BOGARI capital

BOGARI VALUE

Investor Letter 15, Quarter 1 2011 – Fund Classifications

Bogari Value 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 discount to intrinsic value.

Our Performance

In the first two months of 2011, Bogari Value's performance was -1.3%, against Ibovespa's -2.8%.

Since inception[1], our total return was +920%, compared to +69% for Ibovespa. During this period, our NAV per share appreciated to BRL 1,020 from BRL 100.

	Annual Performance		
Year	**Bogari**	**Bovespa**	**Outperformance(%)**
2011	**-1.3%**	-2.8%	+1.5
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**	**Bovespa**	**Outperformance(%)**
2011	**920.0%**	68.8%	+851.2
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

The year 2011 began with a healthy drop in the local market and with the resurgence of external uncertainty.

Even with the recent decline in the Ibovespa, much of the assets linked to the domestic market continue to be traded at higher prices than we would like. However, we are more excited about some assets that have seen stronger declines in recent months. We expect that with the continuity of the market we will be able to continue the acquisition of good assets that present low risk and good returns for the coming years.

In general, our investor letters are organized by sections, the first section being dedicated to update our performance, followed by a brief update on the portfolio, and lastly a section dedicated to general topics, related to companies or the general economy, which we believe to be worth sharing with our investors. In this issue, we will discuss our investment in Grendene, as well as investment fund classifications.

Portfolio Commentary

As we explained in past letters, we took advantage of more significant downturns in the market to make some important moves in the portfolio.

First, as the market receded, we gradually increased our equity position, reducing cash. Additionally, we continued the sale of assets with greater downside risk and/or lower upside potential, and acquired others with lower downside, higher upside and/or comparatively better quality. Even though we manage a long only fund, we have had relative success in avoiding downside. We would like this pattern to continue like this.

Hering, Kroton, Eztec and Equatorial are among the positions we have exited in the last few months. Our exit from these assets does not mean that we no longer like these companies. We actually wish we had not sold some of them, but we believe that other opportunities seemed more appropriate. In particular, Hering and Eztec are companies that we have been involved as investors in one way or another since 2006 and 2008, respectively. We like their business models and trust their management. We hope to be able to invest in the again in the future.

In the next section we will comment our investment in Grendene, a position we have set up starting in the second half of 2010.

As we like to emphasize in our letters, we like to keep our portfolio adequately diversified. Our largest position is currently 10% of AUM and top 5 combined are around 35% of AUM. Our liquidity level is relatively high, holding an 18% cash-position and being able to liquidate almost 90% of our holdings in 10 days.

We continue to hold good assets in our portfolio, with great prospects for the next few years. Additionally, we are positioned to take advantage of a potential market devaluation.

[1] The vehicle was founded on 1 Nov 2006 as a private investment vehicle. On July 8, 2008 it was transformed into Bogari Value FIA.

Grendene

Grendene is one of the largest producers and the largest shoe exporter in Brazil. Their sandals and flip-flops are sold under brands such as Melissa, Ipanema, Rider, Grendha, among others.

The company has its origins in the 70s, when it produced plastic goods. Through in-house innovations, they began producing injected PVC footwear. Over time, the company realized they could command a premium for their goods by creating strong brands.

Its business model is based on heavy investments in marketing to support its brands and the launch of hundreds of products annually. In 2010, the company spent around BRL 130mn in marketing and advertising, which is in line with its guidance for this type of expenses, 8-10% of net revenues.

Domestic sales – which represent 80% of the total – are made through more than 60k points of sale and no customer has more than a 5% share of the company's total revenues.

Its production process is based on PVC-injection, which requires less manpower than a traditional footwear company. This allows the company to gain scale with growth in volumes and leaves it less prone to be impacted by the current shortage of labor.

On the other hand, its restriction to injected articles limits its performance in other market segments. One way to mitigate this limitation is through exports.

The company presents typical characteristics that we like in our investments: good return on capital, high cash generation and low investment needs. Additionally, its revenue is relatively stable, shows some growth, is not financially leveraged and has a defined controlling shareholder.

Due to the global crisis, the company adopted a conservative stance in 2009 and early 2010, considerably harming its 1H 2010 results. Also in 2009, believing that demand would not be strong the following year, the company chose not to increase its prices, believing that it would maintain sales volumes and keep its factories at capacity.

However, between government stimulus and softer than expected crisis, demand turned out to be stronger than expected. The company preferred to maintain its long-standing commercial policy of not making mid-season price adjustments. With the market heated and prices relatively low, sales were above expectations. The company incurred extra costs such as additional shift and overtime to meet customer orders, significantly affecting the cost of the products sold.

As a consequence, the results of 1H 2010 were very weak. One of our hypotheses about the investment was that such results would be temporary and with a return to normal prices it would be possible for the company to return to its historic profitability levels. We started buying at very attractive prices, equivalent to just over 7x 2010 profits, which is good in absolute terms and even better for a market where the prices of assets linked to the domestic market were at much higher levels.

As expected, the second 2H 2010 was very good, with the company showing good volumes and higher prices, which resulted in record margins.

We expect revenues to grow moderately in the coming years, but the company's profit will continue to grow more strongly. Additionally, we believe that there are some optionalities not priced by the markets.

The first – which came to fruition in early 2011 – was the increase in dividends. A peculiar point of the company is the amount of cash accumulated. Its market value is approximately BRL 2.7bn, and its net cash is BRL 850mn, so nearly a third of its value is cash. The problem for the investor in this case is that while the shoe operation has a return of over 25% per year, the cash yields a little more than 10% per year (close to CDI). And with a relevant cash generation and no major need for new investments, the trend was for this cash position to further increase.

The origin of excess cash is that part of Grendene's profit comes from tax incentives. Until 2008, this result was recorded directly in shareholders' equity and could not be distributed to shareholders, only reinvested in the company itself.

With the changes resulting from convergence to IFRS, the result became distributable, provided that it was taxed. After consulting the IRS, it was concluded that the tax rate of this distribution would be around 15%. In its announcement of the results of 2010, Grendene stated that it would distribute around 75% of profits starting in 2011. This should represent approximately 9% of the current market value of the company.

Another optionality is for Grendene to follow the example of other shoe manufacturers and create a network of their own stores. By entering retail, the company would have an excellent channel to advertise its wide range of products, a place to test and have faster product feedback, and capture part of the final margin of sale, which is now in the hands of shopkeepers.

Finally, we believe that having a share of its revenues in USD, which is a problem today, is also an optionality for the future. Although it is difficult to see today, the appreciation of the dollar will eventually generate higher margins in exports.

In short, even in a relatively expensive market, we find Grendene to be a secure investment, with good prospects and a very adequate price (probably still the cheapest consumer company in the stock market). In addition, we are still taking free options that have a reasonable chance of materializing in the medium term.

Musings On The "Taxonomy" of Funds

Taxonomy is the science of classification – originally only the classification of living organisms. Over time, the use of the word has been expanded to its current definition.

Normally, taxonomic schemes are hierarchical. It is initiated by a generic characteristic, shared by the set of items classified, being further divided into subsets with more specific characteristics.

For example, in the world of investment funds, regulatory bodies typically classify these vehicles by the characteristics of their main holdings. Its main subgroups are equity funds, multi-strategy, fixed income, real estate, private equity, among others.

Among the equity funds, which is the subgroup we are in, the most accepted rating is that of Anbima, the self-regulating agent of the Brazilian fund industry. The existing classification of equity funds groups vehicles in relation to their benchmark or the characteristics of their assets. Our fund, the Bogari Value FIA, is classified as an active Ibovespa fund, reflecting our objective of exceeding this index in the long term.

Classifications, like trademarks, are mental shortcuts that help human beings live in an environment where the amount of information available is far superior to that which can be processed by the brain. In this way, this type of resource is regularly used to simplify our decision making process.

We can give an example of this in a very simple way. Imagine that you go to a small diner and read on the menu that the establishment has "a delicious house hamburger", without further details. Of course, what is expected is that they serve a round burger bun with the rounded grilled meat. Imagine the discomfort it would have caused if the waiter brought a sandwich, with the exact ingredients of the hamburger, into a hot dog bun and a sausage-shaped meat.

Psychologically, a great "distance" between your expectation and reality opens up, generating a sense of discomfort and frustration. Your first reaction would be to think they had served the wrong dish, since you had not asked for kafta sandwich on hot dog bread. You might even think that if it were in a pita bread with hummus, it might be nice, if a little strange. After some reflection, it would be natural to ask the waiter what that was. The answer could be that this was the house burger, which is different, but delicious. The characterization of what we classify as a hamburger and poor communication are capable of generating this disparity between expectations and results.

Now imagine that you are on a long vacation in China. After eating only local food for weeks, you miss eating a hamburger, so you go to a McDonald's and order a Big Mac. In that case, you will nearly certainly get exactly what you asked for. Going to a brand name establishment is an easy and efficient way to fully meet your expectations. A good brand generates a certain level of expectation by the customer – in this case the hamburger – and meets expectations without creating a gap to the end result.

The classification of funds is not exactly like this, but also helps little in the understanding of the investment strategy and the risks of each class. We were able to discuss in our letter #12 (July/August 2010) the difficulty of classifying funds according to their strategy. The information that our goal is to beat the Ibovespa adds little value.

Bogari Value FIA has, for some time, been likened to a small-caps fund. This is not completely unfathomable considering our portfolio has always held smaller companies. However, we have always maintained that our objective is to buy good assets at adequate prices, regardless of any other characteristics. Moreover, we have often repeated that we tend to prefer larger companies to small ones, but, under normal conditions, larger companies tend to be more expensive due to their higher levels of liquidity, and for being well known in the markets.

However, over the last few months, larger companies have gotten more attractive than their smaller peers. We have started to take advantage of these opportunities, which drove our portfolio to present a relevant mix of large-cap holdings. Companies like Itau, Redecard, Petrobras and Telemar have become part of our portfolio.

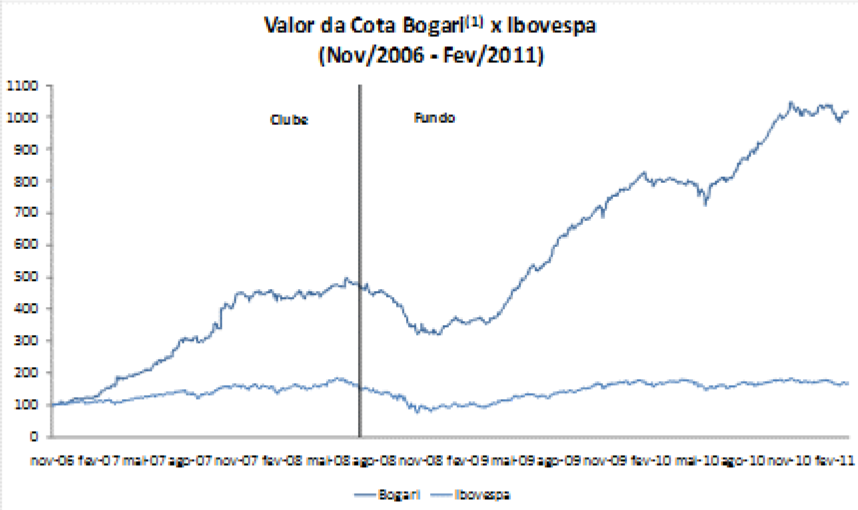
The portfolio of companies we hold is just a consequence of our investment process. We seek to select assets with low probability of permanent capital loss, high probability of increased future cash flow generation, at adequate prices both in absolute and relative terms.

Our Fund should not be classified by the characteristics of its holdings, as we do not aim to focus on a particular type of company. Our sole commitment is with the strategy of delivering performance over the long term. Therefore, we hope to avoid creating a large "gap" between what's expected and reality, so that no one thinks they're buying a hot dog when they're actually buying a hamburger.

Thank you for your trust.

Monthly Returns (BRL – Net of Fees)

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2011	Bogari	-2.0%	0.7%											-1.3%
	Ibov	-3.9%	1.2%											-2.8%
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%



(1) Bogari Value was launched as a regulated private investment vehicle in November 1, 2006. In July 8, 2008, the vehicle was converted into Bogari Value FIA

Main Fund Characteristics (Brazilian Onshore Vehicle)

Administrator	BNY Mellon Serviços Financeiros DTVM S/A	**Subscription**	T+1
Manager	Bogari Gestão de Investimentos Ltda.	**Redemption**	T+30
Distributor	BNY Mellon Serviços Financeiros DTVM S/A	**Settlement**	T+33
Custodian	Banco Bradesco S.A.	**Management Fee**	2.175%
Auditor	KPMG Auditores Independentes	**Performance Fee**	20% over Ibovespa (w/ high watermark)
Minimum Investment	R$ 50,000.00	**Anbima Identifier**	212962
Minimum Balance	R$ 50,000.00	**Classification**	Equities Ibovespa
Minimum Transaction	R$ 10,000.00	**NAV**	Close of Business Day

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