



“The Chinese use two brush strokes to write the word ‘crisis.’ One brush stroke stands for danger; the other for opportunity. In a crisis, be aware of the danger-but recognize the opportunity.”
(John F. Kennedy)

Dear Investors,

HIX Capital is an independent asset management firm focused on Brazilian equities. HIX Capital FIA’s goal is to maximize return on invested capital through a portfolio concentrated in high quality companies. In other words: easy to understand businesses, highly qualified management teams and compelling potential returns. We strive to deeply know the companies as much as possible.

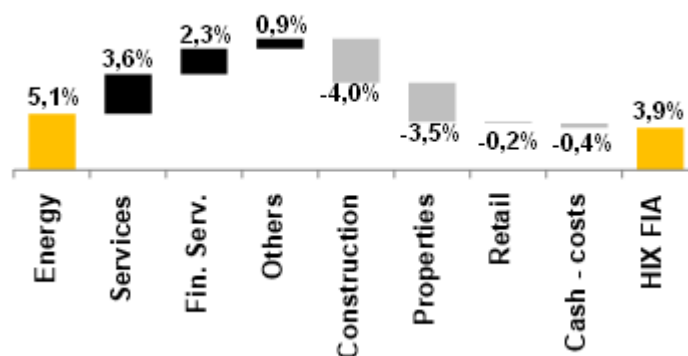
In 2014, HIX Capital FIA delivered a positive return of 3.9%, while the Ibovespa declined 2.8%. Since May 2005, the portfolio managed by HIX Capital FIA’s team gained 622% compared to 95% of the Ibovespa¹. The main positive contributions to the funds performance in 2014 were Equatorial Energia and Tempo Assist, while Tecnisa and Cosan generated the greatest losses during the same period.

Consolidated Results - HIX Capital FIA (%)

Year	HIX	Ibovespa	IPCA + 6%
2012	13.1%	6.8%	4.6%
2013	8.8%	-15.5%	12.2%
2014	3.9%	2.8%	12.6%
Accrued	27.8%	-12.3%	32.1%

Source: HIX Capital

Performance Distribution by Sector 2014 – HIX Capital FIA



Source: HIX Capital

Our belief since the beginning of the year that the Brazilian economy would slow down proved to be true. It is clear from the perspective of all economic agents that fiscal, monetary, and consequently, most government policies, will experience a strong adjustment over the coming years.

¹ Includes the performance of Clube de Investimentos Keep Investing from May of 2005 until August of 2012. The annualized performance for the period was 23,1% pa for the portfolio versus 7,3% pa of Ibovespa.

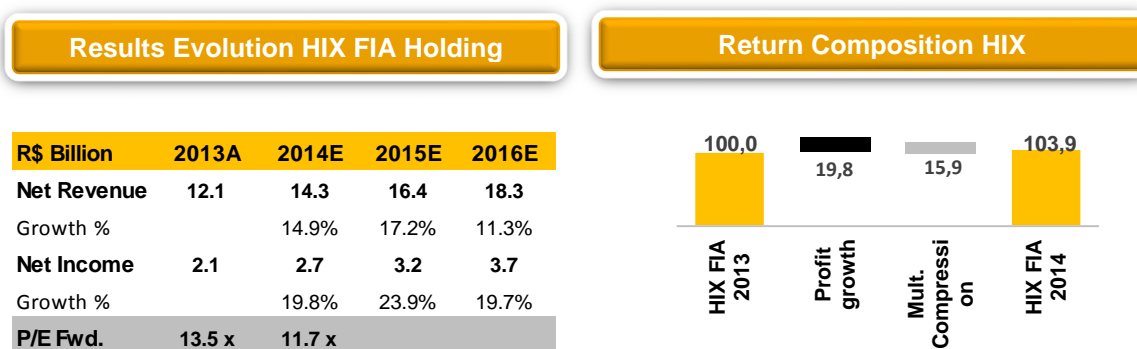


The adjustment itself is not the end but the means. The objective is to control inflation and the fiscal situation, providing local and foreign investors with a safer perspective on the financial soundness of Brazil in the long run. With that, hopes are that investments will resume to a healthy rate and the economy will get back on track. We reiterate that *ex-ante* it is hard to precise the size, duration and the format of the adjustments taking place, but like any medicine, they will have a bitter taste².

Such context does not alter our investment strategy: search for companies with earnings growth dynamics based on internal levers (cost reductions, operational improvements, new projects or placed in markets that have secular growth trends).

We believe that our portfolio is solid, little correlated with the volatility of the market and with high probability of growth in results, even in challenging economic scenarios.

The table below shows the evolution of the results of our portfolio companies and our updated projections. It is possible to observe that the results until the third quarter of 2014 indicate 16.0% and 17.4% growth in net revenues and net income, respectively, very close to our initial expectations.



Source: HIX Capital

Over longer periods, shareholder return tends to reflect the evolution of the operating results of any company. However, in the short term, market participants tend to be irrational. In 2014, for example, the average profit our portfolio holdings grew 19.8%, while the performance of the fund was a mere 3.9%. The explanation for this discrepancy is that there was a significant multiple compression due to the deteriorating expectations regarding the economy and hence the operational future of these companies. However, this trend cannot remain indefinitely and at some point returns should converge to the underlying growth of results.

Thinking Outside the Box

Commonly, investors tend to believe that companies only create significant value for its shareholders when they post high growth levels. It is true that much value can be created when companies grow profitably. However, in seeking accelerated growth rates, it is common for

² Some initiatives such as the increased rates and reduced volumes in loans from BNDES, the reintroduction of the IPI tax on automobiles and some Ministries budgetary cut backs (such as Ministry of Education) can be already observed, as well as its painful effects to the affected sectors.



executives to make mistakes which end up costing for companies and their shareholders a high price.

Examples of such possible mistakes are:

- Leniency with working capital policies (less attention to inventory levels and payment terms) which ends up consuming disproportionate amounts of cash;
- Increases in "non-strategic expenses"³, such as: consulting, administrative or other manufacturing costs, leading to a reduction in operating margins;
- Lack of focus in productivity and efficiency of operations;
- Approval of investments based on unrealistic assumptions, leading to low returns;
- Acquisitions at high multiples, justified by a supposed "strategic value" which eventually lead to losses or sub-optimum returns;
- Shares issuing made in order to finance the common mistakes described above, which may accentuate the negative effects of the wrong decisions,
- Last but not least, often in good times, some executives seek to diversify the operations of their companies and the loss of focus ends up bringing relevant problems in the main activities of the company.

Just as governments, companies also have a hard time assessing problems while navigating in good weather. However, in difficult times, when the rope stretches and reaches its limit, executives have no other choice but to restructure operations seeking increased earnings and positive cash flows. Thus, in many cases, periods of stress are the prelude to significant gains in intrinsic value in subsequent years, provided that the homework is done correctly.

Next, we describe a few projects or initiatives that are mainly initiated in difficult economic times, and that can lead to significant gains to shareholders.

RATIONALIZATION OF OPERATIONS

The opportunity to rationalize and search for efficiency of operations is one of the main orientations of executives in difficult times. Examples of plans that can be derived from these initiatives are many and we will point out some examples of such cases in our portfolio companies.

Reduction of costs and administrative expenses (Itaú 2012-2014):

In 2010, Brazil was one of the countries that best came out of the crisis of 2008⁴. Itaú Unibanco understood that the credit growth drivers for the following years would be mainly loans for auto financing and small and medium enterprises.

This strategy paved the way for significant increase in credit concession, leading portfolio growth at record rates (19% pa), along with profitability expectations. However, expectations could not have been more misleading. The actual delinquency rate was significantly above expected levels and, as a result, the bank's results suffered. In 2012, against the worst expectations, Itaú presented a decline in profit and marked the worst year in terms of profitability since the 2008⁵ crisis.

Eager to resume the position of the most profitable bank in the country⁶, executives began an adjustment process to cut costs and review credit mix, aiming at higher profitability and a smaller risk profile of the outstanding portfolio. Among the main measures, the following are noteworthy: (i)

³ Term coined by Bob Fifer in his book "*Double Your Profits in Six Months or Less*", it refers to any asset that doesn't increase sales.

⁴ In 2010, Brazil's GDP advanced 7.5%.

⁵ Reference to the real state crisis in USA of 2008, which has become systemic.

⁶ In 2012, Bradesco exceeded the Itaú in profitability, measured as ROE or return on equity



cutting more than 20,000 job positions, (ii) renegotiation of contracts with thousands of providers, (iii) review of the lending strategy, (iv) improvement in the range of financial products and services, and (v) sale of some insurance portfolios (auto, large exposures etc.) that showed lower profitability.

As a result, in 2013, Itaú's profit resumed growth and in 2014 the profit increased by 29%, even with more modest growth in the lending portfolio.

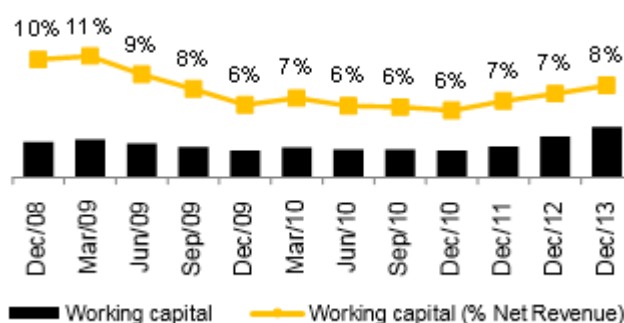
Itaú	2010	2011	2012	2013	2014
ROAE	23.1%	22.1%	19.3%	20.4%	23.4%
Profit growth	46.2%	13.8%	-4.1%	12.7%	29.3%
Credit Card Growth	19.8%	19.1%	7.5%	13.3%	8.3%

Source: Itaú Unibanco

IMPROVMENTS IN WORKING CAPITAL (Dufry 2008 - 2010):

In late 2008, at the height of the last great global crisis, passenger traffic in airports fell sharply and placed Dufry in a delicate position due to a leveraged balance sheet (under risk of breaking covenants). At that time, Dufry operated with a working capital level of 10%-11% of its net revenues, a level that executives believed to be adequate. As the popular saying says, "the need is the mother of invention" and the risk of having the early maturity of its outstanding debt triggered, Dufry executives set up a plan, which sought cost reductions of CHF 25 million⁷ and a reduction of working capital needs of 10%.

The implementation of the plan was successful and by the end of 2010, working capital needs as a percentage of net revenues had reduced by 35% to 6.5%. After the eminence of a big crisis, the company never returned to previous operating levels and maintained WK needs between 6-8% of net revenues, creating significant value for shareholders.



Source: Dufry

⁷ Were able to achieve a reduction of CHF 27 million exceeding the initial forecast.



SALE OF NON-CORE ASSETS (Tempo Assist 2012-2014):

It is not rare to see acquired companies that do not fit the culture or operations of the acquirer and consequently, expected synergies do not end up materializing. In these cases, often the "1 + 1 = 3" can end up as less than 2 and the value destruction is evident.

Whenever it is possible to identify this type of issue early enough, management can sell the acquired asset for a good value. In addition to value recovery, demobilization of such operations enables executives to focus on improving the performance of its core business. Below is an example of one of our portfolio holdings, Tempo Assist.

Tempo Assist began its operations in 2000 and has grown mainly through successive (more than ten) mergers and/or acquisitions. In 2007, Tempo decided to list its stock. Tempo's strategy was to become a "one-stop-shop" service company, particularly for insurers. With the funds raised in the IPO, Tempo acquired several companies and it is not surprising that the results of the acquired companies were significantly short of original expectations. The result of successive acquisitions was a complex organization, with little ability to extract synergies, dispersed management focus and low profitability.

In 2010, Tempo's core business profitability began to subsidiary⁸, and management began a strategic revision of the company's strategy.

In 2011, following the change of top executives (including the CEO), the company began working on: (i) operational turnaround and; (ii) sale of non-strategic assets. Since then, Tempo began collecting the results of all this work.

As described in our letter to investors sent in June 2014, Tempo completed the divestments of non-core assets, which accounted for only 5% of its operating income but generated a return of approximately R\$ 350 million in cash flow to shareholders between dividends and capital reduction (40% of its market value at the time).

In addition, the simplification of operations and the increased focus yielded a positive impact in results: operating income from USS (the company's main business unit) increased from R\$ 25 million in 2011 to over R\$ 80 million in 2014 and corporate expenses were reduced by 20% in 2014 compared to 2013.

OPORTUNITIES OF *MARKET-SHARE GAIN* (Equatorial):

Markets are typically competitive environments where companies compete systematically to increase their market shares.

In favorable market times, when the average operating margin in the same sector is high, most of the players, regardless of their quality, tends to make money (though in different proportions). In such moments, competition increases and most participants have the ability to track the movements of competitors.

In difficult moments though, when the average margin of an industry reaches lower levels, inefficient players tend to lose money, while the efficient players continue to profit. In such moments relevant

⁸ The USS - service company



opportunities of market share gain arise, either organically or through acquisitions at attractive valuations.

As an example, Brazilian electricity distributors are going through difficult market times. The average result of the sector is very depressed and the industry is leveraged as a whole. While efficient operators such as CPFL and Equatorial continue to make money, inefficient operators are struggling to make it through the day. Therefore, we believe that in the coming years acquisition opportunities of these inefficient players in interesting terms will emerge, as happened when Equatorial acquired CEMAR in 2003 and CELPA in late 2012.

In line with Equatorial's strategy of buying poorly managed and financially troubled distributors and turnaround operations, we believe that in the near future there might emerge other potential distributors to be acquired. When an event like this happens, once again a major process of value creation will emerge.

STOCKS REPURCHASE

Some of the most interesting opportunities in difficult markets are share repurchase programs. These programs are very common and take place regardless of economic cycles. However, shareholder value is only created when done below at prices below the company's intrinsic value.

Notwithstanding, such programs are commonly conducted in order to artificially hold stock prices at high levels. However, as a rule, this practice generates little or no value⁹ to shareholders, for the price paid is typically close to its intrinsic value. On the other hand, in times of crisis, when the market sets an overly conservative price for companies and therefore significantly below its intrinsic value, a repurchase program tends to create plenty of value.

Currently, some companies in our portfolio are studying and/or have already initiated share buyback programs, as is the case of Even¹⁰ and BrasilAgro¹¹, which are extremely discounted relative to the value of their assets. Below is an example of a repurchase program for Even's shareholders.

Even's market value is extremely discounted relative to the value of its assets. A program to repurchase 5% of its shares would require approximately R\$ 50 million, which does not affect the company's liquidity significantly, and increases leverage marginally from 56% to 60% of shareholder equity. At the same time, the cancellation of these shares would lead to a positive impact on its earnings per share of 3% and an increase in net assets per share of 3%, which, in our view, is very positive. Another way to analyze the benefits of the repurchase program is that the expected gain on the acquisition of these shares by Even would be 29% per annum at a very low risk.

⁹ And it is not rare that leads to destruction of shareholder value.

¹⁰ Already repurchased 3 million shares in 2014 and is studying opening a new program

¹¹ The company has an approved repurchase program but depends on the sale of some farms to have the cash available to make the same.

**CONCLUSION:**

Brazil is facing hard times but investors tend to overreact. However, quite often times of turbulences create various internal opportunities for operational improvements and value creation. In our search for the best possible investments, we have looked closely at the resilience of the results of our portfolio companies as well as the potential opportunities of efficiency projects.

At HIX, we are taking a cautious approach but we are very excited regarding opportunities that will surely arise. It is impossible to be certain that the current level of the Ibovespa is already at its lowest point and that there will not be better entry points. On the other hand, one can say that the expectations reflected at the market value of many companies already accounts for a good degree of pessimism.

We believe that investors with the very best track records are not those who buy at the lowest point of a cycle (because finding this point it is highly unlikely). Investors with the best performances are those which consistently increase their investments at attractive prices and reduce exposure when there is excess optimism. We are constantly monitoring opportunities to increase exposure in our investments.

HIX Capital:

HIX ended December 2014 with approximately R\$ 90 million under management invested in our funds, increasing our AUM by almost 100%. Our main investors are still families and family offices, with which we have direct relationship, understand and trust our investment strategy and are aligned with our long-term investment horizon.

We remain excited about the growth prospects of HIX and confident with the team's ability to continue growing and finding good investment opportunities for partners and for our investors.

We appreciate the trust,

HIX Capital Management Team