BOGARI capital

BOGARI VALUE FIC DE FIA

Investor Letter 28, Quarter 3 2014 – Portfolio

Bogari Value FIC de FIA is an investment vehicle focused on equity investments in Brazilian public companies. The fund's objective is to provide its clients with long-term capital appreciation by investing in companies whose stocks are trading at a substantial discount to their intrinsic values.

Our Performance

Until November 2014 our return was +5.6%, against Bovespa's +6.2%.

Since inception[1] our absolute return was 1,320%, compared to a return of 37% from Bovespa. During this period, our NAV appreciated to R$1,420 from R$100.

	Annual Returns		
Year	**Bogari**	**Ibov**	**Δ (p.p.)**
2014	**5.6%**	6.2%	-0.6
2013	**4.5%**	-15.5%	+20.0
2012	**25.1%**	7.4%	+17.7
2011	**-0.5%**	-18.1%	+17.6
2010	**29.5%**	1.0%	+28.5
2009	**122.0%**	82.7%	+39.3
2008(1)	**-20.1%**	-41.2%	+21.1
2007(1)	**278.8%**	43.7%	+235.2
2006(1)	**18.7%**	11.4%	+7.3

	Accumulated since Inception		
Year	**Bogari**	**Ibov**	**Δ (p.p.)**
2014	**1,319.9%**	37.0%	+1,282.8
2013	**1,244.0%**	29.0%	+1,215.0
2012	**1,186.5%**	52.6%	+1,133.9
2011	**928.4%**	42.1%	+886.3
2010	**933.3%**	73.6%	+859.7
2009	**697.8%**	71.8%	+626.0
2008(1)	**259.3%**	-6.0%	+265.3
2007(1)	**349.6%**	60.0%	+289.6
2006(1)	**18.7%**	11.4%	+7.3

This year has been marked by two events that attracted much attention: the World Cup tournament and the presidential elections. These events resulted in a decrease in economic activity and the postponement of relevant capital expenditure decisions. Hence, it comes as no surprise that economic activity stalled during the year despite the government stimulus. Consequently, the market acted erratically during the year, and fluctuated with expectations of poll results, ranging from the hope of a presidential change to the fear of political continuity.

The election result was binary, which was reflected in market expectations and the valuation of Brazilian companies.

The incumbent's victory and perceptions of a continuation of economic policies drove lower expected future cash flows than would have been the case otherwise. There were mainly two reasons for this: (1) the reduction of potential growth in the short and medium term, and (2) higher risk perceived by the market, which increases discount rates.

Given this context we opted to build a portfolio which would not be unduly affected by the above risks. Therefore, we reduced some assets that would be vulnerable to the election outcome while acquiring or maintaining assets that were more tied to microeconomic strengths and less dependent on the political and macro environment.

This letter is divided into three sections: a summary of the fund performance (this section), a brief update of our portfolio and a few topics of interest that we believe are noteworthy.

In this letter our main topic will be our portfolio; therefore, instead of offering a brief update, we will comment on our main holdings in more detail. Additionally, we will cover some themes that dominated the elections.

Hiroo Onoda

Hiroo Onoda, officer of the Imperial Japanese Army, died in January 2014. Onoda was known for being the second to last soldier to surrender in World War II (the last was Teruo Nakamura, who received less attention than Onoda). His surrender occurred after many unsuccessful attempts to convince him that the war was over. In order to surrender he demanded that his former superior officer, Major Yoshimi Taniguchi, gave the order in person. At last, in 1974, Onoda surrendered after Taniguchi told him not only that the war was over but also that Japan had been defeated.

The 2014 Brazilian election campaign was marked by radicalization of all parties. Many times we had the impression that we were seeing another Hiroo Onoda.

[1] The vehicle was founded in 1 Nov 2006 as an investment club. In 8 July 2008 it was transformed into Bogari Value FIA and in 26 Oct 2012 in Bogari Value FIC FIA. The average NAV of the fund in the last 12 months was of R$323.3 million and the present NAV is R$302.5 million. The year-on-year returns were 4.0%.

Communist topics such as class conflict and hegemony, among others, reminded us of the Cold War. Sometimes it seemed to be a 1950 redux.

Apparently, someone forgot to mention that the Berlin Wall fell 25 years ago and that formerly communist countries were no longer communist for many years now. Moreover, European citizens are not interested in reliving this experience.

However, soldiers from Onoda´s "tribe" are still fighting. Maybe it is time to call Major Taniguchi so the Onodas can finally surrender.

Our portfolio

Historically, our portfolio turnover tends to be very low, and it was not different in the last quarters. Nonetheless, this year we sold some assets, which were held in our portfolio for a considerable time. The main reason was due to the risk of changes in the economics of the underlying businesses of these companies. Our perception of risk sometimes differs from the market, and shares of these companies kept rallying, at least for some time.

For instance, we decided to sell Cemig based on the risk of a change of governors in the state of Minas Gerais, which would probably trigger a change of the management of the company to a less market-friendly one. Additionally, Cemig's share price was already reflecting a scenario of maintenance for a few years of some concessions which have expired. As the case is complex, and is being decided in the courts, we would rather see it as an optionality. Hence, we decided to take profits on this investment.

We also reduced exposure to some less liquid assets since we believed those assets will suffer over the short term as the Brazilian financial market gets worse and these companies will likely be more heavily discounted by investors relative to more liquid peers.

For example, we decided to dispose of our investment in BHG for reasons related both to the micro and macro outlook. During our selling process the company announced a buyback of all its shares in order to go private. We took advantage of the opportunity and readily sold all our shares. Looking back, we can say the case was more complex than we anticipated due to higher correlation of the industry with the country economy and greater competition, both from new hotels and from new service providers such as AirBnB.

Our portfolio remains focused on good assets at prices which we find attractive. Our top holdings are discussed below.

Itaú (Itaúsa)

The Brazilian commercial banking industry is characterized by a high level of concentration, consisting of a small number of companies with national scope. In a mature industry formed by rational players a price war rarely is benign, most often resulting in losses for all participants involved.

However, in the last couple of years the Brazilian banking industry went through a period of adjustments due to an aggressive competitive stance by public banks for growth and funding.

Itaú distanced itself from spread-based competition and designed a strategy focused on reducing the risk of its portfolio by: (1) targeting growth in credit lines with better guarantees; (2) strict cost control; and (3) an increase in the share of service-related revenues.

Results from previous quarters have supported Itaú's strategy. The bank's return has increased as the new and safer credit portfolio matures and older loans lose relevance. The level of returns currently presented by Itaú have not been this high since 2011.

What we expect:

Public banks are more leveraged due to strong growth in the last few years, which resulted in market share increases gained from private players. Their tight capital base as of today does not allow continuity of the aggressive strategy adopted in the recent past, especially when one considers the additional capital which will be required in order to comply with Basel III rules.

Hence, we expect that lower competition will allow Itaú to grow its portfolio marginally faster, but still cautiously as a result of fragility in the macro environment. If Brazil shows signs of a stronger than expected recovery, Itaú will be in an unparalleled competitive position to seize the gains presented under this scenario.

Cosan

Cosan's share price has been volatile this year. Part of this behavior is explained by the merger between Rumo and ALL, which involved long and complex negotiations. Antitrust approval by Cade is still pending, but some of the uncertainties were resolved as a result of the agreement between both sides and regulatory approval by ANTT.

The Fuel Distribution business has been delivering consistent results through time with positive volume growth and increasing returns despite anemic GDP growth in 2014.

The Sugar & Ethanol business has presented weak returns. And this for mainly two reasons: (1) sugar prices stayed low because of global oversupply of the commodity; and (2) the Brazilian government attempted to tame inflation by freezing pump prices thus negatively impacted ethanol prices. Confronted with a challenging macroeconomic scenario, Cosan has taken several measures such as cost-cutting initiatives and higher use of organic material for energy cogeneration, which we believe will improve profitability.

As for Comgás, the postponing of the tariff revision was positive, as the discussion would not be influenced by the elections. However, until the new terms are defined the company will hold back investments in the network due to the impossibility of properly evaluating their returns.

What we expect:

Although it is a complex subject, we do not see relevant barriers for the consummation of the Rumo-ALL deal. After the merger the resulting company will undergo some great adjustments. Processes, personnel and accounting will be revised. Increases in capacity and efficiency of transportation will require investments, which will take time to mature. However, we expect that after these changes the company will be in a privileged position to generate a significant amount of free cash flow.

In the Fuel Distribution business, we see room for growth, probably at a slower pace than in the last few years since both GDP and the growth of the country's automotive fleet will slow. Notwithstanding these factors mentioned, growth should be supported by the addition of new gas stations via conversion of so-called "white label" stations.

The government has already started and will likely keep correcting (even if timidly) domestic gas prices until they are in line with international levels. In addition, sugar supply has not been going up, which should help to match the supply-demand equation for the next harvests, resulting in higher prices. Hence, we expect the Sugar & Ethanol business to experience profitability increase in the coming years.

In Comgás we expect more investments in the near future, which will start to happen after the tariff revision, when the company will be able to estimate its return on capital invested.

Equatorial

The case for Equatorial has been evolving as expected. Cemar (MA) continues to grow and has excellent operating metrics when compared to the rest of the industry. The fast-paced growth presented by the company's region in the last few years caused a surge in energy demand, which is one of the few variables which can be appropriated by the company during the operating cycle.

In Celpa (PA) case they have been executing its turnaround excellently, achieving in the first 2 years significantly cost reductions, improvements in quality service and loss ratios. There is still a long way to go to meet regulatory targets, but early signs are encouraging.

The main risk to this investment case is related to the likelihood of Brazil being forced to decree a power-rationing program, depending on how dry the rainy season is. As the risk of demand growth resides with the company, this program would likely affect the return of the investment.

What we expect:

Equatorial will succeed in executing Celpa's (PA) turnaround, improving its operating and financial indicators. Cemar will keep delivering good results and maintain its status as an operating benchmark in the industry.

In the case of a power-rationing decree, the impact on valuation should not be very relevant because the company is located in a region of low average consumption. The power-rationing for families with lower consumption will likely be more limited, following the same logic applied in the 2001 episode.

Additionally, we see further potential upside coming from an acquisition in the next couple of years, which we do not see priced as of today. Distributors under Eletrobrás management have been facing difficulties in fully delivering on the required operating targets. The company has not been able to improve operations, which require more investments and better management. After MP 579, Eletrobrás lost a relevant share of its revenues, therefore impairing its investment capacity. Its restructuring plan mentions the disposal of some distributors, which we tend to see as an attractive opportunity for Equatorial.

Cielo

Cielo has been experiencing structural changes in its business model and fiercer competition from new entrants in the last few years. Up until 2010, the industry was a duopoly, before the emergence of new entrants. Finally the Central Bank became its regulator instituting a new regulatory framework.

So far, Cielo has been able to play very well this game as the major incumbent, not acting irrationally with price wars or competing for market share, therefore helping the industry to preserve its healthy profit margins.

Volume growth in credit/debit transactions has been resilient, although at a diminishing rate, which in part is being caused by deceleration in economic activity. On the other hand, receivables discount operations have been growing steadily, reaching almost 18% of its credit volume.

The major risk for this case lies on the regulatory front. The central bank has been establishing new regulatory frameworks, including the end of the remaining exclusivity arrangements between smaller brands and some acquirers. This should introduce more competition as retailers will be able to have POS terminals from only one acquirer, which will accept all brands. Hence, we foresee a more competition in which revenues from renting POS terminals will be lower, but with limited impact. Additionally, we see further space for regulatory initiatives targeting increased competition down the road.

What we expect:

Despite the short term slowdown in the economy, the secular trend is still encouraging for this industry. Brazil still has a relevant part of its population out of the banking system and there is room to substitute paper and check for electronic transactions, perhaps at a slower pace than that observed in the last decade.

The share of new entrants will keep increasing, benefiting from central bank measures to foster competition as mentioned above. However, we believe market share by itself is misleading indicator since it does not account for the fact that the profitability of serving large clients is considerably lower than serving small clients. We see Cielo's distribution channel unequaled in the industry, especially if one considers the scale supplied by its controlling entities (Banco do Brasil and Bradesco). This attribute allows Cielo to reach smaller and more profitable clients than its competitors. Hence, we expect that the company will lose market share in larger clients, where competition is fiercer, but maintain or even increase penetration in smaller clients.

From a regulatory standpoint there are some discussions about changing the payment scheme, reducing from T+30 to T+2 the timeframe when retailers should receive the money from their credit card sales. We believe any change in the timeframe is a delicate matter and shall be discussed with all relevant parties involved. We do not believe this will happen in the short term, especially when one takes into account the fact that the Central Bank's latest measures to increase competition have not been fully implemented and will take time to develop.

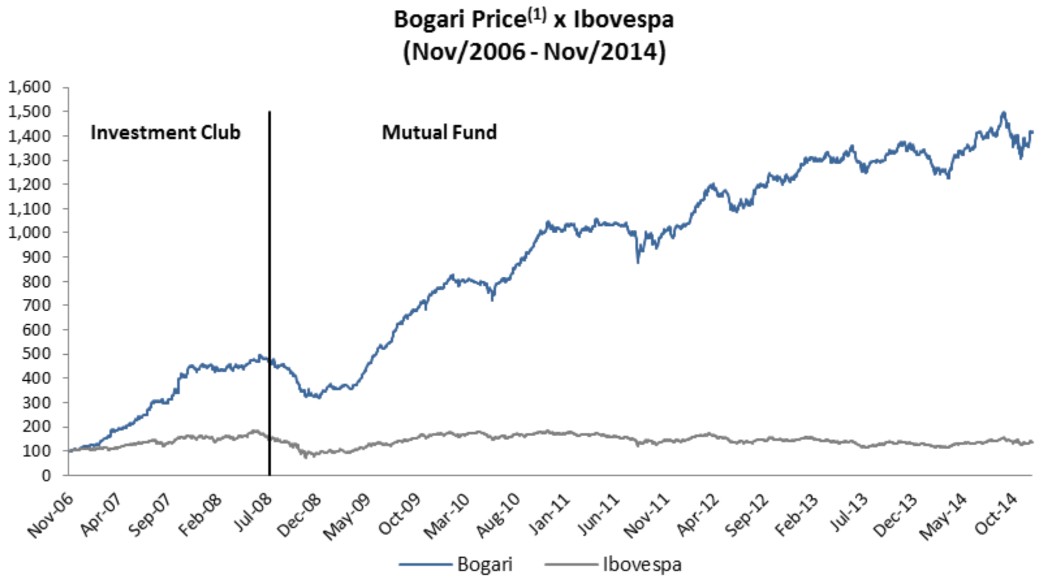
Final Considerations

As we like to emphasize in all of our letters, our portfolio is adequately diversified. Our top holding represents 13% of the portfolio, while our top 5 positions represent less than 40%. The portfolio is very liquid: besides holding 27% in cash and cash equivalents, we are able to sell 90% of the portfolio in 7 days. We continue to hold great companies at good prices and with good future prospects over the coming years. Additionally, we are also prepared to weather a possible market downturn.

Thank you for your trust and support.

Monthly Returns

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2014	Bogari	-5.9%	-0.5%	3.4%	1.7%	1.5%	4.1%	0.2%	6.5%	-7.7%	1.1%	1.9%		5.6%
	Ibov	-7.5%	-1.1%	7.1%	2.4%	-0.8%	3.8%	5.0%	9.8%	-11.7%	0.9%	0.2%		6.2%
2013	Bogari	1.2%	0.9%	-0.4%	1.2%	0.4%	-3.6%	0.8%	0.4%	2.1%	3.7%	-0.7%	-1.5%	4.5%
	Ibov	-2.0%	-3.9%	-1.9%	-0.8%	-4.3%	-11.3%	1.6%	3.7%	4.7%	3.7%	-3.3%	-1.9%	-15.5%
2012	Bogari	5.9%	5.9%	2.2%	0.0%	-6.0%	1.1%	4.3%	2.0%	2.6%	-0.4%	1.7%	4.1%	25.1%
	Ibov	11.1%	4.3%	-2.0%	-4.2%	-11.9%	-0.2%	3.2%	1.7%	3.7%	-3.6%	0.7%	6.1%	7.4%
2011	Bogari	-2.0%	0.7%	2.1%	0.3%	0.0%	-0.9%	-2.9%	-2.1%	-1.9%	4.2%	0.8%	1.5%	-0.5%
	Ibov	-3.9%	1.2%	1.8%	-3.6%	-2.3%	-3.4%	-5.7%	-4.0%	-7.4%	11.5%	-2.5%	-0.2%	-18.1%
2010	Bogari	0.0%	0.0%	-0.4%	-0.7%	-0.1%	1.2%	8.7%	4.4%	6.7%	4.8%	0.3%	1.7%	29.5%
	Ibov	-4.6%	1.7%	5.8%	-4.0%	-6.6%	-3.3%	10.8%	-3.5%	6.6%	1.8%	-4.2%	2.4%	1.0%
2009	Bogari	-1.2%	5.5%	-0.9%	21.3%	12.3%	5.1%	15.1%	7.3%	4.0%	3.0%	8.7%	4.2%	122.0%
	Ibov	4.7%	-2.8%	7.2%	15.6%	12.5%	-3.3%	6.4%	3.1%	8.9%	0.0%	8.9%	2.3%	82.7%
2008(1)	Bogari	-3.6%	3.9%	-1.2%	3.1%	2.5%	2.2%	-7.3%	-0.8%	-12.9%	-13.0%	-0.6%	7.8%	-20.1%
	Ibov	-6.9%	6.7%	-4.0%	11.3%	7.0%	-10.4%	-8.5%	-6.4%	-11.0%	-24.8%	-1.8%	2.6%	-41.2%
2007(1)	Bogari	9.4%	25.7%	14.4%	9.7%	16.3%	13.9%	11.3%	3.3%	8.8%	28.6%	0.6%	2.4%	278.8%
	Ibov	0.4%	-1.7%	4.4%	6.9%	6.8%	4.1%	-0.4%	0.8%	10.7%	8.0%	-3.5%	1.4%	43.7%
2006(1)	Bogari											5.1%	12.9%	18.7%
	Ibov											5.0%	6.1%	11.4%



Note: (1) Bogari Investment Club inception was in November 1, 2006. In July 8, 2008, the investment club was converted into Bogari Value FIA. The last 12 months average assets under management are R$ 323.3mm and the current are R$ 302.5 mm. The last 12 months return is 4.0%.

Fund Information

Administration	BNY Mellon Serviços Financeiros DTVM S/A	**Investment NAV**	D+1 (workdays)
Investment Management	Bogari Gestão de Investimentos Ltda.	**Redemption NAV**	D+30 (calendar days)
Distribution	BNY Mellon Serviços Financeiros DTVM S/A	**Settlement**	D+33 (30 calendar days + 3 workdays)
Custody	Banco Bradesco S.A.	**Management Fee**	2.175% (Max.: 2.5%)
Auditor	KPMG Auditores Independentes	**Performance Fee**	20% of return exceeding the benchmark – Ibovespa (with high watermark)
Minimum investment	R$ 30,000.00	**Anbima Code**	212962
Minimum balance	R$ 30,000.00	**Anbima Classification**	Ações Ibovespa Ativo
Minimum transaction	R$ 10,000.00	**Pricing**	Closing
Maximum initial invesment	R$ 20 million	**Notice**	9hs to 14hs
Target Audience	General Investors		

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