PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Equity Income Fund

Quarterly Investment Report
30 December 2016

FOR PROFESSIONAL INVESTORS ONLY

4Q16 Review and Outlook

The fund marginally underperformed the index during the fourth quarter in what was one of the most challenging periods for alpha since inception in 2010. We outperformed the market by 3.3% in 2016 but all of the outperformance was generated in the first half.

Although the market environment was not ideal for our strategy, it is worth noting that our performance is still dominated by stock picking rather than changes in market sentiment. As an example, note that in the second half of the year we performed largely in line with the market but this was despite being underweight Taiwan and Australia (the 1st and 2nd best performing markets) and overweight India and Hong Kong (the 3rd and 4th *worst* performing markets). On a sector level, we had zero exposure to Resources (the best performing sector) and Energy (the 4th best performing sector) and were very underweight Technology and Financials (which were the 2nd and 3rd best performing sectors). In contrast the fund was overweight Telecoms, Utilities and Consumer Staples which were 3 of the 4 worst performing sectors! And to complete the list of poor "asset allocation" decisions, we held 10% cash. So to finish only 70bps behind the market (after fees) is quite surprising given that just the cash position would account for most of that. The reason that we didn't underperform by more is that, despite this, our 3 stock Indian portfolio rose by 14% during the half (compared to the Indian market which fell by 3%) and these 3 stocks outweighed all the bad performance and positioning elsewhere in the portfolio. The point of this story is to reinforce the idea that our success or failure comes not from what happens to interest rates or the Chinese economy but whether we get our stock picking correct. If we do, this will outweigh the other factors. Of course this works in reverse as well.

The one advantage of the weak performance of the past few months is that it gave us a chance to reduce the cash position, which fell from 12% to just over 3%[1]. We have found that many defensive stocks have sold off to levels which appear extremely attractive and in that sense, we seem to be going against the mood of the market by increasing our exposure to these names.

If you think US bond yields will rise, should you sell PAEIF?

A number of investors suggest to us that rising interest rates (i.e. falling bond prices) will be bad for PAEIF. The logic makes the assumption that we own lots of "bond proxies" and "expensive defensives" which are very sensitive to higher bond yields. But PAEIF is different from most income/defensive funds because we don't really care about short term dividend yield but instead focus on underlying, intrinsic value and generating absolute returns regardless of interest rate cycles. This valuation discipline is demonstrated by the fact that the P/E of our fund is lower than the market (12.8x versus 13.4x) which is very different to the position that many defensively oriented funds find themselves in. Additionally, the weekly correlation between US bond price returns and PAEIF is negative (-0.24 since you ask) so if bond prices *fall*, PAEIF is likely to *rise.* The chart below shows the 10 worst weeks for US bonds[2] and what PAEIF did in those weeks. The average return for PAEIF was +0.1%. If you look at relative performance (instead of absolute) then the correlation is

[1] After the payment of the dividend on 3 January 2017
[2] We use the "IShares 20+ Year Treasury Bond" ETF to calculate the returns

slightly positive (0.28) but the average relative performance[3] of the fund during the weeks below is the same (+0.1%)

Worst 10 weeks for US long bond returns since 2010

Date	US Bond return	PAEIF (absolute)	PAEIF (relative)
11/11/2016	-7.4%	-2.0%	-0.7%
06/02/2015	-5.1%	-0.2%	-1.8%
21/06/2013	-4.8%	-3.8%	0.6%
14/09/2012	-4.6%	3.7%	-0.8%
06/03/2015	-4.5%	-0.4%	0.3%
04/01/2013	-4.0%	1.1%	-1.0%
08/06/2012	-4.0%	1.4%	0.5%
05/06/2015	-3.9%	-0.4%	2.1%
16/03/2012	-3.9%	1.4%	0.8%
01/05/2015	-3.7%	0.1%	1.5%
Average	**-4.6%**	**0.1%**	**0.1%**

Source: Bloomberg

So in conclusion:

- **We have a negative correlation with US interest rates** (higher rates = positive performance for PAEIF).
- **There is no correlation between our relative performance and US interest rates**.
- **We have a VALUE portfolio** (we are invested in high quality companies with non-cyclical earnings but, crucially, which are undervalued by the market).
- **We do not own "expensive defensives"**.
- **None of this means we won't underperform in the future; however, if and when we do, it will be because of our own mistakes, not because of interest rates**.

New Positions

Cheung Kong Infrastructure

Cheung Kong Infrastructure is a Hong Kong based, global infrastructure company run by Victor Li, son of Li Ka Shing. Created in 1996, it prefers to invest in low risk markets with sound regulatory structures and legal frameworks. The majority of its assets are located in the UK, Australia and Hong Kong. It has historically been an intelligent acquirer of assets and its unique structure gives it certain tax advantages over its competitors.

[3] Relative to the MSCI Asia Pacific ex-Japan Index

Investment Case

- **The cash flows are very secure (80% are regulated) and are protected from inflation and higher rates**. If rates increase, this feeds through into higher regulated returns.
- Strong growth in dividends over time.
- Good track record in acquisitions.
- **Cheung Kong Infrastructure** can structure deals in Australia and the UK using shareholder loans. Owing to the fact that the company generally owns only 40% of the assets and the rest is owned by CK group companies, **Cheung Kong Infrastructure** is allowed to offset the interest from these shareholder loans against tax. In addition, because interest income is tax free in Hong Kong, the company can also avoid paying tax on it when it repatriates the income. This means Cheung Kong Infrastructure can pay more than its competitors for the same assets and achieve the same post tax equity IRR.

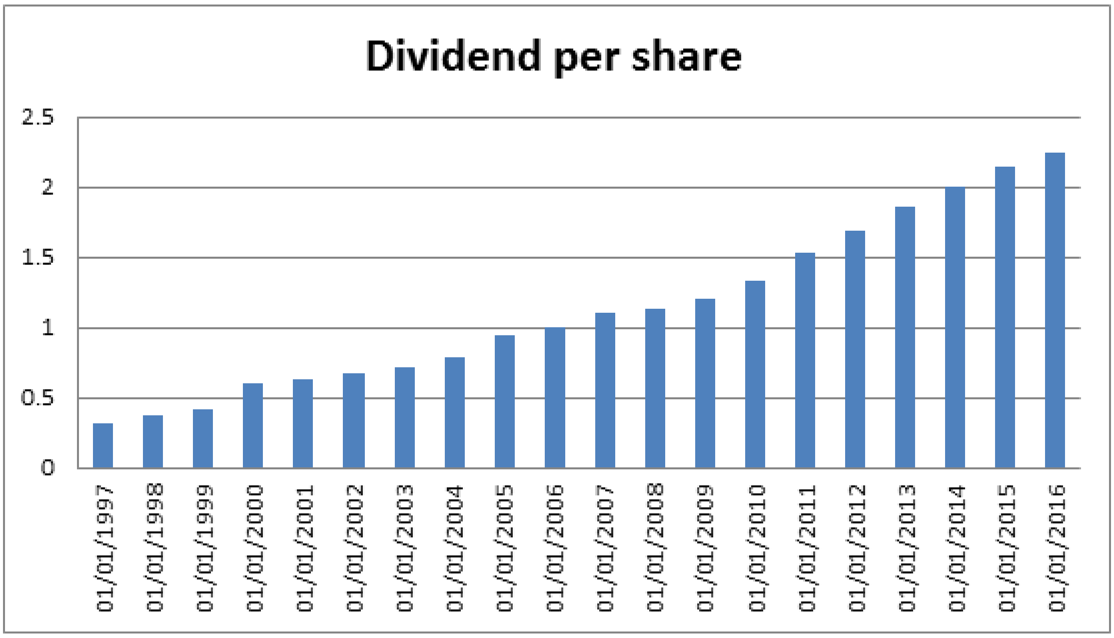
Valuation

The stock is cheap for three main reasons:

- It is a low risk utility stock and therefore has been out of favour in recent months.
- GBP weakness - 60% of its assets are in the UK.
- Concern that the returns that their Hong Kong business can earn will be reset lower when the current regulatory framework expires in 2018. (although Hong Kong Electric is only 6% of NAV).

Dividends

- The company has a strong track record of growing dividends. The dividend per share has increased at 10% CAGR over the past 20 years and the dividend has been increased by at least 3% each year.



Source: Bloomberg

Crown Resorts

- **Crown Resorts** is an Australian casino operator with properties in Melbourne and Perth.
- The company was founded by the late Kerry Packer but is now run by his son James. He bought the original Melbourne casino out of bankruptcy around 25 years ago.
- James Packer has diversified into various businesses outside Australia such as Macau (with Melco) and Vegas with mixed success.
- These have not proved to be particularly profitable investments but the company appears to have learned from this and is now restructuring.
- The main asset is the Crown Melbourne which operates a state monopoly (it is the only casino allowed to operate in Victoria). Although it has recently announced weaker than expected results, it is a high-quality asset that should grow strongly over time and will benefit from growing Chinese tourism.
- **Crown Resorts** also owns the Crown Perth, which is in a weaker position due to the poor economic conditions in Western Australia linked to the mining slowdown.
- The domestic casinos produce EBITDA of around $800m after corporate costs and free cash flow after all capex of around $500-600m. Cash flows should grow at a mid to high single digit rate.
- The international business includes several different assets but the largest of these is a stake in Melco Crown Entertainment, a Macau based casino listed on the Nasdaq.

Investment Case

- The Chinese government announced that it had arrested several Crown employees, allegedly for drumming up business in China which is illegal, and this caused the stock to drop dramatically. Approximately 20% of the revenues and 10-15% of the profits are from VIPs and we believe the share price fall is an overreaction.
- The company proposed a restructuring (which has since been amended) that signalled that the company was planning to spin off its international operations and return to focusing on generating cash flow and dividends from its domestic casinos. We believe this will be positive for the rating of the company.

K-Electric

Source: Author's own photo from trip to Karachi

Investment Case

- **K-Electric** is an attractive investment that benefits from the growth in the Pakistan economy and, in particular, the improving conditions in the power industry.
- It is an integrated electricity company that generates, transmits and distributes power in Karachi.
- The current owner (UAE private equity firm Abrajj) have done an excellent job of increasing efficiency and improving returns.
- There is still substantial upside to come from reducing transmission and distribution losses (i.e. theft).
- The regulatory regime is attractive and offers a relatively transparent regulatory structure, for example, it is far better than Korea or China and more in line with Hong Kong.
- The stock trades on <7x P/E despite having earnings growth of 15% forecast over the next several years.
- It does not pay a regular dividend yet but is expected to start once the business matures.

Kangwon Land

- **Kangwon Land** operates the only casino in Korea that locals are allowed to visit (the other casinos are only accessible by foreigners).
- Although casinos are illegal in Korea, a special act allowed the Kangwon government to enter the casino business in order to help the region cope with the loss of the coal mining industry. It is, therefore, unlikely that any other domestic casinos will open.
- It also operates a ski resort and several non-gaming facilities. Although these are loss making, they help bring more people to the casino and help present the company in a more positive light (think "integrated resort" rather than "casino").
- In our view, it is a relatively straightforward business but sentiment on the stock swings wildly due to noise surrounding taxes and government intervention. This gives us the opportunity to buy the stock during times of pessimism.

Investment Case

- The entire bull and bear case for the stock is based on the fact that it is a government owned monopoly.
- This gives the company advantages, including the fact that it has no competitors and therefore very high margins, and disadvantages, such as they cannot freely add employees, set minimum bet levels on the tables and the process for expansion is very slow).
- In addition, the company suffers from the fact that there is strong political opposition to gaming in Korea which means the tax rate often increases and there is a reluctance to let the casino add more tables.
- As a consequence, the casino operates at very high capacity utilisation (2-3 people deep at most tables) and revenue growth has been extremely stable.
- We believe it is a moderate growth, high margin monopoly business and will grow earnings and dividends steadily over time. The current weakness provides an opportunity to buy the stock at an attractive multiple.

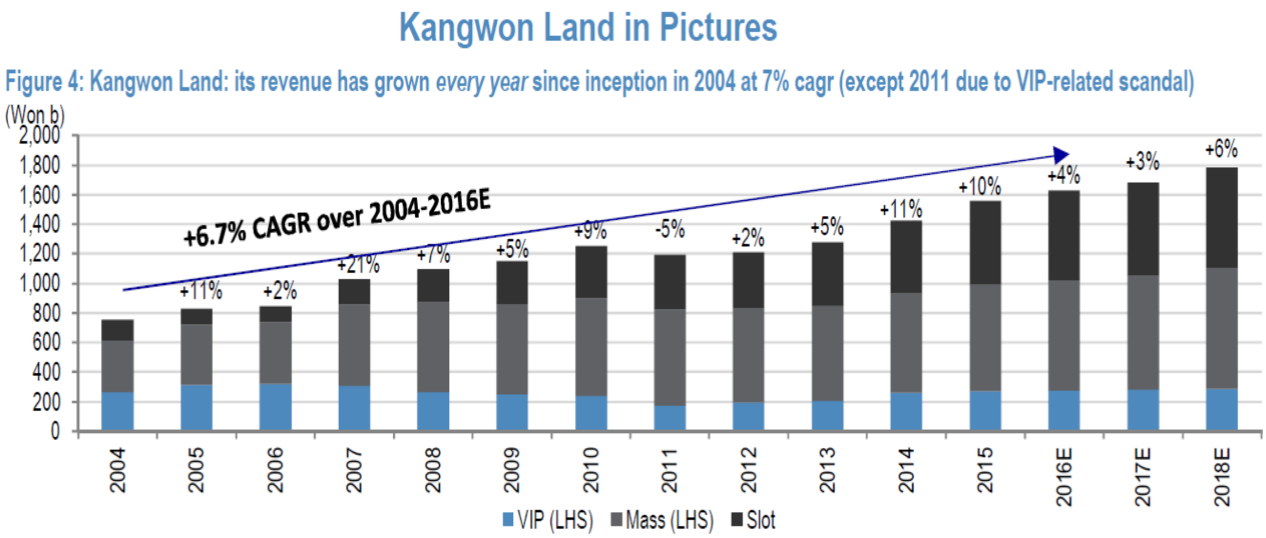
Financial Outlook

- We expect the company can grow revenues at around 5-8% over the next several years on the basis that the company can return to 2012 levels of revenue per table (management added a significant number of tables in 2013 which increased capacity by 30-40%). Our assumptions do not factor in the company adding any more capacity.
- Other factors driving growth include the opening of a new road which cuts the journey time down from Seoul to Kangwon Land from 3:00 to 2:15 hours and the opening of a water park in 2018 (the ski resort increased demand by 25%).
- This should leave to earnings growth of near 10%.
- The company has a significant net cash position on its balance sheet, a net profit margin of 27% and a return on invested capital of 40%.

Valuation

- **Kangwon** trades on a forward P/E multiple of 14x (11x ex-cash) and an EV/EBITDA multiple of 8x, which is a substantial discount to regional comparisons.

- In addition, it generates a dividend yield of 3.5% (the payout ratio has drifted down from 45% to 35%).
- Owing to its unique situation, the predictability of earnings is very high (see chart below).



Source: JP Morgan

Sky City Entertainment

- **Sky City** owns a number of casinos in New Zealand and Australia.
- The largest asset is its casino in Auckland (70% of profits) where, like all of its casinos, it has an exclusive licence to operate.
- It also operates several smaller casinos in New Zealand and Australia, of which the most important is in Adelaide.
- Adelaide has an excellent location and opportunity but needs a substantial amount of investment to get the property to a state where it can maximise the opportunity – this should add 15% to **Sky City's** earnings once it is complete in 2020.
- It is well positioned to benefit from growing Chinese tourism.
    - **Expect the number of Chinese visitors to New Zealand increase from 350k in 2016 to near 750-1000k by 2025**.
    - **New Zealand was named as the 4th most preferred destination for Chinese tourists**.
    - **Chinese gamblers spend around $800 a visit which is 5x the average** for other countries (Brits spend a miserly $100).

Dividend Yield Towards High End of Historic Range

Source – Bloomberg

Exited Positions

Cheung Kong Property

- Deterioration in the Hong Kong and Chinese real estate operating environment together with a lack of confidence on capital allocation led us to sell the position.

Hub Power Company

- The stock reached our price target. Although still trading on an attractive yield, the main asset has a limited life span and so care must be taken to adjust for the fact that the sustainability of cash flows is relatively poor.

KEPCO

- Exited as coal price rise reduced appeal of investment by reducing potential cash flow and dividend growth.

Link REIT

- The stock reached our price target.

Outlook

Although the macro economic environment continues to be uncertain, we operate with the framework that we are not trying to position the fund for higher or lower interest rates or a strong or weak Chinese economy. Rather, we just try and buy uncorrelated stocks that have the best chance of limiting our losses should we be wrong and the highest potential gains if we are right. That said, it is fair to say that our relative performance is affected by macroeconomic events. If interest rates move higher on the back of greater confidence that the global economy is reflating this isn't necessarily bad for our portfolio but, from a relative perspective, it tends to be better for the stocks that we don't own that have more cyclical earnings streams, lower quality balance sheets and "need" a stronger economy more than our portfolio does. So even though we aim to outperform in all market conditions, clearly it is more challenging in that environment. On the flip side, if say the Chinese economy is weaker than expected this year then this would be positive for our relative performance for the opposite reasons.

In terms of our current portfolio, our view is relatively positive, especially when compared to the summer of 2016. We are almost fully invested for the first time in some time which reflects the number of new ideas. We believe that we have substantial upside in valuations and believe the companies we own can maintain and grow dividends even in challenging economic conditions. Of course, the companies we own are not immune to economic cycles but we do think they are in a stronger position to navigate the volatility.

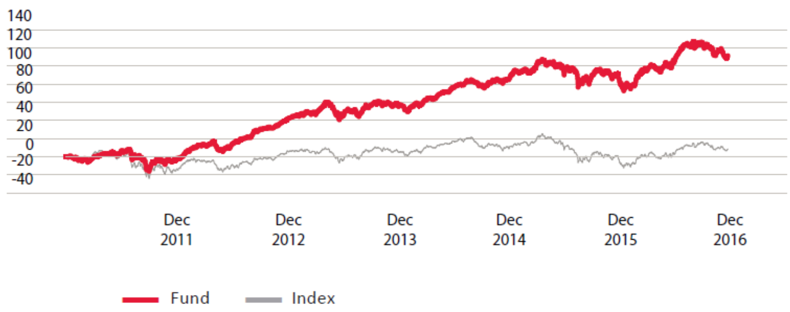
PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 30.12.2016

Class 1*	B USD	Benchmark **
1 Month	-3.16	-1.05
3 Months	-5.19	-4.86
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+	111.18	7.88
Annualised since Inception	13.27	1.27

* 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.

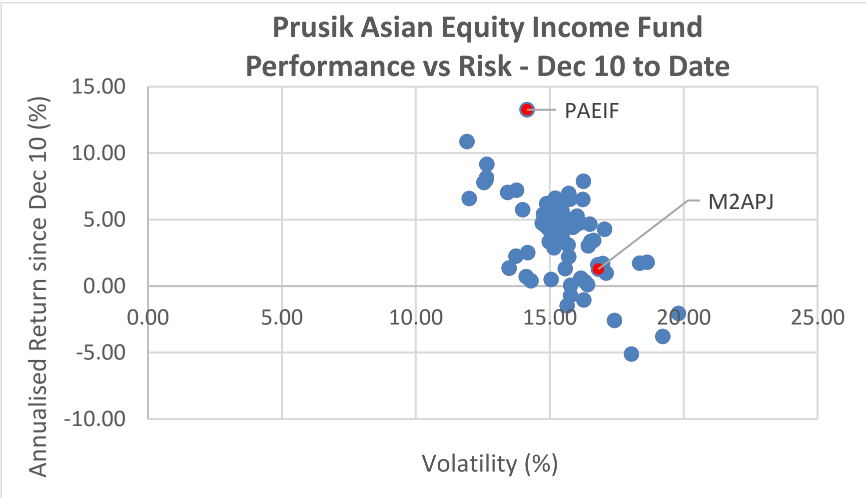
Class 1 B, USD Monthly Performance Summary (%)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
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)	9.80
Beta	0.79
Alpha (%)	11.60
Volatility (%)	14.28

Source: Morningstar
Since inception: B 31.12.2010



Source: Morningstar

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

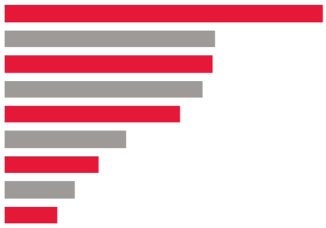
Samsung Electronics Co Ltd	6.9
CK Hutchinson Holdings Ltd	6.5
Power Grid Corp of India Ltd	5.3
AIA Group Ltd	5.1
Beijing Capital International Airport	4.2
Total Number of Holdings	34

Portfolio Financial Ratios

Predicted Price/Earnings Ratio	12.5x
Predicted Return on Equity (%)	15.7
Predicted Dividend Yield (%)	4.8

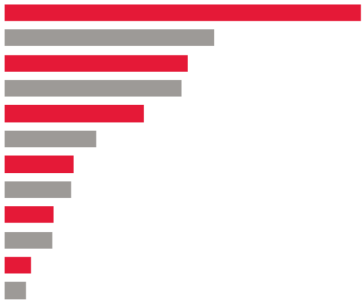
Thematic Breakdown (%)

Consumer	22.1
Power Utilities	14.6
Financials	14.3
Transport Infrastructure	13.7
Communications Infrastructure	12.1
Technology	8.4
CK Hutchison	6.5
Cash	4.8
Real Estate	3.6



Geographical Breakdown (%)

Hong Kong	24.9
Korea	14.6
India	12.8
Thailand	12.3
China	9.7
Australia	6.4
Cash	4.8
Singapore	4.6
Pakistan	3.4
New Zealand	3.3
Indonesia	1.8
Taiwan	1.5



All data as at 30.12.16. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size USD	772.3m
Launch Date	31st December 2010
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GDP, SGD

Share Class Details

Class 1*			SEDOL	ISIN	Month end NAV
A USD	Unhedged	Non Distributing	B4MK5Q6	IE00B4MK5Q67	217.24
B USD	Unhedged	Distributing	B4QVD94	IE00B4QVD949	167.35
C GBP	Hedged	Distributing	B4Q6DB1	IE00B4Q6DB12	168.40
D SGD	Hedged	Distributing	B4NFJT1	IE00B4NFJT16	162.30

*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	149.81
Y GBP	Hedged	Distributing	B4TRL17	IE00B4TRL175	151.34
Z SGD	Hedged	Distributing	B6WDYZ1	IE00B6WDYZ18	150.91

* 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	153.36

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

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

Dividend Dates

Dividends paid twice annually (January and July)

Fund Manager

Tom Naughton
Tel: +44 (0)20 7493 1331
Email: tom.naughton@prusikim.com

Sales & Marketing

Mark Dwerryhouse
Tel: +44 (0)20 7297 6854
Mob: +44 (0)7831 856 066
Email: mark.dwerryhouse@prusikim.com

Jack Barham
Tel: +44 (0)20 7297 6858
Fax: +44 (0)20 7493 1770
Email: jack.barham@prusikim.com

Prusik Investment Management LLP
6th Floor
15–16 Brook's Mews
London W1K 4DS

Web: www.prusikim.co.uk
Email: enquiries@prusikim.com