2Q10 Earnings Results – Conference Call
August 6th, 2010

Operator: Good morning ladies and gentlemen, welcome to Tarpon Investimentos 2nd Quarter 2010 Earnings Results conference call. Thank you for standing by. Today's live webcast and presentation may be accessed through Tarpon's website at www.ccall.com.br/tarpon.

We would like to inform you that this event is recorded and all participants will be in listen-only mode during the company's presentation. After Tarpon's remarks there will be a Question & Answer session. At that time further instructions will be given. Should any participant need assistance during this call please press star zero (*0) to reach the operator.

Before proceeding let we mention that this presentation may contain forward-looking statements which are based on the beliefs and assumptions of Tarpon's Management and on information currently available to the Company. They involve risks and uncertainties and actual results may differ materially from those expressed in such forward-looking statements.

Now I will turn the conference over to Mr. Eduardo Mufarej, Tarpon's Investor Relations Officer. You may now begin sir.

Mr. Eduardo Mufarej: Well good morning everyone, thank you very much for attending this call. As most of you are aware we had strong results year to date. It is a happy moment for us, we are glad to present our consistent operating and financial performance for both 2Q and 1H10. So I will be very straightforward and then I would like to suggest that we get started very quick and we can leave the questions for later that you may have.

So let us move to page 3 of the presentation, where we talk about the quarter highlights. First the assets under management, which are the main driver … which is the main driver of revenue growth and revenue expansion reached R$ 5 billion in the end of 2Q. That is a very strong increase when compared to 2H ... 2Q09.

Our funds and managed accounts in terms of performance posted very good results during the quarter, during 1H in total, but also during the last 12, 24, 36 months. The performance has contributed to these very strong results that we had. Just to give you some sense, until the end of 2Q the returns of our public equities portfolio were 15.6% relative to the Ibovespa index, which was down 11.2.

So it was a good moment for us in terms of outperformance and, I would say, alpha generation relative to the market. It was a good time to stay away from the data component of the market, it was a very fortunate thing for us to see such a strong performance especially when the market went up as much as it did in the last 24 months. Well, especially during the recovery of 2009 as well.

Operating revenues during 2Q amounted to R$ 87.8 million; that is almost 5x what we earned during the same period of last year. Net income was R$ 51.2 million and as we had stated in the past we tend to be very high dividend payers and due to that we made a dividend distribution of R$ 105 million, which is equivalent to R$ 2.55 per share. In any case we will cover these aspects in more detail in the upcoming slides and again, we are open for questions that you may have.

I would like to move to page 4, where we find our assets under management composition and as I have said in all the calls that we had since we listed our company, for us it is very important to have long-standing clients with very good relationships that really give us the necessary reliability to pursue the best investment opportunities in the long run and I would say that part of this strong performance in recent years is related to that. We were able to post good results in an environment that was very negative for most of the industry and that has helped us a lot when you look into 2Q results.

Our investor base we continue to be focused on attracting the most sophisticated investors in the world including endowments, foundations, sovereign wealth funds, pension funds and high net worth individuals and that coupled with the amount of proprietary capital - which comprises 16% of the overall assets under management - gives us the necessary flexibility and the reliability on the capital to deploy very … or to pursue very unique investment opportunities in the long run.

Now moving to page 5, where we indicate our three main investment vehicles. As you might know, our activities are conducted under a three investment vehicle format: the long-only strategy, which comprises the public investments; the hybrid equity, which comprises investments that are made in the public and private side; and the co investment strategy, which we launched in the beginning of this year and comprises primarily co investment opportunities in specific larger transactions.

Now moving to page 6, where we present the historical data of our assets under management. As we disclosed on page 3, our AUM amounted to R$ 5 billion, a strong increase over 2009, but also an increase over 1Q10. I would like to add a point to this conference … on this conference call which relates to what we called the management fee paying assets under management, which amounted to 4.3 billion by the end of 2Q.

Just for you to understand what that means, the management fee paying assets under management represents the capital that has actually been invested and has been deployed and we only charge fees on capital that has actually been deployed. So primarily the balance between the 5 billion and the 4.3 billion comes from uncalled commitments, which is capital that has been sitting aside that will be deployed as we identify future investment opportunities looking forward or co investment structures that we developed in the past that were structured to bring other players or other participants into some co investment opportunities alongside with us. It is important to highlight that after the launching of the co investment strategy or the co investment vehicle in the beginning of this year, our intention is to further develop or further grow this strategy and we believe that the majority of the new co investors that we may attract will come into this strategy.

Also in the chart at the bottom of the page I would like to briefly discuss the growth of the AUM and how it was broken down in terms of performance and net inflows. During 2Q the assets under management growth in connection to performance gains amounted to R$ 212 million, while net inflows were equivalent to 56 million. More importantly, during 1H10 there was a R$ 1.1 billion increase in assets under management and that was … that is explained primarily by the R$ 480 million increase from performance gains and the R$ 571 million from net inflows.

Now if you move to page 7, where we give you some more information about how the AUM breaks down by investment strategy and the respective amount of called and uncalled capital. As you can see the total amount of fund called capital represents R$ 478 million, so that is the amount we have sitting aside for future investments opportunities we may identify.

In addition to that at the end of the quarter other co investment opportunities, as I said, that were done outside of the co investment vehicle that was launched in the beginning of this year represented R$ 206 million. These investments are valued at cost and on those we charge only performance fees, not management fees.

As I said before - but I would like to stress that point - our strategy now is to concentrate the co investment commitments on the Tarpon Special Opportunities fund and at the end of June, the month of June, the assets under management of the Special Opportunities Fund represented R$ 499 million, out of which 315 was committed but uncalled.

In addition to that, as you can see in the chart on the right-hand side of the page you can find the assets under management breakdown by public and private equity. At the end of 2Q Tarpon's exposure to public equity represented 85% of the invested capital, while private equity investment valued at fair value corresponded to 15%.

I would like to move to page 8 where we talk about the funds' performance. On 2Q the long-only equity strategy posted net returns of 6.9% in Brazilian reais and 5.8% in US dollars. For 1H of the year the accumulated returns for this strategy were 15.6% in Brazilian reais and 11.6% in US dollars.

The hybrid strategy, on the other hand, posted net returns of 7.6% in US dollars during the quarter. This strategy is only available for non-Brazilian investors, accumulating a net positive performance of 13.8% during 1H10. Just to give some sense of where the market indexes stayed the same period - just for illustrative purposes, as we do not follow and a stock market index - during the 1H10 the Ibovespa and the IBX indexes posted negative returns of 11.2 and 12.1 respectively, both in Brazilian reais.

Moving ahead to page 9 I would like to go over Tarpon's financial highlights talking about our operating revenues. First management fees. Just for disclosure reasons, we charge management fees on a monthly or quarterly basis and management fees are calculated over the amount of called capital. During 2Q10 revenues related to management fees amounted to R$ 12.8 million, slightly similar amount relative to the previous quarter and more than 70% higher than the 7.5 million earned in 2Q09. These year-over-year better results reflect primarily the growth in the assets under management, so this is primarily where the driver of the growth of management fee revenues come from, the increase in assets under management.

As far as performance fees, during this quarter we were glad to present very strong results as most of you have eventually already seen. This is primarily due to the fact that in the beginning of this year most of our funds were above the high water mark, so we were able to collect performance fees from the majority of the capital that we manage.

So that you understand the rationale, fees are collected performance of the funds when a certain hurdle rate is surpassed and investors and funds pay performance fees on distinct dates of the year depending on the characteristics of the funds. Performance fees in 2Q10 amounted to R$ 75 million compared to 11.6 million of the same period of 2009. During 1H of this year total revenues amounted to 131.6 million against 11.6 for the same period of 2009. So there is a very important growth in terms of performance fee collection.

In terms of high water mark, just for you to have a sense today or at the end of the quarter 99% of Tarpon's assets under management were net asset value or above the respective high water marks.

In addition to that, as of June 30, 2010, just so you have a sense, uncollected performance fees amounted to roughly R$ 23 million and this … those are performance fees that will eventually crystallize and it is just for illustrative purposes, so you have a sense that if the performance fee collection dates were also at the end of 2Q there would be an additional R$ 23 million to be collected. It is important to say that this potential amount may change as it is highly correlated with the performance of the funds.

Now moving to page 10 talking about total operating revenues, we had R$ 88 million roughly. It is about 5x higher than 2Q09. During 1H10 total operating revenues amounted to R$ 157 million against 21.6 million of the same period of 2009.

On the bottom of this page you may also see the operating expenses segregated by recurring and nonrecurring expenses. You see that total operating expenses amounted to R$ 23.2 million during 2Q10, while total operating expenses during 1H amounted to 27.8 million - that is an operating margin of 81%. The recurring portion of our operating expenses, as you may see, is comprised by general, administrative expenses and primarily payroll. The nonrecurring portion is comprised of variable compensation and the provision of our stock option plan.

So for modeling purposes and to understand the business what you really need to see is that when there is no performance fee, when there is no performance fee collection, the nonrecurring portion of the operating expenses tends to be very small. For 1H, the same expenses for 1H10 amounted to R$ 21 million with a variable compensation accounting for R$ 17.2 million. Our stock option provision, on the other hand, which has a non-cash impact, amounted to roughly R$ 4 million.

Talking about net profits moving to page 11, net income in 2Q10 amounted to R$ 51.2 million that is equivalent to about R$ 1.24 per share. This amount represents a net margin of 61% and net revenues increased by almost 500% over the same period of 2009, to be precise 481%. During 1H net income totaled R$ 105 million and that is obviously a substantial increase over the 8 million of the same period of 2009.

In connection with that we announced the distribution of the same amount in dividends, R$ 105 million in dividends that is a 100% payout and equivalent to R$ 2.55 per share. This is absolutely in line with our past statements that Tarpon should be a very strong dividend payer.

Talking about … in more detail about our dividend distribution, if you move to page 12 you can see that the recently declared amount is equivalent to a dividend yield of 30.4% that is based on the average share price of 1H10. In connection with the 2009 fiscal year results, we distributed R$ 15.2 million in dividends and that was equivalent to R$ 0.37 per-share and a dividend yield of 5.5%.

What can we try to extract from that is that depending on the amount of performance fees that are collected or will be collected in the future, the trend is that majority of the fees that will be collected out of performance will be distributed right away to shareholders. Since August 2 and in connection with that we have traded ex-dividends.

Now moving to the last page, which talks about our shares performance, as most of you are aware our shares are traded on the Novo Mercado. Year to date our shares have been up about 25%, outperforming the market heavily and after the announcement of 2Q results shares went up more than 30%. Based on the estimated market price Tarpon's market capital is about R$ 429 million.

And just the last point that I would like to make which was on the press during this week is that on the corporate side we made a joint decision with Mr. Cláudio Galleazzi that led to his resignation and he will leave unfortunately our Board of directors and here we will be replaced by Marcelo Lima, which is one of our executive officers who will be appointed as Tarpon's new Board member.

So with all that said I would like to open the floor for questions, if any. Thank you very much.

Q&A Session

Operator: Thank you. Ladies and gentlemen, we will now begin the Question and Answer session. If you have a question please press the star key followed by the one key (*1) on your touch-tone phone. If at any time you would like to remove yourself from the questioning queue press star two (*2).

Excuse me. Our first question comes from Mr. John Prigoff from Equinox.

Mr. John Prigoff: Hi, congratulations on the great results. Two questions, the first one I understand that you are a kind of transitioning from one compensation structure to another. When I look at the amount of current compensation as a percentage of performance fees it was only 13%; I presume that some of that was due to performance that actually happened during 2009, but the fees were not actually paid until 2010; can you just clarify the discrepancy and maybe help us understand how what future … future nonrecurring comp will look like as a percentage of performance fees?

Mr. Mufarej: Ok John. The performance fee amount is up to 35%, the bonus amount is up to 35% of the performance fees and so it can be less than that. It is up to the compensation committee discretion to define how much will be distributed to the management and all the executives. So it is hard to give you a hard number, how much will that be in the future, as it is absolutely discretionary.

Let me just give you example: we may collect very strong performance fees at a given period, while the performance of our funds has been much below the index or the market as a whole. So that is not a very strong case for very high distribution of performance fees and bonuses to the executives.

So it is a discretionary number. I would say that it should range somewhere between 10% and 20% and gets to 35% in moments where we were able to outperform the market very heavily especially when the market is down. So sorry not to give you a more precise answer, but this is something that will fluctuate looking forward.

Mr. Prigoff: Ok and so the timing effect that I talked about that did not factor into that at all, that was management's decision based on what they thought like they wanted to compensate people.

Mr. Mufarej: Exactly.

Mr. Prigoff: Ok and my other question is about the co investment strategy. In those funds I understand that you do not collect management fees and you only collect performance fees; are performance fees similar to the fees in the other funds or are they higher or lower? A more typical fee structure for a new investor.

Mr. Mufarej: I understood your point. We have two structures for performance fees … for co investment, sorry: one is the old structure where, for example, for any transaction that we would engage that we would call co investors there was no management fee, that was like a SPV vehicle (like a special purpose vehicle) that was built and then investors would come in into this structure and pay only performance fees at the realization of the investment. Performance fees in these vehicles are similar to the others in the traditional Tarpon funds.

On the co investment strategy that we launched in the beginning of this year yes, there is a management fee only on the capital that has been invested, that is lower management fee base; but in addition to the performance fee there is a management fee.

Mr. Prigoff: Ok, but in general the performance fees for new investors going into the structure should be similar, nominally, to the fees on other products.

Mr. Mufarej: Yes, should be, should be.

Mr. Prigoff: Ok, but they are only charged …

Mr. Mufarej: Should be slightly more challenging, I mean, maybe a slightly lower performance fee and eventually a higher hurdle.

Mr. Prigoff: Right ok

Mr. Mufarej: Ok?

Mr. Prigoff: Ok thank you very much.

Operator: Excuse me. Ladies and gentlemen as a reminder, to pose a question please press star one (*1). Once again, to pose a question please press star one (*1) on your touchtone phone.

Our next question comes from Mr. John Prigoff from Equinox.

Mr. John Prigoff: I would just jump back in here to ask you a more general question: can you talk about what your investment strategy is then more recently and is there anything specific that you guys are looking at or just maybe some general market commentary from you as to what you are seeing?

Mr. Mufarej: Well, as I said it was to us as a surprise that especially given the strong run of the market in the past, since the recovery of the crisis in the past 15 months more or less, that we were able to outperform the market. For us it is a common thing, or what we would expect is that when the market … in moments where the market is down or flat we tend to outperform the market; but in more high-flow market we tend to underperform and that was not the case, so it was a very good surprise for us.

What we are seeing here is, I would say, a challenging environment to deploy capital, it is not an easy market; valuations especially in the more obvious stories, the more high-liquidity names very complicated to deploy new capital. So we have been thinking a lot more out of the box trying to find more and unusual things where there is room to deploy capital eventually.

But what I can tell you is that our investment activity, meaning new things and new investments has been very shy year to date. We have not done very much and that is mainly related to what we consider to be a disconnection between prices, market prices and fundamentals.

Mr. Prigoff: Ok thank you very much.

Mr. Mufarej: Welcome.

Operator: Excuse me. Ladies and gentlemen again, if you would like to pose a question please press star one (*1).

Since there are no further questions, this concludes today's question and answer session. I would like to invite Mr. Eduardo Mufarej to proceed with his closing statements. Please sir, go ahead.

Mr. Mufarej: I would like to thank everybody for attending this call, for the questions and if you have any follow-up subject that he would like to touch please let us know, we are here at your disposal. Thank you very much.

Operator: Thank you. That does conclude the Tarpon Investimentos 2Q10 2nd quarter results conference call. Thank you very much for your participation, have all a good day.
