Fund Report

IP-Value brazil Classes

Third Quarter / 2005

INVESTIDOR PROFISSIONAL
DESDE 1988

Index

Introduction: Making History 2

IP-Value Brazil Classes **5**

Portfolio 5

Lojas Renner 5

Informations 9

Miscellaneous **10**

Making History

For those who have not followed closely the recent development of our capital market, we would like to describe a small but significant example of entrepreneurial and corporate evolution in Brazil: the first General Shareholders Meeting of Lojas Renner S.A. as a listed company without a defined controlling shareholder.

But first, it is worthwhile going back a little in time to write a short summary of this company's history. In the nineties, Lojas Renner appeared as a very promising investment alternative, known by only a few in the capital market, despite the efforts made by the company to get closer to the market. This forward movement was interrupted in 1998 by the announcement of the sale of its controlling stake to the US company J.C Penney, which, immediately after the acquisition, placed a tender offer for the remaining shares in the market. This attempt faced a lot of controversy and resistance on the part of a group of minority shareholders at the time. Since then, Lojas Renner has remained a listed company, though with reduced free-float and hardly any liquidity.

It was after these unedifying events that, in 2005, in an unprecedented initiative, the US multinational corporation decided to sell the company's controlling stake in the stock market – instead of selling it to a strategic investor, which has been the rule up to now in our market. Thus, for the first time, the existence of a Brazilian listed company with its stock held by a large number of small shareholders, and without a defined controlling party, became possible. In practice, there would be many shareholders, none of which would alone hold the absolute majority of the voting capital.

Some prior measures were necessary in order to structure the company's governance in this new corporate environment. Among these, we can mention converting all its stock into common shares; joining the Bovespa's New Market; forming a top-class Board of Directors, composed of competent professionals; and drawing up a remuneration program designed to align the interests of the management with those of the company and its shareholders.

Following the recent successful wave of primary placements, the offer of Lojas Renner's stock was a success – both from the point of view of the controlling party, which sold its stake successfully, and the company's intention of having its stock held on a retail basis. The shareholder that acquired most shares had no more than 8% of the capital.

Once the offering was concluded, it was necessary to call an Extraordinary GSM in order to adapt some points in the by-laws, so that they reflected the changes that had occurred after the offering.

The matters to be deliberated were very simple and of merely bureaucratic in nature, but as it was the first meeting after the retail sale of the stock, it promised to be an unique experience.

The meeting was very innovative. In order for any GSM to be held at a first call, a legal minimum quorum is necessary – one quarter of the voting capital, in most cases – which in almost all Brazilian companies is achieved only with the presence of the controlling shareholder. However, as the quorum was not achieved, the Renner GSM could not be held, even though the company had been very pro-active and innovative, strictly following all the recommendations of good corporate governance: it encouraged its shareholders to attend the meeting, sending them detailed explanations of the subjects to be discussed, and also placing at their disposal proxies to represent them.

Some days later, at second call, the meeting was held with the legal quorum – any number of voting shareholders present. It shows that, despite the considerable evolution of the last few years – whether because of the active posture of some investors or due to developments in institutional investor regulations (the CVM and SPC) – the tendency for absenteeism in meetings of Brazilian companies stood out once again.

The number of shareholders present was very low. However, what most called one's attention was the fact that, in practice, the foreign investors (holding the majority of the capital) still find it difficult to exercise one of the shareholder's most important rights: the vote. That may be due to the bureaucracy – which really makes the whole voting process difficult, because there are various legal figures between the company and the shareholder (local custodian, depository bank, the requirement for documents to be certified by a notary and a consul abroad, and for sworn translations, etc…) – or especially because of the lack of knowledge of how to exercise the right to vote.

In the specific case of Lojas Renner, the second one seemed to us to be the greatest cause of difficulty. For example, there were cases of shareholders who, without any justification, instructed their proxies to vote against the proposals on simple issues, such as the case of the mere adaptation and consolidation of the by-laws, both measures that were necessary after the conclusion of the public offering.

After this Meeting, it was clear that it will not be enough for the Brazilian corporation to have "only" a pro-active and dedicated posture in relation to its shareholder base, encouraging, facilitating and explaining all matters comprising the agenda. In addition, it will be necessary to carry out a real educational crusade, describing step by step how and why to vote, and disseminating the fundamental importance of the vote in companies with shares held on a retail basis.

We believe that investors who aim and work for a more robust capital market should act not only as financial investors, but in fact as partners to the company, especially in the case of institutional investors, which have fiduciary duties in relation to their own shareholders or participants.

While the Brazilian market is still in its infancy in this field, we feel that one should support and develop initiatives such as that of the management of Lojas Renner, which is highly committed to being in fact a transparent company, in which shareholders really take part in decisions in which they are involved – thus enabling the company not only to be a success case from the financial point of view, but also to become an example for the evolution and development of the Brazilian capital market.

Examples like the one mentioned above, and also the large number of initial public offerings in the last two years, show the progress and maturity of our capital market.

To this end, the contributions of the large variety of agents involved were necessary. On the supply side, controlling shareholders are accepting the dilution of their participation as a result of the entry of new partners; and, for that purpose, they have had to offer greater protection and fairness – which, in recompense, has improved the pricing of their shares and enabled them to access capital on a competitive basis.

On the demand side, investors are more careful and selective with regard to both the quality of the operations and the companies' corporate governance practices, and now apply discounts for the purchase of shares considered to be deficient in any of these aspects.

From the point of view of self-regulation and regulation, the Bovespa and the CVM have been playing no less important roles. Bovespa's launching of the New Market and differentiated levels of corporate governance, back in 2000, represented a landmark in our capital market. The simple idea that served as a base may be summarized as follows: better than facing a long and always controversial process of legislative change is to draw up a body of rules to which companies can adhere voluntarily and spontaneously.

With regard to the CVM, we have witnessed a regulatory body being increasingly agile and present, be it in rapidly taking a position in relation to matters of extreme importance to the market, be it in imposing tough but correct penalties on those who do not comply with the law. The business environment in Brazil can now rely not only on good rules, but on rules that are in force and are obeyed. The improvement in enforcement has helped to reduce some of our highest costs: the sensation of false protection, and the suspicion that what is written does not count.

Finally, the effort and the work undertaken have now started to show effects that seem to us to be lasting and structural.

The best news is that we are just at the beginning of this process, and the funds managed by IP are well-prepared and positioned in order to benefit from this new leap in quality in our investment environment.

The change in market value of the Classes IP-Value Brazil[1] and IP-Value Brazil II[2] positions in September amounted to 14.47% and 16.44%, respectively. Since February 26, 1993, when Investidor Profissional's management began, IP-Value Brazil Class has accumulated an appreciation of 1,370% – an average return of 24.51% p.a. In the same period, the Ibovespa recorded a performance of 17.45% p.a., and the MSCI Emerging Markets, 8.62%.

Portfolio

In the course of the 3rd quarter of 2005, the percentage of the fund's long position in equities was marginally reduced, from 92% to 90%; and IP-Value Brazil Classes closed the period with 64% of their equity portfolio invested in Saraiva, Coteminas, Brasil Telecom, Ambev and Globex, and in Banco do Brasil warrants.

The portfolio's valuation is at historically low levels. IP-Value Brazil Classes P/E[3] ratio for 2006 is 5.6. The internal rate of return[4] projected for the next 5 years is at the level of 21.6% p.a. above inflation.

From the point of view of shareholder rights, in September IP-Value Brazil Classes reached their highest ever protection level, as measured by the percentage of the portfolio invested in shares with tag-along rights: 77%. In addition, 51% of the portfolio is invested in companies in which we elect, alone or jointly, members of the companies' management bodies (Statutory Audit Committees, Boards of Directors and Advisory Boards).

Lojas Renner

In the month of July, a Public Offering of Lojas Renner's shares was carried out. The operation was a landmark in the history of the Brazilian capital market.

As mentioned in the introduction, this operation underlines the stage of maturity reached by the Brazilian market in the course of the last few years.

But what makes the event even more interesting and enlightening is the fact that, in the past, Lojas Renner represented a watershed in our market. The "quasi" de-listing of the company in 1999 was no doubt one of the most important events inspiring the movement to modernize and strengthen the rules for shareholder protection. It inspired new regulations and a greater awareness of problems and opportunities among legislators, investors and companies.

As a result of this process, there has been a reformulation both in the regulatory sphere and in the mentality of Brazilian entrepreneurs, who now see the market as a genuine, long-term partner for their businesses.

In this report we will recall our past investment in Lojas Renner, and later comment on our present view of the company and its prospects.

Investment Case: Lojas Renner (1994-1999)

At the beginning of the nineties, Lojas Renner was an inefficient family company, until it hired one of the most talented executives in Brazil, José Galló. It was he who transformed this company, which originated from the Southern region of the country, into one of the strongest players in the national retail sector.

Between 1994 and 1998, IP maintained close contact with Lojas Renner. We sought to contribute, among many other things, to improving communications with the market (both nationally and internationally) and to the implementation of incentive plans for executives, aligned with shareholders' interests. These initiatives were added to an excellent operational performance, which raised the stock price by 1150% in less than three years, reaching the peak of R$ 60 per share.

1 Net of all fees

2 Net of management fee

3 Price/Earnings Ratio. Company's market cap. divided by projected earnings. The lower the indicator, all else remaining constant, the cheaper the company.

4 IP Projection, based on the companies' projected earnings for the next 5 years (earnings yield), weighted by each company's participation in the portfolio.

The market recognized the advances made by Renner until the Asian and Russian crises arose. The shares then plummeted, even though the company continued to book solid operating results.

This drop was seen as a great opportunity by J.C. Penney. The international retail giant contacted the Renner family and acquired a controlling stake in the company. On the same day, it published in the papers a public offer for the purchase of 70% of the preferred shares at an average price of R$ 23.71.

The conditions of the offer were extremely unfavorable to minority shareholders. In the first place, the price was very low. In addition, although J.C. Penney had declared its intention of de-listing Renner completely, in practice the offer would leave a large number of shareholders isolated and with no liquidity. IP decided to call the CVM's attention to the situation and start the process of organizing and coordinating the minority shareholders.

Following an order from the CVM, the offer was cancelled. Two weeks later, J.C. Penney presented a new proposal of R$ 25.00. Most shareholders accepted the offer; IP decided to refuse it. The price was still unattractive, and the importance of our investment justified allocating time and effort to seeking a more advantageous exit.

IP then made public its decision to refuse the offer of R$ 25.00. At the same time, a new pact was signed with other investors who were equally unhappy. With our combined stakes we elected a member of the Board of Directors. We were also able to call an Extraordinary GSM, which instituted a Statutory Audit Committee to which we appointed two members. With these measures, we won a stronger position to fight for our rights.

In January 1999, J.C. Penney representatives made contact again with the objective of acquiring our block of shares. After some weeks of negotiations, the stake was sold at R$ 37.61 per share, a value 60% above the initial offer. There was also a payment of dividends of R$ 1.32 per share.

Despite the imperfections in the regulatory environment and the lack of respect for minority shareholders at that time, a highly positive investment cycle was closed for IP-Value Brazil Classes. The nominal gain amounted to 683% in relation to the initial acquisition cost, in addition to the dividends received.

The Renner case, as previously mentioned, was a great landmark in that phase of the Brazilian capital market. Together with the Freios Varga case, in which we became involved soon after, it helped us to call greater attention to the importance of tag-along rights. As a result of later efforts, Saraiva became the first Brazilian company to grant tag-along rights to preferred shares, in February 2000. IP-Value Brazil Classes' portfolio, which had no tag-along rights in any of its holdings in 1999, now enjoys such rights in over 70%.

And, perhaps by an irony of fate, this new phase of the market in Brazil has, as a symbol of its new start, or its turning point, J.C. Penney's sale in the market, on a retail basis, of the controlling stock of Lojas Renner. Not only on a retail basis, but with clear rules of high corporate governance.

This new phase of the Brazilian market can only make us optimistic that new times are arriving. We invest today in a more mature market, with clear rules and operating as a legitimate provider of long-term finance for companies – thus fulfilling its historical role.

Investment case: Lojas Renner (at present)

After J.C. Penney bought control of Renner, the company recorded strong growth, along with the geographical expansion of its operations.

At the beginning of the nineties, the company was a chain of traditional department stores with eight stores, all located in the State of Rio Grande do Sul. During this same period, it went through a restructuring process and decided to focus on apparel. In the following years, the company adopted an expansion plan, entering the closest States (Santa Catarina and Paraná). From 1997 on, the company started to enter the São Paulo market, but the speed and attractiveness of this expansion was hampered by a lack of sales points. By the end of 1998, the company already had 21 stores, from Rio Grande do Sul to São Paulo.

At that time, Mesbla and Mappin, after a long, slow agony, ended up going bankrupt and their stores were auctioned. This was a historic opportunity for Renner, which took the chance to take over the excellent points that belonged to those companies. Between 1999 and 2000, 28 stores were opened, 21 of which were at points previously occupied by Mappin and Mesbla.

At the end of the nineties, Renner bore little resemblance to the company in which we had made our first investment. It had grown from a regional company into one that operated in the main economic centers in the country, taking positions in the important areas of the Southern region (pioneering) and the South-Eastern region (a historic opportunity). This gave it great competitive advantages, considering the characteristics of the Brazilian market. The Brazilian population is predominantly urban, while available sales points are limited in large cities, making it vital to occupy these areas.

This growth also gave it sufficient scale to compete on equal terms with its great competitors (C&A and Riachuelo), and a great advantage in relation to the smaller chains. This benefit is clearly visible, for example, in rental negotiations with large shopping malls.

Another benefit achieved with scale was credit availability. While Brazilian consumers depend a great deal on credit, the banking system does not take care of them. Renner makes 75% of its sales through its own credit card, offering the possibility of dividing the purchase into installments. The company has about 7.6 million clients with its credit cards, who return to Renner itself every month to pay their installments. Thus, a new sales opportunity is created and strong client loyalty is achieved.

Renner's concept also offers a great differential in relation to its competitors. The store is divided according to different lifestyles, which attracts women clients. That is it, the women clients. A large part of purchases is made by women between 18 and 45 years of age, within the middle and upper-middle class consumer bracket. This is a segment that is growing fast in the Brazilian workforce, with increasing income available for personal expenses. They usually have little time available for shopping, and the lifestyle concept offers speed and convenience. The divisions inside the stores are made predominantly in accordance with own brands, rather than by product. These brand-names are themselves created applying criteria that reflect different lifestyles.

However, within the retail sector, it is not enough to be well positioned. Management quality is very important. At Renner, we have the security of finding the same executives who called our attention ten years ago – and with the advantage of greater experience and alignment. After the public offering, the new Board of Directors created an options plan, aligning executives' and shareholders' interests.

What most called our attention during our study for a possible investment in the public offering were the business's prospects for the coming years.

The Renner stores in Rio de Janeiro and São Paulo are not entirely mature yet. The building of the brand and penetration of the Renner credit card are essential for the business to mature. These projects take time to achieve their full potential. The stores in the South-Eastern region still have sales about 25% lower than those in the South. We believe this difference is likely to diminish in the next few years.

Credit operations also present various opportunities. J.C. Penney was hampering the company in the last few years in this area. Soon after the offering, the company had already expanded its maximum financing option from 5 installments without interest to 8 installments with interest. This new form of payment not only leverages sales but also means a profitable financial operation.

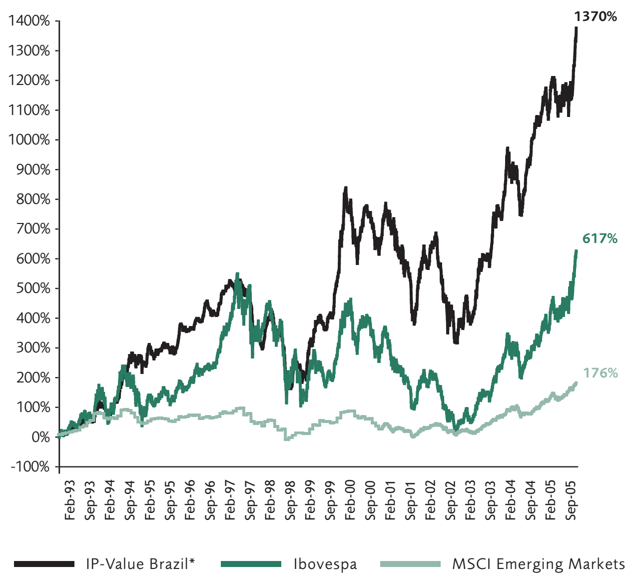
In addition, we understand that the company can use its Renner card platform to sell financial products. These services have not yet been exploited by the company, but several studies are being carried out in order to identify the best opportunities. We would mention the case of a competitor with a platform similar to Renner's that started offering financial products through its own card last year, and whose results have been encouraging. We believe that Renner can increase its profitability by selling financial products through its already well-developed sales platform, which may bring significant results in the future.

Geographical expansion, while posing a challenge, can become a great opportunity. At present, Renner has no store in the North-East. That is a promising region with strong consumer trend and with less competition than in the South and South-Eastern regions.

In short, the company is well positioned within a profitable sector; its managers, who have built successful results over the last few years, remain in the company and are aligned with the shareholders. In addition, the company's prospects for the coming years are very attractive.

We have taken the opportunity to invest again in Lojas Renner.

IP-Value Brazil* x Ibovespa x MSCI EM



* IP-Value Brazil is an offshore mirror 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 on 02/26/1993, its offshore mirror 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 italics.

Performance (US$)	IP-Value Brazil II (2)	IP-Value Brazil (3)	Ibovespa	MSCI EM
September 05	16.44%	14.47%	19.34%	9.32%
August 05	3.22%	4.04%	8.22%	0.90%
July 05	-3.47%	-3.49%	1.92%	7.08%
June 05	2.95%	2.31%	1.45%	3.45%
May 05	2.70%	2.70%	9.25%	3.52%
April 05	-2.62%	-2.48%	-3.00%	-2.67%
March 05	-3.44%	-3.91%	-8.07%	-6.59%
February 05	7.97%	7.63%	17.07%	8.78%
January 05	-4.80%	-4.71%	-6.09%	0.32%
December 04	5.85%	5.31%	7.70%	4.81%
November 04	1.32%	4.99%	13.65%	9.26%
October 04		-0.41%	-1.15%	2.40%
2005 (YTD)	18.56%	16.06%	43.01%	25.51%
2004	7.25%	28.11%	28.16%	26.28%
2003		87.65%	141.04%	56.35%
2002		-26.36%	-45.44%	-6.04%
2001		-7.58%	-25.00%	-2.37%
2000		-0.99%	-18.33%	-30.61%
Last 12 months		27.80%	73.03%	47.18%
Last 60 months		80.90%	63.25%	96.52%
Since 02/26/1993 (1)		*1369.04%*	*617.81%*	*175.57%*
Annualized Return (1)		*24.51%*	*17.45%*	*8.62%*
Historical Volatility		*24.69%*	*44.04%*	*22.11%*
Sharpe Ratio (4)		*0.85*	*0.32*	*0.24*

(1) Inception of IP-Participações
(2) Performance numbers of IP-Value Brazil II are gross of performance fee; inception on November 19, 2004
(3) Performance numbers of IP-Value Brazil and IP-Participações are net of all fees
(4) Sharpe Ratio is: (Annualized Return minus the annual 3-month T-bill return)/Annual Volatility

Structure

IP-Value Brazil II is a Class of IP Investment Fund Ltd, which is an open-ended investment fund organized as a limited liability exempted company, incorporated under the provisions of the Companies Law (2001 revision) of the Cayman Islands.

Investment Manager: Investidor Profissional Gestão de Recursos Ltda.

Net Asset Value Calculator and Brazilian Custodian: Banco Itaú S.A.

Bank: UBS AG, Stamford Branch, CT (USA)

Registrar and Transfer Agent: UBS Fund Services (Cayman) Ltd.

Auditor: Deloitte & Touche

Investment Objective

Obtain significant long-term absolute returns by investing long only in the Brazilian equity market.

Investment Strategy

- **We follow a disciplined, value oriented long-term approach.** We do thorough fundamental analysis to identify companies that are trading at far less than their intrinsic value.
- Our aim is to find Brazilian companies with the best combinations of:
  - Perfectly understandable business;
  - Above average long-term prospects;
  - Managed by people that are competent, honest and aligned with minority investors;
  - Trading at attractive prices.
- **Portfolio turnover is low**, we only buy after having done extensive analysis and developed great conviction. We usually keep our holdings for more than two years.
- **We are in close contact with the managers of our top holdings** in order to understand their motivations, better anticipate their behavior, and help in the matters we have competitive understanding. In some companies, we will work with the managers in order to improve:
  - Company relationship with the market;
  - Capital Allocation;
  - Corporate Structure (spin-offs, shareholder agreements, etc);
  - Alignment of interests (tag along, compensation structures, etc);

Investment Strategy (continued)

- **We invest in a concentrated fashion,** since we do not believe in diluting the best investment ideas with inferior ones. We think that investing without deep knowledge, for the sole purpose of diversifying, is far more risky than concentrating in those companies we have thoroughly studied.
- We do not associate risk with the inevitable short-term fluctuations in the market quotes of our positions.
- **We define risk as the permanent loss of capital** and believe the best way to minimize it is by:
  - Investing with a large margin of safety. Buying cheap enough as to afford waiting for price/value convergence while still making the investment worthwhile.
  - Not using leverage. We will never put our staying power in jeopardy to earn a few more percentage points.
- **We believe our main competitive advantage is having a different investment horizon than that of the market as whole, and sticking to it with discipline.** By focusing on the long-term and having a deep knowledge of the companies we invest in, we are able to take advantage of short-term market overreactions.

Terms and Conditions

Subscription: Daily, in the first business day immediately following receipt of cleared funds and the Subscription Agreement.

Minimum Initial: US$ 250,000

Minimum Additional: US$ 100,000

Redemption: Last business day of each calendar quarter, subject to a previous notice of 30 business days. Payment of redemption proceeds shall generally be made within 10 business days following the Redemption Day.

Minimum: US$ 100,000

Minimum Balance Left: US$ 250,000

Management Fee: 2% per year of the Net Asset Value per Share, accrued daily and paid monthly.

Performance Fee: 20% above 3-month Libor, paid at the end of each calendar quarter or in the redemption, through the automatic redemption of shares of each subscription corresponding to the due fee, subject to high water mark.

Additional Information

For additional information regarding the management of IP-Value Brazil II, please contact us by phone at (55 21) 2104-0506 or by e-mail at contactus@investidorprofissional.com

MISCELLANEOUS

"Munger: I don't want you to think we have any way of learning or behaving so you won't make a lot of mistakes. I'm just saying that you can learn to make fewer mistakes than other people – and how to fix your mistakes faster when you do make them. But there's no way that you can live an adequate life without (making) many mistakes"

"Munger: To the extent you become a person who thinks correctly, you can add great value. To the extent you've learned it so well that you have enough confidence to intervene where it takes a little courage, you can add great value. And to the extent that you can prevent or stop some asininity which would otherwise destroy your firm, your client or something or someone that you care about, you can add great value"

Outstanding Investor Digest, 1998

"Poor investment strategy, whether it is for lack of diversification, pursuing hot stocks, or attempting to time the market, often stems from investors' belief that it is necessary to *beat* the market to do *well* in the market. But nothing is further from the truth. The principle lesson of this book is that through time the after-inflation returns on a well-diversified portfolio of common stocks have not only exceeded that of fixed income assets but have actually done so with less risk. *Which* stocks you own is secondary to *whether* you own is secondary to *whether* you own stocks, especially if you maintain a balanced portfolio. Over time the historical difference between the returns on stocks and the returns on bonds has far exceeded the differences in returns among well-diversified all-stock portfolios."

Extracted from the conclusion of the book *Stocks for the long run* by J. Siegel

INVESTIDOR PROFISSIONAL
DESDE 1988

Av. Ataulfo de Paiva, 255 / 9º andar Leblon
Rio de Janeiro RJ Brasil 22440-032
Tel. (55 21) 2104 0506 Fax (55 21) 2104 0561
contactus@investidorprofissional.com
www.investidorprofissional.com