Vinci Partners listed equities

Quarterly Letter

3Q 2019

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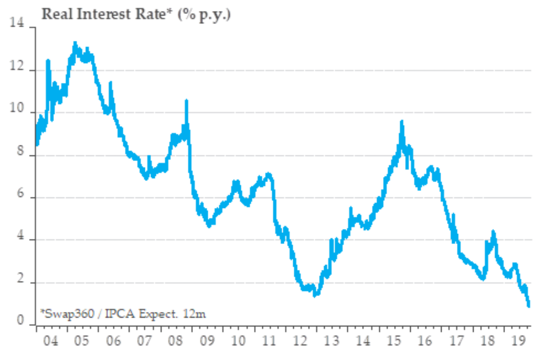
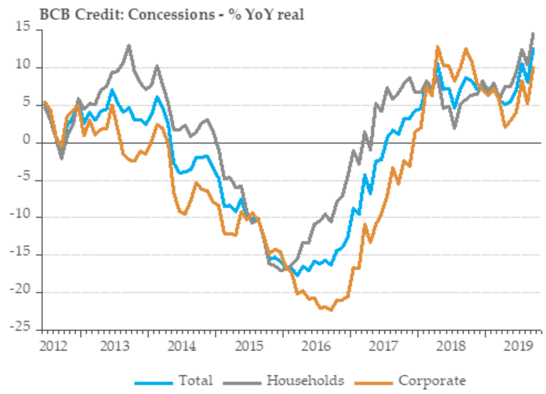
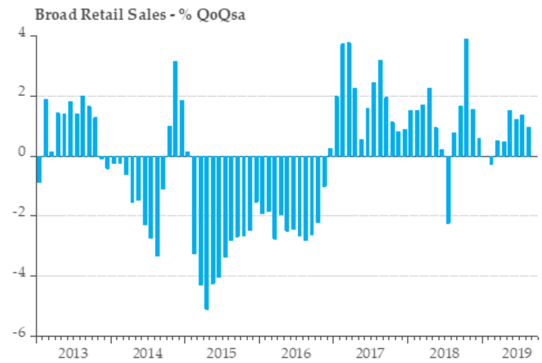
Dear investors,

In the first nine months of 2019, Vinci Mosaico gained 26.2% vs. 19.2% of the Bovespa index. Since its inception in July 2010 [1], the fund has had an average annualized return of 19.3% vs 5.7% of the Ibovespa.

In the third quarter we continued to see signs of recovery of the Brazilian economy. Retail sales, job creation and credit data have come above analysts' expectations, as a result of the private sector's response to falling interest rates and the resumption of confidence. In addition, inflation data remain well behaved (we estimate +3.2% for 2019 and 3.5% for 2020). This makes room for the Central Bank to maintain the easing cycle, which could take the base rate to levels close to 4.0% by the end of 2020 (real interest rates close to zero even in Brazil!).







[1] This Fund originated from the FIA Mosaico split occurred on 14/11/2017.

What has capped part of our recovery is the recessive burden of the public sector's fiscal adjustment (which has impacted investments) and the slowdown of the global economy. As a result, our view is that the Brazilian economy is expected to grow only 1.0% in 2019 and around 2.0% in 2020, although retail and credit figures alone would imply a more vigorous rebound of the Brazilian economy.

With that, we believe the economic environment will remain very favorable for equities. Corporate profits are expected to continue to grow in line with the economic recovery, while interest rates are expected to fall even more.

YDUQS – Barbarians at Tropical Gates

In this letter we will focus on YDUQS (formerly Estácio), the company in which we first invested in 2010 and who has been almost uninterruptedly in our portfolio ever since, becoming the second largest contributor to the fund's performance since inception.

Despite the enormous value created for its shareholders since its IPO in 2007 (+ 570% in this period), YDUQS's history has never been a straight line in terms of value creation and market share gains , unlike companies like Ambev and Itaú Unibanco, that had similar stock performances during this period but followed a completely different path, gaining market share and adding value to their shares. And, in those companies, the relationship among shareholders and management was so harmonious that was almost boring.

On the other hand, the YDUQS corporate saga resembles Bryan Burrough and John Helyar's bestseller Barbarians at the Gate , which tells the story of the hostile take-over of giant US consumer company RJR Nabisco, back in 1988. In the frantic battle over the control of the company, between private equity fund KKR and Nabisco's CEO Ross Johnson, the challenges and many excesses of Wall Street in the 1980s were revealed, such as the enormous power of the CEOs of American corporations, the instability caused by hostile take-over attempts and the insane leverage produced by junk bonds.

Similarly, YDUQS's history tells a lot about the renaissance of the Brazilian capital market over the last 15 years, composed of IPOs revival, the challenges of transforming a family-run business into a corporation, the distortions created by government-led policies (like the student loan program called FIES), the possibility of take-overs and the growing scrutiny of the anti-trust watchdog.

The Estácio de Sá University was founded in Rio de Janeiro by João Uchoa Cavalcanti Netto in 1970. The entrepreneurial profile of its founder led the company to consolidate as a leader in the state of Rio de Janeiro and expand nationwide, reaching the position of the largest higher education company in the early 2000s[2] .

[2] Source: SYDUQS RI ite. Presentation 3Q07 - 12/12/2007

In parallel to the expansion of Estácio, another education group gained prominence in the 2000s, Anhanguera Educacional. This company had a professional management and received an investment from private equity fund Pátria in 2004. Its teaching model was standardized among all units and focused on bringing an affordable monthly tuition to middle-class young Brazilians who worked and studied at the same time. In addition to organic growth, Anhanguera made a series of acquisitions and began offering Distance Learning (DL) under a franchise model. In 2007, a successful IPO was conducted and Anhanguera debuted in the Brazilian stock exchange as investors' darling among Brazil's higher education industry [3].

Estácio's IPO also took place in 2007 but, despite having more students than Anhanguera at that time, it did not seem as ready for becoming a listed company. The family members had just left the day-to-day management and its frenetic growth in previous years had been somewhat disorganized. Many courses were not economically viable (such as the famous surfing and Carnival courses). The management of its units was diffuse, without standardization. Consequently, Estácio's EBITDA margin was about half of Anhanguera's.

In May 2008 João Uchoa sold part of his controlling stake to private equity fund GP Investimentos, in order to bring to Estácio's management team a meritocratic culture and the cost discipline that had characterized GP's previous investments, such as in Equatorial Energia and ALL.

One of the GP partners, Eduardo Alcalay, became Estácio's CEO and began an arduous turn-around process, marked by tough wage negotiations with teachers and a change in the way they were assessed, basing their annual payout on performance in the classes. At the same time, a new academic model was implemented, as well as shared service center and the distance learning business was launched.

This internal rearrangement brought growth to a halt between 2009 and 2011. In the meantime, in 2010, João Uchoa decided to sell his remaining stake through a new stock offering. From that point on, the company would become a corporation, having GP as a reference shareholder, with a 19% stake[4].

At that time, we thought that investing in Estácio could make sense, as we believed that without the ties with the founding family, GP could accelerate its cultural transformation. Estácio's shares were then ~15% below the IPO price due to its frustrating results. However, we were aware that Estácio had a ROIC of more than 25%[5], reflecting the strength of its brand and its asset light business model. Valued at 3x capital employed, Estácio's stock seemed to offer a good equation between price and quality. At the end of 2010, we built a small position of about 1% of the fund.

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[3] Source: Anhanguera: Presentation APIMEC with Analysts and Investors - 5/12/2007
[4] Source: Estácio Participações 2010 Reference Form – CVM site
[5] ROIC 2010 excluding goodwill of the Intangible line . We believe that ROIC without goodwill is a better metric for verifying the quality of the business. On the other hand, ROIC with goodwill is a good metric for evaluating the quality of management capital allocation.

Our small stake forced us to follow the education sector more intensely, which ended up yielding much greater returns than initially thought. Two revolutions were being nurtured in 2011: the reshuffle of the government student financing program (FIES) and the takeoff of DL. And when we fully perceived them , we gradually increased our participation to 10% of the fund throughout the year.

The new FIES made it possible for students to finance all their monthly tuitions at very low interest rates (3.5% p.a.), without paying virtually anything during the entire course and in the four subsequent years to graduation. In addition, it would take them another eight years to amortize the credit. No guarantor was required, and credit was available even to high income students. Pretty much all credit risk of this funding was borne by the government.

FIES increased the number of students in higher education, especially in courses that were less accessible until then, such as engineering and medicine. This growth and the improvement of the average tuition leveraged the results of the education companies. Estácio's EBITDA, for example, rose by an average of 60% p.a. between 2011 and 2014[6].

At the same time, a new avenue of growth was created for education companies: distance learning. The DL had become popular in the previous decade through telepresence classes . The monthly tuition was less than half of that of regular courses and it was only necessary to go to the learning center once or twice a week. This was a very interesting value proposition for young workers (who wanted to study at alternative times) and students in the countryside, where there was often no college around.

However, from 2008 on the Ministry of Education restricted the opening of new centers due to concerns about the quality of the education provided. On the other hand, those companies that had already opened centers could grow their number of students indefinitely. This created a market barrier for the first movers in that segment.

We believe that, among all companies in the sector, the one that really understood the opportunities that laid ahead was Kroton (recently renamed to Cogna). Kroton had been founded in the 1960s by former Tourism Minister Walfrido Mares Guia. Initially it was focused on primary education, but increased its exposure in higher education after its 2007 IPO and the arrival of private equity Advent in 2009.

In 2010, Kroton acquired IUNI, one of the largest educational groups in the country at the time. And together with IUNI came along its CEO, Rodrigo Galindo, the son of the founder of the university. Rodrigo started working in his father's company at the age of 12 and, at 23, had already established his own university.

Galindo became CEO of Kroton in 2010 and, along with a talented team of Advent executives, quickly fixed Kroton's academic model and integrated its acquisitions. Then they began a series of new acquisitions, especially two of the largest distance learning operations in the country: Unopar and Uniasselvi, which together brought about 210,000 students to Kroton (20% of the

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[6] Source: Releases Results of Estácio between 2011 a 2014. YDUQS RI website

DL market at that time) and accounted for almost half of the company's consolidated 2013 result[7].

With the diversification that the DL provided, we noticed that Kroton felt comfortable to step on the gas into FIES with its on-site operation. By the end of 2014, no less than 60% of Kroton's on-site student base had government funding, while at Estácio this number was around 40%.

We acquired a relevant stake in Kroton in 2012 (reaching 8% of the fund), but decreased our exposure over 2013 (selling both Kroton and Estácio), as the shares had risen sharply (ESTC went up +134% and KROT +151% in 2012). However, we kept an intermediate exposure in Estácio (about 5%) because we believed there was an efficiency gap that would be closed over time. In retrospect, this idea proved wrong, because Kroton had more rabbits to pull out of the hat.

In April 2013, Kroton announced that it was buying Anhanguera with shares. The move created the world's largest education company, with a USD 7 Billion market cap and opened up the opportunity for the divestment of Pátria. Estácio's management was taken by surprise, because they thought the company would be the natural candidate for Anhanguera to marry with, since there was virtually no geographical overlap between the two companies.

Estácio's response was timid. In September 2013 the company announced the acquisition of Uniseb, a company four times smaller. Uniseb was owned by an industry entrepreneur, Chaim Zaher, who became a Estácio's shareholder with a 10% stake at the same time that GP was leaving the company. Uniseb's focus was distance learning; and its large number of learning centers (369) would allow Estácio to keep growing in this segment[8].

In 2014, while the Brazilian economy was plunging into a huge recession caused by fiscal indiscipline, the results of education companies were still growing mainly due to the FIES. Although FIES was one of the campaign slogans in the re-election of former President Dilma in that year, its maintenance became increasingly unsustainable, given its high cost to the government (disbursements of R$ ~20 billion/year) and the huge delinquency of the portfolio.

And, in fact, the FIESTA was over. In the last days of 2014 the government drastically reduced the program and the stocks of Estácio and Kroton fell about 40% during 2015.

Kroton began searching for new ways to defend its results, as it saw the risk of having declining margins going forward as FIES-based students were concluding their terms. Buying Estácio seemed to have emerged as the best solution.

Despite the turn-around of the early decade, Estácio had never gone as deep as Kroton in the cost control and efficiency gain agenda. The cost of teacher per student at Estácio was about

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[7] RI website of Cogna. 4Q13 Result Release
[8] YDUQS RI website. Presentation - Acquisition Summary UniSEB D12/06/2014

50% higher than Kroton's. In addition, there seemed to be a tense relationship between the new board (having Chaim Zaher as a new member) and the GP-formed management.

This troubled environment paved the way for Kroton's attack, which made a hostile offer in June 2016. Ser Educacional, another listed company in the sector, and Chaim Zaher himself were also interested in controlling Estácio. In July, Kroton increased its initial proposal by ~35% and obtained the blessing of Estácio's board to take control of the asset.

However, among the necessary conditions of the deal, was the approval by CADE, Brazil's anti-trust authority. And unlike during the acquisition of Anhanguera, this time around CADE had another understanding: the company resulting from the merger of the country's two largest educational groups would create an excessively large market concentration. Therefore, the transaction was rejected in July 2017.

Once the deal between Kroton and Estácio fell apart, an unusual player emerged: Advent, the private equity firm that had been behind Kroton's turn-around and had sold its stake in 2013. Advent bought Chaim Zaher's stake at Estácio in August 2017 after the entrepreneur's apparent disagreement with the rest of the board, which made difficult for him to take control of the company [9].

What Advent saw in Estácio was the same thing Kroton had seen: a huge opportunity to gain efficiency.

And, in fact, efficiency gains began to happen. Estácio's personnel costs fell about 10% p.a. since 2017 due to lower salaries, the increase in the number of subjects shared and greater use of DL in on-site courses. In addition, the company began implementing improvement initiatives in pricing, retention and tuition collection that have already begun to bear fruits[10].

A large part ofthe management was changed. The newcomers were a mix of professionals with prior experiences in Advent's investees with arrivals from other centers of excellence (such as the CEO, Eduardo Parente, ex-Vale), and home-grown quality professionals.

Back to 2019, the outlook is promising. Estácio's distance learning is one of the largest in the country, as well as being one of the fastest growing (+35% in 2019, reaching 210,000 students). In addition, with the economic recovery, on-site education's student in-take finally grew again in the second half of 2019.

The rebranding from Estácio to YDUQS, which took place last July, is not a cosmetic change. Behind this move, we see the intention to transform YDUQS in a holding company having several education brands underneath.

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[9] Source: Brazil Journal: "Estácio: Advent reaches 8.7%; Chaim throws in the towel" 17/08/2017
[10] YDUQS RI website: 2Q19 Result Release

In the last two years, we were surprised by the successful IPOs of Brazilian tech companies in the U.S. stock exchanges. The trend, initiated by PagSeguro, showed that foreign investors are willing to pay multiples much higher than what locals are used to. Two education companies followed the same pattern: Arco (focused on basic education systems) and Afya (medical courses). Both companies trade between 20 and 30x EBITDA 20E, while YDUQS multiple is 10x.

In this context, YDUQS DL and Medicine businesses become candidates for a Nasdaq listing. Worth noting that YDUQS is the largest medical school in Brazil and should double in size by 2024.

Moreover, now that YDUQS has already done much of its homework in capturing efficiency, the new management is already comfortable with the idea of entertaining new acquisitions. Recently, the company announced the purchase of Adtalem's operations in Brazil for about R$ 2 Billion (~ 20% of YDUQS's market cap). Adtalem has in its portfolio Ibmec (one of the most respected business schools in the country) and Wyden, a higher education brand present in the North and Northeast (where YDUQS is already one of the leading players).

We believe that important synergies should be captured from this acquisition and YDUQS should not stop there. As the higher education market is still very fragmented and the company is one of the most efficient players, several other acquisitions should emerge.

With the operation reinvigorated and the new growth prospects, peace is back among the company's shareholders. The barbarians are no longer in front of its gate and YDUQS is ready to open up to the world.

Best regards

Vinci Partners

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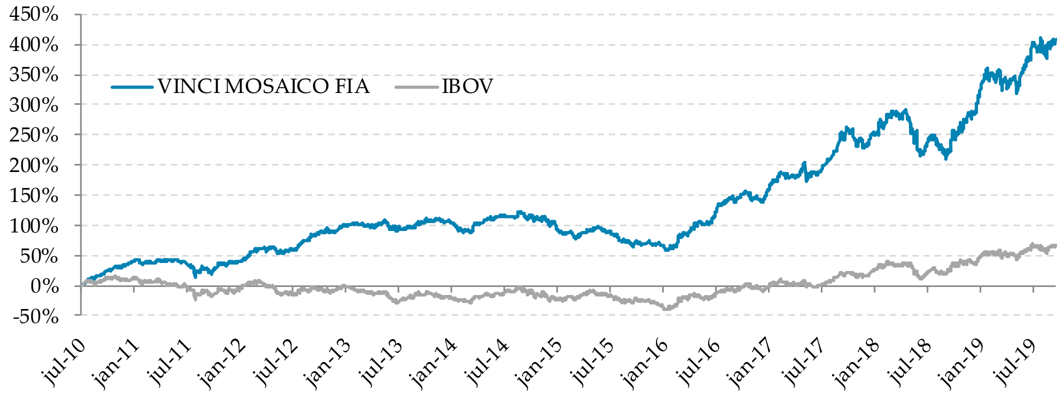
in R$	Jan/19	Feb/19	Mar/19	Apr/19	May/19	Jun/19	Jul/19	Aug/19	Sep/19	2019 YTD	Acum*
Mosaico Fund	13,6%	-2,6%	-1,7%	1,1%	2,0%	6,0%	2,8%	1,3%	1,8%	26,2%	407,8%
Ibovespa	10,8%	-1,9%	-0,2%	1,0%	0,7%	4,1%	0,8%	-0,7%	3,6%	19,2%	66,4%

* since inception in July 12th 2010

in R$	2010	2011	2012	2013	2014	2015	2016	2017	2018
Mosaico Fund	38,7%	-0,2%	43,2%	5,6%	-1,9%	-16,2%	44,9%	40,6%	14,8%
Ibovespa	10,1%	-18,1%	7,4%	-15,5%	-2,9%	-13,3%	38,9%	26,9%	15,0%



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