





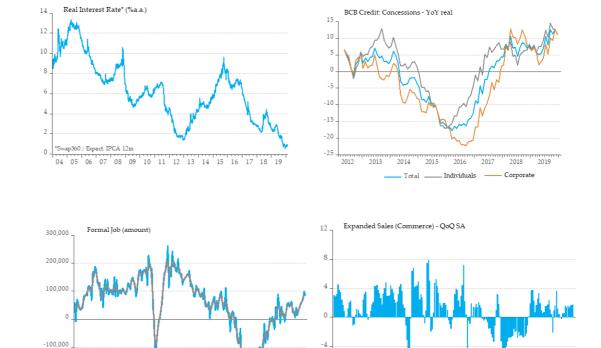
#### 4Q 2019

Dear investors,

In 2019, Vinci Mosaico gained 49.6% vs 31.6% of the Bovespa index. Since its inception in July  $2010^1$ , the fund has had an average annualized return of 20.8% vs 6.4% of the Ibovespa.

During the fourth quarter the main events that impacted the Brazilian stock exchange took place abroad. The truce in the US-China trade war and the Brexit approval by the British parliament significantly reduced the uncertainties surrounding the global economy.

On the other hand, the recent coronavirus outbreak has overshadowed this brighter scenario. It's too early to say the extent of this epidemic's impact, but it's likely that Chinese GDP will be strongly impacted in this first quarter and that there will be a partial recovery of lost production at the beginning of the year throughout the second quarter. Some studies show that China's GDP growth in 2020 could fall from 5.9% to 5.4% due to the coronavirus<sup>2</sup>.



Sources: BCB, IGBE, GAGED and Vinci Partners

CAGED \_\_\_\_\_ Moving Average 3 months

08 09 10 11 12 13 14 15 16 17 18 19

04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19

<sup>&</sup>lt;sup>1</sup> This Fund originated from the FIA Mosaico split occurred on 11/14/2017.

<sup>&</sup>lt;sup>2</sup> JP Morgan-Chase: Coronavirus update: Amplified supply shock and further revision on China's growth and policy forecasts.





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As to the Brazilian economy, we maintain our very constructive view for this year. We expect GDP to grow 2%, driven by lower interest rates that recently hit an all-time-low of 4.25% p.a. and should continue around this level until mid 2021. This is because our projections point to a scenario of low inflation for the next two years years (3.2% in 2020 and 3.5% in 2021). This environment of low interest rates and economic recovery should be beneficial for investments in the stock market.

### Tenda - Henry Ford at the Construction Site

Invariably, the first lessons of a business administration course talk about Henry Ford's important legacy and how his series production method enabled the massification of the automobile. Thanks to continued productivity gains, the price of the legendary "Model T" dropped from \$850 in 1908 to less than \$300 in 1925. As a result, almost half of the American fleet in the early 1920s was comprised of Ford T models.<sup>3</sup>

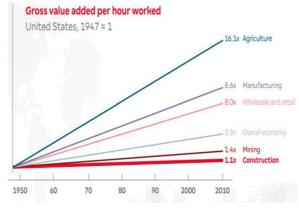
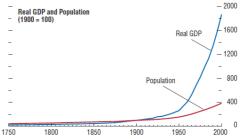


Figure 5.1. World GDP and Population Since 1750

During the twentieth century both output and population growth increased. Howeve as a result of accelerating technical progress, output growth increasingly exceeded population growth.



Source: Tenda Day 2019 presentation

Source: IMF

The innovation and process rationalization, which were nurtured in industrial sector at the beginning of the 20th century, started to influence retail (ex: WalMart) and agriculture (such as in the use of fertilizers and pesticides). This made the last century the most powerful period in economic history on record.

However, a very important sector of the global economy remained stagnant during this period. We are talking about the construction sector, which represents 13% of the world economy. Among the reasons for the low productivity of the constructions are the enormous waste in the construction process, the absence of standardization (each construction site has its own characteristics) and the difficulty in maintaining a constant pace of production.<sup>4</sup>

<sup>&</sup>lt;sup>3</sup> https://pt.wikipedia.org/wiki/Ford\_Model\_T . Visited on 02/14/2020

<sup>&</sup>lt;sup>4</sup> Reinventing construction: a rote to higher productivity – Mckinsey Global Institute.





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However, a Brazilian developer has been able to reduce its unit cost by 40% over the past six years and has become the lowest cost provider in the national low-income housing sector. This company is called Tenda, currently the most profitable developer in the Brazilian stock exchange.<sup>5</sup>



Source: Tenda Day 2019 presentation

The trajectory of the Tenda is more than unusual. The company was founded in the 1990s and went public in 2007. Focused on low income since it was established, Tenda was betting on impulse sales from people who had little credit availability; as a result, more than 20% of its customers ended up giving up on the acquisition. In 2008, on the eve of the Lehman Brothers crash, Tenda was almost out of cash at a time when credit became more selective. The solution was to turn over control of the company to Gafisa, at the time one of the largest Brazilian homebuilders.<sup>6</sup>

At Gafisa's helm, Tenda's problems persisted. Driven by the creation in 2009 of the government program of subsidized low income housing - Minha Casa, Minha Vida (MCMV, or My House, My Life), Tenda continued to grow without worrying about its customers' ability to pay and its control over construction costs.

Tenda was not Gafisa's only troublesome business. Its parent company was also lost in a geographic expansion plan that resulted in major costs overruns. At the end of 2011, Gafisa conducted a due diligence in all of its businesses and recognized a loss of approximately R\$ 1 billion (25% of its equity at the time). Two-thirds of that loss came from Tenda.<sup>7</sup>

With almost R\$ 4 billion in debt and low credibility with the banks, Gafisa was in trouble. Its plan to survive was to transform the huge credits that Tenda had with its customers (around

<sup>&</sup>lt;sup>5</sup> Tenda Day 2019 presentation.

<sup>&</sup>lt;sup>6</sup> Article on Exame – "Gafisa Compra Tenda após queda de 65% nas ações em agosto"; free translation: "Gafisa buys Tenda after a 65% fall on august".

<sup>&</sup>lt;sup>7</sup> Gafisa's Earnings Release 4Q11.





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R\$ 2.5 billion) into cash. Tenda's problematic construction pipeline should be completed and, depending on the outlook, the company should then be wound up.8

The person who stood up to lead this mission was called Rodrigo Osmo, who was responsible for the only division that had been relatively unscathed by the problems of Gafisa, an allotment company called Alphaville.

In 2012, when Osmo became Tenda's CEO, he was aware that he was facing the greatest challenge of his professional career. He was 35 at the time and had built a brilliant career. He had complete an MBA and been an assistant professor at Harvard; as well as worked at Bain & Company and at private equity firm GP before joining Gafisa as a business development director.

The first decision that Osmo took was to make the commercial area also responsible for obtaining financing for the client. This measure created a great alignment of interests and, together with process improvement, reduced the average time for Tenda's client to obtain financing from 40 months in early 2012 to just 11 months at the end of that year.<sup>9</sup>

This first victory by the new Tenda team enabled him to obtain Gafisa's blessing to create some pilot launches that, if successful, could shelve the idea of liquidating the company.

Tenda then started using an industrial approach and, through a trial and error process, a series of small improvements started to emerge at the construction sites. The new projects now only used aluminum molds, which allowed Tenda to build walls faster and with less waste than the traditional structural masonry model. In addition, the new Tenda had only one product for the six regions where it operated. Henry Ford, who used to joke by saying that the customer could have the Model T in any color as long as it was black, would have approved the strategy.

In 2017, two years after the company returned to profitability, Gafisa spun-off Tenda, creating a separate entity with shares listed on the stock exchange again. We had followed Osmo's trajectory from a distance for years and decided to build a position in Tenda a few months after the company's return to the stock market.

What most attracted us to the company was its strategic positioning. Thanks to its low production cost, Tenda was able to offer the lowest price in the market and consequently sell its units faster than its peers. In addition, its streamlined process of transferring customers to the bank helped the company to keep its accounts receivable at a low level. Finally, the company's expenses were among the lowest in the sector, reflecting its frugal culture that can be felt when visiting its headquarters, which is located in a modest building in downtown São Paulo, above one of its stores.

<sup>8</sup> Construcast: #14 – "Rodrigo Osmo: Imóveis fascinantes com 40% de redução de custos"; free translation: "Rodrigo Osmo: Fascinating reality with 40% cost reduction".

<sup>9</sup> Ibid; note 8





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All of these competitive advantages culminated in a return on adjusted equity of more than 20%<sup>10</sup>, which seemed extremely attractive to a company whose market cap was slightly less than its book value.

The explanation for Tenda's low multiples was based on the market's concern about the sustainability of the MCMV program. In the income bracket where Tenda operates, customers benefit from subsidies that (1) generate discounts of around 20% on the purchase price and (2) decrease the interest on their housing loans. This subsidy was close to R\$ 10.5 billion in 2018.<sup>11</sup>.

The FGTS (Brazilian Workers' Pension Fund) pays almost all this subsidy, not the government. As it is not in the government's accounting, this subsidy went through the fiscal adjustment practically unscathed. However, in recent years, the government has allowed billionaire withdrawals from the fund (R\$ 70 billion) to help revive the economy. In addition, lower interest rates impact the fund's profitability and its ability to pay the MCMV bill.

Therefore, under this new scenario, it was necessary for the subsidy to decrease over time to prevent FGTS from having profitability and cash problems. In addition, there has been a valid concern in this government to reduce the charges on wages (among them the FGTS) that contribute to the low productivity of our economy.

In fact, subsidies started to fall. In 2019, after some changes in the program, this amount was already reduced by 25% reaching just over R\$ 7 Bi. New rules should be implemented over the next few years, which should reduce the subsidy and maintain the financial stability of the FGTS.

However, we find it very unlikely that the program will be terminated. This is because Brazil has a huge housing deficit of about 8 million homes and 900 thousand families are established every year (most of them in low income). The benefits of the program to the society are several, ranging from providing safety (leaving slums and areas at risk) and health (sanitation) to the population to the relevant impact that the sector brings to economic activity and to the level of employment.<sup>12</sup>

Many investors currently prefer to be exposed to the medium / high income sector, which has benefited intensely from falling interest rates, instead of investing in low income construction companies, due to the expectation of declining subsidies in the MCMV.

We don't agree with this idea because we believe that the competitive advantages that Tenda, MRV and Directional have in their segment are much greater than the advantages of the leading players in the middle and high income sector. The fact that the low-income market is much larger in terms of number of units, having at the same time less demanding customers and lower margins, allows leaders to have economies of scale and lower costs. At medium and high

<sup>&</sup>lt;sup>10</sup> Removing from the net income other operational expenses of R\$ 98MM from past operations.

<sup>&</sup>lt;sup>11</sup> Source: "Relatório de Gestão - Fundo de Garantia do Tempo de Serviço - Exercício 2018"; free translation: FGTS 2018 management report.

<sup>&</sup>lt;sup>12</sup> Abrainc/FGV – "Análise das Necessidades Habitacionais e suas Tendências para os Próximos Dez Anos" out/2018; free translation: Analysis of housing needs and trends for the next ten years.





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income, as we learned in the last real estate boom, the product is much more "handmade" and less scalable.

We agree with the fact that with less subsidy in the MCMV the addressable market will fall slightly and companies in this segment will be forced to give greater discounts, thus putting pressure on their margins. However, as Tenda has a market share of only 4% within MCMV and is the lowest cost producer in the sector<sup>13</sup>, therefore there is a lot of space to gain market and further consolidate its competitive advantages. Accordingly, we believe that the gradual reduction of the subsidy will have a little impact on Tenda's high rates of return on capital.

The main limitation to Tenda's growth today is not the addressable market, but the fact that its business model is only viable in large urban centers. This is because its aluminum molds can only be used on a regular basis in regions where it builds 1,000 houses per year. Moreover, Tenda is already present in nine of the thirteen metropolitan areas <sup>14</sup> in which it could operate with this minimum size and we believe that it can and should gain market share in these areas.

Tenda could double in size over the next five years, thus achieving launches of 30,000 units per year within the MCMV program<sup>15</sup>, if it's able to combine market share gains in existing areas with the addition of new areas out of the current universe.

Tenda's stock currently trades at 3x its book value and in our opinion would be trading at a lower premium in a scenario in which its current model reaches its full potential, incorporating these new markets.

However, there is a huge opportunity to create value for Tenda: small cities, where a large part of the housing deficit is concentrated and competition is scarce. Tenda estimates that this new avenue of growth could be the size of the full potential of its current model. In other words, another 30,000 homes per year could be built in smaller cities.<sup>16</sup>

Along with this opportunity, there is a great challenge: enabling technologies that allow the company to enter these cities with a competitive price proposition. This will probably involve building a factory of prefabricated panels, which will be assembled as Lego pieces at the construction sites. Using an industry jargon, the name of this method is "offsite construction".

As always, Osmo wants to take one step at a time. Several pilot projects will be carried out over the next two years to test different technologies and their acceptance. Some of them, such as wood and steel frames, are already approved for use in the MCMV, but have not yet proved viable on a large scale in the country.

We believe that Tenda is in a privileged position to find viable offsite construction alternatives. This is because it has the financial resources to invest in a state-of-the-art factory, bargaining

<sup>&</sup>lt;sup>13</sup> Tenda Day 2019 presentation..

<sup>&</sup>lt;sup>14</sup> Ibid; note 13.

<sup>15</sup> Ibid; note 13.

<sup>16</sup> Ibid; note 13.





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power, credibility with suppliers and a great know-how in process optimization. Companies that are also trying to make this concept feasible in Brazil do not have all these attributes.

The international experience shows that Tenda is on the right track. American offsite construction start-up, Katerra, has USD2 billion in revenues and has been valued at USD4 billion<sup>17</sup>. Clayton Homes, controlled by Warren Buffett's Berkshire Hathaway, makes about 50,000 prefabricated houses a year in the U.S..<sup>18</sup>

Time will tell if this new strategy will work out. But, looking at the meticulous way in which the company has dealt with its challenges, we believe that the odds are good. Or in the words of Henry Ford: "Nothing is particularly difficult if you divide it into small tasks".

Sincerely,

**Vinci Partners** 

<sup>&</sup>lt;sup>17</sup> Article on Exame Magazine: "Uma casa em dois dias: a visão da maior startup de construção do mundo."; free translation: "A house in two days: the vision of the world's largest construction startup"

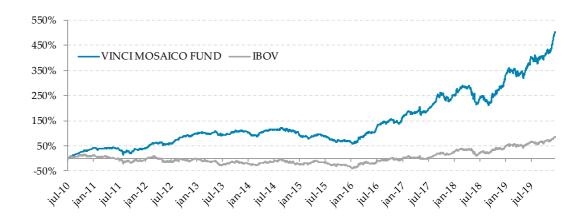
 $<sup>^{18}</sup>$  www.claytonhomes.com/pages/annual-report/ . Visited on 02/14/2020



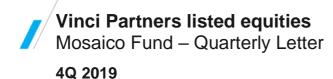


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in R\$	Jan/19	Feb/19	Mar/19	Apr/19	May/19	Jun/19	Jul/19	Aug/19	Sep/19	Oct/19	Nov/19	Dec/19	2019 YTD	
Mosaico Fund	13,6%	-2,6%	-1,7%	1,1%	2,0%	6,0%	2,8%	1,3%	1,8%	3,5%	2,0%	12,3%	49,5%	
Ibovespa	10,8%	-1,9%	-0,2%	1,0%	0,7%	4,1%	0,8%	-0,7%	3,6%	3,5%	-0,2%	6,8%	31,6%	
* since inception in July 1	2th 2010													
in R\$	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019				
Mosaico Fund	38,7%	-0,2%	43,2%	5,6%	-1,9%	-16,2%	44,9%	40,6%	14,8%	49,5%				
Ibovespa	10,1%	-18,1%	7,4%	-15,5%	-2,9%	-13,3%	38,9%	26,9%	15,0%	31,6%				







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