Constellation: Management Report 1Q14

Long Only Performance	Fund	Ibovespa in USD
YTD:	- 1.01%	+ 1.91%
Last 12 months:	- 15.96%	- 20.31%
Annualized Return since inception:	+ 18.70%	+ 5.09%

Long Short Performance	Fund
YTD:	- 0.05%
Last 12 months:	- 9.98%
Annualized Return since inception:	+ 8.23%

Dear Investor,

In this last quarter, investors had their resistance tested by the volatility of the markets again. The Brazilian stock market was down -12.70% in BRL at its worst moment this quarter, but finished the period down -2.12% in BRL and up +1.91% in USD, surprising many.

During this period, the long only fund underperformed the Ibovespa (the fund was down - 4.44% in BRL). This happened because high beta stocks recovered faster, driven by the presidential election polls indicating Dilma's popularity decreasing. The two main opposition candidates defend an agenda of reform that would increase productivity with less government intervention in the economy. Thus, a scenario where the opposition wins would be positive to the long term investment outlook in Brazil. Any new information pointing in this direction should cause investors to reduce their underweight positions in Brazil. This explains why the state owned companies had such better performance in March.

Since our portfolio consists of mainly low beta companies, its performance does not respond immediately to short-term flows, as we saw recently. We believe that our portfolio remains balanced with resilient companies that will be able to preserve profitability in the current scenario of low economic growth and high inflation. Our companies should benefit from a scenario of improved economy but not as much as more cyclical or leveraged companies. However, we are confident that we have the best balance in our portfolio for the longer term. At the end of the day, having short-term gains from more fragile or speculative businesses can seem "smart" like tactical moves, but, historically, our greatest returns have come from companies expanding their business with "baby steps" and low leverage.

In the first quarter, two stocks in our portfolio presented poor performance: Abril Educação and Cosan. In both cases, our analysis and research give us confidence to keep them in our portfolio. It is our understanding that the recent decline in share price was caused by circumstantial reasons and not structural problems, which have not compromised these companies' earnings power. Please see next our updated investment thesis on these two names.

Abril Educação

2013 was a very busy year for Abril Educação (AE) with the purchase of a new language business in February (Wise up and YouMove), followed by a follow-on in April. There was also the acquisition of Sigma elementary schools in Brasilia, and Motivo in Recife, in July. Finally there was also the acquisition of MSTech in December, a provider of digital solutions for schools. All acquisitions contributed to the consolidated Ebitda growth of 23% in the year. Considering only organic growth, there was an increase of 9% versus 2012.

We prefer to look at the earnings per share which is the appropriate metric in this case to measure the actual return to shareholders. According to this metric, the result of the year was lower than expected and below potential. Even with higher leverage (natural given the investments made throughout the year), which should dilute earnings per share in the first year; the operational results were lower than expected. We devoted a lot of effort from our team to assess whether these frustrations with short-term results indicate a permanent deterioration in the profitability of the company. We concluded that the company has a unique combination of good assets and provide an outstanding education service to its clients, but to manage all their businesses cohesively requires strong integration measures. Only with that will they turn these recent acquisitions into profitable ventures. The bright side is that we see these challenges as circumstantial and not permanent problems in the company’s business model.

During this analysis process, we realized that our questions and opinions were well received by the management and controlling group. We then decided to get more involved in helping the company achieve the best performance possible from its team and assets. One of our partners joined the Board of Directors after receiving an invitation from the controlling shareholder, in November last year. This indicates the willingness of the controlling shareholders and senior management of the company to act on important issues that impacted last year’s results.

Our involvement with AE, through our participation in the board and committees, is aligned with our strategy and investment process. We employ a collaborative approach, helping companies when needed in capital allocation decisions, creation of a result driven culture and a corporate environment which rewards performance. We do not have an agenda of radical changes or activism for the company given that we received a friendly invitation to join the board. Our final objective is to help align the interests of the company’s shareholders and its management team.

Since we joined the board of the company, we implemented some initiatives in order to tackle specific issues: (1) creation of an integration committee (with a member of Constellation participating) - this committee coordinates the work of the integration team designated within the company. It has also hired an outside consultant (Galeazzi & Associados) with proven experience in restructuring costs, expenses and reviewing internal processes - the ultimate goal is to implement a "zero cost budget" by the end of 2014; (2) active participation in the people committee, where we also have a member of Constellation participating in the evaluation of the results delivered by the AE team and seeking the appropriate performance incentives for the short and long term. This committee should identify high potential talents within the company and compensate them appropriately; (3) we are also working on the finance committee, evaluating the operating and financial performance of the business units, and helping to enhance capital allocation decisions of the company.

These recent efforts should translate into better performance already this year. AE is an asset light business, so well implemented management measures should deliver results faster than in companies with longer cycles.

We believe the recent underperformance of AE stock is due to the combination of two factors: (1) the follow-on early last year and (2) the aggressive guidance compared to the actual results of the company last year. However, when we analyze the fundamentals of each unit, we see that the company is still healthy and should deliver strong results going forward. Now the company should gradually regain investor confidence.

Cosan

Another investment that has been underperforming this year is Cosan. Even though the company reported good operational results last year, there are some issues that caused its negative share performance. One of them is the dispute with ALL Logistica (supplier of railroad services to Rumo) – apparently this issue has been resolved through the merger with Rumo (sugar logistics subsidiary of Cosan). Another point of concern is the Ethanol business which has not done well recently either. Even with these issues, Cosan’s operational results paired with its attractive valuation show that this is a promising investment over the coming years.

Cosan reported strong results in 2013, even with a weak performance of the sugar & ethanol unit. The main reason for the weak performance in S&E is that the company built up excessive inventory in the third quarter, so Ebitda was down -42% yoy, in the last quarter. Even with this weaker performance in the last quarter, the S&E business delivered a stable Ebitda in the last twelve months. On top of this, the company also ended 2013 with inventories of BRL 1.7bn (the equivalent of 72% of its annual Ebitda) to be sold in 2014, considering current prices. This is a positive indication that Cosan has been able to expand volumes and increase margins in a competitive industry, taking advantage of moments when the supply of its product is lower. Thus, we expect strong cash generation from this segment in 2014.

On the other hand, at the fuel distribution segment, competitive advantages and the franchise value of Raizen (subsidiary that uses the Shell brand) have been contributing to deliver a strong performance. At the last quarter of 2013 Ebitda grew 23% yoy, closing the year with 22% growth vs 2012. Over the last two years, Cosan has achieved a marginal ROIC on its investments of 28%.

At Comgás, their natural gas distribution business, the results were strong not only on the 4th quarter but also during the whole year of 2013. Ebidta grew 31% yoy at the 4th quarter and 45% for the whole year. Besides the strong results, the company completed important investments that will be key in the generation of future earnings.

All in all, Cosan had 22% Ebitda growth in 2013 (pro forma of acquisitions) and 3.2% earnings growth. Strong Ebitda growth was not converted in earnings growth due to the strong investment cycle. Consequently, we expect earnings to grow faster for this year, close to 37%.

In relation to ALL, which has been a source of noise, recent developments occurred in this quarter. Cosan published 2 important facts in February: (1) a proposal to merge Rumo with ALL and (2) split Cosan in 2 companies, segregating the logistics business and simplifying the shareholder structure.

Upon both decisions, Cosan announced an agreement with the current ALL controlling shareholders where Rumo incorporates ALL, creating Cosan Logistics. The transaction assumes Rumo's valuation at 4 billion reais and ALL at 7 billion. Our initial assessment is that the valuation of Rumo is fair but a relevant premium is being paid for ALL shares. We understand that this premium explain a good deal of Cosan's shares recent underperformance.

Cosan's management is comfortable with such premium as they see a bigger value to be extracted from the synergies of both companies combined. Besides, Cosan's management has a proven expertise in developing the logistics business. Rumo was created 5 years ago from scratch with very little equity allocated.

This new company, Cosan Logistics, will have an unparalleled competitive advantage, owing 45% of the railroad lines under concession in the country, which are connected to all the main ports. It is also expected that the relationship with regulators will improve substantially with Cosan's management, paving the way for Cosan to replicate the logistics solutions they created for sugar on other commodities, such as grains and pulp and paper.

Additionally, as mentioned above, with the creation of Cosan Logistics, Cosan is proposing the split of the group activities in two companies, Cosan Logistics and Cosan Energy, the later comprising of the other business – sugar & ethanol, fuel distribution, gas distribution and Radar (portfolio of agriculture land), and maintaining the same solid fundamentals and perspectives of today.

We see the split as a positive initiative for two reasons: (1) the creation of a separate entity to operate in infrastructure and logistics will provide the company with more flexibility and capital structure to make investments in ports, terminals and the railroad assets; (2) it simplifies the shareholder structure to facilitate value attribution to the logistics business, which currently is poorly reflected on Cosan's market value.

Although there was an improvement in the elections expectations for the opposition candidates, we continue to expect 2014 to be a year with high volatility, mainly due to Government related subjects.

We value your relationship and the trust you have placed in us by investing in Constellation. Our investor relations team will be glad to answer any further questions.

Sincerely,
Constellation Team

Constellation
ASSET MANAGEMENT

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Constellation Fund SPC Equities Class – Long Only

Fund Objective

The fund's objective is to provide sophisticated investors with superior risk-adjusted returns by investing in stocks at the Brazilian Stock market through a rigorous research driven "bottom-up" fundamental approach, while carefully attempting to control portfolio risk and transaction costs. The fund does not intend to track market indices and is generally invested 80% to 105% of the NAV. Leverage is rarely used and we attempt to avoid excessive concentration.

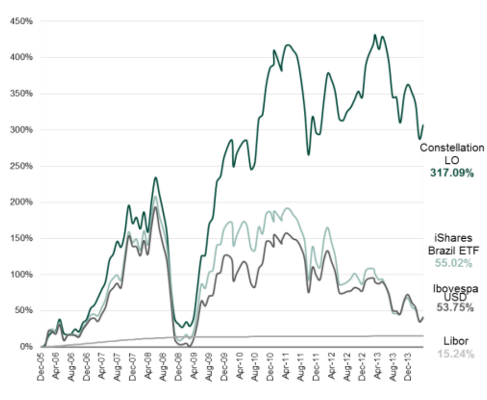
Share Appreciation (Net of all fees and audited by KPMG)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	Since Incep.
2005												2.45%	2.45%	2.45%
2006	12.28%	4.59%	1.81%	12.98%	-13.71%	-1.74%	0.87%	5.37%	-2.81%	9.94%	3.77%	10.64%	49.33%	52.99%
2007	3.43%	6.07%	7.08%	6.20%	15.43%	3.71%	7.66%	-3.21%	8.31%	14.71%	-8.38%	3.03%	82.52%	179.22%
2008	-5.66%	8.81%	-9.70%	16.76%	10.62%	-6.76%	-8.13%	-13.70%	-27.40%	-24.95%	-5.06%	-3.36%	-55.75%	23.55%
2009	5.88%	-4.40%	9.14%	29.69%	23.55%	0.65%	18.58%	4.21%	16.85%	2.64%	8.23%	6.14%	203.31%	274.75%
2010	-9.52%	5.32%	4.32%	0.30%	-10.20%	2.60%	16.98%	1.52%	9.54%	5.25%	1.07%	3.91%	32.09%	395.01%
2011	-5.48%	1.73%	5.06%	0.36%	-1.39%	-1.62%	-5.92%	-9.51%	-14.43%	14.36%	-5.27%	-0.24%	-22.57%	283.28%
2012	11.85%	8.14%	-1.81%	-3.72%	-7.99%	-0.62%	2.85%	1.50%	2.50%	2.61%	-1.82%	10.47%	24.53%	377.23%
2013	5.52%	2.44%	-3.79%	3.44%	-6.10%	-10.33%	-0.05%	-7.95%	9.47%	3.18%	-2.41%	-3.89%	-11.71%	321.35%
2014	-10.66%	4.85%	5.67%										-1.01%	317.09%

Exposure (Delta Adjusted)

Sector	% Long NAV
Education	20.06%
Services	14.74%
Consumer Staples	12.15%
Financials	10.85%
Consumer Discretionary	7.68%
Fuel Distribution	6.47%
Utilities	6.41%
Industrials	4.76%
Metals & Mining	3.45%
Homebuilders	2.53%
Infrastructure	2.40%
Total	**91.49%**
Exposure to the BRL	82.80%

Constellation (net of fees) *vs.* Ibovespa *vs.* ETF



Number of Positions

Stocks	25

Value per Share (net of all fees)

As of March 31st, 2014	476.0635

Sector Attribution

Outperformers	**% NAV**
Education	1.15%
Financials	0.74%
Services	0.48%
Underperformers	**% NAV**
Fuel Distribution	-0.34%
Industrials	-0.16%
Homebuilders	-0.08%

Overall Strategy Liquidity (1/3 of Average Daily Traded Volume)

Tenor	
1 Day	24.2%
1 Week	46.5%
1 Month	75.7%

Market Capitalization

>US$10 bn	22.5%
>US$ 1 bn and <US$10 bn	56.8%
<US$1 bn	12.1%
Total Equity Exposure	**91.4%**

Main Characteristics

Inception Date:	November 30, 2005.
Initial Investment:	US$ 100,000
Subsequent Investment:	US$ 50,000
Subscriptions:	Last Business Day of the month.
Redemptions:	Available series: monthly with 3 months prior notice.
Payments:	Three business days after the redemption day.
Advisory Fee:	1.0% per annum.
Incentive Allocation:	10% of the profit paid annually or upon redemption.
Net Asset Value:	Daily net of advisory fee.
AUM of the Strategy:	US$ 991,484,794

Risk x Return Profile (Since Inception – Net of all Fees)

Annualized Return	18.70%
Annualized Ibovespa USD Return	5.09%
Annualized Standard Deviation	32.50%
Ibovespa USD Annualized Standard Deviation	48.00%
# of Positive Months	62
# of Negative Months	38
Best Monthly Return	29.69%
Worst Monthly Return	-27.40%
ISIN:	KYG238261112

Constellation ASSET MANAGEMENT

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Constellation Fund SPC Class B - Long Short

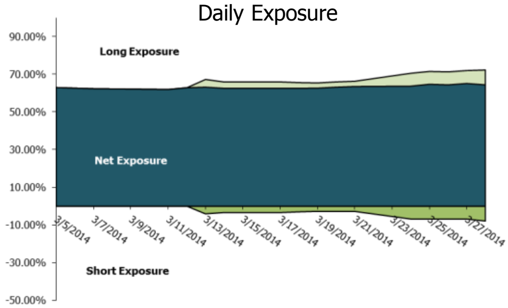
Fund Objective

The fund's objective is to provide sophisticated investors with superior risk-adjusted returns in any market environment. To achieve the objective, the fund employs a classic long/short equity strategy by investing in stocks at the Brazilian Stock Exchange, while carefully attempting to control portfolio risk and transaction costs. Our stock selection is based on rigorous research driven "bottom-up" fundamental analysis.

Share Appreciation net of all fees (* Performance of Long Short Class A until Nov 04, Class B onwards.)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	Since Incep.
2002 *												2.27%	2.27%	2.3%
2003 *	0.97%	1.00%	1.11%	1.65%	-0.29%	0.68%	0.25%	3.10%	2.92%	1.45%	4.71%	1.60%	20.81%	23.6%
2004 *	3.52%	0.22%	0.26%	-1.99%	-0.79%	0.58%	0.68%	3.38%	2.70%	0.67%	-0.09%	8.37%	18.52%	46.4%
2005	6.13%	4.90%	-3.81%	-2.86%	0.50%	1.15%	-1.49%	1.26%	9.20%	-2.11%	4.48%	2.51%	20.76%	76.8%
2006	6.61%	1.20%	-0.38%	8.68%	-3.72%	-1.03%	0.57%	3.67%	-1.85%	0.89%	0.53%	3.42%	19.46%	111.2%
2007	0.85%	3.13%	2.76%	0.87%	5.00%	-0.28%	2.90%	-2.10%	2.54%	3.43%	-4.58%	2.70%	18.18%	149.6%
2008	-1.77%	-0.57%	-3.92%	1.47%	2.45%	-2.11%	-2.67%	-4.32%	-5.36%	-7.55%	-1.10%	-2.39%	-24.88%	87.5%
2009	-0.15%	-1.01%	2.03%	3.69%	4.19%	0.32%	6.20%	1.11%	7.73%	2.45%	2.34%	2.40%	35.75%	154.5%
2010	-2.83%	1.74%	0.93%	-0.04%	-3.60%	0.75%	6.23%	0.95%	3.23%	1.35%	0.75%	1.12%	10.74%	181.9%
2011	-1.56%	0.03%	1.78%	-0.19%	-0.94%	-2.22%	-2.08%	-3.28%	-3.82%	1.66%	-1.61%	-0.54%	-12.19%	147.52%
2012	3.12%	2.66%	-0.62%	-2.03%	-2.57%	-0.59%	2.33%	0.01%	0.58%	0.86%	-2.46%	5.80%	6.96%	164.75%
2013	3.04%	1.87%	-2.26%	2.13%	-3.98%	-5.91%	-0.13%	-6.29%	5.55%	3.29%	-1.31%	-3.08%	-7.60%	144.63%
2014	-7.01%	3.31%	4.05%										-0.05%	144.51%

Daily Exposure



Total Portfolio P/L (Gross of Performance Fee)

	Jan14	Feb14	Mar14	2014
Longs	(6.23)%	1.06%	2.00%	(3.34)%
Shorts	0.02%	0.26%	(0.02)%	0.26%
FX/FX Options/Fixed Income	(0.68)%	2.24%	2.25%	3.83%
Equity /Index Options	0.05%	(0.08)%	-	(0.03)%
Others Expenses	(0.17)%	(0.17)%	(0.18)%	(0.52)%
Total	**(7.01)%**	**3.31%**	**4.05%**	**(0.05)%**

Sector Exposure (Delta Adjusted)

Sector	Long	Short	Gross	Net
Education	13.1%	0.0%	13.1%	13.1%
Consumer Staples	12.9%	0.0%	12.9%	12.9%
Services	10.5%	0.0%	10.5%	10.5%
Financials	7.4%	0.0%	7.4%	7.4%
Fuel Distribution	5.9%	0.0%	5.9%	5.9%
Consumer Discretionary	5.1%	0.0%	5.1%	5.1%
Utilities	4.4%	0.0%	4.4%	4.4%
Industrials	2.4%	0.0%	2.4%	2.4%
Metals & Mining	5.2%	-2.8%	8.0%	2.4%
Homebuilders	1.7%	0.0%	1.7%	1.7%
Infrastructure	1.5%	0.0%	1.5%	1.5%
ETFs/IBOV/Options	0.0%	-4.4%	4.4%	-4.4%
Total	**70.30%**	**-7.27%**	**77.57%**	**63.03%**
Exposure to the BRL				56.20%

Number of Equity Positions

Long	25
Short	3

Value per Share (Net of all Fees)

As of March 31st, 2014	**204.7126**

Overall Strategy liquidity (1/3 of Daily Average Traded Volume)

Tenor	Long	Short
1 Day	66.1%	100.0%
1 Week	90.1%	100.0%
1 Month	100.0%	100.0%

Market Capitalization

	Long	Short
>US$10 bn	22.3%	7.3%
>US$ 1 bn and <US$10 bn	39.6%	
<US$1 bn	8.5%	
Total Equity Exposure	**70.3%**	**7.3%**

Main Characteristics

Inception Date*:	November 30, 2004.
Initial Investment:	US$100,000
Subsequent Investment:	US$50,000
Subscriptions:	Last Business Day of the month.
Redemptions:	Available series: monthly with 3 months prior notice.
Payments:	3 business days after the redemption day.
Advisory Fee:	2.0% per annum.
Performance Fee:	20% of the profit paid annually or upon redemption.
Net Asset Value:	Daily net of advisory fee.
AUM of the Strategy:	US$ 125,923,464

Risk x Return Profile** (Since Inception – Net of all Fees)

Annualized Return	8.23%
Annualized Standard Deviation	10.70%
Sharpe Ratio*	0.63%
# of Positive Months	66
# of Negative Months	46
Best Monthly Return	11.14%
Worst Monthly Return	-7.55%
ISIN:	KYG238261039

* Annualized T-Bill 90 daily return.