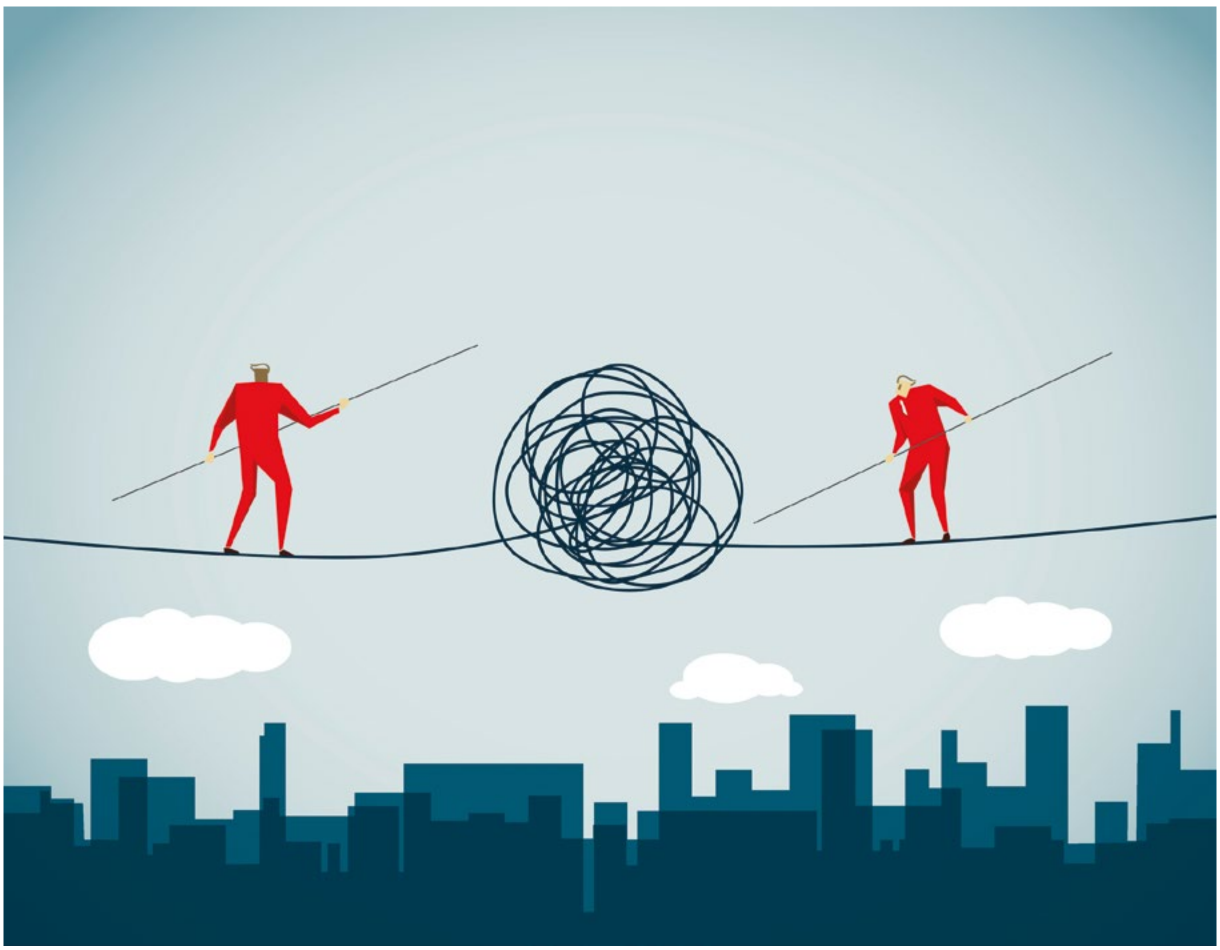
QUARTERLY REPORT

4th QUARTER 2016 IP-Participações



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IP-PARTICIPAÇÕES

Our last report focused solely on one investment: Amazon. This report will be briefer, analyzing the main changes to our portfolio, recent events and how we have sought to position ourselves.

PORTFOLIO

The fourth quarter of 2016 was a good one for IP-Participações Class. Trump's victory and the prospect of higher interest rates in the future led to a strong shakeup and subsequent appreciation of stock indexes.

In the U.S., after a long period of stock underperformance from companies with lower growth and/or regarded as future victims of new disruptors, this movement was partially reversed. Amid an increasing cost of cash, the market finally began to favor companies whose "floor" was closest, to the detriment of many sweethearts trading at high multiples. The financial sector benefited twice; not only due to generally lower stock prices, but also given the positive impact higher interest rates may have on future results.

This sector rotation was positive for the fund. At the time, the most significant investments abroad were Berkshire Hathaway and Wells Fargo – which, since then, rose by roughly 12% and 22% respectively. We took advantage of the decline in prices of other smaller investments (such as Amazon, AB-Inbev, Apple, among others) to increase those positions using a portion of the fund's cash, in addition to the proceeds from partial sales of Berkshire (still our main investment abroad) and Wells Fargo (now a smaller position).

Our positions in Itaúsa/Itaú, AB-Inbev and gold contributed negatively to the quarter, partially offsetting the gains from Berkshire and Wells Fargo. In all these cases, we do not believe the losses are permanent and are happy to maintain the positions.

At the end of the year, given a sharper drop in the Brazilian market and generally better priced U.S. stocks, we resumed investments in some Brazilian companies (particularly Cielo and BM&FBovespa) and reduced some of our investments abroad.

Curiosities of 2016

- Wells Fargo's shares fluctuated between US$43.83 (lowest closing price of the year) and US$57.29 (highest closing price). A variation of more than 30% for a company whose profits have, on average, varied less than 3% in the last three years.
- Berkshire Hathaway's shares appreciated 23.4% in 2016. The variation between highest and lowest closing price was 32%.
- Despite the pessimism over Brazilian banks and their balance sheets, the preferred shares of Itaúsa and Itaú Unibanco ended the year rising 43% and 50% respectively. In our view, they still trade at attractive prices even after these appreciations.

What is our point?

We are sometimes questioned whether the companies we invest in are too conservative or, in other words, if it is possible to deliver good returns by investing in companies so well established and monitored by the market. Such large price variations over a short period for companies as mature as these should give us a clue. The numerous conjunctures associated to these price oscillations certainly do not justify such large fluctuations in the value of these businesses.

Our experience shows that it is not necessary to invest in riskier companies to obtain good returns. On the contrary. With a good investment philosophy, thorough research, focus on only relevant aspects of the business, an investment horizon longer than average and, above all else, a lot of **patience**, it is possible to benefit from market volatility and increase returns while maintaining a large margin of safety – even in notoriously excellent businesses.

Wells Fargo

2016 was a roller coaster for Wells Fargo's shares. We will not waste the reader's time with details of the mess. We will instead limit ourselves to a quick summary.

Essentially, over the last five years, up to two million accounts were opened without proper consent from clients, of a total of 93 million new accounts opened during the period. Management knew about the problem and the LA Times had already published an article on the subject in 2013[1] – describing how some employees used unethical loopholes to beat the aggressive sales targets imposed by the company.

Instead of communicating the issue and quickly attacking the root of the problem by adjusting the incentive system, Wells Fargo presented the problem as small and contained. In this five-year period, the company fired 5,300 people (approximately 5% of the bank's branch employees) for misconduct, which harmed the values and ethical code of the company.

The issue again came to light in September 2016, after convictions and fines totaling US$185 million[2] by consumer protection agencies. The company was slow in communicating the facts and became an easy target for the media and politicians, while regulators kept promising greater scrutiny on the bank. Under pressure, the CEO and some executive directors were forced to leave.

Obviously, we saw the news as negative. Not only due to the adverse impact on the bank's reputation but also because we believe management should have been more incisive and agile in dealing with the issue. All that, however, did not change our mind about the main qualities of the business.

[1] http://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html
[2] US$100 million paid to the Consumer Financial Protection Bureau, US$35 million to the Office of the Comptroller of the Currency and US$50 million to the Los Angeles city attorney.

Wells Fargo has always emphasized their policy to cross-sell financial products to its customer base. The rationale has always been clear: the greater the volume of financial products consumed (real estate financing, current accounts, investment accounts, insurance products, credit cards, etc.), the greater the customers' switching cost to another bank.

In addition, if something goes wrong, it is less likely the client will opt to owe the bank that can execute his mortgage. With many financial products in the same institution, there is a greater propensity for funds to be deposited in this same bank – i.e. for automatic payments. Finally, the gains of scale are clear, since costs can be diluted over existing structures and employees.

For these and other reasons, Wells Fargo managed, over time, to have the lowest funding cost in the U.S. – making it one of the most profitable banks in the country.

The cross-selling culture was not a novelty nor a recently implemented scheme to boost top management salaries – as was claimed by some media outlets and politicians. The bank even argued that it incurred losses to open the accounts, as the majority was not even used. It is important to note that, except for small fees charged to certain customers, there was no material loss to the victims. Of the two million irregular accounts opened, approximately 115,000 were charged, generating an income of only US$2.6 million – which was reimbursed to customers.

As a result, our interpretation was that management simply over-stretched the sales incentives –something that could be fixed. Our understanding was that, for the reasons discussed above, customers would not flock to other banks and therefore the impact would not permanently damage the company's competitive advantages.

We thought it likely the bank would take corrective measures and, within six months or a year, we would no longer hear about the story. Investors would eventually see the "glass half full" again, focusing on the bank's positive characteristics. An example is the huge increase in deposits volumes over the last five to six years, which has not yet translated into higher profitability due to the still very low interest rates – a situation which is now starting to change.

At times like this, it is important to bear in mind that (i) unfortunately we must deal with incomplete information and, (ii) knowing this, we should size our positions based on accumulated knowledge about the company and our conviction regarding the risk/return ratio based on market prices.

Encouraged by the share decline, we gradually increased our investment to a medium sized position. After the recovery in stock price, we once again reduced our position and rerouted these resources as commented at the beginning of the report.

Itaúsa / Itaú Unibanco

The recent highlight was the revelation that Itaúsa is examining a possible offer for a controlling stake in BR Distribuidora – the largest oil distributor in Brazil – in partnership with the investment vehicles of Itaú Unibanco's controlling families.

Given the news, investors who held Itaúsa stock merely as a cheaper proxy for Itaú rushed to sell their shares and buy the bank's shares directly. With the underperformance of Itaúsa's preferred shares compared to Itaú Unibanco's preferred shares, there has been a subsequent increase in the holding discount to about 28%.

According to information provided by Itaúsa, even if it succeeds in its offer for BR Distribuidora, the idea is to keep Itaú Unibanco corresponding to more than 90% of Itaúsa's assets. With reasonable assumptions, this implies the equity value invested by Itaúsa in BR Distribuidora would be approximately R$6 billion.

The irony is that this is approximately the nominal value which Itaúsa failed to appreciate due to the increase in discount to Itaú Unibanco. In other words, the market "wrote-off" the operation: a destruction totaling R$6 billion in a deal in which Itaú Unibanco's controlling families would also put up significant capital alongside Itaúsa.

We have no conclusion yet about the attractiveness of this acquisition or any other acquisitions that may occur, but view that the controlling shareholders of Itaú did not achieve their current success by making bad deals.

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Another quarter highlight – one with a more tragicomic feel – was the traditional annual strike of bank branch employees that lasted about a month (vacation?). In an increasingly digital world where banks seek efficiency gains, what would be more effective and intelligent to accelerate customer training in using online banking tools and consequently reducing traffic and costs at branches?

Panvel

"Just over five years ago, Panvel traded at R$ 25.00/ share. Had we sold our position then even at double its market price (R$ 50.00/share), we would be regretful today. Two years ago, the stock hovered around R$ 70.00 and the same would have happened had we exited at R$ 140.00. The current price is R$ 270.00 and the dilemma is similar."

" In the past quarter, Panvel common shares rose 56.7%, or 158.3% throughout the year." (...) "The shares rose further than we would like. Still, given the opportunities that lie ahead for the company and its ongoing projects, we are confident about the value that is yet to be created."

– 4Q12 Report.

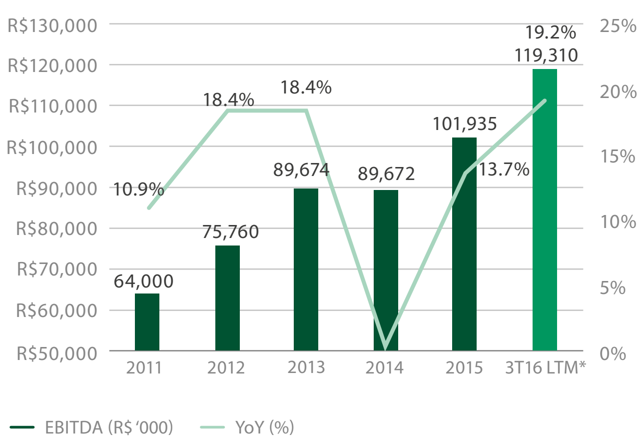
IP-PARTICIPAÇÕES

"In our final report for 2012, we noted that some investors had unfortunately been responsible for an exaggerated increase in the company's share prices — an excess that should be absorbed over the years as it continues along its path of value generation."

– 4Q13 Report.

Since December 2012, Panvel's common shares appreciated 147% (equivalent to approximately 25% per year). As has been the case for a long time, our fund did not acquire more shares – a reflection of our already relevant stake in the company's capital.

Among other factors, the rise in recent years was fueled by a re-rating to levels of other companies in the sector and the company's excellent evolution, after a period of larger expenditure due to the opening of the new distribution center in Eldorado, Rio Grande do Sul:



* 3Q16 LTM: last 12 months at the close of the 3rd quarter of 2016.

Given clear positive long-term trends, such as the growing formalization of the sector, the increasing market share of major drugstore chains and an aging population, the favorable scenario for the drugstore industry is expected to continue for <u>many</u> years.

An excellent evolution within the company is the growing share of the retail segment (Panvel drugstore chain), which currently encompasses about 85% of revenues. Given a greater focus in the segment – whose margins and returns are much higher than those of the wholesale business – the company is better positioned to grow for many years with marginal returns even higher than those obtained in the past.

Recent share volatility was higher than we would have liked, but if the past can be of any indication, returns over time tend to reward more patient shareholders.

OUTLOOK

After Brexit and Trump's election, it will be interesting to watch the consequences in the European Union of the elections of (far?) right wing politicians in several EU countries in the coming months and years.

In all, these events are indicative of highly tangible risks of a reversal – even if marginal – of the globalization process, ongoing during the previous decades. We are especially mindful of this since, if that is indeed the path, many global companies will be significantly impacted.

Meanwhile, the international capital market is reopening to Brazil in response to the positive evolution of the country's reforms. With inflation under control, the reduction in interest rates over coming quarters should alleviate the leveraged balance sheets of businesses and consumers. Despite a slow process, economic deleveraging should create conditions for growth – assuming reforms continue to be implemented.

The public accounts, however, remain alarming. It is therefore essential to not only implement reforms but also make new fiscal adjustments to reduce government deficits as soon as possible. The bankruptcy of the states is also a depressing reality. On the other hand, maybe this discomfort will create the conditions for government to impose a new fiscal regime in the states. Every cloud has a silver lining.

MISCELLANEOUS

"The whole problem with the world is that fools and fanatics are always so certain of themselves, and wiser people so full of doubts."
— Bertrand Russell

"Good things happen to cheap stocks."
— Anônimo

"He who thinks the past is surprise free is bound to have a future full of surprises."
— Amos Tversky

"We have about 3.2 products per household today. We want to get eight. It's an ambitious goal."
— Richard Kovacevich in 1998 (former CEO of Wells Fargo)

"We start with what the customers need, not with what we want to sell them."
—Wells Fargo Visions and Values (Unfortunately the incentives were not as accurate as this)

"We are not abandoning cross-sell. We love cross-sell. Cross-sell is a shorthand for deep, long term relationships with clients. One of the tools is changing: no more product sales requirements. Some people might misinterpret those targets."
— John Stumpf (former CEO of Wells Fargo, forced to leave after the scandal)

"While decentralizing problem solving in society and in organization is essential, the successful management of such decentralization is a complex process of iteration between central and local goals and central and local knowledge."

— John Kay

"'You can't manage what you can't measure' is a maxim that is taught and believed by many in both the business and education sectors. But in fact, the phrase is ridiculous – something said by people who are unaware of how much is hidden. A large portion of what we manage can't be measured, and not realizing this has unintended consequences. The problem comes when people think that data paints a full picture, leading them ignore what they can't see."

— Ed Catmull, CEO of Pixar and Disney Animation Studios

"I think I've been in the top 5% of my age cohort all my life in understanding the power of incentives, and all my life I've underestimated it. Never a year passes that I don't get some surprise that pushes my limit a little farther."

— Charlie Munger

PERFORMANCE

PERFORMANCE **IP-PARTICIPAÇÕES CLASS**

PERFORMANCE

Since February 26th, 1993[2]

LAST 12 MONTHS RETURNS (US$)

	IP-Part. Class[2] (%)	Ibovespa (%)	MSCI EM (%)
December 16	10.89	1.40	-0.16
November 16	-6.46	-10.70	-4.60
October 16	3.56	13.51	0.25
September 16	-0.01	0.62	1.32
August 16	2.94	0.99	2.52
July 16	2.60	10.22	5.09
June 16	16.35	19.06	4.10
May 16	-4.38	-13.70	-4.15
April 16	5.72	11.08	1.02
March 16	14.24	30.80	13.26
February 16	2.32	7.59	-0.15
January 16	-4.24	-9.97	-6.48
12 months	49.33	66.46	11.11

EQUITY HOLDING CHARACTERISTICS

	% portfolio
International Assets	28
Small Cap (smaller than US$ 1bi)[1]	20
Mid Cap (between US$ 1bi and US$ 5bi)[1]	0
Large Cap (larger than US$ 5bi)[1]	17

ANNUAL RETURNS (US$)

	IP-Part. Class[2] (%)	Ibovespa (%)	MSCI EM (%)
2016	49.33	66.46	11.11
2015	-24.67	-41.03	-14.60
2014	-4.05	-14.37	-1.82
2013	-6.16	-26.29	-2.27
2012	18.23	-1.42	18.63
2011	-10.47	-27.26	-18.17
2010	39.52	5.59	19.20
2009	127.67	145.16	79.02
2008	-57.06	-55.47	-53.18
2007	54.10	73.43	39.82
2006	45.32	46.41	32.55
2005	23.13	44.09	34.54
2004	28.11	28.16	25.95
2003	87.65	141.04	56.28
2002	-26.36	-46.01	-6.00
2001	-7.58	-23.98	-2.37
2000	-0.99	-18.08	-30.61
1999	136.73	69.55	66.41
1998	-25.64	-38.44	-25.34
1997	-11.53	34.47	-11.19
1996	32.57	53.23	5.55
1995	3.34	-13.77	-5.21
1994	142.54	58.97	-7.32
1993[3]	50.54	63.92	65.65

CONCENTRATION

	% portfolio
Top 5	43
Next 5	19
Other	7
Cash	28

STRUCTURE

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

OBJECTIVE AND STRATEGY

IP-Participações Class aims to provide absolute returns through long positions in both Brazilian and foreign companies that exhibit interesting combinations of criteria, such as: (i) excellent business models, (ii) a competent and ethical management team, (iii) an alignment of interests between management and minority shareholders, and (iv) prices that provide a good margin of safety and allow for substantial absolute return over a minimum 5-year investment horizon.

ANNUALIZED RETURNS (US$)

	IP-Part. Class[2] (%)	Ibovespa (%)	MSCI EM (%)
Last 5 years	3.67	-9.39	1.55
Last 10 years	8.47	-1.18	2.13
Last 15 years	14.00	7.89	9.82
Since Inception[3]	18.07	9.89	6.75

(1) Only Brazilian companies were taken into account in the market capitalization breakdown.
(2) For the period before IP-Participações Class inception, on December 1995, for reference, we show the Brazilian investment vehicle (IP-Participações) results in dollar terms. The returns are net of all fees.
(3) Inception of the Brazilian investment vehicle, IP-Participações: 02/26/1993.

TERMS AND CONDITIONS

	IP-PARTICIPAÇÕES CLASS
Subscription	Daily
Minimum Initial	US$ 100,000.00
Minimum Additional	US$ 100,000.00
Minimum Balance Left	US$ 100,000.00
Redemption	The redemption day shall be the last business day of the second subsequent month following receipt by the RTA of the redemption form. Payment of redemption proceeds shall generally be made within 10 business days following the redemption day.
Management fee	• 2% p.a. of the Net Asset Value. • Accrued daily and paid monthly.
Performance fee	• 15% of the increase of the Net Asset Value per Share. • Accrued daily and paid semi-annualy or on redemption, subjetct to high water mark.

ADDITIONAL INFORMATION

	IP-PARTICIPAÇÕES CLASS
Investment Manager	Investidor Profissional Gestão de Recursos Ltda. Phone: +55 21 2104.0506 www.ip-capitalpartners.com contactus@ip-capitalpartners.com
Net Asset Value Calculator	BNY Mellon Serviços Financeiros DTVM S/A Phone: +55 21 3974.4600 www.bnymellon.com.br/sf
Brazilian Custodian	Banco BNY Mellon S.A.
Bank	UBS AG, Stamford Branch, CT (USA)
Registrar and Transfer Agent	MUFG Alternative Fund Services (Cayman) Ltd Main Officer: Sherie Dawkins Email: SDawkins@mfsadmin.com OL-Investidor-IR@mfsadmin.com Phone: +345 914 6164
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