



JARDIM BOTÂNICO INVESTIMENTOS

## **JBI FOCUS LETTER #9**

May 2012

## INDEX

<b>PORTFOLIO HIGHLIGHTS.....</b>	<b>3</b>
I. ODONTOPREV .....	3
II. CYRELA .....	4

## PORTFOLIO HIGHLIGHTS

### I. Odontoprev

Odontoprev is the largest dental benefits company in Brazil. We invested in the company in 2008, based on four characteristics crucial to any investment:

1. Sound business: high growth potential – only 20% of the Brazilian population had health insurance by the end of 2007 and, among them, only 23% had dental insurance. With disposable income growing, the search for dental insurance increased 20% per year between 2002-07. In addition, the business is not capital intensive;
2. Efficient administration: the company, founded by a dentist, created an efficient system for pricing and controls of recoverable events.
3. Alignment of interests: among shareholders and managers - the company has a large shareholder base and is listed in Novo Mercado<sup>1</sup>. Key executives receive part of their remuneration through stocks;
4. Discounted price to intrinsic business value: our model showed a 40% price discount.

Between 2007 and 2011, the dental insurance market grew at a rate of 17.5% annually, reaching a 35% of health plan coverage. In the same period, the number of dental plan members of Odontoprev grew 27% annually.

In 2009, the company signed a partnership agreement with Bradesco Dental, increasing its market share from 22% to 33%. This deal virtually eliminated one of the biggest risks we perceived

on the investment: fierce competition coming from major health groups that could afford to "buy market share" by aggressively lowering their prices at the expense of profitability. With the partnership, the company is now four times larger than its main competitor, with 5.6 million members (a number equivalent to the sum of its seven largest competitors).

The company has been working very efficiently to take advantage of this partnership. Since mid-2011, we can see some of the results: dilution of costs and administrative expenses and growth in small/medium enterprises as well as for individuals. Dental plans are currently sold in all of Bradesco's branches where Odontoprev has a list of accredited dentists. Results have been impressive: company's revenue grew 20% in 2011 with EBITDA expanding 48% and EBITDA margin rising 440 basis points to 22.7%. Their operational performance has reflected on its stock price which rose 476% since the bottom of the 2008 crisis (in October) until the end of 2011 against a 53% return of the Bovespa index.

In mid-2011 we decided to reduce the position from 6% to 4% in our portfolios. With an additional 10% increase in price last January we decided to sell the entire position.

Odontoprev represents the second largest historical contribution to the fund. Even though it still meets three out of four investment characteristics we look for in our investments (sound business, efficient management and alignment of interests), there was no longer margin of safety (discount *price x value*) to justify the position. The company remains on our radar

<sup>1</sup> A listing segment designed for shares issued by companies that voluntarily abide to corporate governance practices and transparency requirements in addition to those already requested by Brazilian Law and CVM (Brazilian Securities and Exchange Commission).

for possible future investments depending on price and evolution of fundamentals

## II. Cyrela

The real estate sector grew rapidly in the past few years in Brazil, fueled by a high housing deficit (6 million units), as well as an increase in income and credit availability. Since 2006 several companies in the sector raised funds through public offerings, which led to a sharp growth in developments. Most companies aimed on diversifying geographically and on offering products which covered all income segments. The lower income segment was helped by government incentives and subsidies, through the federal housing program “Minha Casa, Minha Vida”. However, by the end of 2010, we began to identify signs that growth had occurred in a disorderly manner without proper controls.

Since the industry is regional, many companies partnered with local developers. As the need for workforce was faster than their capacity to train and transfer labor to other regions, companies began to outsource. With aggressive growth guidance, companies did not undertake the necessary due diligence before forming partnerships. Poor supervision of the work in progress, especially these outsourced, resulted in actual costs much higher than projected, leading to losses and margins squeeze. This led companies to review their partnerships (ending some of them), and to reduce outsourcing, focusing in markets where their presence was already established. They also reviewed and improved their internal processes and systems, focusing on slower, but more careful growth (with a smaller number of construction projects).

Cyrela, one of the sector's leaders, was the first to recognize these problems and to take actions,

while other companies overlooked these budget overruns. Cyrela's gross margin went down from 34.5% in 2009 to 31.4% in 2010 (most overruns were recognized in the 4Q10 with a 24.5% gross margin) reaching 28.3% in 2011. Due to the specifics of accounting for this industry, sales revenues are recognized overtime, as construction costs are being incurred. Since construction cycles are long, there are still unrealized negative results from projects with budget overruns (representing 30% of total projects) that will be recognized throughout 2012, but with much lower impact on results. Thus, the company expects its gross margin to reach 30% to 34%, with room for a greater recovery in 2013. It is also noteworthy that throughout 2011 there was QoQ improvement in margins (gross, EBITDA and net margins).

We started to invest in Cyrela in January 2011. In 2H10, the market had questioned the company's guidance for new projects. At the same time it announced revisions on budgets to adjust according to actual costs. The price premium Cyrela traded over its peers ceased to exist. We set up an initial position of 3%. As confidence on our investment thesis increased, due to progressively better results, and taking advantage of the drop in share price (down 22% in a single month), we gradually increased our participation, reaching 8% of the portfolio.

While most real estate companies should continue to show margins squeeze and cash burn in 2012, we expect Cyrela to continue to provide margin recovery and cash generation. The stock is trading below 1.0x Price to Liquidation Value (P/LV) with 45% of the Liquidation Value consisting of cash and receivables from projects that have already been concluded.

## DISCLAIMERS

\*The offer and sale of shares of the Funds in certain jurisdictions may be restricted by law. Access to this document or use of the services or information provided herein is prohibited by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law, rule or regulation. \* This document is not destined to investors with residence in Brazil. The Offshore Funds may not be offered, sold, redeemed or transferred in Brazil. \* Participating shares of the Fund may not be sold, transferred or delivered to any person, corporation or other entity that is deemed to be a resident of The Cayman Islands or Brazil. The Funds are not listed on the Cayman Islands Stock Exchange and are accordingly prohibited from making an invitation to the public in the Cayman Islands. \* No registration statement has been filed with the United States Securities and Exchange Commission or any State Securities Authority with respect to the offering of shares in the Funds. \* The shares in the Funds have not been and will not be registered under the United States Securities Act of 1933, as amended (the "Act"). \* Shares in the JBI Focus Brazil Fund Ltd. may only be offered, sold or otherwise transferred directly or indirectly to any United States citizen or resident or to any corporation, partnership, trust or other entity chartered or organized under the laws of any jurisdiction in the United States of America, its territories or possessions in private placements exempt from registration pursuant to regulation D of the Act. \* Shares in the JBI Focus Brazil Fund Ltd. may not be offered or sold within the United States or to any US Person. \* "Public" for these purposes does not include any exempted or ordinary non-resident company registered under the Companies Law or a foreign company registered pursuant to Part IX of the Companies Law or any such company acting as general partner of a partnership registered pursuant to section 9(1) of the Exempted Limited Partnership Law or any director or officer of the same acting in such capacity or the trustee of any trust registered or capable of registration pursuant to section 70 of the Trusts Law. \* Past performance does not guarantee future results. Before subscribing for the shares, each prospective investor should carefully read and retain the Fund Prospectus and Regulation. \* This document is published exclusively for the purpose of providing information and conferring transparency to the management carried out by Jardim Botânico Partners Investimentos Ltd. (JBI), is not the Offering Memorandum of JBI Focus Brazil Fund Ltd. and is not to be considered as an offer for the sale of Shares of the Fund or of any other security. \* Before subscribing for the shares, each prospective investor should (i) carefully read and retain the Offering Memorandum of the Funds and the relevant Supplement or Annex in respect of the portfolio and/or class of shares; (ii) consult with his/her/its own counsel and advisors as to all legal, tax, regulatory, financial and related matters concerning an investment in the Funds. \* JBI takes no responsibility for the accidental publication of incorrect information, nor for investment decisions taken based on this material. \* This is a preliminary document and certain aspects of the information contained herein may change as a result of discussions with potential qualified investors. \* Este documento não se destina a investidores residentes no Brasil. \* As cotas do JBI Focus Brazil Fund Ltd. não são registradas na CVM e não podem ser oferecidas, distribuídas, resgatadas ou transferidas no Brasil.