CVC

We would like to draw your attention to a stock we have been following for a few years, having reintroduced it into our portfolio at the beginning of 2016 and increased our holding in the past month. The stock is CVC (CVCB3), which recently became our main position.

CVC held its IPO in December 2013 and, since the start of this year, had “moved sideways”. This year, CVC’s exceptional operational performance was finally reflected in the company’s stock price, which is up 75% so far this year. It may seem counterintuitive for an investment group that normally looks for investments with a large margin of safety and which normally adopts a contrarian view to buy a stock that has performed so well in such a short space of time. However, despite this robust recent performance, we believe that the price of CVC stock does not yet reflect its intrinsic value or the company’s ability to consistently increase profits with a very high return on invested capital.

CVC possesses the characteristics that we most appreciate in our investments and which have been seen in all of our most successful cases throughout the years. As a financial asset, CVC is a mid-cap stock, until recently, had little liquidity, it was ignored by market players, which usually leads to pricing inefficiency. On the other hand, CVC is an absolute leader in its particular segment, enjoying massive competitive advantages that ensure its capacity to grow, gain market share over competitors and, at the same time, generate high returns for shareholders.

Competitive Advantages

We see CVC as a company that offers a rare combination of factors that enable it to maintain sustainable competitive advantages over its competitors in order to protect profitability over time - something Warren Buffet calls “economic moat”. In many cases, the factors behind a company’s competitive advantages, such as a successful product, current regulations or the price of a cyclical commodity, can be fragile and temporary. At CVC, we see several robust factors that are unlikely to be eroded, such as: **(i) brand** - CVC has an extremely strong and well-known brand that guarantees lower client acquisition costs compared to its competitors. This cost difference is quite apparent in the online environment. While travel agency and airline tickets websites usually spend around 5% to 6% of confirmed reservations on marketing and sales expenses (mainly on Google), CVC spends around 2%. This is because brand recognition means a high percentage of potential customers contact CVC directly through its website without the need for a Google search; **(ii) distribution** - CVC has the largest network of physical outlets in the travel agency industry, with 1,064 stores around Brazil, five times more than its nearest rival; and **(iii) scale** - CVC is the country’s biggest customer for airline operators and hotels, giving it a major cost advantage when it purchases airline tickets and hotel accommodation. CVC has been expanding its market share and currently accounts for 14% of the tourism and leisure sector, more than twice the share of its nearest rival, and a 29% share of the corporate sector (airline ticket consolidators), a figure nearly twice as much as its closest rival. It is interesting to note that both Decolar.com, which is in second place in the leisure sector, and Gapnet + Flytour, ranked second in the corporate sector, focus on selling airline tickets. As it concentrates on package tours, CVC has a scale that provides it with significant advantage over competitors when purchasing airline tickets, and an even bigger differential when it buys hotel accommodation, a highly granular market in Brazil. This difference in scale when purchasing accommodation guarantees a major advantage for its package tours offerings, the company's biggest seller. Package tours are sold as part of a product and service bundling strategy, allowing CVC to remain relatively protected from intense competition in the airline ticket and hotel accommodation sales businesses, caused by the high level of price transparency in both areas.

Management

Our view of CVC's management team has matured since we began following the company after its 2013 IPO. At first, we were worried about the alignment of C-suite management interests, the CEO's short time in the role and the company's structural transformations prior to the IPO. Furthermore, we had some fairly negative memories of CEO Luiz Falco's tenure at Telemar. Over the last few years, we have observed top management's approach in several areas, such as M&A, acquisition integration, operational efficiency, sales and staff motivation. The bottom line is that under CEO Luiz Falco's leadership, management has done an excellent job not only in converting their competitive differentials into profits for its shareholders, but also in enhancing and expanding these differentials, paving the way to a long-lasting period of high performance. Today, we believe the company's management team has become a group of industry veterans, with complementary abilities and (commercial, operational, strategic) characteristics, who are integrated and highly motivated.

Trial by Fire

Our confidence in our CVC investment has increased because of its performance over the past two years, when the company successfully battled against very strong "headwinds" in the macroeconomic environment. Because of its dependence on discretionary spending, the tourism and leisure sector is likely to be one of those most affected by the substantial devaluation of the Brazilian Real, rising unemployment and a decline in the Brazilian incomes. This indeed occurred. The industry has seen a substantial decline in volumes over the past 2 years, mainly in the corporate and online markets - the online channel is likely to see volumes fall 20% in 2016, hotel occupation fell from 60% to 52% and the aviation industry shrank 6% this year. Several companies within this environment faced severe financial

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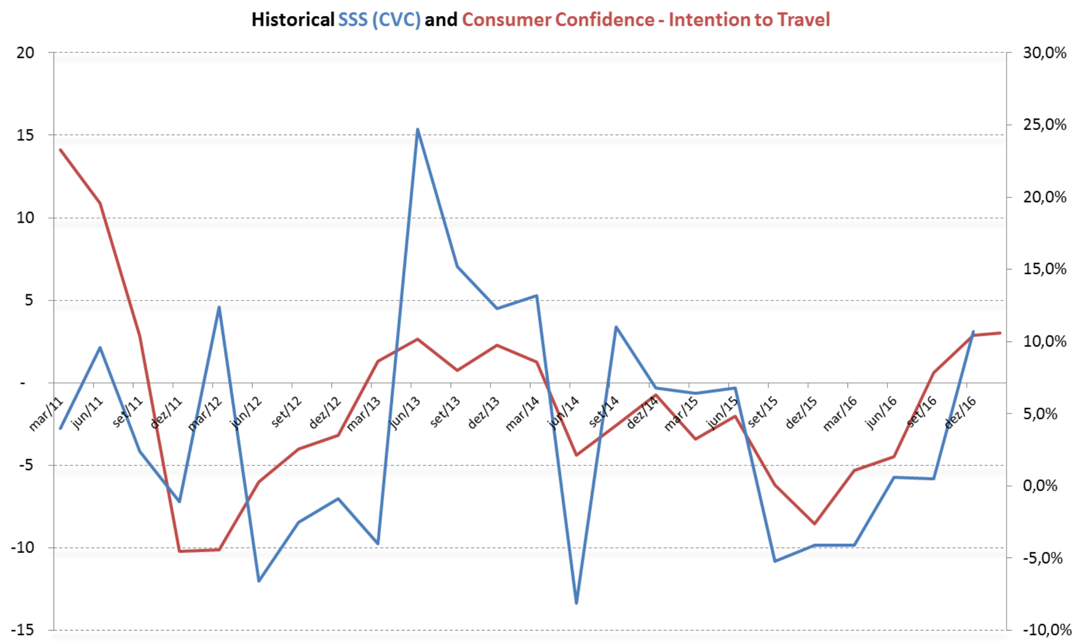
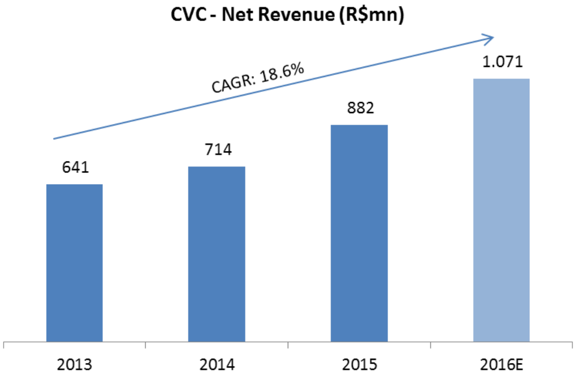
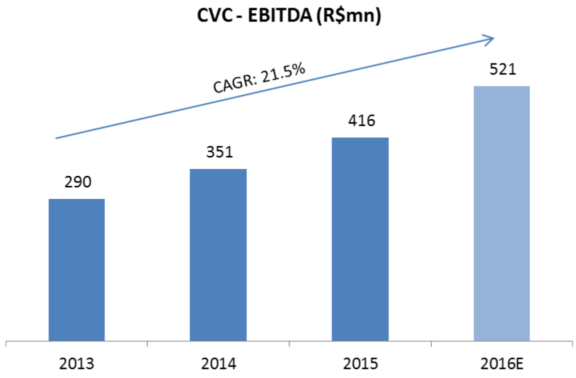
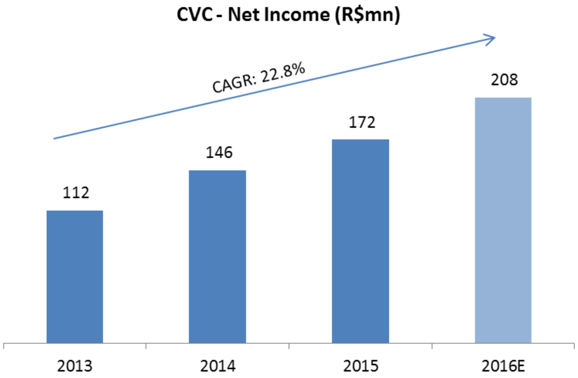
difficulties and some, such as Nascimento, Marsans, Web Viagens and Designer Tours, did not survive. In this challenging environment, the company's competitive differentials and management were of particular note. In the M&A area, CVC acquired Submarino Viagens and Rextur Advance, giving CVC access to the business travel sector, doubling its addressable market. CVC quickly and efficiently integrated these operations, which meant it was able to capture cost synergies and create new revenue opportunities via cross-selling (example: selling hotel accommodation to the corporate sector). Despite the extremely hostile market, their store network grew 25%, from 851 (September/2014) to 1,064 stores (September/2016) and will likely end 2016 with a 2% increase in Same Store Sales (SSS). Results from the recent Consumer Survey - Travel Intent (Ministry of Tourism/FGV) - present a high correlation with CVC's SSS, indicating a potential upturn for this indicator in the last quarter of 2016, shown in the following graph.



The company has come through this challenging period stronger than its competitors and has increased its market share from 12% to 14%, while simultaneously reporting net profits and EBITDA increases of 42% and 48%, respectively.







Among the Bovespa-listed companies that are exposed to the discretionary consumer goods and services sector, CVC was the only company in the past 5 years to maintain profitability as a return on invested capital (ROIC) above 40%, or better. At the peak of Brazilian consumer euphoria in 2011, most discretionary consumer goods and services companies enjoyed extraordinary profitability. A group of companies that had less capital-intensive (asset light) distribution structures, using either a franchise or direct sales model, reported ROIC above 40%, while other companies that had a greater proportion of fixed capital invested in their operations, based on a self-distribution model, reported lower ROIC levels of around 20%. Cyclical demand variations usually have an accentuated effect on operational profitability at companies that adopt the asset light model. In practice, events in 2011 saw profits plummet at companies operating in discretionary spending segments that had adopted the asset light model. The big exception was CVC. Because of its competitive differentials and impeccable execution, it showed massive resilience during an economic cycle that significantly reduced demand of its services and posed a challenge to its asset light business model.

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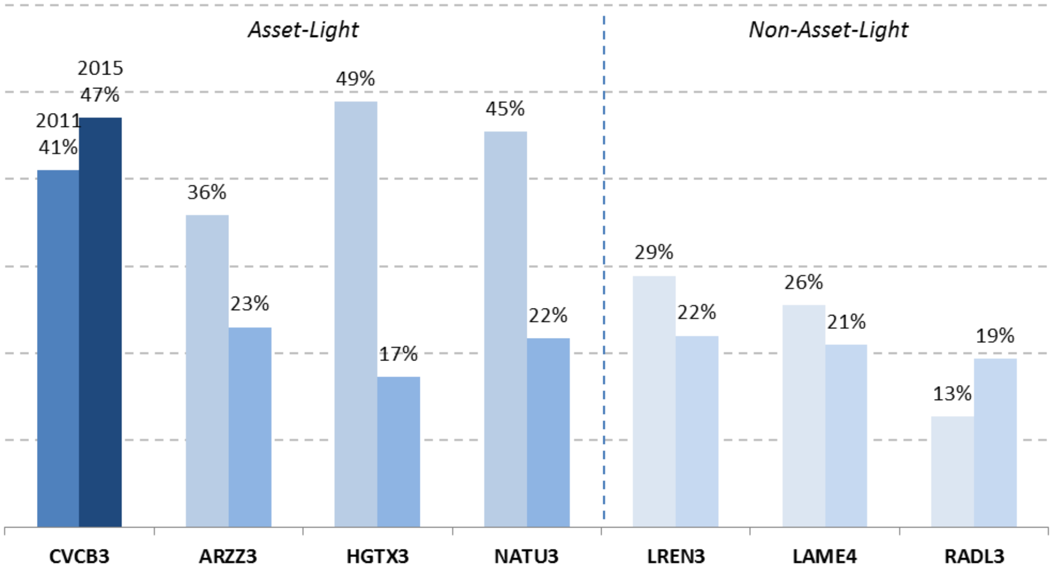
ROIC Evolution (2011 - 2015)



Current stock price / Margin of Safety

Despite CVC's significant growth potential, its resilient business model and the ability to consistently produce high returns on invested capital, CVC stock is trading at low multiples (12x P/E 2017; 5.8x EV/EBITDA 2017), which is comparable to multiples of companies that, in our opinion, do not have the same mix of management quality, sustainable competitive advantages and profit growth potential. We believe that a P/E multiple between 15x and 18x would better reflect CVC's quality and potential to generate results.

Valuation Comps	P/E 2016E	P/E 2017E	EV/EBITDA 2016E	EV/EBITDA 2017E	CAGR (2013-2016E) Revenue	EBITDA	Net Income
CVCB3	15,6x	12,0x	6,6x	5,8x	18,6%	21,5%	22,8%
Peers - Brazilian Asset-Light Companies							
ARZZ3	17,6x	14,8x	11,4x	9,7x	7,9%	2,4%	2,1%
HGTX3	11,1x	10,9x	9,6x	8,8x	-2,7%	-18,0%	-10,1%
NATU3	28,5x	16,8x	9,1x	8,0x	4,5%	-5,9%	-24,9%
Peers - Brazilian Non-Asset-Light Companies							
LREN3	23,2x	19,3x	12,1x	10,3x	14,8%	17,1%	15,4%
LAME4	68,2x	35,3x	10,9x	9,6x	6,6%	15,1%	-13,0%
RADL3	37,6x	31,2x	19,5x	16,2x	21,7%	46,2%	67,3%
Peers - OTAS (Online Travel Agencies)							
Expedia	24,8x	18,5x	12,6x	10,2x	22,4%	29,7%	35,4%
Priceline.com	23,1x	19,9x	18,7x	16,0x	16,5%	17,1%	19,4%

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Why is CVC stock so cheap?

We attribute this low stock price to three key factors.

1- Until recently, a lack of stock liquidity held back many investors. This factor should quickly dissipate. By August 2016, the average daily trading volumes for CVC stock were roughly R$ 6 million/per day. After the secondary offering in August and the ensuing block sale in November, which resulted in Carlyle completely closing out its equity position in the company, the CVC free float increased from 31% to 91.5% and, as a result, stock liquidity has recently increased to approximately R$ 20 million/day. Now, a large number of foreign and local investors for whom CVC stock flew completely under the radar are now keeping a close eye on it.

2 - For some time, major concerns about the macroeconomic environment scared many investors away from stocks at companies exposed to the dynamic cycle of discretionary consumer goods and services. We believe that the forecasts of economic stability and CVC's resilient results during the recent cycle of economic deterioration should dispel any concerns over time.

3 - The risk of disruption from Internet expansion, which will affect travel agencies that have adopted a physical store distribution model. This is a topic that merits an extremely lengthy analysis and discussion, but that isn't our goal right now. We do not believe that this risk will completely disappear, ever. Like many other cases, where drawing parallels from other countries indicates a potential change in the industry's competitive dynamic (ex: Cielo), we believe that this risk perception will dog CVC indefinitely. However, we believe that the idiosyncrasies of the Brazilian market, such as the need to assist inexperienced Brazilian travelers and the reliance on credit, will continue to provide CVC with the opportunities it needs to maintain its service differentials and capture new customers in a competitive environment that has not been commoditized for many years. While the fear of a catastrophe recedes into the distant future, CVC is generating ever-better results and ever more cash for its stakeholders. For investors who buy CVC stocks at the right price and with a wide safety margin, this risk should not pose much of an obstacle to achieving solid returns over time...