Prusik Asian Smaller Companies Fund Plc

Prusik Investment Management LLP

An Independent Asian specialist investment manager

NAV Updates

Series	*December '08*	*QTD*	*YTD*
Class A	78.36	+0.58%	-21.64%
Class B	78.36	+0.58%	-21.64%
Class C GBP	41.91	+2.62%	-7.76%

Fund Size $14m

NAV Update	**December 2008**
Class A USD	
Non distributing	USD78.36
Class B USD	
Distributing*	USD78.36
Class C GBP	
Distributing*	GBP 41.91

The fund rose by 0.5% over the fourth quarter of 2008. As we all know, it was a traumatic three months during which the overall index fell 23%, having been significantly lower than that mid quarter. Asia saw the brunt of brutal deleveraging and nowhere was that more painfully felt than amongst the smaller companies. Leveraged funds were forced to sell investments far beyond levels that really made any sense to us and valuations, finally, became truly interesting.

We took the decision in early October to avoid any company which had any exposure to Western consumption or business investment. Gold Circuit, Ju Teng and Chrome Ate were all attractive in their own right and thematically well placed but we were extremely concerned that they would be caught up in the general downdraught in demand and so sold our holdings. We also cut all exposure to the commodity sector which meant Industrea, a mining services supplier, was also sold. The portfolio was therefore reasonably "skinny" entering the extreme market weakness of October and November which allowed us the scope to take advantage of extreme weakness late in November to increase our exposure, albeit cautiously.

On no count do we feel that the full scale, severity and speed of the crisis in which we find ourselves has yet been fully discounted in share prices. However, by November we felt that we had come to a stage where the hyperbole and doomsday tone was almost surpassing our own predictions and we think that we have been amongst the most realistic and negative observers to date. Perhaps the best way to illustrate the extremity of sentiment was to look at the VIX index which peaked at a record breaking eighty. Furthermore, we could see increasingly large and sustained efforts in Asia to support economies, crucially starting with China.

In the first instance, we have seen the very aggressive run down in inventories is starting to take effect in many industrial sectors. For example, we recently heard that copper inventories are lower than previously thought and that scrap metal supplies are tight. A slight tip up in some commodity prices has started.

This coincides with extreme efforts by the government in China to swing the infrastructure sector into action to stave off further economic decline. As an indicator of how serious an effort this is, the bank lending numbers for December showed near record lending. Furthermore, the early signals are that January lending was double that of December! This, of course, is directed by government as opposed to genuine economic activity, but it is real, as reported to us by various companies we have met who claim no current difficulty in getting funding. We are also seeing unprecedented closure of companies and of industrial capacity. Subsistence or basic replacement demand will recover at some point and, when it does, it may feign a recovery. We categorically expect that supply reduction in, for example commodities, will not keep pace with demand destruction. However, in the short term, both supply and demand are falling. In the confusion, we expect as a result, more stable sales prices and volumes to emerge over the next month or two. This will be a transitory trend but it could potentially act as a powerful boost to sentiment.

If any investor is minded to look for 'value', they will find it in spades. Ben Graham liked buying companies when the value of their net current assets amounted to 66% or more of their market capitalisation.

For example, in Hong Kong alone by early December there were 69 listed companies whose net current assets exceed their market capitalisations. There were 24 listed Hong Kong companies whose net current assets have a value more than twice their market capitalisation. There were 21 companies whose net cash alone exceeds their market capitalisations, implying that their franchises are valued at less than zero. Moreover, the aggregate estimated 2009E dividend yield of this group of companies is around 16%, the estimated average 2009E PER was 3.2x and estimated average y/e 2009E price to book-value was 0.35x. Similar value can now be seen, post the January correction, and also in other markets across the region.

Clearly some of these companies are heading towards losses or have earnings prospects which possess no visibility, or on enquiry, have 'cash' which turns out to be held within a complex derivative product. A fine toothcomb is therefore required at all times. Nevertheless, there are also plenty of lowly valued companies which operate in stable demand areas and have no discernable negative flash points.

In spite of an avalanche of downgrades over the past two months, we believe that sell side analysts have yet to cut their forecasts fully to reflect the dismal prospects. Nevertheless, the modest valuations outlined above are based on new, lower and therefore more, if still not completely, realistic estimates.

Unfortunately, we still see very little discrimination between companies which have sustainable business models and whose managements have anticipated this environment, best reflected in conservative, liquid financial positions, and those whose models and financial positions are more vulnerable. The market remains fixated, rightly so to some degree, on the impact of redemption selling and deleveraging. In the near-term, the effect of this is difficult to quantify. In particular, it is difficult to discern how much of the current market weakness is a reflection of actual redemptions or how much a reflection of anticipated further withdrawals. However, we expect that at some point, when there is a longer hiatus in forced selling and a re-assertion of fundamentals, there will be some very big upward moves in the share prices of a number of companies.

2009

While we feel that we may be due some respite in the short term, we are under no optimistic illusions. We expect to see new lows in 2009. Without wishing to be too depressing, here are some of the trends which we believe, could rear their heads next year.

First, as deleveraging continues, we expect there will be an escalating problem with illiquid holdings. We recently heard that one big US hedge fund alone owns around US$3 billion worth of Asian pre IPO paper. They cannot be alone.

Second, we think that credit card debt will be the next big issue for banks. This is mainly unsecured and therefore undesirable. Business Week estimates that there is some US$950 billion of outstanding credit card debt on the books of the US banks, much of it, some analysts believe, potentially toxic. This will spread the bad debt problem to banks such as JPMChase and Bank of America which have sidestepped the mortgage problems to some degree but have big credit card operations. Perhaps more worryingly, Meredith Whitney estimates that credit card lines currently available to US consumers worth some US$2 trillion could be pulled next year. This would remove another source of liquidity to US consumers and exacerbate the downdraft in consumer goods demand.

Third, we believe that there will be a growing realisation that many companies in the US and Europe cannot fulfil their pension fund obligations to employees.

Fourth, we anticipate that the crisis of trust will continue. This will come hand in hand with a backlash against the recent lack of personal responsibility. As Herbert Spencer noted ‘the ultimate result of shielding men from the effects of folly is to fill the world with fools’. It would be a natural reaction for individuals, companies and countries alike to now withdraw and protect themselves from the mistakes of others.

Acts such as shielding the US car industry from ruin could lead to increased protectionism. Countries like China may start to add strings to their continued support of US asset markets. An influential Beijing think tank has already suggested that, in exchange for China’s continued support of the US Treasury market, Chinese bond holders should be allowed, among other things, to exchange bonds for large equity stakes in US corporates, Chinese banks should be allowed to open branches across America and that America should comply with China’s request to cease selling arms to Taiwan.

Fifth, quantitative easing and the realisation that there is not enough money that can be ‘borrowed’ to plug all the gaps could lead to huge currency gyrations. We are, in particular, concerned that the US Dollar could weaken substantially in future months. This could also generate a major re-pricing of bonds as savers demand higher rates of interest to lend to governments with weak finances.

The Fund

During November and early December we took advantage of the extreme values to increase our exposure. We undertook this with extreme caution and have been careful to keep within the thematic areas we are most confident about, including gold, infrastructure, railways, healthcare, internet gaming and food . We have reviewed several of our current holdings below. As usual we have given ourselves clear valuation parameters for exiting these investments and, given our mixed view of what is coming in 2009, expect to see at least a period of time over coming months where, once again, more cash is raised.

We do, however, feel that the next low will give us some rare opportunities in smaller companies. Here, already, value is truly extraordinary and the surviving franchises will give investors, we believe, one of the most outstanding periods of return in decades.

In the meantime, given our process brings us to companies where revenue is driven by factors outside of the economic cycle, we feel that a simple return to orderly stock markets, where good and bad fundamentals make a difference to stock performance, will also bring strong rewards from our portfolio.

Chinese healthcare

We have been revisiting a number of our old themes. Healthcare in China looks to us to be one of the most promising.

Recently we wrote about the possible boost to China's rural economy of the coming programme of land ownership reform and the resulting transfer of wealth to the people which could come about via the extension of agricultural land leases beyond the current thirty years.

More recently, Zhang Ping, Chairman of the NDRC and a high level representative of the State Council in charge of the economy, has publicly said that the PRC Authorities will be 'taking forceful measures to LIMIT (our capitals) the slowdown in the Chinese economy'. These words do not come lightly and underline what we have been writing for months, namely that the Chinese economy is facing a grave setback as the rest of the world slows.

We expect the Authorities to continue to announce measures to stimulate economy. This started with the announcement of no less than three interest rate cuts in an unprecedented three weeks and the much publicised stimulus package. This trend has continued into 2009 with ongoing announcements to support and stimulate growth. We expected the vast majority of this effort to be focussed on the domestic economy with a bias towards the rural regions, and have not been disappointed. Although the number does not look big recent a recent pledge of RMB 70billion to help pay for treatment of chronic disease in rural areas has particular resonance for us. This is because, spending and stimulus aside, it is a direct move to help people feel more supported by the state which we feel is an essential pre requisite for the next cycle in consumer spending.

Increasing spending on healthcare seems to fulfil all these objectives. Currently, it is quite possible for the average Chinese citizen to spend a year's income on a short stay in hospital. In order to see a doctor, the average Chinese citizen will, in most cities, likely have to arrive at his or her local hospital at 3am. There is no such thing as a National Health Service. If the patient has no money, he or she receives no treatment.

It was therefore unsurprising that, although we are now in year three of a previously planned Rmb 21.7 billion healthcare budget, the recent Rmb 1.18 trillion stimulus package incuded healthcare as one of the ten major areas of focus. Late last year the Authorities officially announced the exact allocation. Rmb 4.8 billion will be invested in the development of rural clinics by early 2009. In conjunction with the spending programme which has already been planned and budgeted, this means that the Ministry of Healthcare has now seen its 2009E budget rise by 22% YoY. We think that in 2010E, the year when this budget concludes, we will see a similar if not greater level of spending announced.

So far, most State healthcare spending has been devoted to building rural clinics. The benefits of this programme have thus been lost in the property boom across China. From hereon, however, we believe that spending will shift towards purchases of equipment and drugs. In this sector, we think that there are a number of listed companies which are set to benefit.

One sub-sector which we particularly like is the provision of diagnostic equipment. Popular wisdom holds that China has a young population. Today, this is still the case. Just over 10% of China's population is over the age of 60. This percentage, however, rises to over 30% by 2050. The ageing of China's population accelerates sharply over the next decade.

Around two years ago, we wrote in detail about how the cost of healthcare could, during this period, be almost too much for the PRC economy to bear given the increasingly expensive nature of treatments of chronic diseases. As a result a strong emphasis on early diagnostic and preventative medicine will be essential.

Aside from providing a better outcome for the patient, this should also prove to be a more cost efficient way for the PRC Authorities to meet the country's likely increasingly onerous healthcare demands. We therefore think that it is extremely likely that China will build its system with this in focus. The adoption of new technologies and perhaps, an intelligent incorporation of traditional Chinese medical practices, which cost less, should ensure that the PRC Authorities build an enviably modern system without being too heavily influenced by the agendas of the pharmaceutical companies which tend to benefit from the lengthy treatment of chronic diseases.

Intriguingly, China Life is already demanding health screening for all future life policy holders. It has teamed up with Hong Kong listed Mingyuan, a company with a proprietary protein chip for detecting cancer. The company is also in the process of introducing similar screening products for tuberculosis, HPV and diseases in newborn babies and is opening a chain of diagnostic centers in major Chinese cities. Mingyuan has margins well above its peer group and trades on 7.7x CY 2009E consensus earnings estimates.

The industry sales growth of medical devices averaged 25% on 2006, 26% in 2007 and 32% ytd in 2008. We think such growth will likely continue in 2009 and beyond at a pace of around 25% per annum.

Private Healthcare

The fund is invested in Raffles Medical which supplies healthcare services in Singapore. Although we expect private hospital admissions to taper a little in 2009 due to the financial crisis, we do not expect to see a slowdown as pronounced as 1998 because international patients comprise a more diversified group than 10 years ago and also because the Singapore government is aggressively pushing to make the city an international health hub. Given the poor political situations in competitor cities such as Mumbai and Bangkok, the governments efforts could be very supportive of patient arrivals. The company has net cash and owns its assets, positioning it formidably for the credit crunch. 2008 saw private admissions rise by 1.9% YTD and achieved overall sales growth of 19.8% in the same period. Raffles has demonstrated it is well positioned to make the most of this growth. Its high operational leverage translated this sales growth to an operating profit growth of 25.2%.
We feel comfortable with Raffles operating margins which were 17.5% in 2008. These should rise slightly to 18.1% in 2009 due to better operational leverage. Raffles is trading at a historically low PE for 2010 of 10.6X and an EV/EBITDA of 5.0X placing it in the lower valuation range compared to its peers and at a significant discount to its Singaporean competitor, Parkway, which has ROA of 3.9% compared to Raffles 10.9%.

Railway infrastructure

Valuations in November gave us the opportunity to re-enter this industry. The fund holds Zhuzhou CSR, China Automation and Midas. Longer term followers of Prusik will know Midas was an “old friend” of ours in 2005-2006. Thankfully in November it fell to levels where we thought it attractively valued again. The increased economic stimulus in China will accelerate further the development of railway infrastructure across the country. We believe that government’s plans will mean that Midas sees strong demand for its aluminium alloy extrusion profiles for rail cars in 2009. In addition to the development of a Chinalco and Northeast Light Alloy Co. JV, which will start in mid-2009 for the manufacture of thick aluminium plates and sheets, Midas also appears to be on track for the completion of its third production line in late 2009. This will raise its production capacity by 50% to 30,000 tonnes of aluminium per annum to meet the expected increase in demand. We expect that Midas will win between S$200m-S$300m of contracts this year alone compared to its current order book of S$120m. With an estimated 2010 PE of 7.0X and a 2010 EV/EBITDA of 4.8X and an ROE of 19.1% Midas is cheap both compared to its peers and in absolute terms. Importantly, Midas also has no debt.

Environmental Infrastructure

We have long been interested in environmental infrastructure companies and although we are wary that expensive solutions requiring major subsidies may temporarily be less of a priority as the recession takes hold, we do believe firmly that a cleaner environment remains a top priority, indeed a necessity, for China. Consequently, and after a dramatic decline which brought extremely oversold valuations, we bought China Everbright International (CEI), a Hong Kong-based investment holding company focusing on environmental protection infrastructure.

China Everbrights investments include the construction and operation of solid waste treatment projects and waste water treatment projects and toll bridge operation. The Company's environmental protection business is divided into four major sectors: waste-to-energy in Jiangsu Province, waste water treatment in Shandong Province, Suzhou Everbright National Industrial Park and the restoration of water quality for Taihu Lake. The PRC's recent Rmb4trn fiscal stimulus package designed to boost the economy is a major driver for CEI, as environmental protection is one of the key investment areas and we are being made aware from a number of different sources that lending in China, which is currently exceeding all expectations on the upside, is being heavily directed in this direction. CEI recently announced the construction of a new waste-to-energy project in Jinan, Shangdong. CEI now sits at a 2010E PE of 10.6X and a Price-to-book of 1.2X after a strong rally of 200% from its recent low but remains in the portfolio for now as we expect positive news flow and rising earnings forecasts could support further rises in share price.

Power transmission & distribution

Chinese Government funded investment in this sector has accelerated and will continue to do so as the country wide stimulus measures announced towards the end of 2008 take effect. Wasion Meters has recently expanded its manufacturing capacity of electricity meters which will help to meet both this demand and also the huge ongoing upgrade cycle in existing distribution networks. Although the company's customers are the huge Chinese power grids Wasion has still managed to negotiate healthy price increases, especially on its 3 phase meters, demonstrating the company's quality product and strong position in the industry.

The company trades at 4x 2010 estimates with ROE rising to over 26% that year. We forecast the dividend yield to be over 7%. We are looking forward to the 2008 results as we believe Wasion's business has been unaffected by the economic slump and that because of the effect the snow storms has last year on earnings comparable numbers could be spectacular. The company purchased nearly 1% of its issued shares last year.

The Chinese internet sector

The Chinese internet sector is of particular interest partly due to its already huge market but also the potential for this market to grow. China's internet user base already stands at a staggering 253 million. However, this constitutes a penetration rate of only 19%.

In order to bring this number into context it is worth comparing China to the USA and to a more locally relevant country like South Korea. The USA has 210 million internet users which translates to a penetration rate of 73%, Korea has 35 million users, a penetration rate of 72%.

In spite of the size of China's user base, it has an internet economy, online advertising spend, online gaming, e-commerce and online travel, which is six times smaller than that of the USA. Clearly the monetization of the Chinese internet base will offer some excellent opportunities as the current young, average age of users in China, 26 years old, increases further and in turn pushes up their purchasing power.

In the US and Korea, the CAGR in internet usage was 40% and 50% respectively until the penetration rate hit 40%. If we conservatively assume a 30% CAGR for China, we will have a country with 400 million internet users by 2012E and up to 558 million in a best-case scenario. With this in mind, we feel the sector is one which will stand out in 2009 as an industry in which earnings growth remains firm.

Entertainment

China's fledging national lottery industry carries plenty of opportunity. Previous examples in Asia have always led to incessant bickering between local and national government over the lucrative revenues lottery generates. Rex has lottery gaming machine supply contracts in place in a number of provinces but crucially seems to accept that there will be regulatory change and has shown the ability to adapt. As well as rolling out its business into a number of new provinces, Rex is focusing on a 'commission' type payment model for managing a lottery system, which also cleverly removes them from the front line of such negotiations.

We are confident that its cash flow generation for this year will be over half its market cap and are forecasting it to rise by 20% for 2010. Paying a PE of 2x 2010 or an ev/ebit of 1.9x makes us feel that even if Rex disappoint on execution (which we do not expect) the current share price already reflects that eventuality. If they execute successfully the shares could be worth many times more than they are currently valued.

We believe that online gaming is possibly going to be one of the surprise areas of resilience in the recession. If you have had the misfortune to lose your job then it is one of the cheapest ways of passing time in 'company'. In Korea we recently added CJ Internet, a developer of online games after a series of conference calls with a number of companies in this sector. Most interestingly, in every case, revenue is undisturbed by the economic downturn. Indeed CJ Internet are guiding for 25% revenue growth in 2009. Although this is partly as a result of new games and a reduction in losses from overseas offices, at the core is very stable demand in a growth industry.

The portfolio trades on 8.6x 2009 forecast earnings, 6.9x 2010 with earnings growth of 24% in 2010 and generates an ROE in 09 of 17.8%.

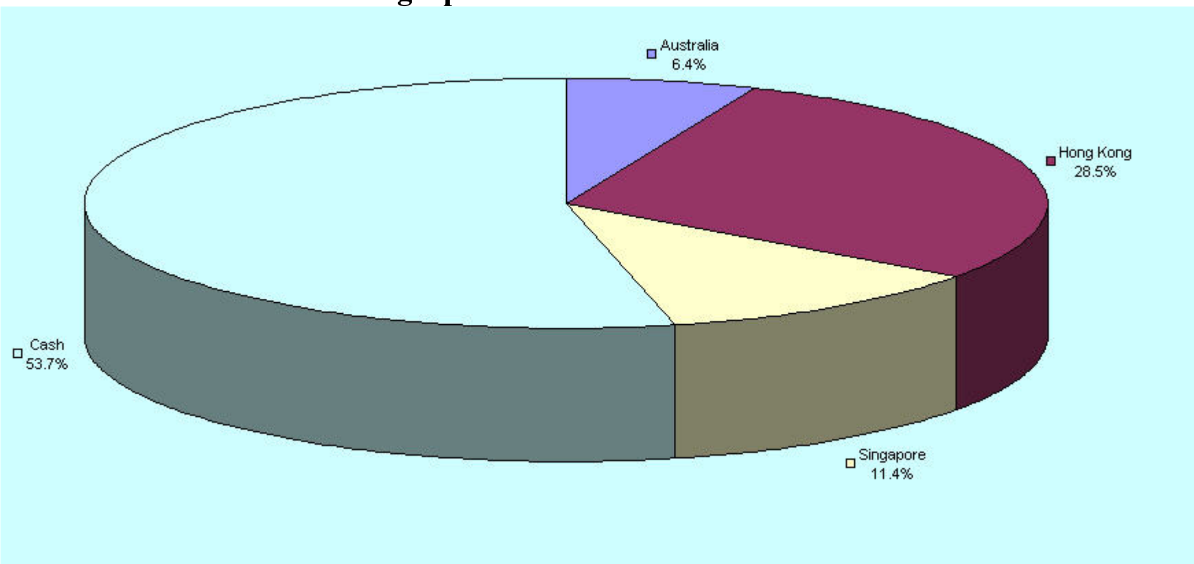
Heather flies to Thailand, Singapore and Vietnam in February and
Ed visits Hong Kong and China in early March.

Simon Rogers, who was part of the Prusik Investment team has left with our blessing to take up a new position at JP Morgan Investment Management. We wish him well in his new role and thank him for all his help and hard work. We already have our eye on two possible candidates to replace him and expect to hire later this month.

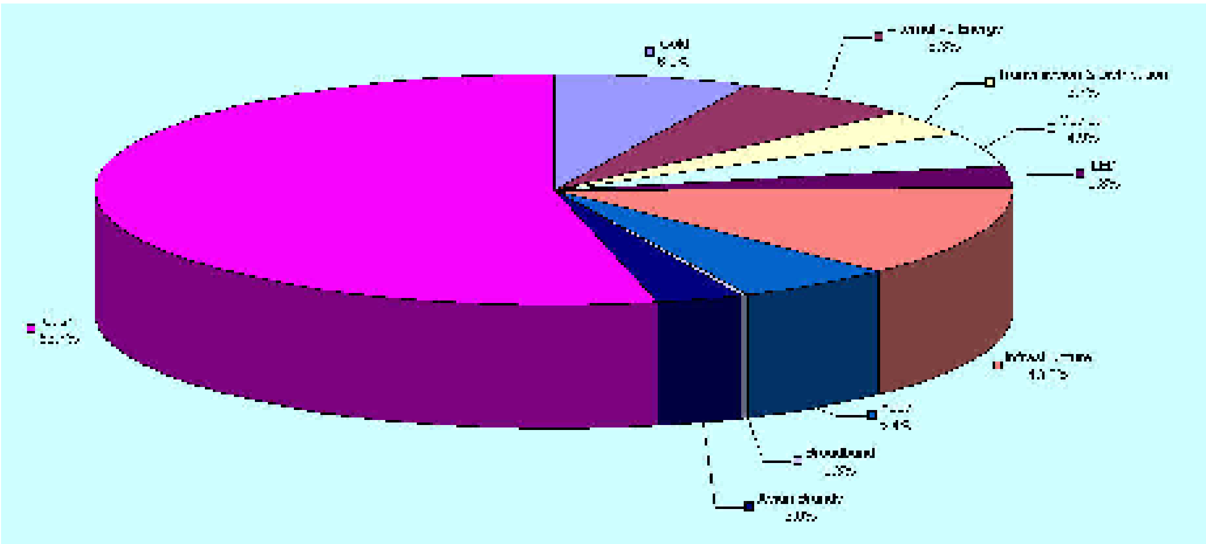
Top 5 Holdings	%
WASION GROUP HOLDINGS L	3.67%
SINO GOLD MINING LTD	3.57%
CHINA GREEN (HOLDINGS) LT	3.52%
CHINA EVERBRIGHT INTL LTD	3.43%
ZHUZHOU CSR TIMES ELECTF	3.42%

Number of holdings	18
Percentage of Fund invested	46.3%

Geographical Distribution



Distribution by Theme



Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dev	YTD
2008			-2.44	0.52	0.26	-6.71	-3.49	-5.53	-8.52	-5.94	0.05	6.87	-21.64

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	Every Two Weeks
Minimum Subscription	USD100,000
Min Subsequent Subscription	USD10,000
Subscription Notice Period	10 business days
Redemption Notice Period	10 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.