



# **BTG Pactual Timberland Investment Group** Research & Insight

Timberland Market Report - First Quarter 2017

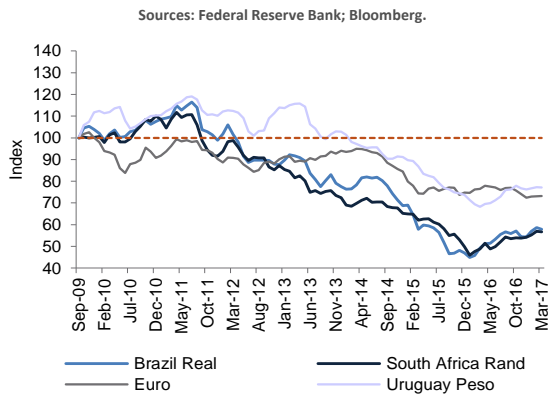


## Table of Contents

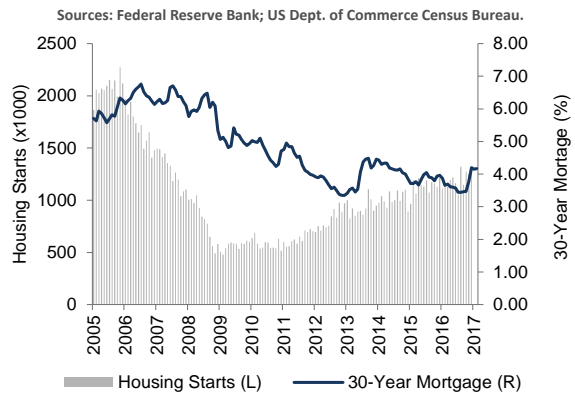
Timberland Investment Dashboard .....	2
Executive Summary .....	3
United States .....	6
Latin America .....	12
Europe .....	17
South Africa .....	19
New Zealand .....	21
Australia .....	22
Baltic Dry Index .....	23
Global Pulp and Paper Markets.....	24
Disclaimer .....	26

## Timberland Investment Dashboard

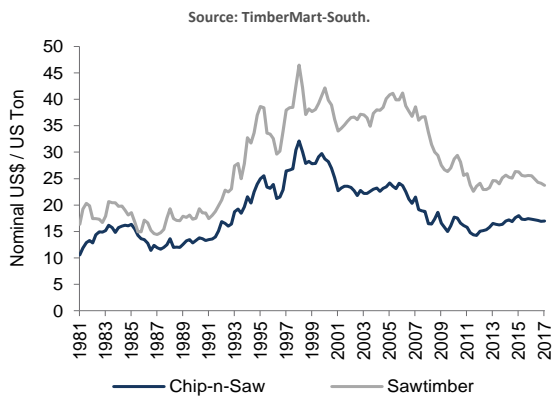
**Indexed Exchange Rates of Selected Countries vs. the US Dollar (2009=100)**



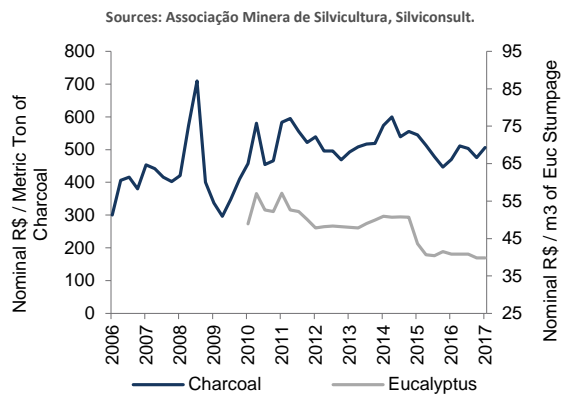
**Annual US Housing Starts, Seasonally Adjusted Annual Rate, and 30-year Mortgage Rates**



**US Southwide Quarterly Pine Chip-n-Saw and Sawtimber Prices**

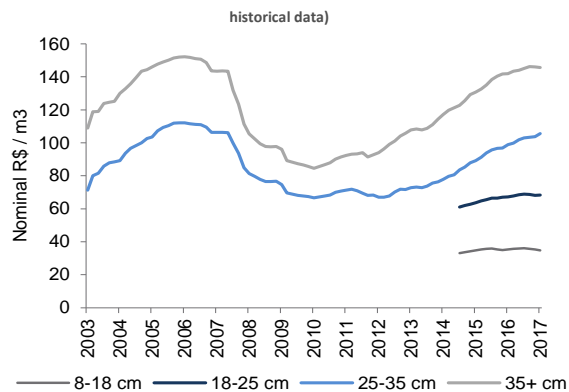


**Quarterly Charcoal and Eucalyptus Stumpage Prices in Minas Gerais, Brazil**



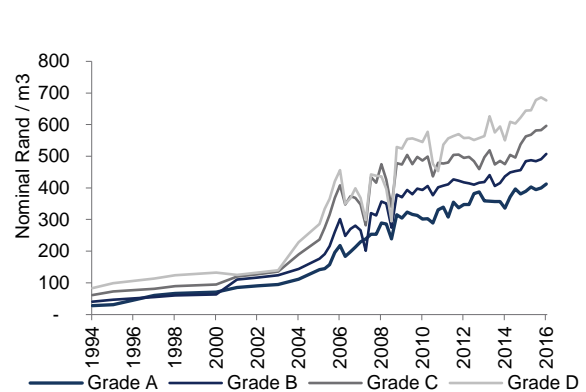
**Pine Sawtimber Stumpage Prices in Paraná State, Brazil**

Source: STCP. (STCP changed small log diameters in Q416 so there is limited revised



**South African Pine Sawlog Prices**

Source: Crickmay and Associates.



## Executive Summary

### United States

- Optimism regarding economic growth, tax reform, healthcare reform, and infrastructure spending continued into Q1 and drove equities markets higher, with the S&P 500 increasing 5.5% over the quarter (following a 4.6% rally from Election Day through year-end 2016).
- The US economy expanded at an annual rate of 2.1% (real GDP) in Q4 reflecting growth in personal consumption, private inventory investment, residential fixed investment, nonresidential fixed investment, and state and local government spending. Exports and federal government spending were drags on growth.
- Unemployment declined slightly from 4.8% in January to 4.7% in February as labor force participation edged higher.
- Manufacturing, as measured by the Institute for Supply Management Purchasing Managers Index, increased to 57.7% in February versus 56.0% in January and 54.5% in December.
- The US housing market continues to strengthen moderately, although the recovery is following an uneven pace. February housing starts increased 3.0% over the prior month and 6.2% over February 2016; multifamily starts accounted for 32.3% of February starts versus a historic average of 23.0%.
- Southern pine sawtimber prices declined -1.6% for the quarter and -7.1% year-over-year.
- Chip-n-saw prices increased 0.4% sequentially in Q1, but declined -2.0% year-over-year.
- Southern mixed hardwood sawtimber prices declined -3.5% for the quarter and -2.6% year-over-year.

### Latin America

- In Q4, Brazil's real GDP declined -0.9% quarter-over-quarter and -2.5% year-over-year.
- Brazilian softwood sawtimber prices were mixed depending on the assortment, although larger-diameter sawtimber grades experienced larger year-over-year gains.
- Brazilian charcoal prices increased 6.3% quarter-over-quarter. The price of eucalyptus used in charcoal production was flat in Q1 versus Q4.
- Despite ongoing political issues, the Brazilian government continues to pursue economic reforms and is now targeting an overhaul of Brazil's pension system.
- In Q4, Chile's economy increased 0.5% year-over-year (declined -0.4% quarter-over-quarter), the slowest pace in seven years.
- Argentina's economy showed some improvement with real GDP growth of 0.5% annualized in Q4 versus 0.1% in Q3, indicating that Argentina may be emerging from its recession. That said, some challenges persist despite President Macri's market friendly initiatives.
- Guatemala's real GDP grew at an annualized rate of 2.6% in Q3 (latest available) versus Q2's 3.6% annualized rate.
- Uruguay's economy increased at an annualized rate of 3.4% real in Q4, versus 1.1% growth in Q3.

### Europe

- In Q4, euro zone real GDP increased 0.4% quarter-over-quarter, the same rate as in Q3. Fixed investment and industrial production were better sequentially. Unemployment remained flat at 9.6% in January.
- Net exports remain challenged. In January (latest month reported), exports increased 13% year-over-year while imports increased 17% year-over-year.
- Estonian pine and hardwood sawlog prices were generally higher while pulpwood prices were weaker.

### South Africa

- In Q4, South Africa real GDP declined -0.3% quarter-over-quarter versus modest growth of 0.4% quarter-over-quarter in Q3. Mining & quarrying and manufacturing were weak.
- Political conditions continue to trouble South Africa. In late March, South African President Jacob Zuma fired Finance Minister Pravin Gordhan over disagreements on government spending, the management of state companies and the national tax agency. The country has also proposed a new law banning foreigners from directly buying agricultural land in the country, as the government seeks to boost ownership for the black majority.
- Despite overall economic weakness, both large- and small-diameter sawtimber logs generally experienced nominal price increases in Q4.

### New Zealand

- In Q4, New Zealand GDP grew a modest 0.4% quarter-over-quarter versus growth of 0.8% quarter-over-quarter in Q3. Agriculture was weaker.
- New Zealand A-grade export log prices firmed in December due to increasing demand from China, moderate inventories, and still low shipping rates. Domestic log prices also increased. Meantime, domestic Chinese sawlog and pulpwood prices modestly declined in Q4 likely due to increased log imports from New Zealand.

### Australia

- In Q4, Australia's real GDP increased 1.1% quarter-over-quarter versus a decline of -0.5% quarter-over-quarter in Q3. Agriculture, forestry & fishing and mining were stronger.
- Australian softwood roundwood prices increased on better Chinese demand while hardwood logs were weaker. Both softwood and hardwood chips declined.

### Baltic Dry Index

- The Baltic Dry Index has increased around 35% since the beginning of the year.
- The index provides a benchmark for the price of transporting major raw materials by sea and therefore serves as a leading global economic indicator.

### Global Pulp & Paper Markets

- In Q1, bleached softwood kraft pulp (“BSK”) prices increased 0.9% versus the prior quarter and 3.1% year-over-year.
- During the quarter, pricing was supported by strong viscose pulp demand (swing wood pulp mills targeting dissolving pulp instead of softwood) and substitution into softwood from hardwood given rising hardwood prices.
- That said, BSK pulp prices have the potential to soften later in 2017 as new capacity continues to ramp.
- Hardwood kraft pulp prices increased 3.9% in Q1 versus the prior quarter, but declined -10.8% year-over-year.
- The hardwood pulp market has improved given better Chinese demand, low inventories, and unexpected mill downtime. The postponement of Eldorado’s new line at its existing Três Lagoas mill in Mato Grosso do Sul state has also improved market sentiment. While there is the potential for supplies to further tighten in the near-term, the start-up of new capacity and potential inventory builds could lead prices lower later this year.
- In the US South, softwood pulpwood prices declined quarter-over-quarter and year-over-year in Q1. Hardwood pulpwood prices also declined in the quarter and year-over-year.
- Eucalyptus pulpwood prices in Brazil declined -1.3% for the three months ended February versus December and -5.1% year-over-year.
- Eucalyptus pulpwood prices in Uruguay were flat quarter-over-quarter in Q1, but declined -3.3% year-over-year.

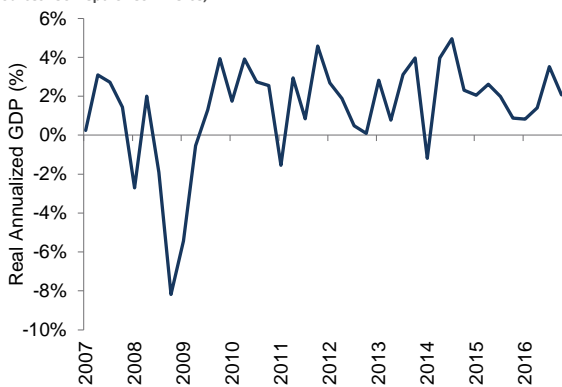
## United States

In Q4 (the latest GDP data available; 1Q2017 GDP expected to be released April 28) the US economy expanded at an annual rate of 2.1% (real GDP), the third estimate released by the Bureau of Economic Analysis. This was below the 3.5% real GDP gain from the prior period (Figure 1). The Q4 increase in real GDP reflected growth in personal consumption, private inventory investment, residential fixed investment, nonresidential fixed investment, and state and local government spending that was partly offset by negative contributions from exports and federal government spending. Imports also increased, which reduced GDP. The unemployment rate declined slightly from 4.8% in January to 4.7% in February while the change in total nonfarm payroll employment (seasonally adjusted) was 235,000 in February versus 238,000 in January. Meanwhile, the labor force participation rate edged higher to 63.0% in February from 62.9% in January and continues to trend along the lowest levels in almost four decades (Figure 2).

Manufacturing continues to improve. The Institute for Supply Management (“ISM”) Purchasing Managers Index, a bellwether of manufacturing activity, increased to 57.7% in February, the highest level since 2014, versus 56.0% in January (Figure 3). The ISM is a diffusion index with values over 50% indicating growth and values below 50% indicating contraction.

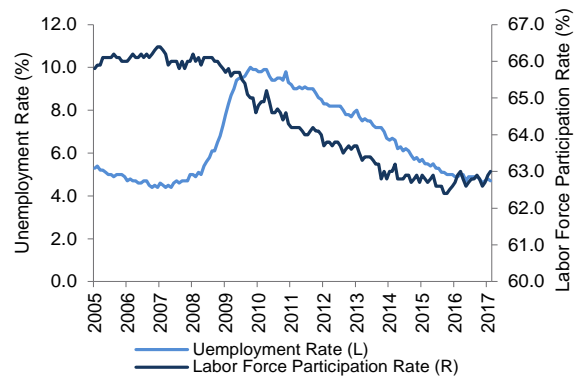
**Figure 1. Annualized Quarterly US Real GDP Growth (%).**

Sources: US Dept. of Commerce, BEA.



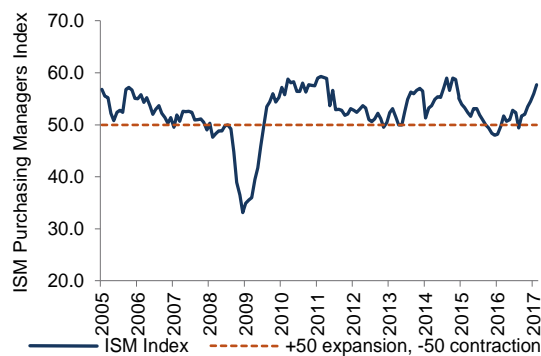
**Figure 2. US Unemployment, and Labor Force Participation Rate.**

Sources: US Dept. of Labor, BLS.



**Figure 3. US ISM Purchasing Managers Index.**

Source: Institute for Supply Management.



## US housing

The US housing market continues to grow, although the recovery is following an uneven pace.

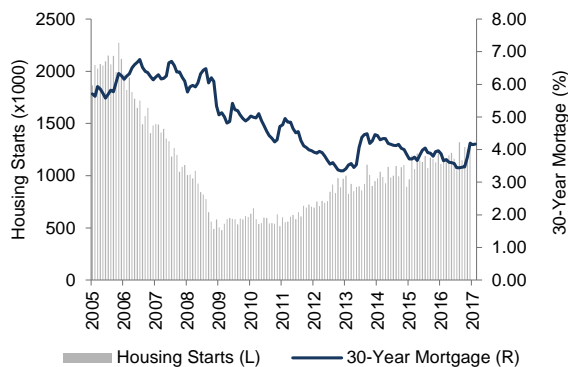
In February, housing starts totaled 1.288 million units. This figure is up 3.0% versus January's 1.251 million housing starts and 6.2% versus February 2016's 1.213 million starts (Figure 4). While the share of multifamily starts as a percentage of total starts declined to 32.3% versus 34.5% in January, it remains greater than the average of 23.0% since 1990.

New home sales increased 6.1% month-over-month in February (Figure 5). The largest increase was in the Midwest (+30.9%) with gains also in the South (+3.6%) and West (+7.5%). New home sales declined -21.4% in the Northeast. Inventories of new homes declined to 5.4 months of supply in February from 5.6 months of supply in January.

With respect to current housing stock, existing home sales declined -3.7% month-over-month in February to 5.48 million units, but increased 5.4% year-over-year versus February 2016's 5.2 million units. Inventories of existing homes increased to 3.8 months in February from 3.5 months in January.

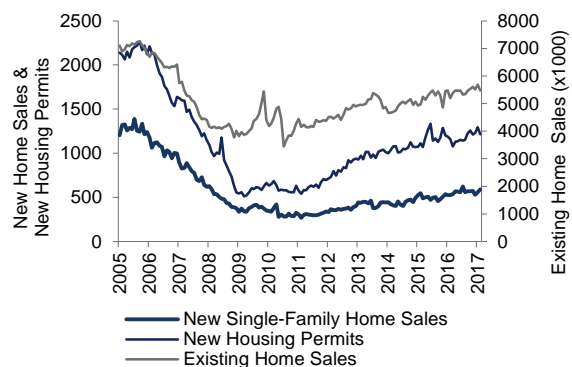
**Figure 4. Annual US Housing Starts, Seasonally Adjusted Annual Rate and 30-year Mortgage Rates.** Sources: Federal

Reserve Bank of St. Louis, US Dept. of Commerce Census Bureau.



**Figure 5. Monthly New Home Sales, New Building Permits, and Existing Home Sales, Seasonally Adjusted Annual Rates.** Sources: US Dept. of Commerce Census Bureau, National Association of

Realtors.



In February, building permits, which are indicative of future housing activity, declined -6.2% month-over-month. This decline was driven by multi-family permits, which declined -21.6% month-over-month, whereas single-family permits actually increased 3.1% month-over-month.

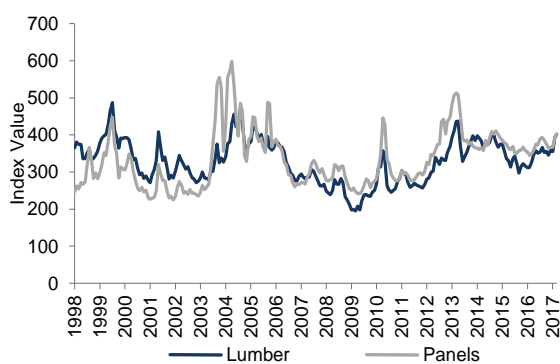
## US forest products and timber markets

Softwood lumber prices increased 8.7% quarter-over-quarter in Q1. This compares to a historical average sequential increase of 4.0% over the last decade. Prices jumped in early February and were generally maintained throughout the quarter, as concerns increased regarding the prospect of duties on Canadian lumber exports. Meanwhile, US lumber exports increased 1.5% year-over-year.

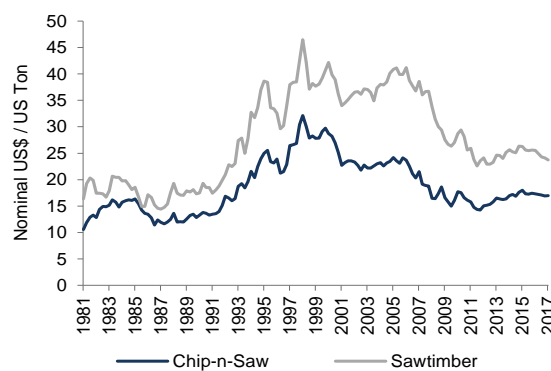


During Q1, structural panel pricing increased 5.3% versus Q4. This compares to a historical average sequential increase of 2.6% over the last decade (Figure 6). Similar to lumber, Oriented Strand Board (“OSB”) prices jumped in early February due to expanding order files as producers anticipated a busy spring construction season. This increase materialized in spite of US OSB production increasing 6.3% year-over-year and imports increasing 17.8% year-over-year in Q4 (production, import and export data are released on a one-quarter lag). Meantime, plywood prices moved higher as demand outpaced supply. US OSB exports increased 2.6% year-over-year while US plywood exports jumped 44.0% year-over-year in Q4.

**Figure 6. US Framing Lumber Index and Panel Composite Index.** Source: Random Lengths.



**Figure 7. US Southwide Quarterly Pine Chip-n-Saw and Sawtimber Prices.** Source: TimberMart-South.

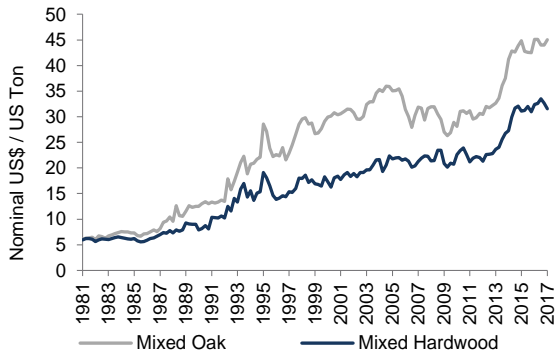


Throughout the US South, pine sawtimber prices declined -1.6% in Q1 and -7.1% year-over-year according to TimberMart-South (Figure 7). Chip-n-saw was mixed, increasing 0.4% sequentially in Q1, but declining -2.0% year-over-year. Significantly drier weather during Q1 increased timber availability and depressed prices.

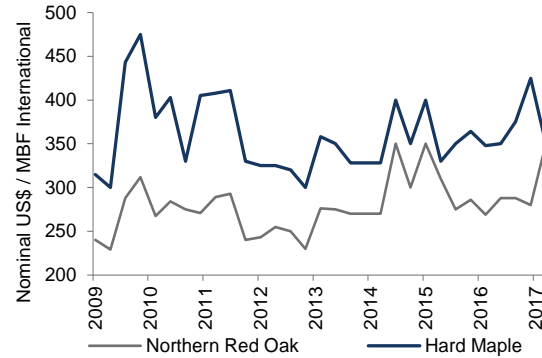
Southern hardwood sawtimber prices were mixed during Q1. Region-wide, mixed hardwood prices declined -3.5% for the quarter and -2.6% year-over-year. Oak sawtimber prices increased 2.3% quarter-over-quarter, but were slightly down -0.2% year-over-year (Figure 8).

During Q1, Canadian sawmiller Conifex stated that it intends to complete Phase I of its El Dorado, AR expansion by the end of Q3 or Q4, which will ultimately result in an additional 180 million board feet (“mmbf”) of capacity. The Klausner mill in Live Oak, FL continues to experience operating issues, laying off 150 employees and cutting back to one shift. The mill has significantly curtailed its wood intake, only taking 25 loads per week. Meantime, Weyerhaeuser is in the process of rebuilding two of its’ sawmills in Dierks, AR (construction to be completed by 2018) and Millport, AL. Given improving wood products markets, there is also market scuttlebutt that Norbord will announce plans to restart its Huguley, AL OSB mill (500 million square feet) later this year. On January 22, International Paper’s Pensacola, FL mill (535,000 tons of lightweight kraft linerboard and 190,000 metric tons (“MT”) of fluff pulp) was temporarily shut due to a digester explosion. The mill resumed full operations in early April. In Q1, Southeastern Asset Management took a 15% stake in Deltic Timber to encourage discussions with potential takeover partners. Deltic also replaced its interim CEO.

**Figure 8. US Southwide Quarterly Mixed Hardwood and Mixed Oak Sawtimber Prices.** Source: TimberMart-South.



**Figure 9. Quarterly Northern Red Oak and Hard Maple Sawtimber Prices in New York.** Source: Forest2Market.

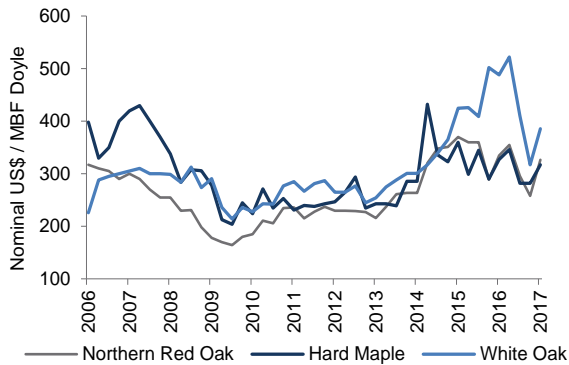


In other timber markets, prices were mixed during the quarter. In New York’s Adirondack region, northern red oak increased 25.0% quarter-over-quarter and 30.1% year-over-year (Figure 9). Hard maple declined -17.6% in Q1, but slightly increased 0.6% year-over-year (Figure 10). In Ohio, red oak increased 26.6% compared to Q4, but was down -2.5% year-over-year. Hard maple increased 12.4% during the quarter, but declined -3.1% year-over-year. White oak increased 21.6% in Q1, but declined -21.0% year-over-year.

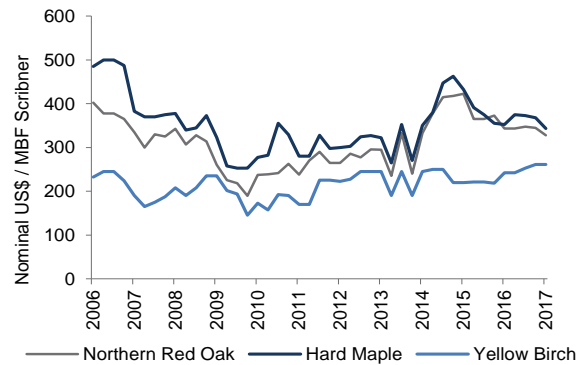
In Wisconsin, northern red oak declined -5.1% quarter-over-quarter in Q1 (Figure 11) and -4.5% year-over-year. Hard maple declined -6.7% for the quarter and -2.7% year-over-year. Yellow birch sawtimber was flat quarter-over-quarter in Q1, but increased 7.6% year-over-year.

In Oregon, softwood sawlog prices increased. The price of Douglas-fir #2 increased 0.8% sequentially and 4.6% year-over-year (Figure 12). As of February 2017 (latest data available), Douglas-fir remains -12.6% below its 2014 peak. The price of Whitewood #2 logs declined -0.3% for the quarter, but increased 7.7% year-over-year. As of February 2017, Whitewoods are still down -18.8% from their 2014 peak. In December 2016 (the latest available data), total softwood log exports to China increased 61.7% year-over-year to 84.71mmbf from 52.39mmbf in December 2015, while softwood log exports to Japan declined -49.2% year-over-year to 19.93mmbf from 39.20mmbf in December 2015.

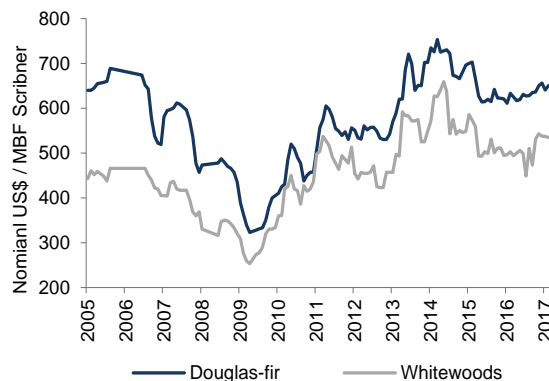
**Figure 10. Ohio Northern Red Oak, Hard Maple, and White Oak Sawtimber Prices in Ohio.** Source: Forest2Market.



**Figure 11. Northern Red Oak, Hard Maple, and Yellow Birch Sawtimber Prices in Wisconsin.** Source: Steigerwaldt and Burns.



**Figure 12. Monthly Columbia River #2 Douglas-fir and Mixed Whitewood Log Prices.** Source: Log Lines.



BTG Pactual Timberland Investment Group (“TIG”) regional asset managers regularly report on conditions that impact wood pricing in their operating areas. In east Texas, Louisiana, and southern Arkansas, there is an oversupply of pine pulpwood given unusually dry winter weather and well-stocked mill inventories. As a result, some mills have been putting contractors on quota. Some of our asset managers noted that some mills have stopped accepting deliveries of wood even though the mills continue to operate. Given challenging market conditions, one large timberland manager in Texas decided to postpone offering potential timber sales. That said, that same manager reportedly continues to aggressively pursue timberland acquisitions in the same wood basket, perhaps in anticipation of better market conditions in the future.

In South Carolina, North Carolina, Georgia, and Florida, dry winter weather and scheduled maintenance downtime at a number of large mills resulted in increasing stumpage availability and weaker timber pricing. Dry weather in Florida & Georgia has also caused fires leading to an increase in the amount of salvage wood on the market. There is the potential for timber prices to remain challenged given the onset of summer and continued dry conditions.

Given International Paper's Pensacola, FL mill outage, timber owners surrounding the mill sought alternative outlets for their wood, delivering as far away as Panama City, FL (over 100 miles). While mills such as WestRock's Panama City, FL mill welcomed the additional tonnage, pine pulpwood prices declined \$2-3/ton due to increased timber availability from drier winter weather. Other grades were also impacted as some timber managers tried to shift to pine chip-n-saw and pine sawtimber; however, mills easily restocked those inventories and consequently put loggers on quota.

In Virginia, timber owners have become more positive on pricing the last few weeks given wet weather. That said, the main issues in this region continue to be an oversupply of wood and end-market mill concentration dictated by two large pulp/board companies.

In Ohio, elevated mill log inventories were worked through during the quarter as wet winter weather curtailed harvesting operations. Presently, most mill log inventories appear to be at normal levels.

In Appalachia, sentiment has improved recently given increased log buyer interest. However, this market tends to be more dependent on exports to the Chinese market, so market participants are closely watching US trade developments with China.

In Wisconsin, many mills have tight log inventories due to a mild winter that prevented loggers from accessing forests. Moreover, an early spring has resulted in further inventory depletion with inventories now estimated to be three to four weeks below normal. As such, prices across most grades are expected to increase in Q2.

#### **US Softwood Lumber Coalition**

Lumber trading accelerated during the quarter given concerns over countervailing and anti-dumping duties on Canadian softwood lumber exports to the US. On April 24<sup>th</sup>, the US Department of Commerce imposed a preliminary 20% countervailing duty against Canadian softwood lumber exports to the US. Over the next few months, the US Department of Commerce will have to make a final determination. Moreover, the US International Trade Commission will need to assess that the US lumber industry has suffered injury before any duty is levied. Importantly, if the US Department of Commerce determines that "critical circumstances" exist, duties would be retroactive for 90 days. The US Department of Commerce is expected to impose antidumping duties on June 23<sup>rd</sup>. Ultimately, the imposition of both of these duties could stem the flow of softwood lumber from Canada to the US, causing lumber prices to further increase.

## Latin America

### Brazilian economy

Brazil's economy continues in a recession, with real GDP down -0.9% quarter-over-quarter in Q4 (-2.5% year-over-year) due to broad weakness. Four of Brazil's six major economic sectors contracted in the quarter including an -0.8% quarter-over-quarter decline in services and -0.7% quarter-over-quarter decline in industry (mining & quarrying, manufacturing, construction, and electricity and gas, water supply, sewerage, and urban sanitation). Investment declined -1.6% quarter-over-quarter after falling -2.5% quarter-over-quarter in Q3. On an annualized basis, the economy has contracted for 11 consecutive quarters. BTG Pactual's Brazilian Economics team currently expects 2017 real GDP of 0.5% year-over-year as the economy continues to undergo adjustments arising from the current recession.

As part of this economic weakness, household consumption continues to remain challenged falling -2.9% year-over-year in Q4 after declining -3.4% year-over-year in Q3. This weakness is partially driven by rising unemployment, which increased to 12.6% in January from 12.0% in December and 11.8% in September. On a positive note, industrial production increased 1.4% year-over-year in January after declining -0.1% year-over-year in December and -1.4% year-over-year decline in November.

Meantime, inflation (Índice de Preços ao Consumidor Amplo or "IPCA") continues to decline, falling to 4.76% in February from 5.35% in January and 6.29% in December, the lowest reading since 2010 (Figure 13). Real rates have also started moving lower as evidenced by declining Treasury inflation-protected bond yields (Figure 14). Meantime, in February, Brazil's central bank cut the Selic rate by another 75bps to 12.25% following a 75bps cut in January as inflation has slowed and the government looks to spur economic growth.

Separately, in Q1, the real appreciated around 4.5% sequentially and 19.4% year-over-year (Figure 15). As a result, exports continued to decline, dropping -1.8% sequentially in Q4 following a -3.2% quarter-over-quarter decline in Q3. Imports increased 3.2% sequentially in Q4 after declining -3.1% quarter-over-quarter in Q3.

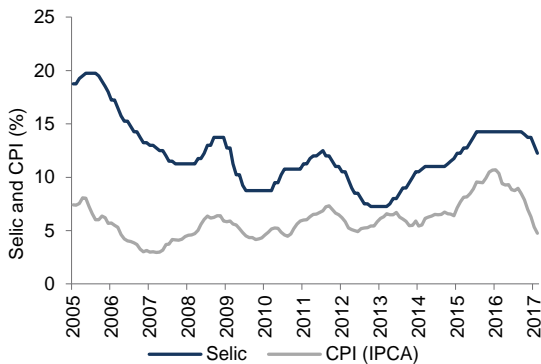
On the political front, the Lava Jato ("Car Wash") scandal continues to unfold with potentially far-reaching consequences. Prosecutor General Rodrigo Janot asked the Supreme Court to open 83 new investigations into politicians based on still-sealed testimony by executives of the construction firm Odebrecht. Janot also requested that another 211 potential cases be sent to lower courts. Odebrecht is one of several large construction firms that paid billions of dollars in bribes to Brazilian politicians and executives at state-controlled businesses, primarily oil company Petrobras. Separately, Brazil is confronting a new scandal as investigators are examining whether companies paid bribes to conceal unsanitary conditions at meatpackers. While this issue has been portrayed as a systemic problem in Brazil, only a few meat plants out of a total of around 4,500 were involved in wrong-doing. While some countries in the Americas, Asia, Europe, and Africa temporarily halted some meat exports from Brazil, Brazilian meat companies had regained access to most of those countries by the end of March.

Meanwhile, the government continues to proceed with economic reforms. Finance Minister Henrique Meirelles noted that Brazil's pension overhaul is likely to be approved in Senate by the start of the second half of the year after clearing the lower house in April or May. The proposed pension changes include homogenizing rules amongst different workers and requiring Brazilians to work longer before becoming eligible for full

retirement benefits. At present, many civil servants and the military are excluded from these reforms. Separately, Moody's Investors Service upgraded Brazil's outlook to stable given a recovering economy, slowing inflation, and attempts to reduce the budget deficit.

**Figure 13. Brazilian SELIC Rate and Annualized IPCA Index.** Source: Banco Central do Brasil, Brazilian Institute of Geography and

Economics.



**Figure 14. Brazilian Treasury Inflation Protected Bond Yield.** Source: Brazil National Treasury.



**Figure 15. US Dollar: Brazilian Real Daily Exchange Rates.**

Source: Board of Governors of the US Federal Reserve System.



**Brazilian forest products and timber markets**

The price of pine timber in Brazil was mixed during the quarter depending on the assortment. Through the end of February, pulpwood (8-18 cm) in Parana State declined -1.4% quarter-over-quarter and -1.2% year-over-year in local currency terms. Small sawtimber (18-25 cm) increased 0.1% quarter-over-quarter and 1.5% year-over-year and large-diameter sawtimber (25-35 cm) gained 1.7% quarter-over-quarter and 6.7% year-over-year. Veneer logs (+35 cm), used primarily for export-oriented softwood plywood, slightly declined -0.3% quarter-over-quarter, but increased 2.6% year-over-year (Figure 16).

The price of larger diameter sawtimber continues to be driven by exports, particularly plywood and lumber. In Q4 (latest available data), Brazilian plywood exports to the US increased 25.1% year-over-year while Brazilian

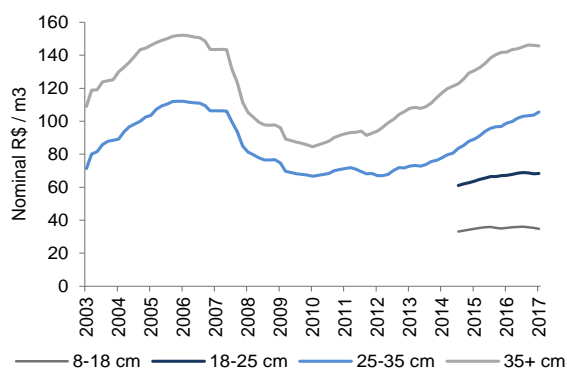
lumber exports to the US increased 53.9% year-over-year. Interestingly, log prices still managed to increase in Q4 despite a 1.5% depreciation in the real.

The global steel sector remains weak due to excess steel capacity and slower Chinese demand. This continues to negatively impact industrial wood charcoal (Figure 17, left axis), which is used to produce pig iron which in turn is used to make steel. Although charcoal prices have recovered from their recent lows, they remain somewhat challenged. That said, in Q1, charcoal prices in Minas Gerais increased 6.3% quarter-over-quarter and 7.7% year-over-year. Charcoal pricing is normally reflected in the price of eucalyptus stumpage (Figure 17, right axis). In Q1, Minas Gerais eucalyptus prices were flat quarter-over-quarter, but declined -2.5% year-over-year, likely a reflection of continued accumulated timber supply in the region.

The price of pine resin, a secondary product that can be collected from pine plantations between harvests, and which is used in the production of synthetic rubber, glues, adhesives, printer inks, etc., increased during Q1. Mixed tropical pine resin increased 6.2% quarter-over-quarter in Q1 while slash pine resin increased 5.2% quarter-over-quarter.

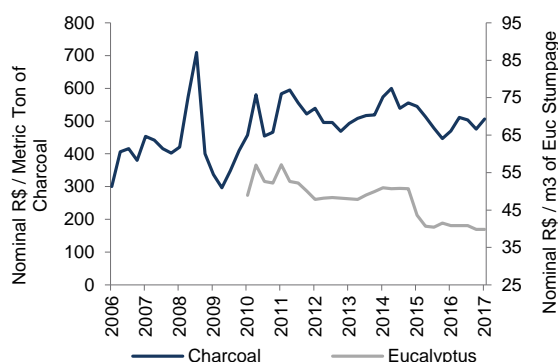
**Figure 16. Pine Sawtimber Stumpage Prices in Paraná State, Brazil.** Source: STCP. (STCP changed log diameters to 8-18 cm from 8-15

cm and 18-25 cm from 15-25 cm in Q416 so revised historical data only extend back to 2014)



**Figure 17. Charcoal and Eucalyptus Stumpage Prices in Minas Gerais, Brazil.** Sources: Associação Mineira de Silvicultura; Poyry

Silviconsult.



### Uruguay

Uruguayan real GDP increased 3.4% year-over-year in Q4 versus 1.1% year-over-year growth in Q3. The agriculture, cattle raising, hunting & silviculture sectors increased 4.5% year-over-year while the transportation, storage & communications sectors increased 8.3% year-over-year in Q4. Utilities was the weakest sector declining -11.9% year-over-year. Gross fixed capital formation increased 14.4% year-over-year in Q4 versus 0% year-over-year in Q3 while household spending increased 1.3% year-over-year versus 0.7% year-over-year in Q3. Exports increased 3.6% year-over-year versus an increase of 1.0% year-over-year in Q3 while imports grew 5.8% year-over-year versus a decline of -0.5% year-over-year in Q3. During Q4, the Uruguayan peso appreciated around 3.4% year-over-year and 2.5% quarter-over-quarter.

Uruguay is still in negotiations with UPM to build a second pulp mill. As part of President Tabaré Vázquez's visit to Europe, he also visited UPM's Biofore House in Helsinki and was hosted by UPM's President and CEO Jussi

Pesonen. During the visit, UPM stressed the importance of cost competitiveness and logistics infrastructure. Meantime, Weyerhaeuser continues to explore strategic options for its Uruguayan assets which include timberlands, a plywood mill, and biomass cogeneration facility.

### **Chile**

In Q4, Chile's economy grew at the slowest pace in seven years, growing 0.5% year-over-year (-0.4% quarter-over-quarter). Mining declined -3.3% year-over-year with copper declining -3.0% year-over-year. A fiscal stimulus has failed to revive demand in a country reeling from a slump in copper prices. Manufacturing declined -2.2% year-over-year while utilities declined -7.6% year-over-year. Positively, agriculture increased 8.3% year-over-year. Given the economic weakness, Chile's central bank has cut its key interest to 3.0% from 3.25%, the second time it has cut rates this year. In Q1, growth is likely to remain depressed given the strike at Escondida, the world's largest copper mine, which ended on March 25 after 44 days.

Gross fixed capital formation declined -5.0% year-over-year, government spending increased 1.7% year-over-year, and consumer spending increased 2.4% year-over-year. Exports declined -2.0% year-over-year while imports were flat year-over-year. The decline in exports occurred despite a 4.7% year-over-year appreciation in the Chilean peso versus the US dollar in Q4.

In addition to these economic challenges, Chile has been facing significant forest fires, which is also likely to hurt future economic output. As of March 13, 2017, a total area of 606,159 hectares has been burned this season per the country's national forest corporation, Conaf. Specifically, CMPC noted that around 19,000 hectares of its forests were impacted costing the company US\$ 41 million. Similarly, Arauco noted that as of March 9 it has lost around 80,000 hectares of forest plantations due to the recent fires, amounting to 2% of total assets and costing the company around US\$ 240 million.

### **Argentina**

Argentina's economy showed some improvement in Q4, with real GDP increasing 0.5% quarter-over-quarter versus 0.1% growth quarter-over-quarter in Q3, indicating that Argentina may be emerging from its recession. On a year-over-year basis, real GDP declined -2.1% versus -3.7% year-over-year in Q3. Argentina's year-over-year decline is the result of a -2.1% year-over-year decline in private consumption, a -2.0% year-over-year decline in public consumption, and a decline of -7.7% year-over-year in investments, largely driven by weaker construction activity (-10.7% year-over-year). During Q4, the Argentinian peso depreciated -52.1% year-over-year (-3.3% sequentially) against the US dollar, which contributed to Q4 exports increasing 7.7% year-over-year.

On the political front, federal prosecutors are investigating at least six cases involving President Mauricio Macri, some of them related to his family's extensive business holdings. Allegations range from influence trafficking to money laundering. Meantime, teachers went on strike in March in a dispute over salary negotiations. Striking teachers want the government to negotiate their salaries on a national level, rather than by individual province. The CGT Labor Federation, an umbrella group representing a large number of trade unions, also organized protests about a range of issues including government job cuts, the lifting of restrictions on imports, and a lack of protection for national production.

Some investors are becoming more interested in investing in Argentina. Lone Star Funds recently opened an office in Argentina while BlackRock, Inc. launched a new ETF focused on Argentina. Meanwhile, Moody's Investors Service raised its outlook for Argentina to positive from stable on an improved policy platform and



the expectation that the country will begin reducing its fiscal deficit in 2018. Moody's maintained Argentina's overall rating at B3, six notches below investment-grade territory. Further, the World Bank approved loans for two housing projects of US\$ 200 million each to improve housing in poor neighborhoods of Greater Buenos Aires and the country's interior.

#### **Guatemala**

Guatemalan real GDP improved in Q3 (latest available data) rising 2.6% year-over-year versus 3.6% year-over-year growth in Q2. All industries improved versus the prior year except mining & quarrying which declined a notable -17.5% year-over-year. Exports declined -0.5% year-over-year in Q3 versus -2.1% year-over-year in Q2 while imports increased 1.6% year-over-year in Q3 versus 1.3% year-over-year in Q2. During Q3, the Guatemalan quetzal appreciated around 1.4% year-over-year and 1.6% quarter-over-quarter.

## Europe

In the euro zone, Q4 real GDP increased 0.4% quarter-over-quarter as compared to 0.4% quarter-over-quarter growth in Q3. Year-over-year, real GDP increased 1.7%. On an individual country basis, growth increased in Germany, France, Italy, and Spain, respectively the euro zone's first- through fourth-largest economies.

Gross fixed capital formation grew 0.6% quarter-over-quarter versus a decline of -0.7% quarter-over-quarter in Q3. Personal consumption and government spending, which both grew 0.4% quarter-over-quarter, were better than the prior quarter. Unemployment remained flat at 9.6% in January versus December and was slightly down from 9.7% in November.

Industrial production increased 0.9% month-over-month in January after declining -1.2% month-over-month in December and growth of 1.5% in November. This increase of 0.9% is due to production of capital goods rising by 2.8% and energy by 1.9%, while production of non-durable consumer goods declined by -0.7% and both intermediate goods and durable consumer goods by -0.4%.

March's Composite Purchasing Manager's Index increased to 56.7 from 56.0 in February, reaching a near six-year high. Inflows of new work and backlogs both grew at the fastest rates since April 2011. Service sector activity increased to the highest level since April 2011, while manufacturing activity remained close to February's near-six year peak. Employment showed the largest monthly improvement since July 2007 as firms sought to hire given increased demand.

Meantime, European net exports remain somewhat challenged. In January (latest month reported), exports increased 13% year-over-year while imports increased 17% year-over-year, resulting in a euro zone trade deficit of €593.4 million.

On the lumber front, Mercer International Inc., one of the largest producers of northern bleached softwood kraft pulp, announced its intention to purchase the assets of one of Germany's largest sawmills and associated bio-mass power plant from Klausner for US\$ 64.1 million (which includes US\$ 9.0 million of working capital). The mill has an annual production capacity of approximately 550mmbf on a continuously operating basis and 465mmbf on a customary three-shift operating basis. Similarly, Holmen signed an agreement to acquire Lingham Sawmill from owner Rörvik Timber for SEK 48 million. The sawmill has a new saw line with capacity to produce 75,000 m<sup>3</sup> per year.

Meantime, Metsa is planning a new birch plywood mill (30,000 m<sup>3</sup>) in Estonia, either in Pärnu or Tartu. The company intends to import veneer from Finland, although it has the option of establishing a veneer production line in Estonia at some future date.

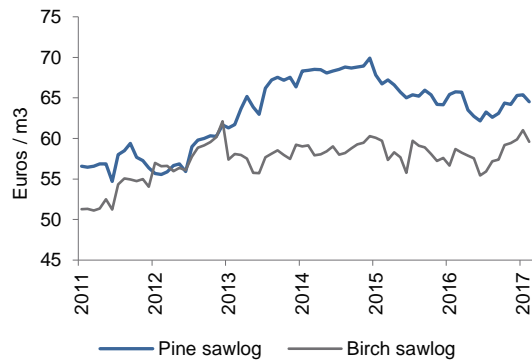
### **Estonian forest products and timber markets**

Despite only modest European economic growth, sawlog prices continued to improve during the last few months. In Estonia, pine sawlog prices (latest data available February 2017) increased 0.5% from three months earlier, but were down -1.9% year-over-year. Birch sawlog prices increased 0.3% from three months earlier and 1.5% year-over-year (Figure 18).

Estonian pulpwood prices were generally lower. Pine pulpwood prices (latest data available February 2017) declined -3.8% from three months earlier and -8.6% year-over-year. Birch pulpwood prices increased 4.4% from three months earlier, but declined -0.6% year-over-year (Figure 19).

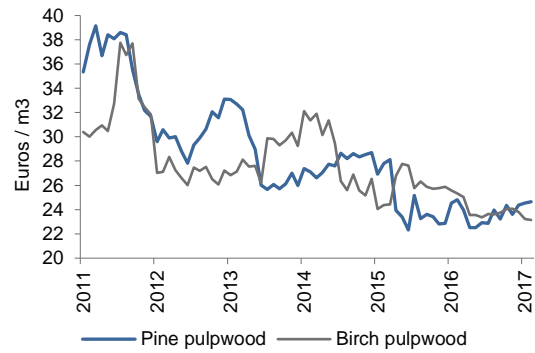
**Figure 18. Estonia Sawlog Prices (Nominal € / m<sup>3</sup>).**

Source: RMK (Estonia State Forest Agency).



**Figure 19. Estonia Pulpwood Prices (Nominal € / m<sup>3</sup>).**

Source: RMK (Estonia State Forest Agency).



## South Africa

In Q4, South Africa's economy slowed versus the prior quarter with real GDP declining -0.3% quarter-over-quarter versus modest growth of 0.4% quarter-over-quarter in Q3. The main contributors to the GDP decline were: 1) mining & quarrying (-11.5% quarter-over-quarter) due to lower production in coal, gold and other metal ores (including platinum) and 2) manufacturing (-3.1% quarter-over-quarter) due to declines in food and beverages, petroleum, chemical products, and rubber and plastic products. Agriculture, forestry and fishing industry slightly declined -0.1% quarter-over-quarter, its eighth consecutive quarterly decline, due to a decline in the production of horticultural products.

On the political front, in late March, South African President Jacob Zuma fired Finance Minister Pravin Gordhan. There had been speculation for some time that Gordhan was going to be fired as he and the President disagreed over government spending, the management of state companies and the national tax agency. Gordhan was replaced by former home affairs minister Malusi Gigaba, who is seen by many as a less experienced replacement, and more susceptible to presidential influence. As a result, S&P Global Ratings cut South Africa's foreign-currency rating to BB+, the highest junk score and signaled that a deterioration of the country's fiscal and macroeconomic performance could drive further reductions. This was followed by Fitch Ratings, which downgraded the government's long-term foreign and local currency debt to BB+ from BBB- with a stable outlook, a non-investment grade rating.

Meantime, South Africa has proposed a new law banning foreigners from directly buying agricultural land in the country as the government seeks to boost ownership for the black majority. Non-residents would still be allowed to hold long-term land leases and minority interests in land holdings, according to the Regulation of Agricultural Land Holdings Bill, published in the Government Gazette on March 17. Foreigners considering selling land must give the Minister of Rural Development and Land Reform first option on the property, according to the bill. The proposal is open for public comment until April 17. Separately, for the 2017-2018 financial year, South Africa raised the income tax rate for the wealthiest individuals (those making more than US\$ 114,000 / year) to 45% from 41%.

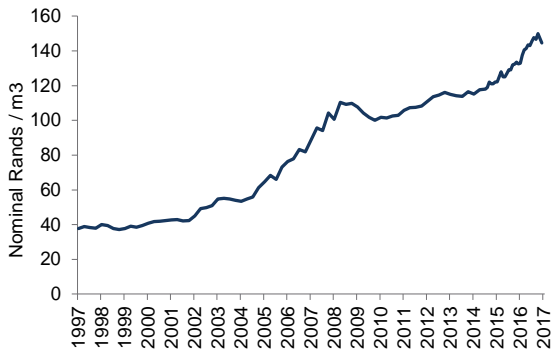
### South African forest products and timber markets

In February, lumber prices declined -1.3% versus the prior three months, but were up 9.2% from February 2016, as measured by the South African Lumber Index, a composite price series (Figure 20).

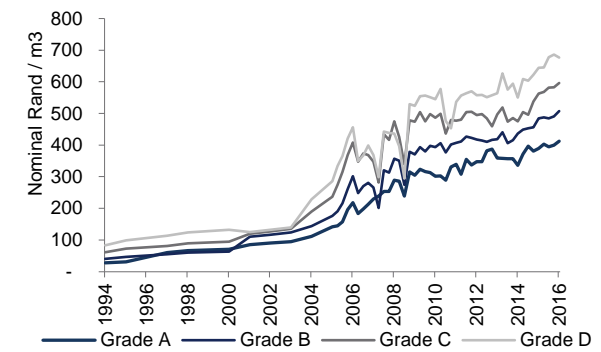
Softwood log prices were also positive (Figure 21). Sawlogs in South Africa are categorized into A, B, C or D grades, with A grade logs being the smallest and D grade logs being the largest. In nominal terms in Q4 (latest data available): A grade logs increased 3.0% for the quarter and 5.9% year-over-year, B grade logs increased 3.3% for the quarter and 4.8% year-over-year, C grade logs rose 2.2% for the quarter and 5.9% year-over-year, and D grade logs declined -1.3% for the quarter, but increased 5.1% year-over-year.

While some of the aforementioned price gains seem steep, it is worth noting that annual inflation in South Africa is around 6.3%, so in real terms most of the gains are less notable. Meanwhile, the rand appreciated around 2.4% year-over-year against the US dollar in Q4 (Figure 22) serving as a tailwind for the aforementioned year-over-year price changes.

**Figure 20. South Africa Lumber Index.** Source: Crickmay and Associates.

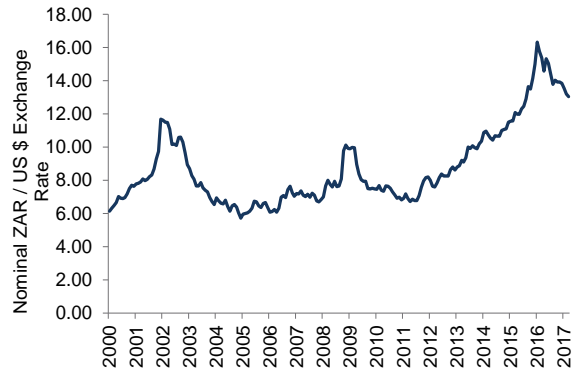


**Figure 21. South Africa Pine Sawlog Prices.** Source: Crickmay and Associates.



**Figure 22. Nominal South Africa Rand to US\$ Exchange Rate.**

Source: Federal Reserve Bank of St. Louis.



## New Zealand

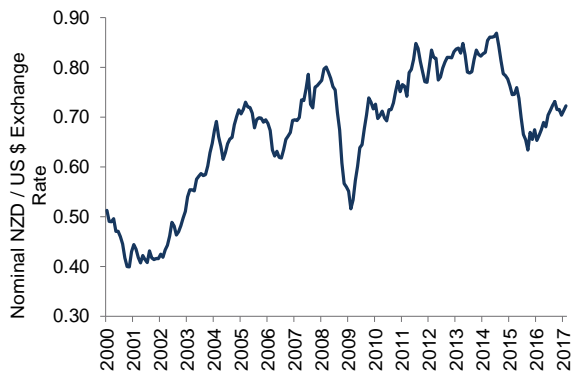
In Q4, New Zealand’s economy slowed versus the prior quarter, with real GDP growing a modest 0.4% quarter-over-quarter versus growth of 0.8% quarter-over-quarter in Q3. Business services increased 1.7% quarter-over-quarter while agriculture declined -0.8% due to declining milk production. Meantime, exports declined -3.8% quarter-over-quarter due to lower exports of dairy products while imports increased 1.9% quarter-over-quarter driven by imports of machinery. In Q4, the New Zealand dollar also appreciated around 1.5% quarter-over-quarter (Figure 23).

### New Zealand timber markets

New Zealand A-grade export logs firmed in December increasing to NZ\$ 157/m<sup>3</sup> from NZ\$ 150/m<sup>3</sup> in September and NZ\$ 111/m<sup>3</sup> in December 2015 (Figure 24). This increase has been driven by improving demand for logs from China (New Zealand’s largest export market), moderate Chinese inventories following the Chinese New Year, and still favorable shipping rates despite recent increases. (As an aside, domestic Chinese sawlog and pulpwood prices modestly declined in Q4 likely due to increased log imports from New Zealand). Meantime, most prices in the domestic log market improved given strength in the housing construction sector (Figure 25).

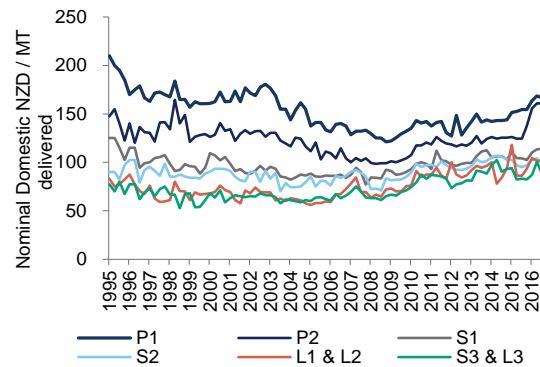
**Figure 23. Nominal New Zealand Dollar to US\$ Exchange**

Rate. Source: Federal Reserve Bank of St. Louis.



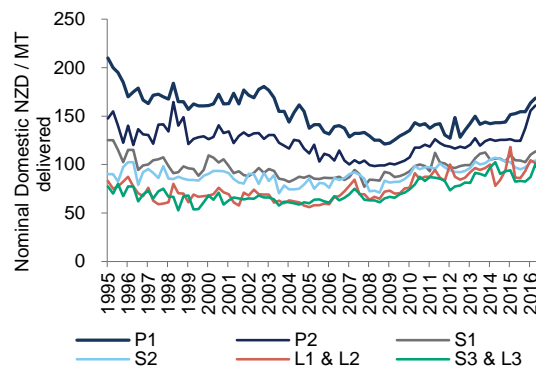
**Figure 24. New Zealand Export Log Prices.** Source: New Zealand

Ministry for Primary Industries.



**Figure 25. New Zealand Domestic Log Prices.**

Source: New Zealand Ministry for Primary Industries.



## Australia

In Q4, Australia’s economy improved versus the prior quarter with real GDP increasing 1.1% quarter-over-quarter versus a decline of -0.5% quarter-over-quarter in Q3. Agriculture, forestry and fishing increased 8.3% quarter-over-quarter due to rises in grains, cotton and livestock production while mining increased 3.4% quarter-over-quarter due to iron ore mining (4.7%), oil and gas extraction (4.4%), and other mining (3.2%). That said, manufacturing declined -1.2% quarter-over-quarter due to machinery and equipment (-7.4%) and metal products (-3.3%). Meantime, exports increased 2.2% quarter-over-quarter while imports increased 1.4% quarter-over-quarter. In Q4, the Australian dollar also appreciated around 1.1% quarter-over-quarter (Figure 26).

### Australian timber markets

Softwood roundwood prices increased 1.3% quarter-over-quarter to US\$ 78/odmt (“oven dry metric ton”) from US\$ 77/odmt in Q3 given improving Chinese demand (Figure 27). That said, hardwood logs declined -1.1% quarter-over-quarter to US\$ 94/odmt from US\$ 95/odmt in Q3 (Figure 28). Both softwood and hardwood chips declined in Q4, falling -1.3% and -3.0%, respectively. Japan reduced its imports of Australian hardwood chips, procuring increasing amounts from both Chile and South Africa.

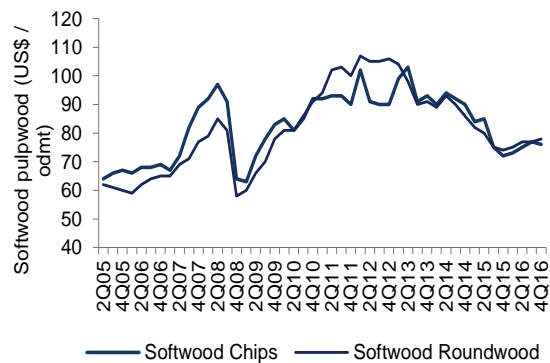
**Figure 26. Nominal Australia Dollar to US\$ Exchange Rate.**

Source: Federal Reserve Bank of St. Louis.



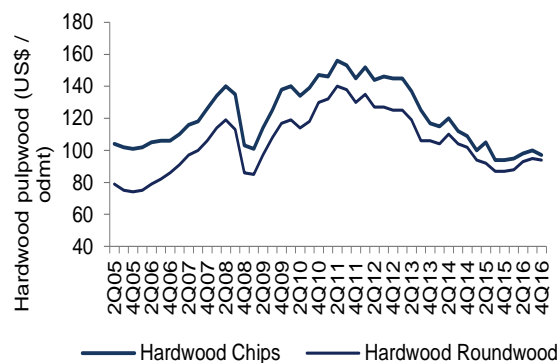
**Figure 27. Australian Softwood Pulpwood Prices.** Source: Wood Resource Quarterly.

Source: Wood Resource Quarterly.



**Figure 28. Australian Hardwood Pulpwood Prices.**

Source: Wood Resource Quarterly.



## Baltic Dry Index

Since the beginning of the year, the Baltic Dry Index, which provides a benchmark for the price of transporting major raw materials including grains, coal, and iron ore by sea, has increased around 35% (Figure 29). The cost of moving these basic raw materials serves as a leading indicator of the state of the world economy. The increase in the index is likely due to improving global demand for commodities coupled with a lower supply of vessels due to recent bankruptcies and weaker charter rates. That said, at an index value of 1,297 on March 31, 2017, the index still remains well below its peak of 11,793 reached in May 2008.

**Figure 29. Baltic Dry Index.**

Source: Bloomberg.





## Global Pulp and Paper Markets

The pulp and paper sectors are a major component of the global forest economy. In countries such as Brazil, Chile, Uruguay and South Africa they constitute the largest segment of the domestic forest sector. The same is true in Asian economies like China and Indonesia. Even in mature regions like North America and Europe, pulp and paper represent the largest single component of the forestry sector.

During Q1, the price of Bleached Softwood Kraft Pulp (“BSK”) in Europe, a bellwether of the pulp and paper sector, averaged around US\$ 816/MT, up 0.9% versus the prior quarter and 3.1% year-over-year (Figure 30). BSK includes both Northern and Southern Bleached Kraft grades (“NBSK” and “SBSK”, respectively).

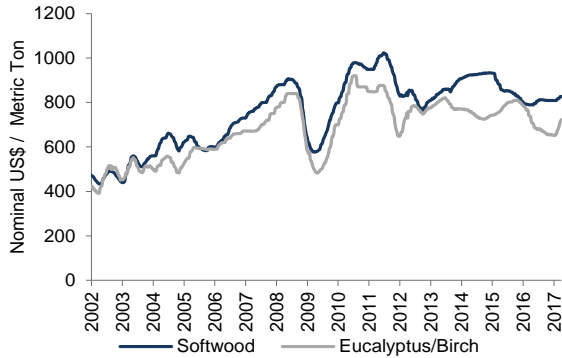
During the quarter, softwood pricing continued to be supported by strong viscose pulp demand which encouraged production at swing wood pulp mills to target viscose pulp rather than papergrade pulp (BSK). The increase in hardwood prices (see below) is also likely causing some substitution into softwood from hardwood causing prices to increase. That said, there is the risk that softwood prices could decline later in 2017 as over 1.0 million MT of new SBSK/fluff capacity continues to ramp up at three new or repurposed pulp lines.

Bleached Hardwood Kraft (“BHK”) prices in Europe, a benchmark, increased 3.9% quarter-over-quarter, but was still lower by -10.8% year-over-year in Q1, averaging around US\$ 680/MT. Prices have improved given better demand and lower inventories.

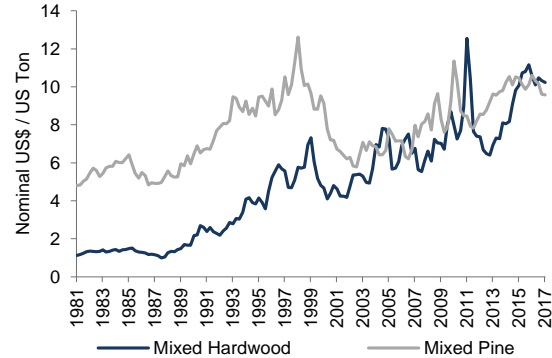
In aggregate, demand conditions in China continue to be healthy while inventories are tight. Per the Pulp & Paper Products Council (“PPPC”), shipments to China increased 15.8% year-over-year in February (and are up 22.6% year-to-date) while global hardwood inventories measured 40 days in February, flat with January, but down from 47 days in February 2016. On the supply front, CMPC halted production at its 1.3mn MT bleached eucalyptus kraft line at its Guaiba mill in Brazil on February 10 due to a water leakage in its recovery boiler, with a total production loss estimated to be around 150,000 MT (production resumed on March 22). Asia Pacific Resources International's 1.5mn MT bleached eucalyptus kraft line at its Rizhao plant in China also ran into a mechanical problem, leading to an insufficient supply of chemicals causing output to be curtailed by 30-35K MT. There is the opportunity for global supplies to further tighten in the near-term given upcoming maintenance downtime between March and June in the northern hemisphere. Longer-term, Brazilian producer Eldorado postponed for the second time the start-up of its new 2.5mn MT bleached eucalyptus kraft line at its existing Três Lagoas mill, in Mato Grosso do Sul state. The company is now targeting a start-up in 2020 versus a prior targeted date of early 2019.

That said, there is the potential for new capacity starts and inventory builds to drive prices lower later this year. Line 1 (1.4mn MT) at APP's Oki mill is currently operating at close to 80% of design capacity (3,200 MT / day versus design of 4,000 MT / day). The company plans to begin production on the other pulp line (1.4mn MT) sometime later this year. Fibria also announced that it is anticipating the start-up of its Horizonte 2 project for September (previously scheduled for October). Meantime, resale pulp prices for most grades have started to decline after peaking in mid-February, which could ultimately translate into broader pulp price weakness.

**Figure 30. Global BSK and BHK Pulp.** Source: FOEX.

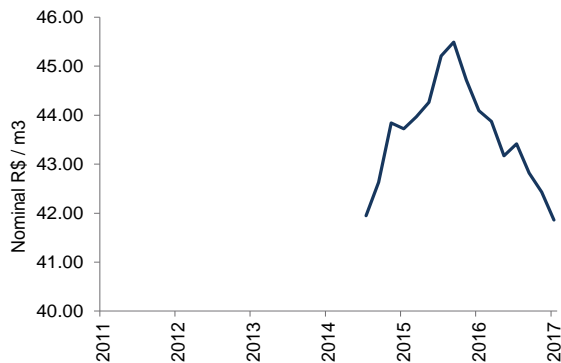


**Figure 31. US Southwide Quarterly Mixed Hardwood and Mixed Pine Pulpwood Prices.** Source: TimberMart-South.

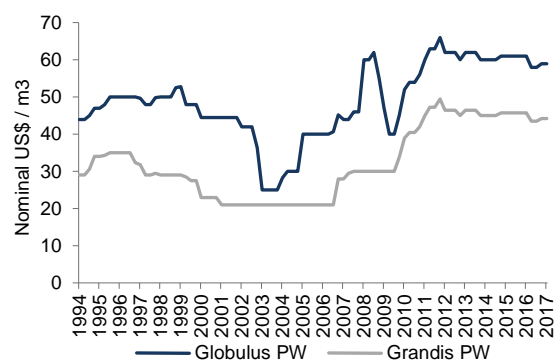


**Figure 32. Brazil Eucalyptus Pulpwood (8-18 cm) Stumpage Prices.** Source: STCP (STCP changed log diameters to 8-18 cm from

8-15 cm during Q416 so revised historical data only extend back to 2014)



**Figure 33. Uruguay E. globulus and E. grandis Pulpwood Prices (Nominal US\$ / m³).** Source: Litenco.



In Brazil, eucalyptus pulpwood prices declined -1.3% quarter-over-quarter (ended February) and -5.1% year-over-year on a countrywide basis (Figure 32). In Uruguay, both *E. globulus* and *E. grandis* pulpwood prices were flat quarter-over-quarter, but declined -3.3% year-over-year in Q1 (Figure 33). In the US South, hardwood pulpwood prices declined -7.2% in Q1 and -22.6% year-over-year while pine pulpwood prices declined -0.3% quarter-over-quarter and -9.8% year-over-year (Figure 31).

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