



Leblon Letter 20

3rd Quarter 2014

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It is our pleasure to share our twentieth 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

The Quarter

The table below shows Leblon Equities Funds' performance in 3Q14, YTD and since inception (November 28, 2008).

	3Q2014	2014	Since Inception
Offshore Funds			
Leblon Equities Partners Fund	-12,9%	-12,4%	125,2%
Leblon Value Hedge Fund	-5,5%	-15,4%	30,5%
Benchmarks			
Libor	0,4%	1,3%	4,3%
MSCI	-9,2%	-2,2%	33,5%
Ibovespa in US\$	-8,5%	0,4%	40,8%

Small and Mid Cap Companies (SMCs) Fund

In this quarter, as we celebrate our sixth birthday, we received excellent news. The Brazilian Development Bank (BNDES) has selected Leblon Equities as manager of a pioneer private equity fund focused on small and medium-sized companies, to be launched in the first half of 2015. This is part of an initiative by numerous market participants and government agents to widen access to the capital markets for SMCs, and facilitate access to long-term capital at a competitive cost. In our 15th Leblon Letter we wrote about these efforts and the work group formed for this purpose that we have been a member of since 2012. Initial proposals were framed at the end of 2013, and recently the CVM (Brazilian SEC), BM&F Bovespa and the Finance Ministry finalized a group of incentives for SMCs to issue shares in the Bovespa Mais, the market segment created to facilitate initial access to the Bovespa for these companies. The incentives include tax exemption for individuals' capital gains on investments, lower costs for listing in this segment, and easier qualifying requirements. The BNDES will operate (i) as an anchor investor for Bovespa Mais IPOs, and (ii) an investor in two private equity funds focusing on these companies and attracting investment from the public. We have just been selected as managers of one of these two funds.

The fund will be Leblon's 'seed' so that in a medium-term future the Brazilian stock market becomes a better proxy for the real economy. The situation that we have today – with only 364 companies listed on the stock market – shows tremendous potential: as we see it, the Brazilian economy could easily have some thousands of companies potentially able to make IPOs. We see the demand for some recent IPOs such as Linx and Ourofino as indicating avid appetite for (good) stories / new companies. We believe the quality of the assets is a preponderant factor for the success of these offers, and also that the quality of an asset does not depend on its size. Finding the right people in the right businesses, we expect to deliver excellent results for the investors of this new fund. One of the consequences, in our view, will be that the investors of our public funds will, in the long term, have a capital market that is more developed, with an ever-broader range of new opportunities for good investments.

Public vs. Private Equity

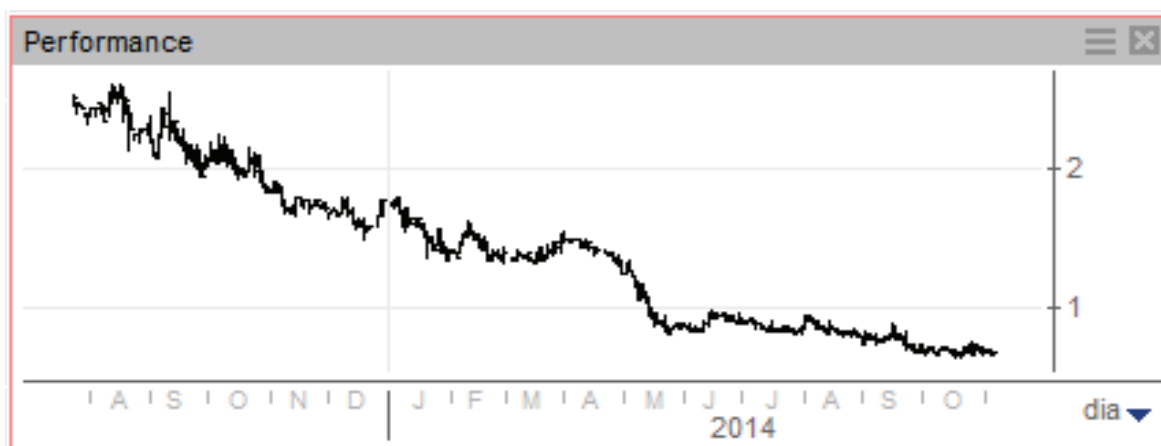
As we expand our activities in private companies, we see some questioning naturally arising as to our team's time allocation between public and private equity. We tend to be skeptical about the term 'synergy' (since we believe synergies can sometimes be overstated) – but not in terms of the synergies between investment in public and private companies, which we believe are important. The thousands of companies in the real economy that are still not yet in the capital market may indeed not yet be public, but they are part of the same 'ecosystem' as the 364 companies that are. The majority of them are clients, suppliers or competitors of the listed companies, and knowing about them and being familiar with them is part of our work as investors in public companies.

Another synergy that is perhaps more intangible, but no less important, is the addition to our analysts' experience. Dealing with private companies often means they have to deal with information that has been much less 'treated' than the information in public company's releases of results. Interaction with the executives of companies and the processes of getting to know the company at an operational/executional level, outside the world of Excel and PowerPoint, also develops an analytical advantage, which our team would be unlikely to have if we were invested only in public companies. At the same time, getting to know the practices and people of companies that are considered to be the 'benchmarks' for their sector, such as Renner and Arezzo, in retail, or Estácio in education, very much enriches the discussions that we have in our private companies.

Historically, in our public equities funds, we have maintained an allocation between 25% and 30% in investments that have a profile similar to those of our investments in private companies. Factors in this activity are the investment horizon, and a more activist relationship with the companies. While as a rule we follow the same principles and philosophy in our investments in public and private equity, in listed companies we deal with the duality between the long-term investment and daily share prices – personified by Benjamin Graham in the manic-depressive character ‘Mr. Market’.

We like the thought-experiment of considering how the stock price of our main investment in private equity, BR Home Centers, would have behaved if it had been a public company in the 6 years during which we have been invested in it. In 2008, when we took on the management of the construction materials retail network Casa Show, that company had declining sales, Ebitda close to zero and debt that was relatively high for a business that requires working capital investments for its operation. At first, the processes of decline in sales and Ebitda and demand for working capital worsened, increasing the company’s debt still further. At that moment, if the company had been a public one, the chart of its stock price might have looked something like this:

(FIGURE 1)



It was necessary to have three changes in the company’s management in three years, until the merger with the Tend Tudo network in 2010, which created the present company, BR Home Centers. Today we believe we have the best people in the construction material retail sector in Brazil. Under the new management, same-stores sales growth over the period 2010 to 2013

averaged 13% p.a. (17% in the Casa Show stores) and Ebitda, which was previously negative at R\$ 20 million, is now at a level to qualify the company for an IPO in 2015 – providing an outlook for quadrupling the number of stores in the long term, with significant improvements in return on invested capital. Over this recent periodo, the stock price chart might look something this:

(FIGURE 2)



There is extensive literature on the term ‘extrapolation bias’, and on investors’ tendency to attribute and excessive weighting to the pattern of a company’s recent past, and extrapolate it to the future. In our assessment this can lead to stock price volatility and even charts like those of our hypothetical example. On the other hand, except in a few very individual cases, the value of a company is never at all likely to have the same volatility in reality as that of its stock price over a short space of time.

Figure 1 is in fact the chart of the stock price of Springs in the last 18 months. Just as it happened to us in Casa Show, Springs had some strategic mistakes, underwent an accentuated fall in sales and Ebitda, and has seen its debt increase in the recent past. It also needed to change executives until it found the correct team to run the retail division, but we did find that team, and it has achieved same-store sales growth above 10% in the challenging year of 2014. In 3Q14 it has posted a net profit, of R\$ 5 million – the first profit in its last 13 quarterly results. Clearly this is very little to celebrate; but with the right people in the retail operation, and with the continuous increases in wholesale market share that it has been achieving (from 35% in 2011 to 45% in 2013), we see Figure 2 as totally feasible for the chart of its stock price in the coming years.

(*)Recurring net profit. There was reported profit in 2Q12, but it was non-recurring, reflecting a sale of assets

Changes in the Portfolio in the Quarter

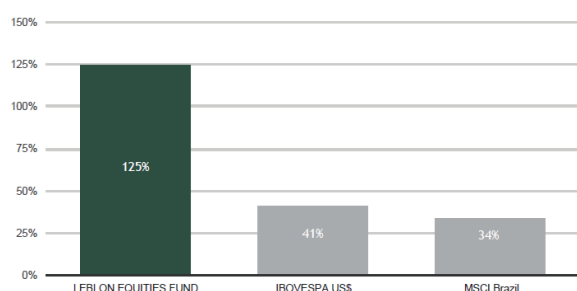
Figure 2, in turn, is in fact the chart of the stock price of Estácio in the last 6 years. Responding to an accentuated fall in stock price, which we believe was for short-term and not structural reasons, we have once again built a medium-sized position in this company, at average price of R\$ 26.80. We also took advantage of a - brief-fall in the price of Renner to increase our position in that company, and it is now one of the fund's five largest positions. We have reduced our positions in Itausa, BM&F and Wilson Sons. For BHG, which was 4.5% of the fund, an offer to delist was made at R\$ 19/share, 36% above the stock price on the day prior to the announcement.

Leblon Equities Partners Fund (LEF)

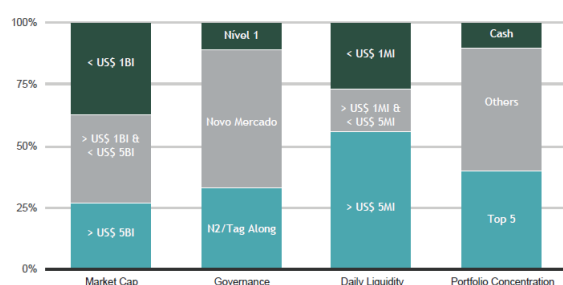
In the 3Q14, the Leblon Equities Partners Fund had a downfall of 12.9% net of all costs, while the Ibovespa index measured in USD fell 8.5%. Year to date, the fund is down 12.4% and the Ibovespa measured in USD is up 0.4%. Since inception, the fund has returned a gain of 125.2% while in the same period the Ibovespa in USD yielded 40.8%. The fund's annualized return since inception is 15.1%, compared to 6.1% for the Ibovespa in USD.

In third quarter 2014, the fund's largest gains were from the positions in BHG, Itaúsa, Petrobras options, Natura and Lojas Renner. The losses came from Saraiva, Springs, Cetip, Eletrobras and Wilson Sons. We started three new positions in this quarter (Petrobras, Eletrobras, and Estácio). We reduced our exposure in BVM&F, BHG, Itaúsa, options in the Bovespa Index, Duratex and Wilson Sons and we increased our positions in Ânima.

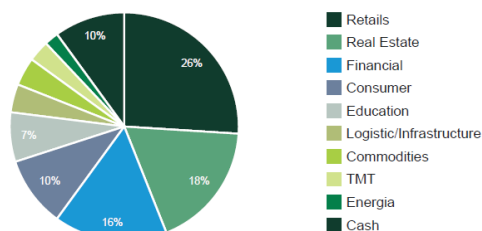
PERFORMANCE US\$ (SINCE NOVEMBER 28TH, 2008)



RELEVANT INFO - EQUITY PORTFOLIO (SEPTEMBER 30TH)



SECTOR BREAKDOWN (SEPTEMBER 30TH)



Last 12 months returns (US\$)

Period	Leblon Equities Fund	Ibovespa US\$	MSCI Brazil
September 14	-17,58%	-19,32%	-19,39%
August 14	7,79%	11,14%	10,77%
July 14	-1,99%	2,00%	1,68%
June 14	3,81%	5,48%	5,09%
May 14	1,17%	-0,88%	-2,04%
April 14	1,31%	3,64%	2,66%
March 14	3,02%	10,38%	10,73%
February 14	5,15%	2,79%	3,21%
January 14	-12,76%	-10,70%	-10,77%
December 13	-1,48%	-2,60%	-4,84%
November 13	-7,88%	-8,36%	-6,82%
October 13	2,49%	4,95%	5,73%
12 Months	-18,56%	-5,93%	-8,27%
ITD (Until 09/30/2014)	125,21%	40,76%	33,52%

Annual returns (US\$)

Period	Leblon Equities Fund	Ibovespa US\$	MSCI Brazil
2014 (until 09/30/2014)	-12,44%	0,42%	-2,16%
2013	-18,24%	-26,29%	-18,68%
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

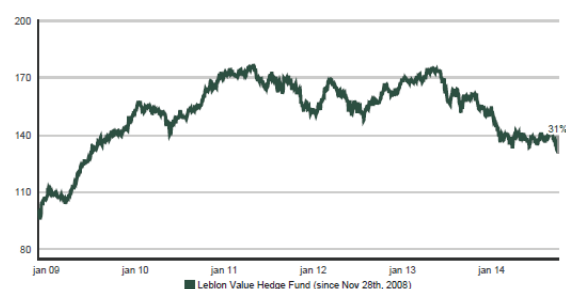
Period	Leblon Equities Fund	Ibovespa US\$	MSCI Brazil
1 year	-18,56%	-5,93%	-8,27%
2 years	-11,24%	-12,98%	-9,83%
3 years	-5,76%	-7,87%	-6,17%
4 years	-7,05%	-14,35%	-12,30%
5 years	-1,40%	-8,64%	-7,71%
Since Inception*	15,08%	6,09%	5,13%
Volatility since inception*	21,76%	30,77%	30,26%

Leblon Value Hedge Fund (LVH)

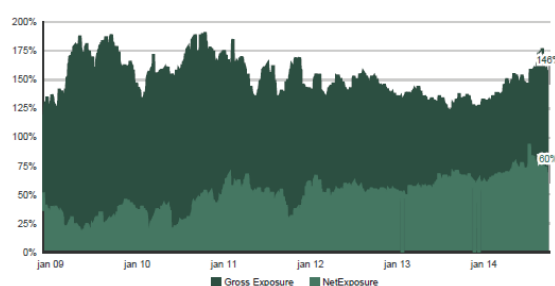
In the 3Q14, the Leblon Value Hedge Fund had a downfall of 5.5% net of all costs, while the Ibovespa index measured in USD fell 8.5% and the MSCI Brazil index fell 9.2%. Year to date, the fund is down 15.4%, the Ibovespa measured in USD is up 0.4% and the MSCI Brazil index is down 2.2%. Since inception, the fund has returned a gain of 30.5% while in the same period the Ibovespa in USD yielded 40.8% and the MSCI Brazil is up 33.5%. The fund's annualized return since inception is 4.7%.

Average gross exposure in the quarter was 158% and average net exposure was approximately 76%. In 3Q14, the fund's gains include the short positions on Eletrobras and Usiminas and also in the long book (BHG, Cielo and Itaúsa). The losses were all in the long book (Saraiva, Springs, Eletrobras, Wilson Sons and Cetip). The changes in the portfolio in the quarter include the changes made in LEF. Additionally, we opened a new short position and a new pair trade. We increased the short exposure in the index and the exposure in another pair trade.

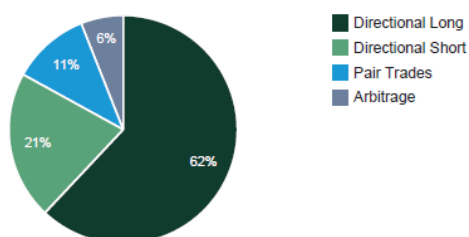
PERFORMANCE US\$ (SINCE NOVEMBER 28TH, 2008)



GROSS AND NET EXPOSURE



STRATEGY BREAKDOWN (SEPTEMBER 30TH)



Last 12 months returns (US\$)

Period	Leblon Value Hedge	Ibovespa US\$	MSCI Brazil
September 14	-8,28%	-19,32%	-19,39%
August 14	3,19%	11,14%	10,77%
July 14	-0,15%	2,00%	1,68%
June 14	0,91%	5,48%	5,09%
May 14	0,03%	-0,88%	-2,04%
April 14	-0,72%	3,64%	2,66%
March 14	-2,40%	10,38%	10,73%
February 14	0,99%	2,79%	3,21%
January 14	-9,35%	-10,70%	-10,77%
December 13	-0,61%	-2,60%	-4,84%
November 13	-4,10%	-8,36%	-6,82%
October 13	1,80%	4,95%	5,73%
12 months	-17,89%	-5,93%	-8,27%
ITD (until 09/30/2014)	30,54%	40,76%	33,52%

Annual returns (US\$)

Period	Leblon Value Hedge	Ibovespa US\$	MSCI Brazil
2014 (until 09/30/2014)	-15,38%	0,42%	-2,16%
2013	-8,65%	-26,29%	-18,68%
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	-17,89%	-5,93%	-8,27%
2 years	-9,06%	-12,98%	-9,83%
3 years	-8,38%	-7,87%	-6,17%
4 years	-4,54%	-14,35%	-12,30%
5 years	-1,49%	-8,64%	-7,71%
Since Inception*	4,72%	6,09%	5,13%
Volatility since inception*	11,99%	30,77%	30,26%

*Inception date of the fund 11/28/2008

PERFORMANCE ATTRIBUTION (SEPTEMBER 30TH)

Cash + FX Hedge	8,19%
Directional Short	2,68%
Pair Trade	0,57%
Non-Equity Hedges	0,00%
Arbitrage	-0,02%
Directional Long	-19,42%
Expenses	-0,29%
Total	-8,28%

Leblon Equities Team

Pedro Chermont – pedro.chermont@leblonequities.com.br

Marcelo Mesquita – marcelo.mesquita@leblonequities.com.br

Pedro Rudge – pedro.rudge@leblonequities.com.br

Bruno Pereira – bruno.pereira@leblonequities.com.br

Felipe Claudino – felipe.claudino@leblonequities.com.br

Eduardo Castro – eduardo.castro@leblonequities.com.br

Victor Uêbe – victor.uebe@leblonequities.com.br

George Earp – george.earp@leblonequities.com.br

Miguel Galvão – miguel.galvão@leblonequities.com.br

Leonardo Vazquez – leonardo.vazquez@leblonequities.com.br

Diana Ventura Rabello – diana.ventura@leblonequities.com.br

Luiz Senos – luiz.senos@leblonequities.com.br

Jayme Azevedo – jayme.azevedo@leblonequities.com.br

Fernanda Avelino – fernanda.avelino@leblonequities.com.br

Luana Costa – luana.costa@leblonequities.com.br

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