Tarpon GT Public Equities: the relaunch in context

Public equities investing was Tarpon's focus during our first ten years of existence. From 2002 to 2012 we made over 40 investments and delivered an absolute annualized return of 31% vs 18% of the Ibovespa index.

However, in the past five years, with the launch of the Tarpon Partners in 2012 (a new hybrid fund that had the same public portfolio as its other vehicles but with the flexibility to invest up to 75% of its AUM in illiquid equity investments), Tarpon started to focus most of our human and financial resources in Owning & Operating (O&O) businesses.

But despite our increased focus on value creation initiatives as opposed to active portfolio management, in the past years, we have continued to come across attractive investment opportunities that we could have taken advantage of, with a less hands-on approach and on a more liquid type of investment, similarly to what we did in our early days.

As a result, and given our strong belief that this activity is very fertile to generate returns, we have taken the step to build a dedicated team and investment vehicle to focus on investing in public equities, with the same traits, strategy and DNA as Tarpon has always invested.

As we believe the opportunity set for this kind of investment combines a very fertile hunting ground with an appropriate timing of entry, such as the worst recession of the past century in Brazil, we decided to relaunch the public equities focused strategy and recommit specific resources (talents and proprietary capital) to this effort, giving birth to Tarpon GT Public Equities, last September.

The main purpose of this relaunch is to offer our investors a portfolio consisting of the most attractive risk/reward assets that one could find, capable of generating alpha in whichever macroeconomic scenario Brazil faces. Therefore, we are constructive with the strong alpha we were able to deliver since the relaunch (23%[1] since November 17, 2016), but more important than short-term result is consistency, which comes from solid investment strategy and process. Our team is aware of how challenging it is to continue to deliver alpha consistently – we do not underestimate this task – but we have reasons to believe that our investment process and philosophy is well suited to do so in the long-term, as it has proved so in the past.

As this is our first dedicated letter, we find appropriate to revisit our investment philosophy in public equities. The topic is broad and we do not have the ambition to exhaust it in only one letter.

Our Investment Philosophy

In the fifteen years of Tarpon´s history **we developed a coherent way of thinking about Brazilian markets**. We have invested in different economic cycles and had our philosophy enriched by the challenges presented by such a volatile financial and political environment. If on the one hand, we have a value approach, seeking for assets trading with relevant discount to intrinsic value and offering us a wide margin of safety. On the other hand, we carefully analyze the investment cycles and look for assets with growth opportunities and inflections points, what we believe is pivotal for successful investments in our country.

The first pillar of our philosophy is to identify **good assets trading at a relevant discount to intrinsic value**. Therefore, the base of our analysis is in-depth fundamental research and a recurring assessment of companies' specifics and industries' dynamics. This process will support the development of our independent estimate of intrinsic value.

For us the best way to reduce investment risk is to invest in companies with business models we can understand, with adequate capital structure and with management team, initiatives and incentives we deem appropriate. For this reason, our analysis must go way beyond the quantitative of the financial statements and that is why we believe that our **real economy background** and **long track record** come as a plus, while digging deeper in the main pillars of each investment opportunity.

Moreover, it is part of our philosophy a preference for **quality businesses**. Companies presenting resilient business models, above-average returns and growth potential are our focus by their capacity to generate value and compound returns over time. Additionally, we look for business with the ability to maintain their competitive advantages and, consequently, protect their long-term returns. Therefore, we believe that to be invested in good companies is also a differential considering the Brazilian high volatility scenario.

Generally, investors agree of what consists a quality business from a quantitative standpoint. One may claim that this consensus does not generate the necessary price asymmetry. Fortunately, markets are not that rational and we still can find undervalued quality companies. Behavioral finance helps explaining why.

Successful investors around the world and our past experience have proven that it is possible to profit from a contrarian mentality to the confirmation bias, which refers to when investors feel better when they are investing along with the crowd. Hence, a **Contrarian Approach** has always been a key pillar for us, and for that reason our research is mostly focused in the search for those investment opportunities that are not evident and that are generally overlooked by the market. We believe that an independent view and a portfolio with low overlap with other investors are essential ingredients for long term consistent alpha generation, and has proved to be the case so far.

Another behavioral trait that leads to discounted stocks is the status-quo bias. Investors and analysts tend to expect that the current trends will persist and have difficult analyzing alternative scenarios. Then, if you add to it a bit of overconfidence bias, possible scenarios will be interpreted as certain scenarios. In one hand, when people think that stocks are going to do well, they overbuy those stocks. In the other hand, companies that are in worse shape, and might be facing trouble, are priced as if that trouble is certain and will last forever. These overreactions generate the kind of opportunities we like.

While price asymmetries may take time to correct, we believe that a **Long-Term Perspective** is essential to be able to take advantage of these opportunities. Investing with this perspective and having investors that share this view has helped us manage periods with high short-term volatility. It is true that investors and companies find in the long-term a good excuse for explaining short-term results. However, the long-term is compounded through successive short/mid-term results, and consistency over time is pivotal. In our view, investing with this perspective is a differential per se.

Aware of some value traps that our philosophy can generate, we try to mitigate this risk by looking for specific elements to support our belief that the convergence from market to intrinsic values could happen in a certain period of time. These **Inflection Points** have been elements that reinforced the investment thesis and have taken different shapes, such as: change in capital allocation strategy, change in management teams, initiatives, or incentives, asset sales and liquidity events, and earnings trend reversals. When present, the inflection point is another element that can serve as a potential guideline for changes in position sizing.

Finally, other differentiation element in our investment philosophy is the **Macro Consistency**. Through time, we learned how important it is to understand macro dynamics in Brazil. While our capital allocation decisions are driven from the bottom-up analysis, we also maintain a macro review as a guideline for the portfolio construction and sizing. By considering the macro background, we aim to ensure that we maintain sufficient diversification in the portfolio to handle potential developments in the future.

In summary, with the benefit of a coherent investment philosophy, tested in the last 15 years, helping us to navigate throughout different scenarios and an experienced team exclusively focused in public equities, we are enthusiast with the new beginning of the strategy at Tarpon. We hope that this letter brings clarity about our views and how we think about the markets.

Performance Update

The portfolio posted a positive 2%[1] return in the 2Q17 while the Ibovespa Index ended with a negative return of 3%. The strategy has continued to deliver a strong alpha in spite of the mid-May political event related to president Temer, returning 27% vs Ibovespa of 4% since the relaunch of the strategy.

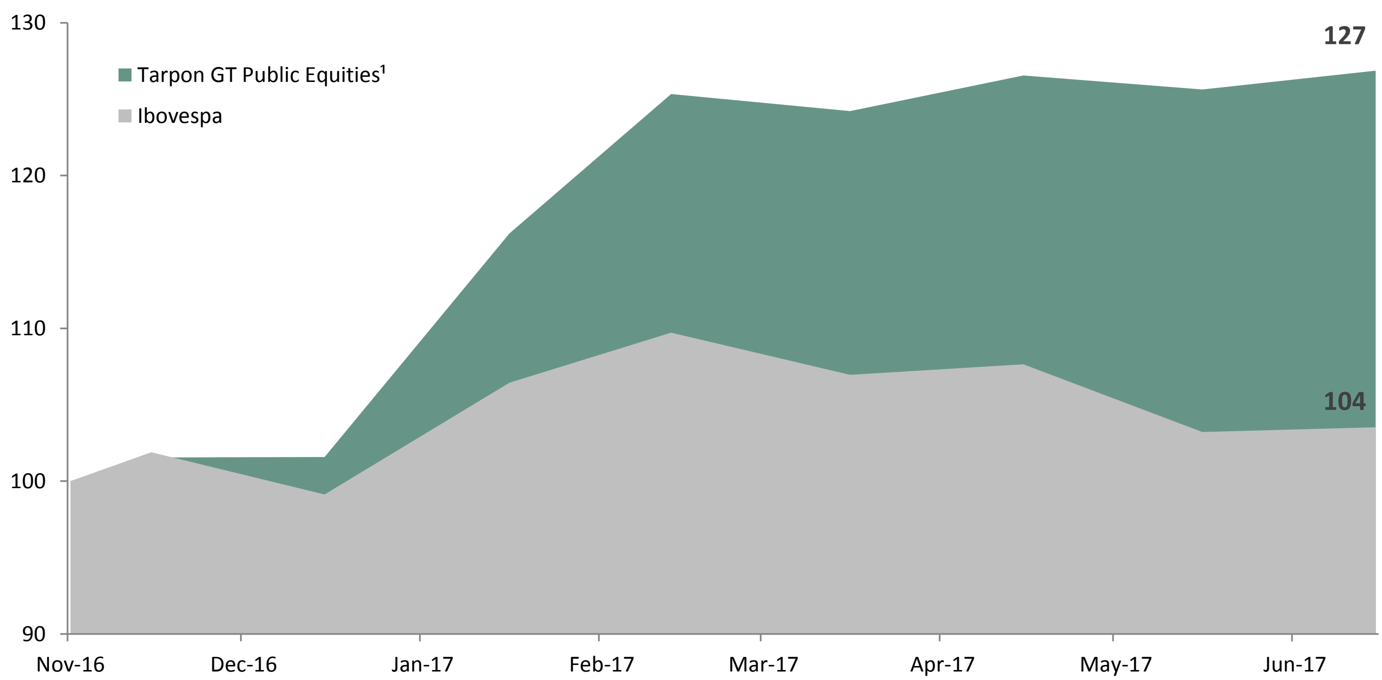
In the more volatile market that followed, the main portfolio holdings showed resilience, especially Tegma, which is our largest position, representing approximately 20% of the portfolio during the quarter. Tegma rose 19% in the quarter, benefiting from the release of supportive figures regarding the local auto demand, especially for light vehicles (sales were up 9,4% YoY in Q2 vs -1,1% in Q1). The growth of the Brazilian auto production was even higher, +24% YoY, benefited from a benign export market and a decrease in the sale of imported vehicles. In summary, the data reinforced our belief that Tegma´s investment thesis is on track and that the company is well positioned to generate returns in the portfolio going forward.

As for the portfolio in general, we continued to actively analyze investment opportunities on a relative and absolute basis, comparing current holdings not only among them but also against new opportunities. In this context, we added two new companies to the portfolio and divested from two other whose investment thesis had matured.

Sincerely,

Tarpon GT Public Equities
www.tarpon.com.br

Performance Since Relaunch



(1) Performance is net of proforma fees. The returns were calculated using the gross returns of the strategy, discounted by the average fees of the Tarpon GT Public Equities Fund (management fee of 1.25% per year and performance fee of 20% of the excess returns above the Ibovespa Index).