BOGARI capital

BOGARI VALUE

Investor Letter 24, Quarter 4 2012 – Risk Taking

Bogari Value FIC 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

In 2012 Bogari Value's performance was +25.1%, against Ibovespa's +7.48%.

Since inception,[1] our total return was +1,186%, compared to +53% from Ibovespa. During this period, our NAV per share appreciated to BRL 1,286 from BRL 100.

	Annual Performance		
Year	**Bogari**	**Bovespa**	**Outperformance(%)**
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**	**Bovespa**	**Outperformance(%)**
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

In the end, 2012 proved to be quieter than expected. Despite much uncertainty, the economic systems were gradually adjusted to avoid a broader breakdown.

Publicly traded equities in Brazil had differing dynamics. Once again, the big winners were themes linked to the domestic markets, this time less so for the growth in earnings and more because of their multiples. Generally, the better performing themes were assets linked to consumption, chiefly those which are associated with quality, and assets benefiting from falling interest rates. Assets linked to commodities have once again suffered with the uncertainties of the global economy.

We believe our performance has been quite adequate. Due to increased uncertainty in foreign markets, and higher asset prices in the domestic market, we have adopted a more conservative stance in 2012. In general, we demand a higher degree of asymmetry in our investments. Our portfolio had an average equity exposure around 70% throughout the year, with no relevant concentration. In reality, we have been less concentrated than our historic average. As we will explain further, this situation has already changed somewhat.

2013 looks like it may be similar to 2012, but different, as usual. The main theme may be a deepening of the global recession which, to some extent, may impact Brazil. It is worth noting that the reaction of regional social-political movements of countries involved in the economic crisis may have more relevant influence in the global arena. One day, the populations of the most affected countries may mobilize around local themes.

However, markets ended 2012 more optimistic than in previous years. It is possible that with the arrival of a deceleration, there could be an inflexion in the expectations of the markets, which may reflect on asset prices.

In the domestic markets, the government will keep fighting to improve the growth in the economy, with the possible disadvantage of worsening foreign markets. Some good macro managers believe the local long-term interest rates could fall further, converging towards that of other markets.

In terms of the local equity markets, the year may be difficult, as was 2012. Assets linked to the domestic market whose prices are not too high should benefit for not being as uncertain as commodity-linked assets.

However, we warn our readers that we are not in the business of futurology, and the scenario presented above is possibly wrong. Therefore, we suggest not taking it too much into consideration when making investment decisions. Since we do not know what will happen, this scenario seems a good starting point from which we will the trail a path always knowing that our main objective is preventing big negative surprises, and not predicting future facts.

In general, our investor letters are organized by sections, the first section being dedicated to update our performance,

[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 and on 26 Oct 2012 in Bogari Value FIC FIA.

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 risk taking in Brazil.

Portfolio Commentary

Throughout 2012, we gradually sold assets which have increased in value and whose investment cases had been exhausted. We have taken the opportunity to purchase other assets with low perceived risk, and good potential for appreciation. With these new allocations, our portfolio has good assets acquired at adequate prices. Additionally, we believe that maintaining our strategy should bring good returns over the coming years, by maintaining our historically low levels of risk.

We are currently analyzing various companies and revisiting others, waiting for buying opportunities. We continue to seek assets with an asymmetry in risk-return, i.e. with a low probability and intensity of a drop, and higher probability of an increase. 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 2013, as we mentioned earlier.

As we like to emphasize in our letters, we like to keep our portfolio adequately diversified. Our largest position is currently 9% of AUM and top 5 combined are around 30% of AUM. We maintain high liquidity, holding a 27% 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.

The Risk of Risk Taking in Brazil

Entrepreneurship and growth

The question of how to foster economic growth during a period of deleveraging has been widely discussed lately. An interesting article published in the middle of 2012 in The Economist[2] discusses the main factors hindering the creation of innovative businesses in Europe, which in turn restricts growth and high-quality job creation.

The EU Commission examined, among other aspects, the consequences of failure. A first observation was that, in European countries, honest entrepreneurs who ceased their activities due to insolvency, ended up being treated as dishonest or fraudsters.

As a result, those countries let entrepreneurs hanging in limbo for years. In the UK, entrepreneurs and businesses that shut down are free of debt after 12 months, and in the USA, in even shorter timescales. In the meantime, in Germany this period is on average 6 years, and in France it can reach 9 years. Keeping entrepreneurs who suffered failures out of the market is not conducive to the creation of new businesses. Firstly because there is a learning curve in creating businesses. Many successful entrepreneurs have had earlier failures in their lives. Secondly, because it turns entrepreneurs more conservative, since the cost of failing may severely hinder their professional future.

Additionally, failure has a moral consequence for the entrepreneur. While an attempt – regardless of its outcome – is valued in Anglo-Saxon cultures, in others it is not necessarily so. In Germany, entrepreneurs with a history of bankruptcies may be forever barred from directorship roles in large companies. And, in general, failure socially penalizes people involved, regardless of fraud.

Another obstacle observed by the EU is labor regulations. If an innovative company must try to survive as long as possible facing uncertainties regarding its products, demand, and markets, it should have the ability to reduce its workforce quickly and at a low cost. The complexity and costs of this reduction in Europe tend to be higher than in the US.

Not surprisingly, therefore, the US has been attracting the best talent in innovation to develop its projects.

Limited liability

Beyond the aspects cited above, another decisive factor for the development of businesses is the limitation of liability for the entrepreneur. Putting the entrepreneur's personal assets at risk renders most investments unviable. It is one thing to have a limited loss and a potential gain, and quite another to lost everything one has accumulated in their lives in the hopes of making more money.

The problem with lack of limited risk exposure means the entrepreneur is putting at stake money which they need to live (savings) to make an amount of money that they would like, but is not essential. Rationally, it makes little sense to take this kind of gamble. Precisely for this reason, limited liability was developed over the times.

With rare exceptions, up to the beginning of the 20th century, entrepreneurship was highly risky. There was insufficient institutionalization, and even less of a legal framework that would preserve an entrepreneur's personal assets in case of failure of the enterprise. In general, the personal and corporate assets were merged, meaning personal assets served as a guarantee for any claims stemming from ill-fated enterprises.

There are various versions for the rise of the concept of limited liability, confining creditors' demands to a company's capital. It is known that in Ancient Rome, corporate entities had unlimited liability. However, heads of families ("pater familias") were responsible for their children and slaves' debt

[2] The Economist, European Entrepreneurs: Les Misérables, July 28, 2012

only to the extent of goods or sums that were given to them. Centuries later, in the city-states of Medieval Italy, as commerce evolved, foreign capital was needed for new investments. In order to attract this capital, limited liability was given to investors; therefore, they were responsible only for the amount they invested.

In modern times, the first law on the matter was created in Germany, in 1892. This law was created following calls from local entrepreneurs who needed a simple corporate framework which would, at the same time, limit their liabilities. Up until then, the main corporate model was that of the public limited company, which was more complex in its implementation and was usually reserved for larger corporations. The new German law therefore guaranteed simplicity and freedom to form a company, demanding a less rigid financial basis.

Whereas the first law was German, the pioneering practicalities took place in England. Indeed, during the industrial revolution in England, there were limited liability companies in practice, but not on paper. According to scholars, the English Crown bestowed this privilege on some projects in order to encourage some undertakings that were just too ambitious to be tackled individually. Besides, many unlimited liability companies managed to convert into *de facto* limited liability companies through contracts that restricted credit to corporate assets. Some studies indicate that up to half of English companies formed from 1720 were not corporations and yet, one way or another managed to reach limited liability.

In Brazil, the first discussion on the matter cam in 1865, in a proposed law submitted by José Thomaz Nabuco de Araújo. On that occasion, the project was debated and rejected by the government. In 1912, Herculano Marcos Ingles de Souza, who was in charge of drafting the new corporate laws, included an entire chapter on limited liability, with the aim of meeting the requirements of the business community. The discussions on the project were delayed and, in 1919, lower house representative Joaquim Luis Osório – based on Inglês de Souza's draft – proposed the creation of a law for companies with shares of limited liability, and the project was accepted and enacted under the decree 3,708/1919.

The Brazilian law was the fifth of its kind in the world, and the first in Latin America. Following Brazil, Chile legislated on the matter in 1923, Argentina in 1932, and Uruguay in 1933.

This law for companies with shares of limited liability was in place until 2002, at which point the Brazilian civil code was amended. What was previously known as a "Company with Shares of Limited Liability" became simply "Limited Company". Furthermore, the 19 articles of the previous law became 36. Currently, this type of company is defined in the articles 1,052 to 1,087 of the Civil Code. In 2011, Law no. 12,441 decreed the creation of the individual company with limited liability, effectively meaning a company could be created by a single partner.

Risk Taking in Brazil

With the drop in interest rates and the perception of a perpetuation of this status, Brazilian investors are changing their habits. Gains from financial instruments ceased to be overly generous, giving rise to a process of investing in more complex assets that are closer to the real economy. Despite still in its infancy, this process should continue as it happened in other countries.

As a rule, investment in companies can be made through a stock market, or by purchasing a share of the company privately. The former is very well known and regulated, with the investor having the ability to acquire stocks directly or via an investment fund.

Investing directly in the real economy outside of the stock markets has specific benefits and risks. Here, Brazil is probably closer to Europe than the USA when it comes to how failure is treated. We still see in Brazil a stigma at the failure of a business, which for one reason or another did not succeed. It is not uncommon for new ventures to fail raising assets if the person at the helm has had a significant failure in the past. Brazilian courts still has a degree of contempt for unsuccessful entrepreneurs, either for believing that assets were syphoned from the project or, more often, because they believe entrepreneurs must suffer for their mistakes.

This naturally limits risk taking. In the end, the typical profile of a Brazilian entrepreneur is that of a dreamer who only succeeded because they had no real concept of the amount of risk they took. Innovating and long-maturing projects are often spurned for investments with a quicker payback window and more conservative business models, but with lower risk and potential returns.

However, what we consider the most important factor is whether the investment loss is limited to the amount committed and the risk to the investor's image.

In Brazil, the principles of the law are correct, because the loss is limited to the company`s share capital. In theory, the exception is when there is proof of misconduct or of personal assets being intermingled with assets of the company, at which point liabilities become unlimited. However, the application of the law in Brazil is different. There are some legal interpretations – especially relating to outstanding labor liabilities – in which the partners' own assets is required to honor liabilities that should have been limited.

While we observed earlier that more flexible labor regulations would encourage risk-taking in innovative projects, the contrary happens, in Brazil. On top of having to comply with paternalistic labour laws, the personal assets of the partners may finally become tied in labor imbroglios. There is more. The system makes so little sense that the partners may be equally responsible for the liabilities, regardless of whether or not fraud has been committed. This means that a partner who holds 0.1% of a company's share capital may end up paying 100% of labor liabilities in a failed project. Rationally, what sense does it make for someone to invest in a project with limited returns and with unlimited risk?

When working for a company, an individual takes on the responsibility that this decision has on their career. However, by "paternalizing" labor relations, the courts assume that the employee lacks the capacity to judge the risks they've taken with regards to their rights.

Since legal enforcement in Brazil is still deficient, various other schemes have been put in place by public bodies in order to prevent violations. However, these maneuvers generate an environment that is not conducive to the development of businesses.

One of those, somewhat unorthodox, is the contamination of different companies – mainly through outstanding tax, fiscal or social security obligations – with a common partner. Often, the outstanding obligation is not the consequence of a default, but simply the matter of an administrative or legal challenge. In theory, the companies should be independent, but in practice, the other company can prove to be an impediment to its normal activities.

The difficulty and the time required to close a company – a statistic so often used by the media – is but the consequence of the issues discussed here. Therefore, in practice, limited liability companies in Brazil are not in reality limited. By employing ruses in order to give back to society (employees and government) by companies that were unsuccessful or had any pending issues, we obtain the contrary effect. With a less conducive environment, the incentives for entrepreneurs to take risks diminishes and we have fewer companies and innovation in the country.

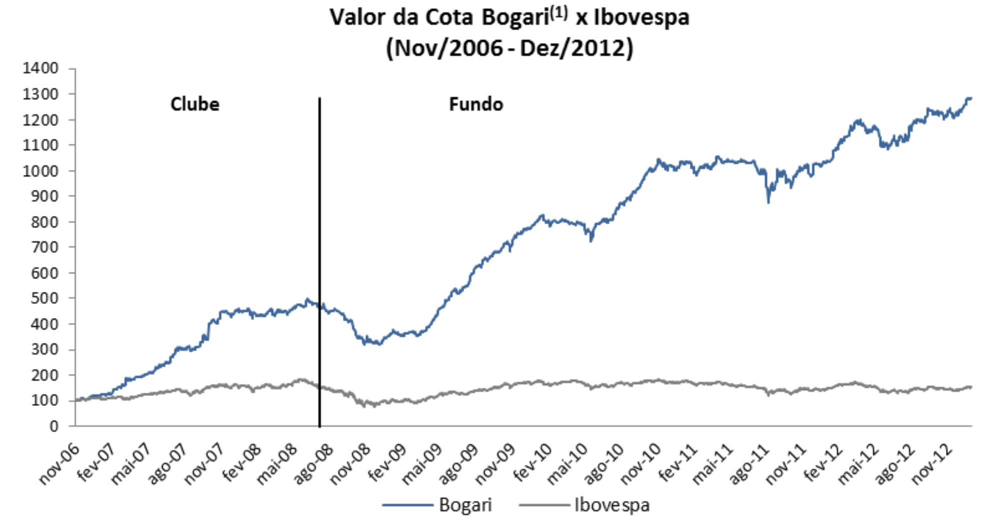
In order to mitigate investor risk, one can set up liability blockers, such as a holding company or an investment vehicle. However, besides being costly, these solutions increase complexity and do not entirely eliminate the risks.

In an environment where interest rates are low and investors start to show more appetite for risk, and on the other hand macroeconomic tools are less effective, investments in the real economy will see a large increase. It is therefore a real pity the environment prevents this growth from being even stronger.

Thank you for your trust and support.

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%	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%



(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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