Vista Equities

Fourth Quarter of 2022

VISTA CAPITAL

In the fourth quarter of 2022, Vista FIA return was -8.8%, compared to the -0.3% of IBOV in the same period.

The Vista Long Biased return was -10.0%, compared to 3.2% of the CDI in the same period.

Since its inception on January 1, 2015, the Vista FIA return is +188.3%, compared to +119.4% of the Bovespa Index in the same period.

Since October 26th, 2018, the Vista Long Biased return is +37.0% compared to +29.1% of the CDI in the same period.

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In this letter, we explore in hindsight some reasons for the performance below our expectations.

A common factor for our investments is to keep the duration longer than the average of the Brazilian stock exchange, concentrated in companies in the commodities and financial sectors. It is a natural effect of investing in growing companies that reinvest their cash. In the period of exceptional and accelerated interest rate hikes that has marked the last 18 months, prices of long duration assets have suffered more than short duration assets.

Raising the economy's basic interest rates also raises financial expenses by putting pressure on companies' profit and cash generation. In situations like this, companies with controlled indebtedness and organic cash generation that covers the need for investments are benefited. Undervalued assets subject to monetization also play an important role in this risk equation.

On the fundamentals side, high volatility in the global environment, with war and its impacts on the supply chain, as well as reverberations in input prices and consumer confidence have also contributed to unexpected short-term exogenous impacts on some of our investees. The risk aversion environment throughout 2022, with an increase in interest rates during the election period, led a large number of investors seeking assets that offered greater predictability at the expense of companies that experienced some operational difficulty, putting pressure on the share price and, consequently, raising risk premiums.

It is natural that the short term is more affected by exogenous, non-structural noise, and shocks. However, short-term events and managerial reactions are important sources of information for the investor, even if their horizon is longer. In a set of short periods, it is possible to monitor the implementation of the plans, the management capacity, and the decision-making process when exposed to mishaps.

From the perspective of normalized results, which avoids clinging to the best or worst moments of the cycles, we see in our investees a successful history and a capable and committed management to restore the best financial performances. Depreciated stock prices and high premiums present an opportunity for the patient investor.

Investment is a marathon, not a short run. We constantly reassess our assumptions and decisions. We remain confident that our investments will present profit grow in the coming years.

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In our Q1 2022 letter, we discussed value generation through asset divestment. At the time, we addressed our investment in **BR Properties** from the perspective of recycling and simplification of the portfolio and, in light of the significant increase in interest rates and the company's leverage level, our opinion was:

"[...] *the path to the top of the cycle can be traced in a less costly way if assets performed are divested to reduce indebtedness. We see in the management of the company an interpretation in line with ours, and we believe that in this way the company will be better prepared to capture new opportunities.*"

In May, the company agreed to sell 12 developed and mostly mature real estate assets for[1] R$5.92 billion – a discount on the valuation value of 14%. The transaction was completed in July with payment of 70% of the agreed amount – the remaining 30% will be updated[2] and paid by July 2023.

The transaction was bigger than we initially imagined and reset the debt. In addition, the successive capital reductions demonstrate that there is no intention to seek new opportunities in the real estate market on the visible horizon. The net balance received was R$11.8 per share, equivalent to 100% of BR's enterprise value[3] at the beginning of 2022.

The first installment of R$8.0 per share was allocated to the prepayment of gross indebtedness of R$6.4 per share and to the capital reduction of R$2.4 per share – around 30% of its market value on the immediately preceding day –, still leaving a net cash that, at the end of October, was R$0.9 per share.[4]

In a second stage of capital structure adequacy, in January 2023, the company called a meeting to vote on the partial anticipation of the second installment of the transaction through a new capital reduction of R$2.75 per share and the distribution of its floor slab portfolio through a fund valued at R$2.66 per share.

Once the new reductions were approved, the remaining company would be worth only R$300 million on the stock exchange, including net cash and a portfolio of 224,000 m² of warehouses in São Paulo. We think that the current undervaluation is excessive, natural in transformations such as the one that the company is going through, and we still see the investment as asymmetric and uncorrelated. The low market value, a non-indebtedness structure, and the recurrence of cash flow also seem attractive for an eventual supply by residual capital.

The investment in BR Properties was the largest exposure and the main positive contribution of our funds throughout 2022. This exposure has been

[1] The relevant exceptions are the buildings in the Parque da Cidade, acquired completely vacant in 2020, and the Ventura Building, with vacancies above the portfolio average
[2] Adjusted by the IPCA until Dec/2022 and CDI from 2023

[3] Transaction amount net of taxes = $5,498 million
Market cap + net debt on 01/01/22 = $5,529 million
[4] According to the 2022 3rd quarter results *release*

passively decreased throughout capital distribution events.

Investments associated with the domestic consumption sector were the biggest performance detractors in 2022. Our investees had a year of market share gain within their segments, with satisfactory revenue growth, but dealt with important margin declines.

For **Alpargatas**, the margin pressure was due to the aforementioned exogenous factors that increased costs in general, from raw materials (commodities) to logistics costs. Price transfers were executed throughout the year, but transits on the company's result with some quarters delays. As an example, in Brazil, Havaianas' gross margin in the first quarter of 2022 was 36.3%, a 6% margin pressure versus the first quarter of the previous year. In the last quarter of 2022, we see that the company might present a good expansion of gross margin versus the same period of the previous year, starting 2023 with another level of profitability.

There were endogenous failures during the year, especially in serving the international market. The U.S. operation (3% of Havaianas revenue in 2022) dealt with larger and longer-than-expected one-off problems with its main customer (Amazon), as well as changes in operation management team. On the other hand, in 2022 the company made the largest investment in its history, which is expected to start generating results in 2023, from improvement in the service level to the international market to productivity cost gains.

Again revisiting our letter on divestments, we discussed Alpargatas' divestment agenda from 2018 to 2022, as well as the reinvestment of the released capital. In the case of the acquisition of 49% of Rothy's capital, the company seems to have paid a high amount, at a time of turning cycle, establishing a challenge to obtain a good return. In order to complete the acquisition, the company had a capital increase, so as not to leverage itself in the face of the most adverse scenario, keeping its capital structure with net indebtedness close to zero. The dilution corresponding to the acquisition was approximately 13%. Assuming the asset is worth zero, this would be the permanent loss of capital (it still seems early for more assertive conclusions as to Rothy's fair value).

Going forward, Alpargatas' organic cash generation allows the company to invest in its business and resume the market share gain trajectory in line with improvements in return on capital. Throughout the year, we increased our exposure in the company, which was a small position at the beginning of 2022, and ended the year among the main exposures of the fund.

Still in consumption, the investment in **Natura** was a great detractor for another year. However, the disappointments were not linked to the domestic environment as in 2021, but to the company's international operations. The war in Russia and Ukraine directly hit countries that account for approximately 20% of Avon International's sales. The indirect effects on commodities prices, inflation, and consumer confidence, in turn, had a strong impact on sales in European countries such as the United Kingdom, which accounts for half of The Body Shop (TBS) brand sales.

Sales frustration at TBS was amplified by the increase in expenses incurred in previous years, executed by the company as investments for future growth that did not happen. The company ended up consuming a lot of cash in the first half of the year, increasing its leverage, which exceeded the barrier of three times its already compressed EBITDA.

With relatively low sales growth expected for the future, Natura's case would be little exposed to the interest rate theme, given the duration of its cash flow. However, with the increase in leverage, the rising cost of debt ends up suffocating the company's profit and cash generation.

The CEO change in June alters the sense of urgency, and priorities are realigned: cash flow and margin. As a result, massive cost cuts are executed at the corporate level, and in the Natura, Avon, and The Body Shop business divisions. More important than the cut itself is having a leaner, less bureaucratic company with autonomous business divisions.

The company announced in the fourth quarter its intention to sell a stake in the Aesop brand. We welcome the monetization of this asset, which would enable a drastic reduction in its leverage. It is worth noting that this eventuality would not be the "destination" or reason for our investment. Our reasoning is based on the creation of a regional leader with the integration of Natura and Avon in Latin America, which will generate R$2 billion of cash annually after the normalization of margins. Aesop has always been a prominent asset in the company's portfolio, but not the central point of future value generation. With a positioning in the global luxury market, in developed markets, we understand that there is liquidity for the asset, even in adverse market conditions such as the current one.

Another case worth mentioning in this letter is **XP**. At the beginning of 2022, we already had a medium-sized investment in the company, but at the end of the first half we made it one of our main investments. We saw the company at a very discounted valuation and, although the moment was hard from the results point of view, we understood that it was still the winner in the investment environment for retail. The competitive environment was worse than it had been in the past, but we attribute the slowdown in its growth much more to the macroeconomic factors that favored the big banks, than to the real erosion of their competitive advantages.

An on-off risk would be the longer-term maintenance of the negative macroeconomic environment. Unlike many cases in our portfolio, the trajectory of interest rates here matters, as it "feeds" the company's competitors, giving them time to rebuild their investment franchises. And it disrupts XP as it generates dissatisfaction from its partners, employees, and its distribution channel, with often unpredictable consequences as the company struggles to rebalance.

We see the company taking important steps such as adapting its cost structure to reality, but we chose to decrease the relevance of the investment in the portfolio, making it again an intermediate position in our funds.

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	-9.5%	4.7%
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%
Oct	8.7%	5.5%
Nov	-12.7%	-3.1%
Dec	-3.8%	-2.4%
Since Inception	**188.3%**	**119.4%**

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	-6.0%	12.4%
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%
Oct	7.9%	1.0%
Nov	-12.3%	1.0%
Dec	-4.8%	1.1%
Since Inception	**37.0%**	**29.1%**