

# Prusik Asia Fund Plc

FSA Authorised  
Recognised Schedule 5



## Prusik Investment Management LLP

*An Independent Asian specialist investment manager*

### NAV Updates

Series	June '07	MTD	YTD
Class A	171.89	+4.79%	17.88%
Class B	171.94	+4.79%	17.92%
Class C GBP	92.59	+4.66%	17.74%

Fund Size \$363m

### NAV Update

### June 2007

Class A USD	
Non distributing	USD171.89
Class B USD	
Distributing*	USD171.94
Class C GBP	
Distributing*	GBP 92.59

The fund rose 4.79% in June as markets surged inexorably higher. This increase was marked by rising volatility, narrowing focus and, behind the headline new highs, an increasingly large number of declining share prices. We take this latter trend as a warning signal that the quality of this rally is, for the time being, no longer improving. Our favourite law of physics appears still to be applicable, namely that in order to raise the temperature of a room, an increasingly larger amount of energy is required to achieve each subsequent degree increase in heat. Liquidity driven markets seem to behave in a similar fashion. Currently, liquidity is abundant. However, the room is already becoming quite hot.

We have raised some cash during the month as valuations began to blink amber on our spreadsheets. As an example, we felt that a 25x plus CY08E PER valuation for a Chinese consumer company fully captured buoyant earnings prospects, as did a 20x plus CY08E PER valuation for a Korean heavy industrial. However, a few weeks on, such PER levels are now considered 'normal'. In many cases, share price valuations are well ahead of even these levels. As a result, either our growth forecasts are too low or we have entered investment

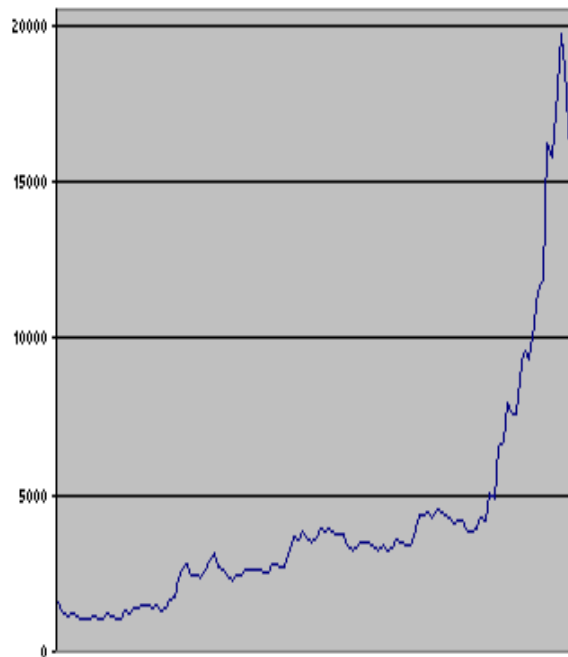
nirvana. We do not think that the former is the case given that a recent visit to Korea established that everything was 'looking ok as forecast' but that there were few new or exciting developments or trends emerging.

We have possibly been too cautious recently and, as a result, have suffered frustration on occasion. However, we remain vigilant and do not wish to be seduced by the siren calls of either 'new' valuation methods, longer forecast periods, abnormally high volumes, generous allowance made for future, yet to be confirmed corporate developments or rapturously accepted placements. Interestingly, we have observed, when analysing our recent investment decisions, that reducing our exposure has not proportionately reduced our performance. This, we think, is because share price performances are currently more mixed than perhaps the headline numbers suggest.

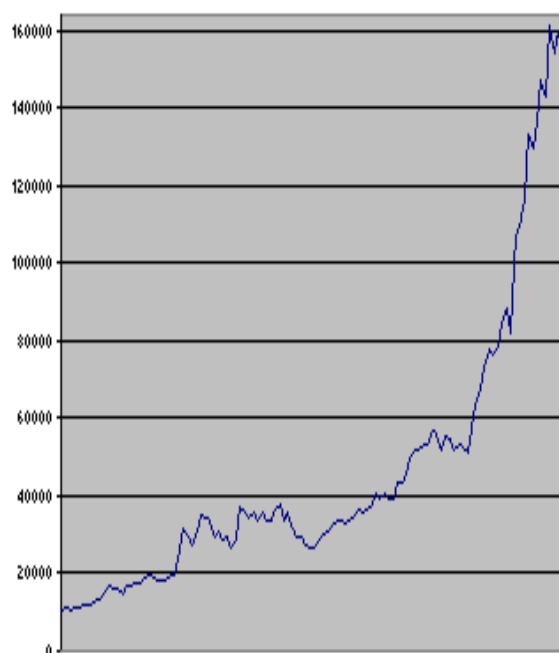
Our themes continue to work well. However, increasingly, we are forced to work very hard to avoid the herd and to find stocks which possess that combination of positive thematic exposure, reasonable share price valuations and tolerable historic share price performance charts for which we look. Sometimes a picture is the most

revealing. Below, we have illustrated three share price performance charts of holdings which we have either reduced or sold recently. The charts commence from October 2005, the date at which we launched the fund.

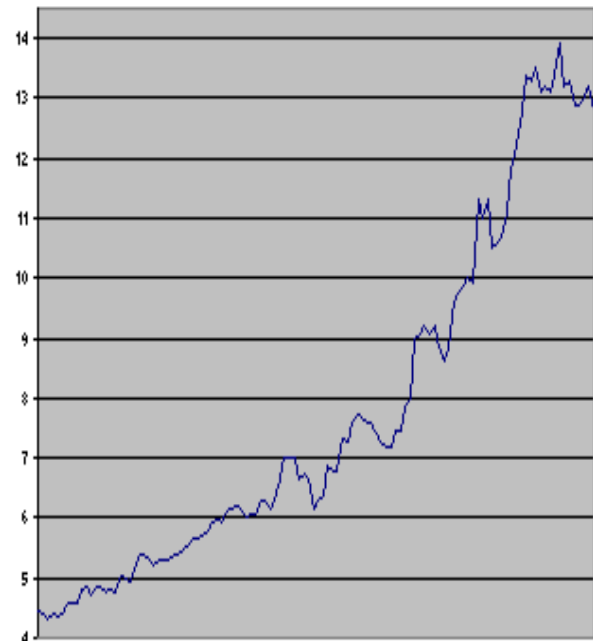
**Korea Cottrell**



**Doosan Corp**



**Kuala Lumpur Kepong**



## Power

There is no doubt that, via our exclusive focus on Asia, we are exposed to a rich, long term investment environment. India and China are in the midst of what appears to be the fastest growing industrial revolution in history. As a result, the growth in demand for infrastructure capacity is staggering. For example, over the last fifty-five years, India built 105 megawatts of power generating capacity. However, over the next five years alone, India plans to add over half as much capacity again. Leaving aside the question as to, first, whether this is actually possible and, second, what will be the potential impact on the cost of related goods which this scale of demand might have, thematically, such trends have been and will likely continue to be very rewarding.

As a result, we have, recently, been rebuilding our investments in India in this sector. It seems likely that, with the dwindling of coal supplies and the approval of more

power projects, the most likely outcome will be increased brownouts in India and a soaring international coal price. Power Finance is an Indian Government backed company, unconstrained by banking regulations, which is able to raise funds at a sovereign rated cost and then lend those funds to the IPPs as the latter build out capacity. Power Finance is enjoying a rising ROE already above its cost of equity. However, its share price is valued at barely more than 1.5x its prospective bookvalue.

In China, there is speculation that the Government will look to replace 20% of China's current coal fired generating capacity with new plant which will emit half the pollutants. As a result, we have switched allegiance from the Doosan Group in Korea, now trading on 22x CY08E earnings, to the Dongfang Group in China, a more direct beneficiary of rising PRC power equipment demand trends. Dongfang has also been winning power generation equipment contracts in the region at the expense of Doosan due to the former's capacity to deliver equipment a third faster than the latter and at a lower cost. Dongfang is, in addition, the front runner to benefit from a roll out of nuclear power in China and has the capacity to manufacture wind turbines. Dongfang therefore has exposure to a number of our themes. Due to the market's possibly unjustified caution on future order flows, we were pleasantly surprised to find that Dongfang's share price was still trading at an attractive valuation. A positive change in the trend of Chinese power generating investment does not yet therefore appear to be discounted in the share price.

## **Intelligent Grid**

Prince once exhorted us to 'Party like its 1969' and the song has been running through our heads recently. The fashions of the 1970s returned some years ago. Other delights of that era such as inflation also could be reappearing. In addition, we think that there is another feature of the 1970s which may also rear its head in the coming years, expensive power and power cuts. However, this time, we think this trend will be driven by different factors to those which inspired its 1970s predecessor.

Blackouts are becoming a more regular feature of modern life from China to Europe. Some 500,000 Americans, for example, are plunged into darkness at some point every year. The cost of not having access to electricity is astronomical. Local newspapers in Vietnam have recently suggested that the economic growth forecast for 2008E may not be achieved due to the failure of the electricity supply to keep up with electricity demand. In the United States, it is estimated that every hour without power costs the average mobile telecom company US\$41,000, the average credit card company US\$2,548,000 and the average brokerage a thumping US\$6,480,000. Power blackouts in the United States are now estimated to be costing the US economy around US\$100 billion per year.

Why is this happening? Please bear with us here as we will be writing about the situation in the United States, not in Asia. This is because the statistics for the US market are more readily available than for anywhere else. However, the situation in the United States is highly relevant given that the same problems as those seen in the United States are emerging everywhere else. This is especially the case in Asia where power management systems are old fashioned and where even the newly

installed systems lack 'smart' solutions.

Here is the anomaly. In the United States, a decade after competition was introduced, long distance phone rates have halved and air fares and trucking rates have fallen by 25%. However, a decade after the US Government opened the electricity generating market to competition, we have seen no such comparable decline in electricity pricing.

The problem is not the result of a failure to invest in big, new, more efficient power plants. Instead, it is a result of nearly three decades of a lack of investment in the expansion and upgrade of the electricity transmission and distribution grid system. For every dollar invested in the power grid in the 1970s, once adjusted for inflation, less than 75 cents is invested in the grid today. As a result, the average electricity substation is now 30 years old and there is often not enough power line capacity to transport centrally produced power over longer distances from new, cheaper generating plants. Utilities therefore have to buy more expensive power from nearby generating facilities and charge their customers accordingly. The US Department of Energy reports show that many expensive generating plants, which were only built to supply occasional peak power, are, as a result, now running flat out some 40% of the year to compensate for this 'congestion' on the grid.

In digital systems, like those for wireless and wire-line telecom networks, via a massive network of microprocessors, the systems self monitor and communicate, thus routing efficiently and protecting the system. As a result of the information gathered on the network usage patterns, peak demand can be predicted,

tariffs can be adjusted accordingly and, via their bills, customers can quickly understand that charges for usage vary according to the time of day. This encourages consumers to adjust their user behaviour accordingly. In the world of electricity grids, none of the above information is readily available or communicated to users. For example, there is no intelligence available either by communication or predictive software to foresee when a large user may, for example, reduce usage due to the shutdown of a plant for servicing. As a result, the electricity generating industry constantly produces surplus energy supply in a form which cannot be stored and, due to congestion, often cannot be sent elsewhere.

This so called 'congestion' problem on the grid has a significant economic impact. Already, US consumers experienced electricity rate hikes in the order of between 27% and 72% in the latter part of 2006, depending upon the individual state. In 2008, it is estimated that 'congestion' will add US\$40 of costs per person per annum on the Eastern Grid. The Eastern Grid serves 200 million people.

But there is more than just the economic cost to incentivise investment in the digitalisation of the system. From an energy saving perspective, a centralised and unintelligent grid produces shocking numbers. Only a third of fuel energy burnt in power plants ends up as electricity. Half is lost as waste heat and a further 8% is lost in long distance transmission. Moreover, 20% of generating capacity exists only to meet peak demand. This capacity runs only 5% of the time and provides only 1% of supply. Additional problems prevail in Asia. For example, in India, it is estimated that over 15% of electricity produced is lost due to theft.

This brings us to the third reason why 'smart grids' are an essential part of our immediate future. An intelligent grid allows decentralised and intermittent power supplies to be accommodated by the grid, something which the current system is unable to do. This means we can build all the wind, solar and other renewable energy sources we like, but until the grid is upgraded, they cannot be efficiently absorbed onto the system.

This third factor alone means that we face a decade or more of seeing heavy spending on electricity grids throughout the world. This will place significant pressure on the resources needed to undertake the grid upgrades and, in order to pay for those upgrades, potentially significant pressure on electricity prices as well. Where spending lags behind demand, further blackouts can be expected.

However, the benefits in the future will be huge. Smart metering, for example, which allows customers to control energy use based on feedback on real time energy prices, is now being trialled in Washington. It has resulted in electricity consumption falling by 10% at peak times. A smart system will also enable the dream of integrating hybrid vehicles with the electricity grid. Each electrically powered car will thus become a giant battery supplying capacity back to the grid when the cars are not in use. Studies show that the existing US power capacity, with a smart grid system, could power 217 million light vehicles. This would require no greater change to the infrastructure than, obviously, replacing the nation's cars with hybrid vehicles with bigger batteries, probably a 10 year plus project, and issuing all car owners with an extension cable. Given

that half of US imports of oil currently go into fuelling light vehicles, the savings are self explanatory. While, as a result, power plants would be running at higher levels, power plants are far more efficient than car engines. In theory, greenhouse emissions could therefore fall by nearly 30%.

In Asia, the current circumstances are little better. We have newer grid systems in some cases. However, we have no digitalisation. China has pledged US\$20 billion of investment in new power systems. However, existing system upgrades are also needed. We think that the digitalisation of electricity grids is potentially a very strong theme globally. Asia will be a major beneficiary of this surge in investment as a supplier of both the required parts and labour. It is estimated that, over the next five years for example over half of the electrical engineers in the United States will retire. The gap will be filled by workers from China and India.

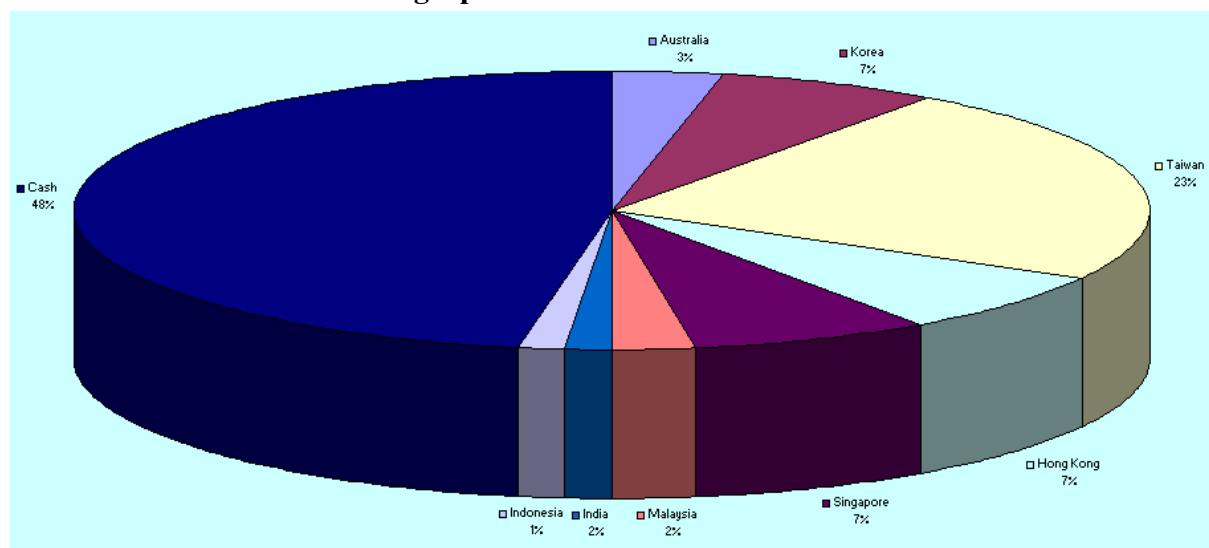
The portfolio is trading on 17x CY07E earnings and 15x CY08E earnings with an ROE of 18%.

Heather visits Korea in August.

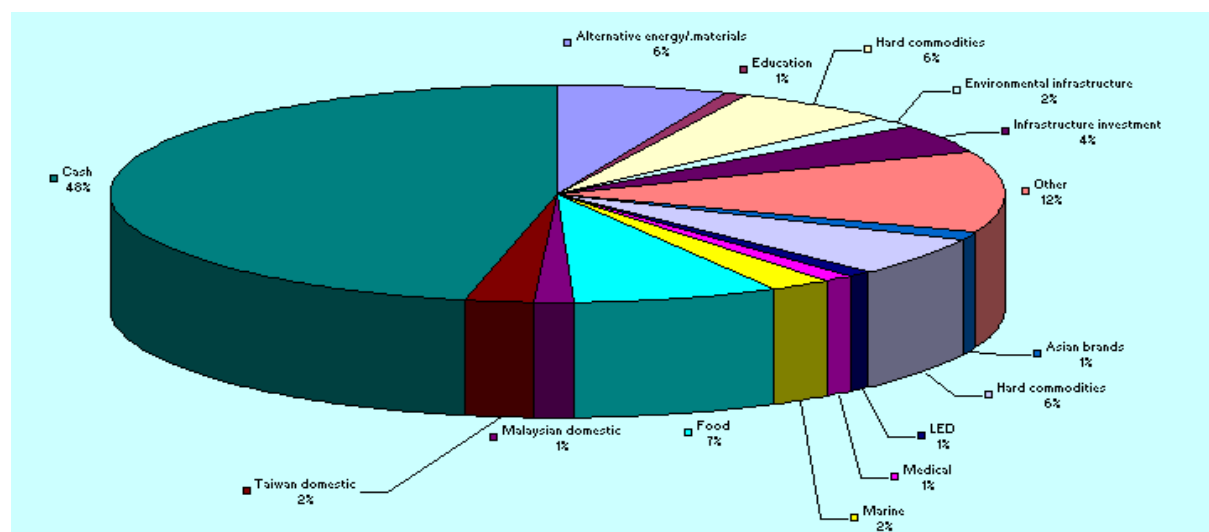
<b>Top 5 holdings</b>	<b>%</b>
Formosa Plastics	3.730
China Milk	3.210
Yanzhou Coal	2.760
STX Engine	2.650
Taiwan Semicond	2.160

Number of holdings 40  
Percentage of Fund invested 52%

### Geographical Distribution



### Distribution by Theme



Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2005										-1.90	5.64	5.08
2006	7.71	0.09	1.84	10.14	-1.95	-0.45	-1.72	0.02	1.23	3.90	7.64	1.97
2007	-0.01	1.28	3.05	4.08	3.58	4.79						

#### Key Parties to Fund

Investment Manager Prusik Investment Management LLP  
Administrator Bisys Fund Services (Dublin)  
Custodian Brown Brothers Harriman (Dublin)  
Auditor Ernst & Young  
Legal Advisors Dillon Eustace (Dublin)  
Simmons & Simmons (London)

#### Key Terms

Denomination USD  
Dealing Day Weekly (Friday)  
Minimum Subscription USD100,000  
Min Subsequent Subscription USD10,000  
Subscription Notice Period 2 business days  
Redemption Notice Period 2 business days  
Dividends  
Class A None  
Class B Annual  
Class C Annual

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Manager Fees  
Management Fee 1.5% p.a. paid monthly in arrears.  
Performance Fee 10% of NAV appreciation. With a 6% hurdle.

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