



Timberland Investment Group Market Report

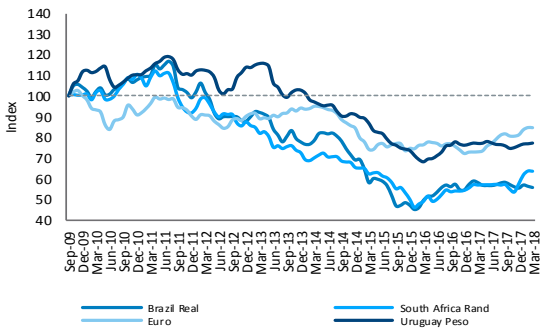
1st Quarter 2018

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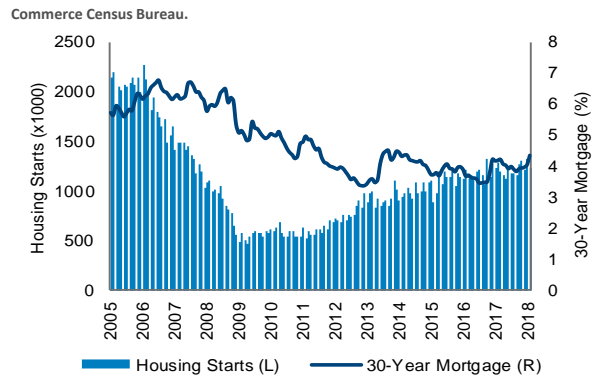
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Timberland Investment Dashboard

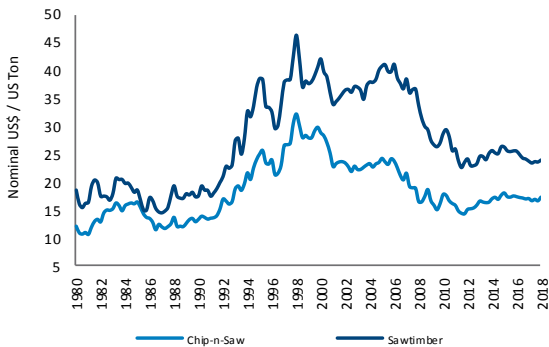
Indexed Exchange Rates of Selected Countries vs. the US Dollar (2009=100). Sources: Federal Reserve Bank; Bloomberg.



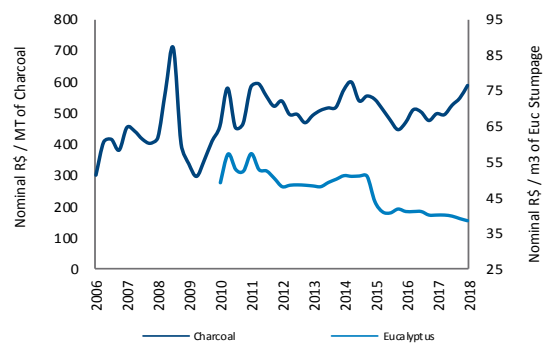
Annual US Housing Starts, Seasonally Adjusted Annual Rate, and 30-year Mortgage Rates. Sources: Federal Reserve Bank; US Dept. of Commerce Census Bureau.



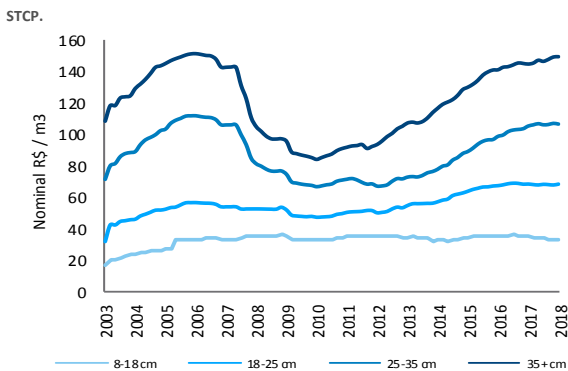
US Southwide Quarterly Pine Chip-n-Saw and Sawtimber Prices. Source: TimberMart-South.



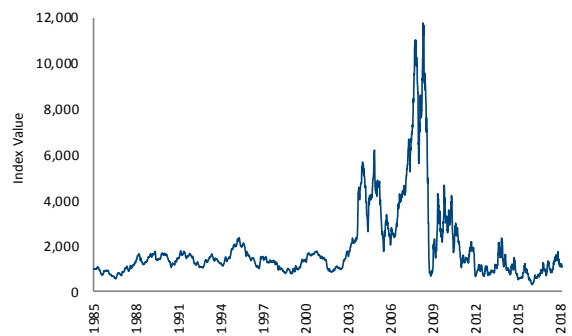
Quarterly Charcoal and Eucalyptus Stumpage Prices in Minas Gerais, Brazil. Sources: Associação Mineira de Silvicultura, Silviconsult.



Pine Sawtimber Stumpage Prices in Paraná State, Brazil. Source: STCP.



Baltic Dry Index. Source: Bloomberg.



Executive Summary

View from the Ground

- In the US South, sawtimber prices were generally stagnant. There were some pockets of modest timber pricing strength in South Carolina, North Carolina, and Virginia, but pricing weakness continued in southwest Arkansas.
- In the US Pacific Northwest, limited timber availability and contractor capacity, stable export demand, and accelerating domestic demand have resulted in tight timber markets and rising timber prices.
- In Brazil, timber demand has notably improved in Minas Gerais given better pig iron demand and strong pulp demand. Elsewhere timber demand has improved given better economic fundamentals while pulpwood remains oversupplied in certain states.

Industrial & Capacity Update

- In the US, lumber producers continue to announce greenfield mills in the South while paper producers continue to shut paper capacity or convert existing paper capacity into growing end-markets such as containerboard. On the mergers and acquisitions front, Potlatch Corp. and Deltic Timber completed their merger to form PotlatchDeltic Corp while WestRock announced its intention to acquire KapStone.
- In Brazil, Suzano announced that it intends to acquire Fibria while Lwarcel announced that it is looking to secure a partner for its mill in Lençóis Paulista, São Paulo state. Klabin announced that it intends to add two new kraftliner and boxboard PMs in 2020 and 2023, respectively, and an entirely new fluff pulp line by 2025.
- In Europe, Metsä Wood's birch plywood in Pärnu, Estonia mill is expected to begin production in the second half of the year. The company also mentioned that it is considering expanding board capacity at one of its three integrated European mills. Drax, the United Kingdom's ("UK") largest power provider, announced that it intends to convert its fourth unit to biomass while Progroup announced that it is considering a new containerboard machine in Germany.

United States

- The US economy expanded at an annual rate of 2.9% in Q4 (real GDP), unemployment remained flat at 4.1% in March versus February, the Institute for Supply Management ("ISM") Purchasing Managers Index declined to 59.3% in March versus 60.8% in February, and February housing starts declined -7.0% over the prior month and -4.0% versus February 2017. However, the overall economic outlook remains positive.
- Southern pine sawtimber prices increased 1.5% for the quarter and 0.8% year-over-year.
- Chip-n-saw prices increased 3.9% sequentially in Q1 and 1.5% year-over-year.
- Southern mixed hardwood sawtimber prices were flat for the quarter, but slightly declined -0.3% year-over-year.
- In the US South, softwood pulpwood prices declined -0.7% quarter-over-quarter and -0.1% year-over-year while hardwood pulpwood prices increased 11.9% quarter-over-quarter and 16.3% year-over-year.

Latin America

- In Q4, Brazil's economy expanded with real GDP increasing a slight 0.1% quarter-over-quarter versus an increase of 0.2% quarter-over-quarter in Q3.
- Brazilian softwood sawtimber prices were mixed, depending on assortment, although larger-diameter sawtimber grades experienced year-over-year gains.
- Brazilian charcoal prices increased 7.4% quarter-over-quarter and have continued a strong upward trajectory into Q2. However, the price of eucalyptus used in charcoal production declined -1.5% quarter-over-quarter, likely due to accumulated timber supply.
- Eucalyptus pulpwood prices in Brazil declined -0.2% for the three months ended February and -0.7% year-over-year.
- Uruguay's real GDP increased at an annualized rate of 2.0% in Q4 versus 1.9% growth in Q3.
- Eucalyptus pulpwood prices in Uruguay were flat quarter-over-quarter in Q1, but increased 1.7% year-over-year.
- Elsewhere in Latin America in Q4, Chile's real GDP increased 3.3% year-over-year, Argentina's real GDP increased 3.9% year-over-year, and Guatemala's real GDP increased 2.9% year-over-year.

Europe

- In Q4, euro zone real GDP increased 0.6% quarter-over-quarter versus 0.7% quarter-over-quarter growth in Q3.
- Gross fixed capital formation grew 0.9% quarter-over-quarter in Q4 while industrial production declined -0.8% month-over-month in February.
- In February, exports increased 3.0% year-over-year while imports increased 1.5% year-over-year.
- In Estonia, pine sawlog prices increased 12.8% from three months earlier and 18.7% year-over-year, while birch sawlog prices increased 1.2% from three months earlier and 6.1% year-over-year.
- Estonian pulpwood prices also improved. Pine pulpwood prices increased 18.1% from three months earlier and 26.3% year-over-year, while birch pulpwood prices increased 15.9% from three months earlier and 33.9% year-over-year primarily due to challenging weather conditions.

South Africa

- In Q4, South Africa's real GDP increased 3.1% quarter-over-quarter following an increase of 2.3% quarter-over-quarter in Q3.
- In February, lumber prices declined -0.3% versus the prior three months, but increased 2.8% from February 2017.
- Softwood log prices were positive. In Q4: A grade logs increased 1.4% for the quarter and 2.4% year-over-year, B grade logs increased 0.2% for the quarter and 6.9% year-over-year, C grade logs rose 2.1% for the quarter and 6.5% year-over-year, and D grade logs increased 2.3% for the quarter and 5.8% year-over-year.

New Zealand / Australia

- In Q4, New Zealand's real GDP grew 0.6% quarter-over-quarter versus growth of 0.6% quarter-over-quarter in Q3.
- New Zealand A-grade export log prices increased in December given improving log demand in China, New Zealand's largest export market. Domestic log prices increased given better demand and limited log supply for some grades.
- In Q4, Australia's real GDP increased 0.4% quarter-over-quarter versus growth of 0.7% quarter-over-quarter in Q3.
- Australian softwood roundwood prices declined partly due to slower residential construction while prices of hardwood logs also declined. Both softwood and hardwood chips moved lower.

Global Pulp & Paper Markets

- In Q1, bleached hardwood kraft pulp (“BHK”) prices increased 7.2% versus the prior quarter and 48.3% year-over-year.
- Prices improved largely due to capacity shifts and mill downtime, which reduced pulp supply.
- Bleached softwood kraft pulp (“BSK”) prices increased 10.8% versus the prior quarter and 29.4% year-over-year.
- During the quarter, softwood pulp pricing increased given steady demand and as softwood producers looked to maintain a positive price spread with hardwood pulp.

*GDP is reported in real terms while timber pricing is reported in nominal terms

**For every country mentioned in this report, real GDP reflects 4Q2017; 1Q2018 real GDP will be released between late April 2018 and mid-July 2018

United States

In Q4, US real GDP expanded at an annual rate of 2.9% versus 3.2% in Q3 (Figure 1). The Q4 increase in real GDP reflected growth in personal consumption, exports, nonresidential fixed investment, residential fixed investment, state and local government spending, and federal government spending. These were partly offset by a negative contribution from private inventory investment. Imports also increased, which subtracted from GDP. The unemployment rate remained flat at 4.1% in March versus February while the change in total nonfarm payroll employment (seasonally adjusted) was 103,000 in March versus 326,000 in February. Meanwhile, the labor force participation rate slightly declined to 62.9% in March from 63.0% in February, continuing to trend along low levels (Figure 2).

Economic activity in the manufacturing sector continued to expand in March, although at a slightly more modest pace. The ISM, a bellwether of manufacturing activity, declined to 59.3% in March from 60.8% in February (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.

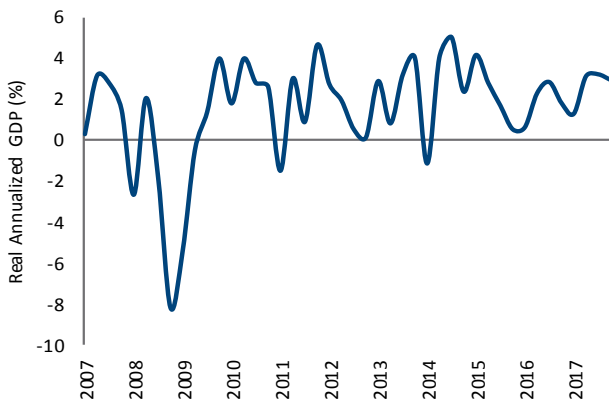


Figure 2. US Unemployment, and Labor Force Participation Rate.

Sources: US Dept. of Labor, BLS.

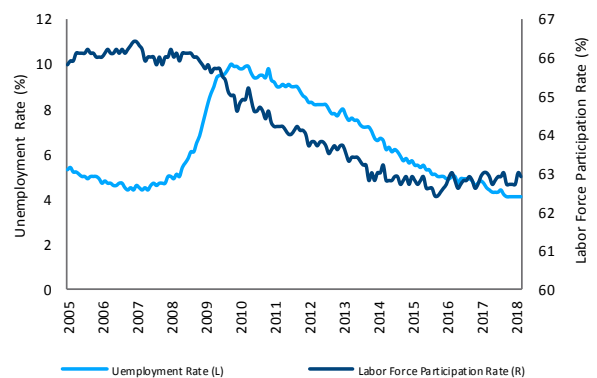
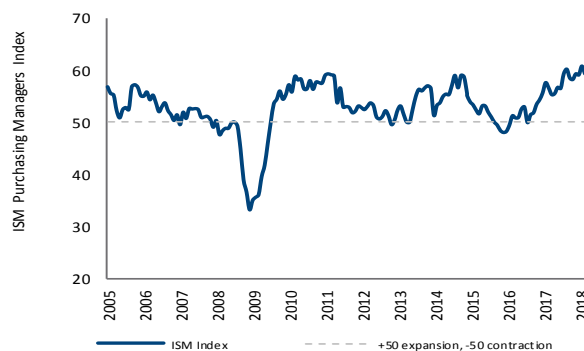


Figure 3. US ISM Purchasing Managers Index.

Source: Institute for Supply Management.



US housing

The US housing market continues to improve, although the recovery is following an uneven pace. In February, housing starts were at a seasonally adjusted annual rate (“SAAR”) of 1.236 million units (Figure 4). This figure is down -7.0% versus January’s 1.329 million units (SAAR) and -4.0% versus February 2017’s 1.288 million starts (SAAR). The share of multifamily starts as a percentage of total starts declined to 27.0% versus 34.0% in January.

New single-family home sales declined -0.6% month-over-month in February (Figure 5). Existing home sales increased 3.0% month-over-month in February (+1.1% year-over-year) to 5.54 million units (SAAR). Inventories of existing homes remained flat at 3.4 months in February versus January, a very low level of inventory by historical standards.

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.

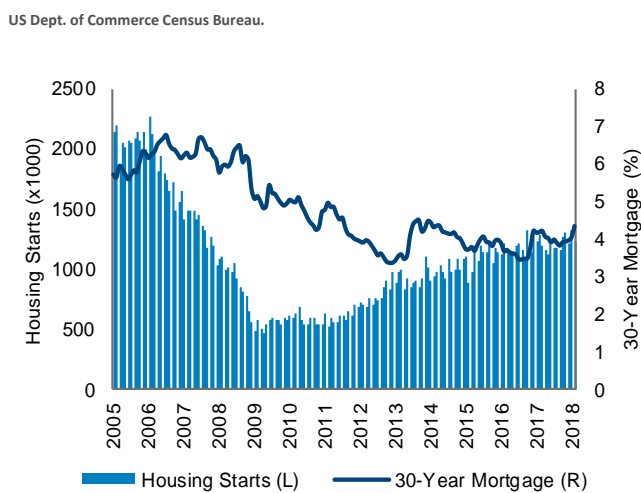
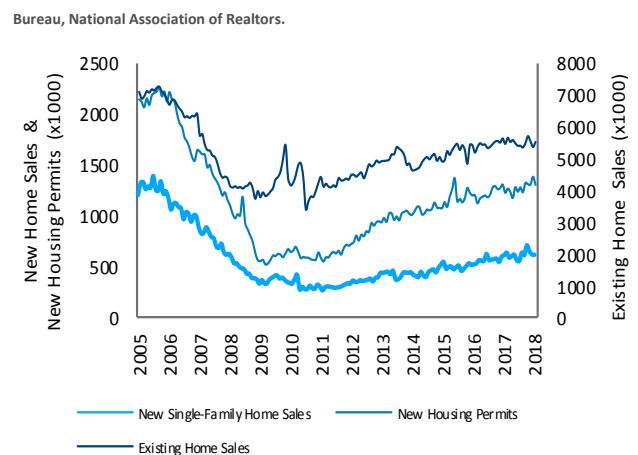


Figure 5. Monthly New Home Sales, New Building Permits, and Existing Home Sales, Seasonally Adjusted Annual Rates. Sources: US Dept. of Commerce Census Bureau, National Association of Realtors.



In February, building permits declined -5.7% month-over-month. This decline was driven by a -14.8% month-over-month decline in multi-family permits and a -0.6% month-over-month decline in single-family permits.

US forest products and timber markets

In aggregate, wood products markets experienced more notable positive pricing momentum than is typical for Q1 given specific market factors. Specifically, average softwood lumber prices increased 11.3% quarter-over-quarter. This compares to a historical average sequential increase of 4.5% over the last decade (Figure 6). After some price weakness in Q4, prices strongly increased in the first quarter due to strong demand, tight inventories, and logistical issues stemming from a lack of available trucks and railcars. During the quarter, the Random Lengths Lumber Index exceeded its previous all-time high of US\$ 510/mbf. Meanwhile, US lumber exports increased 12.0% year-over-year in Q4 (export data are released on a one-quarter lag).

During Q1, structural panel pricing increased 6.0% quarter-over-quarter. This compares to a historical average sequential increase of 3.0% over the last decade (Figure 6). Oriented Strand Board (“OSB”) prices significantly increased during the quarter as order files extended and supplies were limited, partially due to inclement weather that curtailed production. By the end of Q1, North Central 7/16” OSB prices had increased 32.8% to \$405/msf versus \$305/msf at the end of Q4. Meanwhile, Q1 plywood prices were higher than Q4 given lower supplies, steady demand, and tight inventories. By the end of Q1, Southern Plywood 15/32” 4-ply prices had increased 16.7% to \$543/msf versus \$465/msf at the end of Q4.

Figure 6. US Framing Lumber Index and Panel Composite Index.

Source: Random Lengths.

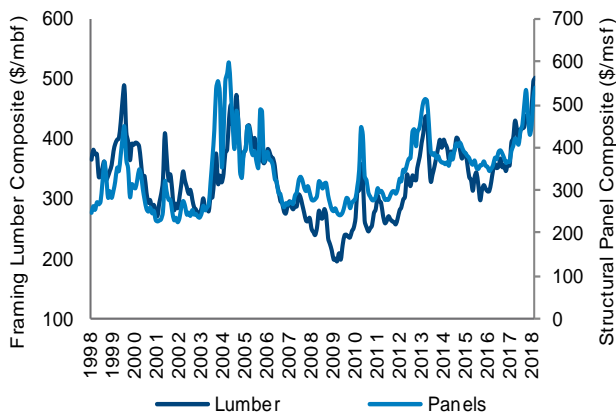
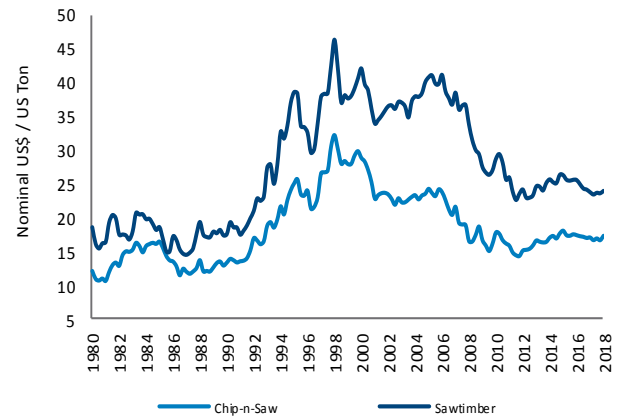


Figure 7. US Southwide Quarterly Pine Chip-n-Saw and Sawtimber Prices. Source: TimberMart-South.



Throughout the US South, pine sawtimber prices increased 1.5% in Q1 and 0.8% year-over-year according to TimberMart-South (Figure 7). Chip-n-saw prices increased 3.9% sequentially in Q1 and 1.5% year-over-year. Pine sawtimber and chip-n-saw prices averaged the highest in Florida and lowest in Tennessee.

Southern hardwood sawtimber prices were mixed during Q1. Region-wide, mixed hardwood sawtimber prices were flat for the quarter, but slightly declined -0.3% year-over-year. Oak sawtimber prices increased 1.0% quarter-over-quarter, but slightly declined -0.3% year-over-year (Figure 8).

In New York’s Adirondack region, northern red oak increased 12.9% quarter-over-quarter, but was flat year-over-year. Hard maple declined -5.9% quarter-over-quarter in Q1, but was flat year-over-year (Figure 9).

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

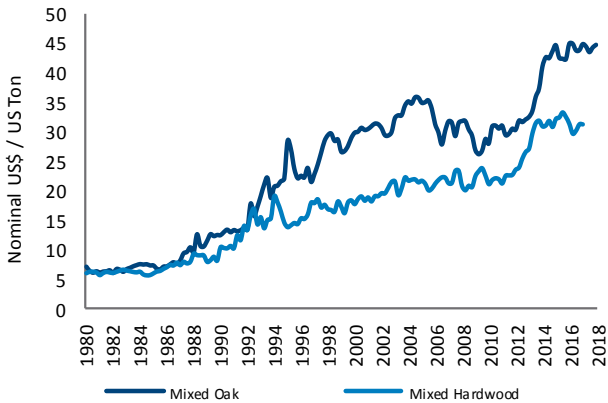
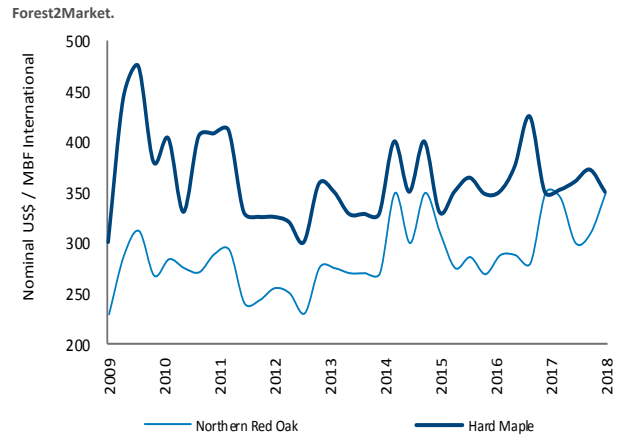


Figure 9. Quarterly Northern Red Oak and Hard Maple Sawtimber Prices in New York. Source: Forest2Market.



In Ohio, red oak increased 20.0% versus Q4 and 47.9% year-over-year. Hard maple declined -10.8% during the quarter, but increased 17.5% year-over-year. White oak increased 12.8% quarter-over-quarter and 43.3% year-over-year (Figure 10).

In Wisconsin, northern red oak was flat quarter-over-quarter in Q1, but increased 22.1% year-over-year (Figure 11). Hard maple was flat quarter-over-quarter, but increased 3.5% year-over-year. Yellow birch sawtimber was flat quarter-over-quarter in Q1, but declined -4.2% year-over-year.

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

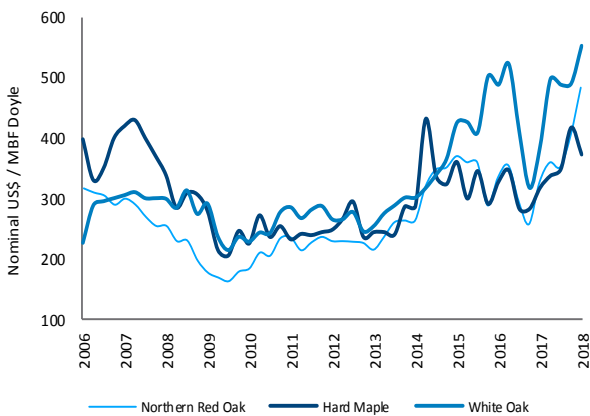


Figure 11. Northern Red Oak, Hard Maple, and Yellow Birch Sawtimber Prices in Wisconsin. Source: Steigerwaldt and Burns.



In the Pacific Northwest, softwood sawlog prices increased across all grades. The price of Douglas-fir #2 increased 5.8% sequentially and 30.6% year-over-year (Figure 12). As of February 2018 (latest data available), Douglas-fir #2 is now 14.3% higher than its prior 2014 peak. The price of Whitewood #2 logs increased 6.8% for the quarter and 29.3% year-over-year. As of February 2018, Whitewood #2 is now 7.4% higher than its prior 2014 peak. In December 2017 (the latest available data), total softwood log exports to China increased 14.6% year-over-year to 96.94mmbf from 84.60mmbf in December 2016, softwood log exports to Japan increased 44.1% year-over-year to 28.71mmbf from 19.93mmbf in December 2016, and softwood log exports to South Korea declined -49.2% year-over-year to 5.87mmbf from 11.56mmbf in December 2016.

In the US South, hardwood pulpwood prices increased 11.9% in Q1 and 16.3% year-over-year while pine pulpwood prices declined -0.7% quarter-over-quarter and -0.1% year-over-year (Figure 13).

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

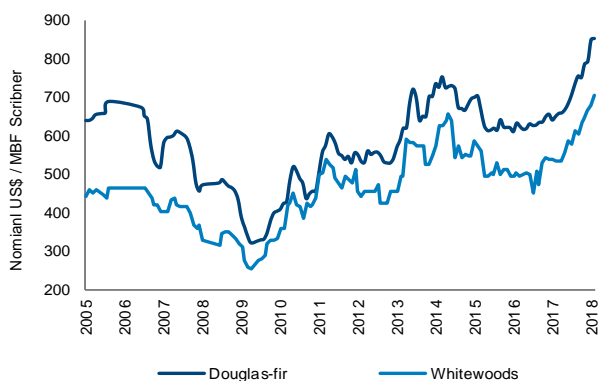
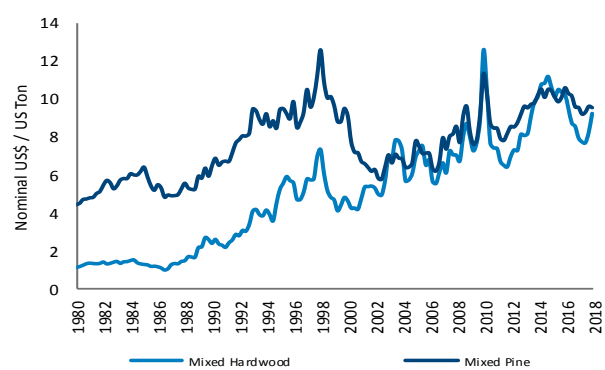


Figure 13. US Southwide Quarterly Mixed Hardwood and Mixed Pine Pulpwood Prices. Source: TimberMart-South.



Industrial & Capacity Update

As noted in our prior research (“Canadian Lumber Producers in the US South”), Georgia-Pacific announced two greenfield mills in the US South: a new 350mmbf sawmill in Warrenton, GA for US\$ 135 million targeted for start-up in the Spring of 2019 and a new 300mmbf sawmill in Talladega, AL for US\$ 100 million targeted for start-up in 2018, Canfor announced the construction of a new US\$ 120 million lumber mill (275mmbf) in Washington, GA with production expected to begin in Q319, and Rex Lumber announced the construction of a new US\$ 110 million lumber mill (240mmbf) in Troy, AL with production expected to begin in 2019 or 2020. Similarly, Tolko announced a joint venture with Hunt Forest Products to build a new US\$ 115 million lumber mill (200mmbf) near Urania, LA with production expected to begin in 2019. The new mill is expected to consume around 850,000 tons of timber annually. In mid-February, Potlatch Corp. and Deltic Timber completed their merger to form PotlatchDeltic Corp, a REIT with nearly around 1.9 million acres of timberland (1.1 million acres in the US South; 600k acres in Idaho; 150k acres in Minnesota), 1.2bbf of lumber capacity, and 300mmsf of panels capacity (plywood and medium density fiberboard).

In paper and board, Verso announced plans to convert the shuttered pulp line and No. 3 paper machine (200,000 tons) at its Androscoggin Mill in Jay, Maine from graphic paper, faced with secular decline, to packaging (190,000-200,000

tons), a growing end-market. Midwest Paper Group (formerly Appleton Coated), a coated paper producer that went into receivership, restarted its third paper machine in late March and began to produce recycled medium, linerboard and specialty packaging grades. Meanwhile, Domtar permanently closed the NC-2 fluff pulp production line at its Plymouth, NC market pulp mill, reducing the company's market pulp capacity by around 80,000 MT, while Kimberly-Clark announced plans to close its Fullerton, CA tissue mill (66,000 tons) as part of its new restructuring program. On the mergers and acquisitions front, WestRock, a multinational provider of paper and packaging solutions for consumer and corrugated packaging markets, announced the acquisition of KapStone, a North American producer and distributor of containerboard, corrugated products and specialty papers for around US\$ 4.9 billion. In March, International Paper, a global producer of renewable fiber-based packaging, pulp and paper products, made a bid, subsequently revised higher, to acquire Smurfit Kappa, Europe's biggest producer of containerboard, corrugated containers and some other paper-based packaging products for around US\$ 11 billion. Smurfit Kappa's board rejected International Paper's unsolicited proposals.

Separately, in February, German Pellets received permission from the Texas Eastern Bankruptcy Court to sell its pellet plant in Woodville, Texas. There has also been some speculation that Sun Paper, which has decided to build a new 700,000 MT fluff pulp mill in Clark County, AR, is now contemplating adding linerboard production as well. While the company has yet to confirm or deny this, any linerboard production would first require amendments to its existing environmental permit applications.

View from the Ground

BTG Pactual Timberland Investment Group ("TIG") regional asset managers regularly report on conditions that impact wood pricing in their operating areas. In South Carolina and North Carolina, activity improved in Q1 given better forest products and paper demand, causing timber prices to marginally increase. In Georgia, Northeast Florida, and Alabama demand was more muted resulting in flat timber prices. Concerns continue to exist that timber prices could decline in the spring as drier weather will increase the stock of operationally accessible timber.

In East Texas, pulpwood is oversupplied and mills are on quota given the amount of available timber. Some of this excess may be absorbed by Roy O. Martin's new OSB mill in Corrigan, Texas, which started pressing boards the last few weeks and which is expected to begin production soon after the mill gets its boards certified. In early April, the mill began taking roundwood deliveries and could consume around 1.0-1.2 million tons of pulpwood at full production. Further, a potential restart of the idled German Pellets pellet plant in Woodville, Texas could consume around 1.0-1.2 million tons of pulpwood when fully restarted. Similarly, the sawnwood market remains oversupplied with mills having ample inventories. Late last year, mills purchased significant amounts of wood and have spent the last few months working through those inventories while making minimal market purchases.

In Southwest Arkansas, Domtar's Ashdown mill has laid off most of its contractors thereby minimizing direct purchases of wood. As a result, pulpwood prices have declined to \$8.50-9.50/ton currently from around \$11-12/ton last year. To offset this, some contractors have been selling pulpwood to International Paper's mill in Valliant, Oklahoma.

In Virginia, demand improved toward the end of the quarter with timber sales occurring at or above appraisal value. That said, timberland owners are increasingly focused on WestRock, which will control the four largest integrated board mills in Virginia following the closing of its acquisition of KapStone.

In Ohio, demand for hardwood sawtimber remains strong given growing end markets including whiskey barrels, railroad ties, flooring, and furniture. In recent months, there has been an increase in the amount of 6' white oak logs being exported to China. There is also some concern about a potential closure of Glatfelter's Chillicothe mill as the company explores strategic options for its specialty papers business.

In Appalachia, demand for quality hardwood sawtimber continues to be strong given growing end markets including railroad ties. As such, a number of sales have attracted multiple bidders with offers exceeding appraisal value.

In Central Alabama, sawtimber demand remains steady discouraging mills from putting loggers on quota. Greenfield mills from Rex Lumber and The Westervelt Company should also help sawtimber demand.

In Wisconsin, timber demand was muted as mills worked through inventories built late last year. Timber demand is expected to improve in late Q2 as mills look to restock depleted inventories.

In the Pacific Northwest, limited timber availability and contractor capacity, stable export demand, and accelerating domestic demand have resulted in tight timber markets and rising timber prices. Favorable conditions are expected to persist until at least mid-2019.

US Softwood Lumber Duties

In response to the US Department of Commerce's ("DOC") final countervailing ("CVD") and antidumping duties ("AD") of 20.83% on imports of Canadian softwood lumber, the World Trade Organization has agreed to establish two panels to analyze Canada's complaint. The first panel is set to explore the actual dispute and the second panel is set to review the US's use of differential pricing methodology in its anti-dumping determinations.

US Paper Duties

In March, the DOC issued a preliminary determination in its antidumping investigation into newsprint and uncoated groundwood ("UM") imports from Canada. The DOC calculated a preliminary dumping rate of 22.16% for all producers, but exempted White Birch and Resolute Forest Products, two companies that were individually investigated. This determination follows the imposition of CVD that US Customs and Border Protection began collecting in January, after determining that Canadian newsprint and UM producers benefit from unfair subsidies. The DOC is expected to announce its final determination around August 2nd while the US International Trade Commission is expected to make a final determination around mid-September.

US Trade Tariffs

In March, the US Trade Representative announced a list of Chinese products, amounting to around US\$ 50 billion, that could be assessed a 25% tariff. A final tariff determination is set for late May. While at present none of the products listed include timber-related finished end products such as market pulp, the tariffs do apply to machinery and equipment used in the pulp, paper, and paperboard production processes.

Latin America

Brazilian economy

In Q4, Brazil’s economy expanded with real GDP increasing a slight 0.1% quarter-over-quarter following a 0.2% quarter-over-quarter increase in Q3. Industrial activity increased 0.5% quarter-over-quarter, service activity increased 0.2% quarter-over-quarter, and agriculture was flat quarter-over-quarter. Investment increased 2.0% quarter-over-quarter following a 1.8% quarter-over-quarter increase in Q3. BTG Pactual’s Brazilian Economics team currently expects 2018 real GDP of 2.9% and 2019 real GDP of 3.1% spurred by easier monetary conditions and improving consumption and investments.

As part of this modest improvement, household spending increased 0.1% quarter-over-quarter in Q4 versus 1.1% quarter-over-quarter growth in Q3. Unemployment increased to 12.6% in February from 12.2% in January and 11.8% in December. Moreover, industrial production increased 2.8% year-over-year in February after increasing 5.8% year-over-year in January.

In March, inflation (Índice de Preços ao Consumidor Amplo or “IPCA”) declined to 2.68% annualized from 2.84% annualized in February (Figure 14). Real rates have also trended lower as evidenced by declining Treasury inflation-protected bond yields (Figure 15). In March, Brazil’s central bank cut the Selic rate by another 25bps to 6.50%, as inflation continues to slow and the government looks to spur economic growth.

Meanwhile, exports declined -0.9% sequentially in Q4 following a 3.3% quarter-over-quarter increase in Q3. Imports increased 1.6% sequentially after increasing 6.5% in Q3. Separately, in Q1, the real slightly appreciated 0.2% sequentially (Figure 16).

Figure 14. Brazilian SELIC Rate and Annualized IPCA Index.

Source: Banco Central do Brasil, Brazilian Institute of Geography and Economics.

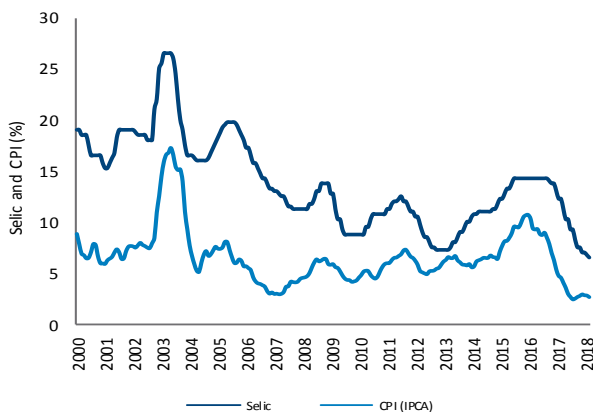


Figure 15. Brazilian Treasury Inflation Protected Bond Yield. Source: Brazil National Treasury.



Figure 16. US Dollar: Brazilian Real Daily Exchange Rates.

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



On the political front, Brazil’s Supreme Court rejected former president Luiz Inacio Lula da Silva’s request to remain free while he appeals his graft and money laundering conviction as part of the continuing Lava Jato (“Car Wash”) scandal and he was sent to jail. And, although Lula da Silva also announced that he intends to run for Brazil’s presidency during the upcoming October 2018 presidential elections, Brazilian law states that anyone who has a criminal conviction that has been upheld in an appellate court is unable to run for elected office. Meanwhile, police arrested a number of individuals (one of them a former adviser to President Michel Temer) in connection with an investigation into whether President Temer accepted bribes for favors to a company operating Brazil’s largest port. On February 27, prosecutors revoked a plea deal signed by Wesley Batista, former CEO of JBS, the world’s largest meat company, claiming he intentionally hid information regarding criminal activities. Wesley and his brother Joesley co-own J&F Group, the holding company of JBS, which has been accused of making illegal payments to politicians. In addition, the military was placed in charge of Rio de Janeiro’s security forces to combat rising crime.

Separately, in early February, the government decided to delay pursuing pension reform as legislators have been unsupportive of passing austerity measures during an election year. As a result, Fitch downgraded Brazil’s credit rating to BB-, three notches below investment grade, citing persistent and large fiscal deficits, a high and growing government debt burden and the failure to legislate public finance reforms. At this juncture, it is unlikely that any significant changes will occur before Brazil general elections in October.

Industrial & Capacity Update

During the quarter, Suzano announced that it intends to acquire Fibria. The acquisition was approved by Fibria’s controlling shareholders, BNDES and Votorantim SA. This combination will create a global pulp leader with combined capacity of 11 million MT of pulp equating to 16% of the global pulp market and around 32% of global bleached hardwood pulp market.

Meanwhile, bleached eucalyptus kraft pulp producer Lwarcel announced that it is looking to secure a partner for its 250,000 MT mill in Lençóis Paulista, São Paulo state and to build a new 1.5 million MT pulp mill in the country. The

company is contemplating both domestic and foreign companies as partners including Arauco, Altri, Ence, and The Navigator Company. Last, Klabin announced that it intends to add two new 400,000-500,000 MT kraftliner and boxboard PMs in 2020 and 2023, respectively, and an entirely new fluff pulp line estimated at 400,000 MT by 2025.

Brazilian forest products and timber markets

The price of pine timber in Brazil was mixed during the quarter. Through the end of February, pulpwood (8-18 cm) in Parana State increased 0.5% quarter-over-quarter, but declined -4.5% year-over-year in local currency terms. Small sawtimber (18-25 cm) increased 0.8% quarter-over-quarter, but slightly declined -0.1% year-over-year while large-diameter sawtimber (25-35 cm) slightly declined -0.4% quarter-over-quarter, but increased 1.2% year-over-year. Veneer logs (+35 cm), used primarily for export-oriented softwood plywood, increased 0.1% quarter-over-quarter and 3.2% year-over-year (Figure 17). The price of larger diameter sawtimber continues to be driven by exports, particularly plywood and lumber.

The global steel sector remains somewhat challenged due to excess steel capacity and modest Chinese demand. This continues to negatively impact global industrial wood charcoal, which is used to produce pig iron which in turn is used to make steel. That said, charcoal prices in Minas Gerais increased 7.4% quarter-over-quarter in Q1 (18.3% year-over-year) and have continued a strong upward trajectory into early Q2, given lower charcoal supply (e.g., fewer producers as a result of the downturn) and an improvement in durable goods such as automobiles (Figure 18, left axis). Charcoal pricing is normally reflected in the price of eucalyptus stumpage (Figure 18, right axis). However, in Q1, Minas Gerais eucalyptus prices declined -1.5% quarter-over-quarter and -4.0% year-over-year, likely a reflection of continued accumulated timber supply in the region.

Figure 17. Pine Sawtimber Stumpage Prices in Paraná State, Brazil. Source: STCP.

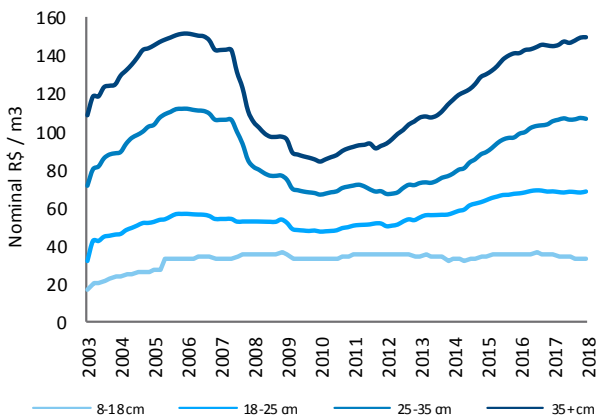
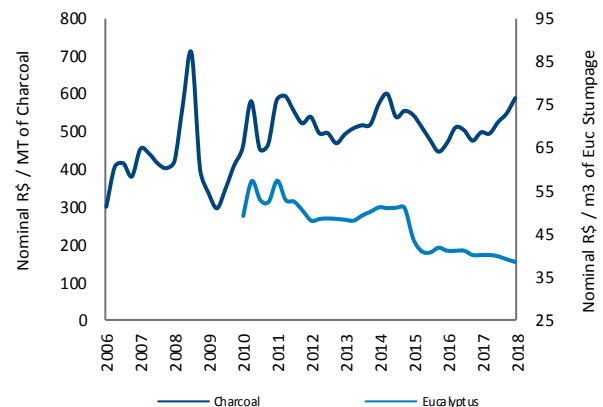


Figure 18. Charcoal and Eucalyptus Stumpage Prices in Minas Gerais, Brazil.

Sources: Associação Mineira de Sicultura; Poyry Silviconsult.



Meantime, eucalyptus pulpwood prices declined -0.2% quarter-over-quarter (ended February) and -0.7% year-over-year on a countrywide basis (Figure 19).

The price of pine resin, a secondary product that can be collected from pine plantations between harvests and is used in the production of synthetic rubber, glues, adhesives, printer inks, and other products, was positive during Q1. Mixed tropical pine resin increased 13.2% quarter-over-quarter while slash pine resin increased 13.1% quarter-over-quarter (Figure 20).

Figure 19. Brazil Eucalyptus Pulpwood (8-18 cm) Stumpage Prices. Source: STCP.

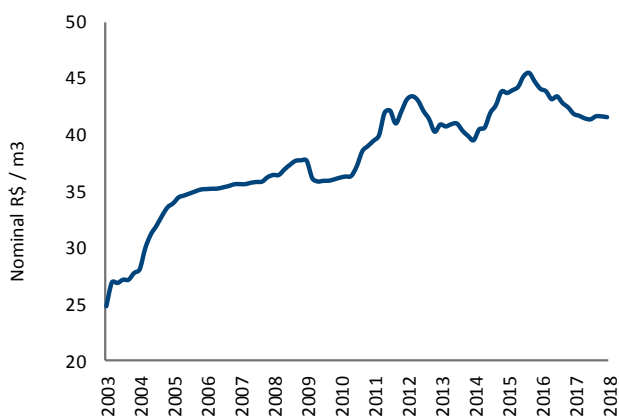
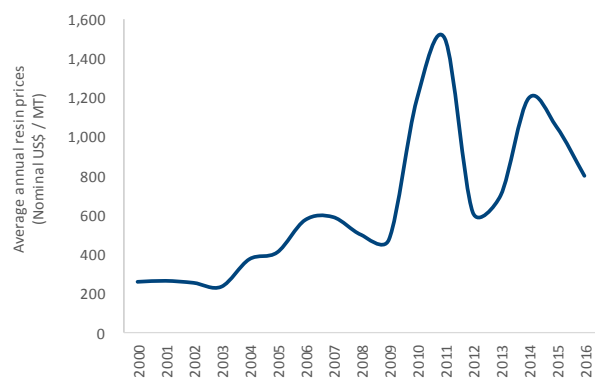


Figure 20. Average Annual Resin Prices in Brazil.

Source: Associação dos Resinadores do Brasil



View from the Ground

Similar to US asset managers, TIG’s Brazilian regional asset managers regularly report on conditions that impact wood pricing in their operating areas. In aggregate, improving Brazilian economic conditions have resulted in better timber conditions in most Brazilian states.

In Minas Gerais, the improvement in timber demand that began in 2H 2017 has persisted into 2018 resulting in higher stumpage prices. In 2017, independent pig iron producers produced around 3.14 million MT of pig iron. In this first three months of this year, those producers produced around 850,000 MT, which equates to around 3.4 million MT annualized, or roughly 8% higher than 2017. Moreover, through February 2018, automobile production has increased 15.1%. While there is some concern around the recent 25% ad valorem steel tariff the US has imposed on steel imports into the US, it appears that the tariff only applies to the finished product, steel, and does not apply to pig iron, which is a raw material used to make steel. Meanwhile, pulp demand remains robust with mills aggressively looking for timber.

In São Paulo (Itapeva region), demand for pulpwood, partially due to an improving packaging market, and sawnwood remain strong. According to the ABPO (Brazilian Corrugated Board Association), shipments of corrugated board, which are used to package a variety of goods, increased 3.9% year-over-year in February following an increase of 5.1% year-over-year in January. With respect to sawnwood, demand continues to increase, rising 3.4% year-to-date according to Ibá (Brazilian Tree Industry). That said, pulpwood supply still remains elevated as the large area of new plantations established in 2007-2009 have started to reach harvestable age.

Similar to the other regions, Parana is benefiting from improving economic fundamentals and timber demand. In Guarapuava, demand has developed for a new 13-18 centimeter log assortment for plywood (Chinese peelers) as compared to the traditional 18-25 centimeter. That said, the area is faced with a surplus of standing pulpwood similar to the situation in São Paulo. Moreover, Arauco owns a number of wood panels facilities and large plantations in the region and tends to be very competitive on pricing with respect to larger diameter logs (e.g., given that Arauco’s panels plants consume smaller diameter logs, the company sells larger diameter logs in the market).

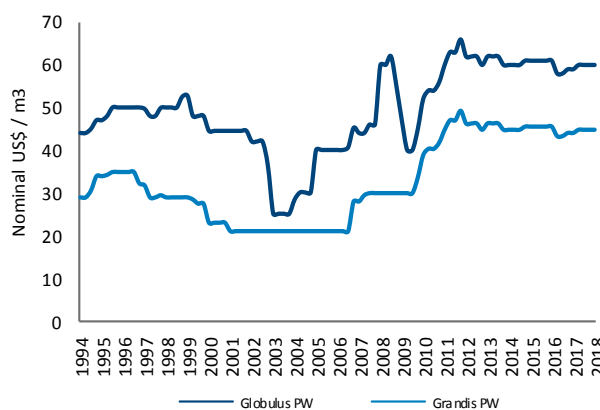
In Santa Catarina, timber demand is improving, but timber supply has increased as tree plantations established around the same time are beginning to be harvested. Moreover, timber demand is concentrated among a limited number of buyers, which tends to make it difficult for timberland owners to increase prices.

Uruguay

In Q4, Uruguay’s real GDP increased 2.0% year-over-year versus 1.9% year-over-year growth in Q3. Commercial activities increased 6.5% year-over-year while transportation increased 6.3% year-over-year. Gross fixed capital formation declined -6.3% year-over-year in Q4 versus a decline of -16.4% year-over-year in Q3 while household spending increased 4.6% year-over-year versus an increase of 4.1% year-over-year in Q3. Exports increased 7.0% year-over-year versus an increase of 8.1% year-over-year in Q3 while imports increased 6.0% year-over-year versus an increase of 3.1% year-over-year in Q3. During Q4, the Uruguayan peso depreciated around -2.2% year-over-year.

In Uruguay, both E. globulus and E. grandis prices were flat quarter-over-quarter in Q1, but increased 1.7% year-over-year (Figure 21). Meantime, in Q4 (latest available data), Uruguayan plywood exports to the US increased 47.1% year-over-year while Uruguayan lumber exports to the US increased 10.1% year-over-year.

Figure 21. Uruguay E. globulus and E. grandis Pulpwood Prices (Nominal US\$ / m3). Source: Litenco.



During the quarter, the Rohatyn Group announced the sale of 17,000 hectares of pine and eucalyptus timberland and 8,000 hectares of other lands with an estimated value of US\$ 100-150 million. The timberland had been owned by GMO Renewable Resources before the company was acquired by The Rohatyn Group at the end of December.

Chile

In Q4, Chile's real GDP increased 3.3% year-over-year following 2.5% year-over-year growth in Q3. Mining increased 6.8% year-over-year with copper increasing 7.9% year-over-year while utilities increased 5.4% year-over-year. That said, agriculture declined -0.7% year-over-year. Meanwhile, gross fixed capital formation increased 2.7% year-over-year, government spending increased 3.4% year-over-year, and consumer spending increased 3.0% year-over-year. Exports increased 2.5% year-over-year while imports increased 5.2% year-over-year. Exports increased despite a 1.4% sequential appreciation in the Chilean peso versus the US dollar in Q4.

On the political front, in March, conservative Sebastian Pinera, a former president of Chile, returned to Chile's presidency after winning the election in December. In April, Chile's Finance Minister Felipe Larraín announced fiscal austerity measures totaling US\$ 500 million to take place over four years including eliminating some spending programs.

Argentina

In Q4, Argentina's economy improved with real GDP increasing 1.0% quarter-over-quarter versus 0.8% growth quarter-over-quarter in Q3. On a year-over-year basis, real GDP increased 3.9% versus 3.8% growth year-over-year in Q3. Argentina's year-over-year improvement is the result of a 4.8% year-over-year increase in private consumption and 20.7% year-over-year increase in investments, largely driven by notably stronger machinery and equipment (32.2% year-over-year) and construction (19.5% year-over-year). During Q4, exports increased 0.4% year-over-year, partially as the Argentinian peso depreciated -13.6% year-over-year (-1.5% sequentially) against the US dollar.

On the economic front, Argentina's Congress passed tax reform late last year with the main goal being to reduce the corporate income tax rate. For 2018 and 2019, the corporate income tax rate declines to 30% from 35%. Beginning in 2020, the corporate tax rate is permanently set at 25%. To address government spending, President Mauricio Macri eliminated governmental pay increases as well as around 1,000 political positions with the goal being to save the government around US\$ 75 million.

Guatemala

In Q4, Guatemala's real GDP increased 2.9% year-over-year versus 2.7% year-over-year growth in Q3. All industries generally improved versus the prior year except mining & quarrying which declined -41.8% year-over-year. Exports increased 0.4% year-over-year in Q4 versus an increase of 1.8% year-over-year in Q3 while imports increased 1.6% year-over-year in Q4 versus a decline of -1.2% year-over-year in Q3. During Q4, the Guatemalan quetzal appreciated around 2.2% year-over-year.

Europe

In the euro zone, Q4 real GDP increased 0.6% quarter-over-quarter as compared to 0.7% quarter-over-quarter growth in Q3. Year-over-year, real GDP increased 2.7%. On an individual country basis, growth slightly increased in France, was flat in Spain, and slightly declined in Germany and Italy.

Gross fixed capital formation grew 0.9% quarter-over-quarter in Q4 versus a decline of -0.2% quarter-over-quarter in Q3. Personal consumption increased 0.2% quarter-over-quarter while government spending grew 0.3% quarter-over-quarter, both slightly below the prior quarter. Unemployment slightly declined to 8.5% in February from 8.6% in January.

Industrial production declined -0.8% in February after declining -0.6% month-over-month in January. This decline is due to production of capital goods falling by -3.6%, durable consumer goods declining by -2.1%, intermediate goods falling by -0.8%, and non-durable consumer goods decreasing by -0.5%, while production of energy increased by 6.8%.

March's Composite Purchasing Manager's Index declined to 55.2 in March from 57.1 in February primarily due to a deceleration in new order growth, inclement weather in some northern regions, and supply-chain constraints. That said, backlogs remain strong and job growth has continued.

Meantime, European net exports (exports less imports) increased year-over-year. In February (latest month reported), exports increased 3.0% year-over-year while imports increased 1.5% year-over-year, resulting in a euro zone trade surplus of €18.9 billion versus a surplus of €16.1 billion in February 2017.

Estonian forest products and timber markets

During the last few months, sawlog prices in Estonia have improved. Pine sawlog prices (latest data available February 2018) increased 12.8% from three months earlier and 18.7% year-over-year. Birch sawlog prices increased 1.2% from three months earlier and 6.1% year-over-year (Figure 22).

Estonian pulpwood prices also increased. Pine pulpwood prices (latest data available February 2018) increased 18.1% from three months earlier and 26.3% year-over-year while birch pulpwood prices increased 15.9% from three months earlier and 33.9% year-over-year (Figure 23). Prices have jumped given limited harvests (and less wood flow) from Sweden due to challenging weather conditions.

Figure 22. Estonia Sawlog Prices (Nominal € / m³).

Source: RMK (Estonia State Forest Agency).

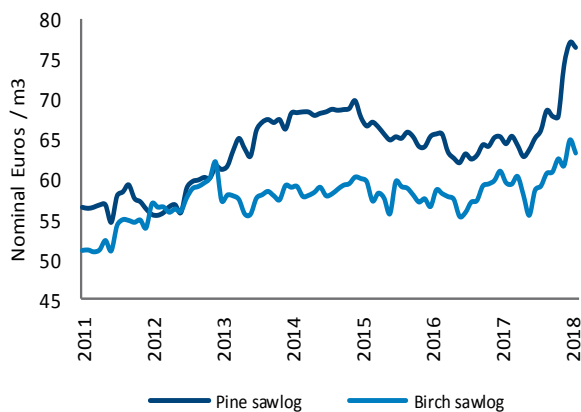
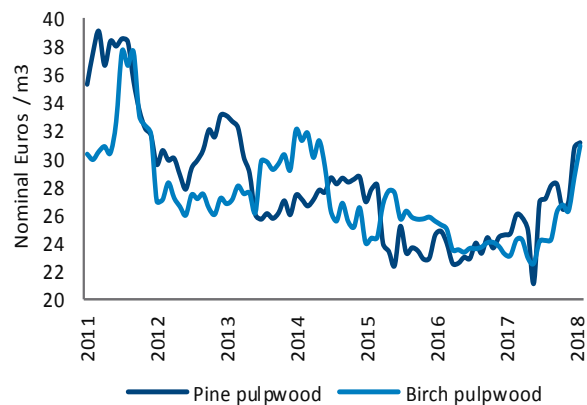


Figure 23. Estonia Pulpwood Prices (Nominal € / m³). Source: RMK (Estonia State Forest Agency).



Industrial & Capacity Update

During Q1, Progroup announced that it is considering a new 750,000 MT containerboard machine in Germany with production targeted to begin in 2021. The company is also exploring adding four corrugated board plants over 2019-2021 in Central Europe.

Meanwhile, Metsä Wood's birch plywood in Pärnu, Estonia mill is expected to begin production in the second half of the year. The company expects the mill to ultimately produce 50,000 m³ of plywood. Metsä has also begun to make progress on the construction of a new 65,000 m³ Kerto® LVL line to its Punkaharju mill, which is anticipated to increase log demand by 160,000 m³ annually. Metsä has ordered around €23 million in equipment including peeling, drying, LVL lay-up, pre-pressing and pressing lines as well as services related to installation and commissioning. The start-up of the new line is expected to occur at the beginning of 2019. Last, the company mentioned that it is considering expanding board capacity at one of its three integrated European mills – the Kemi or Äänekoski mills in Finland or the Husum mill in Sweden.

Further, Drax announced that it intends to convert its fourth unit to biomass from coal after completing favorable subsidy consultations with the UK government. Specifically, the UK government proposed a modification to the Renewables Obligation ("RO") subsidy scheme allowing for a cap to be imposed across all RO-supported units at a power station rather than just setting a cap on support under the RO scheme for any new biomass unit conversions. Drax plans to complete its conversion in the second half of 2018.

In March, Estonia's Tartu City Council cancelled a planning procedure necessary for Est-For to proceed with its proposed US\$ 1.24 billion pulp mill (700,000 MT) and biorefinery in Estonia. The city council cited environmental concerns about the project and that the process for preparing the plan and assessing the impact was not sufficiently transparent or inclusive.

South Africa

In Q4, South Africa's real GDP increased 3.1% quarter-over-quarter following an increase of 2.3% quarter-over-quarter in Q3. The agriculture, forestry, and fishing industry continued on a strong trajectory growing 37.5% quarter-over-quarter while trade, catering and accommodation increased 4.8% quarter-over-quarter.

On February 14, the ruling African National Congress ("ANC") forced then President Jacob Zuma, plagued by numerous scandals and declining support, to resign. Following his resignation, Cyril Ramaphosa, who was only elected leader of the ANC in December, was elected South Africa's president. Since the election, President Ramaphosa has begun to replace some Zuma loyalists in the Cabinet, reinstating Nhlanhla Nene, who Zuma replaced in 2015, as finance minister and Pravin Gordhan, who Zuma dismissed, as public enterprises minister overseeing six of the largest state companies that are mostly financially strapped and mired in graft allegations. On February 27, South African lawmakers voted in favor of a motion to expropriate white-owned land without compensation for redistribution. A November government land audit showed that whites owned 72% of the 37 million hectares held by individuals, more than two decades after the end of white-minority rule. Parliament's Constitutional Review Committee will follow-up with lawmakers on any constitutional changes by August 30.

South African forest products and timber markets

In February, lumber prices declined -0.3% versus the prior three months, but increased 2.8% from February 2017, as measured by the South African Lumber Index, a composite price series (Figure 24).

Softwood log prices were positive (Figure 25). 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 1.4% for the quarter and 2.4% year-over-year, B grade logs increased 0.2% for the quarter and 6.9% year-over-year, C grade logs rose 2.1% for the quarter and 6.5% year-over-year, and D grade logs increased 2.3% for the quarter and 5.8% year-over-year.

Despite the aforementioned price gains, it is worth noting that annual inflation in South Africa is 4.0%, so in real terms most of the gains are less notable and in some cases even negative (i.e., A grade logs: -1.5% real year-over-year, B grade logs: 2.8% real year-over-year; C grade logs: 2.4% real year-over-year, and D grade logs: 1.7% real year-over-year). Meanwhile, in Q4, the rand appreciated around 2.0% year-over-year against the US dollar (Figure 26), but depreciated around -6.9% year-over-year against the Euro (Figure 27).

Figure 24. South Africa Lumber Index.

Source: Crickmay and Associates.

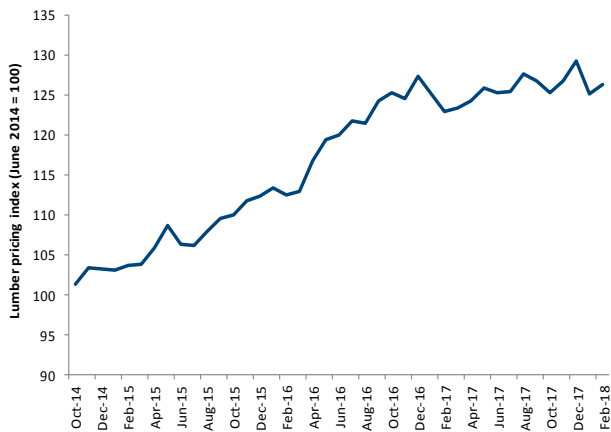


Figure 25. South Africa Pine Sawlog Prices.

Source: Crickmay and Associates.

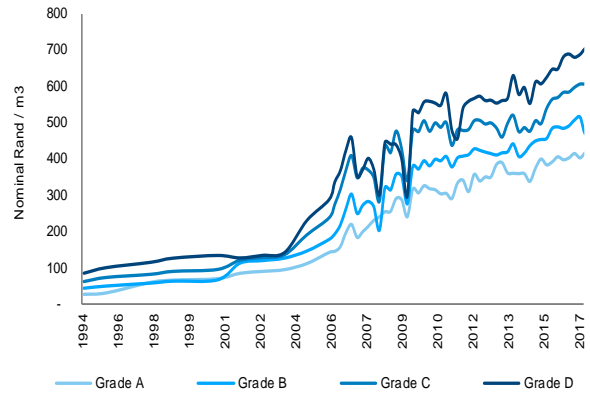


Figure 26. South Africa Rand to US\$ Exchange Rate.

Source: Federal Reserve Bank of St. Louis.



Figure 27. South Africa Rand to Euro Exchange Rate.

Source: Bloomberg.



New Zealand

In Q4, New Zealand’s real GDP increased 0.6% quarter-over-quarter versus 0.6% quarter-over-quarter growth in Q3. Exports were flat as better meat exports were offset by weaker dairy exports while imports increased 3.9% quarter-over-quarter. In Q4, the New Zealand dollar depreciated -4.9% quarter-over-quarter against the US dollar (Figure 28).

New Zealand timber markets

New Zealand A-grade export logs increased 1.8% quarter-over-quarter in December to NZ\$ 168/m³ from NZ\$ 165/m³ (Figure 29) given improving log demand in China, New Zealand’s largest export market. Domestic structural logs used for construction (S1 and S3) were positive given better demand and limited log supply for some grades (Figure 30). While some of the main city centers have experienced slower housing markets, many second tier cities are continuing to experience strong housing demand.

Figure 28. NZ Dollar / US\$ Exchange Rate. Source: Federal Reserve Bank of St. Louis.



Figure 29. NZ Export Log Prices. Source: New Zealand Ministry for Primary Industries.

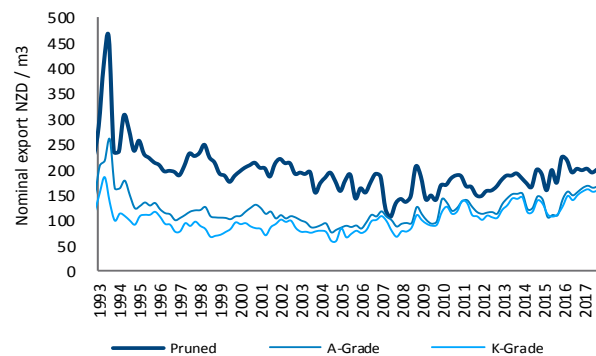
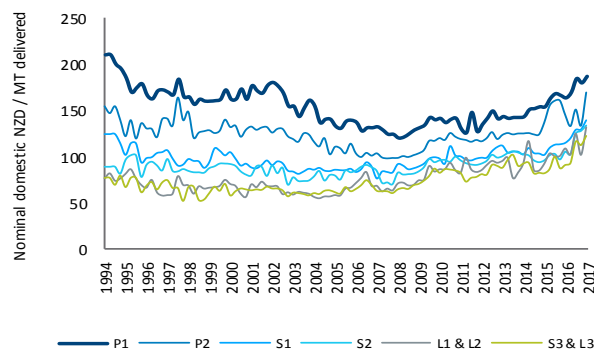


Figure 30. New Zealand Domestic Log Prices.

Source New Zealand Ministry for Primary Industries.



Australia

In Q4, Australia’s real GDP increased 0.4% quarter-over-quarter versus growth of 0.7% quarter-over-quarter in Q3. Manufacturing declined -1.0% quarter-over-quarter due to weakness in machinery and equipment manufacturing (-7.3%) while agriculture, forestry and fishing declined -2.7% driven by declines in livestock, grains, and other crops. Meantime, exports declined -1.8% quarter-over-quarter while imports increased 0.5% quarter-over-quarter. In Q4, the Australian dollar depreciated around -2.8% quarter-over-quarter (Figure 31).

Australian timber markets

Softwood roundwood prices declined -1.2% quarter-over-quarter to US\$ 81/odmt (“oven dry metric ton”) from US\$ 82/odmt in Q3 (Figure 32) partly due to slowing residential construction. Hardwood roundwood prices declined -2.9% quarter-over-quarter to US\$ 99/odmt from US\$ 102/odmt in Q3 (Figure 33). Both softwood and hardwood chips moved lower in Q4, declining -2.4% and -0.9%, respectively.

Figure 31. Australia Dollar to US\$ Exchange Rate.

Source: Federal Reserve Bank of St. Louis.



Figure 32. Australian Softwood Pulpwood Prices.

Source: Wood Resource Quarterly.

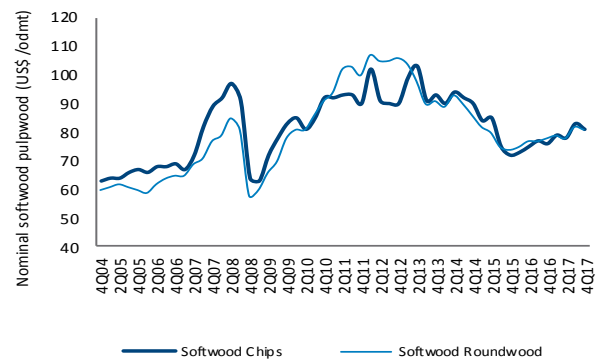
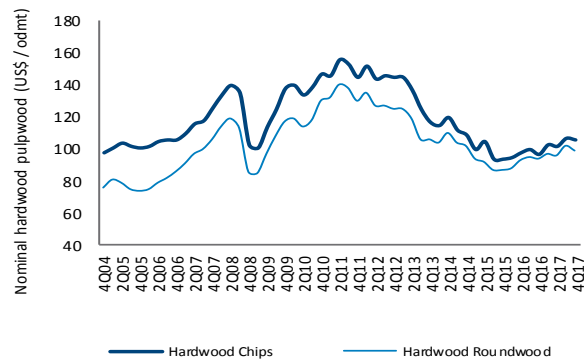


Figure 33. Australian Hardwood Pulpwood Prices.

Source: Wood Resource Quarterly.



Global Pulp and Paper Markets

During Q1, Bleached Hardwood Kraft Pulp (“BHK”) prices in Europe, a key benchmark, increased 7.2% quarter-over-quarter and 48.3% year-over-year, averaging around US\$ 1009/MT (Figures 34 & 35). Prices improved largely due to capacity shifts and mill downtime.

Specifically, APRIL announced that by year-end it intends to reduce its BHK capacity by 500,000 MT per year as the company looks to increase production of dissolving pulp and some Bleached Softwood Kraft Pulp (“BSK”) at its Rizhao and Kerinci mills. Similarly, APP plans to take maintenance downtime at four BHK mills in Indonesia and China (Indonesia – OKI, Perawang, and Jambi; China – Hainan) between the end of March and May, curtailing around 300,000 MT of pulp. Further, APP’s OKI mill is only running at 60-65% of capacity as only two of the four turbogenerators are operating. Fibria also appears to be taking downtime of around 50,000-60,000 MT per month in the first half of 2018 to offset the new tonnage being produced at Tres Lagoas. That said, there is the potential for hardwood pulp capacity to increase as Chenming Paper is starting up a 1.0-1.2 million MT integrated hardwood pulp mill by year-end. Meanwhile, while Chinese pulp demand softened in the first two months of 2018 (shipments to China declined -5.6% per the Pulp & Paper Products Council), this was likely due to destocking ahead of the Chinese New Year in February.

The price of BSK in Europe, a bellwether of the pulp and paper sector, averaged around US\$ 1056/MT, up 10.8% versus the prior quarter and 29.4% year-over-year (Figures 34 & 35).

During the quarter, softwood pulp pricing increased given steady demand and as softwood producers looked to maintain a positive price spread with hardwood pulp. Through February, Chinese imports of BSK increased 7.1%, partially due to Chinese mills continuing to consume more virgin fiber given governmental restrictions on imported recovered paper. There is the potential for softwood pulp prices to further increase as North American pulp producers take maintenance downtime over the next several months and remove around 160,000 MT of production.

Figure 34. Global BSK and BHK Pulp Prices over Time.

Source: FOEX.

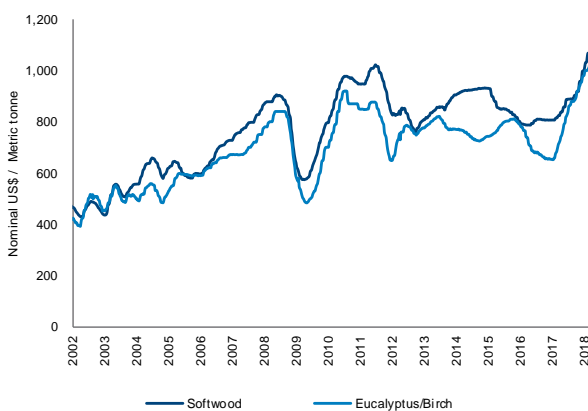
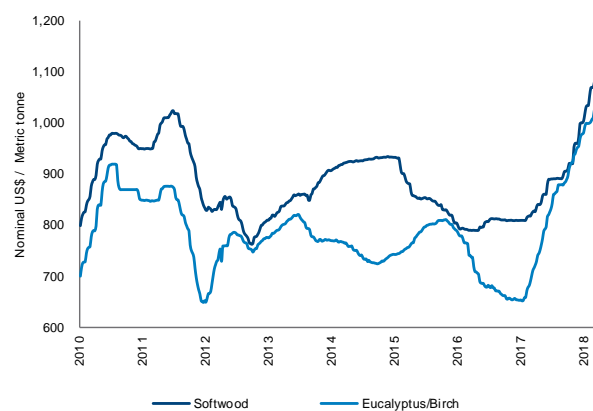


Figure 35. Global BSK and BHK Pulp Prices Recent Performance. Source: FOEX.



Baltic Dry Index

In Q1, the Baltic Dry Index, which provides a benchmark for the price of transporting major raw materials including grains, coal, and iron ore by sea, declined -22.8% (Figures 36 & 37). At a value of 1055 on March 29, 2018, the index remains well below its peak of 11,793 reached in May 2008.

Figure 36. Baltic Dry Index Performance over Time.

Source: Bloomberg.

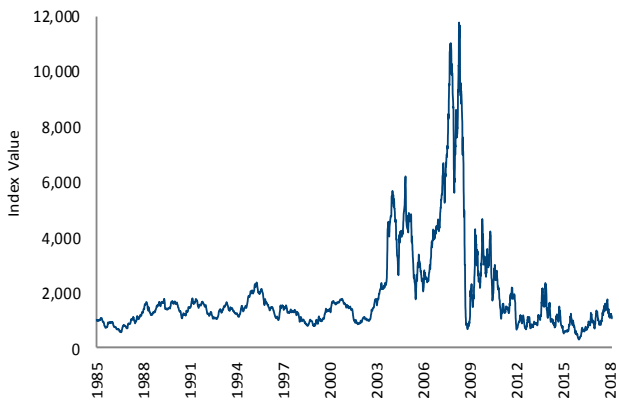
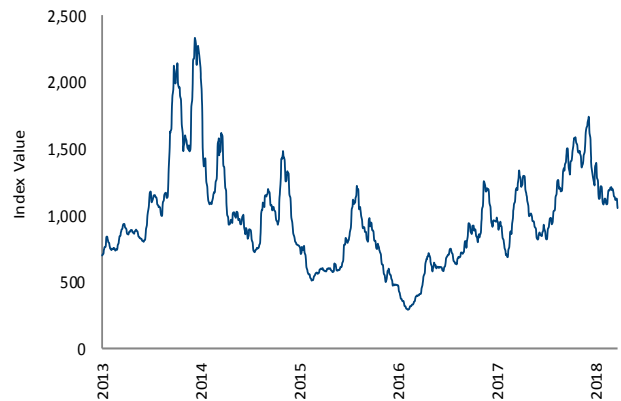


Figure 37. Baltic Dry Index Recent Performance.

Source: Bloomberg.



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