

In the third quarter of 2022, Vista FIA return was 13.0%, compared to the 11.7% of IBOV in the same period.

The Vista Long Biased return was 13.8%, compared to 3.3% of the CDI in the same period.

Since its inception on January 1, 2015, the Vista FIA return is 216.1%, compared to 120.0% of IBOV in the same period.

Since October 26th, 2018, the Vista Long Biased return is 52.2% compared to 25.1% of the CDI in the same period.

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The concept of robust and perennial competitive advantages as a source of high returns on capital, proposed by Michael Porter, is certainly one of the most influential notions of management and investments in companies.

Published between the late 1970s and early 1980s, Porter's ideas helped investors sustain the merit of investing in companies with the expectation of generating additional value in the future, transcending Graham and Dodd's classic value investing method, according to which the return on investment would consist exclusively in the convergence of the discounted price of shares to the static value of assets. The avant-garde began to seek companies with competitive advantages and that were able to reinvest their profits at the same attractive rates applied to the capital initially employed. The reward would be obtained by increasing

the intrinsic value of the assets for a long period, and not by reducing the discount on time.

In today's world, it is a consensus that changes occur increasingly rapidly in all business segments. Companies need to deal with daily transformations in competition, technologies, and even consumer habits. **Naturally, the new environment demands adaptations on the evaluation of investments used by old models.**

Even in the 1990s, warnings about hyper competition already suggested that any advantage created in dynamic environments is ephemeral. Unlike the perfect competition, where there is no differentiation that provides abnormal returns, the most likely **scenario would involve a constant struggle to obtain temporary, sequential advantages that lead to dominance in long time horizons.**

The winning companies in this arena are those that adapt to operate with transient competitive advantages.¹ In other words: identify an opportunity in advance, exploit it to the fullest and move on to the next one before the current one dissipates. The incessant reconfiguration is key to the strategy, because navigating the waves of advantages becomes a continuous process, instead of a traumatic restructuring, either for the incumbent or for the aggressor.

¹Taxonomy introduced in Rita McGrath's The End of Competitive Advantage (2013)

"Every morning a gazelle wakes up it knows it must run faster than the fastest lion or it will be killed.

Every morning a lion wakes up it knows it must outrun the slowest gazelle or it will starve to death.

It doesn't matter whether you're a lion or a gazelle. When the sun comes up, you'd better be running."

Proverb popularized in Thomas Friedman's book
The World is Flat

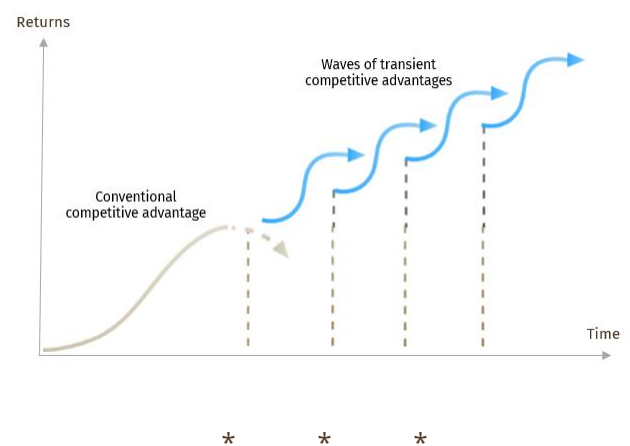
The organization must systematically idealize and drive good ideas, especially those with aptitude for scalability, whether they are products, processes, or technologies. If successful, the initiative should be capitalized. Originating a competitive advantage, the company will have from a few months to many years to exploit it, capturing economic profits, market share, and forcing competitors to react. Ideally proactively, it should radically rethink and reallocate the economic benefits of the previous venture into new seeds before the advantage is eroded.



The complexity of coordinating the necessary competencies is not negligible, given that each chapter demands distinct skills. Innovative minds will hardly have the aptitude for emotionally challenging decisions, such as malnutrition or demobilization of teams and business units. In addition, companies tend to be exploration-oriented and executives who manage these

broad lines tend to deal the cards without having any incentive to transfer resources to new ventures.

By linking these waves that lead from ephemeral superiority to ephemeral superiority, successful companies grow **without relying on just one disruptive foundation**. Perhaps this is why it is common to see fragmented sectors, with no evident entry barriers or competitive advantages encompassing large companies with returns on capital higher than their peers. **Because they do not have a single and obvious vector of superiority, they are investment opportunities that could not be summarized in a "silver bullet."**



Throughout its history, **Localiza** has created a series of transitory advantages, putting itself ahead of its competitors. Several of these advantages emerged as solutions to internal problems or bottlenecks in the car rental activity but ended up becoming decisive for the growth of the business in a sustainable and profitable way.

The car rental business consists of 4 equally relevant steps:

1. Fundraising: obtain a balanced capital structure between equity and debt that allows the lowest possible financing cost;
2. Vehicle purchase: mix of correct and diversified fleet, searching better conditions for acquisition of zero km vehicle;
3. Vehicle rental: profitability of the asset through high usage rates, correct pricing, and cost efficiency; and
4. Sale of the vehicle: sale of the asset at the right time and channel to minimize maintenance costs and maximize the sale price.

Although we see how companies can differentiate themselves in each of these stages, the sector has no entry barriers.

Localiza was founded in 1973 by Salim Mattar, Eugênio Mattar, Antônio Cláudio, and Flávio Resende with the purchase of six used and financed vw beetles. They immediately chose the customer focus as a differentiation strategy and created their first competitive advantage: serving customers 24 hours a day, 7 days a week. At the time, the founders took turns sleeping at headquarters.

Inserted in a capital-intensive industry, Localiza realized that scale and cheap financing would be instrumental for the company's success.

In 1979, the company initiated a series of acquisitions of competitors to increase its scale and to extend discounts in cars purchase. In 1983, it launched the franchise program to accelerate scale growth without increasing capital expenditure.

To get an advantageous negotiation with the automakers, they needed to buy 10,000 vehicles annually. On the other hand, the concentration of vehicles in specific models increased the discount charged on sale to wholesalers.

In the early 1990s, Localiza deployed a new branch on its strategy, perhaps the biggest competitive advantage since its foundation: the creation of *Seminovos Localiza*, to sell directly to end customers. Rental cars were seen as old and heavily used assets. To gain credibility with buyers, Localiza shortened the pre-sale rental time and invested in repair and maintenance. By reducing the life cycle on lease, the company started to buy more cars, increasing the scale, and allowing the diversification of models and brands.

In 1997, the 50-million-dollar investment to buy 33% of the company made by the DL&J fund brought governance maturity and professionalism to the business. The contribution allowed the issuance of 8 year senior bonds. Until then, companies in the sector were only financed within a maximum of 6 months and were subject to the high volatility of financing cost in the country. Financial stability has given space to further fleet growth.

In the late 1990s, Localiza was inspired by the American company Enterprise and created the replacement of crashed cars segment, a service sold to insurance companies to provide a replacement and temporary vehicle to the beneficiary. The concentration of service on a small number of customers compressed prices and required high fleet availability. The demand for a high level of service caused the company to have a more

sophisticated management, based on data from its operations: customer satisfaction, fleet activation time, wear and real depreciation, among others. The new segment not only provided a new increase in scale but led to the acquisition of the efficiency that increased the profitability of all segments of the company.

After years of increasing the scale of the operation, in 2012, the company suffered from the reduction of the IPI tax for new cars and the negative impact on the sale of semi-new ones. Localiza found itself in the need to increase its capillarity, but the situation of the country's economy was already showing signs of weakness and the company did not want to expand the fixed cost base with the construction of new semi-new stores. It was in this context that they created the *"wholesale"* channel, starting the sale of cars to resellers located in smaller cities. These resellers usually buy used cars in the State of São Paulo and Localiza saw an opportunity to reach a customer who would pay prices higher than the conventional wholesale channel. Once again, it was necessary to build credibility with the new channel, since the sale of used cars has great asymmetry of information between seller and buyer. Currently, Localiza sells cars through its website without the dealer even evaluating the car in person. The right decision increased the competitive advantage in the sale of vehicles.

It then created a competitive advantage in the pricing area. By 2014, replacement segments and corporate monthly renters accounted for almost 80% of the car

²Until that moment, most price lists were printed, which made it difficult to constantly change the tariff according to market data and competitor's price.

rental division. With the economy slowdown, the company realized that it needed to encourage the daily rate of individuals to reduce dependence on corporate revenue, which has more cyclical characteristics. A consulting firm was hired to assist in the construction of dynamic² pricing models and test the demand elasticity to price reduction. Between 2014 and 2019, the car rental division's tariffs fell 18.5% in nominal³ terms allowing fleet growth of more than 3 times, and rental EBITDA of 180%.

The growth in the period was also driven by the creation of the rental segment for app drivers, who were initially identified as rivals to the company's business. A pioneer in the segment, Localiza has established an important partnership with Uber. The rental company now has access to information about drivers that was not available to its competitors and has created a payment format with automatic retention of the driver's racing revenue. Both initiatives allowed the company to reduce default, the segment's main villain. Later on, the relationship with Uber could become an important piece in the internationalization of the company.

Experience with app drivers has also strengthened credit analysis, anti-fraud, and theft prevention, skills that would be critical to a new avenue of growth, *Localiza Meo*. The long-term rental program for individuals has great growth potential, mainly replacing vehicle financing. In 2021, Localiza took a major step towards expanding its scale by announcing the merger with Unidas, Brazil's second largest car rental company. We

³Accumulated inflation in the period was 32%, that is, the fall in prices in real terms was approximately 50%.

believe that the stages of purchase, sale, and maintenance of Unidas vehicles should be similar to Localiza, expanding the combined profits.

At the end of this study, the question “*What is Localiza's irreplicable competitive advantage?*” It seems very simple, especially when we agree that the industry's entry barrier is low or non-existent. If there is a brief answer to this question, it would be the business culture, which allowed several different managers, with different experiences and competencies, to consent to use the fruits of successful strategies and products to pave the way for the future. The company is publicly listed since 2005 and has accumulated annualized returns of 29% since then.⁴ Looking forward, the low penetration in Brazil of several services provided by Localiza seems to be an opportunity for companies with competitive advantages to continue generating value.

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In a brief report such as Localiza, the identification and implementation of a competence, technology, or segment creating an advantage seems simple, almost natural in an organization with so many talents. Reality is less kind to the entrepreneur, no matter how competent he may be.

If five years ago we were told that some company would be delivering 80% of the goods sold online in Brazil in up to 48 hours and 55% in up to 24 hours, we would attribute a low probability of success. The logistical challenges in the country, added to the tax complexity,

create one of the most difficult knots to be untied for the e-commerce sector.

These logistical figures were presented by **Mercado Livre** in the disclosure of results for the second quarter of 2022.

In internal discussions about Mercado Livre, the logistics theme was among the main risk factors of the company until the first quarter of 2020, given the high representativeness of Correios (the Brazilian Post Office) at that time. Today, just two years later, we see the topic as an important competitive differential – although it can be reproduced by its competitors, at a high cost of time and resources.

Mercado Envios

The Mercado Envios was founded in 2013. Until then, the delivery process had a high level of friction, especially when compared to competitors, who traded their own inventories. In each transaction, the buyer and seller needed to agree the value of the freight and the seller needed to deliver the goods using any post office branch. The trust issue between the parties was a hindrance to the conversion of sales, as well as the deadlines for sending and receiving.

With Mercado Envios Coleta, in partnership with Correios, goods started to be collected at the seller's address and an order tracking system increased transparency and trust in the platform. It was the possible solution for the Mercado Livre business model at that time, untying the knot of first mile. The company

⁴Considering reinvestment of dividends.

created distribution centers to consolidate the sellers' loads, but the goods only went to this center when the sale of a certain item was made.

The greatest evolution in Mercado Envios business model would come a few years later, with the launch of the fulfillment modality, in which the company stores the merchandise for the seller regardless of the sale of a certain item, doing all the management of the inventory, from receipt and storage to the delivery. As a result, the company is free to choose the last mile logistics supplier, being able to prioritize the level of service and addressing the historical concentration of Correios. It also has greater control over the goods that are traded on its platform, improving governance.

The model was created by Amazon in the US many years before but would face challenges in adapting to the Brazilian tax and logistical frameworks. In June 2015, Amazon's own entry into Mexico, another relevant market for Mercado Livre, may have been the spark needed for the company to be where it is today at the logistics front in Brazil. With a service level comparable to that available in the American market – aggressive in free and fast shipping, taking advantage of the proximity to its fulfillment centers in the USA – Amazon's movement in Mexico may have changed the Mercado Livre's sense of urgency in addressing its Achilles heel to be among the winners of online retail. More importantly, there was a window of opportunity, since the dreaded competitor had not yet accelerated in other markets where they compete, as he had done in Mexico.

Systems and Taxes

There was no way to address tax challenges other than with systems. The development of proprietary systems grants the necessary flexibility for route deviations in the experimentation process. They are also shaped for the company's operations and the markets in which they operate. A billing system, for example, may sound trivial, but given the complexity of an ecosystem with millions of buyers and sellers, in a country where each state has its tax framework becomes a differential. Similarly, a *Warehouse Management System (WMS)* is critical to efficient inventory management. There are good and reliable outsourced systems, which fulfill specific roles, but hardly any will fulfill all that are necessary. It is precisely in these gaps that proprietary flexibility makes up over the years in agility. These intangible assets are much more relevant for a fulfillment to be executed than fixed assets. Still, we understand that proprietary systems are competitive advantages with a shelf life.

Luck?

Before the pandemic, the representativeness of Correios within Mercado Livre sales had already decreased to less than 50%, but the efficiency of its own logistics was still very low. Manual processes, systems intelligence still in need to mature, and consolidation of goods by distribution center and carriers relatively low.

The pandemic would drastically change improvements speed of implementation. If before we would have imagined a horizon of years of investment until a good level of efficiency was achieved, now the discussion had changed to quarters. In Brazil, for example, the volume traded on the platform – called *GMV* – grew 23% in

2019. The GMV scale that was achieved in 2021, following the pre-COVID speed, would be achieved only after 2023. The cost per order of fulfillment was reduced by approximately 50% in 2020 and of similar magnitude in 2021. In short, a competitor that will invest in logistics without the same tailwind that the sector received between 2019 and 2021 will have a lower rate of return on these investments.

"Luck is what happens when preparation meets opportunity."

Roman philosopher Seneca

Overflow

The gain in scale brought not only cost dilution, but also other cascading benefits: (i) the increased demand for logistics services created a network effect of logistics partners, with more and more partners competing for it; (ii) with more competition, Mercado Livre manages to raise the level of service, creating punitive rules for partners that cannot meet the desired quality of service; (iii) service level improvement increases the value perceived by customers of these services on the platform; (iv) which, in turn, generates more recurrence of purchases; (v) attracting more salespeople into the company's logistics.

Mercado Envios does not generate a benefit only for the marketplace. Its effect overflow for other parts of Mercado Livre, to the example of Mercado Ads, the company's digital marketing initiative. To illustrate some of these cross-benefits of the ecosystem, in 2022 ads for goods in the "Full" modality obtained: (i) 3.2x more visits than in the basic modality of the company; (ii) 1.7x more

sales conversion; (iii) 5x more sales per ad. In other words, all the more constant, the investment of sellers in Mercado Ads can increase by up to five times maintaining the return on investment.

2022

In 2022, the company opened new distribution centers in two new states. As you move forward in the ambition for fast deliveries, new challenges emerge.

Also in 2022, the company entered a long-term partnership with Gol Airlines to lease 13 aircrafts for exclusive use. The scale will allow for a level of efficiency in air freight costs that no competitor would have. Even so, even at the maximum level of efficiency, this modality is more expensive than road freight and constitutes another investment in the logistics front. This investment will make it possible to deliver within 24 hours to customers who were used to up to 10 days delivery timeframe. Considering that sales conversion increases, on average, by 50% every business day less waiting on delivery, demand in these regions is expected to increase strongly, generating the virtuous supply network effects – from sellers on the platform to logistics partners.

In 2022 alone, the company is adding 4,000 new technology developers, totaling 12,000. Of these, about 2,000 are allocated to logistics development, a scale of human capital that no Brazilian competitor has the capacity to replicate.

As Mercado Livre expands, its capacity for sustainable investment also reaches another level, increasing the capacity to create competitive advantages that, however

transitory they may be, have a compound effect that is difficult to reverse.

Where is the competition?

In our assessment, Brazilian competitors offer levels of logistics service to sales made in the marketplace comparable to those that Mercado Livre offered in pre-COVID times. They are companies who do not possess the same capital structure robustness, reducing the investment capacity. In addition, they do not benefit from the same tailwind, whether it is market or opportunity cost that Mercado Livre had between 2019 and 2021.

Among the Asians, Shopee, which quickly became one of the protagonists of the Brazilian market, has placed its focus on profiting from the loss-making operation, reducing investments in Brazil and discontinuing operations in the other markets in which it competed with the Mercado Livre. The company does not have the logistics expertise in any of the markets in which it operates and would have to build this competence from scratch, something that has already proven not to be a priority.

Amazon, on the other hand, completely dominates the fulfillment intelligence and has a long-term commitment to Brazil. We have little doubt that they will have a good execution on this front, with investments increasing year after year, to be eventually accelerated if there is a change in the focus from other emerging countries, such as India. For now, the speed in Brazil has been below the speed of Mercado Livre, showing that regional frictions and the need for tropicalizations demand focus and time. Only recently, in September 2022, Amazon

opened its fulfillment centers for sellers who are above the limit of the Simples tax regime (sales above R\$4.8 million per year) and only for the states of São Paulo and Santa Catarina.

We focused exclusively on building the advantage in logistics, but Mercado Livre ecosystem is made up of many other segments and tools. Individually replicable, these segments and tools together form an expressive competitive differential, to be explored for many years, whose fruits can be reinvested in the creation of new differentials. Mercado Pago, Crédito, Ads and Mercado Envios are the ones we can glimpse today, but we hope to be surprised.

We remain at your service.

Vista Capital

Vista FIC FIA Historical Performance

Year	Vista FIA	IBOV
2015	3.2%	-13.3%
2016	53.7%	38.9%
2017	26.7%	26.9%
2018	24.5%	15.0%
2019	46.2%	31.6%
2020	9.9%	2.9%
2021	-20.8%	-11.9%
2022	-12.1%	-6.0%
Jan	3.7%	7.0%
Feb	-1.0%	0.9%
Mar	6.7%	6.1%
Apr	-12.9%	-10.1%
May	1.4%	3.2%
Jun	-9.2%	-11.5%
Jul	7.3%	4.7%
Aug	3.8%	6.2%
Sep	1.5%	0.5%
Since Inception	216.1%	120.0%

Vista Long Biased FIC FIM Historical Performance

Year	Vista LB	CDI
2018	2.9%	1.1%
2019	36.4%	6.0%
2020	21.8%	2.8%
2021	-14.7%	4.4%
2022	-8.3%	5.4%
Jan	6.9%	0.7%
Feb	-1.1%	0.7%
Mar	5.0%	0.9%
Apr	-12.1%	0.8%
May	0.8%	1.0%
Jun	-6.8%	1.0%
Jul	9.1%	1.0%
Aug	3.2%	1.2%
Sep	1.1%	1.1%
Since Inception	52.2%	25.1%

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