency refer to raw material imports. At December 31, 2016, trade accounts payable - foreign total approximately US$1,438 thousand (US$840 thousand at December 31, 2015).

(In thousands of reais)

## 12. Loans and financing

| | 2016 | Company and Consolidated | |
|---|---|---|---|
| | **Weighted average interest rate** | **2016** | **2015** |
| Loans for working capital | CDI + 5.65% p.a. | **169,698** | 148,915 |
| FINAME | 6.07% p.a. | **98,098** | 49,500 |
| FINIMP (a) | USD exchange difference + 5.89% p.a. | **7,579** | 17,284 |
| Advances to suppliers (b) | 1.69% p.m. | **6,505** | - |
| Other | CDI + 2.30% p.a. | **191** | 717 |
| Borrowing costs | | **(4,728)** | (2,915) |
| | | **277,343** | 213,501 |
| | | | |
| Current installments | | **90,482** | 60,203 |
| Noncurrent installments | | **186,861** | 153,298 |

(a) At December 31, 2016, the balances of loans in foreign currency are broken down as follows:

| | **US$ thousand** |
|---|---|
| Working capital (Note 9 c i) | **14,113** |
| Loans and financing - FINIMP | **2,325** |
| | **16,438** |

(b) This refers to advances to suppliers of raw materials carried out through a domestic financial institution and the supplier's approval.

| | Company and Consolidated | |
|---|---|---|
| **Changes in loans** | **2016** | **2015** |
| Balance at beginning of year | **213,501** | 199,237 |
| Loan raising | **139,647** | 141,515 |
| Interest and foreign exchange difference | **28,185** | 32,478 |
| Amortizations - principal | **(68,615)** | (126,043) |
| Amortizations – interest and exchange difference | **(33,562)** | (33,551) |
| Borrowing costs | **(1,813)** | (135) |
| Balance at the end of year | **277,343** | 213,501 |

At December 31, 2016 and 2015, the aging list of noncurrent balances is as follows:

| Year | 2016 | 2015 |
|---|---|---|
| 2017 | **-** | 50,908 |
| 2018 | **68,368** | 45,313 |
| 2019 | **60,183** | 32,575 |
| 2020 | **37,642** | 22,067 |
| 2021 | **10,732** | 1,453 |
| 2022 onwards | **9,936** | 982 |
| | **186,861** | 153,298 |

(In thousands of reais)

## 12. Loans and financing (Continued)

### Guarantees

The main guarantees granted by the Company refer to first mortgage of certain assets located in the Rio de Janeiro and Goiás plants, for the total amount of R$115,680; machinery and equipment located in the respective plants, for R$141,384; restricted short-term investments in the amount of R$3,948 (see Note 4); in addition to trade notes receivable from customers in the amount of R$79,199 (see Note 5).

### Financial covenants

Some working capital transactions are subject to certain covenants, such as limits to new debts, payments to shareholders, and presentation of audited financial statements within previously agreed-upon terms.

Non-compliance with these covenants could cause the transactions relating to working capital transactions to mature earlier.

Management monitors the compliance with such covenants, as well as with other obligations relating to working capital transactions, and understands that they are fully complied with.

During the term of the referred to instruments, the Company shall comply with the following financial ratios:

a) Net debt-to-EBITDA ratio equal to or lower than 3.0 for the loan with Citibank and 2.5 for the loans with Bradesco and Itaú.

b) Net debt-to-equity ratio equal to or lower than 2.0 for the loans with Bradesco and Itaú.

At December 31, 2016, the Company was in compliance with all restrictive covenants.

## 13. Taxes, charges and contributions

| | Company and Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| ICMS - normal and tax substitution regime | **4,771** | 2,600 |
| Withholding Income Tax (IRRF) - salaries, management fees and third parties | **725** | 814 |
| Service Tax (ISS) on withheld tax | **527** | 366 |
| Social Security Tax (INSS) - third parties | **136** | 859 |
| PIS, COFINS and CSLL - third parties | **99** | 761 |
| Other | **3** | 31 |
| | **6,261** | 5,431 |

(In thousands of reais)

## 14. Labor and social security obligations

| | Company and Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| INSS payable | **1,854** | 2,215 |
| Unemployment Compensation Fund (FGTS) payable | **633** | 466 |
| Accrual for vacation pay and social charges | **7,942** | 5,691 |
| Other | **225** | 584 |
| | **10,654** | 8,956 |

## 15. Taxes payable in installments

| | Company and Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| PIS/COFINS | **12,118** | 13,205 |
| INSS | **-** | 3,436 |
| ICMS | **341** | 112 |
| Other | **42** | 78 |
| | **12,501** | 16,831 |
| Current | **1,172** | 3,536 |
| Noncurrent | **11,329** | 13,295 |

At December 31, 2016, the aging list of noncurrent balances is as follows:

| Year | Company and Consolidated |
|---|---|
| 2018 | **1,230** |
| 2019 | **1,071** |
| 2020 | **1,071** |
| 2021 | **1,048** |
| 2022 onwards | **6,909** |
| | **11,329** |

## 16. Contingencies

The Company is a party to lawsuits and administrative proceedings filed with courts and governmental agencies, arising in the ordinary course of its business, involving tax, labor and civil claims and other matters.

Following their legal counsels' opinion, the Company analyzes unsettled lawsuits and, based on its experience referring to amounts claimed by plaintiffs, it sets up a provision in an amount deemed sufficient to cover estimated probable losses incurred from such ongoing lawsuits.

(In thousands of reais)

## 16. Contingencies (Continued)

According to the analysis made by management and its outside legal advisors, probable contingencies and contingencies for which a provision was set up are as follows:

| | Company and Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| Labor and social security | **13,817** | 11,557 |
| Tax | **-** | 6,242 |
| | **13,817** | 17,799 |

Changes in contingencies are summarized as follows:

| | Company and Consolidated | | |
|---|---|---|---|
| | **Labor and social security** | **Tax** | **Total** |
| Balance at December 31, 2014 | 12,222 | 18,585 | 30,807 |
| Additions and restatement | 2,400 | 653 | 3,053 |
| Reversals | (2,883) | (12,996) | (15,879) |
| Payments | (182) | - | (182) |
| Balance at December 31, 2015 | 11,557 | 6,242 | 17,799 |
| Additions and restatement | **6,175** | **-** | **6,175** |
| Reversals (Note 23) | **(3,915)** | **(6,242)** | **(10,157)** |
| Balance at December 31, 2016 | **13,817** | **-** | **13,817** |

Tax contingencies related to PIS and COFINS tax credits amounting to R$6,242, and labor contingencies amounting to R$ 3,915 reversed for the year ended December 31, 2016, refer to contingency installments expired in the respective year.

Management believes that the provisions set up are sufficient to cover any losses deemed probable

Nonetheless, the Company is still exposed to labor claims, and its operations are likely to be inspected by governmental authorities (labor, pension/social security or tax). Such claims and inspections may result in eventual fines and additional payment of social contribution tax or other taxes, during statute barring periods, according to the applicable law. However, management does not anticipate losses due to future labor claims or reviews by the above-mentioned governmental authorities, in addition to those already subject to provision.

(In thousands of reais)

## 16. Contingencies (Continued)

In addition, the Company is a party to civil, labor and tax claims involving possible risk of loss, and for which no provision for contingencies was set up. These contingencies are broken down as follows:

| Type | Company and Consolidated 2016 | 2015 |
|---|---|---|
| Tax contingencies | **14,053** | 7,949 |
| Civil contingencies | **-** | 1,276 |
| Labor contingencies | **1,173** | 1,463 |
| | **15,226** | 10,688 |

Tax contingencies classified as possible loss mainly refer to ICMS-related tax delinquency notices that are currently under discussion at the administrative level. The amounts above include fines, interest and monetary restatement.

## 17. Income and social contribution taxes

a) Deferred income and social contribution taxes - assets and liabilities

Based on the expectation of future taxable income, the Company recognized tax credits on income and social contribution tax losses and temporary differences. The book value of deferred tax assets and liabilities are reviewed on an annual basis by the Company for the purpose of maintaining such assets and liabilities at the estimated realizable value.

Deferred income and social contribution taxes are broken down as follows:

| | Company | | Consolidated | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Deferred tax assets on: | | | | |
| Income and social contribution tax losses | **27,528** | 21,971 | **27,528** | 21,971 |
| Contingencies | **3,578** | 4,725 | **3,578** | 4,725 |
| Exchange losses and hedge | **5,625** | 1,274 | **5,625** | 1,274 |
| Provisions | **1,090** | 533 | **1,090** | 533 |
| Other additions | **3,374** | 1,552 | **3,374** | 1,552 |
| Subtotal | **41,195** | 30,055 | **41,195** | 30,055 |
| | | | | |
| Deferred tax liabilities on: | | | | |
| Equity adjustment | **(23,189)** | (27,806) | **(27,047)** | (32,160) |
| Capitalized interest | **(2,057)** | (1,153) | **(2,057)** | (1,153) |
| Exchange gains losses and hedge | **(3,629)** | (513) | **(3,629)** | (513) |
| Depreciation | **(9,450)** | (4,192) | **(9,450)** | (4,192) |
| Subtotal | **(38,324)** | (33,664) | **(41,182)** | (38,018) |
| | | | | |
| Deferred income and social contribution tax assets (liabilities), net (Note 17.b) | **2,871** | (3,609) | **(986)** | (7,963) |

(In thousands of reais)

## 17. Income and social contribution taxes (Continued)

b) Changes in deferred taxes

Changes in deferred taxes are stated below, on a net basis:

| | Company | | | |
|---|---|---|---|---|
| | **Income and social contribution tax losses** | **Temporary differences** | **Equity adjustment** | **Total** |
| Balance at December 31, 2015 | **21,972** | **2,225** | **(27,806)** | **(3,609)** |
| Income and social contribution tax losses for the year | **5,556** | **-** | **-** | **5,556** |
| Other additions and exclusions, net | **-** | **(3,693)** | **-** | **(3,693)** |
| Realization of equity adjustment | **-** | **-** | **4,617** | **4,617** |
| Balance at December 31, 2016 | **27,528** | **(1,468)** | **(23,189)** | **2,871** |

| | Consolidated | | | |
|---|---|---|---|---|
| | **Income and social contribution tax losses** | **Temporary differences** | **Equity adjustment** | **Total** |
| Balance at December 31, 2015 | **21,972** | **2,225** | **(32,160)** | **(7,963)** |
| Income and social contribution tax losses for the year | **5,556** | **-** | **-** | **5,556** |
| Other additions and exclusions, net | **-** | **(3,693)** | **-** | **(3,693)** |
| Realization of equity adjustment | **-** | **-** | **5,113** | **5,113** |
| Balance at December 31, 2016 | **27,528** | **(1,468)** | **(27,047)** | **(987)** |

c) Reconciliation of income and social contribution tax income (expenses)

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Net income before income and social contribution taxes | **58,324** | 50,126 | **57,777** | 49,787 |
| Statutory tax rate | **34%** | 34% | **34%** | 34% |
| Income and social contribution taxes at statutory rate | **(19,830)** | (17,043) | **(19,644)** | (16,928) |
| Equity pickup | **(206)** | (99) | **-** | - |
| Tax benefits and grants | **21,876** | 13,561 | **21,876** | 13,561 |
| Other tax adjustments | **4,639** | 1,520 | **4,293** | 1,405 |
| Income and social contribution tax income (expenses) | **6,479** | (2,061) | **6,525** | (1,962) |

(In thousands of reais)

## 17. Income and social contribution taxes (Continued)

c) Reconciliation of income and social contribution tax income (expenses) (Continued)

Based on a technical study on taxable profit projections under CPC 32, the Company is expected to recover tax credits resulting from temporary differences and accumulated losses in the following years:

| | |
|---|---|
| 2017 | **2,185** |
| 2018 | **6,257** |
| 2019 | **28,798** |
| 2020 | **3,955** |
| | **41,195** |

Income and social contribution tax losses have no expiration date for offsetting. However, its offsetting is limited to 30% of the taxable profit for the period an offsetting takes place.

## 18. Equity

a) Capital

At December 31, 2016 and 2015, Company capital is broken down as follows:

| Shareholder | Number of common shares | Value | % |
|---|---|---|---|
| Carta Fabril S.A. | **96,289,235** | **96,289** | **100** |

b) Reserve for grants

i) On November 7, 2000, the State of Goiás, through its Finance Department, and Carta Goiás entered into an agreement relating to a special regime for the use of benefits of the Participation Fund to Promote the Industrialization of the State of Goiás (FOMENTAR), which provides for ICMS paid on 30% of the amount payable. From the remaining 70%, a part is recognized as Revenue from grants for the month the tax is paid, and another part is recognized in Current liabilities, under Tax incentives, for later settlement through FOMENTAR bids promoted by the Goiás State Government. At December 31, 2016, the benefit unused balance is R$48,029, which can be used until 2040 (R$55,734 at December 31, 2015).

## 18. Equity (Continued)

b) Reserve for grants (Continued)

ii) Through Decree No. 39853, of September 5, 2006, the Rio de Janeiro State approved the inclusion of Carta Goiás in the Incentive Program for the Recycling Industry Companies, created by Law No. 4178/2003 (“Reciclario”). This benefit expires in 10 years and the Company is currently renewing it at the Rio de Janeiro State relevant bodies.

iii) Through Decree No. 39519, of June 17, 2013 and subsequent Resolution No. 086/2016 of CONDIC, the Pernambuco State granted Carta Goiás the incentives included in articles 5, 6 and 24 of Decree No. 21959 of December 27, 1999 (PRODEPE). The projects included in the priority industrial group (sanitary napkin and disposable diaper) are subject to a 85% reduction on the normal debit balance of ICMS and the projects that are considered a relevant industrial activity (toilet paper, paper towel and napkins) are subject to a 75% reduction on the debit balance of ICMS. The benefit expires in 12 years, renewable for that same period of time.

iv) The incentives computed for the year ended December 31, 2016, in the amount of R$64,343 (R$20,300 for FOMENTAR, R$43,968 for RECICLARIO and R$75 for PRODEPE), were recorded as revenue in the income statement and, at the end of the year, they were transferred from Retained earnings (accumulated losses) to Income reserve from grants in Carta Goiás. The reserve balances at December 31, 2016 were partially used to absorb accumulated losses, as provided for by articles 189 and 195-A of Law No. 6404/76, ad referendum of the Annual General Shareholders’ Meeting, which will approve the Company’s annual financial statements.

c) Equity adjustment

On January 1, 2010, by virtue of the adoption of new accounting standards in Brazil, especially Technical Interpretation 10 (“ICPC 10”), the Company decided to remeasure certain PP&E items at their deemed cost on the transition date, and the matching entry was recorded in the Equity adjustment account.

d) Minimum mandatory dividends

The Company’s articles of incorporation sets forth a minimum dividend of 25%, calculated on the annual net income and adjusted as provided for by article 202 of Law No. 6404/76. Minimum mandatory dividends are recognized as a liability at year-end. At December 31, 2016, no dividends were calculated, since part of the profit is represented by Reserve for Grants.

(In thousands of reais)

## 19. Net operating revenue

| | Company and Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| Gross operating revenue | | |
| Sale of products and goods | **770,489** | 615,026 |
| Deductions from gross revenue: | | |
| Taxes on sales | **(137,865)** | (99,790) |
| Returns and rebates | **(17,905)** | (12,599) |
| Revenue from grants (Note 18.b) | **64,343** | 39,886 |
| | **679,062** | 542,523 |

## 20. Cost of goods sold

| | Company and Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| Raw material | **(202,496)** | (170,654) |
| Personnel and charges | **(56,731)** | (39,096) |
| Packaging material | **(42,211)** | (34,409) |
| Other costs | **(31,240)** | (25,906) |
| Electric power | **(23,937)** | (22,604) |
| Gas | **(18,437)** | (15,415) |
| Depreciation | **(16,595)** | (16,764) |
| Cost of resale | **(5,249)** | (2,031) |
| | **(396,896)** | (326,879) |

## 21. Selling and logistics expenses

| | Company and Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| Funds and bonus | **(39,005)** | (32,553) |
| Personnel and charges | **(30,372)** | (22,380) |
| Freight | **(20,223)** | (17,272) |
| Commissions paid to representatives | **(17,120)** | (11,988) |
| Marketing and sales promoters | **(12,620)** | (9,583) |
| Maintenance, toll fee, fuel and insurance | **(9,431)** | (5,844) |
| Third-party services | **(3,755)** | (3,333) |
| Other travel expenses | **(3,249)** | (2,359) |
| Royalties | **(2,379)** | (782) |
| Allowance for doubtful accounts | **(861)** | (815) |
| Other | **(5,327)** | (799) |
| | **(144,342)** | (107,708) |

(In thousands of reais)

## 22. General and administrative expenses

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Personnel and charges | **(28,701)** | (22,903) | **(28,701)** | (22,903) |
| Contingencies | **(6,175)** | (3,053) | **(6,175)** | (3,053) |
| Professional services | **(5,152)** | (3,382) | **(5,152)** | (3,382) |
| Occupation | **(1,218)** | (1,258) | **(1,218)** | (1,258) |
| Depreciation and amortization | **(4,213)** | (3,344) | **(5,364)** | (4,268) |
| Other | **(908)** | (3,590) | **(907)** | (3,589) |
| | **(46,367)** | (37,530) | **(47,517)** | (38,453) |

## 23. Other operating income, net

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Reversal of provision for contingencies | **10,157** | 15,879 | **10,157** | 15,879 |
| Recovery of expenses | **2,713** | 8,076 | **2,713** | 8,076 |
| Other income | **1,026** | 899 | **1,028** | 1,192 |
| | **13,896** | 24,854 | **13,898** | 25,147 |

## 24. Financial income (expenses)

| | | Company | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Financial charges on loans | **(31,881)** | (23,682) | **(31,881)** | (23,682) |
| Interest and charges | **(6,546)** | (7,258) | **(6,546)** | (7,258) |
| Bank fees | **(4,303)** | (2,787) | **(4,303)** | (2,787) |
| Expenses - hedging transactions (Note 9) | **(8,701)** | (1,568) | **(8,701)** | (1,568) |
| Exchange losses | **(2,095)** | (6,225) | **(2,095)** | (6,225) |
| Fair-value adjustment loss - loans and hedge (Note 9) | **(3,733)** | - | **(3,733)** | - |
| Interest and fines on payment in installments | **(776)** | (1,585) | **(776)** | (1,585) |
| Taxes on financial transactions | **(718)** | (807) | **(718)** | (807) |
| Discounts granted | **(225)** | (249) | **(225)** | (249) |
| Other | **(838)** | (3,855) | **(840)** | (3,855) |
| Total financial expenses | **(59,816)** | (48,016) | **(59,818)** | (48,016) |
| | | | | |
| Exchange gains | **10,674** | 376 | **10,674** | 376 |
| Earnings from short-term investments | **1,427** | 537 | **1,427** | 537 |
| Discounts | **562** | 173 | **562** | 173 |
| Interest earned | **490** | 575 | **490** | 575 |
| Fair-value adjustment gain - Loans and Hedge (Note 9) | **-** | 1,510 | **-** | 1,510 |
| Other | **239** | 2 | **239** | 2 |
| Total financial income | **13,392** | 3,173 | **13,392** | 3,173 |
| | | | | |
| Financial income (expenses), net | **(46,424)** | (44,843) | **(46,426)** | (44,843) |

## 25. Related parties

a) Key management personnel compensation

The Company considers the statutory chief executive officer, the statutory deputy chief executive officer, and the vice presidents as its key management personnel. The amount recorded in P&L for the year, referring to total key management personnel compensation, including bonus, was R$15,428.

## 26. Risk management

The Company's risk management consists of permanent monitoring of the agreed-upon conditions versus effective market conditions and future expectations.

The main financial assets recognized by the Company are cash and cash equivalents and accounts receivable, while the main financial liabilities recognized are trade accounts payable and loans and financing.

Accordingly, the estimates presented do not necessarily reflect the current market values. The use of different market hypotheses and/or methodologies may have a significant effect on estimated realizable values.

Fair value of financial assets and liabilities is included in the value for which the instrument could be exchanged in a current transaction between willing parties, rather than in a forced sale or settlement.

The fair values of cash and cash equivalents, trade accounts receivable, trade accounts payable and loans and financing approximate their respective carrying amounts largely due to the short-term maturity of these instruments. Loans and financing are initially recognized at fair value plus directly related transaction cost. After initial recognition, loans are subsequently measured at amortized cost, by using the effective interest rate method.

## 26. Risk management (Continued)

The Company is exposed to market risk, credit risk and liquidity risk, which are monitored by management. The significant market risks that affect the Company business can be summarized as follows:

**Market risk**

Market risk is the risk that the fair value of future cash flows from a financial instrument will fluctuate due to market price changes. In the Company's case, market prices comprise two main risks: (i) interest rate risk and (ii) currency risk.

**Interest rate risk**

The Company is exposed to the risk of shift in the structure of interest rates, which could be associated with the payment flows of principal and debt interest rates that are currently backed by CDI and Libor. The Company analyzes its exposure to interest rate by following changes in the market. Considering the maintenance of cash equivalents position pegged to CDI, customer financing positions at amounts equivalent to credit facilities taken out to fund these transactions and pegged to the same rates, Management understands that the Company's P&L sensitivity to fluctuations in market interest rates is low.

**Currency risk**

Currency risk refers to the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in exchange rates. The Company's exposure to currency risk refers mainly to its operating activities (inputs acquired at amounts pegged to or denominated in a currency other than its functional currency), as well as loans and financing.

The associated risk arises from the possibility of the Company incurring losses due to exchange rate fluctuations that decrease the amounts billed or increase funds raised in the marketplace.

The Company takes out derivative financial instruments to hedge currency risks of loans and financing, as described in Note 8.

## 26. Risk management (Continued)

### Credit risk

Credit risk is the risk that a counterparty of a business will fail to comply with an obligation under a financial instrument or agreement with the customer, leading to a financial loss. The Company is exposed to credit risk in its operating activities (particularly with respect to accounts receivable), including deposits in banks and financial institutions.

Accounts receivable

Credit risk arises from the possibility of the Company incurring losses as a result of default of counterparties or of depository or investment financial institutions. This risk factor could arise from selling transactions and cash management.

In order to mitigate these risks, management analyzes the financial position of its counterparties, and monitors outstanding positions permanently.

The Company's sales policy considers the credit risk level to which it is willing to be exposed in the ordinary course of its business, as well as diversification of its receivables portfolio, its customer selection, and monitoring of sales financing terms and individual credit limits. Such procedures are adopted in order to mitigate any default issues in its accounts receivable. Management considers that the credit risk is substantially covered by the allowance for doubtful accounts, which contemplates 100% of receivables overdue for over 180 days (Note 4).

Deposits in banks and financial institutions

In relation to short-term investments and other investments, the Company's policy is to work with prime financial institutions. In addition, all the Company's transactions are diluted in several financial institutions, which mitigates its risks.

(In thousands of reais)

## 26. Risk management (Continued)

### Liquidity risk

Management monitors the Company's liquidity level on a daily basis, considering cash flows expected against the amount available in cash and cash equivalents. The liquidity risk management implies the Company's capacity to maintain an appropriate level of cash that is sufficient to settle short-term market positions.

Management has been restructuring the debt currently recorded in the financial statements, and as has been seeking additional funds to expand the Company's business. On the date these consolidated financial statements were issued, the Company had already obtained funds and credit facilities from prime financial institutions, allowing it to extend its debt maturity profile and improve its operating cash flow. Management continues to take the actions planned to obtain the funds required to continue the Company's business expansion.

## 27. Financial instruments

The main financial assets are classified by category as follows:

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | **Financial assets at fair value through profit or loss (a)** | **Receivables** | **Total** | **Financial assets at fair value through profit or loss (a)** | **Receivables** | **Total** |
| Cash and cash equivalents | **23,039** | **-** | **23,039** | 28,237 | - | 28,237 |
| Restricted short-term investments | **3,948** | **-** | **3,948** | 3,650 | - | 3,650 |
| Accounts receivable from third parties | **-** | **93,863** | **93,863** | - | 73,894 | 73,894 |
| Derivative financial instruments | **-** | **-** | **-** | - | 24 | 24 |
| | **26,987** | **93,863** | **120,850** | 31,887 | 73,918 | 105,805 |

(a) Company and consolidated, except for cash and cash equivalents balance, in which Company recorded balances of R$22,744 and R$27,941 at December 31, 2016 and 2015, respectively.

At December 31, 2016 and 2015, the Company did not record investments held to maturity or financial assets available for sale. The fair value of receivables does not significantly differ from book balances, since their monetary restatement is consistent with market rates.

(In thousands of reais)

## 27. Financial instruments (Continued)

The Company recorded derivative transactions for the year ended December 31, 2016, as described in Note 9.

The Company's main financial liabilities are classified and measured at amortized cost, as follows:

| Financial liabilities | 2016 | 2015 |
|---|---|---|
| Trade accounts payable | **81,339** | 74,699 |
| Loans and financing | **277,343** | 213,501 |
| Derivative financial instruments | **9,529** | - |
| | **368,211** | 288,200 |

## 28. Insurance coverage

The Company's policy is to take out insurance coverage for its assets subject to risks. The insurance policies effective at December 31, 2016 for plants cover the global amount of R$256,000.

The insured amounts (maximum guarantee limits) at December 31, 2016, are broken down as follows:

| | 2016 | Insurance company | Effective term | Type |
|---|---|---|---|---|
| Basic – fire, lightning, explosion | **210,000** | BB Mapfre | Nov/2016 to Nov/2017 | Named perils and operational risks |
| Windstorm and smoke | **5,000** | BB Mapfre | Nov/2016 to Nov/2017 | Named perils and operational risks |
| Goods, raw material | **28,000** | BB Mapfre | Nov/2016 to Nov/2017 | Named perils and operational risks |
| Breakage of machinery | **10,000** | BB Mapfre | Nov/2016 to Nov/2017 | Named perils and operational risks |
| Electrical damages | **2,000** | BB Mapfre | Nov/2016 to Nov/2017 | Named perils and operational risks |
| Leaking from tanks and pipes | **1,000** | BB Mapfre | Nov/2016 to Nov/2017 | Named perils and operational risks |
| | **256,000** | | | |

The Company considers that its insurance coverage is consistent with that of other companies of same size and operating in the same industry.

The scope of our auditors' work does not include reviewing and issuing an opinion on the sufficiency of the insurance coverage, which was determined and assessed by the Company's management.