IP CAPITAL PARTNERS

INVESTOR REPORT

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PORTFOLIO

The main positive contributions in 2018 were from our investments in Itaúsa (+34% in 2018), B3 (+21%), Berkshire Hathaway (+3%)[1], Energisa (+40%) and Amazon (+28%). The main negative contributions were from our investments in Panvel (-21%), Facebook (-26%) and AB Inbev (-41%).

Panvel was the largest negative contribution, causing a drag of -2.8% on returns. As discussed in previous reports, the high volatility of the stock is a natural outcome of its low liquidity. The company results continue to steadily grow.

In our report for the fourth quarter of 2017, we discussed the market's cyclical nature, subject to shocks from time to time, and noted that there were signs the market could be over-heated. As discussed at the time, we always strive for balance. The fund is well positioned to benefit from the value creation potential of an exceptional assortment of businesses, while also holding enough cash to capitalize on moments of greater distress. History has long taught us to value the combination of dry powder and market turmoil.

The volatility caused by the Brazilian elections crafted some attractive opportunities during the year, where high potential returns were offered at very low risk of permanent losses. At one point Multiplan and B3 shares were down 26% and 16%, respectively, but ended the year 42% and 44% above their lowest levels. Both Energisa and Itaúsa also saw a gap of almost 50% between their lowest and highest prices during the year. We happily increased our investments in the first three companies. In the case of Itaúsa, we took advantage of its strong appreciation to reduce our position and reallocate capital to other alternatives with a better risk/return profile.

The U.S. market performance in the last quarter was particularly interesting. The Fed's assertions on the trajectory of interest rates, coupled with an increased perception of risk in the credit markets and Trump's threats of a trade war with China led to a sharp correction in asset prices. The S&P 500, which rose 10% during the year, tumbled almost 20% from its peak – its biggest drop since 2009 – and ended the year at -4.4%[2].

Our performance of -14.1% in 2018 was impacted by the U.S. market decline in the last months of the year. We do not believe these losses are permanent – quite the contrary, we believe this decline has created excellent opportunities.

At this point, let's take a step back.

Imagine that, after an extensive search for a property, or any other asset which generates income, you find exactly what you were looking for. You patiently wait until the day you can purchase it at a bargain price. Upon completion, the shrewd reader, aiming to

[1] The stock created good opportunities to manage our position throughout the year, generating a good contribution to the fund, despite the modest accumulated increase.
[2] S&P 500 including the reinvestment of dividends.

maximize returns, rents the property to a third party. Since the cash flow generated is substantially higher than any capital expenditures, the asset generates a good return. You reap these returns for five years, at which point you search for a sale price for the asset. You wait for a good proposal and, when it meets your demands, you sell it. We, thus, have a happy investment story.

Now, instead of waiting five years to consider a selling bid, you receive weekly proposals for the asset. Imagine that, three months after the acquisition, amid the threat of a possible U.S.-China trade war (or any other event that would instill fear in buyers), you receive an offer 10% below your purchase price. In the following week, you receive another proposal, 20% lower. The next week, one more, 30% lower. Should you take such proposals seriously or simply ignore them until you receive an attractive offer?

Did Roberto Setubal agree with – or was influenced by – the market behavior when Banco Itaú's market cap fell below R$160 billion at the end of 2015? Did José Isaac Peres consider selling his stake in Multiplan when its market cap reached roughly R$8 billion at the same time? Itaú's current market cap is approximately R$360 billion and Multiplan's is around R$14 billion.

The common trait between an investor seeking to maximize returns and an experienced businessman is an obsessive focus on the medium-to-long-term value of the business and not its recent prices. When a good business' price falls well below its value, it is no time to despair – it is time to buy more.

The recent increase in volatility in the U.S. stock market (and the greater dispersion of returns at which shares currently trade) provides an ideal environment for our fund. Given the general decline in the U.S. market at the end of 2018 and, at the same time, the increase in the Brazilian market after the elections, we have gradually reallocated our capital to more opportunities abroad, where we see greater discrepancies.

As with Multiplan, B3 and Energisa in mid-2018, most of the companies abroad in which we increased our position — or initiated a new investment — traded 25% to 40% below their highest levels. At the end of the day, our understanding of their value is substantially above their current market cap.

PROSPECTS

The election of Jair Bolsonaro in Brazil and his appointment of a renowned economic team is noteworthy. Never before have we had such a clear opportunity to put the country on track.

As Brazilian citizens, we wholeheartedly hope that the necessary adjustments and reforms get done, enabling the country to undergo a longer-lasting cycle of growth and investment.

On the other hand, as investors, we must consider that after the significant recovery of the local stock market in the last three years[3] and the post-elections euphoria, valuations seem to already reflect a great deal of optimism for the coming years.

Furthermore, we must also stick to our principles[4]. We do not invest in state-owned enterprises, in average business models, or where incentives and governance are not aligned with minority shareholders. Lowering our standards is not an option. If, on one hand, this limits our universe of local companies, on the other, we are convinced it both increases the potential returns of our fund in the long term and reduces the risk of permanent capital losses[5].

Having said that, we are pleased with our investments in Brazilian companies that meet all our requirements. These companies are outliers, trading at attractive prices, and should create substantial value for shareholders regardless of the economy's trajectory. If, on top of that, the economy becomes a tailwind, the returns can be extremely attractive.

Abroad, Powell's remarks and other headlines, such as the U.S.-China trade dispute, continue to create waves of pessimism and optimism. Changes in interest rates or a possible cooling off of the U.S. and/or Chinese economy should be considered, but their importance for future returns is significantly lower than the declines of 25 to 40% in businesses which are healthy, growing and gushing cash flow. At times like this, similarly to experienced businessmen or property owners, investors should ignore the headlines, focus on company fundamentals and take advantage of the rising opportunities. This is precisely what we have done.

We will briefly comment on Alphabet (Google), AB Inbev and Multiplan.

ALPHABET

2018 was marked with scandals and distractions for Alphabet, Google's holding company. Employees protested against its involvement in military projects, its handling of sexual harassment incidents involving former executives, and its plan to launch a search engine in China. Its CEO was called to testify before the U.S. Congress on privacy issues and on the political bias of search results. On the antitrust front, it was fined (€4.3B) by the European Commission for its Android marketing practices. Furthermore, European governments also discussed the imposition of new revenue taxes for technology companies.

Amidst this noise, in addition to the recent correction in the U.S. market, the stock finished the year at approximately the same level it began. This has compressed multiples to even more attractive levels as the business continues to thrive. In the first nine months of 2018, revenue grew 24% year over year. Profit, adjusted for non-recurring impacts, grew 23%. The prospects for the fourth quarter are also positive.

In 2018, Google Drive surpassed 1 billion users and is now the company's eighth service to exceed this threshold. In July, YouTube announced it had

[3] The Ibovespa climbed (R$) 37.5% in 2016, 26.9% in 2017 and 15% in 2018.
[4] See our "Principles", which we shared with our readers in the May-August 2018 report.
[5] We cannot help but imagine the catastrophe that would have befallen the shares of the main state-owned companies if the result of the election had been different.

1.9 billion logged users per month, up by 400 million users (or 27%) in just over a year. Conversations with U.S. advertising agencies indicate an increasing adoption of YouTube by advertisers, attracted by the expanding audience and the new tools created by the company. These are signs that the two main requirements for Google's growth – the ability to attract users and advertisers – are becoming increasingly strong.

On the negative side, government interference is no longer a mere risk but a reality with which Alphabet has to deal. This interference has, thus far, had minor effects on the company, but we are closely following new developments. 2018 saw some important milestones in Europe, including the implementation of new privacy rules (GDPR[6]) and changes in product advertisements (PLAs[7]) in response to an antitrust ruling in 2017. Both have proved benign for Google. We expect a similar impact for the newly announced changes to Android contracts. Although European politicians are choosing to lambaste the company, the reality is that its products are relevant and desired. Contracts are changed, bundles are eliminated, but demand remains strong. It is difficult to replace Google's services. If the idea of taxing its revenue prevails, which seems likely, we see a moderate impact on the company's revenue.

Alphabet engages in activities with predictable secular growth trends within the internet, such as online advertising, video streaming and cloud services for companies — not to mention its "Other Bets" segment, which is not included in our projections. The company is not immune to shocks but should maintain solid growth rates even if the global economy slows. Its shares offer a unique combination of growth, cash generation and an attractive price. Consequently, it is one of the main positions in the fund.

ANHEUSER-BUSCH INBEV (ABI)

In our January-April 2018 report[8], we discussed our investment in ABI. Interestingly, however, we reduced our investment by about half between May and July – an unusual occurence, especially considering the small appreciation of the stock in the period. This decision was based on a combination of negative factors:

- Currencies from the company's main emerging market countries began a devaluation process we saw as problematic. Given the increase in U.S. interest rates, this movement might have been further exacerbated. In fact, between April and the end of the year, the Brazilian real (-10%), the South African rand (-13%), and the Argentine (-44%), Colombian (-13%) and Mexican (-5%) pesos all recorded significant devaluations.

- Operating results from previous quarters had been disappointing, but, up to that point, we did not believe there was cause for great concern, given the company's strong culture and operational track record. However, given

[6] General Data Protection Regulation: https://eugdpr.org
[7] Product Listing Ads.
[8] https://www.ip-capitalpartners.com/relatorio/2018_Abr_RG_Participacoes_EN_Site.pdf

the currency devaluations mentioned above, we feared results might record additional declines as local results were converted back to dollars. Following our reduction, the company suffered a drag of 6.5% in its normalized EBITDA for the third quarter.

- Although already a point of attention, the debt load, given its mostly fixed and long-term nature, should have had a controlled and declining trajectory as results improved. However, given the factors above, coupled with a mostly U.S. dollar-denominated debt (which was appreciating), the time required for deleveraging would increase significantly – increasing the vulnerability of the equity value.

From its highest point in July to year-end, ABI shares declined around 38%. The multiple at which the company trades underwent a significant de-rating. In April, ABI traded at 20x earnings for the next 12 months, below the five-year average of 22.5x. It is currently trading at around 15x.[9]

In October, the company cut its dividends by half after gauging a greater difficulty to amortize its debt. In December, Moody's downgraded the company's debt rating, also citing leverage concerns.

In hindsight, we erred in underestimating some of the risks above and should have been more aggressive in reducing our position. However, our decision substantially reduced the losses to the funds since they occurred before the most dramatic stock decline.

Despite recent hiccups, in important markets such as Mexico, Colombia, China and most regions of Africa, ABI continued to post solid volume growth[10]. The company should deleverage to 3x net debt/EBITDA in 2021 – boosting profits and enabling future investments or higher dividends.

ABI should perform well in the medium to long term, due to: (i) its exposure to developing markets (where beer consumption is growing fast); (ii) its proven ability to execute in these markets; (iii) its high degree of dominance in these countries; and (iv) the past and current alignment of management's and controlling shareholders' incentives.

MULTIPLAN

Our first investment in Multiplan was over 10 years ago. Our report for the first quarter of 2012[11] discussed our admiration for the mall business in Brazil, due to: (i) its recurring and inflation-adjusted revenues, (ii) its exposure to retail growth through a diversified mix of tenants, (iii) its tendency to dominate certain regions, and (iv) transform this regional dominance into reinvestment opportunities via new developments or expansions. Given this is an extremely capital-intensive and long-cycle business, an aligned and competent controlling shareholder is especially important.

[9] Source: Capital IQ
[10] In the first nine months of 2018, Colombia and China recorded volume growths of 3.3% and 1.8%, respectively. Mexico had high single-digit volume growth, while countries like Tanzania, Uganda and Nigeria recorded double-digit growth.
[11] https://www.ip-capitalpartners.com/relatorio/2012_03_IP_Offshore.pdf

Multiplan offers an ideal combination between an excellent portfolio of malls which are dominant in their respective regions and a visionary controlling shareholder aligned with his minority partners. Its portfolio is mostly composed of mature assets whose sales still grow at high rates. BarraShopping and Morumbi Shopping, for example, inaugurated over 35 years ago, posted sales per square meter growth (CAGR) of 8% and 9% in in the last 10 years[12].

During this period, Multiplan multiplied its own gross leasable area (GLA) by 1.5x, net revenue by 2.5x, and EBITDA by 3.2x.[13] This period can be divided into two phases: (i) from 2007 to 2014, when the company was growing at full speed, adding 310,000 sq.m. of own GLA (+120%) to its portfolio; and (ii) from 2014 until today, when it focused on surviving the recession and resumed some investments in new projects.

In this first phase, the company developed eight malls which still account for less than 30% of rent revenue. Five of these malls were opened between 2011 and 2013, and their maturation was severely impacted by the recession. New malls are naturally more fragile and, although these have an excellent future potential, their current returns are well below expectations. According to our estimates, these eight malls had a return of roughly 8%[14] in the last 10 years for each real invested by shareholders. These assets should be seen as "compressed springs" since the original investment has been completed, but the return has been delayed. Any decompression will have a significant impact on company results.

In the medium term, a few drivers should boost the company's growth.

First, tenants' growing demand for good locations (with high foot traffic and the ability to generate sales). During the recession, tenants who opened up shop in inferior locations solely for their lower rents learned the hard way that you always get what you paid for. These second-tier malls suffered due to their sub-prime locations, their exposure to a more price-sensitive segment of the population, or they simply were not top-of-mind for customers. These were, therefore, the first to record steep declines in foot traffic. As a result, the virtuous cycle of the mall business quickly became vicious. Some new malls reached peak vacancy rates of nearly 50% (!), many stopped charging rent to keep remaining tenants and, as a result, investments in the maintenance of the malls plummeted, leading to a worse customer experience and a further reduction in traffic. Multiplan's portfolio, in turn, recorded an increase of 8% in sales between 2014 and 2016, with a decline in only two of its eighteen malls. Occupancy remained, at all times, above 97%. The gap between Multiplan and its peers, which was already significant, became even wider. Tenants have shown an increased preference for Multiplan's malls when looking for new store locations. Multiplan has always focused on generating foot traffic and sales because, if its tenants are selling well, they can always charge healthy rents.

[12] Between 2007 and 2017.
[13] The number of outstanding shares also increased 12.3%.
[14] Considering Funds From Operations (Net Income + Depreciation and Amortization - Maintenance Investments). Period between 2007 and 2017. In the same period, the 11 most mature malls in the portfolio produced a nominal return of around 25% for each real invested by shareholders.

TABLE 1: ANNUAL FOOT TRAFFIC (MILLION)

São Paulo		Rio de Janeiro	
Morumbi Shopping	**24,0**	**BarraShopping**	**34,4**
Congonhas Airport	21,9	Santos Dumont Airport	9,2
Ibirapuera Park	14,0	Christ the Redeemer	3,3

Source: Multiplan's 2018 Public Meeting

The second driver is the opportunity for expansion projects in existing malls. The company has mapped expansions totaling a GLA of around 150,000 square meters in its current malls – where returns are high, thanks to a well-established foot traffic – which would represent an 18% increase in total GLA. We prefer, as its main source of growth, that the company develop its own projects, rather than acquire existing ones.

Lastly, adhering to its strategy of building long-term value creation hubs, the company has almost one million square meters of potential area for sale in regions integrated with its existing malls. On this issue, an experienced controlling shareholder and management will make all the difference. José Isaac Peres' philosophy of creating hubs of people and businesses is very powerful, since developments around malls are valued for their convenience while, at the same time, boost the malls' traffic.[15]

It would not be prudent to discuss retail without examining the biggest structural change underway in the industry: the rise of the online channel. Retailers no longer depend exclusively on bricks-and-mortar stores to reach customers. In the U.S., for example, this phenomenon has resulted in the closure of more than 5,000[16] stores in 2017 alone. By mid-2018, this figure was over 3,000[17]. These closures have given rise to the infamous "ghost malls", with sky-high vacancy rates and very low traffic levels, heading towards extinction.

Although the situation in the U.S. commands attention, there are some important differences in Brazil.

Firstly, the per capita GLA in the U.S. was thirty times higher than in Brazil in 2015. There was clearly an oversaturation of store spaces, and, consequently, any correction is only natural.

Secondly, Multiplan's malls rely more on services and restaurants and less on "pure" retail to generate traffic. Only 43% of its GLA is leased to retailers in the clothing, household and office segments, compared to 63% of U.S. malls. Clothing, household and office item retailers are more susceptible to online disintermediation. The food and service segments (around 46% of Multiplan's GLA) are less exposed to digital migration: gyms and restaurants, for example, are part of people's entertainment and social life. In addition, Multiplan seeks to promote events,

[15] After a recently passed bill in Congress that allows developers to retain part of the amount deposited by buyers in case of a purchase cancellation, Multiplan has re-launched its first real estate project since 2014: the Golden Lake condominium in Porto Alegre.
[16] https://clark.com/shopping-retail/major-retailers-closing-2017/
[17] https://www.daytondailynews.com/business/personal-finance/retail-alert-this-upscale-grocery-store-chain-closing-stores/Mya6paCFrCQgxTn9MiHBCN/

promotions and exclusive partnerships to increase traffic and improve the consumer experience. Nowadays, malls whose only purpose is product distribution no longer create value for retailers or consumers.

Another positive aspect of the industry in Brazil is that malls continue to gain ground from street stores, driven by their natural pulls – security and air conditioning. In certain regions these are extremely relevant differentials.

Finally, retail is searching for a balance between the physical and online worlds with the so-called omnichannel (multichannel distribution). Online and physical distribution complement one another: online distribution is simpler, direct and more convenient, while physical distribution, in places with traffic, offers exposure, connection with consumers, and profitable distribution. Today, a retailer's ideal GLA is certainly smaller than it would have been 10 years ago, but well-located spaces play a major role for retailers. The choice of where to place this smaller number of stores will be simple: in the best located malls, with the highest traffic and the best sales. Multiplan's malls certainly fit the bill.

In mid-2018, amid greater political uncertainty, a curbing of the economy due to the truckers' strike, and a temporary increase in the real long-term interest rate, Multiplan was worth approximately R$10.5 billion, which, for an FFO of around R$700 million in 2018, implied a P/FFO of approximately 15x. We took the opportunity to build a mid-sized position. By the end of 2018, the company's market cap was R$14.5 billion. Despite the 40% increase from its lowest levels, we only slightly reduced our investment. In addition to the many value creation opportunities, any acceleration of the economy will amplify the growth and profitability drivers mentioned above.

MISCELLANEOUS

"The secret for successful investing is to figure out the value of something – and then pay a lot less."
— Joel Greenblatt

"The stock market is filled with individuals who know the price of everything but the value of nothing."
— Philip Fisher

"It often boils down to a bunch of people yelling 'Go this way!!'. And once the crowd gets going, it can get real loud, real fast."
—Sam Zell

"The free market punishes irresponsibility. Government rewards it."
— Harry Browne

"If you can keep your head when all about you are losing theirs...

If you can wait and not be tired by waiting...

If you can think – and not make thoughts your aim...

If you can trust yourself when all men doubt you...

Yours is the Earth and everything that's in it."
— Excerpt from the poem "IF" by Rudyard Kipling, as cited in the 2017 Annual Report of Berkshire Hathaway.

"As a company, philosophically, we are in the hospitality business."

— Rick Caruso, owner of the largest private real estate company in the U.S. Developer and owner of The Grove, one of the best shopping malls in Los Angeles.

"[It] all boils down to the quality of retail real estate, [it] all boils down to showing traffic in those assets."

— Sandeep Lakmi Mathrani, CEO of GGP at Citibank's Global Properties Conference in 2017.

"Half of the 15,000 mutual funds in the US are run by portfolio managers who do not invest a single dollar of their own money in their products."

— Financial Times, September 2016.

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