PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Equity Income Fund

Quarterly Investment Report
30 June 2015

FOR PROFESSIONAL INVESTORS ONLY

THOMSON REUTERS
LIPPER FUND AWARDS 2015
UNITED KINGDOM

PAEIF 2Q15 Review and Outlook

In the second quarter the fund returned +2.2% compared to a market return of -0.9%. The top contributors, all from Hong Kong and China, were **CK Hutchison Holdings**, **Daqin Railway**, **Beijing Capital International Airport**, **Travelsky Technology Ltd** and **Hutchison Whampoa.** The key detractors were **Premium Leisure Corp**, **SK Telecom Co**, **Genesis Energy**, **Samsung Electronics** (preference shares) and **Cheung Kong Property Holdings**.

The big event of the quarter was the restructuring of the **Cheung Kong/Hutchison** "empire". This proved to be very beneficial for the portfolio when the new counters listed. At the end of the month we had 7.9% of our fund invested in **CK Hutchison Holdings** (**CKHH**) and 5.4% invested in **Cheung Kong Property Holdings** (**CKPH**). **CKHH** now consists largely of the telecom, infrastructure, retail and ports assets of the group, whilst **CKPH** retains the real estate assets. Both are attractive, albeit for different reasons.

In the case of **CKHH** the appeal is that the company is now purely focused on infrastructure businesses with the bulk of the portfolio invested in highly cash generative assets with low cyclicality and substantial upside optionality. The stock trades at a 35% discount to its net asset value despite the fact that the owner, Li Ka Shing, has one of the best capital allocation track records in Asia. We would liken investing in **CKHH** to investing in a private equity fund with no fees and at a 35% discount to fair value. Others have drawn a comparison to Berkshire Hathaway Inc, which is also reasonable. Finally, management have stated that if they cannot find attractive investments then they will return cash to shareholders. They have also announced that they are looking to increase the dividend payout ratio. Given that the company paid a large special dividend last year, we are inclined to believe them.

Cheung Kong Property Holdings, from the perspective of the underlying assets – real estate in Hong Kong and China – is arguably less appealing than **CKHH** due to the more cyclical nature of its assets. However, in the case of **CKPH**, the valuation argument is stronger. In addition, as a "spin off" asset, **CKPH** benefits from being a more focused company. In the past, as part of a much larger group, little attention had been paid to maximising the value of the assets. Now that the company is operating as an independent entity, with its sales and profits profile fully exposed, we expect to see more attention paid to maximising the value of each property. For example, Hutchison House in Hong Kong rents at HK$60/square foot whilst AIA Tower, which is just next door, rents at HK$120/square foot. The return on investment from a refurbishment programme for Hutchison House could be very valuable. Trading at a 40% discount to assets with significant upside potential to that valuation, **CKPH** is highly attractive.

China

Our approach to China has not substantially changed in the past year. However, given the recent volatility in that market, it is worth reiterating our view and where we believe we differ from the consensus. For us, the key to assessing the relative attractiveness of investing in China is the economy.

With regards to the Chinese economy, our view is somewhat similar to the conventional view, namely that China is transitioning from a high growth, capital intensive economy to a lower growth, service driven one. Where we perhaps differ from consensus is as follows:

1. **Our view is that a financial, crisis and deep economic downturn, is probably higher than market expects**. Conversations with market participants suggest that most think this is somewhere between highly unlikely and impossible, although international investors tend to be more negative than Asian/local investors. **We would place the chance of a crisis at somewhere between 25% and 50%[1], significantly higher than the market, which we believe places the chance of a crisis at less than 5%.** This means we tend to be more conservative in target valuations and also the type of companies we will consider. The reason we are more cautious is that the corporate debt levels in China have risen extremely rapidly and we struggle to see how Chinese companies will generate sufficient cash flows to repay those debts. Our long standing forecast is that the NPL ratio in China could be between US$500 billion and US$5 trillion, or equal to 5% to 50% of GDP, and until we see banks and the government admitting similar figures, it is too early to argue this is discounted in stock prices. The reason why we have difficulty in understanding the very bearish view (that a Chinese crisis is a >75% possibility) is that the Chinese economy has particular characteristics which might enable the government to avert a crisis altogether, or at least to some extent, manage the speed at which a crisis emerges. Importantly, China's closed capital account, control over the banks and control over major companies, means that China, like Taiwan and Japan in the early 1990s, and unlike Korea in 1997 or Greece in 2015, does not rely on external counterparties to fund its financial system. In our view, it is therefore unwise to construct a portfolio based on a collapse in China, even though we have some sympathy for that view.

2. **We view most of the existing Chinese stocks listed in Hong Kong as structurally unattractive and think they will prove to be value traps in time**. It is our belief that value (as defined by simple accounting ratios) will prove to be unsatisfactory as an investment approach in China over time. Take Chinese banks for instance. Whilst Chinese banks trading on 7x earnings might appear cheap, owing to the likelihood of deregulation and a credit downturn in the market, we believe that ROEs for the Chinese banks are likely to be lower in the future and hence they are not attractively valued. Similar analysis and arguments can be applied to a number of Chinese stocks listed in Hong Kong. Although there will be some companies in China which successfully restructure in order to generate higher returns on capital, in aggregate, we believe most will not. When valuing stocks we attach a higher probability to a "worst case" scenario and therefore our target valuations tend to be lower than the markets'.

3. **Most of the debt in China is attached to "old economy" assets and therefore the deflation in these sectors is disproportionately negative for the Chinese financial system**. Although many bulls on China rightly point to the growth of the "new economy", this will not help lenders as many of these businesses are funded by cash or equity rather than debt.

4. **Political risk in China is under-priced. Whereas 25 years ago, shortly after Tiananmen Square, faith in the Communist Party was extremely low, it is now extremely high.**

[1] Of course there is very little science to these probabilities. We are trying to suggest that it is "more than a tail risk" but still (marginally) more likely that they will avoid it.

Typically, when an economic downturn occurs in a democratic based system the electorate votes the current government out of power. In China this is not possible, so what is the political solution if the current system does not work? Although it is difficult to see any political change in China (and we certainly have no edge in predicting it), many of the actions that the Chinese leadership are taking (locking up lawyers, a massive politically motivated corruption drive, trying to support the stock markets) suggest a party that are fearful rather than confident in their future. While many investors in China might question the robustness of the Chinese Communist Party from time to time, such discussions frequently conclude with complacent platitudes about the Party's long history of survival and ability to reinvent itself. In contrast, we believe the risks to the Chinese Communist Party's continued existence in its current form are at a historical high. However, most investors' sanguine attitude to this risk means that it is unlikely to be discounted by stock prices.

On the positive side, we believe that Chinese government's ability to decide and implement national policy, as well as direct public and private capital in the economy, is amongst the most efficient globally. Arguably this leaves China better placed than other developing countries to navigate and manage a downturn. In addition, although developing a service sector as the Chinese government plans to do, is more challenging that boosting economic growth via fixed asset investment, this political and economic infrastructure should help such a transition occur. Finally, the widespread reforms which the government has announced and initiated in China over the last year, demonstrate not only the government's awareness of the risks we have outlined above but also a clear political will to deal with them.

In conclusion, we believe there remain clear risks to the Chinese economy but acknowledge that China is more likely than not to successfully deal with these challenges. Perhaps the most constructive way to view investing in China is to recognise that the potential range of outcomes is large and that any investment strategy should be designed to take account of this. The practical impact of this is that we need to have companies that can survive difficult periods. However, despite the risks, there will be investment opportunities. We had steadily been reducing our Chinese exposure as the market rallied from early April – our exposure had fallen from 11.8% at the beginning of the quarter in April to 7.2% by the end of the quarter in June – reflecting the reduced number of ideas as the market had risen. However, during the sharp sell-off in the Chinese markets in early July, new ideas are beginning to materialise which might allow us to rebuild our China weight. If there's one thing we love, it is emotionally driven, highly correlated stock market corrections as the good companies get sold down with the bad.

A brief comment on the recent A-share volatility: in short, we believe this can broadly be ignored. We would highlight the following two points though. Firstly, rising stock markets in China have had little impact on the economy. Secondly, we do not believe any of the government measures which were announced in order to support the market would be able to do this successfully in the long term. In fact, we think that the government has made a strategic error in intervening in the market as this may work to delay the inclusion of A-shares in the MSCI index. In terms of valuations, we would note that the median P/E ratio in China has moved from 20x a year ago, to 45x at the peak of the market this year, to 25x at the bottom of the most recent correction[2].In other words, although valuations are by no means cheap, we do not believe we are in a "bubble" anymore.

Finally, on the subject of investing in China, we are pleased to announce that we have recently been joined by a new analyst on the team. Matthew Zhao, having interned for us, is now joining to work as an investment analyst. A native Mandarin speaker and having graduated from Cambridge with a degree in mathematics, he will work on ideas across the region, but will be of particular help in analysing Chinese companies which will soon be by far the largest market in the region. We have consistently pointed out that our weakness as a firm was that the lack of Mandarin language skills needed to be addressed. With Matthew on board, we now have a much greater ability to research stocks in this market.

New Positions[3]

Jasmine International + Jasmine Broadband Internet Infrastructure Fund

During the quarter we have added positions in both **Jasmine Group** and the infrastructure fund, **Jasmine Broadband Internet Infrastructure Fund** (**JASIF**)**,** which was spun off by and is controlled by the group. **Jasmine Group** is a Thai telecom operator offering broadband internet services to households in Thailand. The broadband internet market in Thailand is still immature with penetration rates of just 25%. It has 30-35% market share and is growing subscribers at 10-15% per year.

The Prusik Asia Equity Income Fund's initial exposure to the **Jasmine Group** was via **JASIF**. The fund yields 9.5% and should grow at inflation, so it provides a high yield, low growth stream of cash flows, which we believe is undervalued by the market. Our analysis of **JASIF** involved research of the parent company, and it was this which alerted us to the attractive investment case for the parent. When the shares in **Jasmine International** fell several months ago owing to management's announcement that they were planning to raise equity to bid for a licence in the 4G auction in Thailand, we took a new position in the stock. Unlike the market, we believe that **Jasmine International** will not overbid for the spectrum. Importantly, due to advanced technological developments, the company is able to challenge the existing players by using a "small cell" strategy to compete with the existing cellular operators.

Jasmine International trades on just 3.9x EV/EBITDA, which we believe vastly undervalues the business. Upside comes from a potential resolution (paying less than the market expects) to the 4G auction, a special dividend or even a takeover by one of the existing cellular operators. The dividend yield is difficult to predict as it is dependent on whether Jasmine participates in the 4G auction. As such, current sell side estimates for the company's 2016 dividend yield range from 3.2% to 14%. Monish Parbrai[4], the American-Indian value investor, describes this type of situation as "low risk,

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[2] 9th July 2015.

[3] When discussing new positions we generally exclude positions that we are in the process of building up – particularly if they are small or mid cap stocks where liquidity may be an issue. We also leave out small positions that we have not managed to get a full position in and are exiting (e.g. IPOs).

[4] https://en.wikipedia.org/wiki/**Mohnish_Pabrai.**

high uncertainty", meaning the range of potential outcomes is large but, even in the worst case scenario, the valuation is still attractive.

Hong Kong Telecom

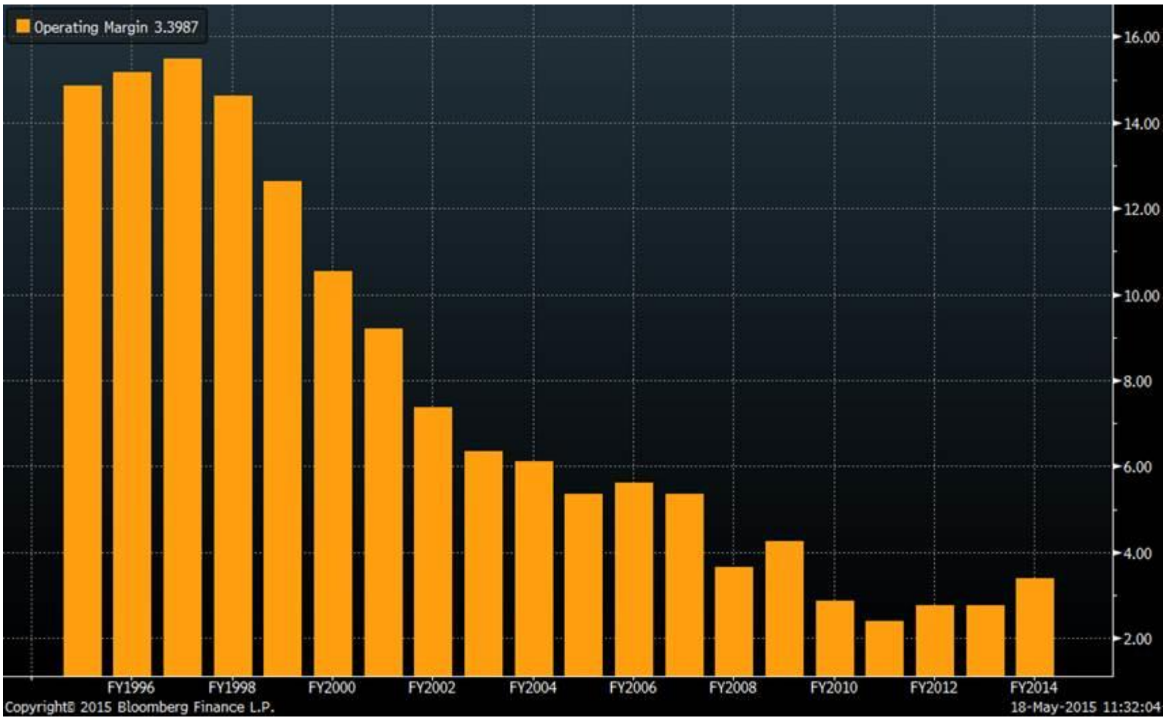
The Prusik Asia Equity Income Fund already has exposure to **Hong Kong Telecom** via its parent company **PCCW**. However, during the quarter we decided to invest in **PCCW's** subsidiary, **Hong Kong Telecom**, directly.

Hong Kong Telecom is the largest telecom service provider in Hong Kong. As well as mobile and fixed line services, it also offers broadband, mobile and cable TV. As we see it, there are two key attractions to the stock. Firstly, the company has acquired one of its competitors in the mobile market, thus reducing the number of players in the market from four to three and increasing its market share to 40%. This has led to higher pricing power as the competitive intensity of the market has declined. **Hong Kong Telecom's** recent results which showed its margins increase from 41.4% to 46.5% attest to this. The acquisition also creates the opportunity for cost cutting led synergies. Management have guided for a 10-15% reduction in costs but it is possible that they will exceed this. Secondly, since the listing of **Hong Kong Broadband**, **Hong Kong Telecom's** only competitor in the Hong Kong broadband market, both companies have committed to paying out 100% of free cash flow as dividends. This significantly reduces the potential for competition intensifying in the broadband market as it reduces the amount of cash flow available for investment. Pricing in **Hong Kong Telecom's** broadband business is also improving as consumers move to higher download speeds on the 100% fibre network. From next quarter, the highest speed broadband service in the world – 10GB – will be available in Hong Kong.

Hong Kong Telecom has a market capitalisation of US$9.2 billion, net debt of US$4.2 billion and produces free cash flow of US$800 million per year and dividends of US$550 million year, placing it on a dividend yield of just under 6%. We would expect the company to grow its dividends between 10% and 15% for the next few years before settling down to a 5% annual growth rate. While we would not claim that the stock offers extreme value, we believe the risk-return is attractive given what we perceive to be the low risk nature of the business and total returns in the range of 15-20% being perfectly possible.

Hon Hai Precision Industry

Over the past 15 years, **Hon Hai Precision Industry's** (**Hon Hai's**) profit margins have been falling steadily owing to rising labour costs in China, a weaker US dollar and a more aggressive competitive environment, which Apple has expertly exploited in order to keep its cost base low.

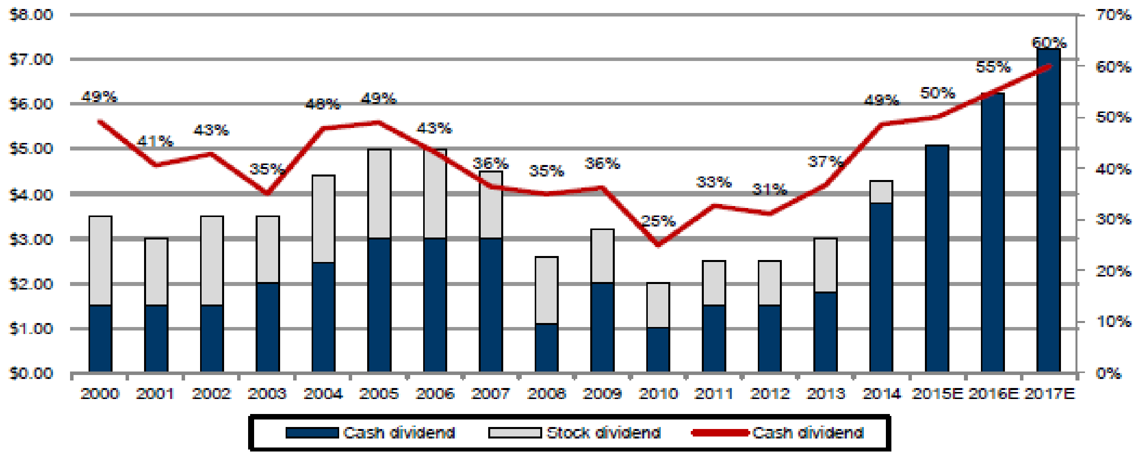


Source: Hon Hai Operating margins - Bloomberg

So what has changed?

Importantly, operating margins for **Hon Hai** appear not only to have bottomed, but also to be expanding once again. The company's 1Q15 results revealed that **Hon Hai's** operating margins have now increased to a 6 year high of 3.8%.

Figure 6: **Highest cash pay-out ever (43%); ten-year high total pay-out (49%)**
In NT$ / total pay-out % on earnings



Source: Company data, Credit Suisse estimates

The consensus view on **Hon Hai** is that post the Apple iPhone 6 product cycle sales are likely to slow considerably, or even fall. It is also widely perceived that **Hon Hai** is losing market share to the likes of Quanta Computer and Pegatron Corp. Although we have no particular edge in analysing the Apple iPhone product cycle and its short term consequences, we would take issue with the view that **Hon Hai's** competitive position is weak and/or weakening. Recently, Quanta Computer has been having problems ramping up the production of the iWatch. And the solution to this? **Hon Hai** has been asked to step in and assist Quanta Computer in solving the issue. Moreover, **Hon Hai's** enormous size relative to its competitors (**Hon Hai** has sales 5x larger than its nearest competitor), means the company has huge economy of scale advantages. Finally, **Hon Hai** has much more experience compared to its peers in working to Apple's demanding quality standards.

The stock's valuation is very attractive, particularly if one considers that it has the equivalent of 25% of its market capitalisation on its balance sheet in net cash. In addition, capital spending is running at substantially less than depreciation and so the company's earnings understate its cash flow generation. With a US$46 billion market cap and net cash of US$11.3 billion, **Hon Hai** produces annual free cash flow of around US$4.5-5 billion. From this cash flow, management plan to pay out around U$1.8 billion in dividends this year. Importantly, this means that while the dividend yield for the stock is just under 4%, the free cash flow yield for the company, post stripping out the net cash from the market value, is 12-14%! Not only does this point to the stock being very attractively valued, it also highlights how much scope there is for management to increase the dividend. Indeed, in the recent results, management announced an increase in the payout ratio to 49%. On more traditional valuation measures **Hon Hai** trades on 9.9x earnings, which places it in the cheapest quintile of stocks in Asia.

Exited Positions

During the quarter we exited three positions: **CapitaLand Mall Trust**, **Travelsky Technology** and **Daqin Railway**. We have excluded from this list the very small positions (<0.5%) which we bought but were not able to get a full sized position owing to the share price moving up too quickly as we were buying.

CapitaLand Mall Trust

We exited this stock for two main reasons. Firstly, a rally in the share price meant the stock was close to our assessment of its fair value. Secondly, rising bond yields worked to reduce the margin of safety for the stock.

Travelsky Technology Ltd

In common with many Hong Kong mid-cap stocks in April and May, **Travelsky Technology** attracted the attention of retail investors seeking Chinese companies listed in Hong Kong. After a 50% rally in April (yes, that is correct), we exited the position as the stock had reached our assessment of its fair value.

Daqin Railway Co Ltd

Daqin Railway's core business – transporting coal across China – has been faced with a tough operating environment in the past couple of years. Despite this, the company's stock price has doubled over the past 12 months. While optically the shares did not look expensive, the stock's margin of safety was no longer sufficient to justify continuing to hold this stock.

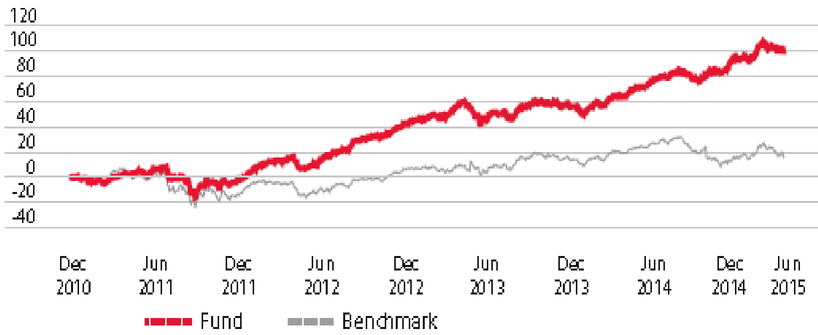
PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 30.06.2015

Class 1*	B USD	Benchmark **
1 Month	-1.97	-3.86
3 Months	2.17	-0.87
YTD	7.37	3.63
2014	16.79	3.26
2013	13.45	3.95
2012	45.90	22.96
2011	-3.96	-15.20
Since Launch+	99.33	17.32
Annualised since Inception	16.57	3.52

* 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: Bloomberg. Total return net income reinvested.

Class 1 B, USD Monthly Performance Summary (%)

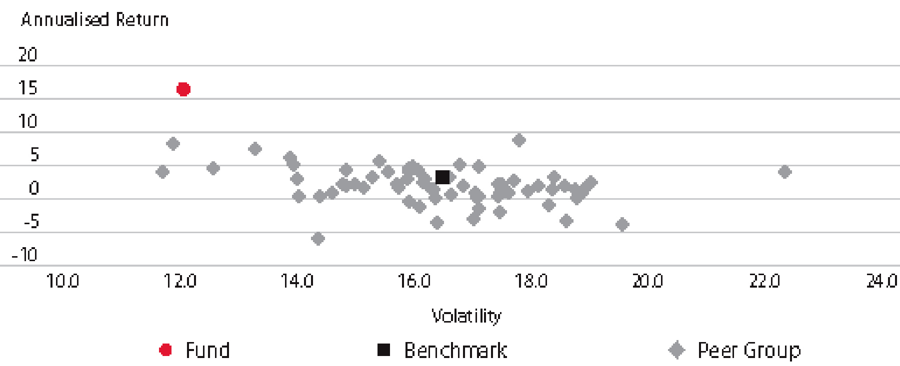
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2015	4.35	1.41	-0.70	6.01	-1.69	-1.97							
2014	-4.34	4.03	1.50	1.58	4.63	2.14	3.50	1.24	-2.54	2.31	2.00	-0.05	16.79
2013	3.93	1.78	0.35	4.57	-0.53	-4.95	1.87	-2.24	5.07	4.15	-0.56	-0.25	13.45
2012	8.12	6.54	1.92	3.20	-7.67	3.84	6.72	1.92	6.36	1.97	2.76	3.63	45.90

RISK ANALYSIS

Risk Metrics	Fund (%)
Tracking Error (% pa)	6.6
Beta	0.78
Alpha (%)	13.8
Volatility (%)	12.1

Source: Bloomberg
Since inception: B 31.12.2010

Risk Adjusted Performance - Class B USD (%)



Source: Bloomberg. Annualised return and 1 year volatility versus the peer group (open ended offshore Asia Pacific ex Japan Equity Fund Index), 31.12.10 to 30.06.15

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

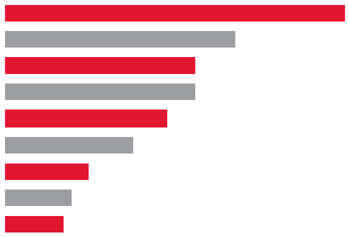
CK Hutchison	7.8
Samsung Electronics	5.9
Cheung Kong Property Holdings	5.3
SK Telecom Co Ltd	4.2
Macquarie Korea Infrastructure	4.1
Total Number of Holdings	37

Portfolio Financial Ratios

Predicted Price/Earnings Ratio	12.7x
Predicted Return on Equity (%)	14.8
Predicted Dividend Yield (%)	4.9

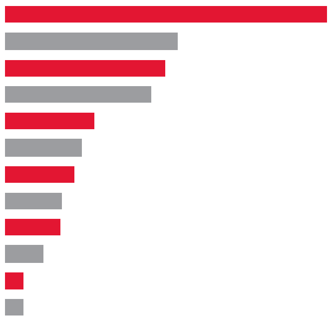
Thematic Breakdown (%)

Communications Infrastructure	23.6
Transport Infrastructure	15.9
Asian Brands & Technology	13.1
Cheung Kong / Hutchison	13.1
Financials	11.2
Shopping Malls	8.9
Cash	5.7
Power Utilities	4.5
Consumer	4.0



Geographical Breakdown (%)

Hong Kong	26.7
Korea	14.2
Thailand	13.2
China	12.0
Taiwan	7.3
India	6.3
Cash	5.7
Singapore	4.5
Australia	4.5
Pakistan	3.0
New Zealand	1.4
Philippines	1.3



All data as at 30.06.15. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size USD	873.4m
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	204.85
B USD	Unhedged	Distributing	B4QVD94	IE00B4QVD949	167.60
C GBP	Hedged	Distributing	B4Q6DB1	IE00B4Q6DB12	168.87
D SGD	Hedged	Distributing	B4NFJT1	IE00B4NFJT16	161.25

*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	151.86
Y GBP	Hedged	Distributing	B4TRL17	IE00B4TRL175	153.40
Z SGD	Hedged	Distributing	B6WDYZ1	IE00B6WDYZ18	152.15

* 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	121.63

* 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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