LEBLON
EQUITIES

Leblon Letter 22

January 2018

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It is with great satisfaction that we distribute our Letter #22, the first of 2018, the year we celebrate our 10th anniversary. In our inaugural letter almost 10 years ago we discussed our DNA and our focus on and commitment to the Brazilian market and equities. Throughout this past decade we remained faithful to the guiding concepts and principles presented in that first letter and our core investment team has remained intact. However, a few changes did occur: we continuously improved our internal processes and interactions and succeeded in attracting and developing new talent, including new partners, to further strengthen the Leblon team. The last ten years have not been without headwinds and turbulences. Nevertheless, looking back we are happy and proud with what we have achieved: Leblon was able to deliver returns in excess of the market in eight out of nine years and our 175% cumulative performance (in US$ net of all fees) since inception compares positively to the 25.5% of the MSCI Brazil over the same period. We thank our clients for their continued trust and we start this new decade with a very optimistic outlook and the same energy and enthusiasm that has driven us since our very first days.

Leblon Equities

Culture and Change

Culture, for the purpose of our discussion, we define as (as per " Google Dictionary): "a set of behaviors and behavioral manifestations of a group of people, such as those within a company or country. It is a complex web of knowledge, beliefs, morals, customs, habits, tasks, and aptitudes. It is not innate, but lived, learned, assimilated, and transmitted. It is alive and in a constant state of change due to time and circumstances."

When we choose where to invest, we undertake two complex tasks: (1) quantifying the value of a company's culture; and (2) foreseeing changes – understanding that each factor influences the other. This is the case not only of companies, but of entire countries (such as Brazil, in our case). Obviously, there are many more factors to consider when investing, but "the rest" is more easily translated (expressed) into numbers. These numbers shape the market consensus and produce more homogenous results (just look at the market consensus on companies' fair values on Bloomberg, for example). Through logical discussions of certain assumptions, we arrive at discounted cash flows, almost like a science, forecasting the future based on the past experience.

But all else equal, how to quantify, for example, the value of "Itau's culture" or of "Bradesco's culture", or even "Brazilian culture"? (whatever that means to different people, each with various levels of knowledge of such organizations and at different stages). How do these cultural differences translate into a model when forecasting, or when using them to compare valuation multiples? These qualitative cultural characteristics are fundamental, and more an art than an actual science – which is why they are treated with such attention in the process of making an investment decision. One does not buy culture on a street corner, nor is it created or understood overnight. There is no replacement value that helps define its worth. Admittedly, from an accounting standpoint, there are intangible assets (trademarks, for example), but even these are a small fraction of what is understood by culture, which is much broader and more meaningful. Even an analyst's most poignant questions to executives or a country's people may not bring full light on the nature of current culture. As in psychology, many times self-evaluation is an impossible task, or at least requires more than just questions and answers. One needs to truly live and breathe a company or a country to fully understand its culture; in the same way that a painting cannot be simply described, only observation allows one to form an opinion.

The second task ("foreseeing changes") has to do with the fact that in an increasingly open and competitive world, thanks to the internet, Google, YouTube, and so on, information on

companies is easily accessible and tends to be well distributed among market participants and well priced-in (even to robots and algorithms based in the past). This was not the case until very recently (perhaps as recently as a few decades ago) when simply visiting a company granted one an informational advantage over other investors. Correctly predicting the future and, more specifically, the changes to come is what distinguishes the opinion and an investor's valuation of a specific company. It has been this way throughout investment history, but with each passing day this factor seems to weigh ever more due to our new digital and global environments. Today, any investor can watch hours of footage of company CEOs halfway around the world at practically no cost. This was unimaginable twenty years ago. In a digital world, where circumstances change faster and perhaps more rapidly than ever before, understanding a culture and how it reacts to the environment is crucial. In much the same way, the value of culture has grown as defining features of companies and countries.

With this more theoretical introduction in the background, we can use these concepts in our discussion of matters more relevant to our dear reader: namely, why and how we are investing our clients' and our own money at this point in time.

To start with, from a macroeconomic perspective, the market is tremendously concerned with the presidential elections in October 2018, seeing the outcome as essentially binary that could lead Brazil to heaven or to hell. The market may not be wrong on this one, as we have learned at great pains how individuals in relevant positions of power (such as Dilma Rousseff) can truly make a meaningful difference. Culture is everything, but it has its origins in the people, in their constant interactions, and in their collective thinking. We cannot speak of culture without speaking of people and vice-versa. It is from this that stems the market's apprehension with new leaderships that will emerge come the elections.

Having said that, Brazil is undergoing a tremendous cultural revolution, a result of the Lava Jato investigations[1], that introduced the concepts of compliance, punishment, consequences and fairness in society. New digital technologies were pivotal in allowing Lava Jato to materialize (Facebook, LinkedIn, WhatsApp, and others) and instrumental in organizing the wave of social mobilizations that brought down the President in 2016. To put this into perspective, when Brazil had its last presidential elections, WhatsApp had 20 million users in the Country – in October 2018, they will be 120 million. We have seen the impact of this trend in elections in the US (Donald Trump) and in France (Macron), where unexpected contenders trounced "mainstream" candidates, a result of the diminishing power of the old media. For further evidence of this, look no further than to the fact that people today spend more time on Facebook than on television.

Furthermore, voters are increasingly younger and less ideologically driven – they have not witnessed the fall of the Berlin Wall, nor have they lived under military dictatorship in Brazil, events that drove an ideological wedge within the Country. In other words, we are witnessing the birth and growth of a new culture in Brazil of ethics, pragmatism, entrepreneurship, and individual liberty in opposition to centralization, that we believe is quickly and irreversibly changing the Country for the better.

The business environment, notorious for its corruption, favoritism, and crushing bureaucracy has reached its limit and society has rapidly started to change. There are more than 1,800 politicians with special jurisdiction privileges caught up in the Lava Jato right now. To put this into perspective, there are approximately 600 representatives and senators in Brasilia. In short, there will be massive political renovation, even if it takes years, pushed forward by a strengthened justice system, and prosecutors and judges equipped with modern technologies capable of providing sufficient evidence to bring down even the most powerful.

This is the critical factor to reduce the cost of capital of the Country: the triumph of the law, the huge cultural revolution currently seen in Brazil, has enormous consequences for the business environment. The cost of capital (discount rate) is not high in Brazil just because the State is fiscally lax, but also because we used to live in a veritable no-man's land. The culture is rapidly changing because we have some of the Country's most powerful businessmen locked up, something unimaginable only four years ago. The "tone at the top" is totally different now. New regulation for state owned companies, approved by Congress in 2017, revolutionizes governance at the myriad of companies that still represent almost half of Brazil's economy. Privatizations will come at a fever pitch over the next few years as this new generation of politicians and the remaining old hands realize they can no longer "own" public companies. This cultural change will dramatically raise the value of companies in Brazil, not just of public companies, but of private ones too.

In our opinion, Brazil will elect a president in October that is neither saint nor devil, but who may certainly surprise us for the better and lead a new Country that is quickly moving onto the right track, culturally speaking. The new president will take over a Country in favorable macroeconomic conditions (a rare event in Brazil, where entrants always face pandemonium when they take office). These include currency reserves of US$400 Billion, a trade surplus of over US$ 60 billion, inflation below 5%, and nominal base interest rates of 7%. Economic recovery is still slow, but sustainable, and will gain strength with greater investments and relevant reforms in sectors such as oil, electricity, ports, airports, railroads, highways, and health, to name a few. Labor reform is another cultural revolution that has

not yet been properly priced in and will massively impact the service sector moving forward. Of course, there remains the problem of the primary budget deficit, but the short-term debt to GDP ratio is strongly favored by the lowered nominal and real interest rates that will persist for an inordinately long period for Brazilian standards (another cultural revolution!). For this reason, there is time to address the fiscal problem with significant privatizations and with pension reform that will come sooner or later. In summary, we believe the next five to ten years will be significantly better from a macro perspective than those that came before.

Moving on to companies, our main investments are currently Petrobras (9.8% of the fund) and Natura (7.1%).

Starting with Petrobras, we see it as an emblematic case of cultural changes. The universally negative coverage it received around the world because of Lava Jato pushed the government to create new regulations for state owned companies that will be mandatory as of June 2018. Throughout the first half of 2017, Petrobras has led the way in adapting to the new law, and it should have a meaningful impact and help prevent the corruption scandals that have ravaged the company. For example, to be eligible for management, candidates must now meet a series of requirements and can no longer be political appointees, related to politicians or elected officials less than five years out of office. Furthermore, the law created a new independently audited channel for whistleblowing, as well as new structures for governance and compliance meant to rethink how decisions are made, as well as how to investigate and punish offences when necessary.

Pressure to change has also come within the context of the lawsuits brought against Petrobras in the US and in Brazil, thus the damages caused by corruption will no longer be tolerated. All of this demands a change in proceedings, headed by the current and highly competent CEO Pedro Parente. If that were not enough, an external investigative commission, led by the Supreme Court's former president, Ellen Gracie, has submitted recommendations to the company that are being fully implemented. In summary, the company's future employees will have a fully developed legal apparatus at their disposal to fight wrongdoing.

This new culture of compliance is revolutionary because it also extends to the economic and commercial level. Selling products without profit is now a violation of the company's bylaws and any change requires a shareholder vote. These policies should remain in place for the foreseeable future given the negative publicity any government would face if it were to backpedal on the matter. The company's debt crisis and the public embarrassment it

experienced dramatically impacted its employees, who should behave differently in future given the training they have received and the resources they will have available to defend the business. The company's decision-making process, now necessarily collective, is also revolutionary. The concern now is that Petrobras may become excessively risk-averse, which raises the bar regarding rates of return calculations on investments. All else equal, Petrobras should become more profitable than it ever has been.

In addition to these cultural aspects, relevant as they are, we add significant and positive structural changes. The sector's regulatory agency (Agência Nacional do Petróleo – ANP) is now more interested in helping companies produce oil and gas instead of keeping wealth buried underground, as has been the case over the last several years. A track record of intense litigation, including for tax reasons, appears to be history, so much so that global companies like Exxon are returning to and investing heavily in Brazil after decades away, and always seeking out Petrobras as a partner. The matter of Petrobras's onerous concession to explore the pre-salt oil reserves also appears to be close to a creative solution that will benefit both the company and the Federal Government. This, along with the upcoming sale of assets, should help accelerate the company's financial deleveraging by generating cash that will in turn contribute to debt-reduction without impacting the company's operational cashflow potential. This is possible because the private sector (generally) operates more productively and can pay higher premiums for these assets.

The market consensus is that oil prices will remain around US$ 50, although every day it remains above that – the trend has been US$ 60 – the company will generate more cash to more quickly hit its debt-reduction target. The improvement becomes evident when we observe the evolution of the company's cost of capital: the company used to pay interest rates of 12% per annum on its dollar denominated debt at its worst moments, and that now it can borrow at around 5% per annum. For such a capital-intensive business, like Petrobras, this is an extremely relevant factor.

We have no doubt that with these cultural and external changes Petrobras will return to profitability on a recurring and sustainable basis as of 2018, in effect changing global investors' risk perception regarding the company, allowing it to negotiate at higher implied multiples and to generate profits for its current investors.

As for Natura, the fund's second largest position, we see another typical case where the market's short-term pessimism grants us an attractive opportunity for a long-term investment. Here, like with Petrobras, we see enormous change underway. Natura has always been conservative, despite innovating in Brazil, particularly preserving and defending its

business model of direct sales using a network of collaborators. However, the advance of competitors such as Boticário and new technologies (e-commerce, big data, and social media) have forced Natura to abandon its comfort zone and embrace different distribution channels. It has done so with tremendous vigor, acquiring The Body Shop and becoming a true multinational company overnight. The company has had operations in Latin America for years and a few stores in France, but these were much more timid ventures than what we see now. While this change gives rise to execution risk, we applaud its move just the same. Change such as this is what we look for everyday: good executives who take risks in sectors and businesses they know extremely well. We believe The Body Shop's expertise in global retail will be fundamental in Natura's modernization, as will Natura's DNA in developing The Body Shop.

The concept of sustainability is global, awaiting a good opportunity to spread further throughout the world; that should happen now. This movement will not occur without sweat, blood and tears, but the result will be a new and much more valuable company that operates on a global scale. The company's potential growth rates from here on out will no longer depend on Brazilian GDP, but on its executives' capacity to execute. Natura's controlling shareholders face a specific challenge at this time: choosing the right people for this task. They have always chosen well in Brazil, but their challenge is now global. We have total confidence that they will choose the right people and take the right steps in this new phase, and that a new global culture will emerge. This investment opportunity exists because the market is overly concerned with the following quarter's results, whereas we look three or four years ahead.

[1]Lava Jato " Car Wash" started as a money laundering investigation in 2014 and uncovered a web of promiscuous relations and a massive corruption scheme that branched into several other criminal investigations

LEBLON EQUITIES PARTNERS FUND

CLASS LEBLON EQUITIES FUND (LONG ONLY)

December 2017 NAV 275,0307

THE FUND

Leblon Equities Partners Fund is an open-ended investment fund incorporated in the Cayman Islands as an exempted company limited by shares. It was incorporated on October 2, 2008.

OBJECTIVES

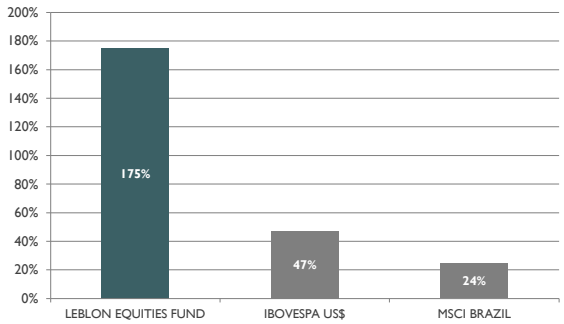
The investment objective of the Class Leblon Equities Fund is to provide sophisticated investors with superior risk-adjusted long-term returns comprised of capital appreciation (capital gains, dividends and interest income) by investing in equity instruments issued by companies listed on the São Paulo Stock Exchange (BOVESPA), which in the Investment Manager's opinion are mispriced relative to their intrinsic value. No designated Investments will be made in respect of the Class Leblon Equities Fund.

STRATEGY

The strategy of Leblon Equities Partners Fund is value-oriented and based on an extensive fundamental research effort. To determine whether a security is significantly mispriced relative to its intrinsic value, the Fund conducts a bottom up analysis of the business. The main valuation tool is Discounted Cash Flow in addition to peer group multiples analysis. The typical portfolio would range from 15 to 20 stocks that individually should not exceed 20% of NAV and the top 5 holdings should normally account for 40%-50% of the NAV. Risk Management is based on liquidity and "margin of safety" when defining target prices. According to the liquidity rule, the investment manager must be able to liquidate 50% of the portfolio within 30 days and 80% of the portfolio within 90 days. It assumes that the Fund is able to sell its investments, on a daily basis, at a pace equal to half of the average daily liquidity for the past 3 months of each investment.

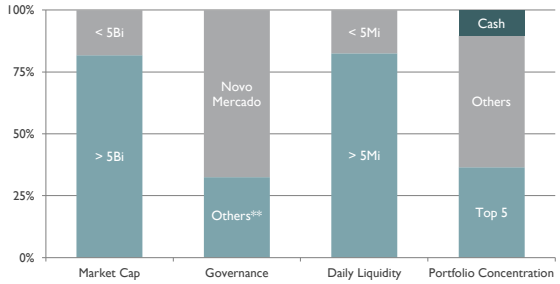
PERFORMANCE US$

Since November 28th, 2008



RELEVANT INFO - EQUITY PORTFOLIO US$

(12/29/2017)



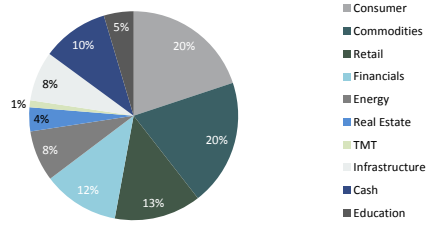
**Notes

Tag Along: 6%, Level 1: 27%

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

SECTOR BREAKDOWN

(12/29/2017)



RETURNS

Last 12 months returns (US$)

Period	Leblon Equities Fund	Ibovespa US$	MSCI Brazil
December 17	4,3%	4,7%	3,9%
November 17	-3,7%	-2,7%	-3,2%
October 17	-2,9%	-3,3%	-3,4%
September 17	8,4%	4,2%	4,2%
August 17	8,7%	6,9%	6,0%
July 17	12,5%	10,7%	10,8%
June 17	-0,9%	-1,7%	-1,8%
May 17	-2,1%	-5,5%	-5,2%
April 17	-2,0%	-0,3%	-0,4%
March 17	-1,9%	-4,6%	-5,0%
February 17	6,5%	4,0%	4,4%
January 17	17,1%	11,9%	10,6%
12 months	50,5%	25,0%	21,0%
Since inception	175,0%	47,2%	24,5%

Annual Returns (US$)

Period	Leblon Equities Fund	Ibovespa US$	MSCI Brazil
2017	50,5%	25,0%	21,0%
2016	68,9%	66,5%	61,3%
2015	-40,7%	-41,0%	-43,4%
2014	-29,1%	-14,4%	-17,4%
2013	-18,2%	-26,3%	-18,7%
2012	18,8%	-1,4%	-3,5%
2011	-21,5%	-27,3%	-24,9%
2010	21,2%	5,6%	3,8%
2009	144,7%	145,2%	121,3%
2008	13,8%	2,4%	0,8%

Annualized Returns (US$)

Period	Leblon Equities Fund	Ibovespa US$	MSCI Brazil
1 year	50,5%	25,0%	21,0%
2 years	60,0%	44,7%	40,1%
3 years	14,8%	7,1%	3,4%
4 years	1,7%	1,2%	-2,3%
5 years	-2,7%	-5,0%	-5,8%
Since Inception*	11,8%	4,4%	2,4%
Volatility inception*	25,4%	32,4%	32,0%

*Inception date of the fund 11/28/2008

*The performance shown above is net off all fees and relates to Series Nov 28, 2008. For a different Series performance please contact MUFG or Leblon Equities.

General Information

Subscriptions	Daily
Initinial Minimal Subscriptions	US$ 500.000,00
Minimum for Subsequent Subscriptions	US$ 100.00,00
Redemptions	Monthly, subject to a 20 days prior written notice.
Minimum Redemption Value	US$ 100,000.00
Management Fee	2.0% per annum of the Net Asset Value. Accrued daily, paid monthly.
Performance Fee	15% of the profits exceeding Libor. Accrued daily, paid semiannually. High water-mark.

Taxes	Apart from registration and annual filing fees, the Fund is not (Cayman Islands law) subject to tax in the Cayman Islands. Each prospective investor should consult its own advisors about the tax consequences for it of any proposed investment in the Fund.
Investment Manager	Leblon Equities Gestão de Recursos Ltda.
Registrer and Transfer Agent:	MUFG Alternative Fund Services (Cayman) Ltd.
Custodian and Calculation Agent:	BTG Pactual Serviços Financeiros S.A. DTVM.

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