PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Equity Income Fund

Quarterly Investment Report
28 September 2018

FOR PROFESSIONAL INVESTORS ONLY

3Q18 Review and Outlook

The fund rose by 0.3% compared to the market which fell by -1.3%. The biggest contributors were **Beijing Capital Airport**, **CK Hutchison** and **CNOOC**. The biggest detractors were **China Xinhua Education**, **Sarana Menara Nusantara** and **Indiabulls Housing Finance**.

Although the cash level at the end of the month was 8.5%, at the time of writing this report, it is <1% and the portfolio is fully invested for the first time since early 2016. **In general, we view the current bearish sentiment as an opportunity to add to risk levels** in the portfolio as the more nervous investors become, the greater the upside potential becomes if that pessimism proves misplaced. Although the momentum in Asia is extremely poor at the moment, valuations are beginning to look extremely attractive – even if earnings disappoint. We are not changing our investment process and still look for companies with strong, recurring cash generation, solid balance sheets and disciplined capital allocation. However, the risk level of some of these newer positions is higher than the average stock in our portfolio due to their greater economic cyclicality. We believe that this risk is compensated for by the upside potential and franchise strength of these stocks.

Our portfolio is very attractively valued both in absolute terms (10.5x earnings), relative to the market (a 15% discount) or relative to history (our stocks trade on a 20% discount to their historical valuations). The 5.3% dividend yield of the fund compares favourably to the weighted average bond yield[1] of 3.0%.

We are finding new ideas across all markets and sectors. As a result, the turnover of the fund has increased substantially compared to 2017 with many more new positions going into the fund[2]. We believe this is positive as part of our strategy involves rotating capital from stocks that have performed well and have less upside potential and reinvesting in stocks that have performed poorly and have greater upside potential and we can only do this if we have a good pipeline of new ideas. For example, one of our new positions is **Wynn Macau** which has de-rated from 22x earnings to 12x earnings so far this year. In contrast, we have been trimming some of our Telecom holdings, (e.g. **Hong Kong Broadband Networks and Digital Telecommunications**), which have re-rated upwards by 5-10%. We are very reluctant (perhaps too reluctant) to compromise on valuation and so during times of market optimism (e.g. the second half of 2017), we struggle to find new buy ideas and our cash level heads towards our maximum level of 15%[3]. When this happens, it is more difficult for us to operate as we are prevented from selling stocks until we find a new position whereas we prefer to consider selling and buying as completely independent positions. Because our cash level is now <1% and we have a (small) bench of new ideas, we can now sell holdings without having to worry about our cash level. The additional benefits of a low cash position are of course eliminating the cash drag and creating a healthy level of paranoia amongst our holdings, such that they may be replaced with younger, fitter candidates if they fail to keep up!

[1] The local 10-year government bond yield weighted for the current PAEIF portfolio
[2] We have 12 new positions so far this year compared to just 2 new positions for the year to September 2017
[3] This is a self-imposed maximum level as we prefer to remain relatively fully invested

New Positions

RIO and BHP

BHP and **RIO** are thought of as commodity stocks but their franchise strength is, in our opinion, due to their ownership of the infrastructure (e.g. ports and rail capacity). Because iron ore is relatively abundant and easy to mine, two thirds of the capital spending is for rail and port capacity and only one third is for the actual mine. As a result, they can be thought of as similar to (but obviously not identical to) an infrastructure business with high, but volatile, margins. **BHP** and **RIO** own some of the lowest cost mines in the world, which are well located for the growth markets in Asia, so they are in a strong position both during times of market stress (as they don't lose money) and during expansion phases (as they are less affected by cost inflation). Concerns about the Chinese economy have pushed down the stocks in recent months but we believe this are now overly discounted. In addition, Chinese mills will increasingly be forced to import more iron ore due to the declining domestic supply (as a result of tougher pollution standards) and because China is focusing its industry on the most productive plants which require the highest quality iron ore (which domestic iron ore companies cannot produce). Both companies trade at around a 10% free cash flow yield and are likely to return much of that to investors over the coming years via dividends and buybacks. They both have essentially debt free balance sheets and significant opportunities to reinvest capital in new, high return projects.

CNOOC

At the time of purchase **CNOOC** was discounting an oil price of US$56/b which compared to the spot oil price of US$80/b and the long-term oil price of US$65/b. Although we have no strong view on the oil price, we believed the risk/reward at that level was attractive and the stock was trading at a 20-25% discount to fair value. Given that our portfolio tends to be "short" Energy (we own no oil stocks and own a number of stocks who use or whose customers use oil), it also is attractive from a portfolio management perspective. It is the cheapest major oil company in the world and trades on an 11% free cash flow yield and offers a 5% dividend yield.

First Pacific

First Pacific is a Hong Kong listed conglomerate which invests across Asia with a particular focus on Indonesia and the Philippines. Its 3 largest holdings are Indofood (the largest noodle company in the world), PLDT (the incumbent Telco in the Philippines) and Metro Pacific (a Philippine infrastructure operator which we also own in the portfolio).

The company has performed poorly over recent years partly due to the fact that they have been hit by the weakness in the Indonesian Rupiah and Philippine Peso – compounded by the fact that they have borrowed in US dollars to finance these assets. In addition, they have made some poor capital allocation decisions including investing in Singapore Power Business and Australian food producer, Goodman Fielder, which has proved troublesome. As a result, the stock now trades at a 48% discount to NAV. At this price, you are effectively paying a P/E of 6x for the 3 main businesses which we believe is excessively cheap. In addition, the stock has a dividend yield of 4%.

Although there are no specific catalysts on the horizon, the company is aware of the huge discount to fair value that the stock trades at and is seeking ways to narrow the gap. In our view, this could include selling off assets to reduce debt, buying back stock or indeed taking the business private.

Wynn Macau

The Macau gaming market is characterised by strong, long-term structural growth but subject to highly cyclical, short-term variation in demand and is affected by Chinese government policy. The structural growth is driven by mass and mass premium markets and is underpinned by several factors:

- **China remains under penetrated** (5-7% of Chinese people have been to Macau compared to 25-30% in US/Hong Kong)
- **Growing Chinese consumer spending**
- **Increasing hotel supply** (+25% from 2017-2020) leading to higher overnight visitation + more visitors from outside Guangdong
- **The Macau regulator restricts the number of tables in operation** which increases barriers to entry and reduces risk of oversupply
- **Increasing infrastructure investment** including Macau Bridge, Hengqin development, Guangzhou-Zhuhai intercity rail connection, Macau Airport expansion

The cyclical outlook for the business is currently negative due to the tighter liquidity environment in China. However, I think the market is too concerned about the impact of any slowdown on demand. In addition, the regulatory outlook is somewhat negative due to concerns that the Chinese government will tighten capital outflow controls + the licence renewal issue remains unclear.

Wynn Macau has one of the best brands in the market with the strongest product as well as the most efficient tables for both VIP and mass due to superior operating and marketing capabilities. This leads to its strong ROIC. It has a "hungry" parent company, (72% owner), which likes to upstream cash, meaning it pays out 75-100% of its free cash flow as dividends. The barriers to entry in the business are high due to the regulatory regime preventing new entrants. Even under conservative assumptions, we believe the company will pay a 8-9% dividend yield in 2019.

Exited Positions

Fonterra

Put simply, this investment was a mistake. The company has invested over NZ$3bn in growth capex since listing but has not managed to generate a return on that investment. Its attempts to move from being just a processor of milk to a consumer company have been unsuccessful. Although the potential in the company remains, the lack of a strategy on how to achieve financial returns (and the suspension of the dividend) means that we have decided to exit.

Sky City

Given the greater competition for capital in the portfolio, we decided to exit **Sky City** given the limited valuation upside together with the risks surrounding the significant capex that they are investing in the redevelopment of their Adelaide casino which is only likely to produce a small return above their cost of capital. The long-term appeal of the company, due to its monopoly in Auckland, remains but we no longer believe the risk/reward to be favourable.

Atlas Arteria

The stock reached our valuation and we decided to exit.

PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 28.09.2018

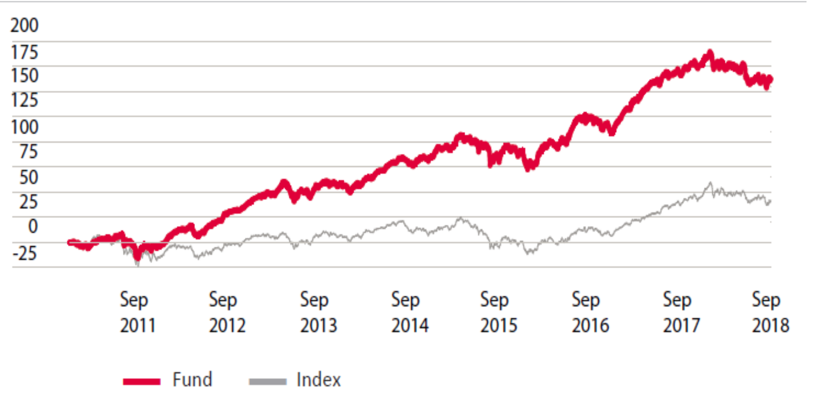
Class 1*	B USD	Benchmark **
1 Month	-0.52	-1.36
3 Months	0.30	-1.33
YTD	-6.81	-5.33
2017	32.79	37.32
2016	10.36	7.06
2015	3.17	-9.12
2014	16.79	3.09
2013	13.45	3.65
Since Launch+	161.32	40.25
Annualised since Inception	13.20	4.46

* Class 1 shares were closed to further investment on 30th November 2012

**MSCI Asia Pacific ex Japan

+ Launch date: B 31.12.2010

Fund Performance – Class B (USD) (%)



Source: Morningstar. Total return net income reinvested.

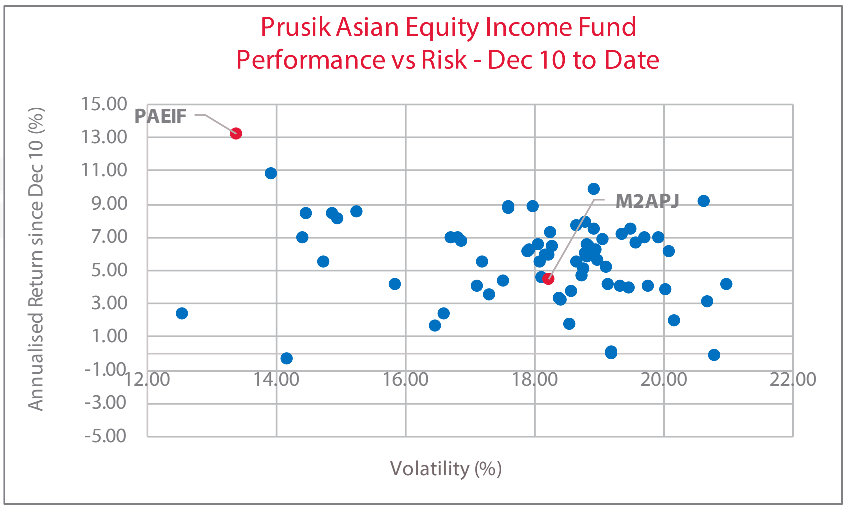
Class 1 B, USD Monthly Performance Summary (%)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2018	2.51	-3.76	-1.26	1.34	-1.18	-4.76	0.96	-0.13	-0.52				-6.81
2017	5.49	4.77	3.98	2.69	3.25	1.11	2.71	0.06	-0.54	2.91	0.85	1.61	32.79
2016	-6.04	-0.37	10.28	0.95	-0.38	2.46	7.56	1.20	0.54	-1.43	-0.68	-3.16	10.36
2015	4.35	1.41	-0.70	6.01	-1.69	-1.97	-1.63	-6.01	-0.70	7.04	-1.91	-0.33	3.17
2014	-4.34	4.03	1.50	1.58	4.63	2.14	3.50	1.24	-2.54	2.31	2.00	-0.05	16.79
2013	3.93	1.78	0.35	4.57	-0.53	-4.95	1.87	-2.24	5.07	4.15	-0.56	-0.25	13.45
2012	8.12	6.54	1.92	3.20	-7.67	3.84	6.72	1.92	6.36	1.97	2.76	3.63	45.77
2011	-2.68	-1.46	2.55	3.90	2.58	-0.60	3.56	-6.06	-12.80	10.62	-3.52	1.79	-3.96

RISK ANALYSIS

Risk Metrics	Fund (%)
Tracking Error (% pa)	9.31
Beta	0.78
Alpha (%)	9.08
Volatility (%)	13.39

Source: Morningstar
Since inception: B 31.12.2010



Source: Morningstar

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

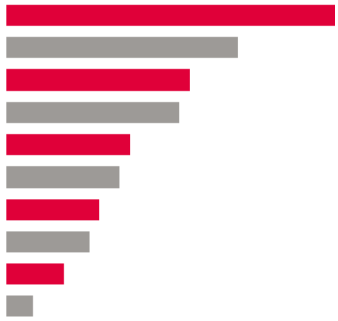
Ck Hutchison Holdings Ltd	6.4
Samsung Electronics Co Ltd -Pref	5.7
Beijing Capital International Airport	5.4
Swire Pacific Ltd	4.6
Zhejiang Expressway	4.6
Total Number of Holdings	32

Portfolio Financial Ratios

Predicted Price/Earnings Ratio	10.5
Predicted Return on Equity (%)	16.2
Predicted Dividend Yield (%)	5.3

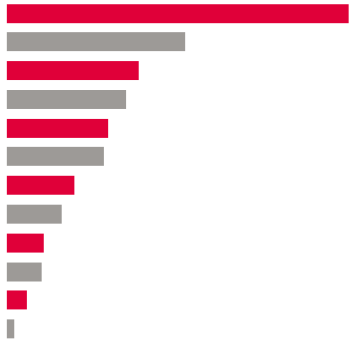
Thematic Breakdown (%)

Transport Infrastructure	24.9
Communications Infrastructure	16.0
Power Utilities	12.7
Financials	11.9
Cash	8.5
Real Estate	7.8
Cheung Kong / Hutchison	6.4
Technology	5.7
Energy	3.9
Consumer	1.8



Geographical Breakdown (%)

Hong Kong	28.9
China	15.0
India	11.1
Korea	10.0
Cash	8.5
Australia	8.1
Thailand	5.6
Indonesia	4.6
Singapore	3.0
Philippines	2.9
New Zealand	1.6
Pakistan	0.5



All data as at 28.09.18. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size USD	895.7m
Launch Date	31st December 2010
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GDP, SGD

Management Fees

Annual Management Fee

1% p.a paid monthly in arrears

Performance Fee

Class 1: None
Class 2 and Class U: 10% of the net out-performance of the MSCI Asia Pacific ex Japan Index (MXAPJ) with a high-water mark.

Temporary Front End Charge: 3% introduced on 2nd December 2013 paid to the benefit of the fund.

Dealing

Dealing Line	+353 1 603 6490
Administrator	Brown Brothers Harriman (Dublin)
Dealing Frequency	Daily
Valuation Point	11am UK time
Dealing Cut - off	5pm UK time
Min. Initial Subscription	USD 10,000
Min. Subsequent Subscription	USD 5,000

Share Class Details

Class 1*			SEDOL	ISIN	Month end NAV
A USD	Unhedged	Non Distributing	B4MK5Q6	IE00B4MK5Q67	268.82
B USD	Unhedged	Distributing	B4QVD94	IE00B4QVD949	192.16
C GBP	Hedged	Distributing	B4Q6DB1	IE00B4Q6DB12	187.63
D SGD	Hedged	Distributing	B4NFJT1	IE00B4NFJT16	183.55

*Class 1 shares were closed to further investment on 30th November 2012.

Class 2*			SEDOL	ISIN	Month end NAV
X USD	Unhedged	Distributing	B4PYCL9	IE00B4PYCL99	171.67
Y GBP	Hedged	Distributing	B4TRL17	IE00B4TRL175	168.30
Z SGD	Hedged	Distributing	B6WDYZ1	IE00B6WDYZ18	170.29

*Class 2 shares were soft closed to new investors as of 30th November 2012. Performance fee based on individual investor's holding

Class U*			SEDOL	ISIN	Month end NAV
U GBP	Unhedged	Distributing	BBP6LK6	IE00BBP6LK66	165.73

*Class U shares are open to current investors only. Performance fee based on fund performance as a whole

Dividend Dates

Dividends paid twice annually (January and July)

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