JBI JARDIM BOTÂNICO INVESTIMENTOS

JBI Focus Letter #13

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MEASURING GOVERNANCE

Since the launch of our equities strategy in 2005, we have emphasized the relevance of corporate governance analysis when selecting new investments. Now that our strategy is completing 8 years, we believe it is possible to establish whether this variable contributed to the performance of our portfolio and, more importantly, to the preservation of our investors´ capital.

An important part of our analysis process consists of eliminating from our investment universe companies we believe do not follow corporate practices adequate and aligned with us as minority shareholders. But what exactly do we mean by that? Basically, we know that as minority shareholders we will not, in principle, be able to influence the controlling shareholders of the companies we invest in. Therefore, we must protect ourselves by making sure minimum levels of transparency and alignment of interests are observed by all companies we could potentially invest in.

This analysis takes place in a very structured manner, with companies receiving grades according to a set of criteria pre-established by our investment team. As we pointed out in past letters, state-owned companies are eliminated in this process given the intrinsic misalignment that results from their own legal nature: public and economic interests not necessarily converge, a fact that may result in substantial value loss for shareholders.

We also take a deep look to the track record of controlling shareholders and managers, taking into account related parties transactions, remuneration policies, as well as the existence of formal complaints from minority shareholders to the Brazilian regulator (CVM), amongst other variables. By following this process, our main intention is to preserve our investments by avoiding unpleasant surprises in the future.

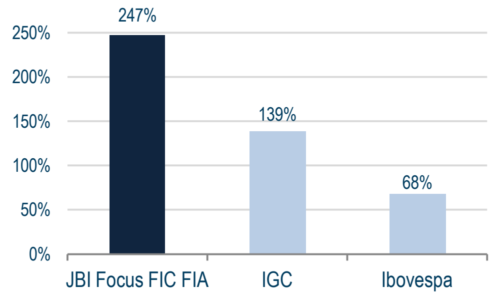
But how to know if we are doing the right thing?

Fortunately, we were not the first ones to believe that better corporate governance practices could create value in the long term. In Brazil, this discussion started to gain shape in the 2000s, when Bovespa launched special listing segments for those companies willing to commit to additional governance practices than those required by law. Later, the Corporate Governance index (IGC) was created, putting together in a single portfolio all companies integrating one of those segments (Level 1, Level 2 and 'Novo Mercado')

Hence, the IGC performance can be seen as a first proxy of the eventual value generated by good corporate governance. In fact, if we take into account the index performance from its launch in June 2001 until August 2013, it generated a return of 642% in BRL terms compared to a 244% return of the Ibovespa, certainly a considerable difference.

If we limit the period under analysis to the existence of our fund (from September 2005 until August 2013), this outperformance remains with the IGC returning 139% and the Ibovespa 68% (see Table 1 below). During the same period, our portfolio was up 247%, what we consider to be the result of a stricter governance filter combined with the successful selection of stocks.

Table 1: Cumulative Returns
16.Sep.2005 to 30.Aug.2013



Despite of being a notable initiative, the IGC has a limited scope since it consists of incorporating into a theoretical portfolio a group of companies based solely on their listing segments. This is obviously an important step, as to be admitted to those segments companies must commit to minimum requirements, such as keeping a free float of at least 25%, conceding tag along rights of 80% to 100% (Level 2) and the monthly disclosure of trades with the company's shares by the controlling shareholder.

Nonetheless, in our view, the mere fact of integrating one of those special levels is not sufficient for a company to be included in our investment universe. Similarly, we could also invest in companies not admitted to any of those segments, as long as we feel comfortable with our analysis, not only from a corporate governance perspective, but especially considering the investment case as a whole. We follow a more detailed process, taking into account additional features, such as a company's remuneration policy, together with a mainly subjective evaluation, largely favoured by JBI partners' considerable experience in the field.

In any case, we believe the best way of evaluating our strategy's performance is based on the analysis of different investment periods. After all, it is not enough to generate good returns in a limited period; one has to be consistent in the long term. That is why we suggest our clients to analyze our track record over windows of at least 5 years, a period we consider to be sufficient for the strategy to demonstrate its consistency and which tends to incorporate the market's highs and lows.

Following this process, we have elaborated the table below:

Table 2: Cumulative Returns
Rolling 5-year investment windows

	JBI Focus FIC FIA	IGC	Ibovespa
Average return	113%	46%	35%
Best return	201%	156%	148%
Worst return	64%	1%	-30%
Positive windows	100%	100%	69%

Table 2 shows us that an investment in our flagship fund in the worst moment of the past 8 years, that is to say, in July 2007, would still have had a positive return of 64% over 5 years (in BRL terms), despite the 2008 crisis. An investment in the IGC over the same period, on the other hand, would be practically flat, while investing in the Ibovespa would have resulted in a loss of -7%, having reached -30% on this index worst window.

Even though if this is not a formal analysis of how much value is added by better corporate governance practices, we see it as a good indicator. The Ibovespa obviously has its own deficiencies and is having its methodology altered, but it is in any way the most followed index of the Brazilian market. Likewise, the IGC, even if with limitations, allows for a better perception of how companies that commit to additional standards of governance in the treatment of minority shareholders differentiate themselves in terms of their stocks' returns.

Although we do not take into account the composition of any of the referred indices at any stage of our analysis process, they still represent interesting parameters of comparison for this exercise of trying to determine the value created by better governance. Based on this quick analysis, we can see that, in Brazil, this was certainly an important variable over the past few years. In our case, the meticulous examination of the governance aspect coupled with the construction of a solid portfolio not only allowed us to succeed in our main objective of preserving capital throughout different market cycles, but it has also resulted in the generation of excess returns in relation to the main Brazilian indices.

**Past performance is not a guide or otherwise indicative of future returns. Before making any investments, each prospective investor should carefully read the fund prospectus. Please refer to the full disclaimer on the last page.*

INVESTMENT CASE – MULTIPLAN

Multiplan develops, owns and operates shopping centers in Brazil. It also undertakes and develops offices and residential buildings adjacent to malls, which allows for synergies through an increase in the flow of people. The company owns 17 high quality shopping centers with over 4,600 stores and has 700k sqm of gross leasable area, the second largest in the country.

The sector has some characteristics we like: resilient revenues with high and predictable margins. On recent years, average sales growth in malls has outpaced the growth in overall retail sales (17.5% vs. 10.7%). As a consequence, penetration of retail sales on malls has grown from 18% in 2006 to 25% in 2012. In the US and Mexico mall sales penetration reaches of 54% and 53%, respectively. We believe that this trend should continue even in a scenario of lower growth and higher inflation. Customers are increasingly looking for safety and convenience when shopping. Furthermore, there still is a strong demand for new areas in shopping malls coming from the international expansion of foreign brands and growth plans of local ones. GAP and Forever 21 recently announced they will start operations in the country and both chose Multiplan's Morumbi Shopping in São Paulo to open their first shops. In terms of predictability and business resilience, leases are usually agreed for a 5-year term, indexed to inflation and with penalties for early termination.

Due to its premium assets, solid business relationships, brand recognition and expertise in managing the tenant mix, the company is able to attract more clients than any other in the sector. Multiplan has a defensive portfolio and an interesting pipeline. Over the last five years, the company has reported an annual average increase of lease revenues (considering same stores) 400 bps above inflation. Among the listed companies in the sector, it has the highest minimum fixed lease rate and the lowest percentage of revenues linked to tenants' total sales, meaning the company is less exposed to sales volatility. Almost 60% of its revenues come from store leases, of which 90% derive from fixed lease rates and 10% are divided between complementary rent and merchandising.

We began investing in Multiplan in March, when the company raised R$ 600 million in a follow-on offer. The money will be used in new shopping centers and commercial towers (50%), expansion of existing malls (30%) and development of projects for sale (20%). The company plans to open one new mall in 2013, and already announced an additional opening for 2016, with four more to be announced in 2014/15. Furthermore, there is also a 150k sqm potential expansion in existing malls and a land bank of 631k sqm for real estate projects.

Within the listed companies in its sector, Multiplan has the best financial indicators when we take into account, for example, rent revenue (p.a.) /sqm (R$ 1.2k vs. R$ 0.9k), EBITDA (p.a.) /sqm (R$ 1.3k vs. R$ 1.0k) and FFO[1] (p.a.) /sqm (R$ 1.1k vs. R$ 0.6k).

[1] *Funds From Operations:* cash generation measurement, calculated by summing net profit, depreciation and amortization.

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