PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asia Fund

Quarterly Investment Report

31 March 2014

FOR PROFESSIONAL INVESTORS ONLY

PAF Quarterly 1Q 2014

The Prusik Asia Fund saw a good start to the quarter, although this reversed somewhat from mid March. While the index only rose 1% during this time frame, underlying stock moves for growth stocks, and technology stocks in particular, were much greater, both on the upside, giving us strong out performance through February, and on the downside towards the end of March. The upshot for the Prusik Asia Fund was that it saw a negative return of 0.7% for the first quarter, which is frustrating after such a strong start to the year.

On the positive side, Vietnam is suddenly on everyone's radar! As an exciting Frontier Market, Vietnam has been a core theme since January 2012 and has performed very well over this period with all of our stock picks, bar one, up considerably since purchase. So far this theme has conformed to our classic 'theme pattern' of quiet, unobserved outperformance followed by 'discovery' by the market leading to further strong performance. In 2014 we expect foreigners will return to Vietnam with even more vigour which would be positive for our stocks.

We have reduced some of our exposure to growth, selling **Haier**, the Chinese branded white goods company plus Chinese and Taiwanese technology stocks **Netease**, **Qihoo 360 Technology** and **Richtek**. At the same time we have been adding to some of our preferred data focused stalwarts such as **PCCW**, the Hong Kong telco, **AIA**, the pan Asia insurance co and **CLP Holdings**, the Hong Kong utility which is working on smart meter technology. We have also added to **Siam Cement**, which we believe was oversold.

In this report we will address how we see the future unfolding for the technology sector, which we continue to like. Thematically, we also remain very optimistic for the tourism, leisure and entertainment sectors, local brands (especially local Chinese handsets brand – the new kid 'brands' on the block!), big data, software, cloud computing and the internet, especially at these less demanding valuations. New themes include soft commodity producers, the 'connected' car and the possibility of China reform. Finally, we are revisiting our telecoms theme, especially in China, where 4G is due to arrive later this year.

Sell in May?

This old adage has some impressive statistics to back it up. Indeed, in three of the last four years investors who have allocated capital to Asia in late June to early July have enjoyed rallies of 12% or more for the rest of the year. Should markets deliver further weakness in the very short term, there is a strong statistical case to support buying into this weakness. We noted these statistics in our April monthly but they bear repetition.

Firstly, the current price to book for the MSCI Asia ex-Japan index stands at 1.55x, which is the lowest it has been in the last five years. Secondly, the price to book gap between the MSCI Asia ex-Japan index and the MSCI World index is -0.48x, also the biggest it has been in the past five years. Thirdly, on a rolling 12-months basis net foreign buying in Asia is at its second lowest level in the last five years. Finally, the price to book gap between cyclicals and defensives stands at 0.47x or its second widest point in the past five years.

In addition, an observation of the credit markets, which in recent years have lead equities, reveals that in April there was ample demand from the US for Emerging Market bond issuance. Asian credit supply volumes were at a record $33billion in April and around 40% of this found its way into US hands. Currently, the Emerging Market / Developed Market yield spread is very close to historic highs; in the coming months if issuance slows and spreads fall this would provide a very supportive environment for Emerging Market and Asian equities.

The conclusion, therefore, is that should there be any further weakness that this could well be a very good buying opportunity.

China Internet

"This is not about technology at all. It's about how it changes peoples' lives forever."

CISCO CEO John Chambers

We wrote extensively about the China internet last quarter having visited many of our holdings in this sector in January. In recent weeks, at the time of writing, the technology sector has undergone an extensive correction. This correction has not just been confined to the China internet but has been seen across the board in technology and in growth stocks in general as well. The catalyst for this capitulation was possibly **Facebook's** acquisition of **Occulus Rift** for $2billion, which sparked both fears of a bubble and a wave of incredulity as analysts struggled to understand why this might be a good idea, both from a practical perspective and in terms of valuation.

We have looked very hard at what might have driven this correction and whether there is anything we missed. What we have found instead – at least in China where our main weighting in the fund is – is a sector which, in our opinion, is still yet to deliver its best and which now represents a very good opportunity to buy. Here, in no particular order, are some of the key reasons why:

1) **Mobile Data Lift Off**. China is about to undergo a massive 4G upgrade. One leading supplier of handset components expects the coming three years to be the best in the history of handsets ever! This 4G network will transform how people in China use the internet and the number of potential transactions that can take place over the internet once again will rise, once again, exponentially. The big companies who are already monetising mobile should see a sharp rise in activity. To give you an idea of what this might entail, **Ericsson** has estimated that in the last year mobile data traffic rose to 2,000 petabytes (that is a 10 with 15 zeros after it!) compared to just 28 petabytes a month for the entire internet in 2011!

2) **Penetration**. Internet penetration levels in China are still low at around 50%. With the lower end smartphones now selling for the same cost as a tank of petrol and the transformational effect of 4G user speeds, the arrival of millions more internet users in China is very likely to take place soon. This will increase the addressable market for online business significantly and therefore, in time, the overall value of the leading companies.

3) **Mobile Payments**. Mobile payments are already transforming Frontier Markets, in particular Africa, and even winning wars! However, according to a top independent advisor to **Facebook** and **Google,** we are about to see a radical change in the way in which mobile payments are used in the developed and developing markets as well. This could lead to another massive increase in the demand for smartphones as well as e-commerce. It is

expected that in the near future companies such as **Visa** will manage transactions by triangulating three things: location (verified by your smartphone), authentication (via your fingerprint, iris or voice) and a rolling, short life 50 digit pin sent to your smartphone and the vendor. In this way it would be possible to effect money transfers anywhere without the need for cards, permanent pin numbers, terminals or fixed lines. Offline and online will become blurred and transaction volumes are likely to rise, benefitting many internet based businesses.

4) **Data usage**. Last quarter we wrote about how effective data usage is going to be a key differentiator between companies and drive phenomenal growth. We have since gleaned further insights as to why data is going to be so important. What we have learned refers to **Facebook** but the phenomenon we are about to describe bears relevance to **Tencent** and **Alibaba** as well. This makes us confident that the value given to the best internet companies is still not too rich.

- **Facebook** now has such detailed data on its users that advertisers can pay to have their adverts displayed to incredibly specific audiences, for example a man aged 35-50 years old who drives a **BMW** or **Mercedes** and regularly drinks orange juice. While advertising has always sought to target a certain demographic, statistics from **Facebook** highlight just how beneficial this level of specificity is. The average 'yield' for an advert placed anywhere on the internet is 0.3% but on **Facebook** this 'yield' rises to 2-3%. This is up to a tenfold increase in the effectiveness of advertising! Given that ultra targeted online advertising is proving to be a much more efficient use of advertising budgets, the growth in digital advertising should be tremendous. Indeed, **Procter and Gamble** spend over US$3billion a year on advertising and have pledged to go from spending just 10% of this on digital media to 50% within the next two years!

- While **Tencent** derives more revenue from PC and mobile games than advertising and **Alibaba** is focused on e-commerce, our point is that the internet companies who are best placed to grow the quickest and remain the strongest are the larger companies which are able to collect the most data and use it more effectively than others. This is the nature of new and disruptive business models which use information and data – the big companies get bigger as they have more data and in turn continue to collect more data because they are bigger and so on.

5) **Social media, games and more data**. General horror at the sums of money paid by **Facebook** to buy **WhatsApp** and **OculusRift** may or may not prove to be unfounded but only time will tell. However, as we have already said, having data on how people are behaving is incredibly valuable. In fact, given how data is changing the nature of advertising the **WhatsApp** purchase may prove to have been a very smart move. The next frontier in advertising is personal recommendations to peer groups and **WhatsApp** is potentially one of the best placed companies globally to capitalise on this as both a source of data and message delivery.

6) **Speed of change and information**. If the iPhone were built using the same technology as the world's first electronic computer, the ENIAC in 1948, this version of the iPhone's electricity bill would run to $50trillion and the device would be the size of 170 giant hangars. Fast forward to 2023 and the average $1,000 laptop will be able to communicate at the speed of the human brain. Computer power has effectively doubled every year for 70 years to a point where its power and effect has now produced a whole generation - namely the under 30s - who think and act quite differently as a result. The technology and companies this generation interacts with multiple times a day are part of their 'norm' whereas for us and for the stock markets this is new and different. Stock markets find this very unsettling as they don't know how, using their traditional tools, to evaluate these new leviathan businesses which are literally a way of life for a generation but often do not seem to have much that is tangible, even in some instances employees! But investors must remember the lessons of all previous industrial revolutions where the old assets become more worthless than could ever be imagined. ***Volatile as these companies share prices are at the moment, the future value is in information, data analysis and the online generation***.

7) **Automation**. We will return to the theme of automation in the context of robots and machines later in this report but for now we want to highlight how much of life now involves interaction with computers. A great example of this is the rise of the Chinese internet companies in banking and investment. **Alibaba's** Yu'e Bao Bank which opened last year in June now has an estimated $85 billion in assets! This is tiny compared to the $9trillion of assets in the Chinese banking system but the portion handled by the internet majors will no doubt grow exponentially from here. The point is that there are still some 'bricks and mortar' industries and businesses that the better online brands are yet to even begin taking revenue from. Online models bring with them lower charges and people are increasingly used to dealing with computers whether they are buying a train ticket or groceries or much, much more.

8) **M&A and the Alibaba IPO**. Lastly, but certainly not least, we are seeing weekly purchases of tech companies by other companies. Most notably in the internet sector **Alibaba** announced a $1.2billion strategic purchase of shares in **Youku** (the Chinese version of **Youtube**) at a 20% premium! This process might only be fuelled by the recent falls in some tech companies' share prices. For those who are not looking to spend capital on acquisitions we are now seeing major share buybacks and director buying. We have also just received the launch notification of the much anticipated **Alibaba** IPO. In the coming weeks as the company goes on a global road-show the market will learn more about this mysterious company. Further, in the process, investors will mostly likely get a better understanding of the value and the future growth of some of the other internet businesses that have been sold down so aggressively in recent weeks.

In conclusion, we believe these are the businesses of the future. They are difficult to value by conventional means but, yet again, none are conventional. However, just because they are strange and new does not mean they are worthless or can be ignored. Most likely the opposite is true; it is, after all, a revolution (of sorts).

Truly International

Truly International was listed in Hong Kong in 1991 and is 44% owned by its Chairman and CEO. The company has been supplying the car market with LCD displays since 1995 and counts every major car company in the world, except Mercedes (although **Truly** is working on this one too!), as a customer. In recent years a large part of the company's revenues have come from supplying camera and touch screen modules to the handset market, in particular the local handset brands in China.

A conversation with the company revealed a very exciting long term outlook. In the coming two to three years the major driver will be smartphones. This will be led by an explosive upgrade in China local branded handsets as the new 4G network is rolled out. Local branded handsets in China are no longer dismissively referred to as 'white box' or unbranded. In recent months the sector seems to have undergone a transformation and created a serious identity. Top end local brands such as **Otto** are selling models which cost over US$500 and are deemed by the blogging community to have such cutting edge designs that the foreign brands may have to copy them. At the other end of the spectrum is **Xiaomi**, which is expected to ship 40-50 million handsets this year at more modest price points of around US$50 at the low end. **Xiaomi** also has designs on exports to at least another 10 countries this year**. Samsung** – watch out! **Xiaomi** is guiding for at least 30% growth in the coming year with rising margins as the hardware specifications improve.

The second driver of growth for **Truly** will be the transformational shift towards technology in the car manufacturing sector. In a few years time cars will have networks of sensors feeding information back to the driver and the garage, covering a number of data points such as tyre pressure. There will also be automated parking. Indeed, the US government has just announced that by 2016 all cars sold in the US will have to have a rear camera for parking. The installation of rear cameras will also require new TFT screens inside the car, an area where **Truly** has a lot of experience. In fact sales of **Truly's** TFT screens to the car sector grew by 400% last year! Management are guiding for 20-30% sales growth in 2014 and they are also doing plenty to increase margins, including improving the product mix. The stock is trading on a 2014 P/E of just 6x, has a return on equity of 24% and a dividend yield of 4.3%.

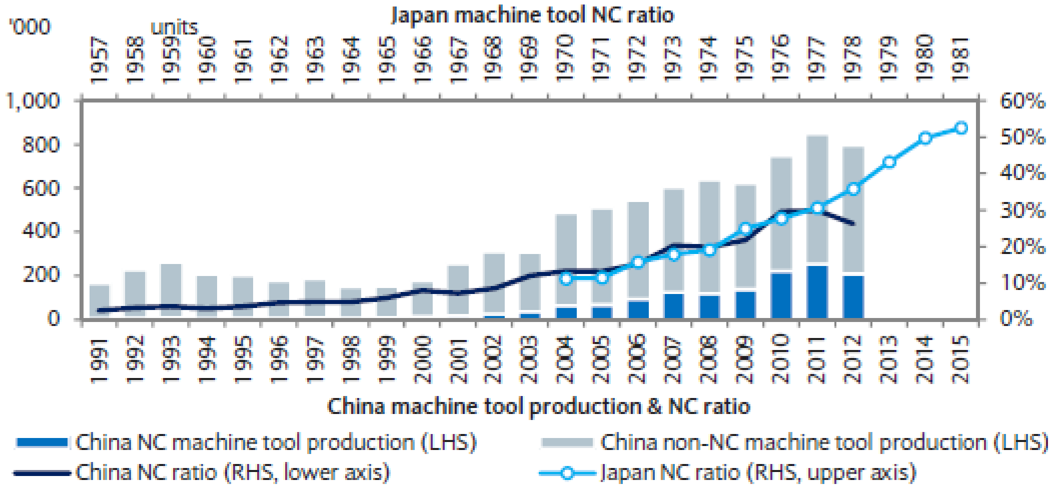
Automation

It is well documented that wages in China have risen up to threefold in the past decade and that the working age population peaked in 2010. Cue the beginning of the automation of China's colossal manufacturing sector, led by the electronics and automobile sectors. This is a vast upgrade which is likely to continue for decades. Perhaps the best barometer by which to understand the scale of what is still to come is to compare China with Japan. In most industrialised countries, robot density, as measured by the number of industrial robots per 10,000 employees, averages about 900. However, Japan has nearly double this at 1,500, while China has just 213! A study of the penetration of numerical control machines in China today puts the usage rates equivalent to Japan in the 1970s!

FIGURE 3

China's NC usage rate currently at Japan's level during 1970s, suggests strong latent growth potential

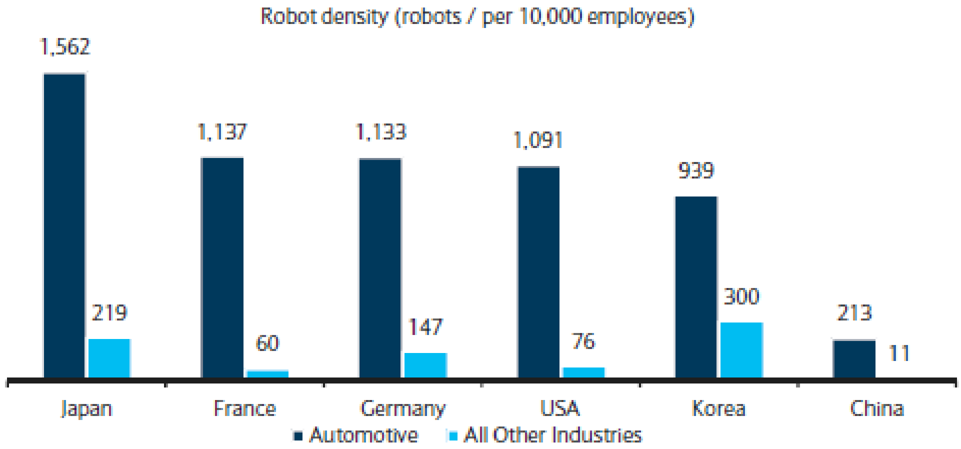
Machine-tool NC rates for Japan and ChinA



Source: NBS, JMTBA, Barclays Research

FIGURE 5

Automotive-use robot penetration high; industrial robot potential significant



Source: IFR World Robotics 2013

Truly, one of our holdings which we discussed above, gave us perhaps the best example of why the trend towards automation is strong, powerful and likely to be long lived. The company told us that for each factory line it has replaced with automated machines it has cut 23 workers who cost RMB 1.1million a year. The cost of a new line is Rmb 2 million, meaning that the payback period is just two years. The process has also enabled the company to claim back 33% more floor space increase capacity by a third and raise quality and yield rates by 2-3%.**Truly** still has 70% of its capacity to automate, giving the company great scope to improve efficiency and margins in the coming years.

Truly production line prior to automation

Source: 2013 Annual Audited Results of Truly International Holdings Limited

Prior to the improvement:

- Length of production line: 44 meters
- Workers: 23
- Production capacity: 9K per day

Truly production line post automation

Source: 2013 Annual Audited Results of Truly International Holdings Limited

High-speed and high-precision automated production line:

- Length of production line: 30 meters
- Workers: 0
- Production capacity: 12K per day

Airtac

Airtac specialises in the development and manufacture of pneumatic parts and its main products are widely applied in machine tools, automated production equipment, car making equipment and special purpose machinery. **Airtac** is at the very forefront of the automation industry and generates 90% of its revenues from China.

The company started out in 1998 and, importantly, from the beginning has focused on vertical integration, meaning that today 90% of its components are manufactured in-house. Owing to this **Airtac** can supply its customers at least 30% cheaper than all of their competitors, including those in China! The result is that **Airtac** is taking market share. It currently has 14% market share in China, although we expect this to rise. **Airtac's** strong and improving market position has not gone unnoticed with Japanese incumbent, **SMC**, with 31% market share in China and its smaller Chinese competitors often trying to offer it terms for consolidation.

The global automation market is expected to grow as much as 15-20% for the next 5 -10 years and **Airtac's** management are aiming to grow ahead of the industry. They are also looking to deliver a gradual improvement in margins which have already increased from 47% in 2008 to over 55% at present.

Despite this positive outlook, **Airtac's** management are not complacent. R&D is a key focus as is expanding distribution in China. Management describe their business offering as 'better sales, same or better product and lower price.'

Hon Hai

Tech conglomerate **Hon Hai** trades on a P/E of 11x and is interesting for the fact that not only does it sell robots but it is also a heavy user of them. In the past two years **Hon Hai** has reduced its workforce from 1.3 million people to just 1 million, whilst increasing sales over the same period by 17%. As a result its wage bill is up only 3% versus the China average increase of 15% and its working capital requirement has fallen by 50%. In addition, **Hon Hai** has big ambitions to take on **Fanuc** in the robot market but its other ambitions are equally interesting. Following on from our previous quarterly report where we wrote about use of data, Chairman Terry Gau has also pledged to become increasingly involved with areas of the business that allow the company access to data and information. This will likely gain momentum with the company's tie up with **Far EasTone**, making it well placed to connect devices that will become the future "internet of things."

China Reform?

There is a bat squeak of reform in the air in China. We believe that the current leadership not only has a grip on proceedings but an iron one at that. True, they appear unbothered about the slowing economy and this is causing great alarm for the stock market which is used to being spoon-fed stimulus packages when growth slows. However, is it possible that commentators are missing something? There has been an almost imperceptible stream of separate events which could be perceived as the start of a very important round of change in China. Is it that commentators are missing that China is going to destroy the 'old' - namely smokestacks, steel, and a dependence on fixed asset investment -to create the 'new' higher value added economy based on tech, consumer, healthcare and financial services? We think there is a chance this has started.

The slim evidence so far is as follows. **Sinopec** has started restructuring its non-core businesses and there have been proposals to restructure **Petro China** into a holding company with assets and operating subsidiaries, suggesting that the government is serious about making SOEs more efficient. There are also rumours that gas price reform is afoot. Meanwhile, there has been more talk on RMB convertibility and there has been much emphasis on cutting down corruption. Finally, the telecom sector has been given clarity on VAT payment reform (negative, but anticipated), whilst at the same time it has been given the go-ahead to share towers, which is far more rational and beneficial to all (except **China Mobile**)in the longer term.

The question is whether these small drips of reform turn into a steady stream. If this becomes a clear trend the longer term implications for the China economy and the 'new' areas of the stock market would be very positive. We are watching these developments very carefully and believe in investing 'alongside' the Chinese government. This could become a very important new theme.

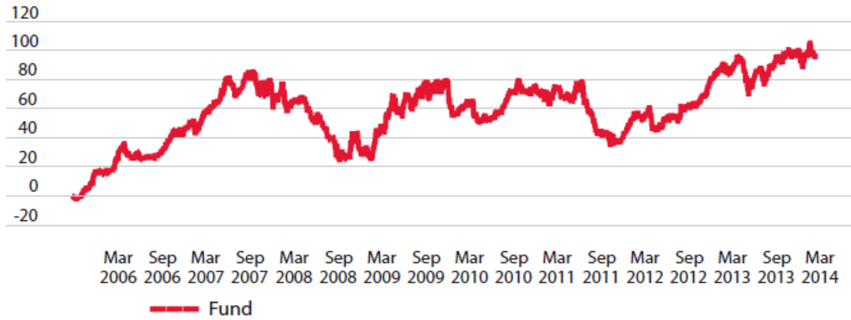
PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 31.03.2014

	USD	GBP	SGD
1 Month	-0.56	-0.53	-0.58
3 Months	-0.77	-0.77	-0.71
Year to Date	-0.77	-0.77	-0.71
Since Launch+	97.90	55.79	9.71
2013	16.63	16.76	16.50
2012	24.68	24.36	23.95
2011	-20.89	-20.70	-20.95
Annualised 5 years	9.36	8.91	-
Annualised 3 years	5.75	5.80	5.36
Annualised Since Inception	8.54	6.05	2.30

Source: Bloomberg
+ Launch date: A: 07.10.05, C: 14.07.06, D: 15.01.10

Fund Performance - Class A USD (%)



Source: Bloomberg. Total return net of fees.

Monthly Performance Summary (%)

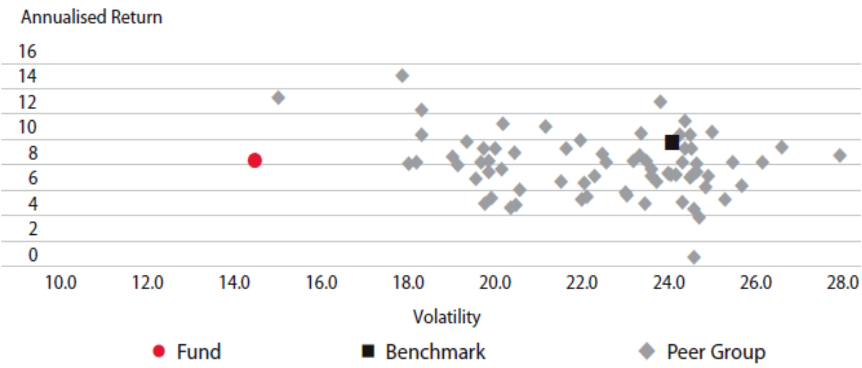
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2014	-3.15	3.04	-0.56										
2013	6.68	3.52	-0.45	1.73	0.09	-7.21	3.75	-3.21	4.60	4.19	1.92	0.66	16.63
2012	5.81	6.55	-0.38	3.08	-6.93	0.67	4.33	-2.54	6.47	0.24	2.45	3.39	24.68
2011	-2.27	-0.70	1.19	1.23	-0.86	0.30	4.32	-11.95	-8.24	-0.55	-4.02	-0.52	-20.89
2010	-9.67	-2.62	3.66	1.67	-7.15	-0.54	0.96	2.98	7.80	0.74	-0.38	1.08	-2.66
2009	-6.90	-2.90	11.16	4.46	10.67	-2.69	6.77	-4.94	6.42	-2.45	4.08	2.12	26.59
2008	-6.78	6.91	-8.06	1.81	0.67	-7.69	0.21	-5.34	-5.33	-7.37	0.02	9.75	-20.84

RISK ANALYSIS

Risk Metrics	**Fund (%)**
Beta	0.61
Alpha (%)	2.43
Sharpe Ratio	0.58
Volatility (%)	14.50
% of the portfolio – which could be sold in 2 business days	93.70

Source: Bloomberg
Since Inception: A: 07.10.05

Risk Adjusted Performance - Class A USD (%)



Source: Bloomberg. Annualised return and 1 year volatility versus the peer group (open ended offshore Asia Pacific ex Japan Equity Fund Index), 7.10.05 to 31.03.14

THEMATIC & GEOGRAPHICAL BREAKDOWN

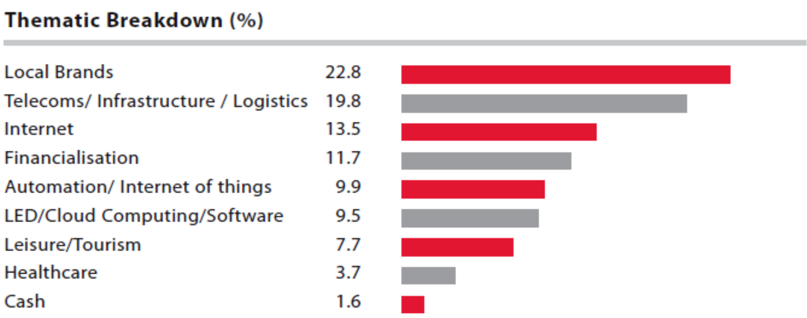
Top 5 Holdings (%)

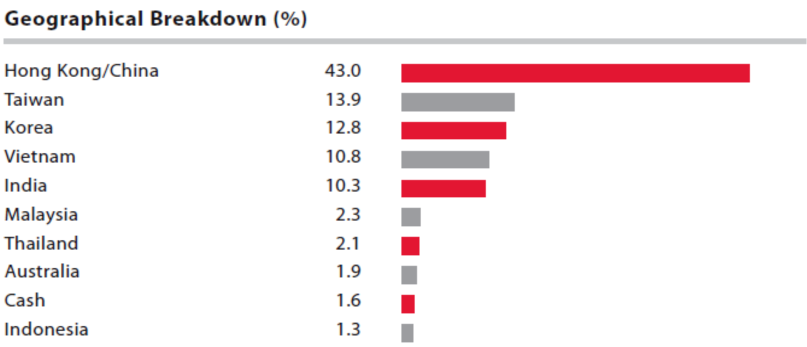
Kinh Do Corp	3.6
Hotel Shilla	3.4
Cheung Kong Holdings	3.4
Haeir Electronics	3.3
Coway Co. Ltd	3.2
Total Number of Holdings	47

Portfolio Financial Ratios*

Predicted Price/Earnings Ratio	15.2x
Predicted Return on Equity (%)	18.4
Predicted Earnings Growth (%)	26.1

*Fiscal year periods





All data as at 31.03.14. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size (US)	75.4m
Launch Date	7 October 2005
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GDP, SGD

Management Fees

Annual Management Fee
1.5% p.a Paid monthly in arrears
Class U – 1% p.a. Paid monthly in arrears
Performance Fee
All classes except Class U: Provided the fund achieves an overall increase of 6% a yearly performance fee of 10% of total returns will be applied.

Class U: 10% of the net out-performance of the MSCI Asia Pacific ex Japan Index (MXAJP) with a high-water mark paid quarterly

Dealing

Dealing Line	+353 1 603 6490
Administrator	Brown Brothers Harriman (Dublin)
Dealing Frequency	Daily
Min. Initial Subscription	USD 10,000
Subscription Notice	1 business day
Redemption Notice	1 business day

Share Class Details

Codes

Class 1			SEDOL	ISIN	Month end NAV
A USD	Unhedged	Non Distributing	B0MDR72	IE00B0M9LK15	197.90
B USD	Unhedged	Distributing	B0M9LL2	IE00B0M9LL22	198.19
C GBP	Hedged	Distributing	B18RM25	IE00B18RM256	107.57
D SGD	Hedged	Distributing	B3LYLK8	IE00B3LYLK86	271.94

Performance fee based on individual investors' holding.

N USD	Unhedged	Non Distributing	B3LP510	IE00B3LP5101	198.09
O USD	Unhedged	Distributing	B3M40N3	IE00B3M40N30	190.36
P GBP	Hedged	Distributing	B3MWDD8	IE00B3MWDD86	105.99
U GBP	Unhedged	Distributing	BBQ3756	IE00BBQ37560	103.03

Performance fee based on fund performance as a whole.

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