INVESTIDOR PROFISSIONAL

Fund Report

IP-Value Brazil

third quarter / 2004

Index

Summary

• IP-Value Brazil's portfolio can be divided in three main categories: PIPEs, Medium liquidity and High liquidity assets.

• The PIPE category joins the best of two worlds: Public Equity investments, for purchasing forgotten and undervalued assets; and Private Equity investments, for selling strategic positions at attractive prices.

• We recently closed another PIPE investment, the one in Companhia Iguaçu de Café Solúvel, with a total return of 497,5%. We believe this strategy will continue to be one of the most important contributors to IP-Value Brazil's performance.

Commentary

The variation in market value of IP-Value Brazil's holdings in September amounted to 3.6%, net of all costs. Since February 26, 1993, the beginning of IP's management, the Fund has accumulated an appreciation of ***1,049%*** in dollars, equivalent to an annualized return of ***23.4%***[1]. In the same period, the Ibovespa recorded a performance of 13.1% p.a. and the MSCI Emerging markets, 5.6% p.a.

Third Quarter 2004 Results

IP-Value Brazil closed the third quarter of 2004 with an appreciation of 8.3%. The main influence on the positive result was the performance of Perdigão and Saraiva, which booked rises of 66.5% and 35.5% respectively. The 14.8% drop in Embratel's shares made a negative contribution to the Fund's performance.

During the quarter, the percentage of the Fund's long position in equities was reduced. IP-Value Brazil closed the quarter with about 85% of its assets invested in stocks.

The main sale in the quarter was of the holding in Companhia Iguaçú de Café Solúvel. This position was situated in the PIPE category (Private Investment in Public Equities). A category we consider one of the most important differentials in IP-Value Brazil's strategy.

The Strategy of IP-Value Brazil

The best way to define IP-Value Brazil is to compare it to a holding company with minority participations in listed companies. A predominant part of the portfolio is concentrated in shares of companies presenting a high potential return in the long term, due to sustainable competitive advantages. A great deal of emphasis is given to the characteristics of the businesses in which the companies operate, to the competence of their managers and to the character of their controllers.

We can divide the portfolio into three different groups:

1. PIPEs (Private Investments in Public Equities): This segment comprises investments with restricted liquidity, but with a high appreciation potential. In these cases, we adopt an active posture. Usually, the exit from the investment is achieved via structured operations.

2. Medium liquidity assets: These are investments in companies with good prospects and low shareholder risk, trading below their fair value. In this category, we adopt a passive posture, since we envisage a catalyst (a change in the level of results, de-leverage, cyclical pick-up, etc.) which will effectively lead to a change in market perception. The exit from such investments takes place through the market in most cases.

3. Highly liquid assets: Investments in short term government securities (LFTs) and in liquid companies are in this group. The horizon of these investments is short to medium term, and the objective is to raise the portfolio's liquidity ratio (a proprietary indicator that measures the degree of negotiability of the assets comprising the portfolio).

The Fund's equity is dynamically allocated among these segments, in accordance with liquidity and investment opportunities. It is common for us to have to choose between liquidity and return. We try to balance our portfolio so that we achieve attractive returns, respecting the limitations of an open-end fund.

PIPEs

Throughout the 11 years of IP-Value Brazil's existence[2], we have allocated an important part of the Fund's net equity to investments in the segment defined as PIPEs.

In such operations, we usually acquire a significant part of a listed company's capital in the market. Sometimes, we nominate members of the company's Board of Directors, Statutory Audit Committee or Advisory Board. We are not involved in everyday operations, but we try to add value in matters in which we have expertise (capital allocation, valuation of acquisitions, communication with the market, remuneration of executives, etc.).

1 Please check Performance Analysis on page 06 for comments on IP-Value Brazil performance numbers in italic.

2 Considering IP-Participações' date of inception.

Our work is very pro-active, always aiming at realizing the "hidden" value—the value that is not always very visible—of our stock positions. The time it takes for the investment to mature tends to be long, liquidity tends to be low, but the returns tend to be very high.

The exit from the investment does not occur in the traditional way, that is, selling to the market. The sale may be made in many different ways: sale to a strategic investor (possibly the controlling shareholder itself), block trade, or the spin-off of a division, among other alternatives.

A PIPE is situated between Private Equity operations (long-term investments in unlisted companies) and stock operations in the market. Through PIPE, the benefits of investing in listed companies (on purchase) are combined with those of investing in unlisted companies (on sale).

In Private Equity operations, the investor negotiates the purchase of shares with the controlling shareholder himself, who knows the business better than anyone else and demands a controlling premium. In PIPE operations, we purchase the stake from a "manic-depressive" partner (the market) which, at certain times, values the assets incorrectly. This asymmetry of knowledge favors us, enabling the purchase of stakes in companies of very high quality at significant discounts.

At the time of sale, given the fact that the Fund holds a substantial stock position, we are usually able to obtain conditions similar to those applicable to Private Equity operations, and more advantageous when compared to a traditional investment in listed companies.

Since the inception of IP-Value Brazil, this type of investment has contributed significantly to the Fund's performance. Throughout the years, we participated in a variety of investments with these characteristics. Among them Elevadores Atlas, Freios Varga, Lojas Renner and CST. Our investment in Companhia Iguaçu de Café Solúvel was another history of success from the PIPE category.

Companhia Iguaçu de Café Solúvel

We started investing in the company's stock in mid-1995, when its market capitalization was below the net cash position. This fact, together with the payment of minimum dividends (12% on the capital stock for PNA shares and 8% for PNB shares) made the investment very attractive. The yield represented by this minimum dividend in 1996 was as high as 45%, a figure that was much higher than the opportunity cost of 27% (the CDI rate).

In addition, in our analysis, one of the Company's main appeals was the fact that it was effectively run in a serious, organized and extremely competent way. The cyclical nature of the business might not be exceptional, but Iguaçu succeeded in generating consistent results and had clear differentials in relation to the other companies in the sector, which made it an excellent asset for the portfolio.

In keeping with our practice, when dealing with Iguaçu we sought to maintain a close relationship with the management, including the nomination of a member of the Board of Directors and two in the Statutory Audit Committee. This work was carried out vis-â-vis the company with a view to furthering the appreciation of our holding and enabling an exit at attractive prices.

The business of Companhia Iguaçu de Café Solúvel

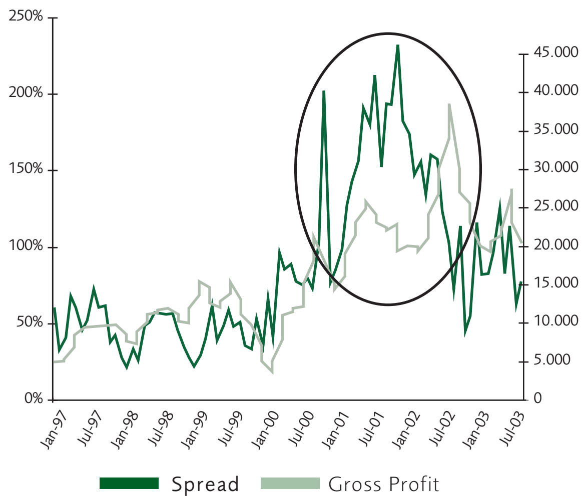
Iguaçu buys the so-called green coffee (harvested in grain) in the domestic market, transforms it into soluble coffee and exports 80% of its output. The company is the 3rd largest soluble coffee exporter in Brazil. The nature of its business is cyclical, and the critical variables for the company are the exchange rate and the spread between the prices of green coffee in the domestic market and soluble coffee in the foreign market.

In the years 2000 to 2002, the coffee producing countries had record harvests. In Brazil alone, the 2002/03 harvest reached 47 million sacks, in comparison with the 1999-2002 average level of around 33 million sacks. This movement created a world oversupply, knocking the price down to the level of just US$ 28.00 per sack. This is equivalent to an 86% drop in relation to the peak of US$ 205 per sack reached in October 1994 (a year of frosts in important producing countries, including Brazil), and 64% in relation to the average of US$ 78.00 for the period from 1990 to 2002.

Although the movement of green coffee has a strong influence on the price of soluble coffee, the volatility of the latter is less intense. Soluble coffee traded in a range of US$65-75 per sack—a 60% drop in relation to the peak of US$ 194.00, recorded in April 1995, and a 35% drop in relation to the US$ 115 per sack average for the same period as mentioned above in relation to green coffee.

As a result, the spread between the two rose to very high levels in 2002, close to its historical peaks. This, together with the currency devaluation of 1999, 2001 and 2002, directly benefited the company's gross profit, which rose at increasing rates, quarter by quarter (see chart bellow).

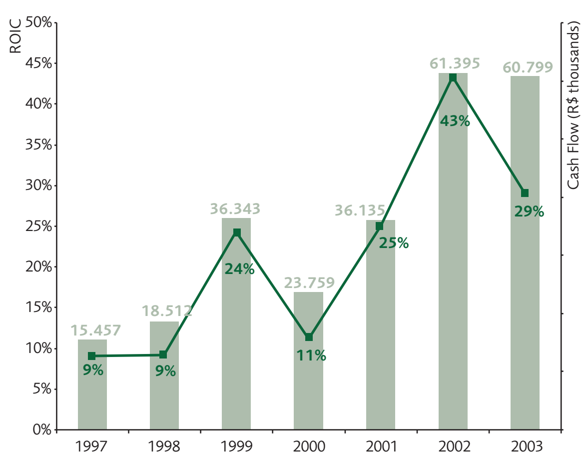
Spread between Green & Soluble Coffee vs. Gross Profit in R$mm



Source: CECAFÉ – Conselho dos Exportadores de Café Verde do Brasil (Brazilian Green Coffee Exporters Council) and Iguaçu's Balance Sheets

The favorable situation caused by the oversupply of green coffee, the relative stability of soluble coffee prices and the currency devaluation all combined to produce a significant improvement in Iguaçu's main ratios. The average growth rate of the cash flow reached 26% p.a. (see chart below). The return on the capital invested amounted to 9% in 1997, compared to 43% in 2002 and 29% in 2003.

Cash-flow Growth in R$ and ROIC (Return on Capital Invested) – 1996-2003



Source: Iguaçu's and IP's Balance Sheets.

IP's contribution

Despite all these attractive features, the company suffered from two important problems, which inhibited the capital market's interest in its stock: (i) extreme lack of liquidity—for example, in 2004, up to the month of August, its PNA stock had only taken part in 16 trading sessions; and (ii) it was controlled by a foreign investor, Marubeni Corporation, which like any other foreign controller, has little motivation to try to keep the stock at a good price in the Brazilian market, because it is able to obtain much cheaper financing in its country of origin.

Therefore, even though the Company's management always observed the highest ethical principles, the lack of a corporate decision to embrace a typical listed company project led us to pay extra attention to any action that might reduce the value of our investment.

Thus, as early as 1998, our first task in relation to the company's management was to acquaint them with the notion of setting up a Statutory Audit Committee with proper representation of minority shareholders. The company understood our position perfectly (this would become a hallmark of our relationship with them), and complied with our request that they set up a committee and elect two members nominated by minority shareholders.

In March 2002, an Annual and Extraordinary GSM was called, including in its agenda a proposal that would be highly prejudicial to preferred shareholders: the extinction of the minimum dividend and, at the same time, the inclusion of a priority dividend of 3% on the book value. With this proposal, the company believed that it was adapting to article 17 of the new Corporations Law (published in October 2001). This article required companies to choose at least one of the three advantages it listed. Our position was that the text of the article was very clear in requiring at least one of the three advantages, but in no way did it forbid the accumulation of two advantages. Therefore, the adoption of one advantage did not require the extinction of another already in existence, which was responsible in large part for the stock's attractiveness.

The company's management accepted our request, suspending deliberation on the matter at the Annual GSM and submitting a formal consultation to the CVM (Securities Commission) about our doubts regarding the interpretation of the new law. Later, the CVM issued its official opinion on article 17 to the whole market, recommending those companies that already had a minimum dividend to accumulate two advantages, with the one most advantageous to the shareholder prevailing.

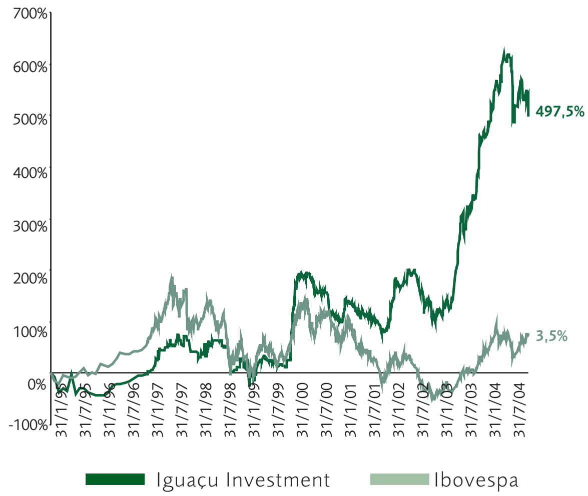
Also in 2002, due to an internal restructuring, Iguaçu started exporting all its production through an unlisted subsidiary. This move practically eliminated the transparency of its results and made it impossible to accompany the evolution of the company's operations. We showed the management that, even though we fully agreed with the objectives of the internal restructuring, we could not be completely excluded from essential information that enabled us to calculate and follow the value of our investment in the company. Once again, Iguaçu was sensitive to our demand and started publishing ITRs (quarterly reports) and DFPs (standardized financial statements) including additional data on its unlisted subsidiaries.

On the occasion of its excellent operating results in 2002, we asked the company why it was that it had never taken advantage of the significant tax benefit resulting from the payment of interest over own equity benefit (IOE). In the past, the company had studied the matter, but had not found it advantageous. In view of our arguments, the Board of Directors studied the question once again and decided to pay IOE. However, based on an interpretation of a decision of the CVM (no. 271), the management adopted an incorrect method of paying the IOE, calculating the sum of the IOE and dividends in such a way as to ensure an equivalent net payment to all shareholders. In fact, the existence of shareholders that are exempt from taxation on IOE results in the latter receiving higher net amounts than other shareholders. This exemption was precisely the case of our investment funds. Here, once again, it was necessary to obtain clarification from the regulating body, whose opinion favored our interpretation, and the company therefore paid a complementary dividend to our portfolios.

In view of the high growth presented by Iguaçu's operations in 2002 and 2003, both its book value and its stock price came to reflect quite adequately the fair value we calculated for the company. Taking into consideration also the obvious conclusion that Iguaçu was not very interested in the capital market, we started negotiating the sale of our position to the controlling company in February of the current year. In August, the negotiations were concluded with a public offer to acquire, in conformity with CVM instruction no. 361/02.

In the almost nine years during which we held the investment in Iguaçu stock, we obtained a return of 497.5% in dollars, equivalent to 22.4% p.a.

Return vs. Ibovespa



Source: CECAFÉ – Conselho dos Exportadores de Café Verde do Brasil (Brazilian Green Coffee Exporters Council) and Iguaçu's Balance Sheets

Conclusion

Experience is essential in the management of this type of investment. Over time, one learns the best way to negotiate the purchase of a stake in companies, how to build and formalize relationships with controlling shareholders and executives, and how to negotiate and structure the exit from the investments.

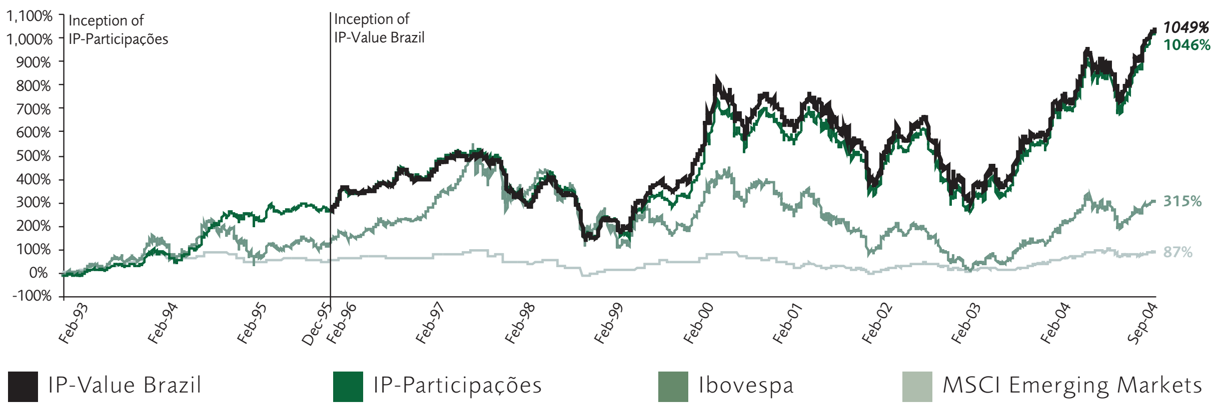
The work carried out in these cases and in so many others should be a great differential for the fund's performance in the future. The experience acquired, especially in exiting the positions, brings great benefits both in originating new alternatives and in the management of the present ones.

A substantial part of the fund's net equity will continue to be allocated to PIPEs; Saraiva and Panvel are currently the main investments in this category.

We trust that with the experience acquired up to now, the continuous efforts of our team and the trust our shareholders place in us, we will be able to build new success stories for IP-Value Brazil.

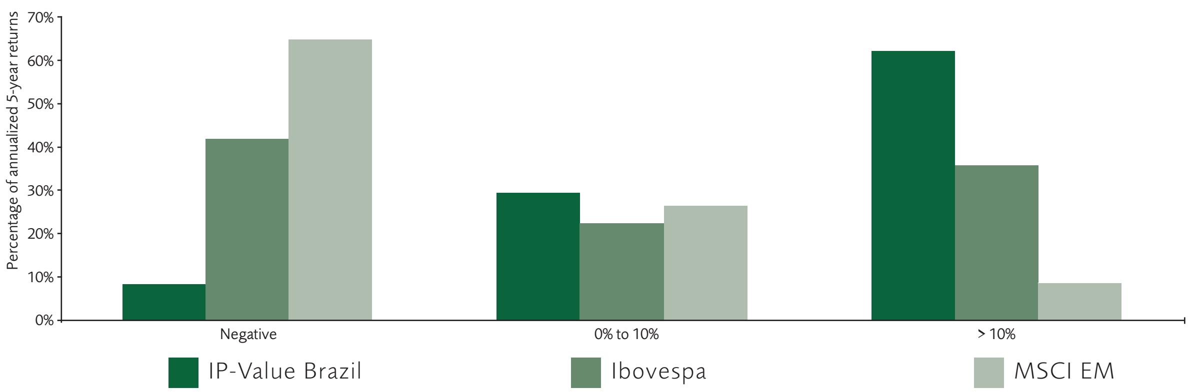
PERFORMANCE ANALYSIS - SEPTEMBER 2004

IP-Value Brazil* x Ibovespa x MSCI Emerging Markets



Trailing Performance Analysis*

Annualized Performance for every 5-year period since inception (daily trailing from 02/26/93 to 09/30/04)



	IP-Value Brazil*	Ibovespa	MSCI EM
1993(1)	*50.98%*	63.95%	46.85%
1994	*142.53%*	51.44%	17.44%
1995	*3.34%*	-9.50%	-12.82%
1996	32.57%	53.25%	5.55%
1997	-11.53%	34.47%	-11.19%
1998	-25.64%	-38.42%	-25.34%
1999	136.73%	69.49%	66.41%
2000	-0.99%	-18.08%	-30.61%
2001	-7.58%	-23.98%	-2.37%
2002	-26.36%	-46.01%	-6.04%
2003	87.65%	141.04%	55.95%
2004 (YTD)	16.34%	5.92%	7.69%
September-2004	3.59%	4.46%	5.78%
Since 02/26/1993(1)(2)	*1,049.45%*	314.84%	87.17%
Annualized Return (1)(2)	*23.45%*	13.06%	5.56%
Annual Volatility	*24.21%*	43.13%	22.38%
Sharpe Ratio (3)	*0.85*	0.24	0.12

(1) Inception of IP-Participações
(2) Performance numbers are net of all fees
(3) Sharpe Ratio is: (Annualized Return minus the compounded annual 3-month T-bill return)/Annual Volatility.

* IP-Value Brazil is an offshore version of IP-Participações, a long-only equities fund based in Brazil and managed by Investidor Profissional. Both funds hold the same positions, the only difference being cash, held in dollars for IP-Value Brazil and in reals for IP-Participações. Although IP-Participações had its inception in 02/26/1993, its offshore version was not created until 12/29/1995. For reference, we show IP-Participações performance in dollar terms for the period between 02/26/1993 and 12/29/1995. To make it easy to differentiate, every time we show an IP-Value Brazil performance number affected by IP-Participações' performance, it will be in italic.

Miscellaneous

• "*No crystal ball is required for investment success. Smart investors stick to investments within their circle of competence, with which they are comfortable whose businesses they have the capability to understand. This does not require accurately divining the meaning of the market´s pattern. You don´t need an opinion on every security. And you don´t need to know which way to lean, following every single news development. You simply need, to be meaningfully correct several times a year in order to earn a solid return on capital without excessive risk.*

The challenge is to avoid the temptation to speculate, to have justifiable but not unreasonable confidence in your analytical judgements, to demand adequate return for the risks you incur, and to control risk through prudent, but not excessive, diversification and appropriate hedging while avoiding the usage of leverage." - Seth Klarman, Baupost Group manager

• "*I can predict the motion of heavenly bodies, but not the madness of crowds.*" - Isaac Newton

• "*I´d love to be able to predict markets and anticipate recessions, but since that´s impossible, I´m as satisfied to search out profitable companies as Buffett is*" - Peter Lynch

• "*If Fed Chairman Alan Greenspan were to whisper to me what his monetary policy was going to be over the next two years, it wouldn´t change one thing I do.*" - Warren Buffett

• "*The power to tax involves the power to destroy*" - John Marshall

• *"People have always had this craving to have someone tell them the future. Long ago, kings would hire people to read sheep guts. There´s always been a market for people who pretend to know the future. Listening to today´s forecasters is just as crazy as when the king hired the guy to look at the sheep guts. It happens over and over and over."* - Charlie Munger on Berkshire Hathaway's 2004 Annual Report

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