

MANAGEMENT REPORT

3rd Quarter 2012



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Disclosure of Past Performance

In the 3rd quarter of the year, Edge Value FIA returned 7.54%, compared to an increase of 5.48% for the FGV100 and 8.87% for Ibovespa.

In the first nine months of 2012, the fund returned 14.37%. In the same period, Ibovespa and the FGV100 returned 4.27% and 12.02%, respectively.

Since the beginning of its activities, in 2004, the accumulated return of Clube San Francisco (currently Edge Value FIA) was 490.48%. In the same period, Ibovespa returned 171.84% and the FGV100 returned 278.05%.

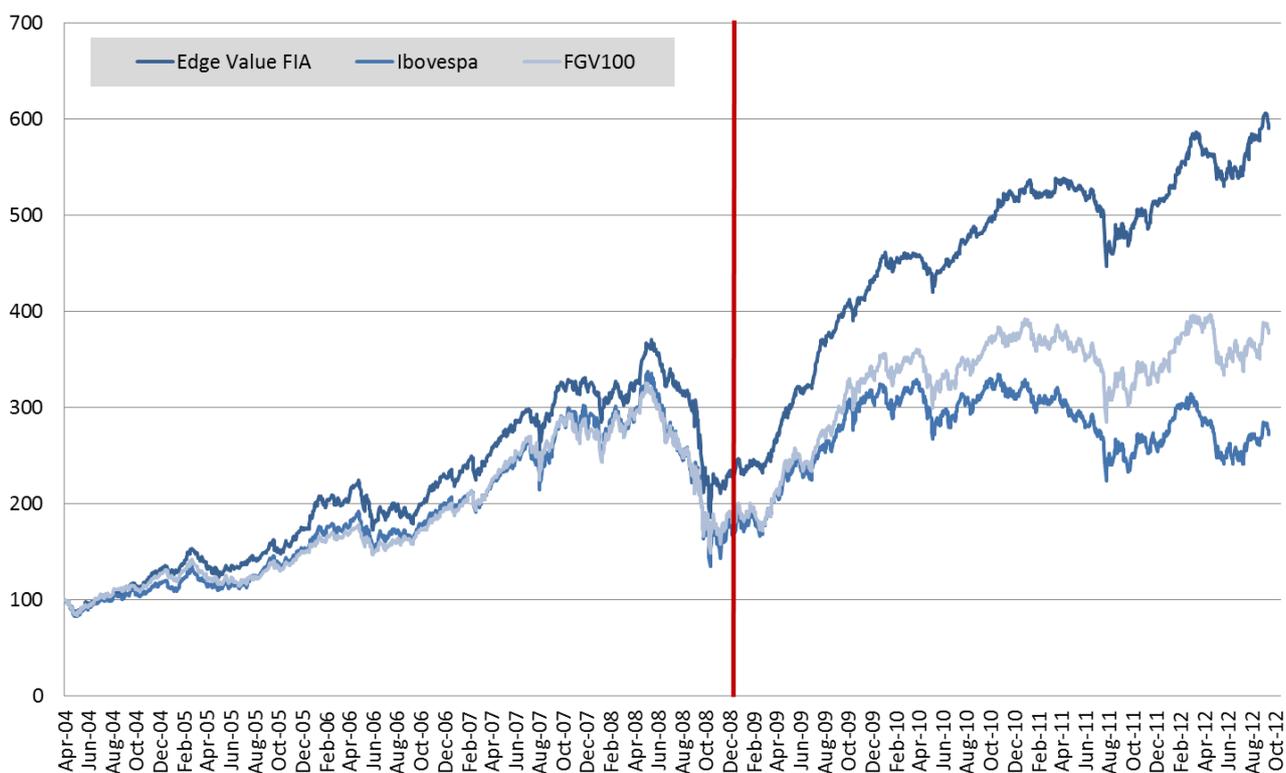
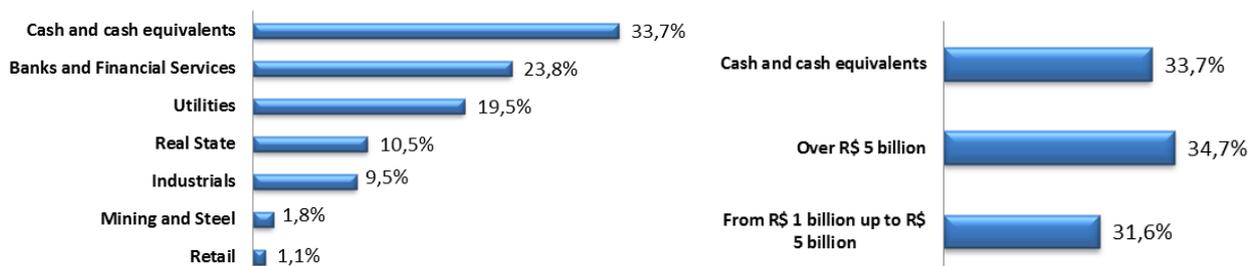
Period	Edge Value FIA	FGV100	IBOVESPA
September 2012	2.05%	6.34%	3.70%
August 2012	3.01%	-1.13%	1.71%
July 2012	2.31%	0.32%	3.21%
June 2012	1.03%	3.81%	-0.25%
May 2012	-3.65%	-12.57%	-11.86%
April 2012	-2.78%	1.40%	-4.17%
March 2012	3.63%	2.41%	-1.98%
February 2012	5.45%	5.22%	4.34%
January 2012	2.85%	7.09%	11.14%
2012 YTD	14.37%	12.02%	4.27%
2011	-1.90%	-10.58%	-18.11%
2010	18.99%	10.22%	1.05%
2009	85.79%	87.65%	82.66%
2008	-27.18%	-34.09%	-41.22%
2007	40.30%	40.06%	43.68%
2006	33.13%	31.55%	33.73%
2005	29.24%	15.15%	27.06%
Since inception (04/15/2004)	490.48%	278.05%	171.84%
Annualized Return	26.03%	20.82%	17.35%
AUM¹	R\$ 52,368.931		

Data from 04/15/2004 to 01/13/2009 refers to the Clube de Investimento Edge Value (the former Clube San Francisco and incorporator of the Clube Triumph). The conversion date for the Edge Value FIA was 01/14/2009.

¹Value on 09/28/2012. The average AUM for the past 12 months was R\$ 47,715,859.

Portfolio Composition and Performance

On September 30th 2012, the portfolio comprised stocks of 11 companies, divided as follows:



The red line represents the conversion date of the Clube de Investimentos San Francisco into the Edge Value FIA (01/14/2009).

Comments

In the quarter, the Brazilian market, as measured by Ibovespa, returned 8.87%. During the same period, Edge Value FIA returned 7.54%.

The main positive highlights were Randon, Grendene and São Carlos. Coelce and Cielo were responsible for the worst negative contributions.

Company	Performance Attribution
Randon PN	2,38%
Grendene ON	1,64%
São Carlos ON	1,44%

Company	Performance Attribution
Coelce PNA	-0,52%
Cielo ON	-0,20%

Macroeconomic Environment

It is well known that developed countries have been confronting a long and expensive process of deleveraging. Credit availability, which has expanded for years, is currently going through a process of contraction and is contributing negatively to economic growth.

In order to counter this scenario, the FED, the ECB and others are adopting expansionist monetary policies, with negative real interest rates and other unconventional measures, such as QE, Operation Twist and LTRO. These have the implicit and explicit objectives of stimulating economic growth and private investment and to depreciate debt via inflation.

Despite being in a much more comfortable situation, Brazil has been affected indirectly by these global macroeconomic woes, via a reduction in international trade, exchange rate appreciation and asset price inflation – these last two as a consequence of the excess liquidity seeking satisfactory returns (called a monetary tsunami by our President). The Brazilian GDP grew by only 0.9% in 2012.

However, this macroeconomic backdrop is not new and we have been monitoring it since 2008 when the crisis emerged. What became clear only in 2012 is the policy chosen by the Brazilian government to promote economic growth.

In a speech² made on September 7th, President Dilma Rousseff announced a “new development cycle for the country”, where the concept of “competitiveness” would become a priority.

In order to achieve this desired competitiveness, a series of measures will be adopted that supposedly reduce the costs of energy, transport, interest rates and taxes, in addition to “balancing the exchange rate”. In summary, these measures consist of:

- (i) Maintenance of a low interest rate policy and adoption of macroprudential measures to control an inflation that persists in not converging towards the official target of 4,5%;

² http://www.youtube.com/watch?v=cKWlyyBYI_s

- (ii) A larger interventionism to reduce the cost of production, such as in the cases of MP 579 (reduction of the cost of energy), the crusade against the banking spread (reduction of the cost of financial intermediation), the recent ANTT resolutions (reduction of the cost of transport), in addition to other already announced measures;
- (iii) Exchange rate intervention to keep the Brazilian Real floating between a band that the government considers “balanced”;
- (iv) Tax exemptions, cheap credit and other incentive packages for selected sectors.

Naturally, it is not our objective to criticize the validity or effectiveness of these measures; we leave this discussion to the economists.

However, it is fundamental that we closely monitor these measures because their consequences can already be clearly seen in company results and in stock market prices.

Recently, one of the measures’ collateral effects was confirmed in a study published by Deloitte³, which showed that the government’s measures worry executives more than the competitive measures taken by their own competitors.

These days, the analysis of the regulatory risk – or the increase in its perception – must be an integral part of any investment decision, in order to avoid capital losses, such as can be observed in the electricity and banking sectors and in Petrobras.

With respect to the management of the fund, we have significantly intensified the monitoring of the sectors that are sensitive to these regulatory measures – especially with respect to our investments in the electrical and banking sector. We have also attempted to take advantage of the opportunities created by the greater perception of regulatory risk, such as in the recent acquisition of AES Tietê.

Additionally, we have concentrated the fund portfolio in companies with the following combination of characteristics, which absorb both the regulatory and inflationary effects:

- (i) Market leadership and/or favorable competitive situation (PSSA, ITSA, BBDC, CIEL, BVMF, RAPT);
- (ii) Inflation protection (SCAR, COCE, GETI, CGAS);
- (iii) Regulated businesses with long concessions (GETI and COCE) and/or a historically favorable regulatory environment (CGAS);
- (iv) Companies that benefit from some governmental measure (RAPT, GRND, MAGG).

³ <https://conteudoclipingmp.planejamento.gov.br/cadastros/noticias/2012/11/26/governo-assusta-mais-que-as-rivais>

Portfolio

Divestment – Equatorial Energia

We invested in Equatorial Energia in April 2010. At the time, the company had announced the sale of the stake that it held in Light to CEMIG.

The transaction occurred via the listing in the Novo Mercado of a company named Redentor Energia – formed by the spin-off of the stake of Equatorial in Light – which would later have its control sold to CEMIG, with a tag-along right for the minority shareholders.

After the disclosure of the transaction to the market, the Equatorial shares surprisingly fell, which was difficult to explain by the fundamentals of the company or the announced transaction.

At the time, we estimated that the possible reasons for the decline were: (i) a concern regarding the reduction in the liquidity of the stock after the spin-off and; (ii) the supply and demand imbalance caused by dividend funds, which divested following the announcement of a payout ratio reduction.

In the following months our concerns dissipated because the liquidity remained at satisfactory levels and the dividends were re-established. The stock surged significantly, but we held on to our investment because we still considered the risk/return relationship attractive.

However, more recently, the Equatorial stock price has significantly increased. This is probably in the expectation of the possible turnaround of Grupo Rede, an electricity distribution company for which Equatorial has shown interest. Despite the managers of Equatorial ranking among the best in the industry, we are not comfortable in paying upfront for the success of the challenging restructuring that awaits them.

Consequently, we decided to sell our entire investment.

- Equatorial Energia ON (EQL3):



Source: Bloomberg/Edge research

Replacement of Itaú ON with Bradesco ON

In the last quarter, we exchanged one third of our investment in Banco Itaú for Banco Bradesco. The decision was taken in order to reduce the concentration of the fund to the specific risk of Itaú, by adding a company with similar qualities. The exposure of the sector remains unchanged.

It is never simple to calibrate the level of concentration. At Edge, we try to maintain our portfolio responsibly concentrated in our best ideas. Normally, no position should exceed 15% of our equity value.

Accordingly, we do not necessarily seek the portfolio that maximizes the performance in the base scenario, but that which is sufficiently robust to preserve the invested capital in the most diverse possible scenarios.

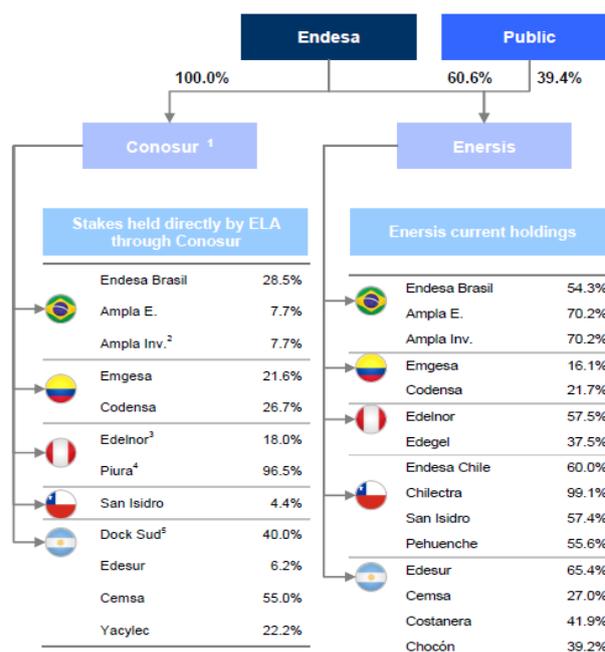
Therefore, our replacement of Itaú with Bradesco serves to marginally increase the robustness of the portfolio, even though at the cost of a somewhat smaller return if our estimates for the future of Itaú are correct.

Coelce – Capital Increase of Enersis

Last July, Endesa, the indirect controlling shareholder of Coelce, proposed a company restructuring in order to concentrate its investments in Latin America in only one vehicle – its subsidiary Enersis, which is listed in Chile.

The proposed transaction, if approved, involves a capital increase of Enersis, through which Endesa Latinoamérica will contribute stakes that it holds directly in several assets, as illustrated alongside (“Conosur”).

The minority shareholders of Enersis will be allowed to participate in the capital increase through a cash contribution. This immediately raised the question of how much could be ascribed to the value of the assets transferred to Enersis.



Naturally, the larger the valuation of the stakes contributed by Endesa, the more cash the minority shareholders would need to contribute in order not to be diluted.

The reasoning for Endesa to perform this restructuring, according to comments made in a teleconference and discussed in presentations, is based on three main arguments: (i) to have cash for potential M&A, (ii) to develop greenfield projects in the region and (iii) to buy out minority shareholders of the controlled companies, including Coelce.

Minorities acquisition of ENI Group ⁽¹⁾

Company	Country	Stake to acquire
Endesa Brasil		4,2%
Coelce		41,1%
EOC ⁽²⁾		5,0%
Chilectra		0,9%
Pehuenche		7,3%
Emgesa		51,5%
Codensa		51,5%
Edegel		37,5%
Edeinor		24,3%
Inversión total	≥4.000	

(1) Subject to market conditions and investors willingness to transfer their stakes
(2) Current stake of Endesa is 60%. Endesa by-laws do not permit exceeding the 65% stake threshold

In view of the possible conflicts of interest and the perverse incentives that surround the preparation of appraisal reports, it is interesting to note that, in this case, if on the one hand it would interest the controlling company to overestimate the value of the assets that it intends to contribute in the capital increase (for the minority shareholders to contribute more money in order not to be diluted), on the other hand it would be irrational to do this if the wish was really to purchase the stake not yet held in the subsidiaries listed in the table alongside.

A first appraisal report, disclosed with the capital increase proposal, estimated the value of Coelce at US\$ 2.2 billion (approximately R\$ 4.4 billion). However, the Chilean regulator determined that the operation should be treated as a related party transaction, which required the preparation of two other independent appraisal reports.

The results of the valuation⁴ of Coelce by the discounted cash flow method are as follows:

	Date	Kd	Ke	WACC	Value by DCF (US\$ million)
Appraisal Report	Jul-12	4,50%	9,50%	7,90%	2.110
Claro y Asociados Ltda	Oct-12	11,20%	12,40%	9,40%	2.362
IMTrust	Oct-12	5,20%	9,40%	7,30%	2.182

Therefore, for us, as investors in Coelce, the intended company simplification and the concentration of the control of the company in only one vehicle – Enersis – is an advance in relation to the current and complex structure of the group in Latin America.

Furthermore, as can be observed in the above table, the valuation range attributed to Coelce both by the report undertaken by Endesa and by the two independent reports, point to a premium of over 50% in relation to the current market value of the company. Naturally, if it is the wish of the controlling company to proceed with an offer to purchase the stake of the minority shareholders, these indications of value will serve as a reference point for us.

Thank you for your confidence,

Sincerely yours,

The Management Team of Edge Investimentos

⁴Claro y Asociados - https://dl.dropbox.com/u/21706128/Relat%C3%B3rios/CA_EN.pdf

IM Trust - https://dl.dropbox.com/u/21706128/Relat%C3%B3rios/IMTrust_EN.pdf

Appraisal Report - https://dl.dropbox.com/u/21706128/Relat%C3%B3rios/informe_capital_ingles.pdf