3R Real Estate FIA

Letter to Investors

Letter to Investors – 4th Edition (3Q2018)

Dear Investor,

3R RE FIA completed 2 years in 3Q18. Although the evolution on the macro side has been in the expected direction, the speed of improvement was unenthusiastic, which impacted heavily on the accounting numbers of the real estate developers (as discussed in previous letters). However, looking at the latest developments summed by the medium and long-term macro outlook following the presidential election, we are very optimistic about the industry and the future performance of 3R RE FIA.

During the quarter we had a lot of volatility, but the 3R RE FIA finished the quarter like the end of 2Q18, with accumulated negative performance in the year of -17.4%. The improvement in the Bovespa index, which ended the quarter with a cumulative performance of + 3.85% YTD, was not reflected in real estate stocks (IMOBB* -19.7% in the year).

After the first round of elections, and a more predictable scenario regarding the result of the second round, the change to risk-on mood was disseminated. The fund closed October with + 30% performance in the month and + 7.4% YTD (+ 19.4% since inception), compared to -1% of the IMOBB* YTD and + 23.3% in the month of October.

Performance – 3R RE FIA x IBOV x IMOBB x Selic Rate (Base 100 – 01/02/2017)

Source: 3R Investimentos and Bloomberg.
* Real Estate Sector Index
** Bank´s Overnight Rate

With the data from the operational previews of 3Q18 published and what we noticed talking to the companies in the sector, the quarter was generally reasonable. It started stronger, but electoral uncertainties influenced sales at the end of the quarter.

For some companies the improvement in net sales may be a little more relevant, especially the companies which the volume of sales cancelations was still very high in the previous quarters. The accounting results may be slightly better, as well as the cash generation. The change in direction is expected to gain momentum over the coming quarters and may be more pronounced if the macroeconomic environment and consumer confidence continues a positive tone.

Analyzing the valuation aspect, using Net Asset Value (NAV) as a metric, 2Q18 has already marked an important inflection point, in line with our expectations. It was the first quarter since 4Q14 that we saw "value creation" considering the companies we have under our coverage. When considering only the companies focused on medium and high-income products, the variation in the quarter was positive. We expect this turning point to be confirmed in the coming quarters as well.

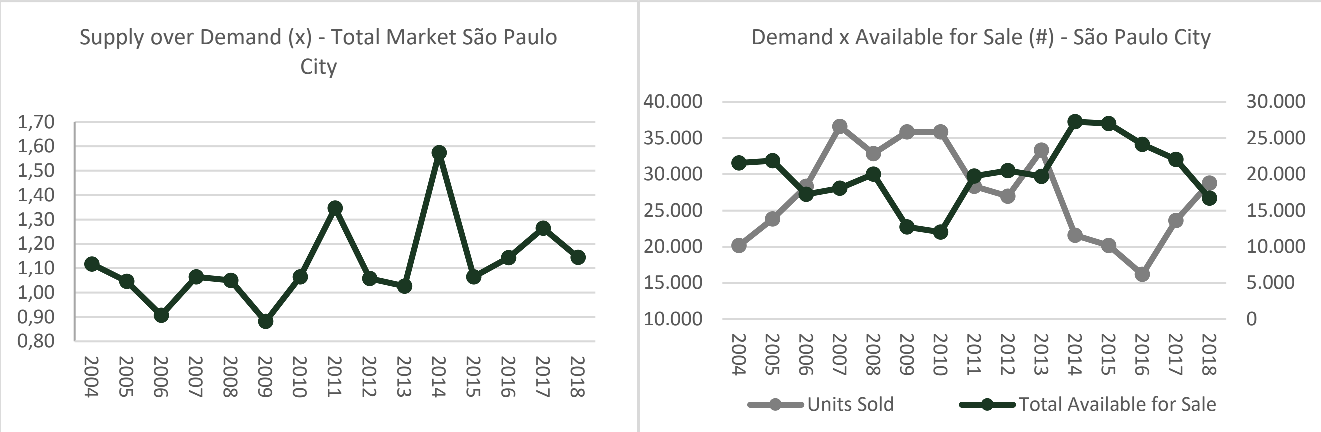
Something new on the operational side of business and industry?

Overall, the news over the quarter was reasonably positive for those focusing on the medium / long term. Two points to highlight:

I. inventories continue a downward trend, returning to 2010/2012 levels;

II. Savings accounts continue to raise funds, and as a result banks' willingness to lend continues to grow.

Supply x Demand



Source: Secovi-SP and 3R Investimentos.

In terms of sales performance, specifically, it was not an exciting quarter. The start of the quarter was relatively decent, but with the proximity of the elections the consumer took a more cautious stance, delaying the purchase decision, which was already expected.

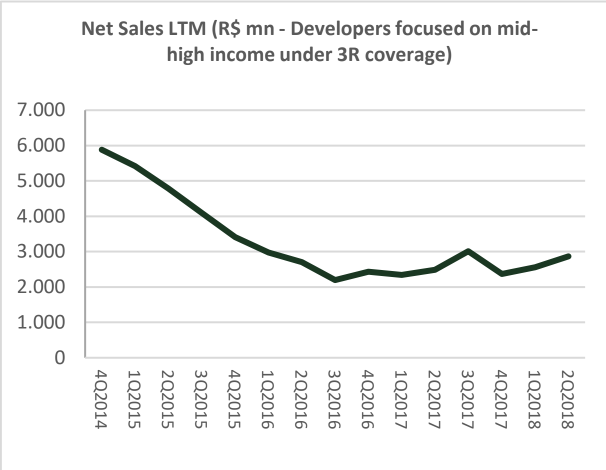
Lastly, the bill that regulates sales cancelations remains stalled in Congress. On the one hand, the election signaled a more pro-business profile in Congress as a whole, which tends to be positive for the sector. Still, some of the senators and deputies who were most involved in the bill and who were previously committed to voting on the bill did not get re-elected, which could delay the approval process or not even be voted. Although we have a murky visibility on the probability of the bill being approved, would be prudent to wait for a solid indication from the congress to be optimistic about the regulatory changes.

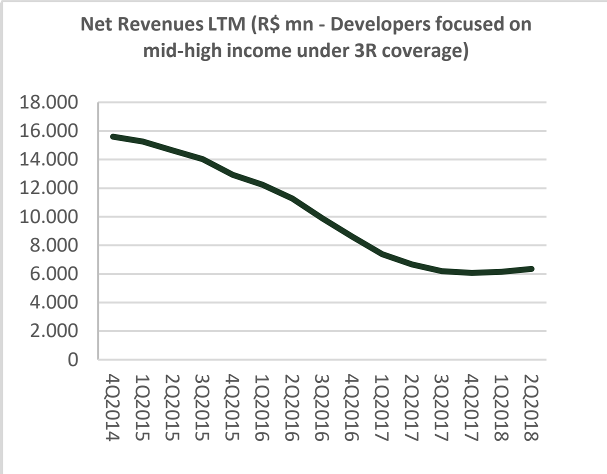
Drivers of value creation continue to move in the expected direction

The reduction in sales cancelations, gross and net sales growth continue a positive trend. It varies from company to company according to the mix of products being delivered (both by product type and location) and by the volume of deliveries.

Therefore, we have already seen a turnaround in the trend of accounting revenues, which should increasingly follow the trend already seen in net sales of companies.

Sales and Revenues trend should converge

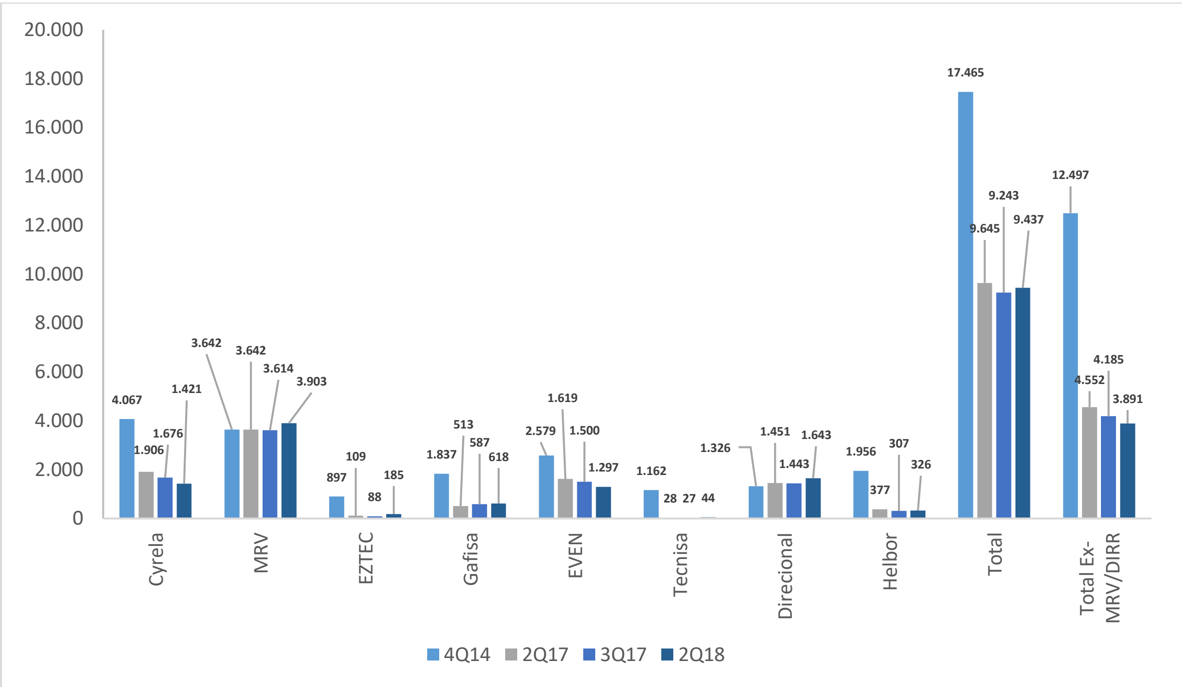




Source: Companies Financials and 3RInvestimentos.

Cash disbursements continues to fall, which should result in companies being able to adjust their capital structure and/or pay dividends.

Total cash to be disbursed with construction (units sold and available for sale - R$ mi)



Source: Companies Financials and 3RInvestimentos.

The next growth cycle, as oppose to prior ones, should not be intense on capital consumption since:

I. Companies landbanks are reasonably adjusted given the severe decline of launches in the past few years including the size contraction of most of the listed companies in the sector;

II. SG&A is reasonably adjusted, and we do not foresee an increment on that front especially at the beginning of the new cycle;

III. There´s still a good volume in the inventories of finished units for sale which is a strong cash generating product for the companies. We believe that the improvement of the business environment coupled with a comeback of consumer confidence the finished unit's inventories should decrease over the upcoming quarters.

Total Inventories and Units concluded as % of Total Inventories

2Q18	Cyrela	Gafisa	EVEN	Direcional	EZTEC	Helbor	Tecnisa	Total
Inventories of concluded units (at market value)								
2008 (VGV R$ mn)	na	90	4	0	4	17	19	134
2012 (VGV R$ mn)	953	194	49	130	102	118	96	1.643
2013 (VGV R$ mn)	971	279	141	154	150	135	127	1.957
2014 (VGV R$ mn)	1.349	283	293	218	335	349	314	3.140
2016 (VGV R$ mn)	2.402	593	674	355	754	914	878	6.569
3Q2017 (VGV R$ mn)	2.656	507	797	473	896	1.250	803	7.382
2Q2018 (VGV R$ mn)	**3.102**	**500**	**893**	**628**	**950**	**1.619**	**964**	**8.656**
Fall from peak	**0%**	**-16%**	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**
Total Inventories (at market value)								
2008 (VGV R$ mn)	na	1.776	1.526	0	324	654	1.364	5.644
2012 (VGV R$ mn)	6.626	1.984	2.062	800	926	1.275	2.026	15.698
2013 (VGV R$ mn)	6.704	2.100	2.439	725	1.153	2.079	2.240	17.440
2014 (VGV R$ mn)	7.331	2.295	2.996	846	1.338	2.427	1.976	19.208
2016 (VGV R$ mn)	6.537	1.760	2.318	1.460	1.368	2.471	1.446	17.359
3Q2017 (VGV R$ mn)	6.212	1.581	2.325	1.439	1.260	2.383	1.154	16.353
2Q2018 (VGV R$ mn)	**5.789**	**1.396**	**2.139**	**1.742**	**1.320**	**2.677**	**1.228**	**16.290**
Fall from peak	**-21%**	**-39%**	**-8%**	**19%**	**-3%**	**0%**	**-45%**	**-15%**

Source: Companies Financials and 3RInvestimentos.

The improvement in the macroeconomic environment and consumer confidence, in a post-electoral scenario, could speed the operational and accounting turnaround of the sector (accelerating volume of launches and improving sales speed).

We adjust the fund's portfolio to maximize the returns and capture a new moment that must begin

In our previous letters, we never touched about how we do our valuation of the Brazilian homebuilder's listed companies. Throughout the 12 years we've been covering the industry, we have already seen many ways of projecting fair value and have used different metrics at different times ourselves.

We do not believe in DCF, given the great uncertainty in the continuity of the volume of launches and the difficulty to project the working capital to be used (which can vary considerably depending on the company's strategy to purchase land, the length of the product cycle and payment scheme offered to the clients).

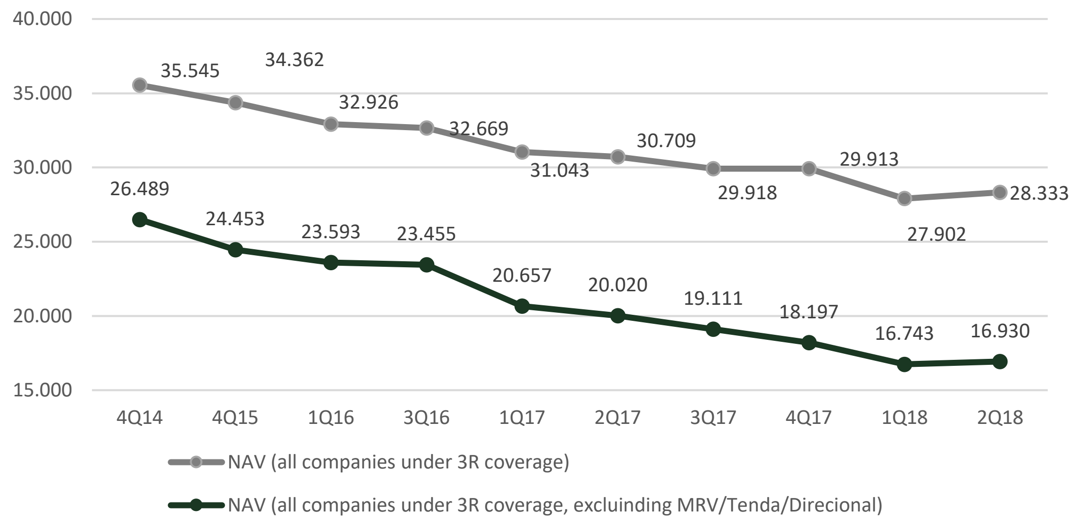
Short/medium term indicators such as short-term accounting profits also have several limitations. Accounting profits reflect what was produced two or three years ago, therefore its detached with the company's cash flow generation.

In all, Net Asset Value (NAV) a relatively simple indicator that reflects approximately the net value (deducting financial debt and provisions for contingencies) of the assets is what we prefer.

The metric also has some limitations that need to be monitored and somehow reflected in the moment of assigning a fair value to the company. The main limitation is the "static view" that is achieved. In the last two years, companies "destroyed" NAV almost every quarter, either by re-pricing assets (reducing inventory value), by operating costs (G&A) incurred every quarter, or due to its excessive financial costs and disproportionate to the company operations size.

We prefer to understand the long-term trend of these variables to have a good assessment of the tendency to create or destroy NAV, and based on that we try to come up with a fair value to the company. The stocks should trade at NAV or at a little discount in a normalized economic scenario and have some premium in a more benign environment. In a benign economic cycle, we expect the companies to create NAV throughout time.

NAV Evolution (R$ mn – companies under 3R coverage)

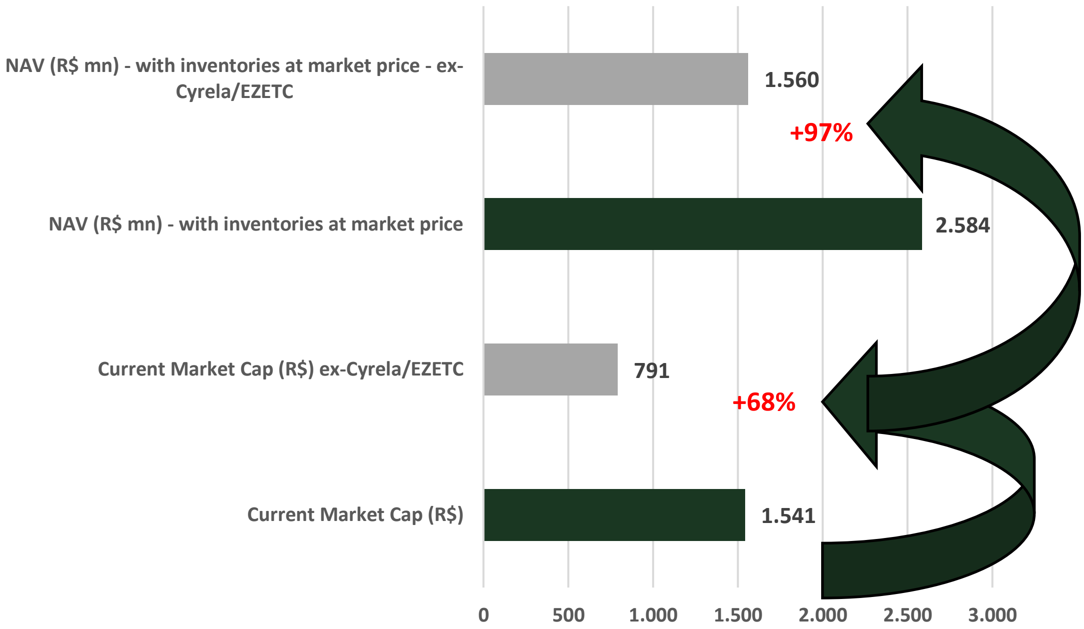


Source: Companies Financials and 3RInvestimentos.

After the first round of the presidential elections coupled with a scenario that appears somewhat favorable, we have made a reasonable adjustment in the Fund´s allocation. We have reduced cash to just under 5% and change our low-income company's exposure to focus on companies that favor middle- and high-income markets that also possess a higher leverage operationally and/or financially.

The difference between the updated NAV, according to our calculations, and the market value of the companies in our portfolio continues to indicate a substantial upside potential. Our average weighted portfolio is at 0.55x of today's NAV. We continue to believe that at the end of the recovering cycle the Fund will deliver an attractive performance to investors.

Discount to NAV



Source: Companies Financials and 3RInvestimentos.

Best Regards,

3R Investimentos Team