

*"It is not about ideas. It is about making ideas happen"*  
**(Scott Belsky)**

Dear Investors,

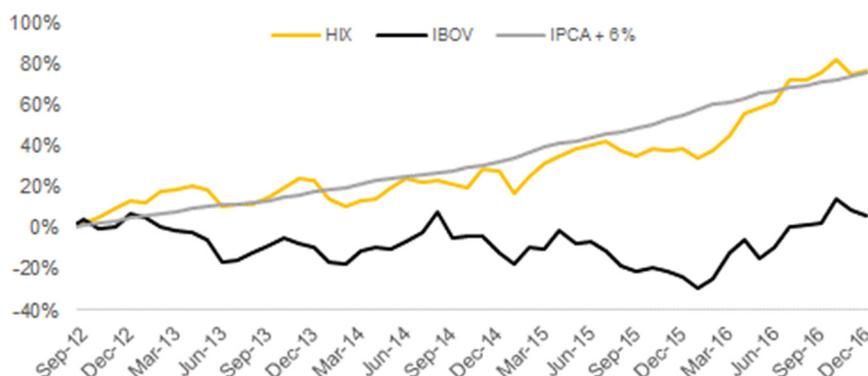
HIX Capital is an independent asset management firm focused on investing in Brazilian equities. HIX Capital Equities Fund's goal is to maximize return on invested capital through a concentrated portfolio of high quality companies. In other words, we look for business's that: (i) have simple business models; (ii) are well managed; and (iii) negotiate at compelling potential returns. We strive to achieve the deepest possible knowledge about the companies and sectors we invest in.

During 2016 HIX Capital FIA gained 27.3%, whilst the Ibovespa index gained 38.9%. Since its inception, HIX Capital FIA, firms original fund, has accrued gains of 71.1% compared to a Ibovespa of 5.5%, and a CDI gain of 57.7%. The portfolio managed by HIX Capital's founding partners has a performance of 895% since inception (May 2005), compared to 139% of the Ibovespa<sup>1</sup> in the same period.

## Consolidated Results

Year	HIX FIA	Ibovespa	CDI
2012	13.09%	6.82%	2.26%
2013	8.78%	-15.50%	8.05%
2014	3.86%	-2.91%	10.81%
2015	8.28%	-13.31%	13.25%
2016	27.29%	38.94%	14.00%
Since Inception	76.10%	5.50%	57.67%

Source: HIX Capital

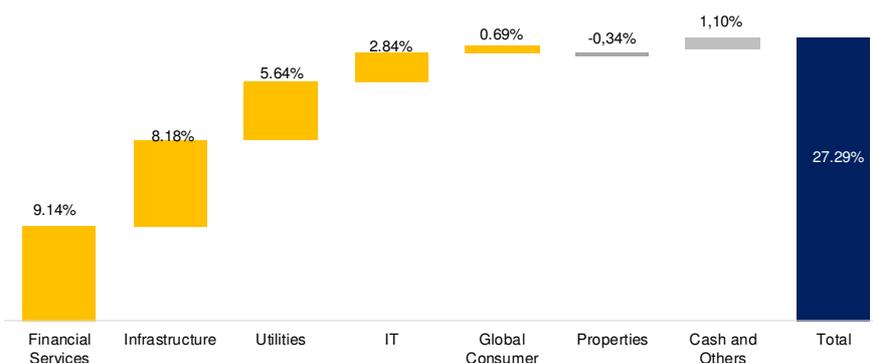


Source: HIX Capital

<sup>1</sup> Includes the performance of the Investment Club *Keep Investing* from May 2005 to August 2012. The portfolio's annualized performance until December 2016 was 22.1% p.a. versus 8.2% p.a. from the Ibovespa.

During 2016 the main contributors to the fund's performance were the investments in Equatorial Energia, Rumo, Par Corretora and Itaú Unibanco. In contrast, Renova, Dufray and Energisa were the portfolio's main laggards. We included below the fund's performance attribution by sector.

### Performance Attribution 1<sup>st</sup> Half 2016: HIX Capital FIA



Source: HIX Capital

### SCENARIO & PORTFOLIO UPDATE:

The second semester of 2016 was extremely volatile both in a political and economic point of view. The Ibovespa continued appreciating sharply, whilst the USD exchange rate increased by 15% compared to the beginning of the year, and 27% when compared to its lowest point in 2016. Looking forward, whilst the pessimists can list numerous worrying factors such as: decrease in tax revenues, low investment and savings rates, significant fiscal deficit and rising levels of unemployment, optimists have already seen positive signs that Brazil may be starting a new positive cycle. Among them we can list (i) approval of PEC (a constitutional amendment proposal that caps governmental expenditure) (ii) the successful anchoring and subsequent slowdown of inflation by the central bank (iii) strong trade balance and, it's worth mentioning, the recovering consumer and entrepreneurial confidence indicators. So far the markets have focused on the positive aspects and have given both the Temer's Government and their economic "Dream Team" the benefit of the doubt.

At HIX we are cautiously optimistic with the current scenario. On one hand we are still cautious about the short-term economic situation and the ongoing political reform agenda, but on the other hand a number of factors have left us more optimistic about the opportunity set for us as equity investors. Amongst these positive factors that, we believe can support a more significant increase in the markets, we would like to mention:

- i. **Corporate Profit Growth:** Corporate profit margins can improve significantly over the next few years without the necessity of relevant revenue increase, driven by the following factors:
  - a. Many companies have undergone significant financial and/or operational restructuring in recent years to adjust themselves to the economic reality and as a result, will significantly improve their results despite the economic environment
  - b. The sharp reduction in interest rates should lead leveraged<sup>2</sup> companies to significantly reduce their financial expenses and, consequently, increase their profits. The increase in profits can enable investments in projects with high returns on capital.

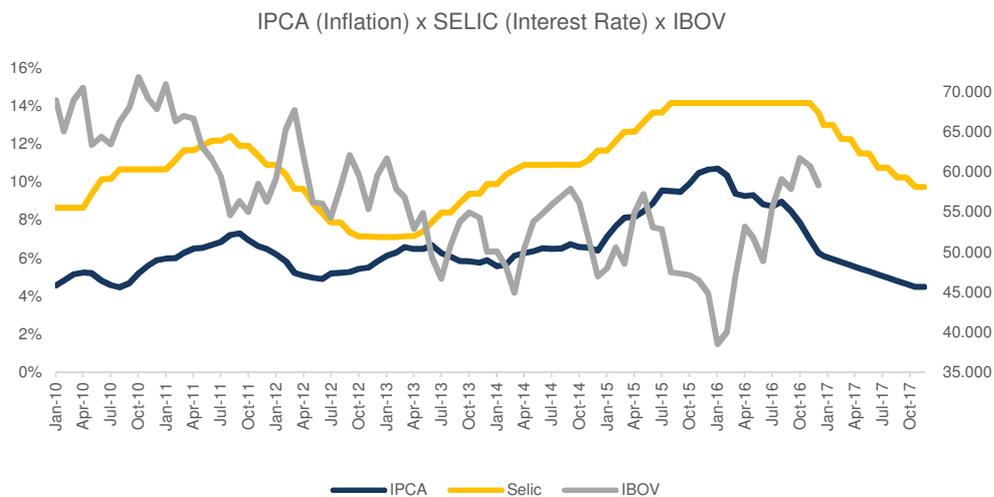
<sup>2</sup> It is worth remembering that the average Ibovespa company have a 3x EBITDA leverage which, assuming a CDI + 3% p.a. leads to a commitment of 52% of EBITDA for interest payments. That should decrease by the end of the year to 39%, which would lead to a 30% improvement in average company profits.

- c. The eventual pick up of the country's growth could bring significant operational leverage to the results of companies that are currently running with spare capacity, which would directly impact operational margins and profit growth.
- ii. **Commodity Prices:** After 2 years of sharp declines commodity prices are slowly starting to recover (as shown in Graph A<sup>3</sup>). This recovery helps the Brazilian economy and exporting companies, reinforcing their investment capacity and attracting more infrastructure investments, among other positive effects.



Graph A: Commodity Index. 2005 = 100. (IMF - <http://www.indexmundi.com/commodities/?commodity=commodity-price-index&months=12>)

- iii. **Inflation Convergence:** The convergence of inflation target expectations opened an opportunity for a relevant decrease in interest rates in Brazil. The market<sup>4</sup> expects the SELIC rate to decline from 13.75% at the end of 2016 to 9.75% in 2017. The decline in interest rates directly affects the valuation of real assets such as real estate and stocks. Just illustrating the effect that the decrease in interest rates can generate on a stock, the fair multiple of the shares of any company<sup>5</sup> should increase between 30% and 50% with a 4 percentage point drop expected by the market. Whether this will actually occur or not is something we can't predict, as there are numerous other variables that impact market valuations but below we demonstrate this correction between these factors in graphical form:

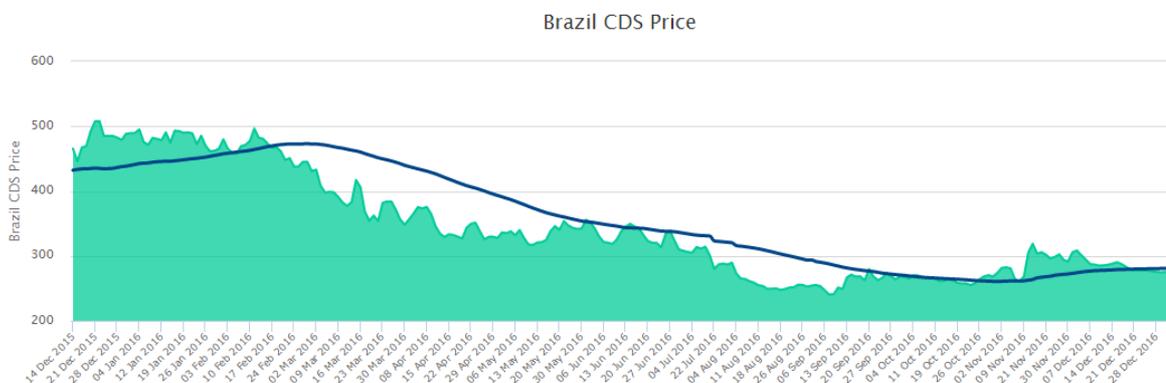


<sup>3</sup> <http://www.indexmundi.com/commodities/?commodity=commodity-price-index&months=60>

<sup>4</sup> FOCUS Research - Banco Central do Brasil on 13/01/2017

<sup>5</sup> Assuming the company has no relevant debts, zero growth in volume and a ROE between 15% and 20%

- iv. **Confidence and CDS:** Last but not least, the resumption of foreign investor confidence with Brazil – as seen on the CDS<sup>6</sup> evolution on graph B – could bring large flows of investment to the country, especially in sectors such as infrastructure and energy, and help accelerate the country’s economic growth.



Graph B: Brazil CDS ( <https://www.assetmacro.com/brazil/brazil-cds/> )

Against this backdrop, we are excited by the fact that we can still find many opportunities to buy into good companies with predictable results and sustainable competitive advantages still at attractive prices. The divergence of expectations that occur in times like these is positive for “Stock Pickers” like us, as it allows us to identify opportunities unobserved by others. At the end of December, the fund had a net exposure of 92.5%, one of the highest in recent years, which reflects our optimism in relation to our portfolio.

### Earnings Performance (HIX FIA Holding Simulation)

Indicators	2013A	2014A	2015A	2016E	2017E
Net Revenue Growth%		17.8%	12.4%	8.9%	13.4%
Net Margin Growth %		17.8%	23.7%	25.1%	20.1%
P/E Fwd.	13.5X	11.7X	13.4X	13.6X	13.3X

Source: HIX Capital

The profit growth of the companies in our portfolio will be the main driver for the upcoming years. The steady growth of the portfolio companies’ profits in 2016 meant that despite the increase in share valuations, the combined portfolio valuation multiple remained attractive. We expect the same scenario in 2017, with profit growth better than revenue growth. The portfolio’s P/E multiple continues to be a reasonable 13.3X, in line with last year’s multiple, and very attractive considering the portfolio’s profit growth profile and company quality.

### INNOVATION IN COMPANIES AND INVESTMENTS:

Recently, the process of innovation has played an important part in our discussions. In an environment where innovative companies like FANGS<sup>7</sup> have been transforming the way companies and people consume products and services, new technologies such as self-guided cars and artificial intelligence threatens to completely change various markets, where catchy phrases such

<sup>6</sup> CDS or Credit Default Swaps are the cost of acquiring insurance against a country’s debt default (<https://www.assetmacro.com/brazil/brazil-cds/>)

<sup>7</sup> Acrônimo para Facebook, Amazon, Netflix e Google.

as “fintechs” and “internet of things” (IOT) dominate the media, developing a consistent innovation plan and being aware of new technologies has become imperative for companies, executives, entrepreneurs and also for us investors.

We believe that ignoring these trends is very dangerous, and have sought to be attentive to relevant technological changes and how these can affect the companies we invest. On the other hand, when analyzing the history of successful companies in Brazil and abroad, some points are worth mentioning:

- Some of the most exceptional performances in companies have been obtained by simple copying and improving best practices from other companies. A clear example of this is Ambev<sup>8</sup>, who copied ZBB<sup>9</sup>, adopted the PDCA<sup>10</sup> and several other good market practices, perfected them and eventually became a global management benchmark.
- Some of the most successful “innovative” companies such as Oracle, Google and our Brazilian Totvs and Linx built a large part of their product and service portfolios by acquiring small companies that had developed innovative products and multiplied their impact, competently taking them to the market;
- Some of the world’s most innovative companies, which have become synonymous with very relevant products, have disappeared or become less relevant because they are embedded in rapidly evolving markets and have failed to launch new products fast enough. Some examples are: Kodak (photographic films), Polaroid (instant photographs), Xerox (photocopiers), amongst others.
- “Search” technology has existed for years when Google emerged and pushed it to the edge of its efficiency and dominated this market. The concept of social networking already existed, but it was only Facebook that raised its usability to another level and become a dominant company when it comes to “connecting” people, and was able to monetize the business. Amazon did not create e-commerce, but the relentless pursuit of innovation and excellence in execution made it become a benchmark in this segment and completely transformed it.

We believe that the exercise of innovation only brings relevant results to companies when strategy and innovation are associated with a strong executional culture. Americans often say “execution eats strategy for breakfast”<sup>11</sup>. In reality, a very important part of the value created by companies comes from exceptional execution and not an idea or the creation of a new product or process. When a company is well managed, most of the time it develops the capacity to be connected to the market and seeks small and large innovations that make them flourish. When a small competitor comes up with a relevant innovation, these companies are quick in acquiring or copying them, or when these possibilities aren’t possible, adjust their business model<sup>12</sup> to stay alive.

When transferring the innovation rationale to the investment world, the conclusion is quite similar. The complexity of today’s economic world makes investing almost a trial-and-error game where key axioms always remain valid. In this environment, it is impossible for a single person or group to completely avoid making mistakes. Since it is not possible to anticipate all market developments, we must work on our ability to adapt and respond rapidly to outside innovations. As Charlie Munger

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<sup>8</sup> Jorge Paulo Lehman has commented on several occasions that “we are not ashamed of copying the best”.

<sup>9</sup> Invented by Peter Pyhrr, an accountant at Texas Instruments during the 70’s ([https://en.wikipedia.org/wiki/Zero-based\\_budgeting](https://en.wikipedia.org/wiki/Zero-based_budgeting)).

<sup>10</sup> <https://en.wikipedia.org/wiki/PDCA> - Diffused by W.Edwards Deming and previously used greatly by Toyota.

<sup>11</sup> Some say the author of this quote is the famous management guru Peter Drucker, but this is not a consensus (<https://www.quora.com/Did-Peter-Drucker-actually-say-culture-eats-strategy-for-breakfast-and-if-so-where-when>).

<sup>12</sup> There are several examples: American Express was born as an express delivery company and today is one of the largest companies in the financial sector. Even small innovations, like the creation of Home Refill that Gillette recently created in the UK and Brazil to counter the advance of the Dollar Shave Club

says: “investing is ignorance removal”<sup>13</sup>. In our view it means that it is necessary to study constantly in order to reduce our ignorance in pertinent subjects and, consequently, to evolve avoiding errors. The important thing is to be right more frequently than wrong, and to have larger wins and smaller losses. This is no easy task and we work hard, seeking constant innovation to try and protect the portfolio in this ever-changing environment.

At HIX we are always attentive to opportunities to innovate in fronts such as internal processes, analysis tools, new methods of analyzing companies, corporate culture and team formation, product structure, etc. Another very important point to mention is that in recent years we have realized that an efficient way to evolve is learning from the mistakes of others. This way, we can capture most of the existing knowledge while avoiding the pain of losses. An example of a process we use at HIX to learn from others’ mistakes and avoid skewed internal analysis is to validate our investment thesis in the “field”, seeking third-party inputs – ideally those who think differently from financial market players, namely, for example, strategic shareholders, executives, operators and entrepreneurs<sup>14</sup> – seeking differentiated perspectives on management, markets, projects and investments. Of course, when working on this type of information it is necessary to avoid the sources’ own bias themselves and carry out proper due diligence analysis.

In summary, while much time and money is devoted to the development of disruptive innovations. The companies that reap the most relevant financial and business results tend to be those who having created, improved or even acquired an existing technology, have the ability to deploy it more efficiently and effectively than their competitors. What we like to observe in the companies we invest in – as well as in HIX – is the combination of the ability to innovate and adapt to changes and transformations in the market, with a result oriented and execution capacitated managerial culture and philosophy.

## **INVESTMENT THESIS UPDATE:**

Usually we use this part of the letter to write in-depth updates on one or two investments, however this time we decided to take a broader approach and make shorter updates on a greater number of the fund’s investments:

### **Equatorial Energia**

On October 28<sup>th</sup>, 2016, Equatorial surprised the market by winning 7 auction concessions for new transmission lines throughout Brazil. The market had already expected the company to bid for a few lots, but the surprise came from the amount of lots won. They represented a 30% share of the total auction, with a total investment volume of R\$3.9 billion over the coming years. The projects are mostly located in contiguous regions so that the company should reap some benefits of scale. In addition, there should be tax benefits from Sudam/Sudene (regional federal development agencies), and last but not least, the renowned quality of Equatorial’s management which will monitor the execution of the investments.

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<sup>13</sup> Short video where he comments on the importance of constant learning in the world of investments:  
<https://youtu.be/NkLHxMWAZgQ>

<sup>14</sup> It is important to avoid seeking innovation only with our Brazilian financial market peers, as these will hardly bring us an innovative and unique idea or point of view.

Lot	Location	Km	Estimated Investment (R\$ '000)	Maximum Auction Revenue Right (R\$ '000)	Auction Revenue Right (R\$ '000)	Discount	Beggining of Operations
8	Bahia	251	444,834	92,657	77,832	16.00%	feb/22
9	Bahia	213	466,115	98,038	70,588	28.00%	feb/22
12	Bahia / Piauí	380	547,501	114,332	102,900	10.00%	feb/22
14	Minas Gerais / Bahia	594	1,060,089	223,057	185,598	16.79%	feb/22
15	Minas Gerais / Bahia	257	433,199	91,108	85,642	6.00%	feb/22
16	Minas Gerais	330	504,598	106,179	106,179	0.00%	feb/22
23	Pará	125	426,985	89,785	89,784	0.00%	feb/22
<b>TOTAL</b>		2,150	3,883,321	815,156	718,523	11.90%	

According to our calculations, the contracted projects will have an estimated return of 15% p.a + IGPM (General Index of Market Prices) and should add around R\$540 million in fair value for the company (or R\$2.7 per share). Once again, Equatorial has surprised us positively, with a new investment that should generate great value to shareholders, and upside we hadn't mapped beforehand.

### Senior Solution:

On November 28<sup>th</sup>, 2016, Senior announced the acquisition of att/PS ([www.attps.com.br](http://www.attps.com.br)), its ninth and biggest acquisition to date. att/PS has a unique and strategic fit, due to the highly complementary nature of their products (Credit, Core Banking, Pension and Health) with Senior's, as well as low client overlap. This consolidates Senior as the largest and most complete software company focused on the financial sector in Brazil, with over R\$130 million in combined revenues for 2017. The transaction value was R\$50 million, divided in R\$35 million as a down payment and R\$15 million to be paid in 5 annual installments (The EV/Net Revenue multiple was 1.0x, lower than Senior's current multiple of 1.3x). There is also an earn-out of up to R\$14 million that is proportionally linked to the achievement of a net revenue target for 2017. We are confident in the ability of Senior's management and the att/PS executives to capture a significant volume of synergies throughout the next years and consequently, in the potential of generating great value in this acquisition.

Our thesis that Senior would be the lead consolidator for this market is proving itself true, and this trend should continue for many years to come.

### Klabin:

On March 4<sup>th</sup>, 2016, Klabin started the pulp production at its new plant in Ortigueira in the state of Paraná (known as the "PUMA" Project) and in the 3<sup>rd</sup> Quarter of 2016 it already reached a revenue of R\$491 million and an EBITDA of R\$101 million. See below a photo of the manufacturing complex below, as well as some highlights of the last Quarter:

- Achieved good operational stability at the plant with a level of 95% nominal capacity. With the necessary adjustments being made during the March 2017 annual shutdown, plant will reach 100% capacity and is perfectly aligned with the original production budget for its first year of operation.
- Fluff production has found good marketability, as the company is already serving 50% of diaper producers in Brazil and are working to win contracts with leading global players. Customers are very satisfied with the product quality, and as a result gaining market share hasn't been challenging for Klabin



Projeto Puma in Ortigueira (Paraná)

When operating at full capacity, the PUMA plant will reach a production of 1.5 million tons per year, with 400,000 in softwood pulp and fluff and 1.1 million in hardwood fiber. However, during Q3, presented revenue of only 84% of this capacity. By the end of the first quarter of 2017 Klabin should double its annual operating cash flow and undergo a strong deleveraging process, which should reduce its current leverage from 4.9x EBITDA at the end of 2016 to 3.3x at the end of 2017.

#### Puma Project: HIX Projections

PUMA	2Q16	3Q16	4Q16	2016	2017
Op. Ratio	48.6%	83.9%	95.1%	75.9%	100.0%
Volume (mt)	182	315	357	854	1.500
Revenue (R\$ '000)	286	491	779	1.556	2.953
EBITDA (R\$ '000)	59	101	354	513	1.670

#### Tecnisa:

Tecnisa went through some relevant events in 2016 which are worth mentioning. The controlling shareholders, in order to reduce the company's financial risk, proposed a capital increase of up to R\$200 million where they, together with Cyrela (one of Brazil's leading residential real estate developers) guaranteed a minimum capital increase of R\$150 million. As a result, Cyrela acquired a 13.5% stake in Tecnisa, and signed a shareholder's agreement that granted the company a seat on the board of directors, which has since been filled by Efraim Horn (Cyrela's Co-President). We believe that the company's strategy remains focused on delivering current projects and monetizing assets, while reducing costs and waiting for the market to improve before launching new projects.

During the year the company delivered approximately R\$2 billion in project's PSV, and will deliver another R\$1 billion in 2017, which once finished would complete 100% of its current projects. Tecnisa's operating expenses have also been reduced and are expected to fall by more than 30% in 2017. Despite sales cancelations and high construction expenses for project delivery, the company managed to generate cash and de-leverage in 2016. We believe that cancelations will decrease in 2017, helping the company improve its net sales volume and consequently its cash flow.

We are also optimistic about the new board format, which coupled with the expectation of a more favorable moment for the company due to acceleration of inventory monetization and as a result cash generation, has led us to increase our position during the company's capital increase.

**Energisa:**

Energisa's main highlight in the second half of 2016 was the realization of its re-IPO which raised approximately R\$1.5 billion. As a result, the company was able to reduce its consolidated leverage from 4.2x net debt/EBITDA to 3.3x, strengthening its capital structure. This will allow investments in its concessions to be intensified, which will undergo a tariff review in 2017 and 2018. This should help sustain growth in its future results.

In 2016 the company has already intensified its investment pace ahead of the tariff revision. During 9M16 the company invested R\$947 million in assets, a 16.7% increase in relation to 9M15. Analyzing only the concessions they acquired through the purchase of Rede Group, which were under-invested, investments increased by 25.9% when compared to 2015.

It is also worth mentioning that the company has continually improved its operational indicators, especially in the companies that it acquired from the Rede Group, which was under chapter 11. Quality indicators showed significant improvement in the Northeastern, Mato Grosso and Tocantins concessions, enabling Energisa to reach its highest levels ever of operational indicators in the states of Sergipe, Paraíba and Mato Grosso. In addition to the quality indicators, there was a strong reduction of 13.6% in operational expenses of Rede Group's concessions.

We expect to see further efforts by the company over the coming quarters, to reduce energy loss as the remaining tariff revisions occur.

**Par Corretora:**

In line with our initial investment thesis, the increase in penetration per transaction in Caixa Econômica Federal (CEF)'s client base has been more than enough to enable PAR Corretora to de-couple from the wider Brazilian economy and continue to grow significantly. Par increased its net income from R\$9 million in 2011 to more than R\$150 million in 2016<sup>15</sup> (75% CAGR p.a.)

In the first three quarters of 2016, the company grew its revenue by 6.9% and profits by 14.0%, an excellent result considering some factors that negatively impacted the company such as: i.) a bank strike during the 3<sup>rd</sup> Quarter, which caused CEF to have 28% less business days with open branches (where PAR sells its main products, especially life insurance), ii.) sharp drop in housing loan growth rates, mainly due to the increase in interest rates, low savings and consumer confidence, which directly impacted brokerage commissions received by PAR, and iii.) delays in the implementation of a few relevant projects in lending products that have been postponed to 2017.

Looking at 2017 and beyond, the scenario should be even better, thanks to the expectation of a drop in interest rate levels and the improvement of the Brazilian economy, which should boost banking activity and, in turn, increase insurance sales at CEF branches. We believe that PAR will continue to grow significantly due to its high cash generation and low investment requirements while paying high dividends.

**Hypermarcas:**

2016 was an important year for Hypermarcas for consolidating its strategic positioning. The board decided that Hypermarcas should focus on the pharmaceutical business and that other business

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<sup>15</sup> HIX Capital estimate.

units would be sold. In 2016, the consumer products business was sold to Coty, while Reckitt Benckiser acquired the condom business. Ontem acquired the diapers unit, concluding the divestment program. Sales amounted to R\$5.5 billion, which represents more than 30% of the company's market value and less than 15% of its EBITDA, evidencing the value created for its shareholders. As a result, the company will have a net cash position of R\$1.7 billion (compared to net debt of R\$2.2 billion in 2015), which should be partly returned to shareholders.

We expect Hypermarcas to be even more focused on the coming years to continue gaining market share and consolidating itself as one of the leading companies in the pharma sector in Brazil. We believe they will be able to grow and gain share in the coming years, through the launch of new products, stronger entry into major retailers, expansion of the pharmaceutical industry and an aging population. In our opinion, this growth will be very valuable, given Hypermarcas' high ROIC (30% excluding goodwill) and the low need for incremental investments in the coming years. Best part of this cash generation should be returned to the shareholders through the repurchase of shares and dividends.

### **BR Properties:**

In December 2016, the company disclosed a material fact communicating the acquisition of the Passeio Corporate building complex in Rio de Janeiro. Negotiations had already been advancing since August, but some conditions were still pending.

The transaction value was R\$715 million, being approximately R\$300 million in cash and the remaining paid over twelve years. The development is a triple A (AAA) complex located in the center of Rio de Janeiro and has 77,000m<sup>2</sup> of office GLA, as well as an additional 6,000m<sup>2</sup> in retail GLA on the ground floor. The acquisition value (without installment adjustments) is around R\$8,600 / m<sup>2</sup>. Whilst on one hand the leasing market in Rio de Janeiro still suffers from a local economy highly correlated with the oil and gas industry, the value paid for the complex seems extremely attractive attaining a good safety margin. When comparing the amount paid versus the replacement cost, we see a 40% discount, especially when the replacement itself is not always possible due to geographical limitations in the city. In addition, Triple A offerings in the center of Rio de Janeiro are limited, and companies often occupy older and worse quality buildings. Thus, we believe that although the lease-up of this asset will be gradual and will occur in the coming years, given the quality of the project and the acquisition price, it should be a good investment for the company.

### **Itaú Unibanco:**

On October 2016, Itaú acquired the retail operation of Citibank Brasil for R\$710 million. In addition to loan, deposit, credit card, asset management and insurance brokerage operations, the transaction also includes: i.) 315 thousand account holders, ii.) R\$35 billion between deposits and assets under management, iii.) 1.1 million credit cards, and iv.) R\$6 billion credit portfolio. Although small (0.3% of Itaú's market cap), the transaction is consistent with the bank's strategy of using excess capital in the acquisition of strategic assets. Also, in November the bank announced its new executive committee, in line with the planned transition process. Roberto Setubal will leave the position of CEO and hereon share the presidency of the Board of Directors with Pedro Moreira Salles. Candido Bracher will take over as new president in 2017. The changes had been designed and planned over the last few years, and signals a smooth transition.

## Rumo:

2016 was an uncommon year in terms of volume for Rumo, but very good in terms of execution of their Business Plan. In relation to volumes, there was a concentration in Soybean exports during April, whilst the loss of the second corn harvest prevented Rumo from operating at 100% of its transportation capacity. On the other hand, the company managed to offset part of these effects with the increase in sugar transport and the extension of the corn harvest to the 1<sup>st</sup> Quarter, causing the volume of the Northern operation (90% of the company's EBITDA) to be practically stable in relation to 2015.

Despite recent setbacks, the company invested around R\$1.9 billion in 2016, with R\$1.2 billion dedicated towards expansion. These investments were concentrated in the acquisition of 65 locomotives (43 for the Northern Operation), 925 wagons (all of them for the Northern Operation) and the revitalization of 472 km of track (73 km in the Northern Operation). As a result, the company was able to increase its average transport capacity by 10% and reduce fuel consumption by 6% (nominal). With the capacity gains the company has been delivering and with the normalization of grain shipments, the volume of the Northern Operation has the potential to grow between 25% to 30% in 2017.

Another relevant fact for the company came on the legislative side related to MP 752 (transport concessions MP), a provisional measure seeking to facilitate new investments in existing transport concessions. This brought positive signs for the renovation of the Paulista network. We hope that the renewal of this concession will be realized in 2017.

## Alupar:

As with Equatorial, Alupar's main highlight during the semester was its successful participation in the transmission auction held in October 2016. On that occasion, the company secured three lots located in the regions of Bahia, Minas Gerais and Espírito Santo, scheduled to begin in 2021/2022. Of these lots, two were won through Alupar's holding alongside Perfin Investimentos (Perfin acting as a financial investor) and the third was won through TBE, a company in which Alupar and Taesa (a large transmission company) are partners.

Altogether, Alupar contracted an additional ARR (Auction Revenue Right) of R\$304 million, with planned investments by Aneel at R\$1.6 billion. The company was able to develop engineering solutions capable of reducing the investments required for each project by up to 20%, allowing the projects to represent and implicit real return on equity rate of 18% p.a. (in the lot won by TBE the returns are closer to 20% p.a.)

Lot	Partner	Location	Alupar Part.	ARR (mm)	Discount	Investment - Aneel (mm)
2	Perfin	Bahia / Minas Gerais	70%	217.7	18.9%	1269
6	Perfin	Minas Gerais / Espírito Santo	70%	146.0	0.0%	698.8
22	Taesa	Espírito Santo	51%	101.0	0.0%	485.8
Total				461.7	9.7%	2454
Total (Weighed by Alupar's %)				304.0	10.3%	1625.2

Additionally, Alupar also won a transmission auction in Colombia, with approximately USD22.5 million in ARR, expected to start in 2021 with an expected investment of USD130 million. In addition to achieving optimal financing conditions, it will be possible to centralize part of the line's operation with a SHP (small hydroelectric plant) owned by Alupar in Colombia, Risaralda. Thus, the company expects to achieve real returns on equity of 18% p.a. in USD.

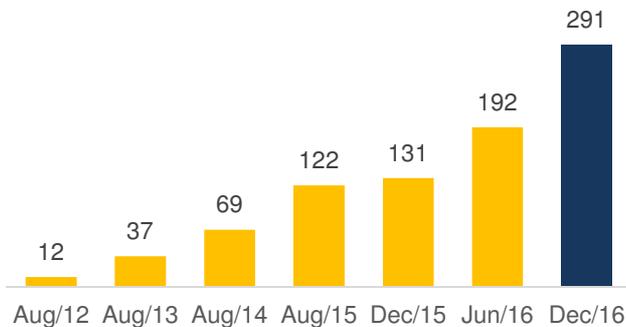
Another highlight of the semester was the sale of its stake in Transchile for USD58.9 million to Ferrovial S.A. The sale of the asset served to strengthen the company’s capital structure.

In 2017, transmission auctions require estimated investments of R\$26.5 billion. We believe that this new cycle of intense investments in energy transmission together with the Alupar’s know-how in the analysis and implementation of projects will present an interesting growth opportunity.

**HIX CAPITAL UPDATE:**

In spite of the challenging scenarios during the recent years, HIX Capital was able to once again achieve significant growth of its Assets Under Management (Total AUM). We finished the year with a little under R\$300 million (roughly USD100 million) under management invested in equities, through open portfolio vehicles and co-investments.

**HIX Capital: AUM Evolution (R\$ million)**



During 2016, we launched the HIX Equities Fund, our exclusive vehicle for offshore investors which mirrors the HIX Capital FIA portfolio. The vehicle currently manages USD20 million and we are looking to grow this vehicle steadily over the coming months and years. We have been steadily engaging potential investors abroad, and are excited with the funds potential.

In the local market, both the HIX Institucional FIA and the HIX Capital FIA grew significantly, whilst redemptions were almost nonexistent. The stability of our investor base leaves us satisfied and comfortable to continue investing with long-term vision.

From a team standpoint, our team is comprised of 9 professionals, working together in a very productive way. Since our inception, we have been focused on creating a culture of excellence in processes, controls and investments, and are happy with the steady progress we have made.

The new Back Office system we deployed in the first half of 2016 has allowed us to improve internal controls, information and compliance, and we will continue preparing ourselves to growth in a safe and secure manner. Positive results are only worth celebrating if they are accompanied by merit and the appropriate processes, which we are constantly searching for.

We remain excited with HIX’s growth prospects and confident with the team’s ability to continue growing and finding good investment opportunities.

We appreciate your trust,

HIX Capital Team