

BOGARI VALUE

Investor Letter 22, Quarter 2 2012 – Expectations

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 substantial discount to intrinsic value.

Our Performance

Up to June 2012, Bogari Value's performance was +8.8%, against Ibovespa's -4.2%.

Since inception¹, our total return was +1,019%, compared to +36% from Ibovespa. During this period, our NAV per share appreciated to BRL 1,119 from BRL 100.

Annual Performance			
Year	Bogari	Ibovespa	Outperformance(%)
2012	8.8%	-4.2%	+13.0
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	Ibovespa	Outperformance(%)
2012	1,019.0%	36.1%	+982.9
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

In the past few months, markets have continued to follow the path of uncertainty. We had a strong correction from the highs reached at the beginning of the year, mainly in cyclical and financial assets.

We continue to seek assets with an asymmetry in risk-return, i.e. with a low probability and intensity of a drop. We maintain our caution with regards to the deployment of capital in the fund, as we believe it is not unlikely there will be better opportunities for buying assets through the course of the year.

Notwithstanding, our portfolio continues to hold good assets at adequate prices and we believe that staying the course on

our strategy – which translated into smaller drawdowns and consistently positive performance – should bring us good returns in the long run.

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 comment on expectation management in the equity markets.

Portfolio Commentary

Over the past months, we saw earnings announcements for the first quarter of 2012. In aggregate, the results were not good, showing a deceleration in the economy.

The financial sector continued to be heavily penalized, mainly through pressure by the government for the reduction of financial spreads. Caixa Econômica Federal and Banco do Brasil were the vehicles used to pressure the banking system in the pursuit of this reduction. We understand that, in spite of the pressure, there was not a generalized irrational stance on the drop of credit costs to clients, as the banks sought better risks and guarantees to offset lower interest rates. Therefore, we do not expect to see large impacts on results, for the time being.

In Itaú, delinquencies increased mainly in auto loans. Lending was loosened in 2010 and early 2011. As a consequence, results for this year will be impacted. However, we do not believe there was a considerable change to the competitive environment and we still like the stock.

The positive highlight so far this year was the education sector, with a significant increase in enrollment. We have been following Kroton for some time, having been shareholders in 2009 and 2010. Late last year we started building up a position in this asset, taking advantage of a drop in its share price. The opportunity arose after the announcement of a capital increase pertaining to the acquisition of Unopar, a distance learning company. With the improvement in the sector, the asset appreciated

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.

considerably, having presented one of the best performances in the stock market this year.

Grendene also had great results, partly as a result of a weaker base for comparison in 2011, but also due to successful new collections. Besides revenues, margins were good, aided by government initiatives to lower payroll taxes. Despite a considerable increase in its share price, we believe the company remains an attractive investment. Additionally, we expect a good volume of dividends.

BR Insurance did not have a good start to the year, influenced by an insurance sector, which, on the whole, grew less than in previous years. A positive note were the changes in management, with a change of Chairman of the Board and the election of a new CEO. This incoming executive is one of the partners of the original brokers that formed the company at the IPO and has a sales background. This change should promoted a greater focus on sales and a bias towards organic growth.

As we like to emphasize in our letters, we like to keep our portfolio adequately diversified. Our largest position is currently 7.5% of AUM and top 5 combined are around 30% of AUM. We maintain high liquidity, holding a 30% cash-position and being able to sell 90%+ of our holdings in 5 days.

We continue to hold good assets in our portfolio, at compelling valuations and interesting perspectives for the next few years. Additionally, we are positioned to take advantage of a potential market devaluation.

From Promises to Delivery: Expectation Management and Facing Reality

People's perception of the future is a factor of great significance for the development of a society. Hope and expectations of a better future enable a human being's planning and organization. Without the perspective of a better future, humans see no reason to continue living life as it is, leading to the possibility of chaos and social unrest, often leading extremist groups to power.

In the financial markets, perceptions of the future have accentuated impacts, for human reactions ultimately translate into short-term numeric representations.

The importance of understanding expectations comes from the fact that we ignore what the future holds and many of our decisions must be taken today, so that their effects are perceived tomorrow. Decisions are taken based on the best understanding of the facts at the time and the establishment of a scenario of potential outcomes. As this emerges, the management of these expectations becomes necessary so that economies move forward adequately.

Specifically in the world of investing, managing expectations of the agents is crucial. Among the various methodologies of business valuation, the most widely used is the discounted cash flow. Under this view, the value of an asset is a function of its capacity to generate cash flow in the future, discounted

to present values. Since we cannot predict the future, we know that our capacity to suppose what will happen what will happen to a company is based on expectations for that asset.

A very promising scenario tends to generate optimistic analyses and high values for the asset. On the other hand, negative perspectives ultimately generate depreciated values. The extremes are accentuated because human beings have the characteristic to perpetuate the present. This characteristic, known to be one of the heuristics most studied by behavioral finances, is known as representativeness.

If we assume the market to be efficient most of the time, i.e. that normally negotiated assets are well priced, we have an interesting dynamic. Asset prices are calculated based on an unknown future and which, in turn, influences the formation of its price on the market. However, when these expectations are not met, the price of that asset tends to be corrected on the market.

In the service industry, expectation management is also fundamental in order to create a positive experience for the client. The reason being that, because the production and consumption occur simultaneously, there is great difficulty in guaranteeing the quality of the service. This is not the case when it comes to products, because production precedes consumption, and it is therefore easier to guarantee its quality.

The service consumer anchors (another heuristic) their pre-consumption expectations in what communication they can capture that a given establishment is trying to convey. In order to avoid dissonances between what is perceived and the actual experience, there must be coherence between words and actions. As an example, when we go to a more expensive and exclusive restaurant, we expect to receive great food and service. A bad experience will come from the failure to match the client's expectations. On the other hand, if we go to a simple and accessible restaurant and perceive great service and food, we will probably be pleasantly surprised and will be satisfied.

What does all this have to do with the world of investing? As previously said, the expectation of the agents is an important input in the process of asset price formation. Therefore, as a rule, anchoring investor expectations and avoiding large dissonances becomes an important role in the relation of companies with the market.

When expectations are consistently met, investors tend to get comfortable and company managers earn credibility as providers of a service. When, on the other hand, expectations fall short, investors lose tolerance up to the point of loss of credibility.

The most reasonable attitude for a long-term project is to keep expectations at a level that can be regularly matched. In operational terms, this means keeping growth and earnings expectations within reasonable levels where execution is consistent and feasible.

Short-term investors often try to create momentum for their stocks through strong growth levels and then taking advantage of the increase in stock prices to sell. Often at some point, asset prices go through a correction because proposed operational levels are not reasonable leading to a breakdown of expectations, as is currently the case with homebuilders.

Perhaps the clearest example of this dynamic is reflected in the markets through the volatility of the “X companies” (of Eike Batista’s EBX Group). His genius is undeniable. Very few entrepreneurs were able to build what he did in so little time. The reality however is plain to see. The projects are ambitious, with long maturities, and filled with uncertainties. Keeping expectations high helps to raise assets in the markets in the short term, but hurts credibility over the long run. This adjustment in expectations severely impacted the group’s shares.

There is no easy way in the world of business: over the long run, expectations and reality must converge and in our case, we prefer an upward convergence than a downward one.

In other fields, the level of expectations created does not match reality. The press has been publishing a litany of articles about the Higgs boson, dubbing it the “God particle”, a term that is disliked by the scientific community – probably because scientist who are well-versed with the particle have less divine expectations than the general public who ignores the subject. Below is a text published in the Financial Times on July 6th 2012:

“...The great American physicist Leon Lederman originally called the Higgs boson the “goddamn particle” in reference to how difficult it was to find. His publisher changed the phrase to “god particle” to publicise Professor Lederman’s new book.

Despite the disapproval of other physicists, including Prof Higgs, no one can doubt the public relations value of this tag.”

Creating high expectations for complex and abstract themes has some advantages. As few know the subject well, in some weeks the public will have forgotten the divine characteristics of the particle, without the need for its proof. Unfortunately, in the investment world the dynamic is different.

On the Challenges of Writing a Regular Investor Letter

As our readers know, we have originally set out to produce a bi-monthly investor letter. However, what most don’t realize is how difficult it is to elaborate. We will use this section to explain the fundamentals used to select the themes and the

consequences this choice has on the process of producing and publishing our letters.

The themes we aim to discuss must have the following criteria: at least somewhat intelligent, interesting, relevant, and convenient.

Somewhat intelligent for it would not make sense to waste our readers’ and our time with obvious conclusions.

Additionally, the theme should be interesting in terms of its originality. It would make little sense to address day-to-day markets or the world’s economic situation. It would make more sense to elaborate and explore theories on less explicit causes and consequences or tackle subjects that are more unusual.

Relevance comes from the correlation of the theme with the reality of our business. No matter how interesting, it would make little sense to discuss musical theories or trends in art without a clear analogy to the investment world.

Finally, convenience because we are not here to stir controversy for its own sake, but to constructively discuss the themes in question.

The challenge of publishing a regular letter stems precisely from finding a theme that contains all these characteristics. Most often, the themes are relevant and convenient, but are not in the least intelligent or interesting. Other times, the themes are intelligent, relevant and convenient, but are no longer interesting because they have been widely discussed in the market. In such cases, we miss the timing of the theme, as was the case with a potential discussion of Redecard. Finally, sometimes the themes are reasonably intelligent, interesting and relevant, but their discussion is not convenient.

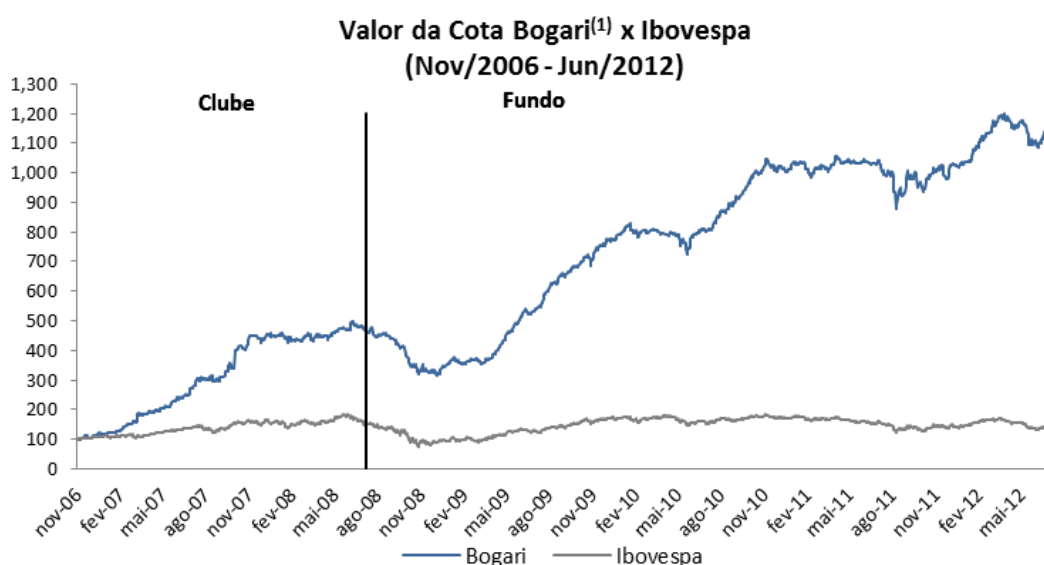
Therefore, at times we lack a “cool” theme to discuss in our letters, and since it is not our style to scrimp on quality we prefer to delay publication rather than discuss a theme that falls short of our standards. Therefore, for the first time since 2008, we have delayed our April/May letter so much that we effectively gave up on publishing it altogether.

While we do not like to do it, we prefer it to writing “anything” just for the sake of it. This shall be the case going forward. We will continue to strive to bring our readers good themes bi-monthly. However, in case we cannot, we will maintain our constitutional rights to silence, which is better than just publishing anything.

Thank you for your trust.

Monthly Returns (BRL – Net of Fees)

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2012	Bogari	5.9%	5.9%	2.2%	0.0%	-6.0%	1.1%							8.8%
	Ibov	11.1%	4.3%	-2.0%	-4.2%	-11.9%	-0.2%							-4.2%
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%



(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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