QUARTERLY LETTER

2Q2015

EQUITY SRATEGY

In the 2nd quarter of 2015, **Alaska Black FIC FIA - BDR Nível I** returned -5.43%, compared to +5.40% of IPCA+6% (*benchmark*), +3.02% of CDI and +3.77% of the Bovespa Index.

	2Q15 (%)	Since Inception (%)
Alaska Black	-5.43	16.78
Ibovespa	3.77	-6.47
IPCA+6% a.a.	5.40	55.17
CDI	3.02	37.54

The performance attribution for the quarter, by sector, is shown below:

Asset	Perf. Attribution 2Q15 (%)
Petrochemical	+0.06
Healthcare	-0.23
Consumer Goods	-0.39
Steel	-0.83
Real Estate	-1.01
Industrials	-3.08
Arbitrage	+0.40
Cash	+0.15
Cost	-0.02
Management Fee	-0.48
Total	**-5,43**

The fund ended the 2nd quarter of 2015 with the following characteristics:

1. Investments and Divestments: We currently hold 11 companies in our portfolio. In this 2nd quarter, we executed a relevant change in the fund's portfolio. We divested from 8 companies and invested in 4 new businesses. What made this change possible was the worsening of the pessimistic feeling towards Brazil, and the continued appreciation of American

stocks. Out of 8 divestments, 7 were American companies. The 4 newcomers are Brazilian companies and, as anticipated in our last letter, 3 of them are cyclical.

2. IRR: As a result of the changes above, the expected internal rate of return from the portfolio rose substantially from 19.22% in the 1st quarter of 2015 to 22.04% per year in the 2nd quarter. If we consider a long-term inflation in Brazil of 5.50%, the fund has an expected real yield of 15.68%. We now have 11 companies with expected individual rates of return ranging from 15.05% to 28.79%.

3. Dividends: The fund received in the 2nd quarter of this year approximately R$ 688.2 thousand in dividends from invested companies (dividends and interest on equity);

4. Other Revenue: The fund had a positive return of approximately R$ 351 thousand in other income/expenses such as share lending, arbitration/hedge operations and cash compensation.

In the following table, we show the net revenue and net profit of the fund in the first quarter of 2015, considering the current portfolio, in comparison to the results obtained in the first quarter of last year, and considering the portfolio of a year ago.

We aim to inform our investors how much the fund, similarly to a holding company, is earning of revenue and profit, and how this has evolved over time.

As an example, if the fund divests a number of shares representing R$ 4 million (approximately 10% of the fund's equity), that generates R$ 200 thousand in profit (stock priced at 20 times the profit), and invests the same R$4 million in another company that generates R$

500 thousand (stock priced at 20 times profit), means that the fund increased its net income by R$ 300 thousand.

With this data in hand, our investors have the real value of how much revenue and profit their investments are generating, still being able to compare them with a year ago. As this information is show in percentages, it can be applied to any amount of investment, that is, for those who want to know how much R$ 500 thousand from their investments are generating in revenue and profit, can simply multiply by the percentages.

The purpose of this information is to give the magnitude of the revenue and profit of the fund's companies, considering the investments and disinvestments of that period. To avoid the effects of inflows and outflows, we will inform the numbers as a percentage of the total equity of the fund. Therefore, when we say the net revenue in 1Q15 was 19.21%, it means that the sum of the fractions of the revenues owned by us by each of our invested companies, result in 19.21% of the fund's equity, or R$ 7.74 million, in this case. This also applies to the net income. For 1Q14, the same procedure was carried out, that is, considering the fund portfolio at the time, and the results obtained a year ago.

With this information, it is possible to compare the investment in the fund versus businesses in the "real economy". However, we understand that the above revenues and profits are as real as with closed companies. The only difference is that they're priced at all times.

Find the table below:

Variation (%)	1Q14	1Q15
Net Revenue	9.81	19.21
Net Profit	1.18	1.50

It is worth noting that from 1Q14 to 1Q15, revenues practically doubled, while profits rose 27%. This occurred given the fact that we have divested companies with a relationship of higher price per revenue than newly invested companies. And as the newly invested companies suffered more in their margins versus the US companies we divested, the increase in net income did not occur in the same magnitude, but even so, it rose significantly (+27%).

Both by expected internal rates of return and by superficially looking at revenue and profit multiples, the fund has a more attractive portfolio than a year ago. This was only possible thanks to the current crisis that caused a cheapening in high quality companies.

Investment

One of the most comprehensive ways of defining the act of investing is to give up something today, in order to have benefits in the future. It doesn't matter what is invested, be it time, matter or energy, the logic is the same. In the world of finance, what is invested is capital, in the purchase or creation of any asset, with the expectation of future returns in the form of earnings, coupon, etc., or through appreciation of the asset itself. It is common to see comparisons between investing and speculating, but the difference is conceptual. Investments are generally related to longer terms, unlike what happens when there is speculation. Throughout the letter, we will emphasize some other differences.

The spectrum of financial assets available to invest is huge, from simple government bonds, through corporate debt, real estate, stocks to the most complex derivatives. In general, they all relate to debt or equity of some entity, whether public or private. In order to invest in equity, it is usual to demand more return than in debt, given that the creditor receives before the partner, in the event of bankruptcy.

Investing in companies, public or private, is essentially the same thing, with the exception of a single detail. In public companies, there is the market factor, which shows everyone the purchase and sale price of that asset, in real time. In private companies, this same information is not public. The mere presence of a price causes people to treat publicly traded companies irrationally differently from private ones. The origin of this irrationality lies in thinking that price and value are the same thing.

Price vs. Value

When the entrepreneur opens his business, he has several concerns in his head, his corporate structure, his working capital, how is the market in which he operates, how is his team, his competitors, etc., but how much his business would be worth every minute is not something he would waste his time on. Whether the business is a restaurant, small industry, clothing franchise or mechanic shop, the positive or negative daily variation of 1%, 2%, in its market price isn't something that matters in the day to day of the entrepreneur.

To set up a mechanical shop, including machinery, equipment and working capital, imagine that a person invests one million reais, with a required return of 20% per year. After a year, this same workshop is generating a 22% return on invested capital, due to good operations. Being a privately held company, its shareholder does not know the minute-by-minute price of its business, but it knows its value. Wouldn't even consider selling it at a discount.

Imagine now, if the company had its capital listed on the stock exchange, its price would vary according to the last negotiations carried out, whether they are close to the real value of the business or not. In the latter scenario, imagine that a holder of 1,000 shares of the company is an investment fund undergoing redemptions, and therefore needs to sell its shares on the market at any cost. Imagine that these shares represent 0.01% of the shop's total capital. On the other hand, potential buyers would be interested in paying the lowest price they can for that position. In the event that the deal comes out at a 50% discount to the market price, there is the following effect: the seller lost 50% of his investment, as he made the sale. A buyer who was already an investor in the shop managed to increase his position at an advantageous price, but the pricing of the asset will "mark to market" his current stock of shares in the company, and consequently, his share. If the shareholders of this fund did not know the difference between the market price and the real value of the business, they would be scared of the share, they would order redemptions and the vicious cycle would continue. The same dynamic could happen in the opposite direction, if someone agrees to buy stocks much above the value, in order to price their stock of shares upwards. The shareholder would perceive a positive appreciation in the price of his share that would not represent the real value of his investments, but would attract "investors" excited by the recent positive shares of the fund.

Despite being extreme, the scenarios above show that price does not always reflect value. With this lesson in mind, investing in publicly traded and privately held companies becomes very similar, and a good investor can benefit greatly from unsubstantiated price drops. Just look at the buyer's logic of the shop's shares, in the example above. They gave him the opportunity to pay half the price for something that, to him, has not changed in value. Mathematically, your return on capital employed will be double in this transaction, as long as the business continues with the expected cash generation. And the only variable capable of equalizing price and value is time.

We approach our investments in the same way as the owner of the shop thinks about it. Who are the people who will take the decisions that will impact our capital? What is the return on our allocated capital? What are the competitive advantages? What are the entry barriers? What are the possible changes in the market for acting? How does the training process take place? Is the company dependent on a key person? Is there a renewal of leaders? Are there tax incentives? Are there political risks? Are there privileges or lobbies that support the margins?

What we seek is to obtain returns on our invested capital through the generation and distribution of cash from the investees. The appreciation of the stock price over the years is a consequence of corporate results. If this convergence to fair value does not occur, the longer the term of the investment, the more irrelevant the asset price is in determining the total value of the investment. This is because the dividends received and reinvested in the stock itself become the most responsible for the total accumulation of wealth. It is even better if the company goes through periods of extremely discounted prices, as the accumulation of new shares will accelerate, which will consequently generate more income from future dividends.

The daily variation of the stock price is nothing more than a “consultant” at the door of “our company” telling us minute by minute how much the market buys or sells a fraction of it. When the market is optimistic, it accepts to pay dearly. When he is afraid of the future, he barely “shows up” at our door to give a price, or when he does, he offers a low price. The consultant does not directly influence our company's profits, let alone its long-term fundamentals.

By doing so, we make the stock market an actual partner in our investments. As the market is not efficient and participants' emotions interfere in decision making, sometimes the market offers a price below our perception of value for our investments, sometimes above. Extending the logic of the mechanical shop example, a price above the value implies a lower Internal Rate of Return from that moment on. Similarly, a price below the value results in a higher IRR for the investment made at this price. We seek to invest at high IRRs and divest when expected IRRs are low. The only things we have to do is identify the best investments, stay invested at the best rates of return and wait for the price movements that the market offers us to rebalance our portfolio. We are not afraid when the market offers us a low price for our investments. We have the chance to buy and grow our investments in assets with extraordinary future returns. What we can never do is invest in assets with low rates of return on capital, even if these are getting more and more expensive in the market. We cannot justify buying an asset with a bad expected return just because the market is increasingly optimistic about the stock.

Volatile stock price vs. stable company values

Without the proper psychological framework, without a real understanding of the difference between price and value, investing in stocks ends up resulting in mediocre or even disastrous returns. The main misconception is to assume that stocks are extremely risky investments just because of price volatility.

In the chapter "The Pattern of Change in Stock Earnings and Stock Prices" from the book "The Intelligent Investor" by Benjamin Graham (1949), he reasons that the intrinsic value of a company is based on the average cash generation over an economic cycle.

Certainly, this cash generation will be lower in recessions, and higher in periods of expansion. If, for example, a company generates on average 20 reais of cash per share in periods of recession and 50 reais per share in periods of economic expansion, we can say that the average generation is 35 reais per share, in a complete economic cycle. If by chance, by discounted cash flow, we conclude that the fair value is 10 times the cash generation, we can say that the intrinsic value of the company is 350 reais per share

Benjamin Graham, however, says that the behavior of the share price differs greatly from its intrinsic value. During periods of economic recession, the company generates 20 reais per share and can be traded at 5 times the cash generation, for example, resulting in a price of 100 reais per share, and in periods of expansion the share goes to R$ 750 per share (15 times the generation of 50 reais). However, in both cases, the intrinsic value is the same 350 reais per share. The hypothetical example above reflects the vast majority of asset price behaviors on the stock exchange.

The lesson to be learned is that a company's value, whether measured by discounted cash flow, book value, or a multiple of average earnings over a complete economic cycle, is less volatile than the stock price on the computer screen, or than shares in an equity fund. Another lesson to be learned is that with the right temperament, and with a real understanding of the emotional instabilities of the market, investors can take great advantage of the prices offered by market participants.

In the chart below of a company in which the VentureStar Black fund invested in the last quarter, we can see the price change over time versus the company's equity evolution (values in BRL per share). Equity, in the case below, is a very conservative measure of the company's real value, but it serves to illustrate that its temporal evolution is less volatile than the share price. This is due to the fact that equity, as well as the company's real intrinsic value, tends to be less susceptible to market mood swings, and more dependent on fundamental issues related to the company's operations. In the example below, equity varies very little, unlike stock prices and fund shares, due to bailouts, selling pressures, increased pessimism, or an unfortunate statement by a federal government official.

It is worth mentioning that the graph below is on a logarithmic scale, where straight lines mean constant growth rates. From the company's history below, an average increase in equity of 15% per year can be seen, even after the distribution of dividends. Unlike the equity value, the share price has a more erratic behavior, which gives us the opportunity to invest in favorable moments such as the current one for this company.

Portfolio

As anticipated in the last Quarterly Letter, the fund invested in two cyclical companies in the industrial sector. Normally, we had been avoiding this sector, due to the weakness of the Brazilian GDP, and the low level of business confidence. However, after an unanimity of indicators already pointing to pessimistic levels, the prices of these stocks already incorporate a prolonged unfavorable scenario. In the case of our models, a perpetual pessimistic scenario.

Here is our projection for the current portfolio, for net revenue, gross profit and net profit:

(R$ thousand)	2015	2016	2017	2018	2019	2020
Net Revenue	30.959	33.836	36.319	39.420	42.785	46.237
Gross Profit	11.818	13.418	14.368	15.617	16.990	18.418
Net Profit	4.504	4.994	5.351	5.889	6.512	7.046