

Constellation: Management Report 2Q12

Long Only Performance	Fund	Ibovespa in USD
YTD:	+ 4.56%	- 11.17%
Last 12 months:	- 17.69%	- 32.36%
Annualized Return since inception:	+ 23.44%	+ 9.67%

Long Short Performance	Fund	Ibovespa in USD
YTD:	- 0.17%	- 11.17%
Last 12 months:	- 9.53%	- 32.36%
Annualized Return since inception:	+ 9.89%	+ 25.67%

Dear Investor,

The second quarter was one of those periods that challenge investors' convictions. After strong markets in the beginning of the year, especially driven by lower-quality or high-beta companies, the second quarter was quite the opposite as commodity-related companies, homebuilders and banks were mostly responsible for the sell-off.

The market correction was intensified by foreign investors' USD1.8bn outflows from already-listed stocks in the quarter, which were in fact offset by inflows into IPOs (initial listings are not included in the Ibovespa index calculation). The outflows were mainly driven by macro factors: European crisis, unemployment in the US and concerns regarding China lower growth. In addition to that, Brazilian macro figures have been coming out weaker: GDP close to 2% this year, mainly due to softer industrial production and lower consumer leverage. This is why, in general, retail sales have been coming out lower in the last months compared to the same months of 2011.

As a consequence of a weaker GDP, Brazil's Central Bank shows no signs of bringing to an end the country's year-long easing cycle. As mentioned in our previous letter, we are currently at the lowest cost of capital period of the last decades, but still there has been no significant inflationary pressure. This new Brazilian interest rate level, if sustainable, should allow the country to grow significantly, perhaps not as high as the 4% average from the 2003-2010 period, yet probably much higher than the 1.9% of the last 12 months.

Long Only strategy performance and exposure

Despite international investors not being that interested in Brazilian stocks lately, our long portfolio performed relatively well. Our Long Only fund was down -11.96% in the quarter (mainly due to currency depreciation), compared to -23.54% of the Ibovespa in USD. Year-to-date our Long Only fund is up +4.56% while the Ibovespa in USD is actually down -11.17%.

We believe our companies have performed well due to good reported operating results, even in a low-GDP environment. Most of our companies have delivered good numbers because they are in industries with resilient demand and/or they have competitive advantages. Besides, some companies have either been consolidators in their industries or come up with new promising projects. These were the cases of: (i) Kroton, continuing to be the consolidator in Education, especially in Distance Learning ("e-learning"), now becoming the leader with more than twice the number of students than its closest competitor; (ii) Ecorodovias, a company that we will describe in detail in this letter and a position which we have increased during 2Q12.

We mentioned last quarter that our cash level was a touch higher than 20%, given that we did not find enough interesting opportunities to invest in. Since then, (i) as stock prices of companies we monitor fell off significantly, (ii) interest rates kept on falling and (iii) growth is at a moderate pace; we became more comfortable to put money to work and also to add to existing positions. At the end of the quarter, our Long Only strategy was close to 95% invested.

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Long Short strategy performance and exposure

In the second quarter of 2012, Class B (our Long Short strategy offshore) was down -5.11%, and -0.17% YTD. It is worth pointing out that the long book of the Long Short strategy is almost identical to the Long Only, but weighted differently due to the composition of the short book. Other major differences are basically the net exposure and the shorts. We'll focus on both in the following paragraphs.

Regarding the net exposure, given the market correction in the quarter and the permanent search for new investment alternatives, as mentioned, we did find new places to put our money to work and also increased the size of existing positions. At the end of the quarter the net was at the 40% level (32% Beta adjusted). The gross exposure was also raised to 85%, with the addition of new shorts.

On the short side, we are finding interesting stand-alone ideas and themes. Not all is rosy in the Brazilian economy. There is no credit bubble, but the consumer is definitely less euphoric and more conservative. Some consumer discretionary stocks, that are priced for perfection should disappoint. Increased competition is another challenge some companies are facing. Some are less well-prepared to face it.

We are also finding some valuation asymmetries in Financials, Power and Infrastructure, while our investments in Education (through Kroton and Abril) continue to be our main long positions. In sum, we have been adding more risk to the strategy based on valuation and companies' dynamics, not much based on macro views.

Ecorodovias' investment case details

Throughout this year, we have been increasing our investment in Ecorodovias gradually, as we have become more and more comfortable with the company's strategy and management team. We started to monitor the company a few years before its IPO, back in April 2010. The reason for such interest was that Ecorodovias has been one of the most successful players in Infrastructure in Brazil for the last 15 years, especially in toll-roads. As a reference, it is commonly treated as a "benchmark" in our monitoring and research process.

The company's business model is based on finding ways to address the lack of transport infrastructure in the main logistics corridors in Brazil. Basically the pillars of our thesis rely on growth opportunities from unfulfilled demand for infrastructure, given the Government's limited balance sheet. The thesis is supported by the experienced management team, proven to know how to extract value from such opportunities, and by the company cash-generating assets, with high returns, in premium locations.

Main assets – sound and growing revenues and cash flow

The company operates 6 toll-roads concessions acquired during the Federal and State governments' privatizations (toll fees represented 78% of Ecorodovias' 2011 revenues). These highways are at privileged locations as they are part of the main logistics corridors of the country: in the South and Southeast of Brazil, an area responsible for 72% of the GDP.

The founders' decision to invest in highways in the beginning of privatizations in the 90s was outstanding, as the IRRs of these projects were extremely high: between 18% and 20% a year in real terms. The rate of return was this high due to (i) uncertainties related to highways and its toll activities, as the sector regulations had not been tested before; and (ii) high Brazilian interest rates at that time.

The IRR did not seem as high at the moment of acquisitions as it did later on. Ecorodovias actually managed to be more efficient than projected under concessions' contracts. The company was able to keep up with the high operating standards of the highways, with significant improvement in security and adding capacity, yet with less capex than initially anticipated. This was the first driver of value creation.

The second driver responsible for leveraging the IRR came from traffic volume, which was in fact much larger than estimated. The strategic positioning of the highways definitely helped the company benefit from international trade growth over the last decade, generating even more value to its shareholders.

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The key driver for our decision to invest was not the potential increase in traffic flow but actually more related to the management of the company, as mentioned before. Throughout the years, the company opted to acquire highways in key areas in the South and Southeast of Brazil: responsible for a big portion of the GDP, with growing economic activity, where international trade passes through. A lot of highways were privatized in the last 15 years; some seemed “cheaper” than others. In some cases, and according to some competitors, Ecorodovias seemed to be paying up for some of these highways, but, in the end, opting for higher quality assets proved to be the key for success, as these assets generated much higher returns than first anticipated.

Here are a few examples that justify our high conviction on the quality of the assets: (i) Imigrantes group of 5 highways, the only highway complex to connect São Paulo to Santos Port (the largest port of Latin America, with 39% of container cargo’ market share); (ii) Ecopistas highway, the most modern to connect São Paulo to Rio de Janeiro state – the largest GDPs of the country; and (iii) Ecosul highway that connects Porto Alegre in the South of Brazil to Rio Grande Port and to Mercosul.

Another highlight in Ecorodovias case is its cash flow stability. Historically, cars and trucks’ traffic has been very stable and, in fact, a multiple of GDP growth. Not to mention that the toll-road concession contracts are linked to inflation, so one can say that these contracts are in “real terms”.

Logistic Terminals – an emerging business that could be a growth catalyst

Besides roads’ concessions, 16% of the company’s last year’s revenues came from logistic terminals. Ecorodovias’ terminals are located in their highways influence area, therefore bringing a strong competitive advantage to Ecorodovias in terms of logistic packages (or “one-stop-shops”) to be offered to their clients.

Even though this business still represents a small portion of the revenues and cash generation, it has been growing tremendously and it has proved to be very profitable. A challenge in doing business in Brazil is actually related to the so called “Brazil cost” and it has a lot to do with the poor infrastructure and lack of quality of logistic services in the country. We strongly believe Ecorodovias is one of the best players to take advantage of this opportunity, present solutions to this growth bottleneck and still provide good returns (as we have seen until now).

We see this move as an initial step in the company’s strategy to integrate highway and port assets to service providing through logistic terminals. The recent acquisition of a terminal at Santos Port (the most important port in Brazil) shows how focused the company is on growing a business where it possesses a strong competitive advantage.

Financial highlights and capital structure

When we first invested in the company, we estimated an approximately BRL 1.2bn EBITDA for this year, which would leave the company with a low debt/EBITDA level (close to 0.9x). We saw the company as an excellent combination of stable cash generation, in a low-cyclical business and with natural monopolists’ characteristics (as it is extremely hard for a competitor to come up with another alternative for a highway). On top of that, strong growth should come from the company’s ability to consolidate logistics solutions and possibly add new investment opportunities in their current highways and/or other transport businesses such as airports.

Even though this is a pretty stable business from the cyclical point of view, Ecorodovias was able to double its EBITDA in the last three years. An interesting exercise to do is to compare this case to other “more appealing” ones in terms of potential growth. These other examples commonly under delivered, while this not-so-exciting highway and logistics business was able to double its profits!

Opportunities to keep on profitably growing

The Government (either Federal or at the State levels) does not have enough funds to make basic investments in Education, Healthcare, Social Security; to cover their expenses and still allocate capital to infrastructure. However, the country needs plenty of investments in highways, ports and airports. Ecorodovias created a sound platform (financially speaking as well as in terms of its operational and management capability) to service this demand. A real and unmet demand allows the company to capture significant and differentiated levels of return.

Current Ecorodovias’ investments have a return between 9 and 15%. We believe the company should keep on delivering such high level of returns as investment opportunities come up.

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Ecorodovias investment and the expected return

Ecorodovias highways – the company’s main assets – have a real and unlevered IRR ranging from 10.3% to 20.6%. If we compare that to the Brazilian risk free rate, the company’s spread is actually around 7% and 8%; providing a comfortable margin of safety.

Our due diligence indicates that authorities and regulators are working with additional investments (apart from what was initially estimated on contracts) of BRL 3.3bn to either improve highways’ conditions or increase capacity in the next 3 to 4 years. Extensions to current concessions would actually generate additional value to shareholders of BRL 1.2bn to BRL 1.5bn. That is already considering a minimum real IRR close to 9%, significantly lower than the current contracted IRR.

In terms of consolidated cash flow to equity, Ecorodovias’ stocks bring almost 12% real IRR to shareholders today; not considering, once again, opportunities that could be created by using the company’s balance sheet to invest in other assets and businesses (“free-options” to current shareholders). We see the company trading at 13x 2013 PE – a multiple that does not translate the premium asset it represents in our view.

We believe Ecorodovias’ ability to keep on delivering strong earnings growth is understated. We think earnings could grow around 17% a year, compared to an annual 53% realized in the last 4 years.

Risks involving our investment that we monitor in detail (which our analysts have been giving special attention to) are related to: (i) the company’s investment decisions, mainly those involving new businesses (ports and airports, specifically); (ii) attracting the right people to manage these new businesses.

It is important to note that as the Brazilian economic activity is growing at a slow pace for a while (and below its potential), we are also working with weaker traffic flow for Ecorodovias’ highways than in previous years: 2% for this year, in line with the GDP in the past. Still, toll-road revenues should grow as high as 9%, given price increases implemented throughout this year. The company’s consolidated revenues should grow in the north of 10%. These figures make us comfortable with the company, as, even in a low-GDP environment, Ecorodovias should deliver solid growth numbers (organic earnings should grow, this year, 13% and 17% considering recent acquisitions).

New addition to our team

We are pleased to share with our investors that Luciano Ferreira has just joined as a senior investment analyst. Luciano has more than ten years of professional experience. Previously, he worked for a combined six years as a buy-side analyst at two value-oriented funds, Dynamo Asset Management in Rio de Janeiro and Cantillon Capital Management in New York. Earlier in his professional life, Luciano worked in Investment Banking at UBS and was part of a group of advisors to the secretary of finance of the State of Sao Paulo. He holds a BA in business administration from Fundação Getúlio Vargas and an MBA from Columbia Business School. We would like to welcome Luciano to the Constellation team.

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

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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.

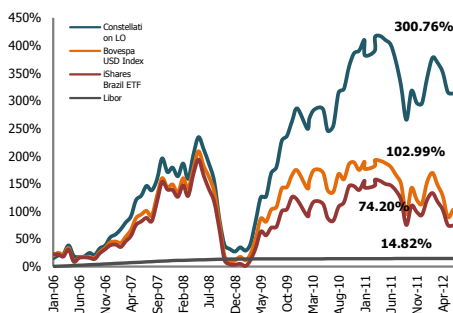
Share Appreciation (Net of all fees and audited by KPMG)

	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%							4.56%	300.76%	

Sector Exposure (Delta Adjusted)

Sector	% Long NAV
Education	17.38%
Utilities	16.07%
Metals & Mining	11.13%
Financials	10.87%
Homebuilders	9.97%
Infrastructure	9.43%
Services	8.78%
Consumer Discretionary	5.27%
Healthcare	4.42%
Sugar & Ethanol	3.25%
Others	1.15%
Energy	1.07%
Industrials	0.00%
Consumer Staples	0.00%
Total	98.80%

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



Number of Positions

Stocks	28
Investment Cases	16

Value per share (net of all fees)

As of June 29th, 2012 **457.3402**

Stock's Sector Contribution

Outperformers	% NAV
Utilities	0.45%
Metals & Mining	0.40%
Homebuilders	0.38%
Underperformers	% NAV
Financials	-0.58%
Homebuilders	-0.47%
Education	-0.39%

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

Tenor	
1 Day	31.8%
1 Week	63.5%
1 Month	85.9%

Market Capitalization

>US\$10 bn	23.5%
>US\$ 1bn and <US\$10bn	70.0%
<US\$1 bn	5.2%
Total Equity Exposure	98.8%

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 per Strategy:	US\$ 583,419,978

* Equities Class

Risk x Return Profile (since inception – net of all fees)

Annualized Return	23.47%
Annualized Ibovespa USD Return	9.67%
Annualized Standard Deviation	35.49%
Ibovespa USD Annualized Standard Deviation	42.46%
# of Positive Months	50
# of Negative Months	29
Best Monthly Return	29.69%
Worst Monthly Return	-27.40%
ISIN:	KYG238261112
* Risk free rate is T-Bill 90 return.	

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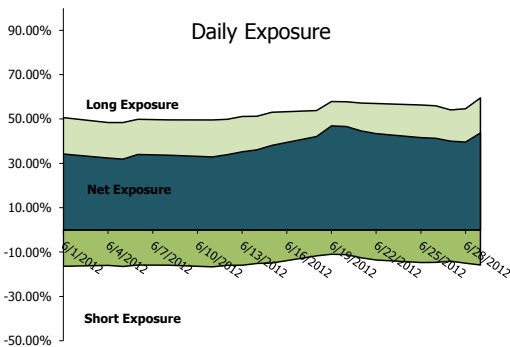
Constellation Fund SPC Class B - Long Short

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. The fund's net exposure generally remains between 10% to 50% net-long, and leverage is used conservatively.

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%							-0.17%	147.10%	



Sector Exposure (Delta Adjusted)

Sector	Long	Short	Gross	Net
UTILITIES	12.3%	0.0%	12.3%	12.3%
EDUCATION	7.9%	0.0%	7.9%	7.9%
FINANCIALS	8.8%	-1.4%	10.2%	7.4%
INFRASTRUCTURE	5.0%	0.0%	5.0%	5.0%
HOMEBUILDERS	5.0%	0.0%	5.0%	5.0%
METALS & MINING	5.5%	-0.8%	6.3%	4.7%
SERVICES	4.2%	0.0%	4.2%	4.2%
ENERGY	1.7%	0.0%	1.7%	1.7%
CONSUMER DISCRETIONARY	2.5%	-1.0%	3.4%	1.5%
SUGAR & ETHANOL	1.3%	0.0%	1.3%	1.3%
HEALTHCARE	2.0%	-0.9%	2.9%	1.2%
OTHERS	0.9%	0.0%	0.9%	0.9%
INDUSTRIAL	0.0%	-0.2%	0.2%	-0.2%
CONSUMER STAPLES	0.0%	-0.3%	0.3%	-0.3%
PULP & PAPER	0.0%	-1.6%	1.6%	-1.6%
ETFs/IBOV	2.5%	0.0%	2.5%	2.5%
OPTIONS	0.0%	-9.7%	9.7%	-9.7%
Total	59.52%	-15.82%	75.35%	43.70%

Total Portfolio P/L (gross of performance fee)

	Apr12	May12	Jun12	2012
Longs	(0.52)	(1.80)	(1.03)	3.49
Shorts	(0.02)	1.36	0.54	0.10
FX/FX Options/Fixed Income	(1.49)	(2.08)	0.24	(2.82)
Equity /Index Options	0.17	0.12	(0.16)	0.12
Others Expenses	(0.17)	(0.17)	(0.18)	(1.02)
Total	(2.03)	(2.57)	(0.59)	(0.17)

Number of Equity Positions

Long	28
Short	8

Value per share (net of all fees)

As of June 29 th , 2012	206.8811
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Overall strategy liquidity (1/3 of daily average traded volume)

Tenor	Long	Short
1 Day	61.7%	70.6%
1 Week	85.2%	100.0%
1 Month	100.0%	100.0%

Market Capitalization

	Long	Short
>US\$10 bn	19.7%	10.5%
>US\$ 1bn and <US\$10bn	37.2%	5.3%
<US\$1 bn	2.6%	0.0%
Total Equity Exposure	59.5%	15.8%

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 per Strategy:	US\$ 219,550,528

Risk x Return Profile** (since inception - net of all fees)

Annualized Return	9.90%
Annualized Standard Deviation	10.57%
Sharpe Ratio*	0.77%
# of Positive Months	53
# of Negative Months	39
Best Monthly Return	11.14%
Worst Monthly Return	-7.55%
ISIN:	KYG238261039
* Annualized T-Bill 90 daily return.	

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The performance data is net of all fees, allocations and Expenses (and based on return of an investor participating in "new issue" securities). This performance data was (audited by KPMG/Unaudited) and has been computed by the Investment Manager. Actual performance will also vary for individual investors depending upon, among other factors, the timing of investment and withdrawals (and the investor's eligibility status regarding receiving profits and losses from "new issues") (the performance data includes reinvestment of dividends). Past performance is not indicative of future results.

The Dow Jones is a well-known stock market index which is included merely to show the general trend in the equity markets in the periods indicated and is not intended to imply that the Fund's account is comparable to the index either in composition or element of risk.

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