



BOGARI VALUE

Investor Letter 17, Quarter 2 2011 – Law and Economics

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

As of June 2011, Bogari Value's performance was +0.1%, against Ibovespa's -10.0%.

Since inception¹, our total return was +934%, compared to +56% for Ibovespa. During this period, our NAV per share appreciated to BRL 1,034 from BRL 100.

Annual Performance			
Year	Bogari	Ibovespa	Outperformance(%)
2011	0.1%	-10.0%	+10.1
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	Ibovespa	Outperformance(%)
2011	934.4%	56.3%	+878.1
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

In the beginning of July our vehicle has completed 3 years as a fund and, in November, will complete 5 years since inception. We are satisfied with the consistency of the application of the strategy and, as a consequence, of the results obtained. We would like to share that in the last weeks Bogari Value was elected by an international publication the best Brazilian equity fund and also the best equity fund below US\$ 100mn.

The second quarter of the year was marked by intensified external market concerns and a slowdown in domestic market growth mainly due to rising interest rates.

Ibovespa fell 10% while our fund's NAV remained broadly unchanged. Although the result is nominally weak, in relative terms we have outperformed our benchmark by over 10%.

As discussed earlier, we believe that the year will continue to be difficult. However, our portfolio, as commented before, is one of the best in recent 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 Redecard, followed by commentary on the influence of the concepts of *law and economics* in Brazil.

Portfolio Commentary

Despite believing that the market, even after corrections, continues to adequately price many of the public equities, our portfolio has the best prospects since 2009. The main positions have changed little in the last few months, but we have taken advantage of recent drops to acquire larger stakes in some companies and start new investments with a good potential for the next few years.

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 a 20% 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.

Redecard

Redecard captures credit and debit card transactions, interconnecting merchants, card issuers and banks. It is responsible for accrediting commercial establishments, capturing transactions, approving transactions with the client's credit card brand and card-issuing bank, and then making payments to retailers.

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.

The acquiring market in Brazil has developed around retail banks. Initially, banks were responsible, in addition to the issuance of cards, also for the accreditation of merchants and settlement of transactions. Since the second half of the 1990s, banks have basically organized into two groups, each of which prioritized one of the major international brands (Visa and Mastercard). Thus, Redecard was created by Itaú, Unibanco and Citibank and Visanet (now Cielo), by Bradesco, Banco do Brasil and ABN Amro (now Santander). With this, the functions of card issuer and that of the acquirer were separated, but control remains in the hands of the big banks.

The growth of the industry was large, driven mainly by increased access to banking of the population, increasing substitution of payment methods like check and money by debit and credit cards, and generally the increase of household income. Over the last ten years, credit card transaction volumes have grown by more than 20% per year and debit by over 30%. We do not see this growth reaching the same rates as in the past, but it should still continue at somewhat high rates. An advantage of this industry is that inflation is automatically passed through to the acquirer's revenue, since they earn a percentage of the transactions made. In this recent scenario of high inflation, we do not have to worry about price pass-through as in other sectors.

Until the middle of 2010, the exclusivity in the transactions by brand persisted, with Redecard being responsible for any transaction with MasterCard, and Cielo for Visa transactions. The two companies had practically a duopoly, since the other existing brands operate in specific niches or have little penetration in the market. This situation of virtual duopoly changed due to pressure from government agencies, which saw that the gains in scale from the growth of the industry were not being passed on to other links in the chain, especially the shopkeepers, due to lack of competition.

The return on capital was and still is very high compared to other sectors. Marginal investments are low and cash generation is high, with no need for significant reinvestment. With this, for established players, it is possible to grow at high rates and still revert enough cash to shareholders in the form of dividends.

It was "agreed" between the government and companies that the second half of 2010 would see the end of the monopoly on capturing transactions from brands. Thus, both Redecard and Cielo began capturing Visa and Mastercard transactions, allowing one company to compete for the other's market. We believed that competition between the two companies would be mild because, economically, it did not make sense for the two dominant players to enter into a price war. Redecard, because it had a smaller market, might have more to gain by being more aggressive, because the market share of Visa that it did not capture was larger, accounting for around 60% of transactions. However, its competitive stance was very aggressive, leading to intense and quick drop in prices.

Although we followed the industry closely in this time of competition, we had not started to buy the shares in either

Cielo or Redecard, because their share prices were pricing a fall that was feasible in our scenarios. However, after the first quarterly results following the beginning of effective competition, stock prices fell to levels that made us comfortable. As is very common in the market, the price reflected a perpetuation of the competitive landscape at the time, that is, a sharp fall in margins for several successive quarters.

As shares fell, we were able to build up a relevant position in our portfolio, however the fall was abruptly interrupted by the departure of the then president of Redecard. Considered by many to be the instigator of the price war, this dismissal sounded as a warning that there would be a truce and competition would be more rational. The indications are that Redecard discounts have been exaggerated and we must have a healthier competitive environment ahead.

As for new entrants, we have Getnet as an effective competitor nowadays, with Santander behind its operation. In addition, there are statements of intention from other international players about plans to enter Brazil. We see great difficulty for new entrants, since this is a business of scale and capillarity. Scale is needed to dilute the large operating costs and capillarity needed to reach small merchantss, where the largest margins can be found. Scale can be obtained by providing service to large retailers, however these already represent the smallest margins in the industry. To achieve capillarity, it is necessary to have a sales channel spread throughout the country, which is exactly what large retail banks have. As the largest are already aligned with some acquiring company, it will not be easy to achieve a national level operation.

We believe that Getnet should grow and can reach a share equivalent to Santander's market share in banking. It is even possible that a relevant new player may enter the market, however it will require a very large investment over a long time horizon, so we think this event is of low probability. In addition, if there was anything positive about this reduction in margins due to the competition between Redecard and Cielo, it was to make it even more expensive for a new entrant to be able to take market share. In short, we are unlikely to have multiple players in this market as we see in international cases, as there are very great advantages for established players.

Currently, we still see a lot of potential in shares of both companies, as we have as a base scenario a cooling of the competition and the continuous growth of the market as a whole. With that, at some point we should see a return on corporate profit growth, momentarily interrupted by the tightening of margins due to competition.

At this moment, we have a bigger position in Redecard, as we believe that it has been more penalized, has a still relevant potential market share to capture from Cielo (its market share is still much smaller) and we still have an optionality of a possible capital closing. In our opinion, it would be perfectly feasible for Itaú, now sole controller of Redecard, to repurchase the portion of shares held by minority shareholders.

Law and Economics in Brazil

Law and economics, pertains to the economic analysis of laws. Its definition may be the application of economic theory to analyze the formation, structure, processes and impact of laws and legal institutions. The idea of using economic concepts to analyze the impact of laws and institutions is older than it seems. Historians find evidence of this type of analysis in authors such as Adam Smith, Machiavelli and David Hume, among others.

However, the modern form of economic law analysis began to be formed in the 1950s. In the 1970s, such knowledge was taught at universities and Chicago became one of the important centers of discussion. The most relevant themes are: institutions and institutionalization, market regulation and competition, as well as human behavior.

The existence of institutions, the stability of rules and respect for the rule of law are fundamental for the evaluation of the project for a nation. In Brazil, this understanding is new and still in the consolidation phase.

The end of the dictatorship and the return of the rule of law marked the maturing of the Brazilian economic model. The transition was not easy. While previously we had a non-democratic state that, paradoxically, respected economic rules, soon after we came to have a new democratic state in which the politicians had great difficulty to understand limits and what should be the example to form a nation.

Large businessmen who worked with the government in this transition phase comment that while what was agreed with the military government was respected, with politicians it was no longer the case. In view of the above, it is not surprising that at that time we had runaway inflation, a foreign debt default and the impeachment of a president. Almost as a counterexample of the basic concept of law and economics, we had the promulgation of the Constitution of the Citizen of 1988, which in the best fashion of a paternalistic country created a series of rights for the people without any obligations in return.

The country's adaptation to the democratic model was rather troubled. The maturing of the political class was slow. However, in evolutionary terms and, taking away its excesses, the new constitution played an important role in the institutionalization of the country.

Then we were fortunate to have a president like Fernando Henrique Cardoso, perhaps the most important case of being the right person in the right place at the right time. With a solid academic background, he knew the value of institutions. His government had a strongly structuring and modernizing character. Issues such as the importance of economic stability, regulatory agencies, Fiscal Responsibility Law, privatization, universalization of education and family grants, have been initiated here.

Unfortunately, the maturation process is not linear in all areas, and the schizophrenic profile of the government still contributed greatly to worsening the situation in some areas. However, the government's balance was very positive and

its end was crowned with the transmission of the presidency to a leftist party, in full respect of the democratic institutions.

Lula, despite not having had the institutionalizing profile of his predecessor, ended up being a great president. Perhaps his chief characteristic as ruler was to have had the good sense to look around and see what the people wanted. The main achievement of Lula, no doubt, was to end the "Lula risk". His common sense was fundamental to seeing that the people could not stand the economic instability, and 2002 was certainly a good example of what could happen if he continued to defend some more radical ideas of the left. Fundamental, from a historical point of view, was the Letter to the Brazilian People, which, despite trying to "create a new model", confirmed the commitment of the then candidate to the current economic model, with a deepening of respect for contracts.

Lula, contrary to what may seem, contributed a great deal to the institutionalization of the country by respecting its rules and leaving the potential Chavista revolutionary discourse aside. His ideological bent even remained transparent over the years, however, he maintained his commitment to respect for contracts. Stability was the will of the people.

What the ruling parties did very successfully was learning to play with those new rules. They quickly understood how Republican logic worked and began to act at the edge of the rules. At the same time, regulatory agencies were losing power, privatization was made on a piecemeal basis (even more mature than in the previous government) and the state became more present in some areas and more clearly encouraging some "national projects". Social programs were strongly driven with great success.

With practicality, the new governors understood that the market could boost their projects so long as they were aligned with the economic interests. With economic stability, the capital market was reborn. The Natura IPO represented the revival of the Brazilian Stock Exchange, now through the Novo Mercado, in 2004. Still surfing the commodity boom and the world growth, the Lula governments were a success. Never before in the history of this country have so many people made so much money. The rich became richer, many entrepreneurs, this time from the real sector of the economy, became very rich, poverty declined and a new middle class formed. Undeniably a success.

Without surprises, Lula was able to elect his successor. Surprisingly, he elected a president with little charisma or political experience, despite extensive public experience. However, we would prefer to pass our judgements on Dilma in a few years.

After this recap on the current Brazilian history, we must discuss the economic impact of the last years. What we now find to be basic was not the case for some time. What we call respect for contracts refers to creating the rules and maintaining them while the game is being played. A game cannot have its rules changed midway, only for those who have not started.

Having a democratic political model (executive and legislative) and having a stable and reliable legal model are worth a lot. In fact, the easiest way to understand the value of institutions is to go to a country where they do not exist or are weak.

For years, some friends have had business with Ecuador. It was interesting to note that years of work were interrupted by the fall of the president, exchange of the judiciary or something similar. What actually happens is that fewer people want to do business with the country and those who want it, demand more guarantees and a bigger return to pay the risk. Undoubtedly, political and judicial instability increases the cost of capital and reduces potential growth.

A text that had a lot of influence in Brazil, elaborated in 2003, was "Credit, Interest, and Jurisdictional Uncertainty: Conjectures on the Case of Brazil" by P rsio Arida, Edmar Bacha and Andr  Lara Resende. The group of authors argues that the uncertainties affect the interest rate curve and the exchange rate. Certainly, the text, released at the beginning of the Lula administration, helped in the process of developing respect for contracts in the local market. The Fiscal Responsibility Law was one of the most important contributions of the FHC government. Its first paragraph clearly synthesizes its basis.

"Responsibility in fiscal management presupposes a planned and transparent action, which prevents risks and corrects deviations that may affect the balance of public accounts, by meeting income targets between revenues and expenses and complying with limits and conditions in which refers to the renunciation of revenue, generation of expenses with personnel, social security and others ...".

From then on, the impact of the measures at the macroeconomic level was theoretically evaluated. Moreover,

noncompliance with the law imposes a series of punishments for members of government, including detention. Regardless of society's ability to punish its rulers or not, the cost of doing something significantly badly has increased a lot and thinking about the actions has become necessary. The acts of each leader came under control, at least causing a lot of headache.

Regulatory agencies have been formed to regulate and supervise economic sectors, such as electricity, telecommunications, railways and others. The agencies were created on top of an appropriate regulatory framework and provided important technical bias in the discussions of a particular sector, allowing the microeconomic understanding of each one. Issues such as monitoring the dynamics of industry, definition of rules, supervision, consumer protection and stimulation of competition are the main issues monitored. The clarity and stability of the rules, for example, was responsible for attracting new investors who have made large investments in recent years in the regulated sectors.

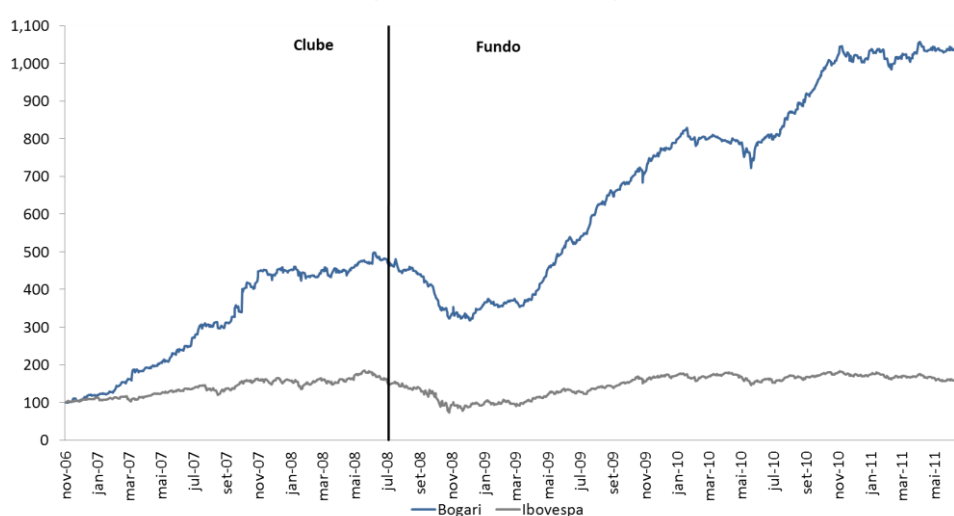
So in a brief survey, we can say that Fernando Henrique laid the foundations and Lula ended the Lula risk, allowing the country to be respected for its institutions and finances with the help of Chinese commodities demand. With this, modern capitalism arrived in Brazil. The success achieved in the recent past reinforces the discourse of respect for contracts. And the concept of "law and economics", although not exactly defined in these words, undoubtedly contributed to the improvement of the country. In addition, it contributed to Brazil becoming "fashionable" among international investors, perhaps even with some excess of optimism. But that is the theme for another letter.

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%	2.1%	0.3%	0.0%	-0.9%							0.1%
	Ibov	-3.9%	1.2%	1.8%	-3.6%	-2.3%	-3.4%							-10.0%
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%

Valor da Cota Bogari⁽¹⁾ x Ibovespa
(Nov/2006 - Jun/2011)



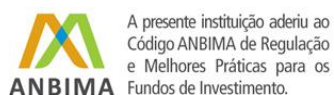
(1) Bogari Value was launched as a regulated private investment vehicle in November 1, 2006. In July 8, 2008, the vehicle was converted into Bogari Value FIA

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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In order to comply with applicable law, all investors must provide to the administrator copies of their identification documents prior to investing in the fund.



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