FUND REPORT

VBF CLASS A

THIRD QUARTER / 2007

INVESTIDOR PROFISSIONAL
DESDE 1988

Index

Introduction

This is the second report on the VBF Class A of the IP Brazil Fund SPC (VBF). When we wrote the previous report, last July, we were still in the phase of building the portfolio. At that time, the VBF was 68% invested in equities.

In the following months, especially during the days of high volatility in August, due to the crisis in the American sub-prime mortgage market, we took advantage of the opportunities to increase positions and buy shares of other attractive companies that were being traded at excessive discounts. Although it is not the main motivation for VBF's creation, as value investors we will always take advantage of our contrarian and long-term posture in moments of panic. By the end of the month, we had reached the level of investment in equities proposed in VBF's investment strategy.

Thus, we reached the end of September with 95% of the portfolio invested in equities. VBF is fully invested.

We now have the opportunity of checking if the characteristics of the present portfolio are coherent with the strategy and expectations created by IP's investment team at the beginning of the fund's management:

As of the end of September, as may be observed in greater detail at pg. 17, 67% of the portfolio is invested in companies that we qualify as PIPEs – in other words, investment stories that combine a situation of low stock liquidity with an activist shareholder posture on the part of IP. More than 60% of the portfolio is invested in companies classified as small or mid caps, and 70% of the portfolio is invested in shares which offer us protection by tag-along rights.

In July the fund's first investment in private equity was effected, a position that in September corresponded to 2.46% of the portfolio, within the 15% foreseen for this type of investment.

We believe that there are many opportunities in the private equity segment. Among the 1,000 largest companies by the net sales criterion, more than half are not yet listed at the Bovespa. There are many sectors of the Brazilian economy in which the main companies are still unlisted.

Although we have the freedom to invest in companies of any industry, we are concentrating our energies in the retail and education segments. In the former, we

% of portfolio[1]			
5%	Cash & Equivalents		• Money market instruments
min of 80%	Equity	Collab./BPIPE[2] Investments	• Low liquidity but very high potential returns • Close contact with controlling shareholders and management • Exit usually through structured operations (block-trade, spin-off, etc) • Investment horizon of 5 years or more
		Passive Investments	• Companies trading at attractive prices • Exit through the stock market (passive management) • Investment horizon of 2-3 years
up to 15%		Private Equity Investments	• Opportunistic investments in local companies

Note:

(1) Actual mix is dynamic, with percentages varying over time

(2) Brazilian Private Investment in Public Equities: investments in listed companies where acquisitions of significant stakes in illiquid stocks are achieved at significantly discounted prices

have a long history of investments in Brazil, and at present we nominate Members of the Board for four of the eleven companies listed at the Bovespa. We have been following the education sector in Brazil for more than 15 years and have prospected for private equity opportunities in this industry since 2005, even before the launching of VBF. It is a fragmented sector with only three listed companies in Brazil.

Currently, we are at different stages of the investment process with Brazilian unlisted companies, which together represent investment opportunities of approximately USD 160m in private equity.

Thus, we conclude that today we have a portfolio in line with VBF's initial proposal, although we do believe that the proportion of investments in private equity will increase over time.

The VBF closed the month of September invested in 18 companies. Below we present an update on Springs Global and Telemar. Also, we discuss the investment cases behind Saraiva, Fosfértil and Mills, our first private equity investment in VBF.

SPRINGS GLOBAL (SG)

Name: Springs Global Participações S.A.	
Sector/Industry: Textile	
Ticker: SGPS3	
Share Class: ON	
Tag along: 100%	
Price*: R$ 21.82	
Market Cap*: USD 1,02 Bn	

* As of September 28, 2007

As mentioned in the June management report, SG's listing process was concluded in the month of July, with a total offering of R$655.5m in Bovespa's Novo Mercado segment, 68% being fresh funding for the company.

At present, SG's structure is the same as Coteminas' own structure. Coteminas transferred all of its productive plants to SG, as a capital subscription, in January, 2006, with the result that it held 62% of the total capital. In addition to Springs Global itself, what was left within Coteminas was only cash and a 52% participation in the capital of Santanense (a denim company that is very small compared to SG).

In the pricing of the SG offering, very conservative assumptions were used for the recovery of the company's Ebitda margin, to be reached after the restructuring process – the main factor responsible for SG's current weak results – is concluded.

The pricing range – R$19 to R$21 – incorporated an Ebitda margin between 9% and 10% from 2008 on – a level that seems to be a considerable improvement on the present range of 1% to 5%, reached by SG in the last 6 quarters. However, two factors lead us to believe that the stable margin after the restructuring can be closer to the 12% to 15% range.

(i) Since 2006, SG has been transferring 9 of the 15 plants that existed in the USA to Brazil, where production costs are considerably lower due to the higher competitiveness of labor, proximity to the areas where cotton (the main raw material) is produced, and the synergies achieved by taking advantage of Coteminas' large-scale plants. It should be noted that this strategy of transferring plants is a large-scale operation, involving, for example, transferring a capacity larger than the largest Asian textile plant.

The process of closing the units in the United States and also resuming production in Brazil has been gradual. This means that the plants remain a long time incurring high fixed costs, without having these costs diluted by the normalization of production. In fact, SG has been operating well below its capacity. In the last quarter, the company operated at 50% of its capacity, which gave rise to its worse EBITDA margin to date: 1.2%.

SG has already eliminated R$25mm per quarter in operating expenses, and when the process of transferring plants is concluded, it expects to reduce its production cost per ton by 30%. Considering this fact and this assumption, the Ebitda margin reaches 12% in our estimates. This 12% mark also appeared in an exercise made by the company's management in relation to the 2006 results. The 2006 margin would have been 12% if all the plants had been already operating at full capacity in Brazil since January 2006.

(ii) The margins of 20% to 30% generated in the period from 2000 to 2005 were much favored by the exchange rate at the time. In addition, the level of cotton prices benefited the company's ratios due to the drop in prices for this commodity, which is responsible for 45% to 55% of the total production cost.

Considering Coteminas' previous exchange rate exposure (75% of sales and 60% of the costs in Dollars), the new situation, with the exchange rate at R$1.85 per Dollar and cotton prices, on average, 20% higher, would produce an Ebitda margin of 17.2%.

SG's exchange-rate structure (85% of sales and 75% of costs in Dollars), under the same exchange-rate and cotton price conditions as at present, produces a 14.9% margin.

Moreover, SG's Asian competitors have been presenting margins between 17% and 22%, with the same operating costs but smaller dilution, due to their low production capacity. (The largest Chinese producer has 10% of SG's capacity, and the largest Indian producer has 40% of SG's towel capacity, although it does not produce sheets.)

The Indian companies – more comparable because they have equivalent quality, and therefore product pricing similar to SG's – are at the higher edge of the range, reaching Ebitda margins of 20% to 22%.

If SG reaches 15% margins, it will generate an Ebitda of US$320mm in 2008, as against the estimated US$90mm for 2007. However, there are two risks that could prevent this margin from materializing in 2008:

(i) SG is still extremely dependent on the large US retailers, whose consumption represents no less than 80% of its revenues. Therefore, SG needs to acquire companies in Europe so as to diversify its sales and change its mix in the direction of branded and licensed products, with higher margins. The company's target is to have this type of product reach 70% of sales, as against the current 56%.

These acquisitions are under negotiation, but should not have any effect before 2009. This leaves SG excessively exposed to the US market, which is facing prospects of a fall in growth, leading consumers to replace high-priced branded products with private label products, which carry a much lower margin. In fact, the third quarter of 2007 was weaker than expected for US retailers. If this trend continues, we believe that SG will not reach the 15% margin as early as 2008, recording a margin closer to 12%.

(ii) Ironically, the second risk factor would be precisely the purchase of a large company in Europe at the present time, because the large European companies are still going through a restructuring phase, closing inefficient plants and outsourcing production to countries with low production costs. As this cycle is not yet concluded, SG might end up acquiring inefficient plants in Europe, which would imply another year of restructuring, with the transfer of European plants to Brazil in 2008. Fortunately, there are some smaller companies that already operate only with their brands and their distribution systems, and that do not have those undesirable inefficient fixed assets. We believe that SG's short-term target is this type of company, and that the larger ones will be left for a second stage, when they are already structured. This strategy will probably raise the acquisition price, but it is more profitable than purchasing inefficient assets and taking on the cost of transferring them to Brazil.

Therefore, if we consider a 12% margin for 2008 as the most realistic, SG may be expected to generate an Ebitda of US$258mm and a profit of US$106mm in 2008, vis-à-vis an Ebitda of US$90mm and a net loss in 2007. These estimates mean that SGPS3 is trading at 5.2x EV/Ebitda 08 and 5.9x P/E 08.

The IP funds acquired a significant lot in the SGPS IPO in July, at R$19. The stock has appreciated by almost 20% since then, and based on our discounted cash-flow estimates, using the conservative assumption of a 12% long-term margin, we reached an additional upside potential of over 40% for SGPS3. If the company reaches a 15% margin, the upside potential is close to 80%.

Telemar

Name: Telemar Norte Leste	
Sector/Industry: Telecom	
Ticker: TNLP3	
Share Class: ON	
Tag along: 80%	
Price*: R$ 61.14	
Market Cap*: USD 10,20 Bn	

* As of September 28, 2007

We continue holding a positive view of the attractiveness of our investment in Telemar common shares (ON). The risk/return ratio is favorable, especially when the failure of the auction at the Bovespa on October 11 is taken into account.

It should be recalled that this was the second time the controlling shareholders tried to alter the company's shareholder structure, which is inadequate due to its complexity and the low economic interest the controlling shareholders hold in the group – close to 18% of the total capital.

In September last year, Tmarpart proposed an absorption of shares, or "stock swap", under which the result would be the migration of shareholders from the holding company (TNLP) and the subsidiary (TMAR) to Tmarpart, which would then be listed in the Novo Mercado without a defined controlling shareholder, thus becoming a corporation. The positive points in this migration were clear, because the company would have a simple, flexible structure, with a high level of governance, and could therefore be traded at prices that would be more compatible with its strategic value.

However, the cost of this restructuring turned out to be too high for the preferred shareholders, since the suggested exchange ratio meant a big dilution of their stakes and a corresponding concentration for the controlling shareholders. According to the CVM's orientation, the minority shareholders themselves had to approve the operation, which resulted in its failure.

In April of the current year, Tmarpart proposed a new structure for the operation, which we thought more appropriate, because it was based on the cash purchase of all of the preferred shares of its companies (TNLP and TMAR). The prices were stipulated at R$35.09 and R$67.50 respectively. Despite the potential size of this transaction (over R$10 billion), the suggested price did not seem to us to be attractive to a significant number of shareholders. This perception was confirmed by the result of the offer for the subsidiary's stock (TMAR), under which only 26% of the shareholders agreed to sell their shares.

Another factor that added complexity to the process was the existence of a condition for the offer for the holding company's shares (TNLP) to be realized: the need for at least 2/3 of the shareholders to accept. Taking into account the diversity among shareholders (foreign investors, ADRs, individuals, etc.) and the low level of acceptance of the price suggested by the company, we felt that this condition placed another obstacle to the success of the proposal. Even with the example of the low acceptance of the TMAR offer, the 2/3 condition was not removed. However, the controlling shareholders increased the price offered for TNLP PN shares, from R$35.09 to R$45.

We saw the possible consequences of the auction as follows: if the operation was successful, Tmarpart, in accordance with the controlling shareholders' intention, would be listed in the Novo Mercado. The R$8 billion in debt taken from banks for the acquisition of the PN shares would be in the company's balance sheet. Tmarpart would use the dividend flow from TNLP and TMAR to amortize part of this debt. According to the clauses of the financing, the first amortization should take place in up to four months; as a result, the longer the restructuring took, the larger the dividend distribution (in which all shareholders would participate) would have to be. The dividend yield for this first amortization could be around 8%.

After this step, there would be the possibility of TNLP and TMAR being absorbed by Tmarpart, at market prices.

This sequence of actions would be beneficial to the controlling shareholders, as it would probably result in the strong appreciation of their recently acquired stake in PNs, because of the greater attractiveness of the company's shares in the Novo Mercado.

If we considered, for migration, a ratio of around 1.5 between the price of the ONs and the PNs (recent average), and that the company in the Novo Mercado would trade at multiples of 5x EV/Ebitda, we would have a price of R$ 75 for the common shares (TNLP3). This would mean an appreciation of around 20% on the prices prevailing at the end of September.

One of the risks for our investment was the possibility of migration using a 1x1 ratio, in other words, one PN share to be exchanged for one ON share. However, even in this situation, we reached a price of R$ 60, close to the level at which the shares were trading.

In our view, the best result for the common shares would be the failure of the auction. Thus, the original situation would be maintained, with controlling shareholders holding a much more significant percentage of TNLP ON shares (54%) than of PNs, and with the intention of realizing the asset's strategic value.

On October 11, before the closing of this Report, it was clear that the offer had failed with only 50% of the shareholders having accepted the offer. Though the amount was considerable, it did not reach the 2/3 condition imposed by the controlling shareholders.

Although it is difficult to foresee the controlling shareholders' next steps, we believe they are likely to go back to using the previous strategy, i.e., maximizing the control premium, causing the ON/PN ratio to increase and enabling a migration at market prices. This scenario would benefit the common shares (TNLP3) due to the tag-along right. Assuming an ON/PN ratio of 2, and the company in the Novo Mercado trading at 5x EV/Ebitda, the price of the TNLP3 would be around R$85 – which indicates an upside potential of approximately 40%.

The uncertainty regarding the exact form of conclusion of this process leads us to recall the real reason for the investment: Telemar is an asset with substantial strategic value not reflected in the price of its shares. In view of the characteristics of the assets that are available to capture this distortion and the diversity of possible solutions to be proposed by the controlling shareholders, we consider the TNLP common shares as the most appropriate vehicle for our investment.

Saraiva

Name: Saraiva S.A. Livreiros Editores	
Sector/Industry: Publishing/Retail	
Ticker: SLED4	
Share Class: PN	
Tag along: 90%	
Price*: R$ 32.07	
Market Cap*: USD 498 MM	

* As of September 28, 2007

Taking advantage of the market's fall in August, we acquired more of Saraiva's stock. The company's results for the 2Q07 had hardly been released, and the market panicked. At the peak of the crisis, on August 16, Saraiva released a Notice to Shareholders indicating that negotiations for the acquisition of Siciliano were under way. In spite of the very good numbers for the quarter, and even better prospects with the potential acquisition of the competitor, the company's shares fell as much as 15%.

Since the offering effected in April 2006, Saraiva has been undergoing an intense transformation process. The changes have occurred mainly in the bookstore division (Livraria Saraiva), with the hiring of a new team of executives that introduced a more aggressive posture in sales and cost controls for the division. As a result of this work, sales are growing rapidly – 29% compared to last year – with a 33% increase in the number of stores and 20.9% in same-store sales. In addition, the bookstore division reached a 5.3% EBITDA margin in the 2Q07, compared to only 1.0% in the 2Q06.

The offering also meant an addition of R$ 63 million to the company's cash position, which increased its capacity to effect attractive acquisitions. The purchase of Siciliano would bring the company attractive sales points in several cities – more than half of them in São Paulo and Rio de Janeiro. At present, Siciliano has 63 stores, representing about 15,000 sq.m. of total sales area. If realized, the acquisition will represent an important addition to Livraria Saraiva's current 34 stores.

In the past, when observing the trading prices of Saraiva's shares, we used to consider that by buying them the shareholder would take the publishing house (Editora Saraiva) – a business with strong entry barriers and high returns – and would receive "for free" the bookstore division – a business with great potential, though still not properly exploited. Nowadays, it is possible to invert this reasoning. If we take into account the multiples paid for other listed retailers in Brazil, when buying Saraiva's shares today the shareholder takes the bookstore division, a retail business in rapid expansion, and receives for free the publishing house – which maintains the same attractive fundamentals. This is one of the reasons that leads us to maintain our investment in Saraiva, which completes 12 years in October 2007.

FOSFÉRTIL

Name: Fertilizantes Fosfatados S.A.
Sector/Industry: Fertilizers (Materials)
Ticker: FFTL4
Share Class: PN
Tag along: -
Price*: R$ 65.02
Market Cap*: USD 3,77 Bn

* As of September 28, 2007

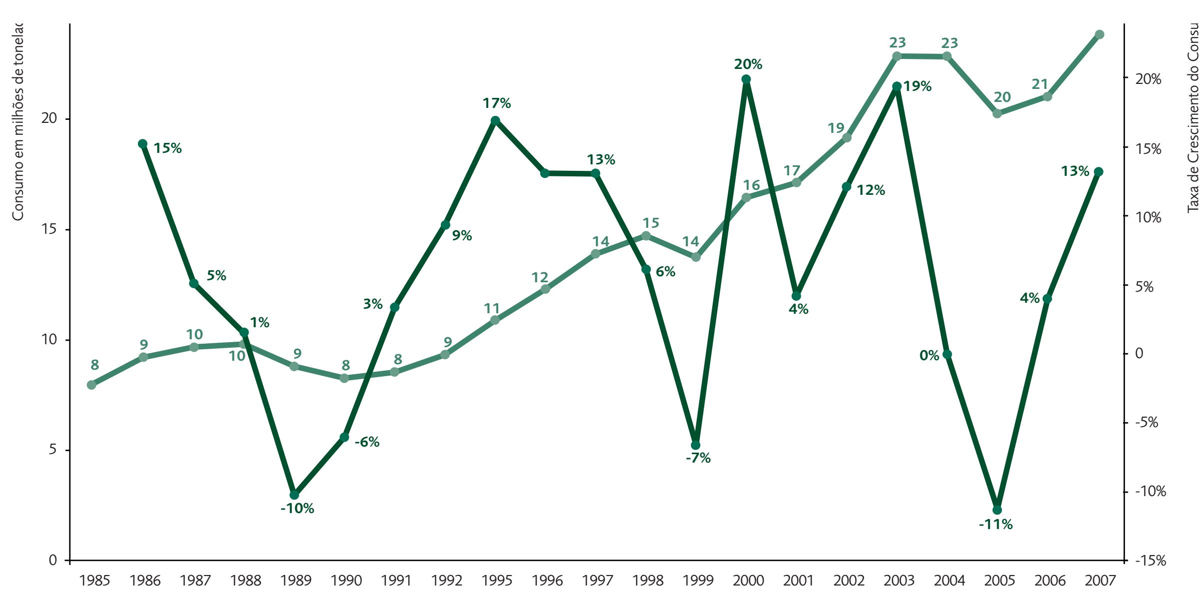
We have studied Fosfértil for quite some time; it was also one of the main positions in our funds between 2000 and 2003. We maintain a great interest in this company, which operates in a secular growth sector (fertilizers/agriculture) and has important competitive advantages – it has phosphate-rock mines and plants located close to the center of expansion of Brazil's agricultural frontiers (Central-Western region).

The location of the phosphate fertilizer plants in the Northern region of the State of Minas Gerais makes freight costs much more competitive than those of the imported product. This advantage – which historically represents an overprice of around 20% to 30% in relation to the imported product – is likely to become significantly more pronounced given the current rise in international freight prices, which, in turn, have been pulled up by the growing Chinese demand for ores. If this country continues at a similar rate of demand growth, the question of high freight costs will take from two to three years to get back to normal, when new vessels with transoceanic capacity reach the market.

Since the beginning of 2006, we have seen that two factors may significantly favor the company's results:

(i) Brazilian agriculture, after facing reduced demand for 3 years (2004-06), with a general reduction in prices for farm products and even a severe drought in the South of the country, started presenting, already in mid-2006, all the necessary conditions for a quick recovery: producers adjusted the supply, and as a result, farm products started a strong price recovery. In addition, the rising trend in agriculture became even sharper with the definitive decision of the USA to dedicate a significant part of its corn crop to the production of ethanol, which is to be added to fuels. This scenario of stronger demand for fertilizers, due to the continuous rise in agricultural prices, is being consolidated for the 2006/07 harvest and being confirmed for the 2007/08 harvest. See chart below for Brazilian fertilizer demand.

BRAZILIAN FERTILIZER CONSUMPTION



Source: ANDA – Associação Nacional para Difusão de Adubos (National Association for the Dissemination of Fertilizers)

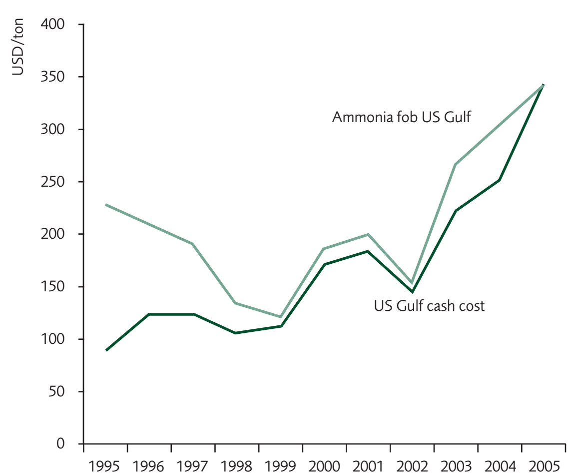
We believe that the situation of low farm product inventories that has been observed in the last two years, together with the significant growth rate in food consumption in emerging countries, such as China and India, and worldwide interest in ethanol, will be responsible for sustaining agricultural prices at a higher level for a long time.

Historically, the evolution of agricultural prices has determined the behavior of fertilizer prices. Therefore, this rising trend in agricultural prices would itself be a good reason to sustain the prices of fertilizers at the present level (they are already 100% to 130% above their historical average).

(ii) The above argument might be sufficient in a scenario of fragmented and undisciplined fertilizer producers, who even in a heated market would promote lower prices in order to increase their market share. However, the market for phosphate fertilizers witnessed a significant consolidation for the first time in September 2004, when Cargill bought IMC Global. This merger gave rise to Mosaic, the world's largest phosphate fertilizer company, with 15% of global market share and 56% of the US market. As a result, the top five players then had almost 35% of the world market. It is not such a strong concentration as that seen in the mining business; but there is a factor that helped, and will continue to help, to keep the price of phosphate products high: the two companies that formed Mosaic were booking very low returns, and the resulting company was born already carrying a significant debt. That led to the decision to shut down plants that were equivalent to 10% of the US capacity. Very soon, the effect of the more restricted and coordinated supply was felt, and since then, the price of phosphate products has been rising – from US$200/ton in 2004 to US$430/ton in 2007. As Mosaic's results are very much leveraged on the prices of phosphate products, it is in the interest of the largest world producer to be extremely disciplined so as to ensure the reduction of its debt.

In Fosfértil's second market, that for nitrogen-based fertilizers, the concentration is not so pronounced, but for the time being, the idea of the "marginal producer" has prevailed – that is, large-scale, lower-cost producers have been allowing small-scale, higher-cost producers located in the US Gulf to determine the price. These producers depend on natural gas to produce ammonia, which is a basic product for nitrogen-based fertilizers. In the chart below, it is possible to observe that, despite the rise in ammonia prices, natural gas has also been showing historically rising prices. Therefore, the fact that these producers have hardly raised their contribution margin at all helps to support the price of ammonia and other basic products for nitrogen-based fertilizers, which ends up giving greater security to the prices of the fertilizers themselves.

Ammonia Price X Cash Cost in – Gulf



Therefore, bearing in mind the above-mentioned factors, we believe that Fosfértil will continue to benefit from these high prices for a long time.

We are also studying the foundations of a theory that argues that the rise in prices (from 100% to 130% above the historical average) should be permanent, or that the prices sustainable in the long term should be even higher. This theory is based on possible similarities with what has occurred in the mining/steel market, and also on the fact that agricultural products have become raw materials in the energy chain and not only in the food base.

The rise in fertilizer prices does in fact show some fundamentals similar to the rise in the prices of iron ore and steel, which in recent years have moved to a new historical level. We could mention the strong expansion in demand, in the case of iron ore/steel, due to the need to sustain infrastructure growth in China, and in the case of fertilizers, due to the increasing limitation of farm land vis-à-vis population growth. In addition, a new component has appeared in the fertilizer market: demand from the energy sector.

Another similarity between the two sectors is that both iron ore and phosphate-based fertilizers and potassium come from natural resources that are concentrated in certain parts of the world and therefore constitute scarce, non-renewable resources. Finally, one observes that, just as iron ore represents a low percentage in the steelworks' cost structure, fertilizers also represent less than 15% of farmers' costs. All these factors make it possible for agricultural products/fertilizers to be the great beneficiaries of a second general rise in commodities, this time concentrated in the so-called "soft commodities"

The excellent market prospects for Fosfértil, together with the potential expansion in the company's capacity with high yields, lead us to invest in Fosfértil once again. However, our portfolio's exposure to FFTL4 is not very relevant, because we believe that the market price already incorporates a large part of the company's good prospects. We are in fact studying the case in greater depth so as to determine the real dimension of these favorable prospects.

We also think that the company's exposure to exchange-rate risk is high: fertilizers, because they are perfectly tradable commodities, have their prices fixed in dollar terms, but only 40% of the company's costs are linked to the US currency.

Finally, we observe that, at present, there is a great conflict among Fosfértil's shareholders: Bunge, Mosaic and Yara. At the end of last year, Bunge announced the absorption of Bunge Fertilizantes by Fosfértil. Bunge Fertilizantes purchases basic fertilizers from Fosfértil, mixes them and sells the final fertilizer directly to farmers. That is a phase of the chain with lower added value and lower returns. Besides the fact that the business is less attractive, Mosaic and Yara have been questioning the valuation of the two companies that is the basis for the absorption operation. For that reason, until now, said absorption has not materialized because the corporate process is constantly being suspended by the Courts, through preliminary injunctions obtained by Mosaic and Yara. In fact, we agree with the argument that Bunge Fertilizantes was over-valued and believe that its absorption would somewhat reduce Fosfértil's value. However, the most important point here is that carrying out this absorption is a pre-condition for the definitive posture of aligning interests (migration to the Novo Mercado and tag-along rights for all shares). Meanwhile, the shares available at the stock exchange continue to be the preferred shares, without tag-along rights. Without the absorption of Bunge Fertilizantes, the company's multiples and value are more attractive, but in compensation, the shareholder risk is greater.

One reaches the conclusion that FFTL4 is trading at 6.1x EV/Ebitda 07 (without taking into account the absorption of Bunge) and has an upside potential close to 25%, already considering both the new, recently announced project for a 30% expansion in the phosphate production capacity and the absorption of Bunge Fertilizantes, which – although a solution for the corporate imbroglio may seem rather far away – does seem to us a definitive item in the agenda of Bunge Ltd, Fosfértil's current controlling shareholder.

Mills

In July 2007, the first private equity transaction of VBF was made. VBF Class A investors received shares of VBF Class S, the "side-pocket" structure where this new investment was allocated.

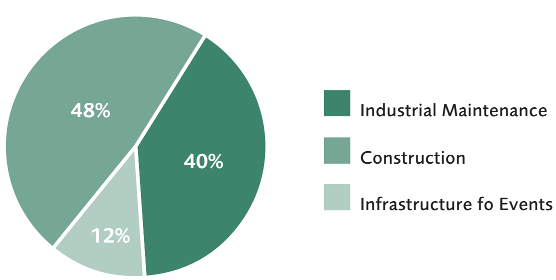
Mills do Brasil Estruturas e Serviços Ltda. (Mills) operates in the construction and industrial sectors. The company renders services and rents and sells equipment in the following segments: industrial construction, maintenance of large industrial plants, and the supply of infrastructure for large entertainment and leisure events.

The company was founded in Rio de Janeiro in 1952 and has branches in other states, including São Paulo, Bahia, Brasilia (Federal District), Espírito Santo and Minas Gerais.

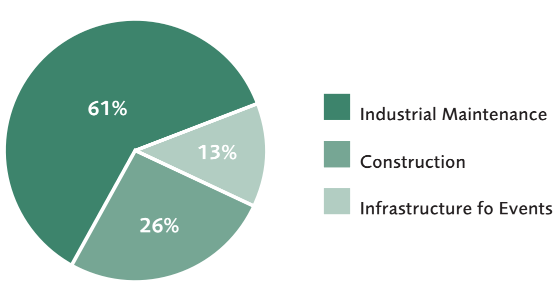
Business Model

Of the company's three lines of business, the most important are the construction and maintenance segments.

Revenue breakdown 2006



Ebitda breakdown 2006



Construction

The construction business is very capital-intensive. Mills supplies scaffolding, shuttering, bracing and other equipment for infrastructure building work, such as highway overpasses, bridges, airport extension, and the building of thermo-electric plants, shopping malls, etc. Mills' remuneration is based on a rental contract for this equipment. The company may supply its own equipment or equipment that has been hired from third parties.

When big contractors/building companies take on large-scale infrastructure projects, they often outsource the supply of a large part of the equipment to third parties such as Mills. These companies prefer to be free from the need to tie up capital and include in their assets a large variety of equipment, which is specific for each type of building work, and also requires maintenance.

Mills is the leading player in this market, with a 33% market share in 2006. Its main competitive advantage is its portfolio of products, which is acknowledged to be more complete than that of its competitors. Depending on the project, if it hires one of Mills' competitors, the contractor will probably have to hire another supplier also, in order to obtain all the necessary equipment. Mills has a strong reputation for being able to supply a wide variety of quality equipment, in good time.

After decades of low investment in infrastructure and two exchange-rate devaluations (1999 and 2002), most of the companies that compete with Mills suffered a great deal. In 2005, when the Brazilian construction market started to grow again at an extremely fast rate, Mills took the lead; and with IP's capital injection it accelerated its growth and significantly expanded its market share. Revenues and EBITDA of this division are expected to grow by 48% and 80% in 2007, respectively.

The prospects for profitable growth are very encouraging. We are at the beginning of a long cycle of infrastructure investments in Brazil, which had been suppressed by decades of high interest rates and prohibitive capital costs. The market turn-around caught most of Mills' competitors underfunded and with difficulty in keeping up with the growth in demand for equipment, shuttering and scaffolding for building work. Besides creating very attractive opportunities for consolidation, this allows Mills to achieve high ROIC in the short and medium term, simply by replacing hired equipment with equipment of its own. The market situation is so favorable for well capitalized companies that such replacement generates returns of over 30% p.a. for Mills.

Industrial Maintenance

The industrial maintenance business is labor-intensive. Mills supplies equipment and labor for maintenance services (accesses, labor and services for industrial painting and thermal insulation) in large industrial plants, especially for the petrochemical, petroleum, steel and pulp & paper industries.

The contracts with clients are long-term lasting, generally from one to four years. Companies prefer to outsource these types of services because they are not part of their core activities and require a high degree of specialization, especially due to the risk of accidents.

The industrial maintenance market, though not exposed to the strong growth drivers of the construction segment, has healthy characteristics in the composition of Mills' business portfolio. Revenues are predictable to a large extent and the business is not subject to big fluctuations over time. Because it is not necessary to employ a lot of capital in this business, and because Mills is able to charge its clients a premium, thanks to the recognition of its brand, the maintenance business generates attractive returns.

There are several consolidation opportunities in this segment which are being analyzed, and Mills, since it is the only company that combines a strong balance sheet, good management, financially skillful partners and size (critical mass), is clearly the natural agent of consolidation in this segment.

Infrastructure for Events

In addition to its two main lines of business, Mills supplies infrastructure for large events that require temporary structures such as stages, grandstands, sports arenas, tents and sheds. A good example was the Pan-American games in Rio de Janeiro, in July 2007.

This is still a small market, estimated at approximately R$ 200m for the suppliers of infrastructure for events.

The Investment Case

Unlike many Brazilian unlisted companies, Mills is well organized, with a variety of internal processes that are very similar to the practices of the best listed companies. We are positively surprised at the quality of the management and the level of accountability at the company. Mills has adopted EVA since 2004 as a tool for evaluating the company's performance and the executives' remuneration; in addition, it operates in total compliance with the laws and regulations, and for many years has had its financial statements audited by one of the Big Four.

Mills is a typical example of a relatively small company which is benefiting a great deal from the reduction in capital costs in Brazil. Until 2006, in its main line of business, the supply of construction equipment, the company incurred high costs in hiring a disproportionately large part of this equipment from smaller companies in order to supply it to the final clients. In this operation, the company earns a spread between the rental it pays its suppliers and the rental it charges its clients. The company estimates that it can increase the Ebitda margin of its construction business from 29% in 2006 to somewhere around 45% in 2011. At least half of this gain in margins would come from the elimination of rental costs, thanks to the purchase of equipment enabled by the injection of capital into the company.

The same effect is expected in the industrial maintenance business, where half of the revenue comes from the supply of equipment. The company's projections point to an increase in the Ebitda margin from 10% in 2006 to 19% in 2011 which, once again, would be the result of a combination of productivity gains and a significant reduction in equipment rental costs.

Mills should close 2007 with revenues of R$ 190m, Ebitda of R$ 38m, and profits of R$ 12,5m. The rapid organic growth expected for the next few years, together with the acquisition opportunities in the sector, should allow Mills to acquire sufficient critical mass to qualify for an IPO in about two years.

Performance – VBF Class

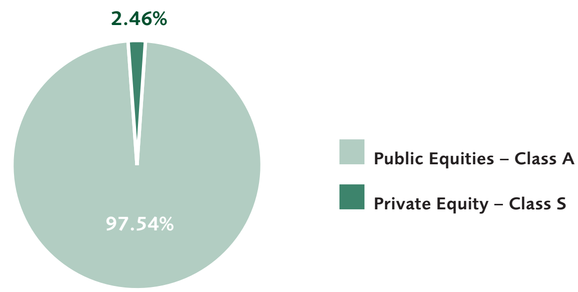
VBF Class A		Performance (USD)[3]				
	% Invested Equities	VBF Class A	VBF Class S	Classes A + S [2]	Ibovespa	MSCI EM
September 07	95.13%	5.61%	6.47%	5.63%	18.68%	11.05%
August 07	94.61%	-4.99%	-4.48%	-4.98%	-5.49%	-2.09%
July 07	82.87%	3.06%	-0.84%	3.00%	3.77%	5.33%
June 07	68.36%	3.12%	-	3.12%	3.71%	4.73%
May 07	64.13%	9.04%	-	9.04%	12.47%	4.98%
April 07	54.76%	5.75%	-	5.75%	9.04%	4.64%
March 07 [1]	30.36%	1.64%	-	1.64%	10.42%	7.69%
2007 (YTD) [1]	-	24.97%	0.85%	24.94%	63.46%	41.89%
Since inception [1]	-	24.97%	0.85%	24.94%	63.46%	41.89%

(1) Inception VBF Class A 2007, Mar 06

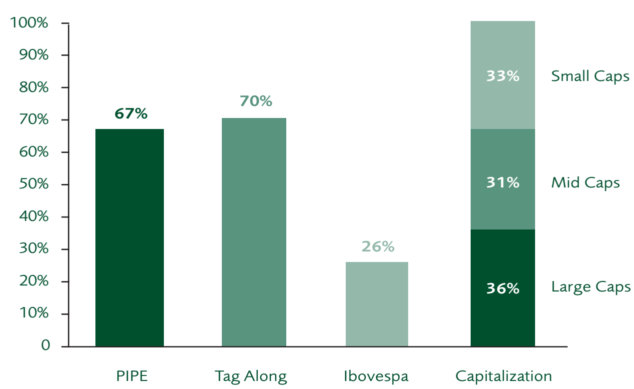
(2) Inception VBF Class S 2007, July 06

(3) Net of all fees

Breakdown Public Equities x Private Equity

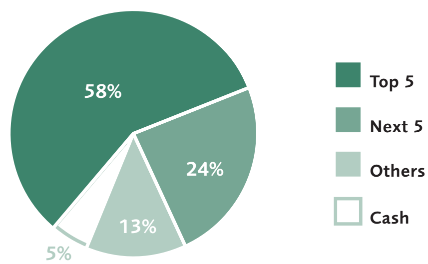


VBF Class A – Equity holding characteristics*



* PIPE: Private Investment in Public Equity/Tag Along: % with tag along rights/Ibovespa: % in the index/ Capitalization: small (smaller than US$1b), Mid (between US$1b and US$3b), Large (larger than US$3b)

VBF Class A – Portfolio Concentration



Portfolio Multiples*	2007E	2008E
Price/Earnings	20.41	13.75
Price/Book	2.85	2.64
Enterprise Value / EBITDA	10.84	7.82
Return on Equity	18%	19%
Dividend Yield	3.2%	3.5%

* Estimate by IP

Structure

IP Brazil Fund SPC, VBF Segregated Portfolio is an exempted company registered as a segregated portfolio company, incorporated under the provisions of the Companies Law of August 3, 2006 of the Cayman Islands.

Investment Manager: Investidor Profissional Gestão de Recursos Ltda.
Net Asset Value Calculator: Mellon Serviços Financeiros DTVM S.A.
Brazilian Custodian: Banco Bradesco S.A
Bank: UBS AG, Stamford Branch, CT (USA)
Registrar and Transfer Agent: UBS Fund Services (Cayman) Ltd.
Auditor: KPMG
Inception Date of Classs A: March 06, 2007

Terms and Conditions

Subscription: On scheduled rounds. Closing day of the first round was March, 2007.
Next Round: November, 2007
Minimum Initial Investment: USD 1,000,000.00
Redemption: Lock-up Period of 18 months. Redemption dates on the last Business Day of each calendar quarter, with a three months prior notice
Maximum Redemption: Limit of 10% of the issued shares of the class in each quarter of the first five years after the lock-up period and 15% thereafter.

Terms and Conditions (cont.)

Management Fees: (i) 1.0% per annum of the Net Asset Value of the VBF Segregated Portfolio allocated to fixed income investments, including but not limited to cash, and (ii) 2.0% per annum of the Net Asset Value of the VBF Segregated Portfolio allocated to the remaining Investments.

Any Management Fee and Incentive Fee payable in respect of any Class S Shares representing Designated Investments will not be paid until the realization or deemed realization of the Designated Investments.

Incentive Fees:

- 20% computed on returns in excess of IPCA+9%, with catch-up mechanism:
  – between IPCA+9% and IPCA+10% p.a.: 100%
  – above IPCA+10% p.a.: 20%
  note: IPCA is the Brazilian Broad Consumer Price Index
- High-water-mark mechanism avoiding double charging for same performance
- Accrued daily and paid semi-annually

Additional Information

For additional information regarding of VBF, please contact us by phone at (55 21) 2104-0506 or by e-mail at contactus@investidorprofissional.com

Miscellaneous

"The key to making money in stocks is not to get scared out of them." — Peter Lynch

"Liquidity is a coward that vanishes at the first sign of trouble." — Ray Devoe

"You try to be greedy when others are fearful, and fearful when others are greedy." — Warren Buffett

"If you owe the bank $100 that's your problem. If you owe the bank $100 million, that's the bank's problem." — J. Paul Getty

"The safe way to double your money is to fold it over once and put it in your pocket." — Frank Hubbard

"There is nothing unique about the Crash of '29. It is something that happens about every 20 to 30 years, because that is the length of the financial memory. It is about the lenth of time needed for a new set of suckers to come in and imagine that they have a new and wonderful fix on the future." — John Kenneth Galbraith

"October. This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August, and February. " — Mark Twain

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