Constellation: Management Report 2Q15

Long Only Performance	Fund	Ibovespa in USD
YTD:	- 10.82%	- 9.42%
Last 12 months:	- 27.16%	- 28.80%
Annualized Return since inception:	+ 13.73%	+ 1.60%

Long Short Performance	Fund
YTD:	- 0.24%
Last 12 months:	- 9.26%
Annualized Return since inception:	+ 7.28%

Dear Investor,

In the 2nd quarter the Long Only fund was up 7.29%, accumulating -10.82% for the year, in line with the Brazilian market. The bulk of the negative performance this year is due to the Brazilian Real depreciation, -14.66%. In local currency the market is doing relatively fine.

In the last quarter the economic activity has remained weak, and should remain so for the whole year. We still see a challenging environment for earnings in the short term. Companies are finding it hard to grow the top line, while cost (labor and utilities) has been growing. The silver lining is that the government is working hard to fight inflation and to get to a decent fiscal surplus. Once there is better visibility on when inflation is going to recede, interest rates should come down and this could be a boost to the economy, earnings and the market.

In the current unexciting macro environment we are happy to invest in companies that have the ability to grow earnings consistently at mid-teen rates. We call them compounders. Compounders are rare animals, by the way. They are hard to find. When you find one, study thoroughly why it has been able to grow earnings nicely and if it will continue to do so. If it is trading at an attractive valuation, invest big.

What makes a company able to grow consistently is usually a strong franchise, which allows it to raise prices at or above inflation if needed. Being able to grow the top line and benefit from economies of scale is a powerful combination. Economies of scale are important because they bring operational leverage, leading to earnings growing at higher rates than revenues. In addition, having the opportunity to re-invest earnings at high rates helps compound growth for the long run. As Charlie Munger says it:

“The ideal business is one that generates very high returns on capital and can invest that capital back into the business at equally high rates. Imagine a $100 million business that earns 20% in one year, reinvests the $20 million profit and in the next year earns 20% of $120 million and so forth. But there are very few businesses like this. Coke has high returns on capital, but incremental capital doesn’t earn anything like its current returns. We love businesses that can earn high rates on even more capital than it earns. Most of our businesses generate lots of money, but can’t generate high returns on incremental capital — for example, See’s and Buffalo News. We look for them [areas to wisely reinvest capital], but they don’t exist. “

"Over the long term, it's hard for a stock to earn a much better return than the business which underlies it earns. If the business earns 6% on capital over 40 years and you hold it for that 40 years, you're not going to make much different than a 6% return—even if you originally buy it at a huge discount. Conversely, if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you'll end up with a fine result."

There is one caveat to be a compounder; consistency in growing earnings is paramount. However, once you built the franchise and earn superior returns, competition will certainly come and most of the times force returns down. In order to stay profitable, companies need to build barriers of entry. Barriers of entry are not obvious at all. Most people think that access to capital, brands and size are unique barriers. They are not. Capital is abundant in today's world. Brands do not guarantee customer loyalty. Size matters only if it helps you benefit from economies of scale.

In the end of the day, real barriers of entry are customer captivity, monopolies/patents and economies of scale (usually large and complex distribution networks). All the companies in our portfolio have one or more of the aforementioned characteristics. Some noticeable examples: Abril Educação (k-12 education) has huge barriers of exit. It is very costly for a school to switch to another Learning System. From a parent's perspective, it is not without cost to move your kid to another school. Cielo (credit card acquirer) has huge scale with the largest network in the acquiring business. BRF also benefits from having the largest refrigerated distribution network in Brazil. Kroton benefits strongly from scale and definitely has costumer captivity. All of these companies also have strong franchises. They add value to their customers and have consistently been able to grow earnings. We would like to focus on two additional compounders, Linx and Equatorial.

Linx

Linx is the indisputable leader in software for retailers in Brazil. It has 33% market share, larger than the sum of the 2nd, 3rd and 4th players.

SaaS - Software as a Service is a fancy name of a business model where the client does not own the software, but pays recurring revenues to use it, as a subscription. The acronym SaaS started to be used in 2001, but Linx had such business model long before, since its foundation in 1985, even when cloud applications were not available.

By designing its revenue model as a subscription, Linx has lower revenues in the beginning of its relationship with the client since it does not charge license fees, but maximize the net present value of that client in a long lasting relationship. Churn, therefore, is critical, and has been very low, around 3-4% a year.

We understand churn will remain low in the future due to high barriers to exit for the clients. Linx's main products are ERPs and POS (Point of Sale) software, both highly critical to clients' operations, very complex to change once the company adapted to it and it is not much of clients' expenses (we estimate that it represents around 0.5% of expenses).

Focus and specialization were key to take Linx to this strong position. In some sub-verticals, like apparel, Linx's leadership is especially strong (we estimate it might reach 80% in specialty apparel retail). This fortress in a segment creates material economies of scale – retail software R&D is diluted in a much larger client base – in addition to customer captivity.

The combination of high barriers to exit to the clients, with inflation protected revenues and economies of scale is very powerful, and makes Linx a classical compounder: add clients in their niche market where they are very dominant, grows its revenues when its clients expand their store base, has a churn lower than inflation that adjusts its revenues, and, on top of that, deploys capital in acquisitions, always in the retail universe (we estimate the consolidated after tax ROIC of their 19 acquisitions to be 17%).

Although attached to the growth of stores of its clients, Linx is not a retailer, and does not grow its revenues based on its clients' sales. Some of Linx's largest clients are conducting material expansion plans regardless macro challenges ahead of us: Lojas Americanas, being Linx largest client, is an important example, intends to nearly double its number of stores in 5 years, and every new store imply additional inflation adjusted recurring revenues to Linx. There are several others strong retailers that use Linx software, and will keep on consolidating their markets (e.g. Renner, Arezzo) and expanding their store base.

We understand that these factors explain why Linx has grown organically 19% per year in the past 5 years, and we expect it to keep growing 14% per year for a long time. Linx's subscription model imply 100% conversion of earnings in cash, and its EPS has grown 18% per year since 2008, even with its share count increasing 2.4x in the period. We have high conviction on our EPS growth expectation of around 15% for many years.

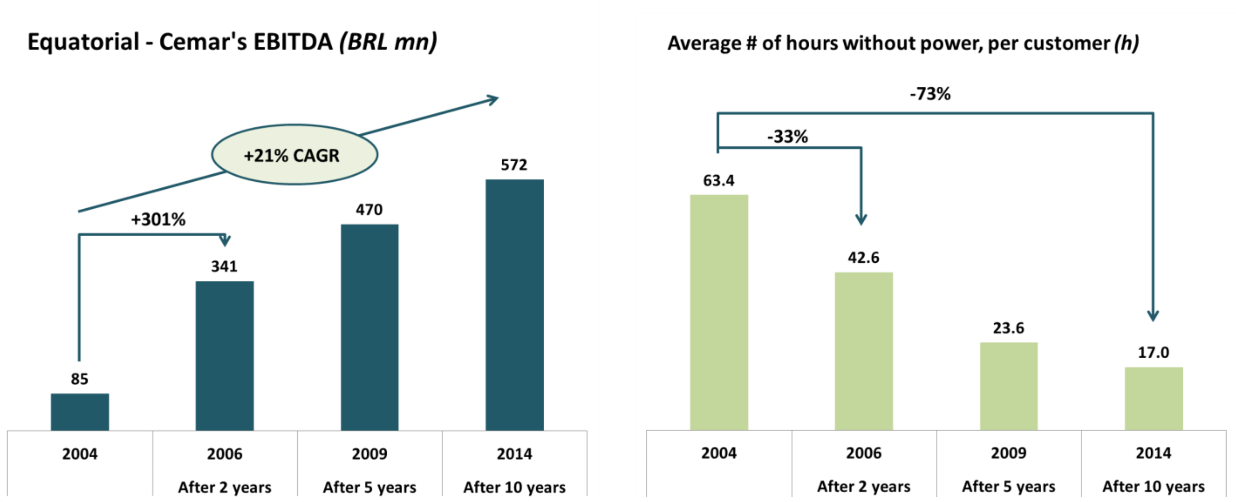
Equatorial

Equatorial owns electricity distribution concessions in the northern States of Maranhão and Pará, and also holds investments in power generation. It is a company in which we have been investors in the past 3 years.

The IPO of Equatorial was in 2006, two years after the company was re-structured by GP Investments. At the time, it had only one asset: Cemar, the electricity distribution concession in Maranhão. When the new management took over, the company was highly indebted and had very inefficient operations.

Cemar became continuously more efficient: they went from 32nd place in quality of service in Brazil in 2004, to 3rd in 2014. The financial results also followed: its EBITDA increased from BRL 85 mm in 2004 to BRL 340 mm in 2006, up 300% in the first two years with the new management, and has grown to BRL 570 mm in 2014 (compounded at 21% per year).

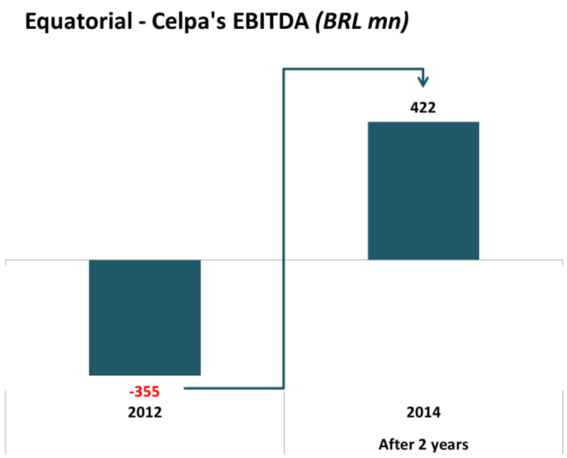
Cemar: better results, higher quality standards

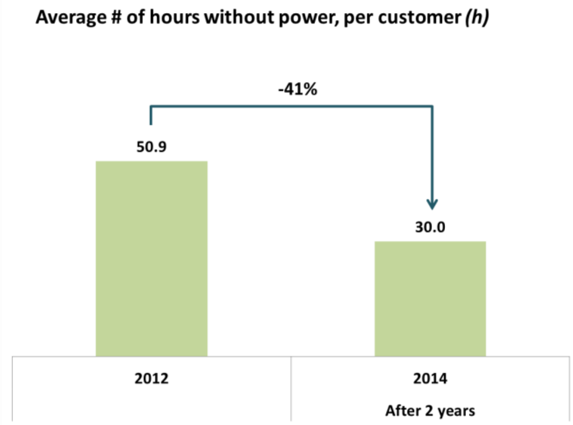


Applying the experience obtained in the successful turnaround of Cemar in other similar operations was a potential source of incremental value creation. While opportunities did not arise, Equatorial proved its capital discipline and returned capital to its shareholders. In the 5 years following the IPO, which valued Equatorial at BRL 1.0 bn, the company returned BRL 700 mm in dividends.

In 2012, the opportunity for an acquisition finally came: Equatorial bought Celpa, the electricity distribution company in the State of Pará and since then its turnaround has been the management's major challenge. This new opportunity triggered our investment. In about 2.5 years, the results are impressive: Celpa, which had negative EBITDA (BRL -355 mm in 2012), now generates more than BRL 400 mm/year.

Celpa: once again, Equatorial performed significant improvements





What's important about both the acquisitions of Cemar and Celpa is that the price paid by Equatorial had a very reasonable margin of safety. Both companies were acquired with a substantial discount to the value of the assets, and at the same time Equatorial had the skills needed to multiply their earnings power and obtain attractive returns on the invested capital.

Equatorial is another good example of a compounder. Electricity distribution is a (natural) regulated monopoly, and therefore a business with a huge barrier to entry where pricing and competition are not major concerns.

As a regulated company, Equatorial's exposure to economic cycles is far less intense, which leaves us comfortable with our investment even in an adverse time of GDP growth. Simply put, the remuneration for the operation of the distribution network is raised if its cost of capital increases, making it a resilient company.

In addition to the improvements in Celpa, Equatorial is well positioned to acquire other distribution companies and once again replicate successful turnarounds. Furthermore, industry consolidation could bring clear benefits to all stakeholders: local population would have a better quality of service, the State could increases tax revenues, while the operation would be more profitable to its shareholders, which in turn would help increase investments in the concession and perpetuate this virtuous circle.

Equatorial's recurring cash flow should reach BRL 800 mm/year in 2016 (11% yield), which in practical terms could allow Equatorial to buy another company as big as Celpa. Equatorial trades at 11x P/E 2016, with an expected annual IRR of 20% in BRL for the next 3 years.

We are enthusiastic with the opportunity set in the Brazilian market regarding quality of companies and valuations. When the economy is going to improve and the market to reflect that, we don't know. We'll continue working hard and visiting companies (615 visits ytd), and we'll wait patiently. A final note from Charlie Munger again:

"How do you get into great companies? One method is what I'd call the method of finding them small get 'em when they're little. For example, buy Wal-Mart when Sam Walton first goes public and so forth. And a lot of people try to do just that. And it's a very beguiling idea. If I were a young man, I might actually go into it.

But it doesn’t work for Berkshire Hathaway anymore because we’ve got too much money. We can’t find anything that fits our size parameter that way. Besides, we’re set in our ways. But I regard finding them small as a perfectly intelligent approach for somebody to try with discipline. It’s just not something that I’ve done.

Finding ’em big obviously is very hard because of the competition. So far, Berkshire’s managed to do it. But can we continue to do it? What’s the next Coca-Cola investment for us? Well, the answer to that is I don’t know. I think it gets harder for us all the time....

And ideally we’ve done a lot of this—you get into a great business which also has a great manager because management matters. For example, it’s made a great difference to General Electric Company (NYSE:GE) that Jack Welch came in instead of the guy who took over Westinghouse— a very great difference. So management matters, too.

Occasionally, you’ll find a human being who’s so talented that he can do things that ordinary skilled mortals can’t. I would argue that Simon Marks—who was second generation in Marks & Spencer of England—was such a man. Patterson was such a man at National Cash Register. And Sam Walton was such a man.

These people do come along—and in many cases, they’re not all that hard to identify. If they’ve got a reasonable hand—with the fanaticism and intelligence and so on that these people generally bring to the party—then management can matter much. However, averaged out, betting on the quality of a business is better than betting on the quality of management. In other words, if you have to choose one, bet on the business momentum, not the brilliance of the manager.

But, very rarely, you find a manager who’s so good that you’re wise to follow him into what looks like a mediocre business.”

- Charlie Munger’s speech, “A Lesson on Elementary, Worldly Wisdom As It Relates To Investment Management & Business”.

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 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.

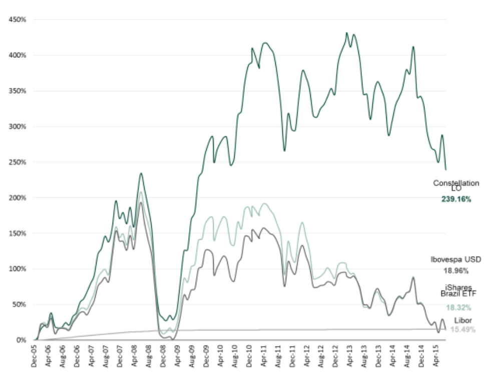
Share Appreciation (Net of all fees and audited by KPMG)

	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%	2.69%	3.07%	5.48%	-1.21%	7.94%	-13.82%	0.38%	-2.96%	-8.76%	-9.74%	280.31%
2015	-5.53%	-1.12%	-11.02%	10,92%	-7.34%	4.39%							-10.82%	239.16%

Exposure (Delta Adjusted)

Sector	% Long NAV
Financials	26.46%
Education	16.50%
Consumer Staples	14.67%
Utilities	10.65%
Services	9.59%
Consumer Discretionary	4.94%
Pulp & Paper	3.51%
Industrials	3.43%
Infrastructure	1.50%
Total	**91.24%**
Exposure to BRL	91.60%

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



Number of Positions

Stocks	22

Value per Share (net of all fees)

As of June 30th, 2015	387.1117

Sector Attribution (month)

Outperformers	% NAV
Financials	1.04%
Education	0.50%
Utilities	0.45%
Underperformers	**% NAV**
Services	-0.44%
Industrials	-0.07%
Pulp & paper	-0.01%

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

Tenor	
1 Day	44.3%
1 Week	74.0%
1 Month	87.5%

Market Capitalization

>US$10 bn	41.1%
>US$ 1 bn and <US$10 bn	42.7%
<US$1 bn	7.4%
Total Equity Exposure	**91.2%**

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$ 651,178,077

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

Annualized Return	13.73%
Annualized Ibovespa USD Return	1.60%
Annualized Standard Deviation	31.70%
Ibovespa USD Annualized Standard Deviation	47.70%
# of Positive Months	69
# of Negative Months	46
Best Monthly Return	29.69%
Worst Monthly Return	-27.40%
ISIN:	KYG238261112

Constellation
ASSET MANAGEMENT

Intended to the recipient only - CONFIDENTIAL

Constellation Fund SPC Class B - Long Short

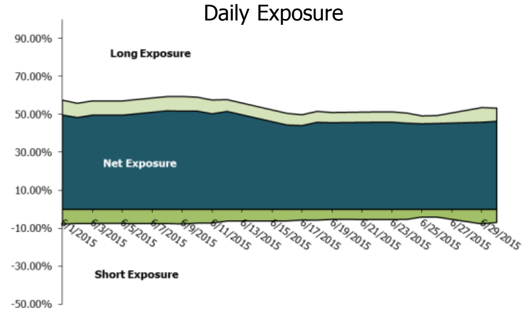
Fund Objective

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%	1.94%	1.90%	2.73%	-1.44%	5.61%	-8.51%	1.08%	-1.01%	-4.53%	-2.96%	137.39%
2015	-1.59%	0.75%	-4.21%	5.34%	-2.51%	2.27%							-0.24%	136.82%

Daily Exposure



Sector Exposure (Delta Adjusted)

Sector	Long	Short	Gross	Net
Financials	13.5%	0.0%	13.5%	13.5%
Services	9.6%	-1.7%	11.3%	7.9%
Education	7.6%	0.0%	7.6%	7.6%
Consumer staples	7.2%	0.0%	7.2%	7.2%
Utilities	6.9%	-2.2%	9.1%	4.8%
Industrials	2.5%	0.0%	2.5%	2.5%
Consumer discretionary	2.1%	0.0%	2.1%	2.1%
Pulp & paper	1.7%	0.0%	1.7%	1.7%
Energy	0.7%	0.0%	0.7%	0.7%
Infrastructure	0.7%	0.0%	0.7%	0.7%
Fuel distribution	0.6%	0.0%	0.6%	0.6%
ETFs/ Ibov/ Options	0.0%	-3.1%	3.1%	-3.1%
Total	**53.3%**	**-6.9%**	**60.2%**	**46.3%**
Exposure to the BRL				40.90%

Total Portfolio P/L (Gross of Performance Fee)

	Apr2015	May2015	Jun2015	2015
Longs	3.53%	(0.12)%	1.03%	4.03%
Shorts	(1.37)%	0.36%	(0.10)%	1.01%
FX/FX Options/Fixed Income	3.66%	(2.57)%	1.41%	(4.04)%
Equity /Index Options	(0.30)%	0.02%	0.13%	(0.07)%
Others Expenses	(0.18)%	(0.20)%	(0.20)%	(1.10)%
Total	**5.34%**	**(2.51)%**	**2.27%**	**(0.24)%**

Number of Equity Positions

Long	25
Short	3

Value per Share (Net of all Fees)

As of June 30th, 2015	198.2569

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

Tenor	Long	Short
1 Day	86.6%	100.0%
1 Week	99.9%	100.0%
1 Month	100.0%	100.0%

Market Capitalization

	Long	Short
>US$10 bn	21.4%	3.1%
>US$ 1 bn and <US$10 bn	27.1%	3.8%
<US$1 bn	4.7%	0.0%
Total Equity Exposure	**53.3%**	**6.9%**

Main Characteristics

Inception Date*:	November 30, 2004.
Initial Investment:	US$100,000
Subsequent Investment:	US$50,000
Subscriptions:	Last Business Day of the month.
Redemptions:	Available series: monthly with 3 months prior notice.
Payments:	3 business days after the redemption day.
Advisory Fee:	2.0% per annum.
Performance Fee:	20% of the profit paid annually or upon redemption.
Net Asset Value:	Daily net of advisory fee.
AUM of the Strategy:	US$ 77,044,475

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

Annualized Return	7.28%
Annualized Standard Deviation	11.00%
# of Positive Months	72
# of Negative Months	55
Best Monthly Return	11.14%
Worst Monthly Return	-8.51%
ISIN:	KYG238261039

* Annualized T-Bill 90 daily return.