ALASKA

ASSET MANAGEMENT

BIANNUAL LETTER

2S2019

Built to last"

We ended 2019 with some important paradigms shattered. The idea of using fixed income as a way to obtain consistent real returns was buried in Brazil, the Brazilian investor began the process of "rehabilitating" the addiction to investing in CDI. This opens up an invaluable opportunity ahead; we will be able to take part in building an investment environment that encourages entrepreneurship and the allocation of resources to productive assets, whether they are listed on the stock exchange or not. However, as in any rehabilitation process, there will be a lot of discomfort on the part of those who abstained from the "fat" CDI era. Knowing this, we have an obligation to intensify financial education efforts so that the transition of this new wave of investors has the least amount of trauma possible.

First of all, the question is: are we prepared for the new reality of the market?

The main concept that we must accept in order to deal with this new investment reality is: CDI IS NOT INVESTMENT AND IT IS NOT MADE TO BUILD WEALTH. Just as the risk-free rate in the USA, in Japan, in Switzerland does not build wealth, we have to get used to the CDI in the same direction. The ideal scope of a risk-free rate is only to preserve the purchasing power of a given stock of money and not to provide consistent real earnings with very little risk. A country that maintains excessively high interest rates, as was our case from 1994 until a few years ago, ends up ruining the environment for entrepreneurship, innovation and productivity. An inertial force is also created for the concentration of wealth, since the assets of those who are already rich accumulate real gains without the need to be allocated to productive assets. At the same time, high interest rates represent a considerable barrier to entrepreneurship. In the coming years, we should expect a different dynamic, since equity creation will occur with investments in productive assets.

When it comes to building wealth, our greatest mentor and partner, Luiz Alves Paes de Barros, is always a good source of wisdom. For him, the best form of capital allocation for the purpose of building equity is the stock market, because it offers a unique combination of expressive returns obtained by entrepreneurs with liquidity comparable to that of fixed income. These characteristics of the stock market allow for agile decision-making. There is also the bonus of not having to work directly at the company to enjoy the profits and appreciation of the asset. Even so, many people are reluctant to invest part of their wealth in stocks. When we ask why, we often hear that price fluctuations and volatility are frightening, exactly the factors that make, in our opinion, this asset class much more attractive. It is a conceptual problem, given that there is still a lot of confusion between what is investment and what is speculation with financial assets.

Making an investment in stocks makes us partners in a company. Because of this, the decision process should not be different from the one we would use to invest in privately held ventures, such as a bakery, workshop, farm or restaurant, for example. Extrapolating this concept, we come to the conclusion that a diversified stock portfolio should be treated as a holding company for productive assets, cash and income generators. That's exactly how we do it in Alaska. From this perspective, we derive an investment process that takes into account factors relevant only to the businesses we are evaluating. For us, the organized market (exchange) brings only advantages, if it ended tomorrow, we would continue our routine of evaluating companies without having to change our day-to-day activities. The companies we are analyzing would continue there, with their operations running normally, selling products, services and calculating profits. We would continue to closely monitor its operating performance. Nothing, absolutely nothing regarding the company's value creation would change if the company were not listed. At Alaska, we would continue to increase and decrease shareholdings, with exactly the same investment philosophy, even if there were no shares traded on the exchange. The only change would be to increase the bureaucracy of our movements. We would have to reach an agreement in negotiating the purchase or sale of equity with the counterparty, an exhausting process that could take a long time. After agreeing the price, we would carry out the transfer of money and share properties via banks and notary offices. The investment philosophy would not change.

What really matters?

Before doing any kind of calculation with a company's financial indicators, we have to decide what return we should demand from it in order for it to be an attractive investment option. This is the least accurate stage of the process, as we try to quantify several intangible factors or factors that are not easily represented in the financial models that we make in the other stages of the evaluation. It is also the moment that each investor must define and consider what YOUR priorities are when evaluating a business, after all, there is no definitive investment process. What we consider important may not be relevant or even not within the circle of competences of another investor profile. We know how tempting (and practical) it is to create a 'silver bullet' that works for every type of investor. Simplifications and generalizations only advertise those who seek to make a living playing guru (something we see appearing more and more around).

Each item in our analysis process has well-defined evaluation criteria classified on a simple scale, with easily differentiated levels. Excessively complex scales only increase the subjectivity of the process and hinder the isonomy of evaluation among the various people who may use it. Among the criteria we analyze are: each company's market, competition, regulatory environment, specific demand characteristics, returns on capital and existence (or not) of competitive advantages. Lastly, the most important part, who are the people behind that business. Most of the return we require from a company is defined by our vision of executives, controllers and all those who are somehow involved in the business. After all, we are analyzing whether or not we will be partners with these people.

We know the power that good people have in transforming bad businesses into excellent ones, and there are countless examples where people contributed to the failure of hitherto profitable businesses. Teams that deserve top marks in this aspect in our investment process are those that constitute a workforce capable of acting in unison around the same goal; each professional works as an extension of the other. Behind this level of coordination and alignment, there is almost always a strong corporate culture, which gives work guidelines to each professional and motivates them with a greater purpose, and not just the promise of financial results. Everyone rows in the same direction naturally. As a result, there are very few companies that deserve the highest score, a merit reserved only for teams that prove to be truly exceptional. “In our investment process, the corporate culture is the most relevant item. It can be the company's greatest competitive advantage, the source of long-term value creation. And the great difficulty is not identifying it, but rather having the discipline and patience to avoid companies with bad cultures, no matter how "cheap" they may seem in the eyes of accounting, and giving due time for companies with good ones to cultures reap their fruits.” (quote Q1 2015 letter – Alaska Asset Management).

This first phase of the analysis gives us a good idea about the company we are considering investing in; we have already managed to quantify the minimum return we should demand from it as a possible investment. The next step consists of assessing the company's future cash flows through financial modeling, through which we will arrive at the internal rate of return implicit in the company's current price. However, before moving on to an example of the process in practice, we would like to take a step back and talk in more detail about the importance of choosing to partner with the right people before embarking on any type of endeavor.

A little bit of history: Alaska

We find it practically impossible to discuss the power of the right people united for a greater purpose without remembering our own experience in these 4 and a half years as a manager. In 2015, the investment environment was radically different from today; double-digit interest rates, a government with accumulated scandals and an environment of uncertainty that made investing in the stock market “something for crazy people”, since many believed that we were taking big steps towards a dollar at 5 reais and an economic tragedy inspired by Venezuela. Fortunately, we had a group of “crazy people” who saw the opportunity there and got together with the purpose of creating a management company that was, above all, independent, with funds shaped by us and for us. None of this would be possible without the unrestricted support of Angela Freitas and Luiz Alves, our two most important partners. They were the ones who really bought into the idea of setting up a fund outside industry standards, with no commitment to being “saleable”. We were driven only by our conviction that we were approaching a “low” cycle, as we already mentioned in our letter for the 3rd quarter of 2015.

We had a clear purpose and an exceptional group of partners, but we did not imagine the path that 2016 would open for us. The independence of thoughts brought good returns to the portfolio and these, in turn, caught the attention of some "retail" shareholders, who began to invest with us through the platform of XP Investimentos, our first major partner. Until then, retail was a segment in which our partners had no experience; was seen by many as a bad client modality for a long-term fund because they are “unstable” and dislike volatility. Fortunately, we also had the support of people like Luciana Seabra and Felipe Miranda, in addition to the entire Empiricus team, who strongly encouraged us to dive headlong into this segment, even convincing us to open a vehicle aimed at the general public, the Alaska Black FIC FIA II - BDR Level I.

The following months were real tests for the manager. In 2017, in the first major setback, we realized that the choice to serve retail was the best possible. We experienced one of the worst daily returns on the market (-28% on “Joesleyday”) and our partner base did not abandon us. On the contrary, we had 1,000 new investors in the 30 days following the event, in addition to the unconditional support of all partner institutions that distributed our products. It was a test for everyone, our partners, our institutional partners, our quota holders, and, without exception, everyone was successful. Volatility, something that previously “scared retailers”, became the manager’s trademark, there were tense moments during 2018, such as the difficult truck drivers’ strike and the uncertain election period. These were moments that strengthened the relationship between everyone close to the manager and that also crowned our decision to dedicate ourselves to the retail investor. We repay the trust with efforts to have the highest level of transparency and presence possible, regardless of the moment of the fund share.

There were 30 of us in 2016, 700 in 2017, 35 thousand in 2018 and, at the end of 2019, we reached more than 180 thousand investors, or rather, partners. For the coming years we want more of the same, in addition to expressive returns in the long term, we want to increase our capillarity even more and reach as many people as possible with information about the variable income market, as we know that the future of the industry will be very better if we do our part to help. We want to use this opportunity to thank everyone who is part of our history for their support.

Back to the process...

The work carried out by Alaska analysts is best illustrated through a theoretical example. Imagine that, for purposes of diversifying lines of business, Alaska begins to evaluate an investment in a restaurant. We can invest in an existing establishment or open one “from scratch”. First, we would need to figure out how much of a return we must require from such an undertaking for it to make financial sense. For this, nothing better than applying the methodology we already use for stocks on the Stock Exchange.

The first topic we analyze is the expected profitability on the invested capital of the enterprise in question. As it is a quantitative metric, the analysis is straightforward: the greater the return on invested capital, the greater our perception of quality. Next, we have to analyze how resilient these results are and whether or not we should expect a cyclical behavior from this type of undertaking. We make no value judgments about business model cyclicality as long as we can understand the causative factors. We judge as better the businesses that tend to be more resilient in times of economic contraction. The restaurant sector shows a sensitivity of results to disposable income metrics, that is, it suffers more in crises. However, establishments with more established brands tend to go through these moments more smoothly. Hence, some risk factors can already be concluded: brand - the more established, the better (see our letter from the 4th quarter of 2014); return on invested capital - the higher, the better; resilience (discussed in our 1st half 2017 letter) of results - the bigger, the better. As we advanced in the studies and delved deeper into the characteristics of the business, we built our perception of the risk involved in the undertaking.

The next item concerns the business environment in which the enterprise in question is inserted. We evaluate everything from the regulatory and technological environment to the possibility of structural changes in the business model. In our example, the analysis is quite simple: restaurants have existed for thousands of years and, even with the advent of delivery apps, fast food and other innovations, they will continue to exist. On our rating scale, the less prone to change a given market is, the better. Technology companies tend to have a low assessment in this regard, due to the constant need for investments in order to avoid technological obsolescence. State-owned companies are also penalized for similar reasons, as they are subject to regulatory changes (see electricity companies in 2012).

Next, we analyze whether there are (and what are) the entry barriers in the sector. We consider their absence a negative factor, as new competitors may appear at any time. The restaurant segment has very few entry barriers, requires relatively little money for initial investment. In this way, there is a great turnover in the sector. We come across this phenomenon every day when we walk through Itaim Bibi (neighborhood in the south zone of São Paulo/SP), where dozens of new developments are inaugurated and closed routinely. Therefore, our business idea would score poorly on the barrier of entry.

We left for last the most important factor of all: who are the people behind the venture? Will we have partners? Who will they be? What are your experiences in the sector? Have you had other partners before? Who will be responsible for operating the restaurant? And the cook, do you have previous experience? What is your team's background? All these questions are worth much more than all the topics we discussed earlier. Thus, they will define most of the return required for the investment in the establishment. As we have already made clear before, a cohesive, consistent team with a clear purpose is capable of exceeding expectations, creating lines of business and provoking excellent surprises.

All analyzes serve to give us a consistent basis on the specific enterprise, as well as its industry, competitors, regulatory environment, etc. With that, we were finally able to define the premium over a risk-free rate that we will require to invest in this venture. The next step is to find out what the implicit rate of return (IRR) is for this venture through our cash flow projections.

We take a restaurant as an example, but any cash generating business (or not) can be seen as a bond (debt security) that pays coupons or periodic interest (monthly, half-yearly, annual...). The logic is always the same. Every investment from a fundamentalist point of view is subject to the same laws of financial mathematics: how much you pay in relation to how much you receive. What connects payments and receipts of a given cash flow over time is the internal rate of return (IRR). Paying less, receiving more or receiving earlier increases the IRR, this is good, the opposite is bad. Cash flow will be calculated after completing estimates of your revenues, costs, working capital, investments, growth prospects, indebtedness, among many other factors. Conceptually, it is a cash flow, or coupon, as we see in many financial instruments.

In summary, our main selection criterion is simple: given the price of an investment and its future cash generation, we seek to understand the internal rate of return on allocated capital. Those who are used to discounted cash flow models know that we want to find the discount rate that, if used in the mathematical model, equates the present value of future cash flows to the cost of an investment.

So far, this is all just theory, Excel, future estimation. It would have null value if the results in practice did not confirm what we expect. The theory has to have relevance and applicability in the real world. How has the IRR behaved in practice? Let's see.

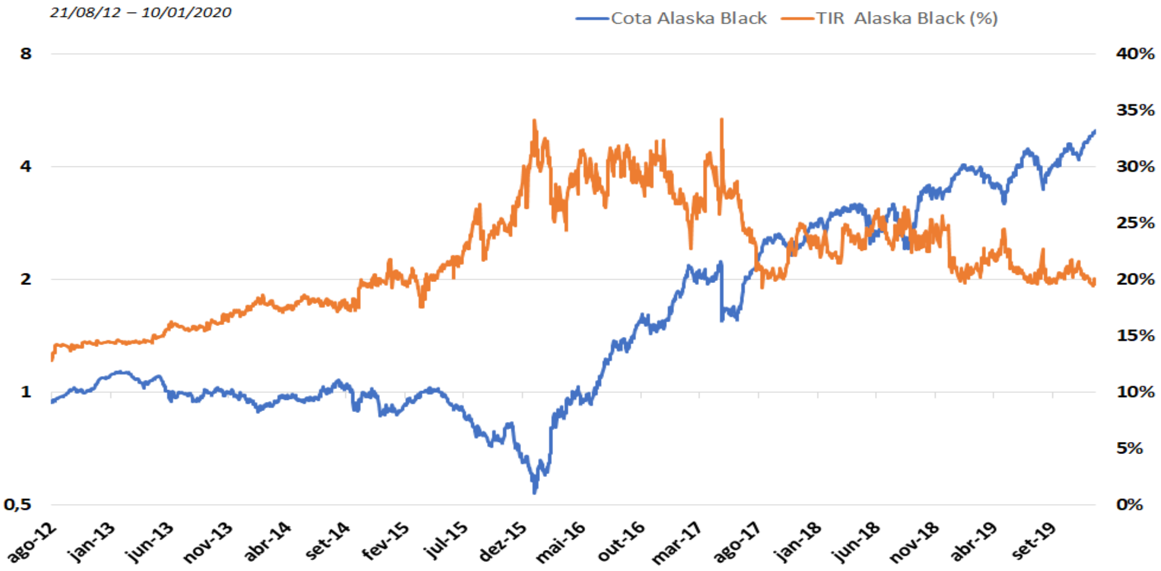
Although we have been calculating the IRR of all fund companies since 1/1/2012, we only started to register daily from 8/21/2012. Until 01/10/2020, the Alaska Black FIC FIA - Level I BDR had a total return of 432.40%, which results in an annualized return of 25.39% per annum.

Alaska Black's daily average IRR since 08/21/2012 is 22.01%, calculated by weighting the IRRs of each stock in the portfolio by their respective exposures. In very short terms, fund performance and the average capital allocation IRR may differ. However, over longer timeframes, annualized fund performance and average expected IRR MUST CONVERG. If they do not converge to close values, there are errors in the cash flow estimates. Someone who always invests with an expected IRR of more than 25% and ends up with a portfolio with a much lower return than that is making mistakes somewhere in their process.

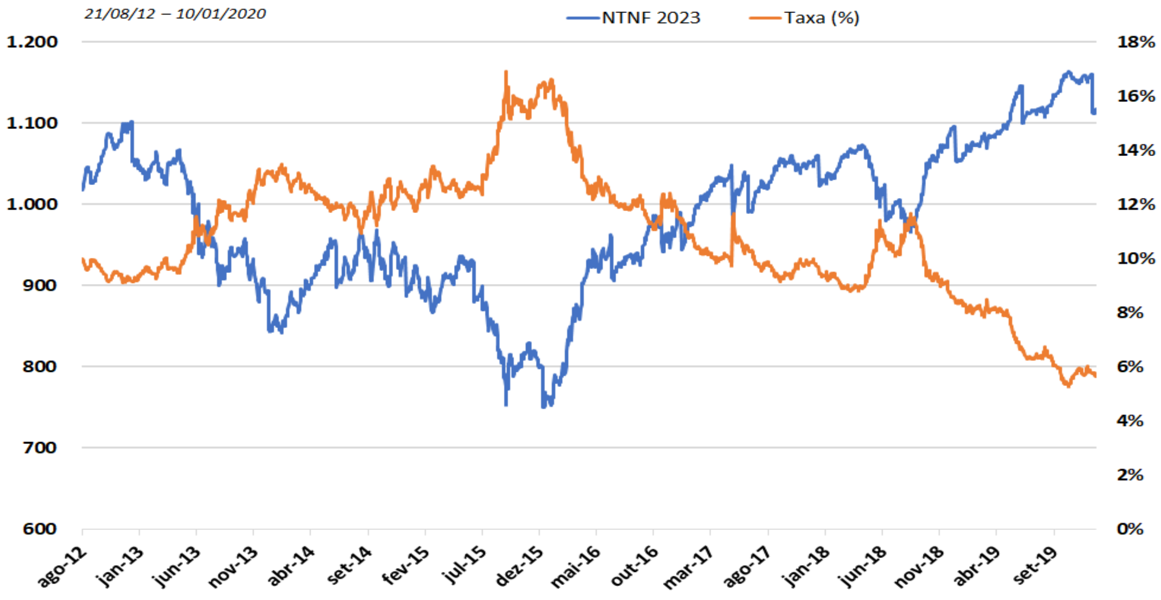
This monitoring of the portfolio's IRR and subsequent performance serves as self-discipline. We do not see our portfolio as a pile of stocks with random returns, but as equity slices of companies that entitle us to a fraction of the company's cash flow. We think of stocks as "variable coupon bonds." Like bonds, companies have "yield to maturity" (IRR) and "duration" (sensitivity to changes in the discount rate). The big and main difference is that companies are living assets that adapt, evolve and change. This dynamism requires a lot of attention and studies!

In order to show the opposite nature between the IRR and the price, we have graphed Alaska Black's cumulative return in parallel with its daily IRR. The start date is 08/21/2012, IRR and return should have the opposite behavior, as in a bond (NTN-F 2023, price versus yield). Price and Yield (TIR) go hand in hand.

Graph of Alaska Black shares versus fund IRR since 8/21/2012:



NTN-F 2023 Yield vs Unit Price (PU) chart since 08/21/2012:



As with bonds, the higher the implied internal rate of return (the higher the yield), the higher the return in the subsequent period. This is evident in late 2015 and early 2016, when we had IRRs of around 35% on Alaska Black. Today, our IRR is 19.67%, still high. The intention with this follow-up is not to become myopic. Today's IRR gives us an excellent clue as to what future returns will look like. Therefore, low price is evidently a starting point of high returns in the future - and vice versa. A low IRR follows the reverse logic and is therefore bad.

Another interesting analysis is the sensitivity of the IRR implied by portfolio appreciation and depreciation. Typically, the sensitivity of our portfolio is approximately 8x. For every 8% that the quota goes up or down, the IRR goes up or down by 1%. Quota falls, TIR rises. Quota rises, TIR falls.

Black's IRR stood at around 14% in mid-2012, which in that year represented a 3 to 4% premium over the 10-year pre-fixed interest rate. Today, the IRR of 19.67% represents a premium of approximately 13% over the 10-year Brazilian interest rate. For Black to return to having an IRR of 14%, the shares in the portfolio would need to rise at this exact moment by approximately 40% (5% x 8 of duration). Note that this value is just an estimate, as the duration of the fund does not change linearly with the fall in the IRR (convexity of the duration curve).

Each investor must judge which methodology works best for him/herself, be it the calculation of IRR, upside, target, exit multiple or any other evaluation and monitoring metric. For us, tracking the implied internal rate of return is ideal.

What about the market?

Until now, the market has been left out of our discussion of the investment process, for one simple reason: for us it should be seen only as a trading desk, with the advantage of having available prices that vary up or down daily. By gathering time, independence (really) and a diversified portfolio of assets, we managed to take advantage of most of the market fluctuations, whether positive or negative. The year 2019 is an excellent example. At the same time that the stock market (Ibovespa) rose 31.58%, we had assets in our portfolio with almost a 50% decline and others with much better performance than the index. As our investment process seeks to maximize the fund's IRR, we are “obliged” to sell a little of what went up and buy more of what went down, since their IRRs went in opposite directions. It's the way we've found to make our relationship with the market easier. If it went down, we bought it, as the IRRs increased, if it went up, we rebalanced the portfolio in search of higher IRRs. A good investment process is one that takes us away from the emotions of the market and translates them into clear instructions to be followed. The market exists for us to take advantage of it, not the other way around.

Performance Attribution – Alaska Black

In the second Half of 2019, **Alaska Black FIC FIA - BDR Nível I** returned +19.30%, against +5.15% of the IPCA+6% p.a. (benchmark). The accumulated CDI for the period was +2.81%.

Alaska Black FIC FIA II - BDR Nível I returned +21.34%, against +14.54% of the Ibovespa Index (benchmark). The accumulated CDI for the period was +2.81%.

Alaska Black Institucional returned +25.03%, against +14.54% of the Ibovespa Index (benchmark). The accumulated CDI for the period was +2.81%.

Alaska 70 Icatu Previdenciário FIM returned +14.40%, Against +6.72% of the IMA-B Index (benchmark). The accumulated CDI for the period was +2.81%.

	2S19	ITD*
Alaska Black FIC	19,30%	507,25%
Ibovespa	14,54%	103,77%
IPCA + 6% a.a.	5,15%	148,90%
CDI	2,81%	107,68%

*Inception in 29/12/2011

	2S19	ITD*
Alaska Black FIC II	21,34%	205,44%
Ibovespa	14,54%	87,09%
IPCA + 6% a.a.	5,15%	32,45%
CDI	2,81%	23,87%

*Inception in 03/01/2017

	2S19	ITD*
Alaska Black Institucional	25,03%	162,85%
Ibovespa	14,54%	67,48%
IPCA + 6% a.a.	5,15%	30,57%
CDI	2,81%	21,78%

*Inception in 21/02/2017

	2S19	ITD*
Alaska 70 Icatu Previdenciário FIM	14,40%	29,80%
IMA-B	6,72%	32,89%
Ibovespa	14,54%	36,78%
IPCA + 6% a.a.	5,15%	18,14%
CDI	2,81%	10,41%

*Inception in 02/05/2018

The breakdown of half-year performance by sector is shown below (Alaska Black Master FIA fund):

Strategy	2S19
Consumption	11,00%
Logistics	5,73%
Pulp & Paper	3,69%
Shopping Malls	3,34%
Industrials	0,86%
Education	0,79%
Cash	0,51%
Oil and Gas	0,51%
Technology	0,37%
Real Estate	0,31%
Mining	0,16%
Steel	0,04%
Utilities	0,00%
Arbitrage	-0,03%
Costs	-0,11%
Hedge/Macro	-1,48%
Petrochemicals	-1,53%
Total	**24,16%**

*The table above shows the results of the Master fund. The costs of the invested funds were different due to their performance fees being charged in different indicators.

The fund ended the 2nd half of 2019 with the following characteristics:

1. **Investments and Divestments:** At the end of the second half of 2019, the fund consisted of twenty shares. There was the departure of a company from the Oil and Gas sector, the entry of two shares from Industry and the merger of two companies from Shopping Malls.

2. **IRR**: The fund's expected internal rate of return at the end of the second half of 2019 was 19.67%. In the first half of 2019, the fund had a return rate of 20.54%.

3. **Dividends:** In the second half of 2019, the fund received in earnings (dividends and JCP – interest on equity) 0.63% of the average equity for the year 2019.

4. **Other Revenue**: The fund had a result of -1.12% in other revenues/expenses such as share leasing, Arbitrage/Hedge/Macro operations and remuneration on cash in the period.

We see the Alaska Black fund as a holding company. In this way, we show in the table below the revenue and profit of the "Black holding", as well as how much these values represent of the fund's equity.

We compare the portfolio at the end of the second half of 2019 with the portfolio we had a year ago. The absolute increases in revenue and profit are consequences of the increase in the fund's equity and the growth in the companies' operating income. As a percentage of Shareholders' Equity, the reduction indicates greater exposure to companies with higher multiples (Revenue/Market Value and Profit/Market Value) and also expansion of the multiples of investee companies due to stock appreciation. The net margin (Net Income/Net Revenue) of the "Black holding" went from 5.41% at the end of 2018 to 5.06% at the end of the second half of 2019.

R$ Thousand	31/12/2018	31/12/2019	Variation
Net Revenue	1.684,51	**2.809,00**	**66,75%**
Net Profit	91,21	**142,16**	**55,87%**

% of fund AuM	31/12/2018	31/12/2019	Variation
Net Revenue	80,12%	**63,11%**	**-21,24%**
Net Profit	4,34%	**3,19%**	**-26,38%**

Markets

Risk assets performed well in general in the second half of 2019, with emphasis on the American stock exchanges and the Ibovespa, which reached new historic highs. Despite the trade war between the US and China, as in the first half, continuing to affect prices in global markets, the assets reacted well to the stimuli adopted by the main central banks of the world, such as rate cuts and expansion of their balance sheets. These stimuli were necessary, as one of the side effects of the trade war was the slowdown in global economic activity, mainly in the manufacturing sector in Europe.

After many advances and setbacks in the talks between the US and China, the chance of a partial agreement (Phase 1) has become increasingly concrete. Allied to this, the monetary policies adopted by central banks resulted in a stabilization of global activity, which in turn had a positive impact on risk asset prices at the end of the semester.

In the domestic environment, in addition to the trade war, two other local issues took the attention of market participants, one of which was conditioned by the other: progress in the process of the pension reform and the Central Bank's position regarding a new cycle of cuts at Selic.

Despite the benign nature of inflation rates and expectations being anchored, the Central Bank conditioned the start of cuts in the basic interest rate to concrete advances in the course of the social security reform, and this occurred shortly before Congress went into recess; the pension reform was approved in the first round in the Chamber with a vote that was largely favorable and above expectations, in addition to the basic text estimating substantial savings for the government over the next ten years.

This was the necessary trigger for the Central Bank to start the Selic cut cycle that lasted throughout the semester. The drop in interest rates, together with a local economic recovery, even if gradual, were the main factors for the appreciation of more than 14% of the Ibovespa in the semester.

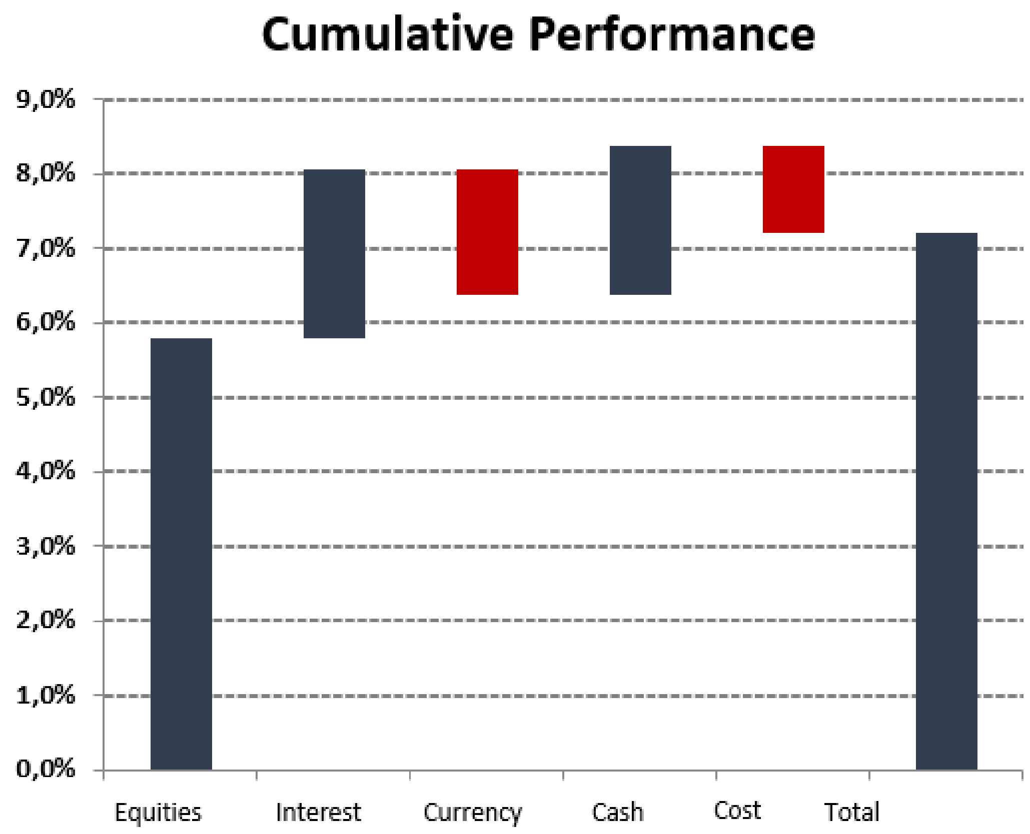
The exchange rate, in turn, was unable to keep up with the good performance of the stock exchange and presented a devaluation of more than 4% in the period. The main factor behind this performance was the drop in the interest rate differential between Brazil and the US. Despite the fact that the Fed cut its basic interest rate by 75 points during this period, the downward cycle in the Selic rate has so far been 200 points. In addition, we had a one-off factor, the great disappointment of market participants with the participation of foreigners in the transfer of rights auctions, which caused the market to readjust its position in the exchange rate, amplifying the depreciation of the real against the US currency. These derogatory effects were minimized with the prospect of stronger growth in the local economy in 2020.

Alaska Range

In the second half of 2019, the Alaska Range fund returned 7.22% against 2.81% for its benchmark, the CDI. As mentioned in the previous section, the fall in the basic interest rate and the recovery of local activity were the main factors responsible for the strong appreciation of the Ibovespa in the period, and it was precisely this asset class, variable income, that most contributed to the fund's performance. in the period. In addition to maintaining a net long position in variable income throughout the semester, the fund's equity portfolio outperformed the Ibovespa in the period, further expanding gains.

In the interest rate market, the fund mostly had a short position in rates in the middle part of the curve, which generated positive results as the downward cycle in the Selic extended and inflation indices surprised positively. The gains from this position were reduced at the end of the semester, when the shock in meat prices together with inflationary fears of the exchange rate devaluation that occurred in November caused a repricing of the yield curve.

As in the first semester, the behavior of the exchange rate was difficult to predict. In addition to noise from the external environment, mainly due to the trade war, factors in the local environment pointed in opposite directions. On the one hand, we had the fiscal issue being addressed mainly through pension reform and the activity differential between Brazil and the US was narrowing, and, on the other hand, we had the interest rate differential between Brazil and the US narrowing and the disappointment with the participation of foreigners in the onerous assignment auctions. Finally, this asset class, as in the first half, contributed negatively to the fund in the period.



We appreciate the trust of our customers and partners.

Thank you,

Alaska Asset Management