Rio de Janeiro, August 31, 2020

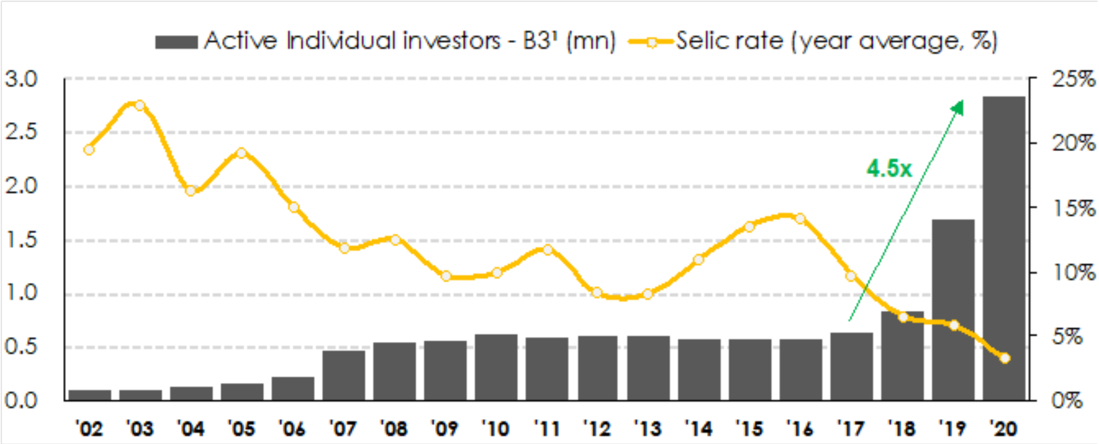
First and foremost, we hope you and yours are doing well in these unprecedented times. While working from home has its challenges, our investment process has not been interrupted at all; quite the contrary. It has been a very productive year so far and an eventful three years since our last letter, and we look forward to sharing some updates. In the next few pages we will briefly update you on the investment environment in Brazil how 3G Radar and our portfolio have evolved, and how we have been incorporating innovation into our investment process. We will also elaborate on the investment case of Grendene (GRND3), which has been one of our largest positions since 2018.

Investing in Brazil

After 24 years of either PSDB or PT Government and a very competitive election in 2018, we had a new Party take office in Jan/19. President Bolsonaro (former PSL) announced a very competent economic and infrastructure team (among others). The agenda was (is) to promote structural reforms and reduce the size of the Government by an ambitious plan of privatizations and new concessions. We saw a couple of important wins like the Social Security Reform and New Water Bill, but most of the agenda has not yet passed Congress, or was delayed because of Covid.

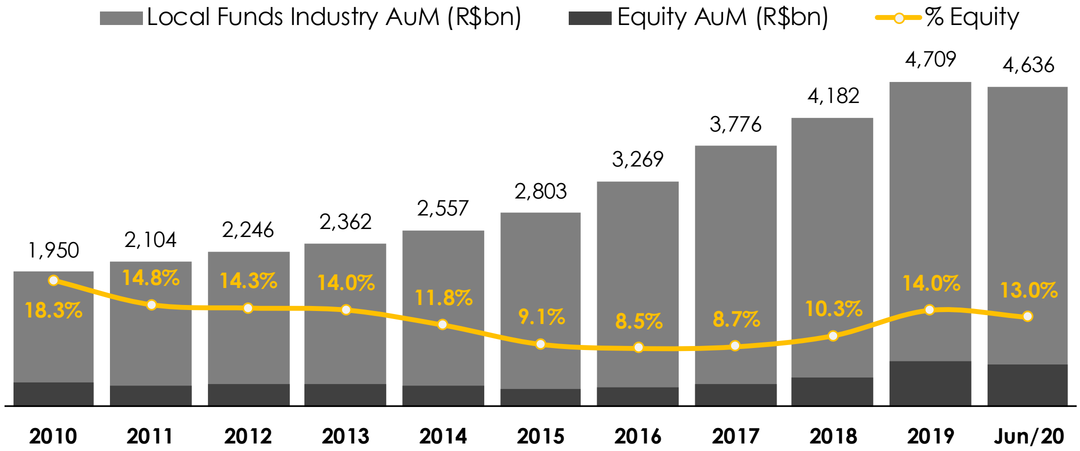
With inflation under control and a sluggish GDP, the Central Bank cut rates to a record low of 2% (from 14% just four years ago), and we were starting to see Brazil emerge from a long-lived recession. Unfortunately, the pandemic forced the Government to pull the emergency brake and announce several incentive plans that will have an estimated cost of approximately 10% of GDP in 2020. Hopefully this unforeseen deficit will accelerate the agenda of reforms (fiscal, administrative and political), concessions and privatizations (Eletrobras being a priority) so we can get back on track.

The decline in interest rates triggered a long-awaited migration from fixed income into equities. Local individuals, pension funds and institutional investors that were used to high government yields for decades are now desperately searching for higher returns. As you can see below, the number of active individual accounts in B3 skyrocketed from 500 thousand to almost 3 million in just two years. We are also witnessing a recovery in the percentage of the asset management industry allocated to equities from 8.5% in 2016 to 14% in 2019, which in our view is still very low when compared to other countries.



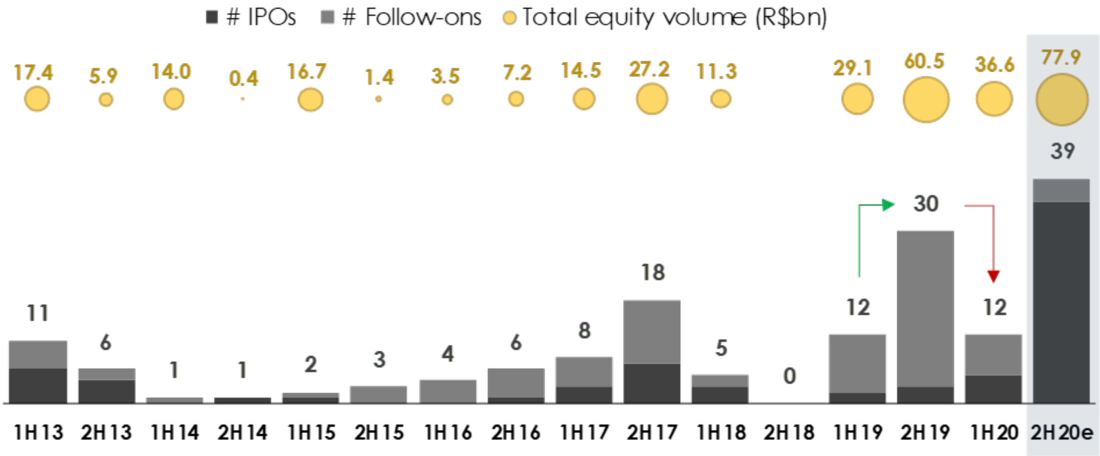
¹ Sum of active individual accounts per custodian. Individuals with more than one account are double-counted. As of April/20, B3 registered **2.4mn** active accounts, but **2.0mn** individual investors

Sources: B3, Brazilian Central Bank



Sources: Anbima, BTG Pactual estimates

This phenomenon has led to a significant increase in trading volumes and a long pipeline of IPOs and Follow-ons. If it were not for Covid-19, we would have seen a record year in capital markets in 2020. We expect this will happen in the next twelve months. Although we have not been finding compelling valuations among recent IPOs, we are enthusiastic to see that our investment universe is increasing and that capital markets are strengthening their role in funding the growth of Brazilian companies.



Source: B3, CVM

All of the above impacts us in terms of investment capacity. Since 2015 we have voluntarily returned over R$2 billion in five different tranches in order to maintain our Fund within our assessed capacity. Considering what we have returned to investors since inception, gains would represent 82% of AUM. This is not an easy discipline, but a necessary one as we want to keep our focus on compounding returns, not fees.

In Mar/20 we decided to re-open our Fund as we saw extremely attractive valuations and excess capacity following the drawdown. As expected when you have a high-quality and long-term investor base, almost every LP have been adding to their investments after we reopened the fund.

3G Radar Update

This month we celebrated seven years, and we are pleased to share that we are still the same team (which has been growing together for the past 10-23 years), we still diligently follow our investment process (which is constantly improving), we maintain our focus on long-term value (although it looks out-of-fashion to some) and we continue to reinvest >75% of our total compensation every year into the Fund (partners represent nearly 30% of AUM).

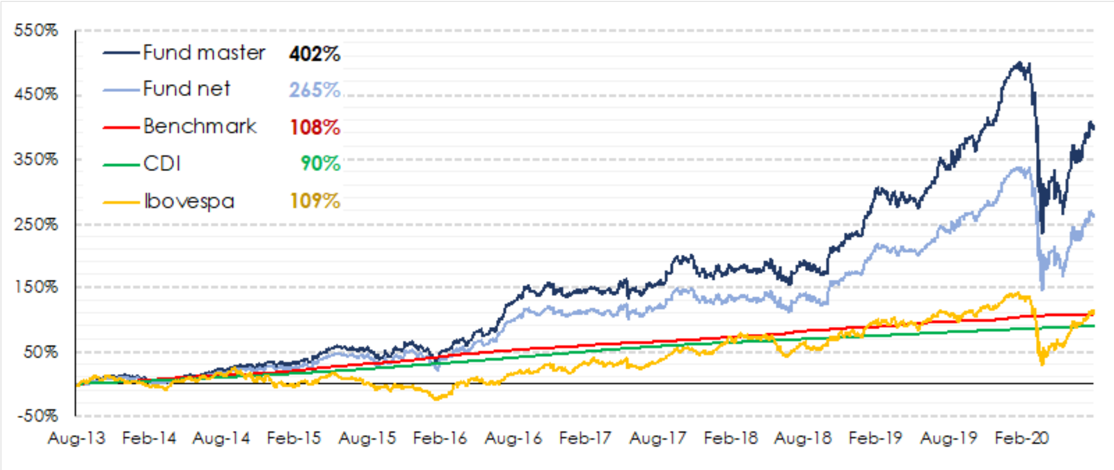
Since inception[1] our Fund is up 402% (249%/19.5% p.a. in real terms), while our benchmark is up 108% and the iBovespa[2] is up 109%. Our Special Situations Fund is up 55% since the first capital call[3] and 124% since the second capital call[4], while our benchmark[5] is up 20% and 16% during those periods. We have returned all capital invested, and the remainder, which is pure profit, is up 10% since the last time we returned capital.

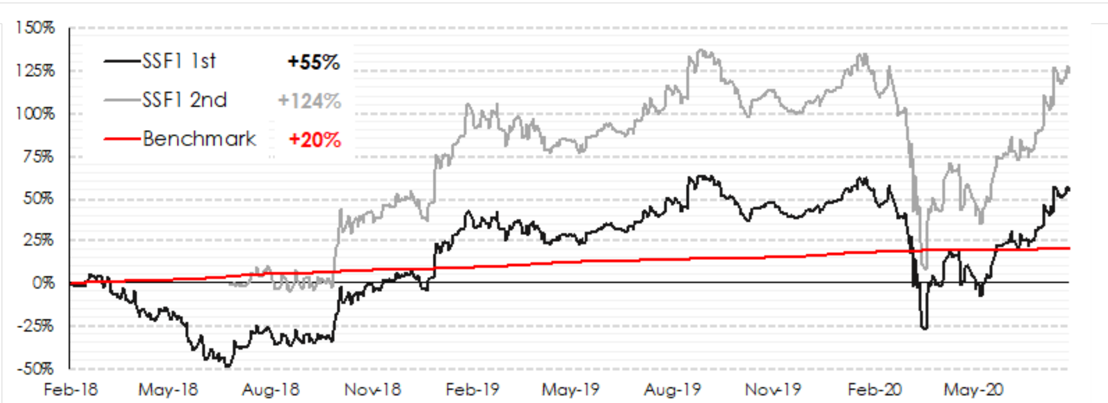
[1] Since inception: From August 1, 2013 until July 31, 2020.

[2,5] Please refer to the Notice at the end of this letter for additional detail regarding performance comparisons to index performance.

[3] From February 6, 2018 until July 31, 2020.

[4] From June 29, 2018 until July 31, 2020.

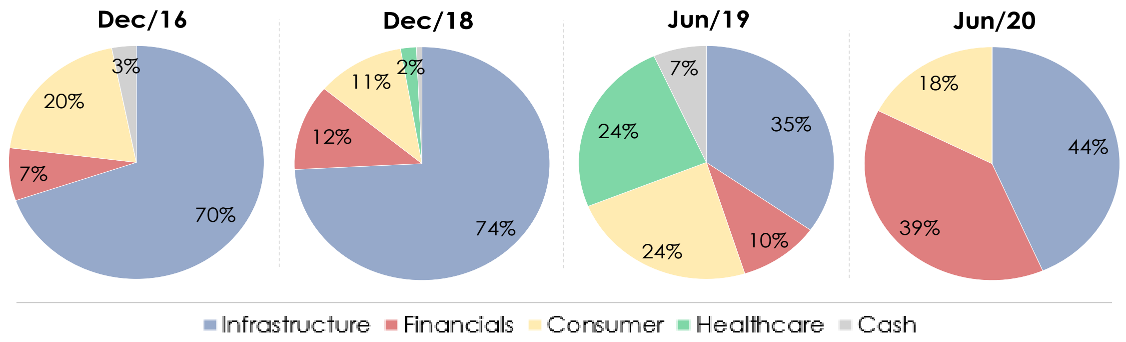




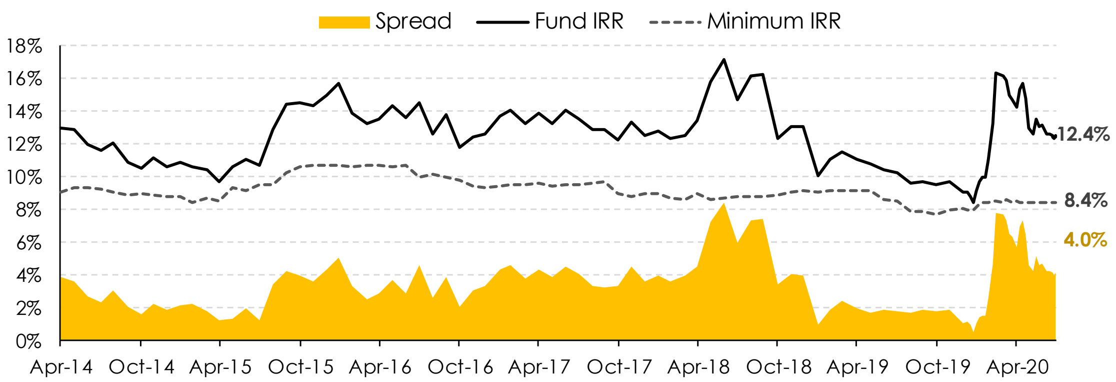
In many ways, Brazil has had a lost decade. The average GDP growth between 2011 and 2019 was a mere 0.7%. But despite political turmoil and a sharp economic downturn from 2014-18, our results to date attest that value is always there to be found, and we are therefore proud of our team's ability to defend and grow capital during such turbulent times. Brazil is never as good as its potential, but also not as bad as it often looks.

Throughout these years, our portfolio has been a clear reflection of independent research and outspoken debates. Since our work essentially involves disagreeing with consensus, we concentrate our portfolio in 5-12 high-conviction businesses which are typically different from indexes and not part of our peers' holdings. From inception to this day, we have managed to find compelling opportunities in different sectors, always based on margin of safety and risk-return asymmetry.

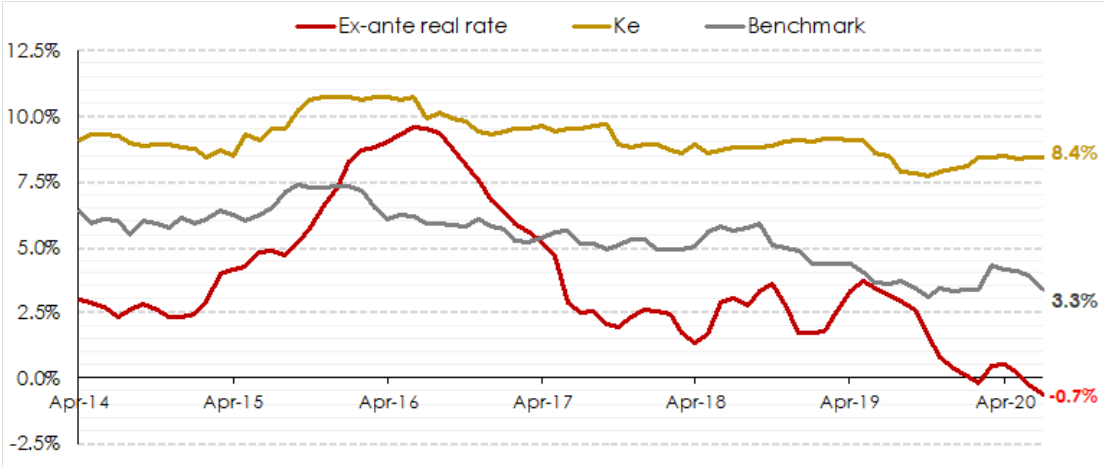
In the first five years we found most opportunities in infrastructure sectors and saw high performance attributions from names like ELET6, TRPL4, ENBR3, EQTL3 and WSON33. Although we still own three of these companies, in the last two years our portfolio rotated from infrastructure into financials, consumer and healthcare. This was a pure function of relative performance as we followed our rebalancing process. As a result, we saw relevant contributions from names like QUAL3, BBSE3, PCAR3, FLRY3 and PARD3.



Today the portfolio has seven holdings, of which BBAS3 is the only "new" position. We have been shareholders in WSON33 since 2010, ELET6 since 2012, BBSE3, ENBR3 and CIEL3 in and out since 2013 and GRND3 since 2018. We currently see a double-digit real IRR for all seven positions and an overall expected IRR of 12.4% + inflation for the Fund. We are mostly invested in real businesses that consistently generate and distribute cash (average Dividend Yield of 6% p.a.). Our companies have low financial leverage, very attractive risk asymmetries, and their NPVs should not be significantly impacted by this crisis. For 60% of our portfolio, we own over 5% of the outstanding shares in the class in which we invest. In terms of constructive engagement, we have helped to appoint members of the board and/or fiscal council for 80% of our portfolio.



Although the recent plunge in short-term interest rates has attracted many new local investors to the stock market, our implied cost of equity for our investment universe has not changed significantly, as can be seen in the following chart. Because our investment process focuses on long-term fundamentals, this decline in short-term interest rates did not materially change our required expected returns.



Our Portfolio During the Crisis

Needless to say, the current crisis will have significant negative impacts on the economy as a whole, as well as on many sectors and companies—some permanent and others temporary. On the other hand, this environment has created (as in all crises) significant opportunities for our funds, and we are happy with how our process, the massive market volatility, the increase in premium for liquid stocks (and discount to illiquidity), and the profile of our fund (and investors) allowed us to increase not only the size of our fund, but also our fund's expected return.

As our investors are aware, our qualitative process favors companies with strong moats, and low leverage. When the crisis started, all companies in our portfolio were in a comfortable financial and/or business situation.

After running exhaustive simulations and many hours of video and conference calls with companies and stakeholders, we confirmed that our invested companies would have no need to access capital markets to support their operating expenses and debt amortizations, even with a very sharp decline in sales. In addition, the impact on NPV would be very low.

The table below summarizes the changes in our portfolio. It shows the expected return, dividend yield, and P/E for our portfolio as of Jul/20 and compares them to how they would be if our positions had not changed since Dec/19. As you can see, the intrinsic value has increased 3.7%, while the average 2020-22 dividend yield increased 1.3pp, avg. earnings yield 1.6pp and real IRR 2.2pp (worthwhile noting that a great part of expected return increase came via excess return widening). We are pleased with the optimization we conducted in the past few months since it increased our expected return, albeit by a small margin.

3G Radar fund	Portfolio return [1]	Portfolio IRR	Excess return	Upside	Acc. DY (20-22)	Avgerage P/E 21
Exposure jul/20 *Current exposure*	-13.1%	12.4%	3.9%	78.0%	16.6%	11.8x
Exposure dec/19 *No rebalancing*	-12.4%	10.2%	2.3%	71.6%	12.6%	16.1x

[1] Portfolio return gross and YTD

Innovation: Risk and Opportunity

For years we have extensively discussed how to assess innovation as part of our investment process. Some sectors were more exposed than others. For some companies this was a major risk, while for others it could be a transformational opportunity. Initially we decided to address these questions when discussing moats of each business. But the pace of change has been accelerating, so in mid-2019 we took the whole team on an exploratory trip to China, which in many ways is ahead of developed countries in terms of technology adoption.

In two intensive weeks, we visited 42 companies in six cities, learning about Fintechs, Healthtechs, AI, Robotics, SaaS, Logistics, etc. It was an amazing opportunity to see in loco how innovations are affecting businesses and day-to-day life. We returned with a higher sense of urgency and incorporated what we learned into our due diligence process. We also hired a very experienced tech specialist to help us incorporate innovation into our investment process.

The democratization of access to technology has shortened the adoption timeframe for new products and ideas, influenced habits and expectations, destroyed barriers to entry, and made it faster and easier for insurgents to threaten entrenched corporations. As the world becomes increasingly VUCA (Volatile, Uncertain, Complex, and Ambiguous), the best companies will be forced to evolve more quickly than in past decades. As long-term investors obsessed with the intrinsic value of companies, we need to analyze the current and future impacts brought by these perpetual changes to the companies and sectors we cover.

In the past, well-respected second-level thinkers praised companies that had such strong business models and moats that their leaders could be fairly hands-off and still produce good results. However, in the present and future multifaceted business environment, agility matters. The laws of the game, and even the game itself, can be unstable and unpredictable. It has become harder than ever for businesses to have a clear sense of who their competitors may be, let alone what financial resources, advanced technology, and powerful distribution channels they may have. This environment of uncertainty makes it challenging to choose appropriate priorities, pace, scale, and depth of action. No matter how impenetrable their moats may seem today, even juggernauts are doomed to fail in the long term if they have weak leaders at the helm.

For us, innovation is all about solving problems, not necessarily about creating anything new. We cast a wide net to discover and evaluate potential opportunities for and threats to the companies we cover. We have developed a methodology to track emerging companies and assess whether they are likely to be tailwinds, disruption risks, irrelevant noise or opportunities for established corporations. We investigate megatrends like 5G, IoT, and voice technology to understand which sectors, companies, and strategies will be most impacted by these developments. Without these proactive analyses of new technologies and market entrants, our assessments of intrinsic values would be incomplete.

Grendene

Grendene was founded in 1971 by brothers Alexandre and Pedro Grendene and has become one of the world's largest footwear producers, having manufactured on average 165mn pairs per year in the last 3 years, approximately 16% volume share in Brazil and 1% of the global footwear market.

Grendene runs an integrated model and produces its footwear at five industrial sites in Brazil, totaling eleven state-of-the-art plants with an installed capacity of 250 million pairs per year and around 18,000 employees. Grendene's products are made by injecting mostly PVC and other materials such as EVA.

Grendene has consistently demonstrated its commitment to sustainable fashion. The company's Sustainability Policy has led to a number of important achievements, including: (i) 30% of the raw materials used are from recycled sources, (ii) 85% of the energy used in manufacturing comes from clean renewable sources, including a photovoltaic solar plant that Grendene has built that generates 2.630MWh per year (enough to power 1.831 houses for an entire year) (iii) 100% of effluents are treated, 54% are currently reutilized and the company has a bold target of reutilizing 100% of effluents.

The company has specific product lines for women, men, and children. Most of the volume comes from flip-flops and sandals, but it also produces sneakers, platforms, boots, among other models. Most of its revenue comes from Brazil (approximately 80%), and the remainder comes from international sales in 90 countries. The most relevant brands include Melissa (launched in 1979 and re-launched in 1996), Ipanema (2001), Grendha (1994), Zaxy (2008), Rider (1986), Cartago (2009) and Grendene Kids, with Melissa being the most important financially.

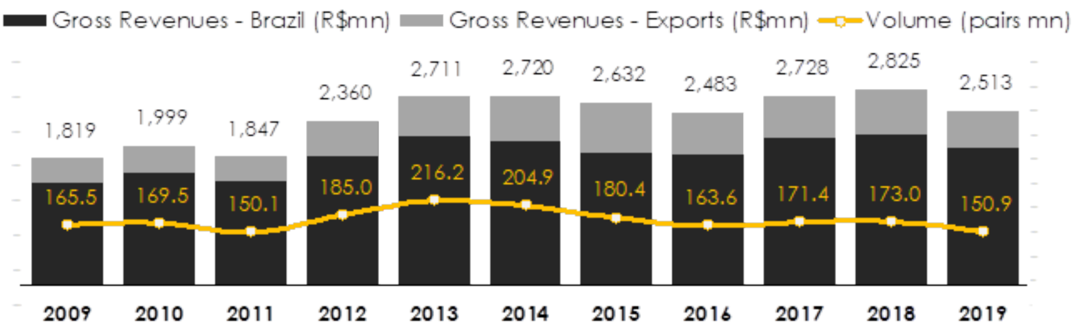
Below are a few examples of Grendene's varied footwear products:

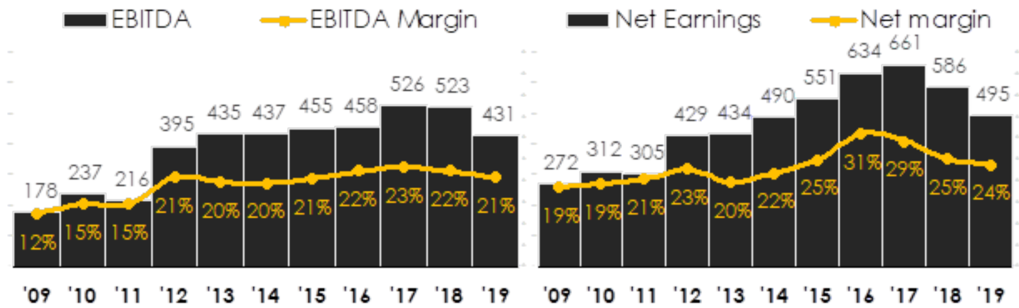
Grendene's performance in the last ten years (2009-2019) was consistent, with an EBITDA CAGR of 9% and Net Income CAGR of 6%. During the period, Grendene also paid out R$2.8 billion in dividends (40% of current market cap) and increased net cash position in R$1.3 billion (19% of current market cap).

Grendene performed well and was able to preserve the bottom line even in a tough top-line environment where the economic crisis caused the Brazilian footwear market to lose 14% of total volumes since its peak in 2013, according to Abicalçados (footwear producers association). On the export side of the business, Grendene has also suffered from the economic crisis that hit Latin America, especially Argentina, Paraguay, and Venezuela. Grendene's topline performance did not isolate itself from the sector decline, presenting a Volume and Gross Revenue ten-year CAGR of -1% and 3%, respectively.

The company's numbers could have been even better if it were not for the poor performance in 2019. From 2009 to 2018, Grendene presented Volumes, Gross Revenues, EBITDA and Net Income CAGR of 0.5%, 5.0%, 13% and 9%, respectively. Also, given Grendene's large cash position of R$2.0 billion (30% of market cap), the decline in interest rates caused an additional impact to the company's Net Income, especially in 2018 and 2019.

The company's bad performance in 2019 in Brazil was not macro related, but rather a result of an unusual poor commercial strategy and execution. In Latin America, the crisis in Argentina did play an important role in the volume decline. In 2019, Gross Revenues, EBITDA and Net Income were down by -11%, -18% and -15%, respectively. The company's bad performance was concentrated mostly in 1Q19 and management reacted with a correction plan. The remainder of 2019 was better, though not yet at a satisfactory level. The most important structural initiatives will only start to yield results from 2020 onwards. Over the years we have seen good and bad quarters (even years), and we are confident that Grendene will be back on track fast. The first two months of 2020 were signaling that the year was poised to be a good one if it were not for the pandemic.





We first invested in Grendene during the second half of 2018, but the opportunity to aggressively increase our position came in the first quarter of 2019 after the stock plummeted following poor Q1 results. We believe it is a great asset with an adequate margin of safety and close to what we believe to be the bottom of the consumption cycle in Brazil.

We have been following Grendene since its IPO in 2004 and during this period we learned that Grendene is a profitable and consistent business with strong competitive advantages such as strong brands, an exclusive distribution network, and a state-of-the-art production complex with proprietary technology to produce a wide variety of high-quality injected footwear at low cost (cost per pair in 2019 was US$1.8, even less now at current BRL). It is important to highlight that Grendene is one of the very few Brazilian companies (aside from commodities) that are successful in exporting its products.

Grendene has a clear controlling shareholder but also a seasoned management team that takes care of the company as owners. From a risk perspective, management has been very conservative. We found no material balance-sheet liabilities—quite the opposite: They have a tax-credit-contingent asset from a dispute that they have already won in the supreme court that is worth 7% of market cap.

Grendene has also chosen a business model that minimizes fixed cost and capital risk. To list a few examples: (1) Their retail presence exists only through franchisees, (2) Their inventory is built under a "make to order" system to reduce exposure, (3) they adopted an export model instead of building local presence to avoid fixed costs, (4) They never made acquisitions or deviated from their niche of injected footwear (they once started a business to produce plastic injected furniture, but they pulled the plug after two years, cutting their losses fast).

The company also has a strong capital structure and a large idle capacity to grow without the need for additional capex. Moreover, they have a series of internal initiatives that we consider to be underappreciated by the market—we will elaborate on those initiatives below.

Although most consumer names have had a strong multiple re-rating in this low-interest-rate environment, Grendene has been out of this hype. We believe this is partially because of poor results in 2019 and low daily trading volume, but also because it is less understood by the broad market, despite being the second largest footwear company in the country. To this last point, it is worth mentioning that the company has had poor communication with the market since its IPO.

We currently see Grendene with an 11% real IRR under conservative assumptions and trading at a PE multiple of 22x for 2020E and 13x for 2021E (14x considering 2019 earnings) with a dividend yield of 10% accumulated in the next 2 years.

Even in more traditional valuation metrics, Grendene seems cheap; the stock trades at 1.9x book value, for a consumption business that does not depend on deploying capital to grow. Based on our projections, Grendene's book value plus dividends should equal its current market cap in 2024.

We believe that once the pandemic is over, Grendene will benefit from the economic recovery without the need for additional capex, with fixed cost dilution resulting in high marginal returns on additional volumes as it reduces the current idle capacity of 35-40%.

The 20% share of dollar-denominated revenues from exports might also be a positive to the company given BRL depreciation. Normally, this would serve as a hedge to dollar-denominated raw materials. This time, however, the net effect of BRL depreciation could be positive to earnings due to the strong correlation of PVC and other raw materials with oil prices, which are also down. But regardless of the short-term effect on earnings, a more devalued currency will help the company become more competitive in its business abroad.

The company's top management team has been with the company for more than 30 years on average and, as already mentioned, we see in them a strong ownership culture. They have grown the company to its present level, with a strong market position, building the brands organically and reaching a high profitability, with an ROIC of 24% recently, which is top-notch in the footwear industry globally.

Grendene has a large cash position of 4.6x net cash to EBITDA (30% of market cap). There are specific reasons for such a big cash position, but in practical terms this reduces risk significantly and we believe this strong balance sheet will be used to strengthen their position post-pandemic, as well as to deploy strategic initiatives we will comment on below.

From a governance standpoint, we like the fact that Grendene has a clear controlling shareholder (Alexandre Grendene and family) with a 70% stake in the business and a significant portion of their net worth in the company. Also, the company is listed under the Novo Mercado rules, Brazil’s highest governance level.

Although we consider Grendene an overall well-managed company, as evidenced by its trajectory and top-notch profitability, every company must adapt to survive in the long run, and Grendene’s case is no different.

We have identified gaps in the go-to-market strategy in Brazil and globally. The company has begun to tackle some of these gaps through structural projects, though not yet all of them. We believe that improvements in these areas are critical to defend the company’s leadership position and grow the business.

i. Better serving its retail clients

One important market challenge is that retailers have been reducing their inventory coverage, and the fashion industry is turning faster than ever. In this scenario, short lead times are a significant competitive advantage. Grendene’s “make-to-order” system results in a lead time of around 30-40 days for retailers. Reducing delivery to closer to 15-20 days could be transformational. Given that Grendene’s manufacturing process is already very flexible, we believe they are well positioned to make this improvement by applying data and an intelligent order management system. We also believe that retail customers could be better served using more technology in the process. For instance, the current third-party Sales Rep model could be significantly improved by further using CRM and technology. This is a field we have not yet seen a willingness from management to address, although some improvements will happen as the company implements its digital strategy, which involves a B2B solution.

ii. Digital Transformation and Direct-to-Consumer

Technology is changing the consumer and retail landscape deeply, bringing both challenges and opportunities. Brand owners now have the ability to better understand and reach end consumers directly via their own website, marketplace platforms, social media and other channels without the need to own and operate a large brick & mortar chain.

Grendene did not have a digital strategy until 2019, which is late in our opinion. It is important to acknowledge they did shift a significant portion of their marketing budget to online channels over the past few years, but from a transactional point of view, all ecommerce websites were still managed by a third-party partner. The company did not have a clear marketplace strategy or even a B2B platform to better serve its retail customers.

The company started to close this gap in 2019 with the creation of Digital Transformation and DTC unit being run by Paulo Pedo, one of their most senior executives. The Digital transformation and DTC project consist of 3 pillars:

i. Transactional—E-commerce and Omni-channel
ii. Technology and Consumer Lab
iii. Cultural transformation

Grendene has historically been a company with strong industrial, brand, and product design competencies, but not robust retail skills. Over the past 8 years, Grendene started building its own retail footprint through the Melissa franchise program, which reached a total of 336 stores in Brazil in 2019. Since the early 2000s, the company's local e-commerce websites have been operated by a third-party partner. Starting in Aug/20, Grendene will be re-launching and taking control over the operation of the websites of all seven brands. Additionally, Grendene will also launch a B2B website allowing the company to reach and better serve small retailers.

Taking control over the online platform means that the company will have to build inventory to serve it. Currently Grendene operates under a "make to order" model, and building an inventory buffer will enable/improve a series of initiatives such as Omni-channel in Melissa stores, Marketplace presence and even Omni solutions to retailers when they run out of stock, by having shorter lead times.

The second pillar of the digital transformation was the creation of their technology and consumer lab, called Bergamotta Works. The Lab aims to use data and technology to deeper understand consumers, allowing for more accurate business decisions over time. The lab also has the mandate of analyzing investments in start-ups that can address problems Grendene has.

The third and extremely important pillar is the Cultural Transformation of Grendene's people, which is under the responsibility of University Grendene. More than 100 employees have already begun training sessions, and they will be the multipliers of a more agile and digital culture within the company.

iii. Approaching Key Countries

Another important opportunity for Grendene is the international market, especially given the depreciation of the BRL. Grendene had its best days in 2013 and 2014, with volumes above 50 million pairs/year and BRL slightly above the BRL 2.0 level. The company had a large share in Latam, a region that has been suffering recently, and growth elsewhere has not compensated for the loss in Latam.

Grendene has an export model in which the distributor manages the business locally. This model is very cost efficient and brings little risk to Grendene. Currently a team of around 50 people manage 86 distributors in more than 90 countries. The problem with this model is that it is less profitable, limits growth and prevents Grendene from really developing its brands abroad.

Grendene's most relevant countries are not the world's largest footwear markets. We believe that key countries such as the US and China (and more countries in the future) should have a dedicated and experienced team running the business locally. Although still in the early stages, Melissa is going in this direction. However, none of the other brands (Division 1, as they are called internally) are considering this approach yet. Grendene's main competitor, Alpargatas (owner of the Havaianas brand) is following this more localized approach, and we believe that over time this clear benchmark, along with Melissa's initiative, will facilitate the implementation of a localized model in key countries for more of Grendene's brands.

Melissa is already an international brand selling more than 2 million pairs of shoes outside of Brazil per year. It has two flagship stores outside of Brazil—one in London and another in New York—and more than 140 exclusive stores operated by distributors. In addition, Melissa has websites in US and Europe.

Management decided to focus on truly making Melissa become a global brand. The internationalization of the brand consists of building a strong local presence in key markets starting with the US and China, where the company will relaunch its websites and start to develop its Omni-channel strategy operated by Grendene itself. We believe this will not only allow the company to better communicate the brand and grow the business but also incorporate the distribution and retail margins. This strategy can be extremely profitable given that currently a Melissa pair is exported for US$12 on average and retails at US$90-US$100. For 2020 Grendene had planned the opening of 20 company-owned stores—ten in the US and ten in China. Given the Coronavirus pandemic, these openings were postponed.

As we described above, Grendene has built a very efficient, profitable, and low-risk model. The company has reinvented itself many times over the years by launching new brands, revamping old ones, entering retail through its franchise model, communicating online with end consumers, becoming more environmentally friendly and adopting new manufacturing technologies. We remain confident in Grendene's ability to improve its sales and go-to-market strategy in Brazil and abroad—if it succeeds, our investment results will certainly surpass our conservative projections (margin of safety).

When the tomb of King Tut (1341–1323 BCE) was excavated, they found dozens of footwear items, including elaborately decorated flip-flops. It is believed that humans have been wearing shoes for as long as 40,000 years. There are certain products that are unlikely to ever be made obsolete by technology, and footwear is one of them. While evolution will certainly occur, footwear is here to stay, and for the reasons stated above, so is Grendene.

Once again, we thank you for your support and, as always, welcome both your feedback and the opportunity to discuss any portfolio ideas.

Best Regards,

3G Radar

NOTICE