aster capital

5th Letter to Investors

1H 2024

Agenda

1. Portfolio review

2. It is all about the earnings

Dear Investor,

In this fifth of our letters to you, we review the performance of our portfolio in the first half of 2024, with a detailed look at our leading holdings, and, discussing the current opportunity set, conclude with why we see the current moment as attractive.

Interest rate environments were adverse in both the US and Brazil, but US markets performed well. The Nasdaq and S&P were both strong – up 18.1% and 14.5%, respectively – mainly on solid operating performance by big tech and the increasing momentum of the AI narrative. In Brazil, the context was negative: the interest rate scenario worsened significantly, with the 3-year fixed rate rising from 9.7% to 12.1%, and equities performed poorly, with the Ibovespa (IBOV) down -7.7%, and the Small Cap Index (SMLL) down -14.8% in the half year (1H24).

At the end of April, Brazilian assets began to decouple, on the downside, as the US interest rate scenario began to improve, while the Brazilian outlook continued to weaken due to growing concerns for its fiscal outlook.

In Brazil, 10-year real fixed rates were at 6.4% at the end of June, compared to 5.8% at the end of 2023. This was negative for the performance of other asset classes, especially equities, but, in our view, the prices of many good businesses in Brazil declined excessively in proportion to this context.

Period	Ibovespa performance	% of Ibovespa stocks with positive performance
2021	(11.9%)	30%
2022	4.7%	41%
2023	22.3%	66%
1H 2024	(7.7%)	22%

We reiterate that we view our portfolio as a non-operational holding company of some of Brazil's best businesses, designed to pursue solid risk-adjusted returns. In 1H24 these positions continued to deliver strong operating performance, but this was not reflected in the performance of their stock prices, and as a result, the Aster FIC FIA declined in value by -7.3% in 1H24:

Portfolio: Weighted averages	1Q24 LTM[1] vs. 1Q23 LTM
Revenue growth	20%
Ebitda growth[(a)]	25%
EPS growth[(b)]	27%
ROIC	21%

Source: Aster Capital estimates, companies' filings and Bloomberg
(a) Ebitda growth of the portfolio, ex-MELI = 23%
(b) EPS growth of the portfolio, ex-Nubank and MELI = 24%

1. Last twelve months

Our last letter highlighted that despite a 31.1% increase in the value of the Aster FIC FIA in 2023, the portfolio's 1-year forward P/E[2] closed the year at the same level as at the end of 2022. We now see an even more extreme version of this phenomenon, with the 1-year forward P/E of the portfolio, at the end of 1H24, down -16% from the end of 2023.

Attributions

Below, we discuss the three top detractors in 1H24: **Localiza**, **Equatorial**, and **Banco BTG**, in that order.

Localiza

During 1H24 we revised **Localiza's** EPS[3] for 2024 and 2025 by -12% and -16%, respectively. We think that this revision explains the bulk of the -33% decline in the company's stock during 1H24.

A deterioration in the used car market caused this earnings revision. **Localiza** purchases cars at discounts, rents them for a period, and completes the cycle by selling them - yielding margins that generate an ROIC[4] of 5 to 7 percentage points above its cost of debt. If the selling price of vehicles is lower than initially budgeted, margins decrease, and so does ROIC.

The crisis in the automotive production chain due to the pandemic reduced the supply of new vehicles. It resulted in price appreciation for new and used cars across the industry in 2020–2022. This situation stabilized in 2023, and the stabilization is expected to continue through 2024.

Due to the limited availability of auto models that **Localiza** considered ideal, as well as the inflated prices, the company decided to limit car purchases in 2020–2022, and extend the usage of its existing fleet. We are now experiencing the consequences of this decision, at a moment when discounts between prices of new and used cars are increasing: lower than expected realized selling prices have reduced margins on sales of used cars.

It's important to note that **Localiza's** core business is car rental and that its competitive dynamics continue to be positive in this activity. It is unusual to find an undisputed market leader in such a large market that is still organically growing its revenue by 20% annually, expanding its competitive scale advantages over a few structured competitors, and still finding opportunities to deploy capital at attractive return rates. These positive attributes largely explain why we continue to be holders of Localiza despite the now more challenging used car market.

Localiza is currently trading at 1-year forward P/E of 12.9x, lower than its average of 13.3x during Dilma Rousseff's second term[5] as president – the period of the worst recession in Brazil's history, during which the 3-year fixed rate averaged 14.2%, more than 200 basis points above the 12.1% rate at the end of 1H24.

Source: Aster Capital estimates and companies' filings
2. (Price) / (Estimated earnings in the next 12 months)
3. Earnings per share
4. Return on Invested Capital
5. From January 1st, 2015 to April 17th, 2016

Equatorial

Equatorial has a strong track record of capital allocation, and its acquisition of CELG in 2023 – an electricity distributor in Goiás – was a new turnaround opportunity. In less than a year under **Equatorial's** management, we have revised our operating profit estimates for **CELG** upward by more than 50%.

Even so, **Equatorial's** stock price fell by -12.7% in 1H24. We believe this can be attributed to a combination of factors: (i) high financial leverage at a time when interest rates have risen; (ii) uncertainty while a new regulatory framework for early extension of electricity distribution concessions is under discussion; and (iii) perception of risk associated with its aggressive bidding in the privatization of **Sabesp**.

At time of writing this letter, we are confident in the soundness of **Equatorial's** capital allocation strategy in relation to **Sabesp.** It has emerged as the sole potential strategic shareholder in the privatization auction, at a price that we consider attractive for its stockholders. Additionally, we expect to see early extension of concessions in Pará and Maranhão, which bolsters our confidence in Equatorial delivering solid results.

Given **Equatorial's** leverage, we see the worsening interest rate environment as the only true detractor in the list we refer to above. We continue to believe that Equatorial is a unique asset in its segment, offering unusual returns for assets of this quality (with an implied real IRR above 12%).

BTG Pactual

BTG Pactual has been a sizable position in our portfolio since the fund's inception. Despite its exposure to capital market cycles, it has expanded its market share in all its business segments, strengthening its franchises, which feed into each other in a virtuous cycle.

The current interest rate scenario is testing the strength of its business model, and we are positively surprised by its operating performance in this context. Its revenue diversification has reduced its exposure to the more cyclical Investment Banking and Sales and Trading segments. Total revenue, for example, was up 22% YoY in 1Q24, and revenue in the Wealth, Asset, and Credit franchises alone was up 24% YoY- these revenue lines generate significant carry that sustains the business's growth.

BTG increased its profit by 16% YoY in 2023, and we expect it to grow at a similar pace in 2024, maintaining its ROE[6] above 22% in two years, which have been challenging for the sector.

Due to its strong competitive positioning in the current markets, its ability to continue consolidating high-income retail, and its potential to grow in the mid-size company segment, we believe **BTG** has a profit growth opportunity over several years. Our base case shows a nominal 3-year IRR of 26%, if for an exit at P/E of 11x (or 3-year IRR of 22%, for an exit at P/E of 10x).

Source: Aster Capital estimates and companies' filings
6. Return on Equity

BTG is another example of a business in our portfolio associated with the interest rate cycle (e.g. lower capital market activity), whose shares performed poorly in 1H24 but which maintained the quality of its business and its operational superiority over its competitors, and for this reason it remains among our top 5 positions.

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Our three largest attributions in 1H24 – in this order – were **Nubank**, **MercadoLibre**, and **Santos Brasil**.

Nubank

Nubank (**NU**) was the highlight of the portfolio in 1H24, maintaining solid operating performance that confirmed the pillars of our thesis. It made significant advances in the half-year in three areas: its rollout of payroll loans; expansion of its deposit base in Mexico; and increase in its unsecured personal credit origination (e.g. Pix credit).

The strategic successes in Mexico are an excellent example of NU's execution capabilities. By raising the remuneration of its deposits to 15%, **NU** targeted the main vulnerability of its incumbent competitors, bringing in more than USD 3 billion in deposits within a few months. The higher funding cost for a limited period attracted millions of customers with higher incomes than the initial cohorts.

As we discussed in our 1H23 letter, **Nubank** has a highly engaged customer base that is being monetized with credit products. With the launch of new products (some innovative, such as PIX payments in installments on the credit card), this monetization is occurring faster than we expected.

At the same time, revenue growth is not accompanied by increased expenses, with **NU** maintaining its lean structure of only 8,000 employees. One critical pillar in the **NU** thesis is scale gains through intensive use of technology, and this continues to materialize.

Despite the solid operating performance, after a 77.6% increase in the stock price (in BRL) in 1H24, we assessed a lower margin of safety in our investment and decided to reduce our exposure. **NU** is among our most significant reductions in 1H24 but is still one of our top 10 positions.

MercadoLibre (MELI)

MELI continued to deliver solid performance this semester, with significant market share gains. Its growth has been so strong that it has revised its hiring plan, increasing its target for new employees from 6,500 to 11,000. 1Q24 was its sixth consecutive quarter of sequential acceleration in YoY growth in unit sales in the country. According to our estimates, **MELI's** GMV[7] grew 30% YoY in the semester, confirming our expectation that the accelerations in percentage growth in the second half of 2023 indicated a step change in its GMV in Brazil in 2024. Its fintech operation, especially credit, is also doing very well in Brazil: according to our estimates, MELI already has three businesses in the country with annual operating profit (Ebit) greater than BRL 1 billion: Ads, E-commerce ex-ads, and Credit.

Source: Aster Capital estimates and companies' filings
7. Gross Merchandise Value

In Mexico, **MELI** is at the best moment in its history. In commerce, it has been growing in unit sales and GMV by around 30% YoY for two years, surpassing 30% in market share and increasing its market share lead over the second-largest player. Further, we estimate it has built a credit portfolio of over USD 1 billion in the country, and 60% of the total payment volume (TPV) of credit cards is made outside its marketplace operation. This growth has been accompanied by increase in margins: its Mexican margins have never been so high, and are now even higher than in its Brazilian operation.

The scenario in Argentina is still challenging – but there are signs of improvement, and today, we even consider the possibility that Argentina could be a source of positive surprise in the coming years. After a strong 4Q23, due to demand being brought forward in expectation of a currency devaluation, the fundamentals of **MELI's** Argentina operation in 1Q24 were poor, and combined with the devaluation this caused a disappointing result.

On the other hand, (i) less than 15% of the company's Ebit is currently in Argentine pesos, which mitigates the impact of any further deterioration in Argentina; (ii) we believe that 1Q24 was the bottom point for the e-commerce operation in the country – we estimate that **MELI's** volume growth has turned positive again in 2Q24; and (iii) the fintech operation is more vital than ever in the country, since Mercado Pago has become ubiquitous even in physical retail, and the company's Mercado Crédito operation in Argentina, though small, has the highest profitability of all the countries in which it operates.

Despite a 17% rise in its stock price (in BRL) in 1H24, our 1-year forward P/E was reduced by 10% over the half-year due to the earnings growth carryover effect. MELI remains among our top 5 positions.

Santos Brasil

After eight years of an unfavorable balance between supply and demand at the Port of Santos, its main area of operation, **Santos Brasil** experienced a turnaround in 2021. After prices had fallen by around 40% in the previous eight years, there was a significant price recovery between 2021 and 2023 (about +150%): the adjustments were basically to restore the effects of accumulated inflation.

In 1H24 there was a significant recovery in the company's volume: 26% growth YoY, with the new pricing table in effect. We expect this to translate into reporting earnings for the half-year more than doubling YoY.

Source: Aster Capital estimates and companies' filings

Santos Brasil's competitive positioning is exceptional. It operates in the best port in Brazil, a mandatory stop for all shipping companies in the international flow, and the closest port to the country's largest consumer region. For years, it has had the best-positioned terminal to capture all increases in demand for services in the Port of Santos — but only this year has this demand reached the level where full capture of this value has become possible.

This position of strength has been solidified by new cargo handling and storage contracts made so far in 2024, as a result of which, during this half-year, we increased our 2024 earnings estimates by 37% — factors which we believe correspond to the strong performance of its stock price (up 48.8%) in 1H24.

 Source: Aster Capital estimates and companies' filings

Assessment of the opportunity set, in Brazil

We are concerned about Brazil's fiscal scenario, but the micro performance of good businesses in the country has been positive. In our overall assessment, the combination of these opposing factors is still favorable.

Attached is a presentation focused on this debate, including a case study of Dilma Rousseff's second term. During that term, Brazil experienced the most significant recession in its history, with stock price multiples at levels similar to today's.

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We emphasize our availability to build a close and transparent long-term relationship with our investors. We want our partners to understand us well. We appreciate and value your trust. Once again, thank you.

The Aster Capital Team

Agenda

1. Portfolio Review

2. It is all about the earnings

Backdrop

Today, we see multiples very close to those seen during the worst recession Brazil experienced, during Dilma Rousseff's second term

The macro and micro scenarios are substantially better than that period when the multiples were similar

In our assessment, the yield curve was the primary factor that negatively impacted stock performance in 1H24

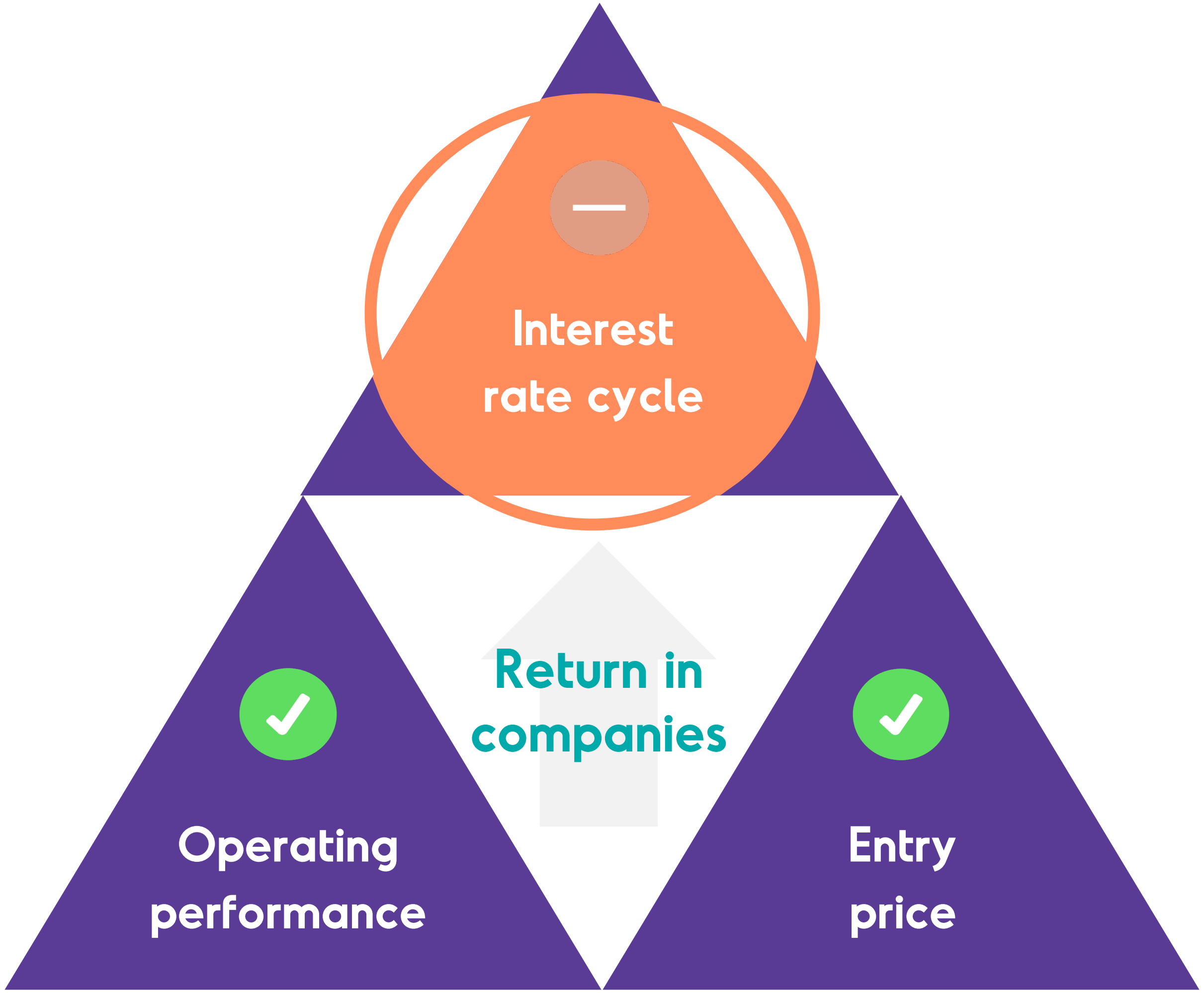
The determining factors for returns in companies

The 'interest rate' pillar has been the primary force determining returns

We understand that the three determining factors for future returns in investing in companies are:

- Interest rate cycle (cost of capital)
- Entry price (initial multiple)
- Operating performance of business

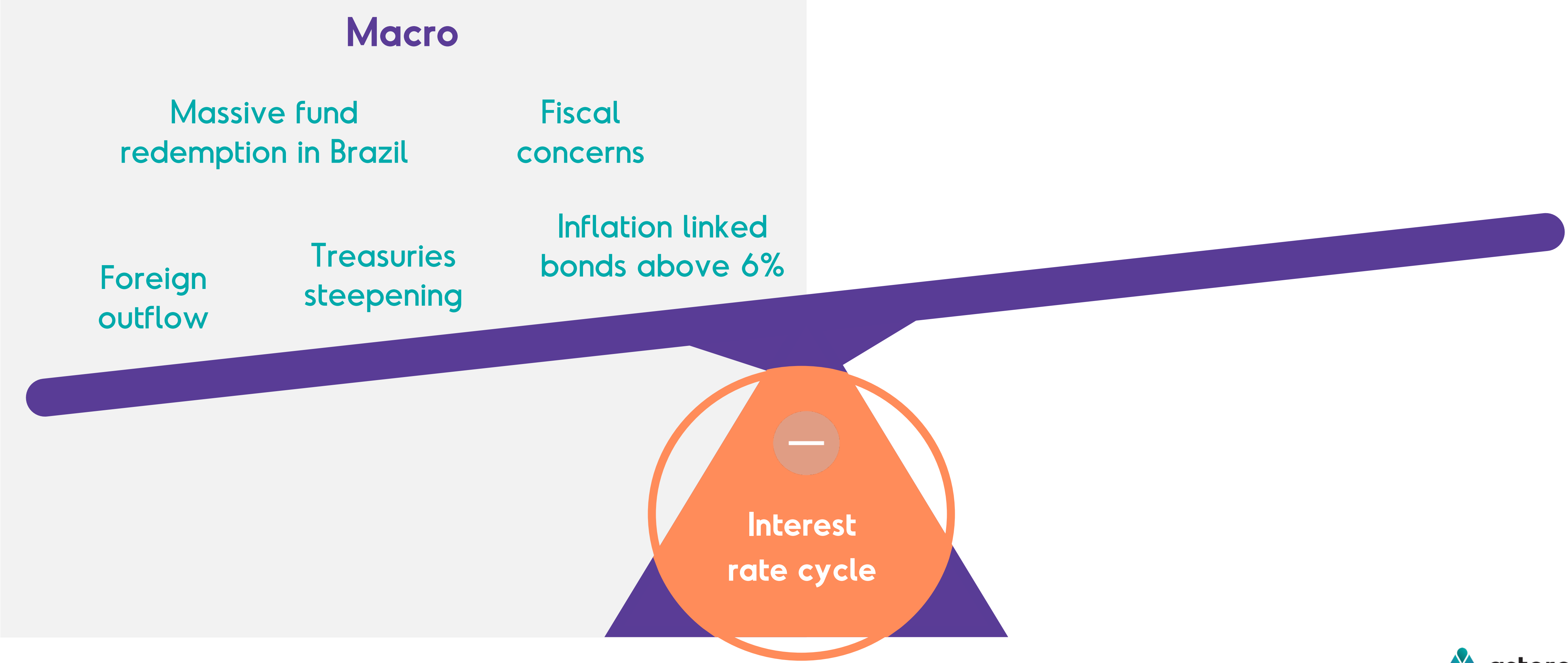
Our assessment is that two of these factors – operating performance and entry price – are currently attractive, despite the worsening interest rate cycle.



 Source: Aster Capital

The weight of the interest rate cycle...

On one side, treasuries steepening, and political noise – have both pressured cost of capital...



 Source: Aster Capital

…has outweighed operating performance

…while on the other hand, good businesses continue to deliver good results

Macro

Massive fund redemption in Brazil

Fiscal concerns

Inflation linked bonds above 6%

Treasuries steepening

Foreign outflow

Operating

btg pactual

RDsaúde

mercado libre

REDE D'OR

nu

itaú

Operating performance

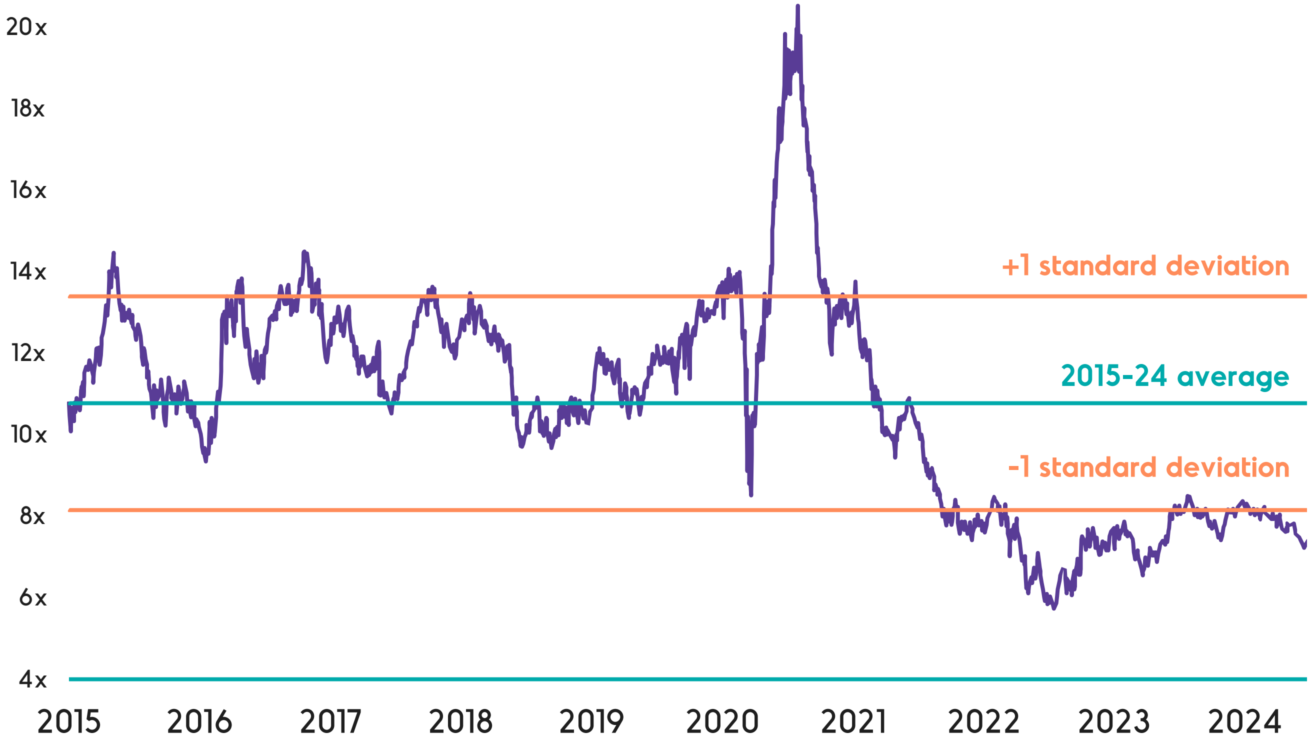
We continue to see solid operating performance by the companies in our portfolio

 Source: Aster Capital

Meanwhile, multiples remain depressed

This chart has been extensively used - but what does it really mean?

Ibovespa P/E[1] 1-year forward



We often hear that the P/E multiple of companies on the Brazilian stock exchange is low. For this to be true, **companies must deliver the expected earnings**

The effective delivery of company earnings is essential for the expectation of good returns to materialize

Source: Aster Capital and Bloomberg, up to June 30, 2024
1. P/E 1-year forward = Index (Price) / (Estimated profit for the next 12 months)

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So how does operating performance today **compare to other times of depressed multiples?**

Has Brazil 'blown it' again?

How do the last 18 months resemble what we experienced in 2015-16?

How did the context impact earnings at that time?

 Source: The Economist

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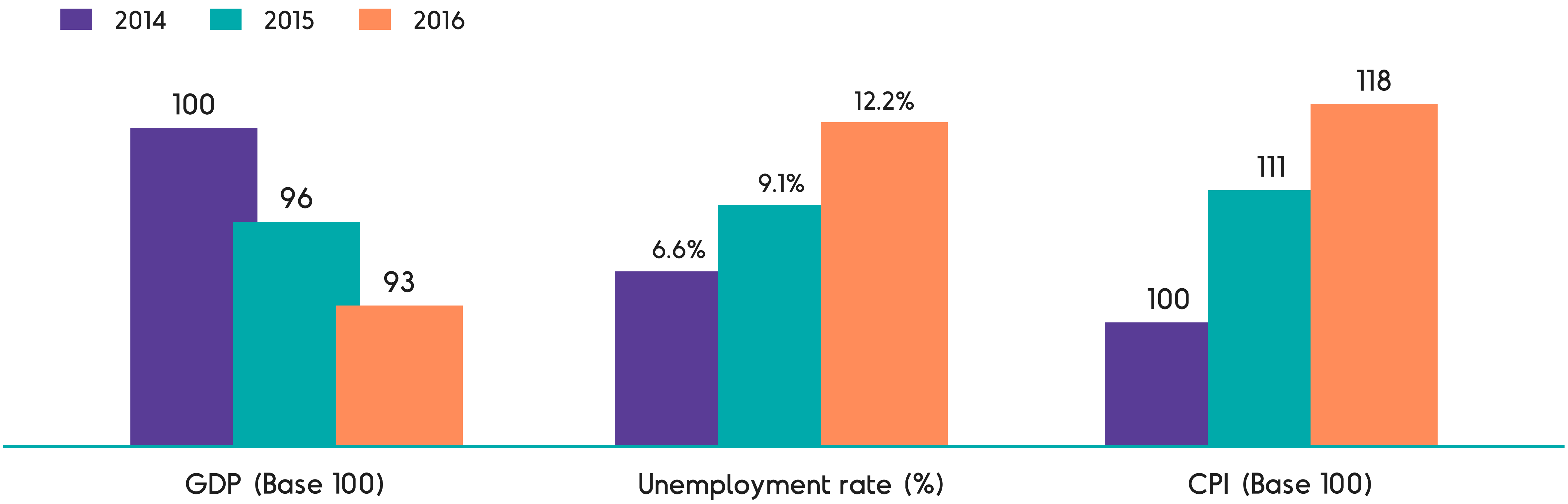
In 2015, the macro environment was hostile to businesses

Falling activity, unemployment, and inflation harmed operating performance

Activity and inflation indicators



Source: Aster Capital and IBGE

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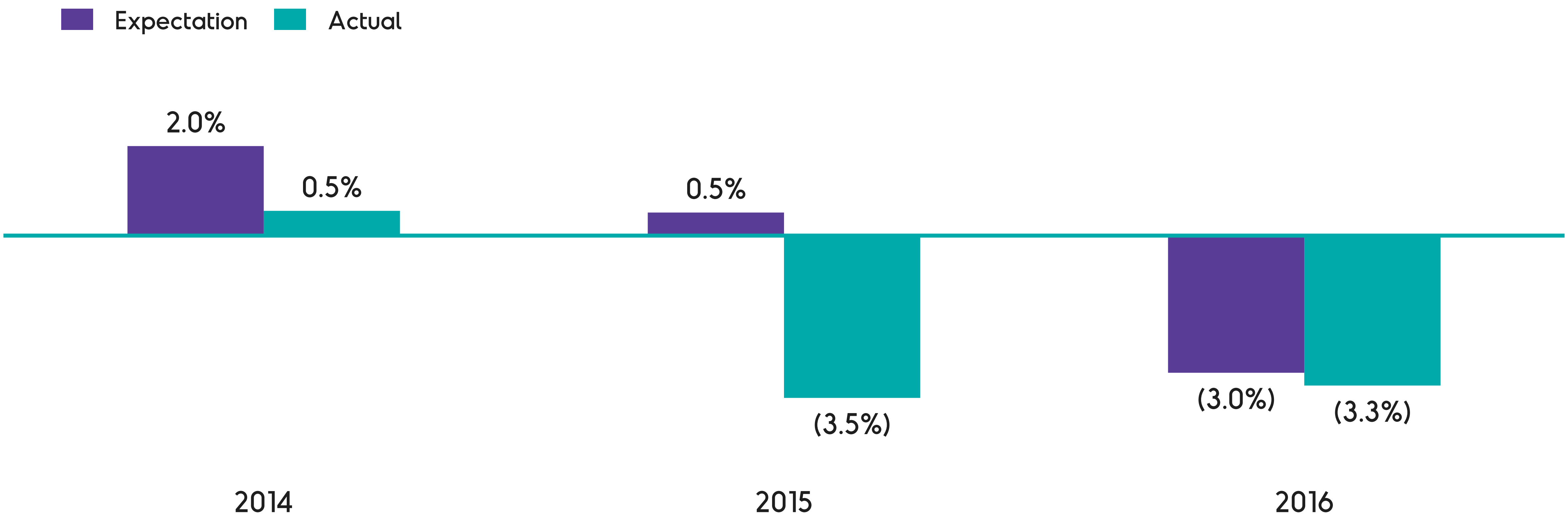
GDP growth disappointed sequentially…

Companies faced a period of continuous downward macro revision

GDP growth expectation[1] at the beginning of the year vs. actual (%)



Source: Aster Capital.
1. Brazilian Central Bank's "Focus" Report

...and earnings forecasts were massively revised downward

There was a severe deterioration in expected earnings in the 18M following Dilma's election

Expected earnings 1-year forward (Base: Dec. 31, 2014 = 100)

Source: Aster Capital and Bloomberg, up to June 30, 2016

1. EPS: earnings per share

2. SMLL: The Brazilian Small Cap index. Analogous to the Russell 2000

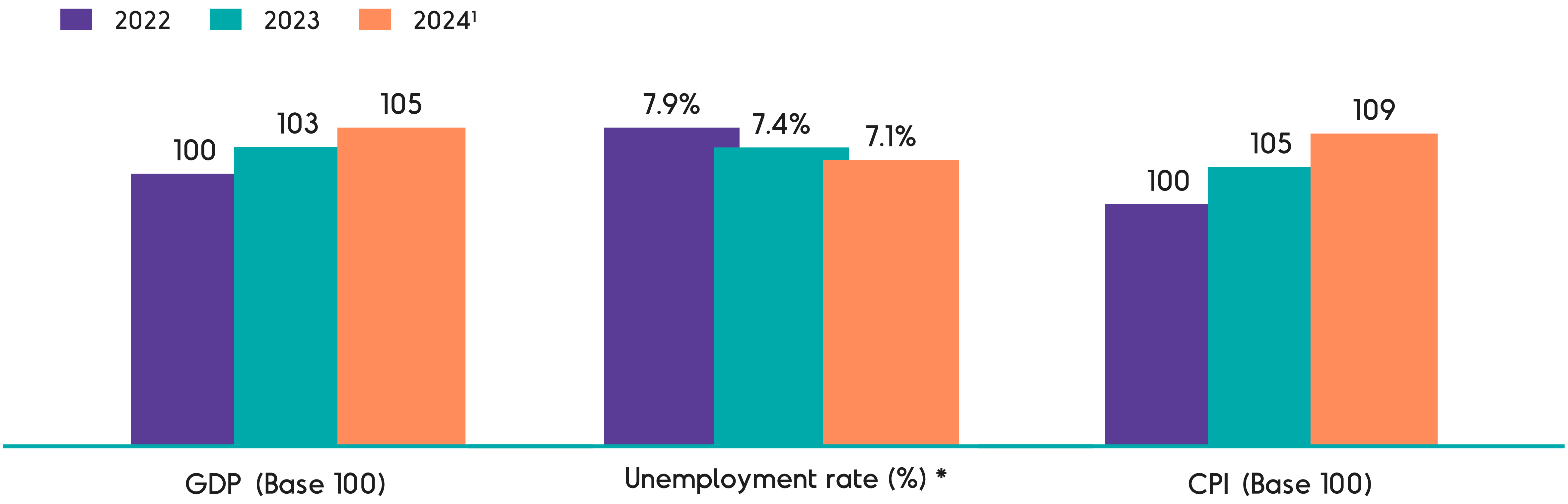
Were multiples low or earnings expectations high?

Are we experiencing this again now?

Today's perception has been worse than reality

Growth, employment and inflation have helped, or at least not harmed

Activity indicators

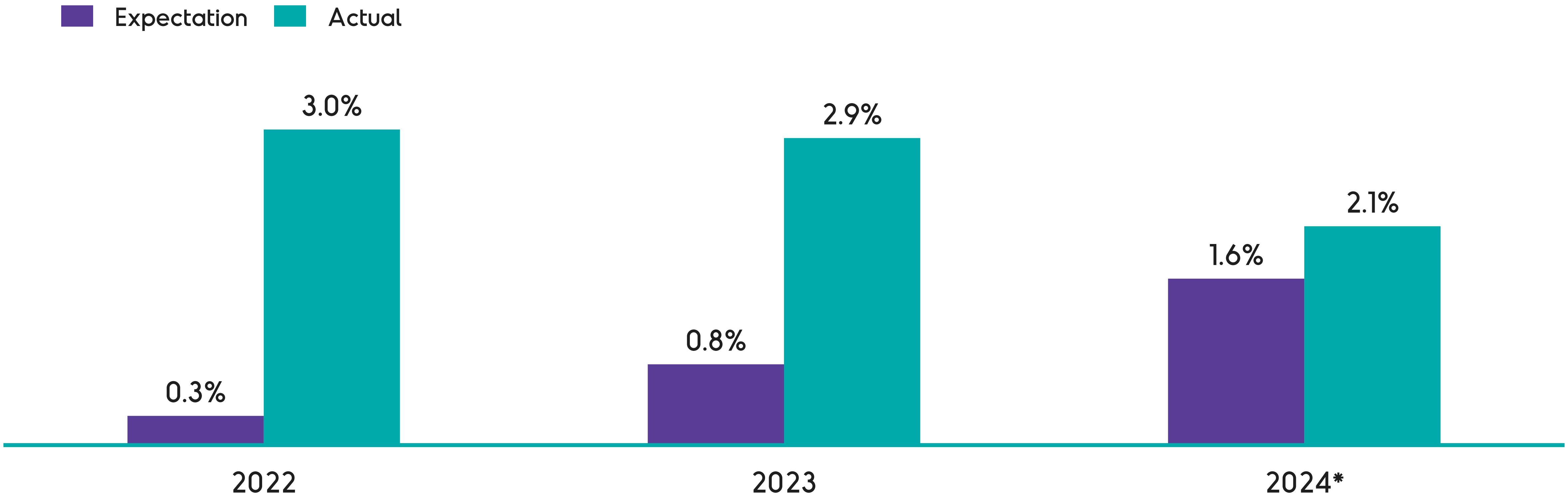


Source: Aster Capital, IBGE, and Brazilian Central Bank's "Focus" Report (June 28, 2024)
* Up to the latest available data as of May 2024

GDP growth has surprised to the upside...

In contrast to Dilma's second term, the GDP has been performing above expectations

GDP growth expectation[1] at the beginning of the year vs. actual (%)

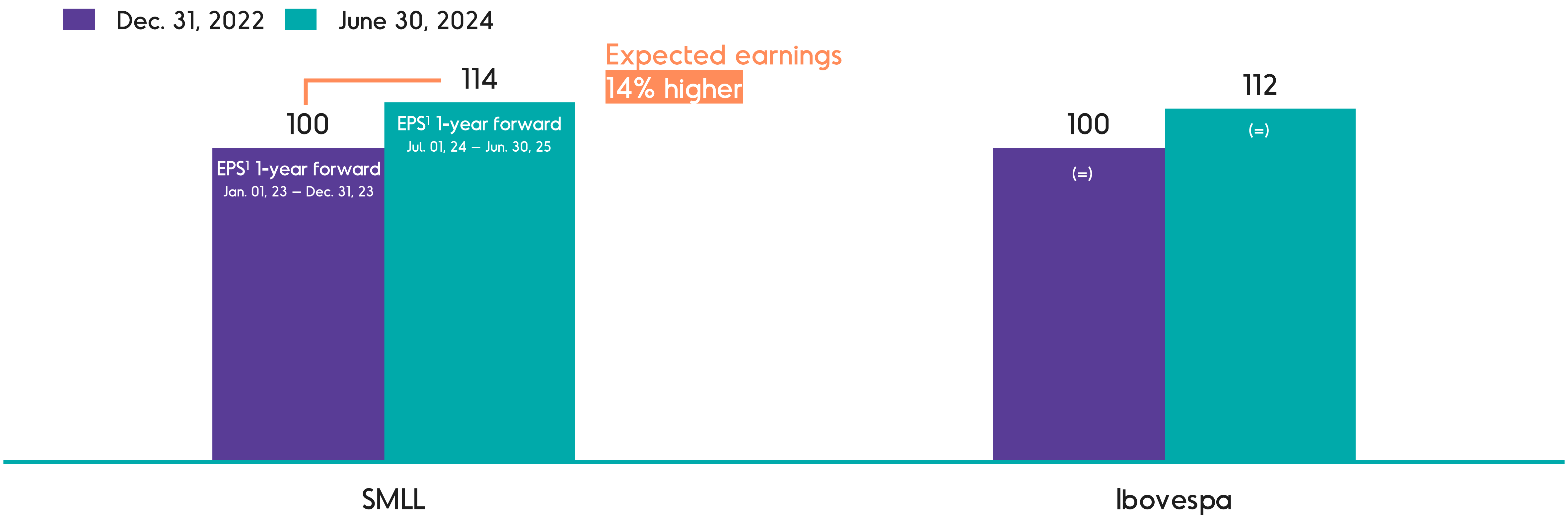


Source: Aster Capital and IBGE
1. Brazilian Central Bank's "Focus" Report
*Actual 2024 = Focus Report expectations (June 28, 2024)

...and expected earnings have increased over time

In the 18 months following the most recent election, earnings expectations continued to grow

Expected earnings 1-year forward (Base: Dec. 31, 2022 = 100)



Source: Aster Capital and Bloomberg up to June 30, 2024

1. EPS: earnings per share

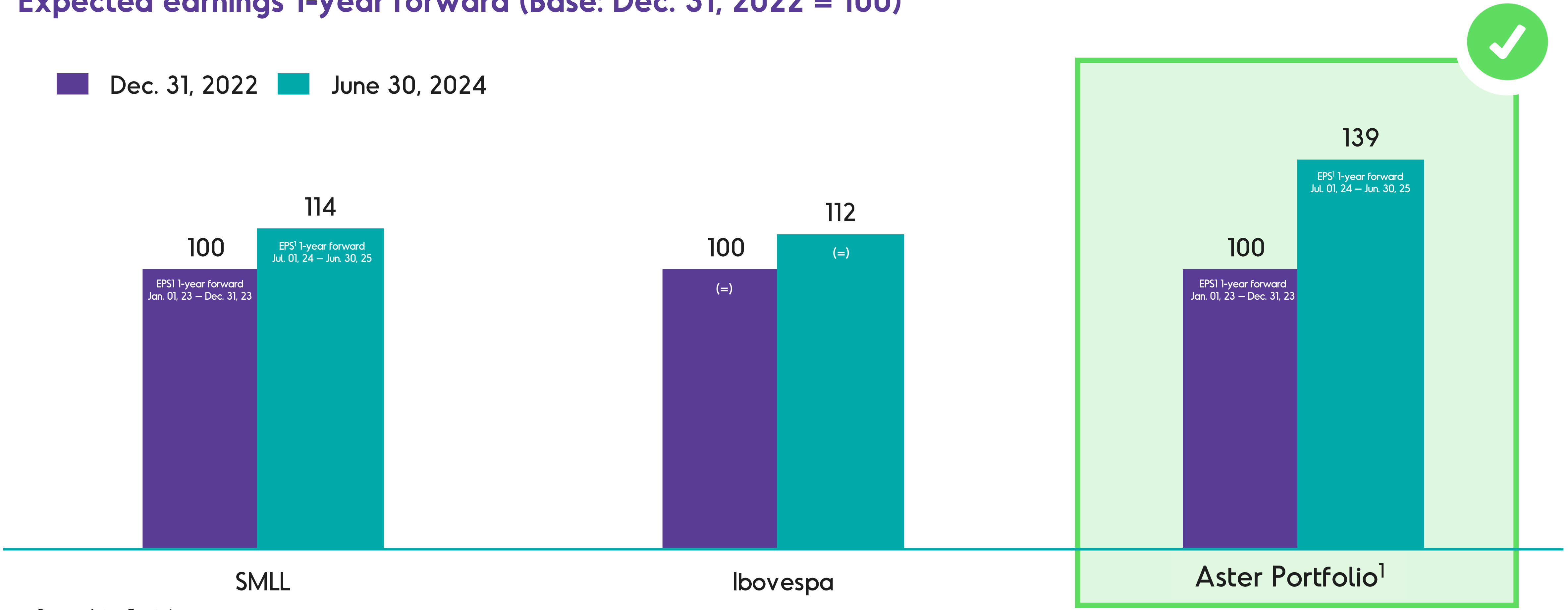
Some good businesses have had

an even more favorable dynamic

Expected earnings of the portfolio[1] has been very positive

Our portfolio continues to deliver robust operating performance

Expected earnings 1-year forward (Base: Dec. 31, 2022 = 100)



Source: Aster Capital

1. Weighted average assuming the portfolio of June 30, 2024. We do not include Nubank, Inter, and Amazon in our analysis, as they excessively distort the portfolio average. Including these positions, the expected profit would be 169 instead of 139 as of June 30, 2024 (Base: Dec. 31, 2022 = 100)

The businesses in our portfolio have delivered solid results

These figures were delivered with interest rates even higher than what we have today

Portfolio: Weighted Average	1Q24 LTM vs. 1Q23 LTM
Revenue growth	20%
EBITDA growth(a)	25%
EPS growth (b)	27%
ROIC	21%

Actual 12-month results delivered by the companies in our portfolio up to the last reported quarter

Source: Aster Capital estimates and companies' financial data
(a) Excluding MELI, weighted average EBITDA growth of the portfolio = 23%
(b) Excluding Nubank and MELI, weighted average EPS growth of the portfolio = 24%

Solid operating performance is why we see current multiples as an attractive opportunity

 Source: Aster Capital

Multiplan

For a tangible illustration, we looked at one individual company in which the main attributes have not changed much since Dilma's recession:

Premium portfolio	+	Owner-run company	+	Preserved competitive position

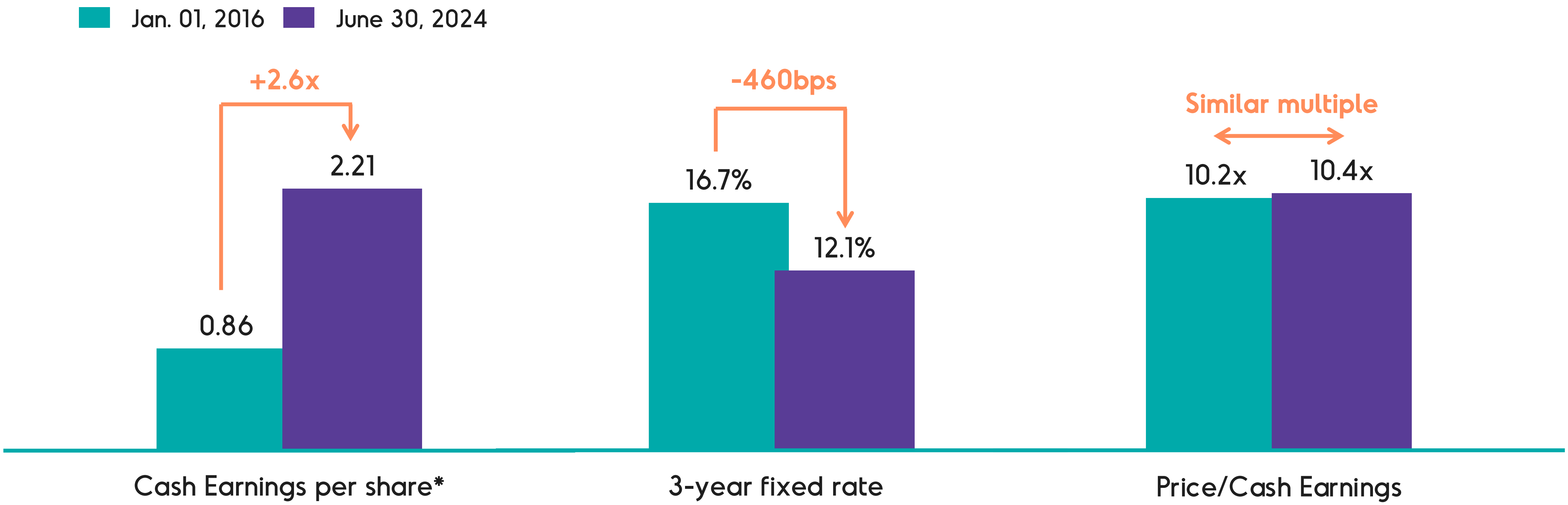
 Source: Aster Capital

'Dilma' multiple with fixed-rates 460bps lower

Multiplan

Earnings performed well since Dilma's recession up to now, suggesting a healthy operation

Multiplan: 3-year fixed rate, Price/Cash Earnings[1] and Cash Earnings per share[2]



Source: Aster Capital and Bloomberg to June 30, 2024
1. Cash Earnings = FFO (Funds from Operation) is a cash profit metric used in the shopping center sector
2. FFOPS = FFO per share
* 2016 FFOPS and expected FFOPS for 2024

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Multiplan

Solid operating performance + Attractive entry multiple = Good risk-adjusted expected return

 Source: Aster Capital

Critical assessment of expected future returns

Earnings is key, but it is not the only factor for returns

Exit multiples can be used to artificially create high expected returns

Can be used to "create" expected returns

Expected value = **Dividends paid** + **Expect Earnings** x **Exit multiple**[1]

Depends essentially on solid operating performance

Source: Aster Capital

1. Premise used to estimate the selling price in a divestment

Percentile as a tool for assessing the exit multiple

The multiple percentile enables the assessment of the investor's assumptions

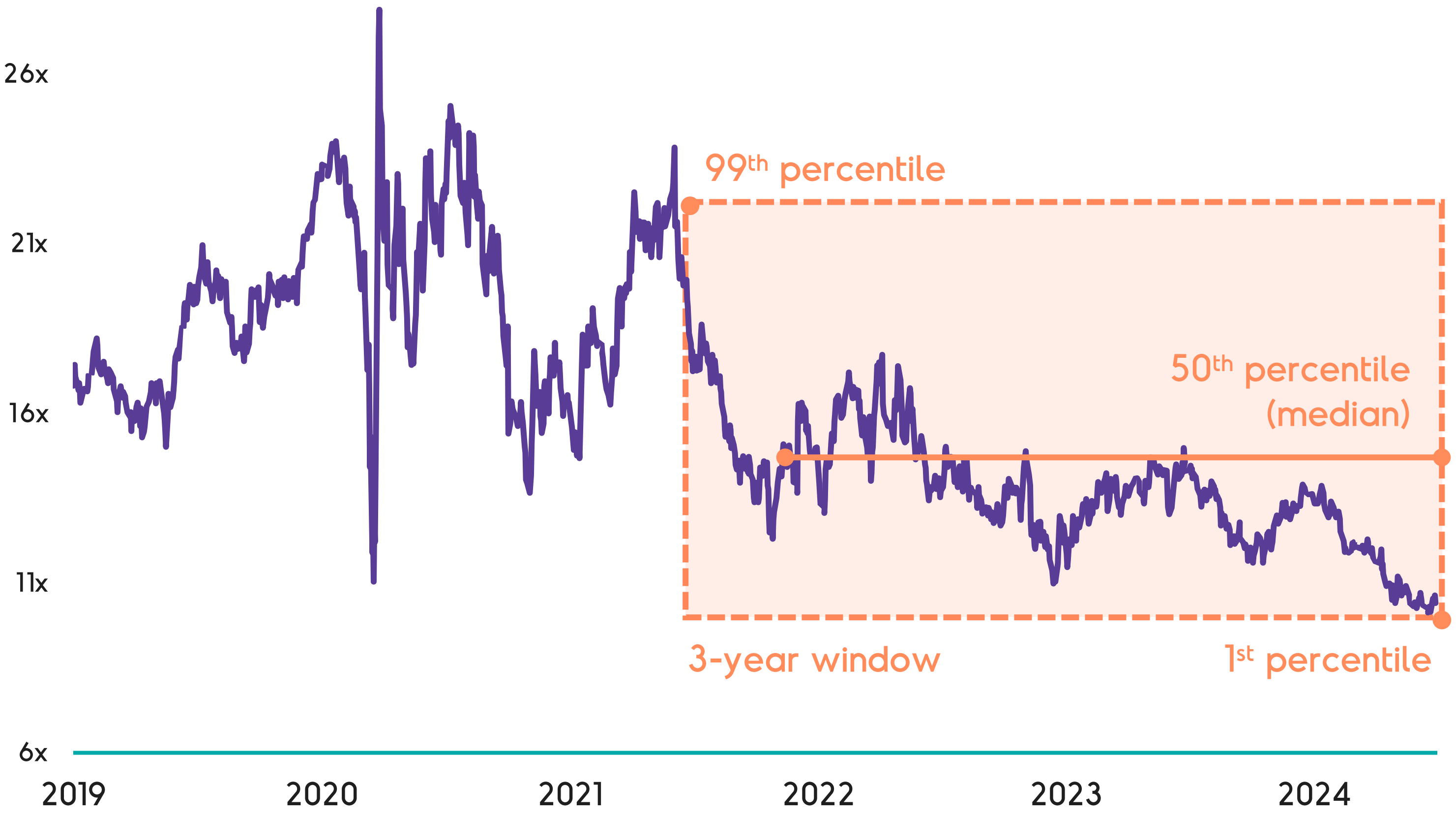
What is the percentile?

A percentile shows your position within a certain sample

If you are in the 90th percentile, it means you outperformed 90% of the group. If you are in the 50th, half were better and half worse

When we talk about multiples, being in the 90th percentile means that only 10% of the values observed during the period analyzed were higher

Multiplan as example: P/Cash earnings[1] 1-year forward – Percentiles



Source: Aster Capital and Bloomberg

1. Cash Earnings = FFO (Funds from Operation) is a cash profit metric used in the shopping center sector

Aster Portfolio

Exit P/E multiple
= 27th percentile (3-year window)

**25% p.a.
expected return**

To estimate the expected return[1], we use an exit multiple for each company in the portfolio

Each exit multiple is in a certain percentile within its own historical sample

We then calculate the weighted average of the percentiles of each company in the portfolio

Result of this analysis, 73% of the time, the multiples were higher than those used as exit multiples

Source: Aster Capital
1. Expected return = Internal Rate of Return (IRR)

Aster Portfolio

Exit P/E multiple
= 27th percentile (3-year window)

**25% p.a.
expected return**

Solid expected returns across different exit multiple percentiles

10th percentile	22%
20th percentile	24%
27th percentile	25%
40th percentile	28%
50th percentile	30%

Source: Aster Capital
1. Expected return = Internal Rate of Return (IRR)

Key messages

There has been much debate about the levels of multiples in Brazil today, **but we believe sound earnings performance is the most important discussion**

In contrast to 2014-16, when we experienced successive earnings revisions, the businesses in the portfolio have continued to grow nicely

On average, the companies in our portfolio are delivering earnings growth even better than we expected 18 months ago

Modest improvements in the interest rate scenario could lead to excellent returns, as it would unlock the combination of the 3 critical factors for stock investment returns

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