Nebraska Capital - Investment Report - April, 2015

This is Nebraska`s first investment report. In these reports we intend to update both current and potential shareholders about our main investments and any evolutions in our company, modus operandi, or investment process. The fund`s results and overall thoughts on investments are still going to be covered on our Annual Letters. This first edition, nonetheless, begins with some background on Nebraska and our way of working. Thus, this first part has some overlap with our Annual Letters, but a few concepts that are deeply explored here (in the second topic especially) are important to understand the comments on the processes behind our major investment decisions.

Background and working model

None of Nebraska`s partners had previous experiences in the financial markets before launching the company; hence, we did not do so because managing other people`s resources was a natural consequence from our way of living. This is not to say we are not in the business to make money, to the contrary, we dedicate ourselves strongly to it, and expect to fulfill our ambitions through Nebraska. But this is relevant in that being outsiders we have no prior commitments to the industry's standard procedures and routines. Moreover, our business backgrounds has shaped our minds to think about profiting from good returns on our assets rather than from wages or fees from managing third parties` assets.

We have founded Nebraska because our experience managing companies and passion to study businesses, along with broad readings, especially about Munger`s and Buffett`s valuable teachings, gave us confidence that we have the right mindset and can do well with capital allocation over the long term. In addition, and perhaps even more importantly, we saw no investment company applying our mentors` teachings in Brazil as comprehensively as we would like to do. We, thus, set out to offer a different investment product, which is better defined by the two major themes discussed bellow.

1- Business structure and principles:

Nebraska was molded after Buffett`s partnerships from the 60's. We have created a structure that deeply aligns our interests with that of our shareholders and tend to attract long term capital:

- Our administration fee is very low (currently 0.86% including all custody and legal costs) and, as it is supposed to cover monthly expenses rather than enriching the partners, it is agreed with our shareholders that Nebraska`s part of those 0.86% will fall by 5% every year we have net money inflows to the fund (from the last time the fee decreased).

- Our performance fees are 25% of gains exceeding that of the CDI rate and with advancing high water marks.

- We have only one investment portfolio. Nebraska`s partners are not allowed to hold investments (other than fixed income) out of this portfolio, and we must reinvest at least 70% of everything we make on performance fees.

- Cash redemptions from shareholders are registered twice yearly only, at the end of June and December, and are paid six months after registration.

We deeply believe that having those strong principles in place fosters the right motivations and preoccupations in our minds, which in turn propel the right routines and processes that will define our culture and long term success. Any resemblance to the famous phrase below by Oliver Wendell Holmes is not a coincidence.

"*Watch over your thoughts, for they become words. Choose your words, for they become actions. Understand your actions, for they become habits. Study your habits, for they become your character. Develop your character, for it becomes your destiny*."

2- Organization, routine and investment process:

Having great partners, Gabriel and Bruno, who take care of the fund`s operations and Nebraska`s activities overall, and Leonardo, who manages all clients' relations, we concentrate studies and investment decisions on two people, Rafael and Guilherme. Both of us had owned and managed businesses before Nebraska, and we do not think of ourselves as stock market analysts. Keeping with Holmes`s line of thought, if we did so, we would be telling the world, our shareholders, and partners that our job is to constantly come up with opinions and superb investment ideas. This, in turn, would lead to actions and routines that do not fit our personalities and would be damaging to our business; for example, it could lead to a relentless pursuit of value, an information overflow, and bad decisions.

We see ourselves as co-managers of a holding company. We do not expect a flow of investment ideas from each other; but we do expect an enormous dedication to keep informed and learning about our current holdings, to investigate opportunities as they appear within or near our circle of competence, and to study businesses and capital allocation as broadly as possible. In summary, we follow the example of the eight CEOs mentioned in William Thorndike`s "*The Outsiders*": we delegate managerial activities in our holdings, use those businesses to enrich our knowledge, and sometimes make capital allocation decisions about which we are fully accountable.

Just as money constraints are usually good for management teams, limited time and personnel seems to be beneficial for our activity. Our daily routine is to read as raw information as possible about the companies we are studying, such as financial reports, reference forms, old prospectus, and regulatory documents. Whenever possible we talk to clients, competitors and managers. We dig deep into details and make many notes and accounts with past financial reports. But, for us, the world is more random than spreadsheets suggest; hence, we avoid wasting time and brain power on stretching premises and making valuation accounts - the DCF model is not a tool in our arsenal. Once we are knowledgeable enough about a company, if its stock price is right, value will scream at us.

Our model is not unique, to the contrary, it has proved successful for many, such as Buffett, his recent hires Todd Combs and Ted Weschler, and others. However, we must not overlook the fact that this model has likely been used by many people who did not achieve success enough to be remembered here. We constantly question and revise our model and, although its advantages are clear and compelling, we have learned to identify and respect its limitations.

We are just two people focused on studying businesses; we live far away from our country`s financial center; and we have less contact with other investors and companies` managers than most of our competitors do. Therefore, it is natural that we will operate in a competitive disadvantage to understand some companies - in the end of this letter we will mention one example of a "non-investment" that defines how we respect this limitation. These disadvantages may either be surpassed with time or not. Furthermore, we must define our circle of competence very well and have the discipline to focus within it. Buffett has reportedly made most of his fortune in four business sectors: insurance, banking, media, and consumer products. Thus, we have no problem acknowledging that the businesses we will deeply understand will be few, and have devised a process to avoid humans` natural tendency to overestimate our own capacities - basically we put companies in three different boxes: (1) too hard pile, (2) possible investments, but without much concentration and only at bargain prices, and (3) core holdings.

With about 350 companies, more than half of which are totally outside of our scope (too hard pile, no liquidity, government control, global commodities, etc.), Brazil`s stock market is too small for value investors to be successful relying mostly in quantitative aspects; there is simply not enough companies to invest using simple metrics (low P/E, discount to book value) while avoiding complex situations (high debt, bad regulation, etc.) and getting as much diversification as such strategy requires. From experience (bad, to be clear), we have also learned that those "cheap, but not so good companies" must be absurdly cheap (thus extremely rare) to be good investments on average, because if we are misled and pay a fair price for a bad business (or even for a reasonable one that holds and badly deploys its earnings), our returns will suffer over the long term, especially in Brazil, where inflation and real interest rates are quite high. Thus, we do not expect most of our performance to come from investments in group (2); our radar is tuned, nonetheless, and periodically nice opportunities appear - as it is currently the case with a couple of small-cap companies whose shares are diving for forced sales from funds facing redemption calls.

Fortunately, it is our nature to love studying businesses and their qualitative aspects, to dedicate substantial time to some enterprises, and to look for great returns along with companies, not only from the market's irrationality. Our long term ambitions for Nebraska also require us to develop this ability. Some of Buffett`s greatest investments, such as the final purchase of GEICO, ABC Capital Cities, See`s Candies and Coca-Cola, were not successful because he exploited some strong market`s irrationality, but rather, because he selected the right companies for the long term.

Therefore, over the years we have been carefully selecting companies (less than ten to date) that would fit as our core holdings, on which we could invest forever and concentrate a high percentage of our equity. Those companies are going to appear in our portfolio in different times and proportions according to our assessments of entry price, alternative opportunities and risk. But to be clear, we do not expect turnover to be high in this front and have no hurry to see all companies from this group in our portfolio.

Main investments as of March 31, 2015

As this letter is already getting long, we will mention the rationale and investment process behind our major investments, especially Equatorial and Vivo, but get into further details about Itaú only. We will also explain the "non-investment" decision as mentioned before. Given the long term nature of our investments, in subsequent reports, we will certainly cover other holdings in greater detail.

At this point it is important to mention that we devote a great deal of time thinking over anything that could disturb our rationality. As "*Influence*" author Robert Cialdini has demonstrated, writing down one's opinions creates the kind of commitments that are certainly detrimental to investors who need to be able to change their minds if new facts and circumstances dictate so. Therefore, we will try to offset the downside of writing about our investment rationales (this is the first time we do so) by clearly stating (and perhaps creating a counterbalancing commitment) that everything written below represents our current thoughts, about which reassessments and/or new facts may provoke significant changes.

1- Itaú (34.7%):

Itaú has been one of our major investments since we launched the fund in August 2011. At the time we already thought that retail banking is an intrinsically good business almost everywhere and that in Brazil, given the market`s concentration, it is much better. Itaú has done extremely well over the past; since 2003 its annualized rate of return for net worth appreciation and dividends was 24.2% and its stock returns, including dividends, was 21.5% (for Itaúsa, the holding company). Since 1997, returns are 25.3% and 27.0% respectively. Past returns are no guarantee of success though. We need to understand the history behind those returns and how it connects to the current environment.

Coming into *Plano Real's* transition period (mid 90`s) our banking industry was based on regional players (many state owned) that had been focused on profiting from low cost deposits in a highly inflationary environment and lending money at high rates, mostly to large companies (usually with shared controllers) and to the government. With the stabilized inflation, stricter regulations and accounting procedures established by the Central Bank, and a developing market, inefficient players were rapidly incorporated by the few survivors who had management and balance sheets in place to excel. The evolution in the retail part of the business, regarding efficiency in terms of technology, distribution channels, and compliance to serve an expanding base of clients proved a strong factor towards consolidation. In the end, our banking industry has five national players, two of which state owned, that control more than 80% of deposits and an even larger percentage of individual accounts.

The pace of evolution seems not to have diminished. Itaú keeps pouring more than R$2.00 billion annually in software and hardware, and has cut its workforce in Brazil from more than 98 thousand to less than 87 thousand between 2011 and 2014. Short term fluctuations apart, interest rates have been falling, and banks` balance sheets have grown expressively. Both of these factors have led to a much more competitive environment for loans, bringing spreads down and riskier loans on board.

In this context, regarding Itaú`s economics going forward, it is tough to imagine competition from others than Banco do Brasil, Caixa, Bradesco and Santander; hence, understanding Itaú`s position within the industry and compared to these peers is what really matters. Itaú is controlled by two of Brazil`s most successful business families (Setubal and Moreira Salles), whereas Bradesco`s control is quite pulverized and Santander is owned by its Spanish parent. Thus, to begin with, we think Itaú has an advantage from an alignment of interest standpoint, which overtime brings more rational decisions.

Rational decisions, by the way, is the name of the game for future high returns on equity. According to Itaú`s management (and not a surprise for whoever studies the business in developed economies), the banks highest returns are not on providing loans, but rather on a wide array of services, such as the credit card ecosystem (issuing, acquiring, servicing), fees, insurance products, investment banking, and others. Itaú is seen as the "middle class bank" in Brazil, which should help regarding growth in these profitable business lines. Of course you need loans to attract clients that will use these other services, but how you go about that is hugely important.

During 2011 and 2012 Itaú`s and Bradesco`s economic fortresses were questioned as the government used Banco do Brasil and Caixa in a public campaign to bring spreads down and the effects of a 10-year high growth cycle surfaced in high loss ratios in some credit portfolios, such as vehicle financing and consumer credit provided in partnership with retailers. For us, Itaú`s and Bradesco`s level of rationality would define the outcome for them back then, and still is what matters going forward. The reason for that is that those two banks are so large and important to Brazil`s economy that the country just needs their cheap sources of funding and distribution channels to keep moving; hence, it is in their managements` hands to decide whether to fight for market share in the short term or to be rational, preserve asset quality, and improve their competitive positions going forward.

We have studied deeply and compared exhaustively the financial statements for Brazil`s leading banks and some smaller ones as well. The more we did so, the more we liked Itaú for its intrinsically better economics due to a great client base. But what has really attracted us is what we have seen since 2011 regarding its managers` decision about the option in the previous paragraph. To be clear, Bradesco is also a great business that is doing well; we just appreciate and understand Itaú a little more.

Between 2011 and 2014, Itaú`s credit portfolio grew 9.4% annually (a low figure considering an average inflation of 5.7% and last decade`s high expansion, when Brazil's credit/GDP ratio expanded from 25% in 2001 to 49% in 2011). Itaú's personal loan portfolio grew even less, 7.8% yearly, or R$37.50 billion over the same 3-year period, of which R$30.50 billion came from payroll credit lines, which are very safe as monthly installments are automatically deducted from paychecks and the great majority of borrowers are either pensioners or stable government employees. Moreover, most of growth in payroll credit has come from a new JV with BMG, the previously leading independent originator of these loans in the country. As BMG had no good funding sources to support its loans on a renewed competitive environment it got along with Itaú`s proposal for the JV in 2012 and transferred most of its loans to Itaú`s balance sheet over the following years - most importantly, it also transferred many clients with cross-selling potential. Thus, a very large part of Itaú`s personal credit portfolio growth was not due to "new money" to the economy, but rather due to acquisitions (Credicard's one contributed as well). Finally, Itaú`s personal loans to vehicle financing fell from R$60.00 to R$29.00 billion between 2011 and 2014, while transitioning to more conservative loan to value ratios and shorter maturities, showing an enormous discipline from its management team to select profitable loans. Not surprisingly, default ratios above 90 days for personal loans fell from 6.6% to 4.7% in the period.

Besides BMG, Itaú has made other nice deals, such as acquiring 50% of Redecard (its acquiring arm) that it did not already own and Citibank`s long established card issuance business in Brazil, Credicard, expanding Itaú's leadership in the segment. Between 2011 and 2014, Itaú`s non-interest revenues rose from R$23.70 to R$32.60 billion, or 11.2% annually, while its non-interest expenses, besides loss allowances, rose only 5.7% yearly. Its equity went from R$71.30 billion to R$95.80 billion during the same period, even after 32% of profits being distributed as dividends, and ROE bounced back to 24% after reaching a low point of 19.4% in 2012. We wish the low point of other businesses were a 19.4% ROE as well.

Meanwhile, government controlled banks expanded their balance sheets, attracted the clients Itaú and Bradesco rejected and pushed their leverages to new highs. Between 2011 and 2014, private and foreign banks kept their combined credit/GDP ratio stable at about 27.5%, but public banks pushed their loan balances from 21.4% to 31.6% of GDP. The consequence of all this was their own weakening, which is well represented by the fact that Banco do Brasil had to let go part of its profitable insurance arm and, more recently, part of its card business - despite the benefits of privatizing those good businesses, the bank itself has become a company with weaker economics. In other words, whereas Itaú has devoted capital and focus to grow profitable businesses, some competitors have either failed to do so as successfully, or even done the opposite. Management's rationality has clearly strengthened the business over the long term.

Concluding, Itaú is the kind of investment we look for: its managers and controllers are aligned, it is an intrinsically great business, we deeply understand how it works on practice, we have been studying it for many years, and it is extremely cheap - we invest in the holding company, Itaúsa, for a P/E of about 8.5x as of March 31. In spite of all of this, we see some risks: we cannot ignore the inherent leverage in banking; succession is an issue given Roberto Setubal`s successful journey as CEO; and the organization needs to keep finding challenges for its capable, ambitious and well paid executive team. Regarding possible default issues in loans to large enterprises involved with sectors suffering relevant problems in Brazil at the moment, we worry little as we believe any losses would not be as large as to significantly impair Itaú`s earning power given its conservative capitalization. In addition, in case a bad scenario occurs, its competitors have a proportionately higher exposure (in terms of impaired loans to equity), and the competitive landscape would be even better for Itaú afterwards.

2- Equatorial (11.3%) and Cemar (4.1%)

We have been studying the energy distribution business since Nebraska`s early days. In Brazil, distribution companies do just their core activity (though many are controlled by holdings with interests in energy generation as well). Each distribution company must report individual financial and operational statements to the national regulator (ANEEL). So, in energy distribution we have a sector with dozens of companies reporting reliable information to study - something very rare in Brazil. Regulatory rules are also easily available, and many companies are public traded. All of this is great for Nebraska; we have always felt that with time and focus we could understand about this business almost as much as any other investment firm.

It took us years, but we finally grasped the important concepts behind Equatorial`s past success and future potential late in 2013. We started with a small investment, kept studying, visited the company`s operations, got more familiar with its management team and added to the position as our confidence grew.

Equatorial is a holding created to acquire a 65% controlling stake in Cemar, the distribution company in the Northeast state of Maranhão, in 2005. Back then, Cemar was broken and under ANEEL`s conservatorship. Energy losses (a great indicator of operational efficiency) were at 31%. Cemar`s turnaround was impressive; energy losses fell to 18% recently; and we estimate that the annual return on regulatory equity was about 30% between 2005 and 2013. This success comes from great management in combination with favorable regulatory rules.

Energy distribution is an activity that requires constant, fragmented investments and huge human resources in customer interactions. Both factors make the business highly susceptible to managerial practices. Brazil has only one national regulatory body for 36 large distribution companies, many of which are state owned and - surprise - badly managed. The way ANEEL has found to deal with this immense task is to compare all the companies and define targets for operating expenses and quality metrics through a benchmark system. Thus, well managed companies have above average returns, and everyone has an incentive to improve. This incentive, although omnipresent in theory varies greatly in practice. Usually state owned companies don't even care about such incentives, and many others, controlled by large multinationals, fail to transform ANEEL`s incentives into the right motivation for executives and field managers.

Equatorial, in contrast, has focused on putting appropriate meritocratic systems in place and expected results have appeared. Late in 2012, having formed people assets in Cemar, Equatorial acquired 96% of Celpa, Cemar`s neighbor state`s (Pará) distribution company, from creditors in the bankruptcy process and has been improving its operational metrics significantly.

Currently trading at almost two-and-a-half times consolidated regulatory equity, on which regulated returns should be about 10% in real terms for standard companies, Equatorial is not an obviously cheap investment, but with a deep understanding of its business we believe it is an investment with little downside and significant potential. In summary, we believe the benchmark system and the relatively growing consumption in its areas offer Equatorial potential to obtain productivity gains and sustain returns much above ANEEL`s cost of capital for many years - while concurrently benefiting its customers.

We also like a natural hedge that exists in this business: in case regulation gets tougher, badly managed peers will suffer a lot and new acquisition opportunities may appear to Equaltorial`s disciplined executive team. We appreciate when the second and third derivations of potential issues (such as a tougher regulation in this case) end up being favorable for our companies - even when they bring some short term pains.

Regarding risks, Equatorial is controlled by investment firms. We have no thoughts on those firms specifically, but controllers from "financial markets" are often susceptible to short term and other disturbing interests. Nonetheless, nothing of the sort has surfaced so far and management seems really shielded from this influences, if they exist at all. For example, the company showed rationality by avoiding bidding higher and letting go a quite large deal in 2013. Also, although information is widely available, only once each four or five years when ANEEL approves the capitalization of regulatory assets, we can really measure results for any distribution company.

Finally, Cemar has a small free float and we have been able to buy those shares at a much lower valuation than Equatorial`s.

3- Vivo (Telefônica Brazil) (7.2%)

Like energy distribution, telecommunications is a sector with plenty of available information; this, along with the fact that studying the sector's development in other countries such as the U.S helps a lot, makes Vivo a company that overtime, after hours and hours of study, fits nicely into our circle of competence.

Telecom is not a simple business to understand, to the contrary, the complexity is quite large. But this is the kind of task we like to focus our energy on: complex problems that are solvable through curiosity and dedication - after all, in this sector, competition is restrained to few players, barriers to entry due to scale are very high, technological advancements are equally available, and membership based revenues tend to move slowly either up or downwards. To mention an opposite task: we do not feel able to understand global, commodity businesses such as mining - the variables, market players and competitive forces are so many and constantly moving that our minds cannot handle.

In telecom, themes such as the quality and reach of fixed assets and the difference in business models amid players are very important. Also, only after studying the sector's historical development since the 1998's privatization, one can fully grasp the reasons for each player's current strengths and weaknesses. For example, understanding that Vivo's wireless business is a combination of almost all of the incumbent government controlled entities that launched cell phones in Brazil is hugely important. In this business, as in many other subscription based ones, being the first mover and getting ahead in terms of scale is very relevant.

Vivo's predecessors naturally attracted the richest families when cell phones were launched, and got ahead in deploying their networks. As the business evolved, and attracted mass markets, Vivo has always had more revenues, operating earnings, and, consequently, higher investments, marketing and commercial expenses than its peers. These factors, in turn, sustained the company's market share and attracted the best clients closing the positive feedback loop. To clarify, over the last four years, Vivo has had about 30% market in share in number of accesses, but got approximately 42% of the industry's service revenues before interconnection, a metric to which we give good value.

Interconnection revenues, which are fees paid by both fixed-line and wireless final users every time they call a wireless line from other operator, are declining rapidly according to regulation and will be almost zero by 2019. These revenues still represent a large part of the industry's free cash flow, and for Vivo's competitors' that had been focused on prepaid plans even more so - likely more than 50% from our estimates. This changing dynamic forces players to go after subscription and data revenues, and eliminates the incentive that clients still have to sign up more than one phone line to enjoy "on-net" discount from different providers - Brazil is one of the countries with the highest ratio of wireless lines to total population, it is about 137% in 2014, versus 103% in the U.S. We believe both ongoing changes are beneficial to Vivo given its marketing power and superior quality. In fact, this is already showing up as the company's market share in the most valuable postpaid lines has grown from 35% in 2011 to 40% recently.

One of us is a major shareholders in a private business that relies on individual (or family) subscriptions that have similar features to pay-TV and postpaid wireless plans, such as marketing expenses hiding profits during growth periods. Thus, we understand from the guts the economic value of good subscription services and the fact that Vivo`s current results are being held back by its strong expenses to grow its postpaid basis.

We appreciate Vivo's competitive position in wireless, from which the company derives more than 2/3 of its revenues and almost all of its free cash flow according to our accounts (management does not display operating earnings per segment). Its wireline business, however, is mostly based on old copper lines from the privatization and is naturally declining as the concession model has not incentivized investments. Thus, on a consolidated basis what we see over the last years are stalled operating earnings and growing investments (in wireless and recent deployments in fiber-to-the-home, apart from the concession assets).

In our appraisal, the concession's results are hiding the wireless ones. And even the wireless earnings are understated because of growth expenses. Some people wonder that even higher capital expenditures to deploy 4G and lower interconnections fees will hurt free cash flow in the next years. Perhaps that is true, but we focus on the long term implications: having almost no debt and thus a competitive weapon on its balance sheet, the best wireless client base, the best brand, and most of the industry's free cash flow, we think any short term pressures are just likely to strengthen Vivo's edge, which should surface in accounting results and higher cash flows (to which we give more value) over the long term.

Concluding, the company's free cash flow before investments in FTTH and spectrum, taxes and interest is almost R$5.00 billion, which, compared to a market capitalization of R$50.00 billion, provides a good margin of safety. The company's large equity base, of R$44.00 billion, is a great incentive for controllers to distribute dividends as interest on owners capital (deductible for tax purposes and tax free for us as a stock fund); thus giving us some safety regarding a high dividend. Vivo was our only new investment in 2014, however it is not a large position yet. Although its operating performance compared to that of competitors is good, we still cannot assess management and governance so well. GVT's acquisition, by instance, is quite difficult to appraise given the rich valuation and the company's still significant dependence on voice revenues - on the other side its rapidly expanding and fiber-rich last-mile network seems quite valuable, for the wireless segment as well.

4- Gerdau (16.1%)

Gerdau is a global steel company with operations mostly in Brazil and the U.S. Besides the core, we do not understand its other businesses deeply; and to the extent we do we don't think their economics are favorable over the long term. Thus Gerdau is certainly a group (2) investment. To be clear, it is a quite different investment from Equatorial, in which we fully understand the drivers of revenues, margins, returns, and, most importantly, the competitive environment.

We invest in Gerdau since late 2011. We understand well the economics of the company's core activity, which is long-carbon steel in Brazil. With almost complete verticalization and two players dominating 90% of the market, this business is inherently good, with ROIC above 20% on average over the last 15 years, and 18% in 2013. It was suffering with a highly valued Brazilian Real in 2011, but its fundamentals were in place, and we judged results would rebound, as it actually happened: between 2011 and 2013 operating earnings rose from R$620.00 million to R$1.40 billion, or from US$370.00 million to US$620.00 million (2014's result for this individual subsidiary is not yet available, but is likely to be about the same as 2013's).

Overall Gerdau has sold almost 18 million tons of steel in 2013, only 4.3 of which in its Brazilian long carbon steel unit, which, nonetheless, accounted for more than half of the company's R$2.60 billion in operating earnings. We believe this subsidiary alone is worth over half of the company's enterprise value, comprised of a market capitalization of R$13.00 billion and R$13.40 billion in net debt.

Gerdau's other segments, such as an integrated mill in Brazil and mini mills in the U.S. and Latin America, are, though not completely, certainly, much more commoditized than its core business. Operating earnings for all other segments between 2011 and 2013 went from R$2.20 billion to R$1.20 billion, or from US$1.30 billion to US$500.00 million. We do think these earnings are at a low point now. But, even though we have studied those businesses a lot over the years, reading many financial filings from American competitors, analyzing the industry's dynamics over there, and visiting some of the players, we still respect the limitations of our assessments here.

As of December 2014, Gerdau's tangible book value was R$20.00 billion (adjustments for current market values for fixed assets would likely increase this number by more than 30%). 2014's net income was R$1.40 billion and free cash flow before working capital changes and growth capital expenditures was slightly higher than that, providing a high initial yield on our investment - especially when compared to businesses that have their assets and earning powers defined in U.S. dollars as is the case for most of Gerdau's units, even the core Brazilian one.

As a reminder of the risks of this investment, Gerdau's high-ROIC operations have low demand for capital. However, the company culturally retains most of its profits, and has recently been allocating those in projects which returns are more defined by global competition in commodities than by local economic factors.

5- Iochpe - the "non-investment"

Iochpe has been transformed from a struggling conglomerate into a focused, leading player in automotive wheel and structural components supplier. This transformation was led by its current chairman, and until recently CEO, Dan Ioschpe. He is highly regarded as a very capable manager and his results point in this direction. Entering 2008-09's financial crisis, Iochpe's competitive position, earnings, and balance sheet were in great shape, enabling the company to pursuit an international expansion. Since then, through what seems opportunistic acquisitions, Iochpe has become one of the leading global players in auto wheels; but it has done so by highly leveraging its valuable Brazilian assets.

In our pursuit of great managers and aligned controllers, we have been studying Iochpe for a long time and with great care. But acknowledging our limitations to understand the company's global operations have made us sort the company in the "too-hard-pile" so far. A large part of its international operating earnings, for example, come from a JV in Turkey, a business that relies on that country's favorable conditions to export manufactured goods to Europe, and which sustainability we cannot appraise. Competition in Europe has also proven a tough subject to study as we could not find good information yet. After all, too many of the company's activities are out of our circle of competence, and with our working model, there is not much we can do about it in the short run.

In case markets become irrational and offer bargain prices, we can deal with some level of uncertainty regarding our assessment of a given company's operations. However, that must come along with some source of margin of safety, such as a strong franchise (ALL's irreplaceable rail-lines) or a good discount to tangible assets without much leverage (Gerdau).

Over the last twelve months Iochpe's equity market value has fallen by more than 50% to about R$1.10 billion. Its enterprise value, nevertheless, is still R$3.30 billion, a substantial leverage for a company with operating earnings below R$400.00 (after minorities' interests) and tangible invested capital bellow R$3.50 billion. As we prime for capital preservation, seeing no margin of safety to protect us from our own limitations, we have so far not wasted much time to say no in this case.

We appreciate your attention,

Nebraska Capital April 2015