PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Equity Income Fund

Quarterly Investment Report
29 September 2017

FOR PROFESSIONAL INVESTORS ONLY

3Q2017 Review and Outlook

The fund returned 2.2% compared to the market return of 6.0%. The underperformance was as a result of our lack of exposure to some of the more cyclical and growth oriented stocks in China (e.g. the Chinese real estate sector rose by 59%!). Although our China portfolio is outperforming the market year to date[1], it underperformed significantly this quarter returning just 1.8% compared to the MSCI China which returned +14.8% - powered mainly by the Internet sector to which we have no exposure (more on this below). This cost us just over 300bps which explains most of our underperformance. Our cash position, which has averaged almost 10% year to date, has also not helped.

Although we run the portfolio with an absolute return mentality, we are keen to avoid prolonged periods of underperformance versus the index as we view it as our cost of capital. We should be able to outperform the index over time because, compared to the overall market, the stocks that we own:

a) Can grow at a faster rate than the typical company as they have higher "economic scalability"[2]

b) Have a higher dividend yield (approximately 50% more than the market)

c) Are undervalued both in absolute terms and relative to the market (trading at 12.4x P/E which is an 8% discount to the market)

If we can't do better than the market (and so by definition a low-cost index fund) then it would seem difficult to justify the existence of the fund in the long term. So even if we don't consider the overall market when constructing our portfolio, we don't think it makes sense to ignore it when it comes to measuring the performance of the fund.

PAEIF de-rating

	PAEIF	MXAPJ
YTD Return	+25.9%	+27.2%
P/E (31 Dec 16)	12.5x	12.9x
P/E (29 Sep 17)	12.4x	13.7x
P/E "re-rating"	**-1%**	**+6%**

Source: Prusik/Bloomberg

The table above highlights the fact that, even though the fund is up 26% this year, the forward P/E of the fund has actually declined. This is because the earnings expectations for the fund have increased by approximately the same amount. What is perhaps more interesting is that the **earnings expectations for our fund have increased faster than the overall market** despite the cyclical improvement that we've seen this year. In particular, stocks such as **Samsung Electronics**, **Beijing Capital Airport**, **Gree**, **Indiabulls Housing Finance** and **Zhejiang Expressway** have all seen substantial increases in earnings estimates. This provides some comfort that the underperformance is due more to valuation changes than underlying growth.

Why don't we own Tencent and Alibaba?

Given that Tencent and Alibaba have returned 76% and 97% respectively year to date and are now largest and third largest stocks in the index, it is worth spending a moment on why we don't own either stock and are unlikely to do so. Although we believe the prospects for both companies are excellent due to their strong franchises and high growth potential, we don't think they fit the criteria of the fund and, more importantly, the mental models which we use to value stocks do not work particularly well for securities like these. Our starting point for valuing a company is to calculate a "downside valuation" by asking the question "what is this company likely to be worth if our investment thesis is proved incorrect?" In other words, if our assumptions prove to be too optimistic, how much money could we lose. In the case of Tencent where the company trades on 45x 2017 earnings, the downside risk appears high. It is difficult (although not impossible by any means) to see how the P/E rating could go substantially higher if growth continues to be strong but relatively easy to see how it could move substantially

[1] Year to date our China Portfolio is +54.6% vs 44.4% for the index. Source: Bloomberg.

[2] By "economic scalability" we mean that they can grow earnings without needing to reinvest a substantial percentage of those earnings in capital investment and therefore can avoid diluting existing shareholders.

lower if growth is lower than the market expects. Of course, bulls would argue that the growth potential and competitive advantage that Tencent has, means that this is overly conservative and we wouldn't disagree with the logic but, our approach is to assume that we are going to be wrong between ⅓ and ½ of the time[3] and so we need to think what would happen in the case of Tencent if that was the case. The bigger the downside is to this downside valuation, the less chance of being wrong we can accept. In the case of Tencent, even bulls would likely agree that the P/E rating assumes that growth will continue to be rapid. However, even if it continues to grow earnings at 20% per year (the historic average), if the P/E rating returns to a more normal level (20-30x) over the next five to ten years then the total return will be substantially less than this as one "amortises" the P/E compression over that time. If the company grows at less than 20% the returns are likely to be substantially worse as the P/E compression is likely to be larger and occur over a shorter period.

It is worth thinking about what happens if I am wrong and the stock continues to re-rate from this level in the same way that is has over recent years. **Given that the market capitalisation of the stock has increased from just over US$50bn in early 2013 to US$420bn today then, if this rate of growth continues, the market cap will be over US$3 trillion in 4 years' time**. To justify a valuation of that magnitude, the company will likely need to be the most profitable company in the history of the world (even on 20x earnings it would be earning US$150bn/year).

Why is our cash position so high?

It is important to stress that our cash position doesn't reflect a bearish view on the markets. We don't raise cash because we think markets are going to fall. Our cash level has risen because we have sold more stocks than we have bought this year. Of course, this is correlated to market moves – when markets rise rapidly we will often find that stocks are becoming less attractive and vice versa – but the actual cash position is a residual. We tend to view buy and sell decisions discretely so when positions get expensive we sell them even if we don't have any buy ideas to reinvest that money in.

New Positions

Guangdong Provincial Expressway

Guangdong Provincial Expressway owns 3 roads in Guangdong Province. It is geared into the development of the Pearl River Delta area and region around Hong Kong/Macau. The stock is very cheap (8x P/E and 8% dividend yield) with 30% upside to our base case DCF valuation and 50-100% to more optimistic DCFs. It is a "B share" which means the shares are listed in China but B shares have always been available for foreigners to buy – they are denominated in HKD but are much less liquid than A-shares or H-shares and so don't attract much attention. We expect traffic growth of 10% for the remainder of the concession period (approx. 5 years for 1 road and 20 years for the other 2). There are some risks that capital allocation may deteriorate if the company does not continue to pay out 70%+ of earnings as dividends (they have only committed to do so until 2017) but we believe the valuation discounts this.

Nagacorp

This is a company that we have owned in the past but have revisited as the stock price has fallen substantially due to concerns surrounding a large equity issuance which is necessary to expand the capacity at the casino. **Nagacorp** operates the only licenced casino in Phnom Penh, Cambodia and has exclusive rights within a 200km radius until 2035. It will open a new casino complex in November this year which doubles the capacity and funded this expansion by an issue of equity to the chairman, Dr Chen. Because this results in a doubling of the shares on issue, the stock price has been weak and this led to the opportunity to buy into the company at an attractive valuation. It trades on approximately 5x EV/EBITDA and, assuming that it can generate US$300-400m in net profit when the expansion is fully operational and pays out 60% of this as dividends, the stock would yield 10% at the purchase price. It is a relatively high-risk stock because of the political environment in Cambodia and the risk that the regulatory environment deteriorates but we believe the current risk/return profile is attractive.

[3] In other words, for every 10 stocks that we buy, 3 to 5 of them will turn out to be mistakes and we risk having to sell these at our "downside valuation"

Shenzhen Airport

Shenzhen Airport operates the monopoly airport in China's fourth largest city and will benefit from the continued growth in Shenzhen – the technology hub of Asia. A mixture of strong passenger growth (8-10%), a shift towards international traffic (including potentially opening a duty-free concession) and increasing operating leverage, we think bodes well for cash flow and dividend growth over the next several years. In addition, the company benefits from an advantageous relationship with its parent company when it comes to capital spending in that the parent company pays for the construction of new runways and the listed company pays a proportion of revenue in return for that, which is very positive for return on capital (as although *owning* airports is an attractive prospect, *building* them is not given the high capital costs). Trading on 10x EV/EBITDA we believe the upside potential is significant.

Exited Positions

Hyundai Motor Preference Shares

We exited as the investment case deteriorated since our initial purchase. Specifically, we have downgraded our expectations for the Indian business which was, along with the cheap valuation and large cash position, a crucial part of our bullish thesis.

PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 29.09.2017

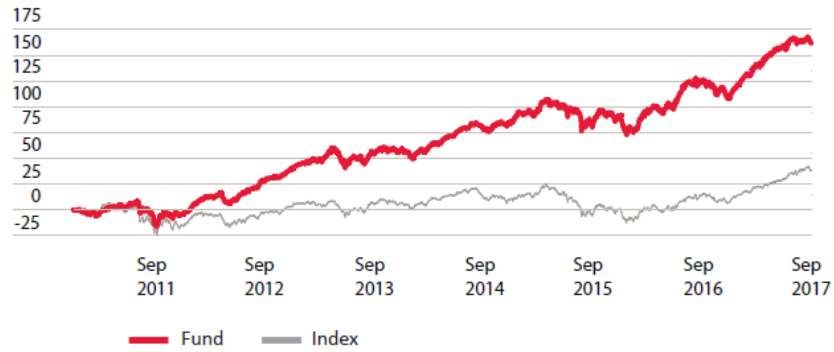
Class 1*	B USD	Benchmark **
1 Month	-0.54	-0.28
3 Months	2.21	6.04
YTD	25.92	27.17
2016	10.36	7.06
2015	3.17	-9.12
2014	16.79	3.09
2013	13.45	3.65
2012	45.77	22.63
Since Launch+	165.92	37.20
Annualised since Inception	15.59	4.80

* 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.

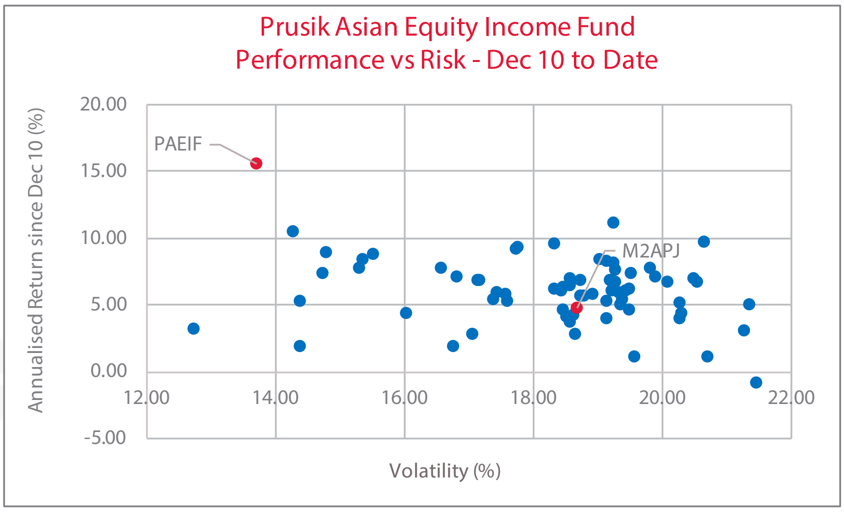
Class 1 B, USD Monthly Performance Summary (%)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2017	5.49	4.77	3.98	2.69	3.25	1.11	2.71	0.06	-0.54				25.92
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)	9.50
Beta	0.78
Alpha (%)	11.15
Volatility (%)	13.71

Source: Morningstar
Since inception: B 31.12.2010



Source: Morningstar

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

Samsung Electronics-Pref	8.3
CK Hutchison Holdings Ltd	6.6
AIA Group Ltd	5.7
Zhejiang Expressway	5.5
Beijing Capital International Airport	4.8
Total Number of Holdings	33

Thematic Breakdown (%)

Transport Infrastructure	16.3
Consumer	14.7
Communications Infrastructure	14.6
Cash	13.4
Financials	12.0
Power Utilities	11.3
Technology	8.3
Cheung Kong / Hutchison	6.6
Real Estate	2.9

Portfolio Financial Ratios

Predicted Price/Earnings Ratio	12.4x
Predicted Return on Equity (%)	15.4
Predicted Dividend Yield (%)	4.4

Geographical Breakdown (%)

Hong Kong	22.8
China	17.9
Korea	15.3
Cash	13.4
Thailand	10.4
India	8.4
New Zealand	3.3
Indonesia	2.7
Australia	2.4
Pakistan	1.7
Singapore	1.4
Cambodia	0.3

All data as at 29.09.17. Source Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size USD	962.4m
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	273.55
B USD	Unhedged	Distributing	B4QVD94	IE00B4QVD949	203.18
C GBP	Hedged	Distributing	B4Q6DB1	IE00B4Q6DB12	202.25
D SGD	Hedged	Distributing	B4NFJT1	IE00B4NFJT16	195.91

*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	181.52
Y GBP	Hedged	Distributing	B4TRL17	IE00B4TRL175	181.43
Z SGD	Hedged	Distributing	B6WDYZ1	IE00B6WDYZ18	181.88

*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	170.99

*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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