PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Smaller Companies Fund

Quarterly Investment Report

28 June 2013

FOR PROFESSIONAL INVESTORS ONLY

2Q13 Review and Outlook

For the first half of 2013 the Prusik Asia Smaller Companies Fund generated a positive return of 7.7%, significantly better than the MXAPJ Index return of around -5.6%. Following a strong performance in 1Q13 the fund continued to outperform in 2Q13, losing 4.5% while the index fell 7.3%, although clearly in absolute terms the fund lost money. May was a particularly good month with the fund up 3.6% while the index fell by more than 4%. However, some of this good performance was given back in June when the Prusik Asia Smaller Companies Fund fell by 9.4%, more than the index fall of 5.8%. Despite the sell-off in ASEAN, particularly the Philippines and Thailand, during the quarter many of our ASEAN holdings were key contributors to the fund's performance. Overall, **Airports of Thailand**, **Naim Holdings** and **Sino Grandness** were the biggest contributors to performance while our gold holdings were the biggest detractors.

So what happened in June?

June brought the worst of the global 'taper tantrum' correction and this was exacerbated in Asia by a very sharp deterioration in the liquidity environment in China combined with worsening fears over a slowdown there. Stocks which had performed well year to date and where valuations were less attractive were sold down the most. Owing to this, smaller companies and ASEAN suffered disproportionately.

The Philippines and Thailand were amongst the worst performing markets in the MXAPJ in June, each down around 9-9.5% in US$ terms (less in local currency terms). As of the end of May the Prusik Asia Smaller Companies Fund had a 12% weighting in the Philippines and a 19% weighting in Thailand versus index weightings of roughly 1% and 2%, respectively. As such it is unsurprising that the fund's performance was weaker in June.

Where is our ASEAN position now?

At the time of writing the fund has a 54% weighting in ASEAN, less than the +70% weighting which characterized the fund for the first half of the year. The distribution is also now slightly different. The weighting in Thailand has been cut by 7% and the weighting in the Philippines has been trimmed by 3% and we have been putting more money to work in Malaysia. It is worth noting though that we had been adding to Malaysia for some time on the basis that investors appeared to have become too downbeat in the run up to the elections, a decision which proved to be very lucrative. We now have around 10% of the fund in Malaysia. Looking at aggregate headline valuations there is good reason to be trimming the fund's exposure to the Philippines and Thailand, which are on 18.7x P/E and 13.6x P/E, respectively, versus the MXAPJ on 12.2x P/E. Equally, below the larger cap index constituents there is a raft of smaller cap companies in Thailand and the Philippines which are generally much cheaper and it is because of this that we still have sizeable weightings in these markets.

Outlook

The markets have registered a significant decline at some point during the year for the last few years. The question then is was this 2Q correction any different? One notable factor is that since May, when markets began the correction, cyclicals, Korea and select China stocks have all done relatively well. This possibly tells us a number of things. Firstly, it suggests that many funds are holding roughly the same kind of stocks: quality, defensive, consumer, domestic and definitely not China and so by definition these high quality stocks were all these funds had to sell. Secondly, with cyclicals now suddenly starting to perform a bit better there's a real possibility (whisper it quietly!)

that the global economy is actually picking up. We have recently carried out a very thorough set of conversations with Taiwanese small cap analysts and company management teams. Smaller companies in Taiwan tend to be outstanding and often the number one or two player globally in slightly obscure export driven niches such as sewing machines or bathroom taps. Anecdotally these companies are starting to see some pick up and better visibility. Thirdly, this recent rally in cyclicals could simply reflect the fact that the cyclical to defensives price to book gap was at 90% of the 2008 lows meaning some kind of normalisation was due.

Overall, we believe there is a reasonable chance that what we have just seen was a kind of mid cycle correction. This is the usual transition phase as the market weans itself off very easy money and faces down the prospect of rising interest rates, accompanied by better growth and often in the end inflation. After the correction there usually follows a very strong period of equity performance driven by growth, which eventually leads to rising inflation and one interest rate hike beyond comfortable.

Interestingly, what we are possibly seeing now is the early flinches of a recovery but with absolutely no sign of inflation. We also see no lending bubble in Asia, with the possible exception of China, nor do we see ridiculous valuations, save for the top half a dozen consumer names in each country which are very over owned. Indeed the MXAPJ Index came within a hair's breadth of an average price to book ratio of 1.4x during the quarter which has always been the absolute trough value level in non-recessionary times. Over the past 15 years buying at this valuation level, excluding recessionary times, has resulted in positive returns 100% of the time and of significant proportions.

We are, therefore, comfortable to keep the faith in Asia. We are taking an optimistic but not exuberant view of the recovery prospects and with this in mind we are gradually increasing exposure where cyclical recovery will help but is not required. For example, we have been adding to niche technology names in Korea, **KCP** and **Infraware**, which are benefitting from the growth in smartphones and the increasing sophistication of smartphone related technology as well as consumer plays in Sri Lanka, **Cargills Ceylon** and **Distilleries Company of Sri Lanka**, which we visited on a recent investment trip to the country. We will explore these themes and companies in more detail below.

China

In the second quarter the Chinese government spooked the stock markets by allowing a sharp decline in liquidity amid a clearly slowing economy. Given the backdrop of unquantified bad debts in the shadow banking system, clear anecdotal evidence of real pain at the small and medium enterprise level owing to slower growth and a lack of available credit, not to mention rumours that the size of the debt problem could be as great as 40% of GDP, it is unsurprising that this caused considerable alarm.

However, we are comforted by the simple fact that one of our better connected advisors had warned us weeks ago that this was coming. This suggests to us that the move is an intentional one, designed to precipitate a clear-up program for the banks and local governments and thus clear and pave the way for the new reforms planned over the next 5 years, including a move to a convertible currency from 2016. That said, this does not reduce the considerable risk that China still faces. We cannot pretend the numbers aren't vast and with state owned enterprises now drafted in to prop up smaller companies in the private sector the logjam facing the reformists is severe. Moreover, we think this process will take place with very little in the way of growth-related policy to ease the minds of fund managers or the path of the local private sector.

You are probably reading this and feeling comfortable that your exposure to China is very low or that you are even short! The key point here is that you are not alone, indeed very far from it. Short exposure to China is extremely high, as much as three weeks volume in some companies! Almost all fund managers are underweight. This is not an understatement. Since 2007 the Shanghai Index has fallen by two thirds and in turn the market has almost been written off. We recently met with a top rated China banks analyst who visited 75 fund managers prior to seeing us. Of the 56 long only managers she had seen only 3 were neutral or overweight Chinese banks and 2 of those were long term holders and deep value funds!

HOWEVER, isn't the clamping down on financing of legacy, bankrupt businesses and a clear up of the banking sector exactly what the bears wanted to see in China? The key question is are we about to pass an invisible line after which the progress in China is constructive, the problems are quantified and managed openly and in turn the progress in business is positive in the longer term?

We are also looking at valuations in China with new eyes. On a P/B to ROE basis China is the cheapest market in the region. It is possible to buy good companies such as **China Shenhua**, which has consistently delivered a ROE over 18% every year since the company IPO'd, on valuations comparable with those reached at the nadir of 2008. At present the shares are on just 1.3x P/B, 7.6x 2013 P/E and are yielding 5.1%.

Of course there are many unknowns in the progress of China from here and so we feel that the situation from an investment perspective is perhaps best expressed in terms of probabilities. As happened in 1998 and 2008, when things are very bad and appear near the bottom, it is possible to have one final and violent leg down of around 30%. The same could be true of China. We think the market has given at least a 50% probability to this happening in China, and while we do think this is possible, we also believe that the risks are lower than this, hence the opportunity.

The key question is how to do this whilst keeping risk at a minimum in case our assumptions are wrong. We are, therefore, looking for companies which fulfill the following criteria:

- **Relatively non-cyclical demand** so they will not be as affected by the slowdown in growth.
- **High margins** so that even if demand slows, profits should be less affected.
- **Strong balance sheets** so there is limited need for external financing as the banking sector shrinks.
- **Trading at distressed or underestimated valuations** so that even if we are wrong our downside is limited.

Perfect Shape

One way of gaining exposure to China but keeping risk to a minimum is to find strong themes that are growing despite the economic cycle and companies which are safe from unhelpful government intervention and currently undervalued. Beauty treatment companies in China is one such area and we recently increased our exposure to this theme by taking a holding in **Perfect Shape**.

Perfect Shape, founded by an ex doctor, uses the latest technology developed in Europe and the US designed to help users lose weight. It now has 55 stores spread across mainland China and Hong Kong and derives around 80% of its sales from mainland China. Management recently launched a new advanced treatment service aimed at wrinkle reduction which is three times more expensive than the slimming programme and is much higher margin. The service has been trialed in **Perfect Shape's** Hong Kong stores with much success and so management are now focusing on rolling out the same service in mainland China. The founding family hold 75% of the shares and in light of this have been very focused on paying out dividends since the company listed. The company has US$100 million market capitalization and is trading on a March 2014 P/E of 9.1x and is yielding a whopping 11%.

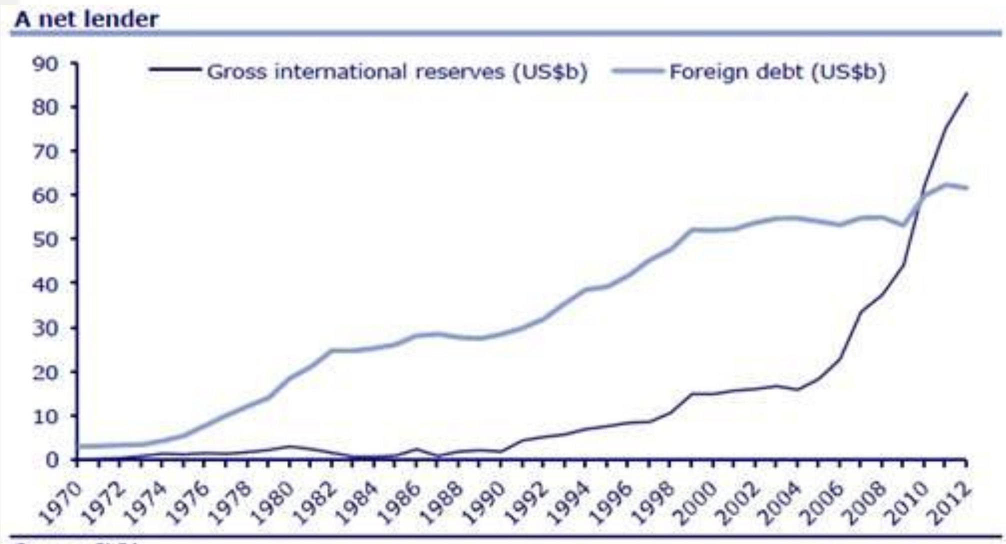
Philippines: A Case Study

During the recent market correction in May and June the Philippines fell over 20% from its high. This took place amid much conjecture as to whether interest rates are too low and stocks too expensive. We can see why both seem worrying. Deposit rates have fallen to as low as 2% whilst the stock market P/E had risen to 17x.

With these conditions in place we think it's worth taking the time to look at the Philippines as a bit of a case study. In short we don't disagree with either concern but would argue that timing is everything and the cycle still has a way to go.

Firstly, let's look at the valuation. Counter intuitively, given the past history of politics in the Philippines, the average P/E for the market over the past 17 years is 17.6x. Following the correction at the end of June the market had fallen to 15x 2014 earnings, leaving some upside for those who believe in mean reversion but plenty to worry about for those who think this, bluntly, is just too high. We would say that anything close to 14x for this market, given the history and the fact that today's fundamentals soar well above those of the past, is a great buying opportunity. Here's why in simple pictures:

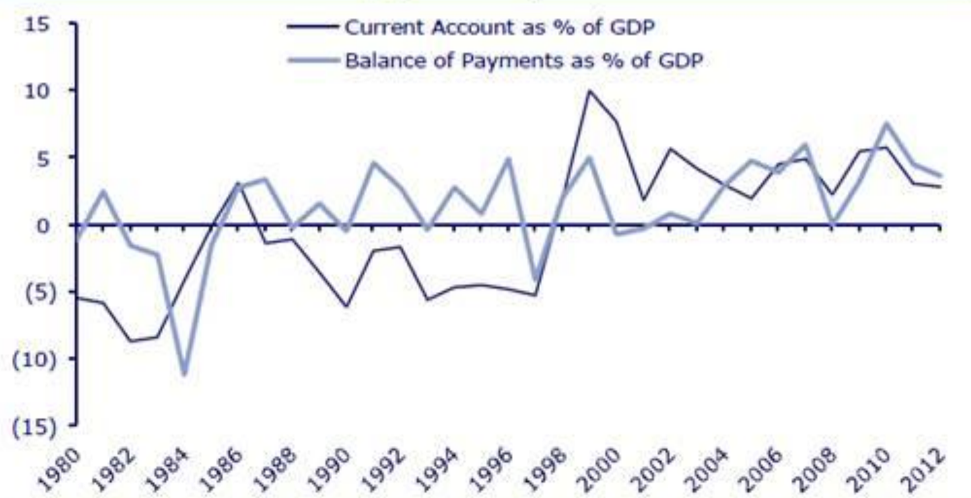
- The Philippines is a net lender in the global debt markets so investor talk of excess local debt denominated in US dollars is unfair.



Source: CLSA

- The current account and balance of payment surpluses remain impressive. Indeed the current account surplus now stands at 5.3% of GDP and what's more it's growing.

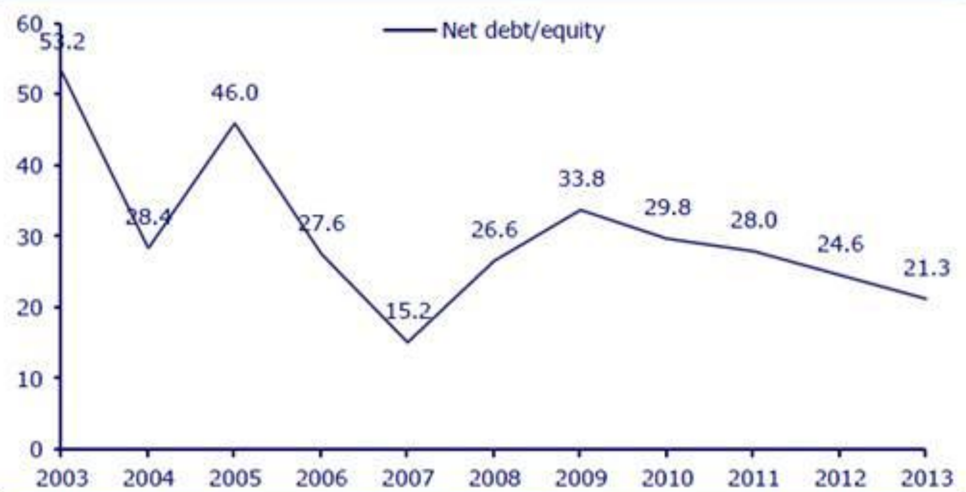
Figure 4
Current account and balance of payments surpluses



Source: DOF, CLSA

- Philippine companies are just not that leveraged. Does this look dangerous or even like the end of the cycle to you?

Figure 5
Leverage of Philippine companies

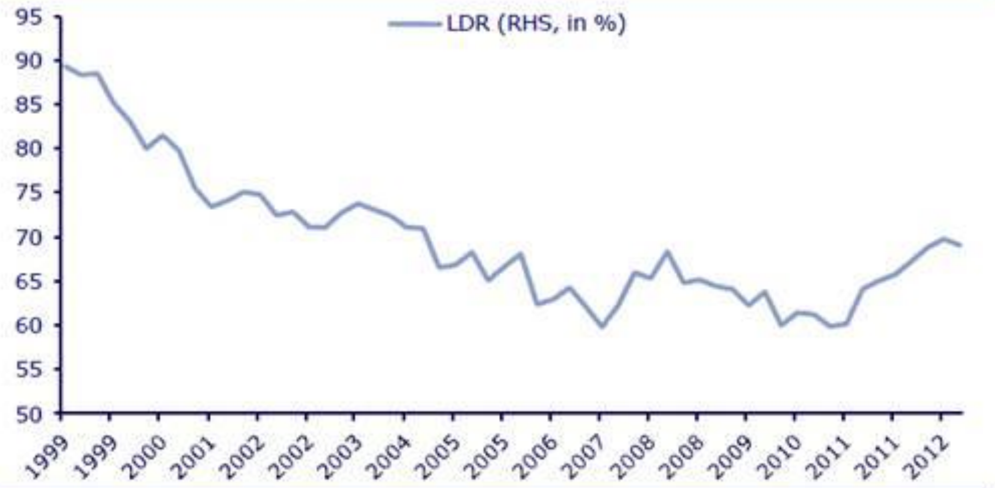


Source: CLSA

- Loan to deposit ratios remain pretty low. Indeed as of May bank lending has been growing in the order of 13% year on year and is very well spread across all sectors. This is firm but modest progress without signs of overheating.

Figure 6

Time series of loan-to-deposit ratio

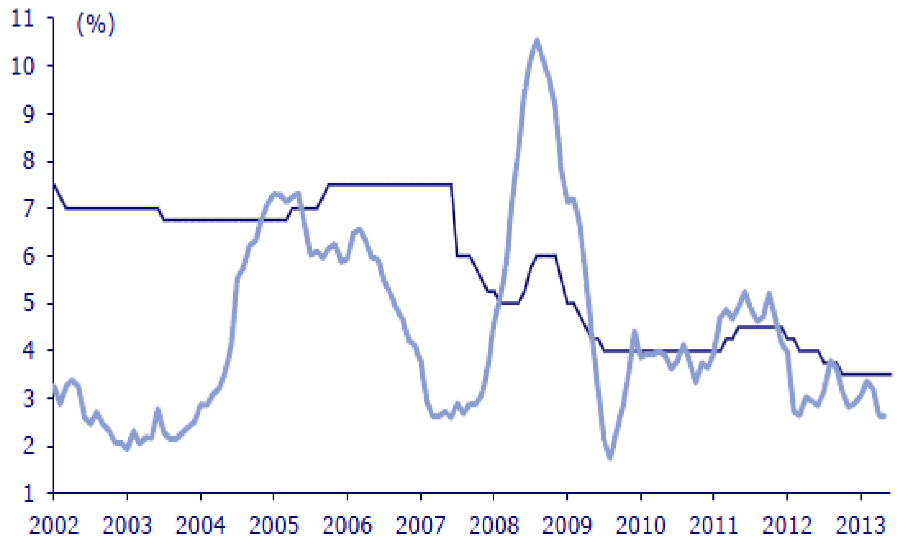


Source: CEIC, CLSA

- Inflation is benign, up 2.6% in May and 2.8% in June. This brings the year to date average to 2.9%, which is still below the government's 3-5% target for the year. In the Philippines there are no populist style minimum wage increases and wage inflation of just 4% is expected this year. Moreover, the strong growth in Business Process Outsourcing (BPO), call centers with a largely international customer base, are often located outside of central Manila meaning that costs in the city centre are not bid upwards.

- We think the government is still very much inclined to keep interest rates at bay, with no real urgency to tighten policy any time soon. However, GDP did grow 7.8% in the first quarter, the fastest pace in Asia, so we can see that it is possible that this might change in the coming months.

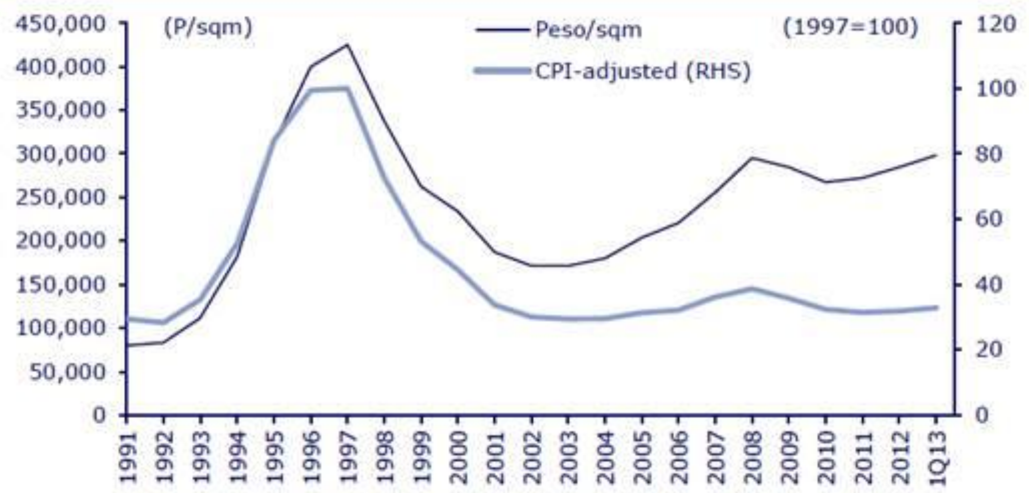
Philippines CPI inflation and BSP key policy rate



Source: CEIC Data, Bangko Sentral ng Pilipinas (BSP)

- Property prices in the Philippines still sit 30% below their 1997 pre-Asia crisis peak. In fact on inflation adjusted terms they are 67% below this peak! Manila is one of the few cities where, anecdotally, young analysts can still afford to live walking distance from the office!

Land values in Makati CBD in nominal and real terms



Source: CLSA, CEIC Data, Colliers International

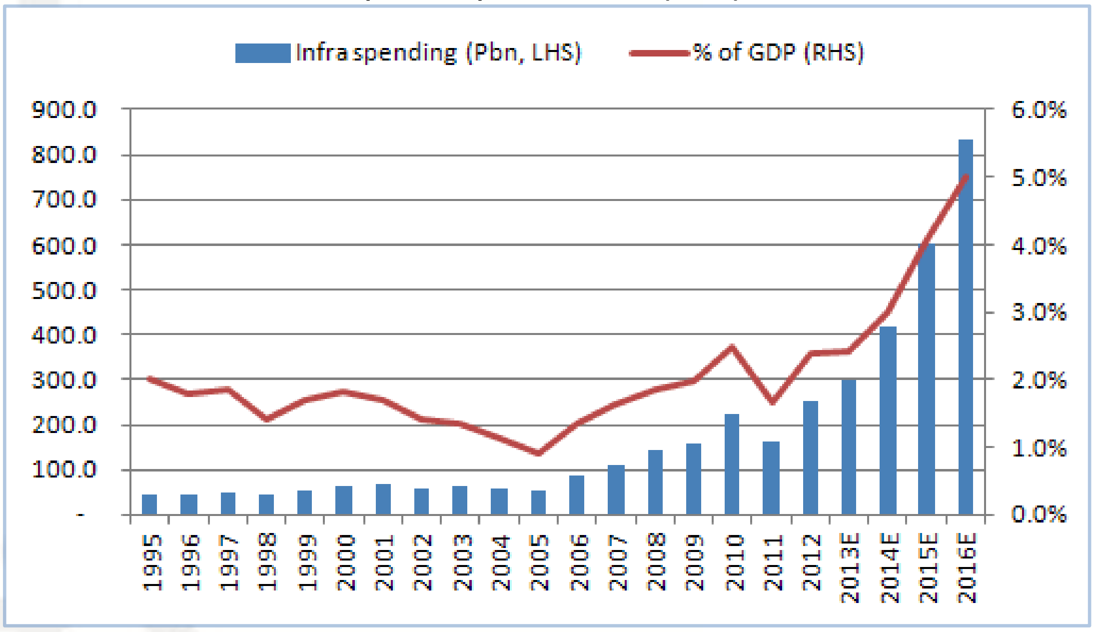
So what is still to come for the Philippines before this cycle is over?

Firstly, we expect to see an increase in investment, both public and private. So far investment has been led by the private sector and this has risen consistently for the past five quarters. We expect this to continue to rise as companies are planning to expand, lending rates are low and liquidity is plentiful. In addition, there has not really been a capex cycle since the 1990s. We think this is an important point for the Philippines as we can see a proper business cycle building, not just a financial one.

Additionally, the government wants to aggressively ramp up overall infrastructure spending to about 5% of GDP from 2.5% in 2012 and 2013 and from a woeful 1-2% over most of the last 20 years. According to Budget Secretary Butch Abad the aim is to **treble the infrastructure budget from around US$6 billion in 2012 to around US$20 billion by 2016**. The focus is to improve the environment for tourism, agriculture and manufacturing.

It's important to note that these figures do not include any of the 12 big-ticket Public Private Partnership (PPP) projects which are also slated but barely started. To further put this into perspective, we estimate the value of the 10 largest PPPs to be around US$5 billion, with the outlay spread over the construction period of 3-4 years for each one.

Special Deposit Accounts (SDAs)



Source: CLSA Asia Pacific Markets Limited

Finally, there is a rather extraordinary development building in the savings environment which could lead to an extraordinary boost to liquidity. Banks are starting to unwind Special Deposit Account placements (SDAs) following the new rules recently announced by the Bangko Sentral (BSP). As of the end of June there is a whopping US$41.8 billion in these accounts. The BSP wants to limit the access to the SDA starting in the second half of this year. They released a circular in May saying that SDAs in Investment Management Accounts (IMAs), the conduit by which retail investors have their accounts managed by trust banks, need to be wound down. The process is required to take the following schedule: 30% by end the end of July and 70% by the end of November. How much of the

SDA's are in IMA form? Many bank trust departments we've spoken to estimate that 50% of all SDAs are in IMA form or around US$21 billion. So, by the end of July, 30% of US$21 billion will no longer be allowed to be rolled over into SDAs. The balance of 70% will not be allowed to be rolled over by the end of November.

So where will the money go? Many bank trust departments and treasury groups estimate that most of this will find its way into ordinary time deposits as really this pool of savings was destined for time deposits originally but instead was attracted to SDAs because the yields were around two times higher. This is very positive for the cost of funds for the banks and some are already lowering their time deposit rates in response. To put this figure in context, the entire peso deposit base of the banking system is roughly US$92 billion. So if all the US$21 billion were to go into ordinary time deposits then the peso deposit base would expand by 23%!

However, since time deposits would earn a negative real return there is also an expectation that some of the US$21 billion coming out of SDAs will find its way into other risk assets such as equities and property. While it’s very hard to estimate how much, if 10% of SDAs went into Philippines equities, about US$2.1 billion, that would already rival the amount of total net foreign buying seen in the first half of 2013.

Conclusion

The cycle in the Philippines still looks to be incomplete with few, if any, signs of overheating, save for equity valuations. Naturally, we can now see how things may heat up in the coming year but we expect that while the flavor is more disinflationary than inflationary, equities could do well and revert to the top end of historical valuation bands. The current correction is thus a good entry point.

Niche Tech in Korea: KCP and Infraware

We have two great new holdings in our Korea portfolio which we would like to tell you about. Both are amongst the raft of new specialist technology companies which are changing how we use and how we think about our mobile phones. Many app and mobile technology companies are not listed so we were very excited to discover these two little gems. The first is **KCP**, a Korean online and mobile payments company and the second is **Infraware**, the developer of a specialist app which enables users to read and edit spreadsheets, power point presentations and PDFs on your phone with such ease and slickness that **Samsung Electronics** has decided to pre-load the software onto its smartphones.

E-commerce, as is well known, is a rapidly growing industry and that is not set to change any time soon. Attracted by the lower prices and added convenience consumers globally have been flocking to buy more online and Korea is no exception. In recent years e-commerce players in Korea have been seeing sales growth in the region of 10-30%, multiples higher than what the 2-10% the lackluster bricks and mortar companies have been achieving. Some analysts are predicting that online shopping in Korea will more than double its share of the total retail market over the next 10 years going from 6.5% in 2012 to nearly 15% by 2022. A key driver for this is likely to be demographics. The biggest spenders online in Korea are people in their late twenties and early thirties because this is the age bracket where they have the winning combination of being technologically literate, having grown up with the internet, and sufficient disposable income to shop away.

As the number of people in Korea with these characteristics increases with time so we should expect the surge in e-commerce to continue. Moreover, the operating environment for shopping online via mobiles in Korea looks huge. In 2011 the e-commerce market in Korea had an estimated value of Krw 999 trillion but mobile based shopping only accounted for 2% of the total market. We believe mobile based shopping will help grow rather than cannabalise the market.

KCP, set up in 1998 by the leading credit card companies in Korea, specializes in safe, secure and simple online payment systems for people shopping on their PCs, and more recently smartphones, and thus is well placed to capitalize on the growth opportunity in online and mobile based e-commerce in Korea. It is the number three player in a market where the top three players account for 80% of the market and in recent years it has been gaining ground on the number two player – **LG Uplus'** 24% market share now betters **KCP's** 23% market share by just a hair's whisper. Moreover, we believe **KCP** will continue to gain market share from here. **KCP** should also benefit from the strategic partnership it has recently signed with **KT Corp**, plus **KCP's** investment in a joint venture focused on location based services bodes well for the future too. The company has a market capitalisation of roughly US$160 million and the shares are trading on just 15.6x 2013 P/E, significantly below some of its global peers such as **Gemalto**, which is trading on 25.6x 2013 P/E.

Infraware is one of those rare breed of tech companies that has seen its core business wiped out by technological advancement only to completely reinvent itself – and with great success – in a very short time frame. As recently as 2010 **Infraware** made 60% of its sales from browsers for feature phones. Clearly, with the advent of smartphones this business had a limited shelf life. Fortunately, management had the foresight to have prepared for this watershed. The key turning point was **Infraware's** decision in 2009 to acquire **Boratech**, a company set up by ex-**Samsung Electronics** software engineers. Prior to this **Infraware** had been working on an app which allows users to view and edit spreadsheets, PDFs and other work related documents on their smartphones but there were glitches in the product and **Infraware** needed a distribution channel. **Boratech** answered both these questions. Not only did **Boratech** have a lot of experience of working with Microsoft Office but also **Boratech** helped grease the wheels for **Samsung's** decision to pre-install **Infraware's** Polaris on its Galaxy S3 and S4 models. The change in fortunes for **Infraware** was dramatic. Its Polaris app now counts for 70% of sales and has 78% market share in the Android market. In addition to Polaris, **Infraware** has burgeoning business ventures in mobile security and a new and innovative scanning app where you can turn a photo into an editable document at the click of a button. With compelling new ideas in the pipeline and a core business that should see double digit growth driven by continuing strong demand for Android phones, we are very excited about **Infraware's** prospects. The company has a US$280 million market capitalization and is trading on a 2013 P/E of 15.9x.

PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 28.06.2013

	USD	GBP	SGD
1 Month	-9.40	-9.58	-9.37
3 Months	-4.45	-4.57	-4.26
Year to Date	7.72	8.07	8.07
Since Launch+	65.70	68.94	21.81
2012	30.80	31.05	30.69
2011	-19.28	-19.86	-20.04
2010	16.43	16.90	7.90
2009	59.70	56.10	-
2008	-21.60	-18.40	-
Annualised 3 years	9.30	8.99	8.98
Annualised Since Inception	9.81	10.20	5.87

Source: Bloomberg
+ Launch date: A: 08.02.08, C: 25.03.08, D: 15.01.10

Fund Performance - Class A USD (%)

Source: Bloomberg. Total return net of fees. Since launch: 08.02.08

Monthly Performance Summary (%)

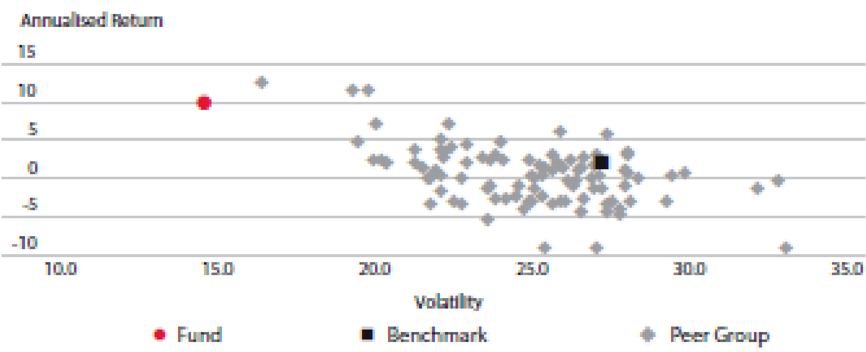
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
2013	7.27	3.73	1.32	1.82	3.58	-9.40						
2012	5.05	7.75	-1.04	4.29	-5.53	3.11	2.27	-0.65	5.40	1.27	4.12	1.81
2011	-2.15	0.43	2.35	3.75	-0.57	-1.22	3.60	-11.67	-8.27	0.37	-5.50	-1.07
2010	-0.70	-1.52	3.68	3.23	-4.23	1.20	0.83	2.74	7.45	3.62	-2.11	1.67
2009	-3.55	-2.02	-5.64	16.67	17.71	-3.66	8.91	-2.01	5.48	-2.16	4.42	4.81
2008			-2.44	0.52	0.26	-6.71	-3.49	-5.53	-8.52	-5.94	0.05	6.87

RISK ANALYSIS

Risk Metrics	Fund
Beta	0.56
Alpha (%)	8.5
Sharpe Ratio	0.67
Volatility (%)	14.6
% of the portfolio –which could be sold in 2 business days	73.6%

Source: Bloomberg
Since Inception: A: 08.02.08

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), 8.02.08 to 28.06.13

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

Kolao Holdings	3.2
Sino Grandness Food Industry	2.9
Silverlake Axia	2.7
Super Group Ltd	2.5
Thai Tap Water Supply	2.5
Total Number of Holdings	69

Portfolio Financial Ratios*

Predicted Price/Earnings Ratio	10.7x
Predicted Return on Equity (%)	21.8
Predicted Earnings Growth (%)	21.4

*Fiscal year periods

Thematic Breakdown (%)

Infrastructure	25.2
ASEAN Consumer	14.5
Local brands	12.8
Domestic Consumer	11.7
Cash	9.1
Tablet/Smartphones/OLED	7.3
Entertainment/Tourism	6.3
Vietnam	4.8
Oil Services	4.5
Singapore Office	1.9
Financial Services	1.1
Gold	0.7
Healthcare	0.2

Geographical Breakdown (%)

Thailand	16.9
Singapore	16.0
Korea	15.4
Philippines	11.0
Malaysia	10.2
Cash	9.1
Hong Kong/China	6.5
Vietnam	4.3
Indonesia	3.7
India	2.0
Sri Lanka	2.0
Taiwan	2.0
Australia	1.0

All data as at 28.06.13. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size (USD)	147.3m
Launch Date	8 February 2008
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GBP, SGD

Share Class Details

Codes

Class 1			SEDOL	ISIN	Month end NAV
A USD	Unhedged	Non Distributing	B2PKN21	IE00B2PKN210	165.70
B USD	Unhedged	Distributing	B2PKN32	IE00B2PKN327	165.86
C GBP	Hedged	Distributing	B2PKN43	IE00B2PKN434	86.75
D SGD	Hedged	Distributing	B3M3HJ5	IE00B3M3HJ55	228.35

Management Fees

Annual Management Fee
1.5% p.a Paid monthly in arrears
Performance Fee
10% of NAV appreciation conditional on a 6% hurdle

Dealing

Dealing Line	+353 1 603 6490
Administrator	Brown Brothers Harriman (Dublin)
Dealing Frequency	Weekly, Friday
Min. Initial Subscription	USD 10,000
Subscription Notice	2 business days
Redemption Notice	2 business days

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