Shareholders` letter - 2011

Attention

We would like to emphasize the importance of reading this letter.

For those whose investments are relevant relatively to your net worth, the reading may bring alignment and tranquility.

For those whose investments are not relevant, you may find reasons to start changing this reality – something that will be appreciated – at the right moment.

This material intends only to release some information and clarify Nebraska Capital`s asset management strategies, thereby it must not be regarded as a sales offering of quota from investment funds or any other security, and it does not constitutes the prospect referred to in CVM`s Instruction 409 or in AMBID`s Auto Regulation Code. Investment funds do not rely on guarantee from the administrator, money manager, any insurance mechanism, or Bazil`s FGC (Fund for Credit Guarantee). Past performance does not guarantee future profitability. For analyzing investment fund performances it is recommended at least a 12-month period. Nebraska Capital is not responsible for any accidental publication of incorrect information, or for investment decisions based on this material.

NEBRASKA
CAPITAL

March 2012

Overall Comments

On August 25, 2011, after passing through some necessary, but time demanding bureaucratic steps, we launched our fund. If, on one side, the wait was a little frustrating, on the other it was well offset by the time of the launching. On August 08, just after Standard and Poor`s downgraded the US`s debt, the main Brazilian stock market index, the Ibovespa, fell almost 10%, closing the day at 47,793 points - it had begun the year at 69,305 points (a slump of 31%). Thus, given the moment our fund got started, we could allocate your money in some valuable companies for cheap prices. This reflects our investment rationale: stocks are just certificates of property of underlying businesses. As we do not believe in foreseeing market movements, we focus on studying these businesses, and if the market, for some irrational reason or short-term motivation, enables us to become partners in these companies, we will do it, without wondering.

It is essential that all of you, our partners, have clear in your mind the way we see the stock market`s volatility. It is a friend of the good investor and an enemy of the bad one. Hence, 2011 was a great year for investors like us. This is not the usual commentary, after all, the year was full of uncertainty and fears, and many funds suffered with bad results and withdrawals. For us, periods like these are magic. We appreciate them, since we look for companies as if they were not publicly traded, and use the capital market just as a mean to intelligently allocate money. In a fund like ours, formed mostly by partners (that is how we consider all of you) who are businessmen, we are sure none of you thought your businesses were worth 10% less on Monday 08 August, than on previous Friday, as the Ibovespa`s slump suggested. Moreover, it is not the case that on Friday stocks were generally too dear, which would sustain the argument that the 10%-slump was a deserved correction, but rather, the Ibovespa had been falling for some time. That Monday was just the extreme of an irrational behavior that happens from time to time. Therefore, we emphasize that on these days, we shall be happy, because others are offering us great products (companies) for “in-sales” prices. We love those sales promotion, after all which is the rationale behind investing in a company if it is not being purchased below (preferably much below) its intrinsic value?

This is the concept we use for appraising companies: intrinsic value, which equals the value that a rational businessperson would pay for the company. Clearly, owners tend to regard their companies as more valuable than those really are (people do the same for their cars, houses, boats etc., but this is another subject). This is the reason the word rational is highlighted above. It is not rare to find, in initial public offerings (when owners are selling part of their businesses), gas stations being sold as petroleum companies, newsstand as publishers, and craft makers as industries. There are even more recent examples of companies that are yet to produce something, being sold as if they were like Coca-Cola or Wal-Mart – both companies that deliver consistent results for a long time. Therefore, we have as a rule to keep ourselves to reality and consistent facts when evaluating businesses. This probably will make us pass some “big” opportunities, often from IPO`s. This is not our business.

Closing this topic, we would like to recognize and thank all of you for the trust, especially because of your decision to invest in this uncertain, but undoubtedly right time – it is difficult. This ensures us that the job attracting the righteous persons was well done, and that we have intelligent partners, with long-term orientations. Nothing as a well instructed businessperson for this alignment. Many have passed through high inflation, confiscation, moratorium, amid other risks, and your businesses flourished ultimately. Our fund shall have a similar path. We will have tough moments, but our well-established principles will lead to the achievements of our goals.

2011`s Results

%	NEBRASKA CAPITAL FIA	CDI	IBOV	NBKA - IBOV	NBKA - CDI
2011*	8,30	3,83	7,18	1,12	4,47
Since Inception	8,30	3,83	7,18	1,12	4,47

*Since 08/25/2011 – fund`s inception date. Nebraska Capital FIA`s returns are presented after taxes and costs, Ibovespa`s numbers are before any deductions, in other words, before management costs. Both are presented before taxes that the investor must pay.

As we claim to be long-term investors, who worry about particular companies, and use the stock market to serve our interests (rather than the opposite), any commentary about our 2011-result would be incoherent. Actually, any conclusion over investment strategies in four months is precipitated.

Our expectation (not promise) of results should be measured in periods of five years (but we ask a minimum of three). In each time period, we expect to obtain 5% over the CDI (Brazilian interbank short-term interest rate), before allowance for performance fees. This means a valorization of approximately 4% over the CDI for our partners. Relatively to the Ibovespa, we believe that each three years we may achieve a considerable advantage over the index, except for three years of a bullish market, when the index rises a lot and constantly.

We believe that, as we start our partnership, it is essential that (1) we align our expectations and (2) establish how we shall be measured before actual results – not after. We will explore both questions below.

Regarding our result expectations, we emphasize the importance of a consistent superior performance over an established cost of capital, the CDI rate. If in a single year 4% over the CDI does not seem too compelling, over the long-term, with help from compounding effects, this performance is very attractive. It was not without reason that Benjamin Franklin deemed compounding interest rates the eighth wonder of the world, and Albert Einstein as the greatest mathematical discovery of all times. Nonetheless, in order to enjoy compounding effects, we must have (a) time, (b) consistency, and (c) few losses.

We ask permission to become a little more mathematicians here, but this comprehension is fundamental for those who have a long-term investment horizon, as all of us (do not feel constrained about recurring to your calculators – we did it as well). Supposing (and really, just supposing – we do not believe is such kind of forecasts) that the Brazilian “risk-free” interest rate, the CDI is 10%, and that we will deliver our partners a 4% return over the CDI, our overall performance would be 14% annually. The next table displays the performance of an hypothetical R$ 1 million investment under these circumstances.

	Years					
Return	1	5	10	20	30	40
CDI 10%	1.100	1.611	2.594	6.728	17.449	45.259
Goal 14%	1.140	1.925	3.707	13.743	50.950	188.884

However, this table alone is not enough, after all would it be good for someone who invested one million Cruzeiros in 1972 (that year currency) to have almost 189 million Cruzeiros nowadays? – for those not used to Brazil`s inflation in the period, it would not. (Perhaps, for its scarcity, a money paper of Cruzeiro could be worth something for collectors). For us, long-term investors and adept to the Value Investing philosophy, the righteous investment definition is “relinquish current purchasing power, with the rational expectation of having more of it in the future – after paying all due taxes”. Regarding this theme, we have attached Warren Buffett`s article published on Fortune Magazine on February 09, 2012 – reading such article has discouraged us to write about the same issue.

Continuing our class about compounding interest rates (those who finish the course may obtain a certificate in our office), within the 10% “risk-free” interest rates, we have an inflation expectation. For example, with a 10% CDI rate, it would be reasonable to use in our accounts (not foresee) a 5% inflation rate. Therefore, using our latter investment definition, our result expectation is better defined as delivering our partners an 8.6% real return annually, as opposed to 4.8% real return obtainable from the CDI. Below the same table, showing these latter numbers.

Return	1	5	10	20	30	40
4.80%	1.048	1.262	1.592	2.535	4.035	6.424
8.60%	1.086	1.509	2.276	5.178	11.784	26.816

Obs.: For real returns, divide nominal ones per inflation. Example, if CDI = 10% and inflation = 5%, we may divide 1,1 per 1,05, to obtain 1,048, or 4,8% of real return.

This table demonstrates what really matters. If the economy`s real interest rates become close to 5%, after 40 years, an investments in CDI (with reinvestments of proceeds in the same terms) would multiply the initial purchasing power for 6,4 – nothing bad. Nevertheless, with the same macroeconomic variables, if we manage to achieve an 8.6% annual rate of return, our purchasing power would increase 27 times! We are not the ones to disagree with Franklin, Einstein, or Buffett.

With the above table, we intended not only to display the compounding effetcs, but also that the inflation is a very important component for investments. Especially in Brazil where, even after well succeeded implementation of the Real, inflation rates are still relevant. This, because of the same compounding effects, makes our money worth less as times passes.

Nonetheless, for both preceding tables to become reality, we must take a lot of care regarding what we consider risk: permanent loss of capital. This occurs not when the market prices of our companies fall for irrational reasons, but rather when there is a permanent loss of these companies` intrinsic values, leading to ultimate values below the price we paid for them – an extreme example would be the bankruptcy of an enterprise in which we invested. Such kind of losses are particularly punitive in an investment program that counts on consistency. For example, if we manage to achieve our expectations and deliver our partners a 14% return throughout 10 years, as we already now, the compounding effect of this result is very high (271%). However, if on the 11º year we have a bad (not tragic) year, losing 20%, this single year would make our accumulated annual rate of return to fall from 14% to 10,4% - just slightly over the CDI`s supposed 10%. This would make our fund goes from a great accumulated performance for a mediocre one in the following year – mediocre because such rate of return could be achieved with fixed income investments with low risk in the proposed scenario. This example shows that losses are always disproportionate to gains. In Brazil, where high cost of capital and inflation prevails, this effect is multiplied. Before closing this paragraph, we would like to emphasize that a slump of 20% in the market price of our companies does not qualify as a permanent loss of capital and thus does not threaten us – as long as these companies` intrinsic values remain intact.

As to our performance relatively to the Ibovespa, we expect to beat the index each minimum period of three years, besides in three years when the index rises a lot consecutively. Unfortunately, unlike Buffett does in the US in the attached article, in Brazil, we cannot assert with confidence that stocks will have an edge over fixed income when we look at past records of both. Theoretically, it might happen, and we believe that in the long-term it will. However, we have not a number as clear as that we have against the CDI for our performance compared to the Ibovespa, because since when Brazil has a stable currency, if we analyze in periods of five, ten, and fifteen years, in two of those periods (five and fifteen), the CDI beats the Ibovespa, and in the other vice-versa.

Nevertheless, for the index nature, we have conviction that we will deliver superior performance than a passive investment in the index will do, in the long-term. As Benjamin Graham highlights in his classic “The Intelligent Investor”, in the short-term, the market is a voting machine, but in the long-term, it is a weighting machine. In other words, in the short-term, emotions prevail, whereas in the long-term the fundamentals do. And, once again, we count on the compounding effects to transform a not-so-attractive annual advantage into a compelling accumulated performance.

Clearly, as being formed by emotional human beings, the market exaggerates in optimism and pessimism. We, trying to be as rational as possible (perhaps too optimistically wishing so), tend to buy before the bottom of the pool, and sell much sooner than arriving at the sky. Because of the markets irrational behavior, that happens from times to times (impossible to foresee the next time), we focus on analyzing the companies we understand, and in case the market offers us such enterprises for promotion prices (as it did in 2011), we will buy, in case the opposite occurs, we shall sell.

The understanding of the previous paragraph is what brings us conviction of superior results. After all in moments when stocks are rising without the underlying companies` intrinsic values accompanying such price increases, we will be on the side benches, studying and waiting for the moment to pass (if Brazil`s stock market keeps soaring in 2012, these “studying” moments may soon arrive). In order to be effectively rational, we must leave the party before getting drunk, even though it lasts until the Sun comes out and still has great fun. On the other side, when others are still passing through a big hangover, we will already be ready, costumed (with cash) to enjoy the next party.

With that clarified, our 2011 result was not the expected. Our obtaining results relevantly above the Ibovespa (remembering that our 8.3% result was after

costs and performance fees), in periods when the market delivers high gains, as were the last four months of 2011, is not going to happen usually. Actually, the beginning of 2012 shows it, the Ibovespa is rising a lot, and our portfolio, though advancing substantially, is lagging behind.

Because of our more effective risk control – the discipline -, by selling stocks as their prices approaches the underlying businesses intrinsic values (if our analysis is correct) we will avoid permanent capital losses. Because of the loss effects above explained, when the market`s exaggerations are eventually corrected, we expect to gain advantages over the Ibovespa. Clarifying, relatively to the index, we expect to lose much less than it in moments of slumps, gain something during stabilities, and try to keep pace when it soars. However, when such rises are too high (more than 20% in 12 months) we will have difficulties to follow the index. We consider a better performance falling 10% while the Ibovespa slumps 20% than gaining 25% when the index gains the same.

Concluding, as we have already emphasized, it is important that our expectations be clearly established in the beginning of our partnership. In case we do not achieve them, at least approximately (in real terms), there is no reason for our money to be invested in this fund, and all of us would be better off looking for other alternatives. As opposed to other funds and even many companies, we have begun drawing the target then throwing the arrow, instead of just painting a circle around the already-thrown arrow wherever it is. Eventually, for one who does not know where he/she is heading for, any road is a path. Finally, our expectations are nothing more than it; we do not promise results, but we do promise to be faithful to our principles and that most of our money will be invested along with yours. As Warren Buffett wrote in his 1963 Annual Letter, “we cannot promise results, just a common destiny”.

Investments as of December 2011.

Below are our main investment positions in the end of 2011. We present them because of a fairness question. According to Brazil`s investment system, the CVM (regulation entity) publicizes openly the portfolios of every fund in its site, allowing a three-month period of occultation, which we utilize, in the maximum. As amid us, there are partners who are more connected to the investment world and thereby follow this kind of information, we have judged fair to disclosure our portfolio for all partners here. Hence, the information that will be available publicly on April 1º, is open below (regarding the main positions), before this date, for all at the same time.

Main Positions:

Company	Invested Capital R$	Earnings R$	Capital R$ 29/12/11	%
Bradesco	9.309.133	248.573	10.148.877	14,37%
Banco do Brasil	9.195.968	201.810	8.496.450	12,03%
Itaú Unibanco	7.995.344	104.192	8.381.203	11,87%
Cielo	7.273.244	92.017	8.203.640	11,62%
Bic Banco	7.328.576	152.482	6.837.280	9,68%
Gerdau	5.506.847		5.647.250	8,00%
Redecard	4.419.456	10.964	5.061.546	7,17%
Grendene	4.603.066	124.620	4.767.800	6,75%
Comgás	3.641.145	29.970	4.563.960	6,46%
Outros	818.321	20.156	787.938	1,11%
SUBTOTAL	**60.091.100**	**984.784**	**62.895.944**	
Caixa e Equiv.			7.729.329	10,94%
TOTAL			**70.625.273**	**100%**

Regarding our portfolio above presented, we would like to highlight three aspects: (1) high concentration in a few companies, (2) many big companies, with high liquidity and high market value, and (3) many investments in the same sector, banking.

Firstly, regarding concentration, we acknowledge the importance of some diversification as a protection for future inherent uncertainties. However, for a group of businessmen like us, there is no sense in allocating little capital in our best idea; nor it is rational to invest few Reais in a bad idea just because it has no “correlation” with our other positions (correlation is not a term used in our company). Such a policy can lead us to short-term volatility (after all companies do not know that we

measure their results every time the Earth completes a turn around the Sun), but we believe that by focusing on the businesses we best understand, utilizing rational premises, and keeping our discipline, such a policy will bring us great results in the long-term (always it).

The second and third points are interconnected. For the opportunity we saw in some banks, we have a high concentration on big companies, with high liquidity and market values. We do not believe that this situation will be usual, because in more "normal" periods, we shall find more distortions in the market value of small companies, which usually attract few investors. Eventually, auctions with few buyers are good for those who are indeed looking for purchases.

About the third point, it is not of our style to comment on our investment decisions so that we can feel free enough in our judgments, especially when they occasionally change. Nonetheless, because of our high concentration in the banking sector, we will make some commentaries about it below.

The market value of banks in general fell significantly last year. This happened not only with national banks, but also all over the world. In these moments, when the market exaggerates in its fear, we feel delighted. We cannot see how Brazil`s economy could function without banks, in especial the four big ones, publicly traded, that domain the market (Itaú, Bradesco, Banco do Brasil, and Santander), having adequate profitability. Especially considering that these banks risk is mostly in Reais, which Brazil`s Central Bank can print at any time. However, for some smaller banks we consider the risk substantial, even after the slump in their market values. Every time we are confronted with some optimistic or pessimistic market view, normally based on the most recent and alarming (positive or negative) news, we stop, think independently, and try to reach our own conclusions.

Banks are a particular kind of business, since they must operate with a high degree of leverage in order to obtain good returns on their capital. Such leverage can be as high as nine times (and still count on third party resources to form the capital base) according to Brazil`s current legislation (before the burst of the subprime crisis, it was higher than 20 times in the US). Naturally, such leverages makes the business intrinsic risk high. The main risks a bank may incur can be segregated in risks from liabilities, assets, and the relation between both.

Liabilities of banks regards third party funding, as it does in any other company, but banks have a particular source of funding, clients` deposits. In spite of being a cheap source of money (cheaper than the CDI for big banks), deposits are a volatile liability, as the client can withdrawal the money when he wishes or needs. However, as experience from the last quarter of 2008 proved, deposits run towards big banks during uncertain moments. Hence, these companies benefit from deposits low costs, without having to worry about this source volatility. For the other banks in the system, deposits are not as cheap as for big banks (depositors require more returns from these banks), and have much more liquidity (which is bad for liabilities), this forces these institutions to have particular attention with the maturity of this liability, often in exchange for returns.

The other side, that from assets, may be basically divided into tradable securities and loans. In the case of big banks, there is much more, like insurance, private pension plans, asset management, health insurance, investment banks, and other subsidiaries – all of these activities must be analyzed and understood before receiving our money. With the economy`s past high interest rates, banks could manage to achieve good returns on assets without incurring too much risk, because the spread between funding costs and available yields on safe government bonds was rather high. This is not the case anymore. Hence, in order to obtain good returns, banks need to increase their credit operations, and this has higher risks, since there may be defaults, and the money can be locked, diminishing the liquidity (which is desirable for assets). For small and middle banks, even more loans are necessary, since these institutions` funds are not cheap enough to deliver reasonable spreads in relation to safe, fixed income securities.

As the pursuit for yields gains force, loans become riskier, as the American mortgage case showed. But in Brazil loans are very different: with much shorter maturities. Mortgage loans do not achieve 10% of big banks` loan portfolio, and other loans use to be shor-

term and carry some warranty. There was indeed a high elevation in default rates as the credit expanded. However, for the advantage of working with short-term loans, banks can fast and effectively pass this delinquency cost to their clients, in the form of higher interest rates.

Having briefly analyzed the assets and liabilities, it is important to understand how they are linked. For big banks, which are considered “safe harbors”, this worry is smaller. Nonetheless, such preoccupation must always exist, since a wave of withdrawals is fatal, even for the world`s biggest bank. But, for small and middle banks, such as Bic Banco, the relation between assets and liabilities is of essential relevance – and monitored, along with its default rates, closely by us. Bic has rather shot-term loans, and is working towards stretching even more the maturity on its liabilities. Currently, the bank has on average liabilities with three times as longer maturities as its assets.

This is not to mean that we do not have any worry about the banks. In a country where the gross domestic product grows between two and four percent annually, a credit expansion over 12% (in real terms) must bring problems, in the form of high default levels, as we are observing. Because of this and other reasons, we are constantly monitoring our banks and the system, and have some diversification within the sector, by investing in four companies. Eventually, if we are correct, for banks that have returns on invested capital above the long-term cost of capital, a stable, but still relevant inflation, like Brazil`s, help, since a borrower must increase his/her loan volume in order to maintain his/her purchasing power, or leverage level. Thereby, the bank invests new capital in its same core business; expanding it at good rates of return (such a combination of high level of reinvestments in a profitable business is both rare and valuable).

Finally, to keep coherence with one of our principles, that of transparency, we need to comment about a mistake we made in 2011, which could have passed unnoticed because it is no more in our portfolio and low in value. We have invested a little (less than 3%) of our capital in a construction company that was being traded much less than its liquidation value, and had a high amount of short-term receivables. However, because of the nature of the business, we have made a mistake for not giving due importance to the company`s cash flow, and our loss could have been even higher. As soon as we noticed this mistake, we sold out our hole position even though there was a chance of obtaining good returns with the investment. Differentiating process from result is essential. Considering the available facts, our current analytical capabilities and knowledge, we are not capable of defining a trustworthy value for this company; moreover, we do not have confidence on its future cash flow.

Having recognized the mistake, we hope to have learned a little bit more about this kind of business e don`t commit the same mistake again. Here at Nebraska, we aim at committing only new kinds of mistakes! New mistakes will happen, since investing is about dealing with the future, which is uncertain. We must warrant that (a) we will make much more right investments than wrong ones; (b) when recognizing an error, we will realize the loss as soon as possible (the first loss is always cheaper); and (c) we will learn the most from every mistake, so that we do not repeat it.

NEBRASKA
CAPITAL

Annual meeting

On April 13, we invite all of you to be with us in the auditorium of the building where we have our office, the FK. On this day, we intend to clarify some occasional unresolved themes, disclosure the first quarter preliminary results, and answer to everyone`s doubts. We anxiously wait for all of you. We shall send another brief letter in July, with the first semester results, and perhaps some comments on some relevant issue.

Below, we reproduce our manifesto, which we delivered to every partner as of the initial investment (Appendix.1), and then we have attached Warren Buffett`s article about investments, published on Fortune Magazine on February 09, 2012 (Appendix.2).

Any doubts or questions, do not hesitate to contact us.

Respectfully,

Nebraska Capital

Astir Brasil	Bruno Claudino	Gabriel Barbosa
Guilherme Partel	Leonardo Fração	Rafael Sá