



Leblon Letter 16

3rd Quarter 2013

www.leblonequities.com.br

It is our pleasure to share our sixteenth Leblon Letter. Once again we hope this channel of communication will be of interest, and succeed in conveying our opinion on important themes affecting our investment decisions.

Thank you and Regards,
Leblon Equities

Leblon Equities – the first five years

When we look at the companies we invest in, we see three fundamental factors for their success:

- (1) satisfied clients;
- (2) profits;
- (3) quality processes and people who are happy with their work, and whose interests are aligned, with a common ambition for the future.

Leblon Equities celebrated its fifth birthday in September. Analyzing ourselves using the same framework that we look for in investees, we can say that we are happy with our first 5 years:

Today we have more than 300 clients, who are well diversified by origin (55% Brazilian, 45% non-Brazilian), most with investments that have achieved their aims (and whom we thus hope are satisfied). We have been a profitable company for the last four years – and these are quality earnings, coming primarily from performance fees and not management fees (which means that our clients have also earned).

Each year our company grows, and has a wider, more varied and more experienced group of people and partners. Our purchase, in 2011, of the equity stake of our strategic partner Farallon, which in the short term meant a reduction of US\$70 million in our assets under management, and a significant personal investment by the partners, has shown itself to be a successful move. We succeeded in replacing them with other clients; and today the executives have a larger share of the business.

The team of founding partners, who came from different origins, work more efficiently today than at the beginning, because they know each other better. Our continued ambition remains the same: to find the best investment opportunities in Brazilian equities for investors with a long-term view.

We are now a team of 19 – ten people working directly with investment analysis and management, and nine partners. The five founding partners – Pedro Chermont, Marcelo Mesquita, Pedro Rudge, Bruno Pereira and Felipe Claudino – are still in the company. We subsequently added three – Victor Uébe, Laura Tostes and George Earp – and in 2012 we welcomed our ninth partner, Eduardo Castro.

Every day the team matures further. We expect soon to be adding more partners.

In the five years between its inception and September 30, 2013, Leblon Ações Fund (long only onshore fund) gained 129%, net of all costs. This compares with a gain of 6% in the Ibovespa, 29% in the IBX index and 59% in the CDI rate. In that period the Leblon Equities Hedge Fund (equity hedge onshore fund) gained 91%, net of all costs.

In these five years we made five private equity investments. They were in retail, education, technology and infrastructure services, and they helped us to better understand the listed companies that we invest in. The most profitable investments we have made so far for the long only and equity hedge funds were in companies we had known for a long time (Saraiva, BR Foods, Lojas Renner), and in companies which we had in the past invested in or analyzed as a private equity investment: Mills, Aliansce, Estácio and Cetip.

We have made our share of mistakes. These have usually been in investments where we overestimated our understanding of the facts. Happily, we were more often right than wrong – accounting for our positive performance over the 5 years. We have learnt a lot from mistakes, and in the future we will avoid the same routes. We will increasingly concentrate on the strategy that has been successful: concentrating on the assets that we know well. As for other mistakes – well, we will no doubt find some new chances...

We feel that completion of this five-year period does finally give us our first significant window for assessing performance. In the short term any investment fund's performance is almost entirely determined by unpredictable factors. As the period increases, non-predictable factors begin to lose importance, and performance becomes more a function of fundamentals such as: (i) the quality of the management team; (ii) a rational investment philosophy followed with discipline and patience; (iii) competitive advantages of the manager in his niche; and (iii) governance that maximizes the alignment of interests between the management team and the clients.

Today there are some thousands of investment funds in Brazil, and there will always be some that can show a glowing track record. On the other hand, that group will not always represent the best risk-return ratio for investors.

The tendency to invest in 'the fund that's been performing best recently' is a strong one. This approach, however, often means few questions are asked about the real risks that the managers

of such a fund may have been running.

We would suggest at least seven questions for qualitative evaluation of risks:

- How much do the managers really know the assets?
- What is the managers' capacity to adapt to different market conditions?
- What is the rationale of the investments?
- Do the managers have any significant and sustainable competitive advantage?
- Are the fund managers' interests aligned with those of clients?
- How much might have been lost on the investments that were successful?
- How much might have been gained on the investments that were not successful?

There are few funds and managers with a long enough track record where one can assess performance in different market trends. When the period for analysis is short (less than five years), factors such as luck and the manager's profile increase the difficulty of assessing risk. Of course luck (which is by definition non-sustainable) plays an important role in track records. And also, personality traits: a manager may be particularly adapted by personality to a specific condition of the market – and this may result in non-sustainable periods of relative high performance. As an example, one might argue that managers with high risk aversion will tend to perform better in bear markets, and less well in bull markets.

As a great Brazilian¹ poet said, "Writing means ... cutting words". And Warren Buffet pared well when he summed up: "Risk comes from not knowing what you're doing."

Finally – if you are our client, we thank you for your confidence. If you are not yet, we would have great pleasure in the opportunity to start a new relationship of success, for the next 50 years...

¹ According to many, that great Brazilian poet was Carlos Drummond de Andrade. But journalist Armando Nogueira said that when he asked Drummond to confirm this, Drummond denied it.

Aliansce

We were shareholders of Aliansce from its IPO in 2010 until February 2013, when we sold our position at around R\$ 25/share because we believed the valuation was not attractive. We also opted against investing in the follow on offer, priced at R\$ 23.2/share. In June this year we again invested in a sizeable position in Aliansce (6% of the NAV of the Leblon Ações and Leblon Equities Hedge Funds), at R\$ 18.50 / share.

In recent months a combination of factors has weighted on the valuations of shopping mall companies and income properties. A prevalent view was that they were suffering from a new phase of high interest rates. In our view, though, the underlying reality in relation to shopping malls was that investors were questioning the sustainability of continued growth of rents, and whether occupancy rates could be kept so high, given the increasing competition with the opening of a record number of new malls and a potential cooling of the retail business as a whole, resulting in a scenario in which excessive occupancy cost might simply make store tenants' stores economically unfeasible.

Brazil's mall sector has grown very fast in recent years. The Brazilian Shopping Centers Association (Abrasce) reports that in 2006–12 total gross leasable area (GLA) rose by 7.3% p.a., and that the number of malls grew at 4.5% p.a. – and is expected to increase by a further 17% by the end of 2014, with 78 new mall openings. Even considering that in the last three years mall operators have opened only 37% of the number of new malls they pre-announced, that is still a strong growth rate.

In contrast to recent years, this new cycle of expansion is concentrated outside the big cities and led by smaller companies and new entrants. We estimate that 60% of the GLA of the malls announced to open in 2013 and 2014 is outside big urban centers, and that only 30% of the expected new GLA will be built by listed companies and their large unlisted competitors.

In this situation Aliansce is well protected by the positioning and competitiveness of its main assets. Some 90% of its revenue comes from malls in Brazil's larger state capitals; and 60% comes from assets that have more than five years, in well-established locations. Aliansce's good investment track record of recent years, and the scale of its leasing efforts in comparison to smaller competitors makes us confident of good allocation of capital in new projects.

The growth rate of retail sales has been slowing, but we believe Aliansce is well positioned for a more adverse situation because it has the lowest occupancy cost of the three large listed companies (9.7%, vs. sector average of 11.5% in the last four quarters). Even in a situation of zero growth in sales, and discounts on rents by competitors, it still has a ‘cushion’ before having to offer discounts to its own tenants. Finally, we believe it will be the quality of each asset that will be determinant for occupancy rates and rent levels, and we expect a significant part of Aliansce’s profit to come from assets that have a unique position – and as such are likely to be more resilient in a more challenging scenario.

GGP (General Growth Properties, of the USA) announced the sale of its 40% stake in Aliansce to CPPIB (the Canada Pension Plan Investment Board) (which bought 27.58%, for R\$ 24.8/share) and to Aliansce’s founder and CEO Renato Rique (who bought 12.41%, for R\$ 23.0/share) resulting in CPPIB holding 27.6% of the company, and Rique 23.6%. We see this change as positive, because it not only indicates a value 15% higher than its current market price², but also shows the commitment and confidence of the major shareholder and the senior management – who both increased their stakes in the company.

In our assessment, investing in Aliansce at R\$ 18.50 is equivalent to buying a perpetual security earning 11% p.a. above inflation. In this calculation we considered only the existing malls and projects that have been announced, with a conservative estimate of rent growth at 2% p.a. plus inflation, and in our view with good chances of generation of additional value through new greenfield projects, expansions and acquisitions. Aliansce still trades at a discount to comparables, in spite of (a) holding assets whose rents have been growing faster than the sector average, (b) having a valuable portfolio of assets focused on the middle income class, and (c) already showing the capacity to generate good returns from greenfield projects, not only in the Southeast but also the Northeast and North of Brazil.

The table below shows our target prices for Aliansce assuming various real rates of rental growth. All the scenarios consider scale gains due to new projects and expansions, resulting in Aliansce achieving an Ebitda margin of 80% in the medium term, close to those of its large-scale competitors.

Aliansce: sensitivity of valuation (R\$ per share)
to discount rate and real rental growth rates

Discount Rate	Real Rental Growth Rate		
	1%	2%	3%
8%	26,4	28,6	31,0
9%	22,3	24,2	26,1
10%	19,3	20,8	22,4

²R\$19.90 / Share, closing price of september 30th, 2013

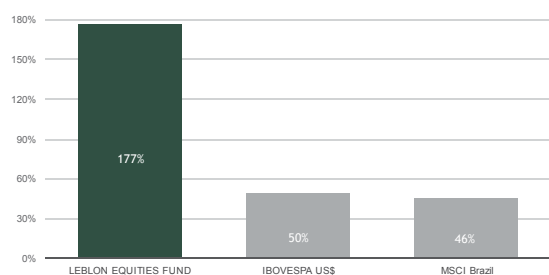
Leblon Equities Fund

In the third quarter of 2013 the Leblon Equities Fund posted a negative return of 1.9%, net of all fees, compared to appreciation of 9.6% in the Ibovespa in US dollars, and a gain of 7.7% in the MSCI Brazil Index.

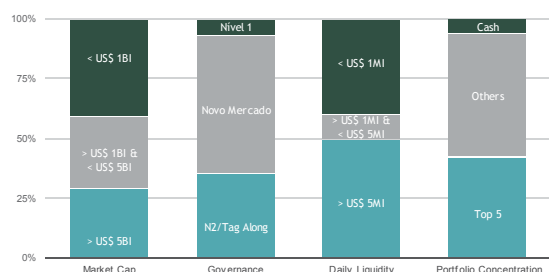
Since its inception, the Leblon Equities Fund has appreciated by 176.5%, net of all fees, compared to appreciation of 49.6% in the Bovespa index in dollar terms, and 45.6 % in the MSCI Brazil Index.

The fund's annualized return since inception is 23.7%. In third quarter 2013 the main positive contributions were from Gerdau, Itaúsa and BR Foods, more than offset by depreciation in Springs Global and BHG.

PERFORMANCE US\$ (SINCE NOVEMBER 28TH, 2008)



RELEVANT INFO - EQUITY PORTFOLIO (SEPTEMBER 30TH)

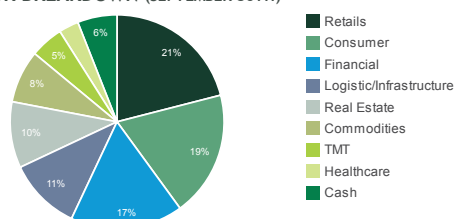


Notes

Level 2: Bovespa's listing segment that demands high level of corporate governance.

Novo Mercado: Bovespa's listing segment with the highest standards of corporate governance

SECTOR BREAKDOWN (SEPTEMBER 30TH)



RETURNS

Last 12 months returns (US\$)			
Period	Leblon Equities Fund	Ibovespa US\$	MSCI Brazil
September 13	10,45%	11,35%	12,14%
August 13	-7,47%	0,09%	-2,43%
July 13	-4,05%	-1,68%	-1,57%
June 13	-11,38%	-15,07%	-12,64%
May 13	-6,18%	-9,71%	-7,35%
April 13	3,24%	-0,18%	0,84%
March 13	-2,0%	-3,74%	-1,45%
February 13	2,97%	-3,28%	-2,64%
January 13	3,49%	0,77%	2,83%
December 12	7,70%	9,37%	7,05%
November 12	-1,80%	-2,92%	-3,11%
October 12	4,11%	-3,59%	-1,45%
12 Months	-3,21%	-19,46%	-11,34%
ITD (Until 09/30/2013)	176,54%	49,63%	45,55%

Annual returns (US\$)			
Period	Leblon Equities Fund	Ibovespa US\$	MSCI Brazil
2013 (until 09/30/2013)	-12,10%	-21,31%	-13,27%
2012	18,85%	-1,42%	-3,50%
2011	-21,55%	-27,26%	-24,85%
2010	21,17%	5,59%	3,78%
2009	144,67%	145,16%	121,25%
2008*	13,81%	2,44%	0,79%

Annualized returns			
Period	Leblon Equities Fund	Ibovespa US\$	MSCI Brazil
1 year	-3,21%	-19,46%	-11,34%
2 years	1,40%	-8,81%	-5,09%
3 years	-2,84%	-16,98%	-13,59%
4 years	3,46%	-9,31%	-7,56%
Since Inception*	23,68%	8,79%	8,16%
Volatility since inception*	21,53%	31,87%	31,44%

*Inception date of the fund 11/28/2008

Leblon Value Hedge Fund

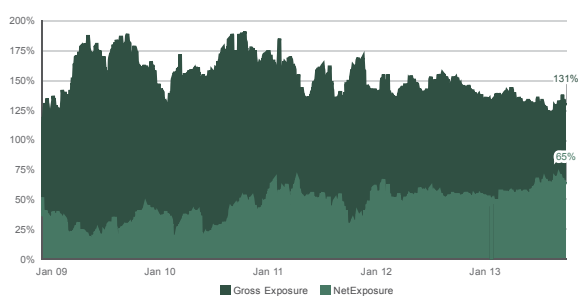
In 3Q 2013 the Leblon Value Hedge Fund posted a negative return of 3.3%, net of all fees. Since inception this fund has returned a gain of 59.0%, also net of all fees, with an annualized return of 10.2% p.a.

In the quarter, the fund posted gains in arbitrage, and losses in its long book and short book. The fund's average gross exposure in 3Q 2013 was 128%, and its average net exposure was approximately 64%.

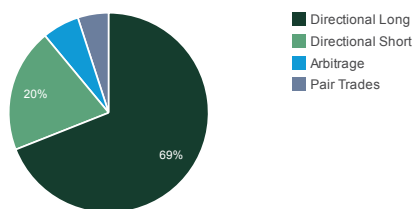
PERFORMANCE US\$ (SINCE NOVEMBER 28TH, 2008)



GROSS AND NET EXPOSURE



STRATEGY BREAKDOWN (SEPTEMBER 30TH)



RETURNS

Last 12 months returns (US\$)			
Period	Leblon Value Hedge	Ibovespa US\$	MSCI Brazil
September 13	2,37%	11,35%	12,14%
August 13	-3,79%	0,09%	-2,43%
July 13	-1,85%	-1,68%	-1,57%
June 13	-5,33%	-15,07%	-12,64%
May 13	-0,72%	-9,71%	-7,35%
April 13	2,57%	-0,18%	0,84%
March 13	-0,26%	-3,74%	-1,45%
February 13	1,31%	-3,28%	-2,64%
January 13	-0,05%	0,77%	2,83%
December 12	2,72%	9,37%	7,05%
November 12	0,08%	-2,92%	-3,11%
October 12	4,12%	-3,59%	-1,45%
12 months	0,76%	-19,46%	-11,34%
ITD (until 09/30/2013)	58,98%	49,63%	45,55%

Annual returns (US\$)			
Period	Leblon Value Hedge	Ibovespa US\$	MSCI Brazil
2013 (until 09/30/2013)	-5,86%	-21,31%	-13,27%
2012	10,30%	-1,42%	-3,50%
2011	-10,53%	-27,26%	-24,85%
2010	11,98%	5,59%	3,78%
2009	43,35%	145,16%	121,25%
2008	6,61%	2,44%	0,79%

Annualized returns			
Period	Leblon Value Hedge	Ibovespa US\$	MSCI Brazil
1 year	0,76%	-19,46%	-11,34%
2 years	-3,19%	-8,81%	-5,09%
3 years	0,38%	-16,98%	-13,59%
4 years	3,14%	-9,31%	-7,56%
Since Inception*	10,17%	8,79%	8,16%
Volatility since inception*	11,52%	31,87%	31,44%

*Inception date of the fund 11/28/2008

PERFORMANCE ATTRIBUTION (SEPTEMBER 30TH)

Directional Long	9,92%
Pair Trade	0,56%
Arbitrage	0,44%
Non-Equity Hedges	0,00%
Directional Short	-2,65%
Cash + FX Hedge	-5,71%
Expenses	-0,19%
Total	2,37%

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