PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Equity Income Fund

Quarterly Investment Report

31 March 2014

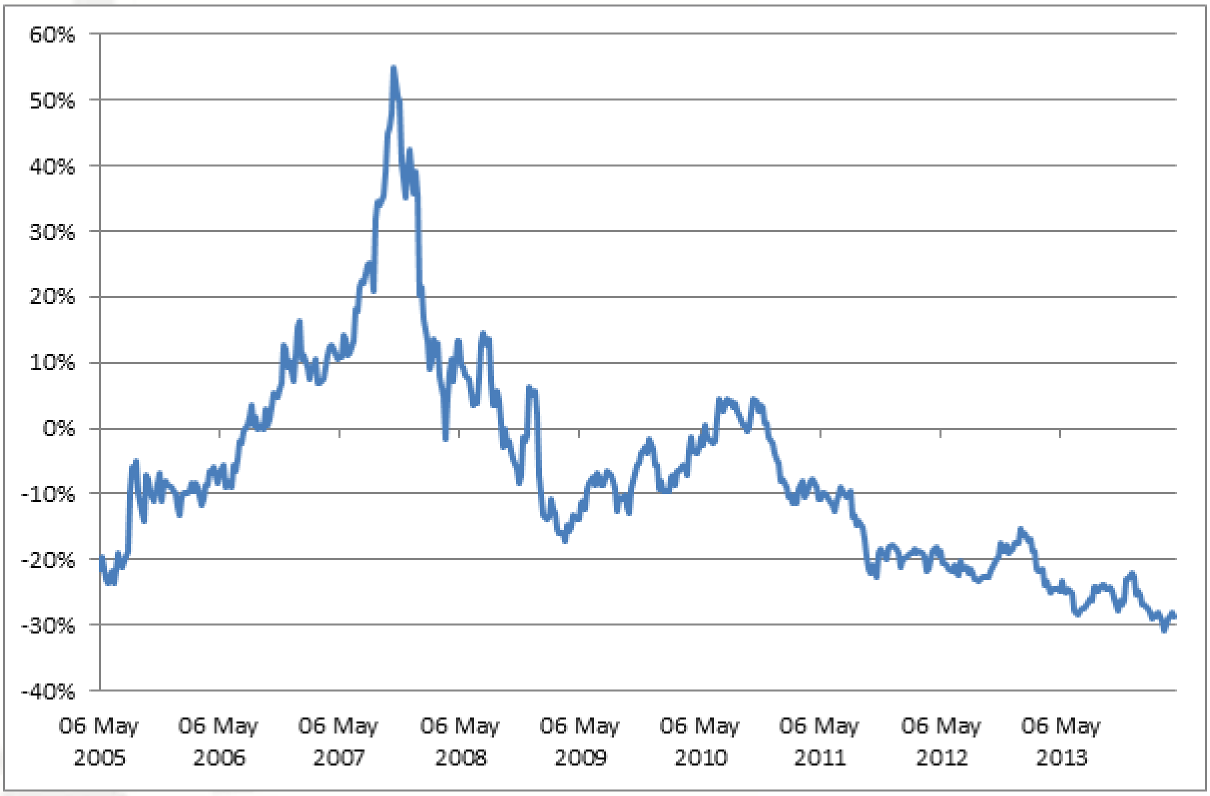
FOR PROFESSIONAL INVESTORS ONLY

LIPPER
FUND AWARDS 2014
UNITED KINGDOM

Q1 2014 Review & Outlook

The fund rose by 1.0% in the first quarter which was exactly in line with the market. The stock picking within markets was relatively strong but our overweighting of Hong Kong and China versus our underweighting of Australia cancelled out the positive alpha. In rough terms, the Australian market outperformed the MSCI Asia Pacific ex-Japan index by 500bps and the Hong Kong and China markets underperformed by 500bps. Given our approximate 20 percentage point overweighting of Hong Kong and China and 20 percentage point underweighting of Australia, this cost us around 200bps of performance. To the extent that Hong Kong and China continues to underperform the region our performance is likely to be constrained in the short term. However we believe the valuation discount that the stocks we own trade at, means that we are reasonably relaxed remaining heavily exposed to this area. The chart below shows the discount at which the China market trades to the MSCI Asia Pacific ex-Japan – which itself trades at a historically high discount to the world.

China P/E relative to the MSCI Asia Pacific ex-Japan Index



Source: Bloomberg

China

China continues to be the single biggest risk to both the region and our portfolio. Although we believe that an implosion in the Chinese economy and a disorderly banking system collapse is possible, it is not our base case scenario. The reason China may be able to avoid the sort of banking crisis we saw in Asia in 1997/98 or in Europe/US/UK more recently is due to the fact that the government still exerts a strong control over both the banking system, the money markets and the capital account. In addition, it runs a current account surplus and has US$4trn of foreign exchange reserves. Although none of this provides a 100% guarantee against a “Lehman’s moment”, they do make it more difficult to create a full scale banking crisis. However, I do believe that this view is somewhat consensus and that the market places too high a trust on the Chinese government's ability to solve any financial problem – no matter how great. So I think we need to look at what would happen during a more troublesome downturn.

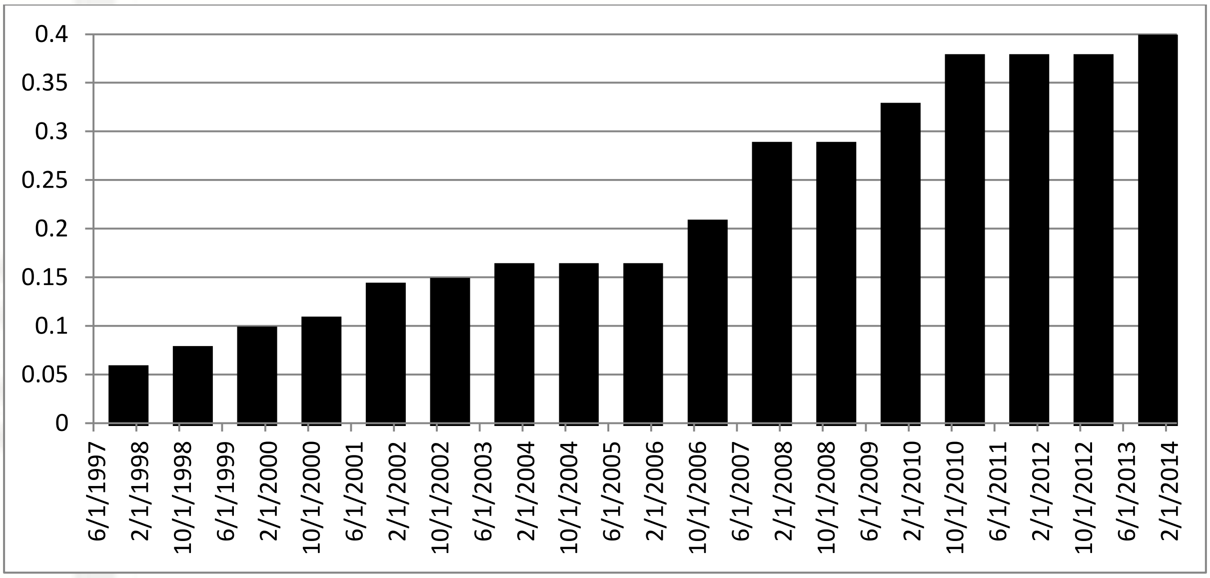
The statement below is worth some thought. The reason I include it, is not so much to suggest that China will avoid a banking crisis this time, as it has avoided it in the past, but merely it is *possible* for it to avoid a meltdown despite having a substantial amount of capital misallocation, that may well lead to much higher bank non-performing loans.

"In 2000, according to the International Finance Corporation, Chinese NPLs were estimated to be on the order of $440bn, equivalent to 40% of all bank loans or 42% of 2000 gross domestic product"[1]

Yet despite that, from 31 Dec 1998 until 31 December 2003, the MSCI China outperformed the S&P 500[2]. The point is that even if we do believe that China will suffer from a high level of non-performing loans, it does not follow that Chinese equities *must* underperform. The reason for this is that the government has the ability to deal with the non-performing loans over a number of years and transfer them onto the central government balance sheet. This process is fraught with risk, however it does not mean that it is not possible.

Below we show the dividend payment history for **Jiangsu Expressway**, one of our larger positions in China. As can be seen, during the late 1990s when all 4 major Chinese banks were having their equity wiped out, the dividends were never cut and actually more than tripled between 1997 and 2001. From 1997 until 2013, dividends have increased by an annual rate of 15.3% and the stock has generated compounded annual returns of 17.0% a year in USD terms. In fact, during the period discussed above, **Jiangsu Expressway** generated a total return of 26.1% per year.

Jiangsu Expressway annual dividends (RMB/share)



Source: Bloomberg

[1] http://reai.harvard.edu/files/Peiser_Richard_and_Wang_Bing.pdf
[2] MSCI China returned (-)1.6% compared to (-)2.9% for the S&P 500 (Source: Bloomberg)

So what are the characteristics of **Jiangsu Expressway** that allowed it to grow dividends and generate very attractive shareholder returns during this period of huge financial turmoil?

By their very nature, toll roads tend to be low risk businesses. Once a road finishes the ramp up phase, traffic growth tends to be relatively stable. Over time, development around the road not only leads to traffic growth but also reduces the risk of competing roads as the surrounding land appreciates in price making it more difficult to acquire. As incomes rise, the cost of time also rises which means drivers are more willing to pay money to avoid a longer trip on the competing "free" roads. Increases in tolls move traffic off the toll roads and onto the free roads which further increases the attractiveness of the toll road as the time saving becomes greater. This leads to very limited elasticity of demand to price rises.

The other attraction is the high margins. In the most recent results, **Jiangsu Expressway** generated an EBITDA margin of 88% on its toll road operations. The margins are high because, after the road is built, the only costs are toll collection and maintenance of the road (which is taken through the operating cost line – not depreciation). This means that falls in traffic levels do not have a dramatic impact on cash flows – and therefore dividends – as the operating leverage is very low. Although it would be a stretch to say that these assets can be regarded as bonds, they are arguably closer in structure to bonds than they are to equities.

As a result of these characteristics (structural growth and limited operational leverage), **Jiangsu** was able to grow earnings and dividends during China's last financial crisis. We believe this combination of high profit margins, strong balance sheet and limited economic cyclicality to mean that they have every chance of continuing to grow dividends during the next economic crisis. Even if they cannot, the structure of the business limits the risk to permanent loss of capital.

M&A

Given that many of the characteristics that we look for in stocks (annuity like cash flows, simple business models, high barriers to entry and non-cyclical) are similar to what the private equity firms look for, it is not surprising that **Goodpack** (one of our new holdings mentioned in the 4Q13 report) announced that it has "received approaches from a number of parties" about a potential bid for the company. It has been reported by Reuters that firms including Blackstone and Carlyle are considering a bid and Brambles of Australia disclosed that it had held talks in the past. Although it will be frustrating if the company is taken over, as it was a stock we felt could compound at a high rate for many years, it does highlight the optionality in the portfolio from owning these types of companies. Private equity firms are able to inject much more leverage into a company than would be possible in the public markets and so are able to arbitrage the low valuations that many of these companies trade at in the listed market. The rumoured pricing for the takeover of S$3/share is almost twice what we initially paid for the stock 6 months ago.

Special Dividends

Although we would never buy a company purely to receive a special dividend, many of the stocks that we own have overly conservative balance sheets and strong cash flow generation. This means that it is possible that the boards will decide to return cash to shareholders by way of a special dividend. These payments are not sustainable but I believe are positive as they return excess cash to shareholders and often does not detract from the operating potential of the companies. There have been several cases of that so far this year including:

1. **Great Eagle** - This Hong Kong property company has announced a special dividend of 3% as a result of the spin-off of their hotel division.
2. **Coal India** - 90% owned by the Indian government and with a net cash position equal to half their market capitalisation, **Coal India** paid a special dividend equal to 10% of their share price in January. Given the government shareholding, this is an effective way of the government extracting cash from the company without too much "leakage" to foreign investors.
3. **Cheung Kong & Hutchison** - Perhaps the most surprising and important of all, **Cheung Kong** and **Hutchison** announced that they would pay a special dividend of HK$7/share which, when combined with the final dividend, results in an 8% dividend yield. This is the first time they have paid a special dividend in their 40 year history. As these positions total 12% of NAV, these positions alone will generate almost a 1% yield for the fund as a whole.

Changes to Portfolio

During the quarter we made several changes to the portfolio, the most notable of which was the decision to sell both **HSBC** and **Standard Chartered**. Following that sale we have virtually no exposure to the banking sector. The reasons for the sales were related but not identical.

- For both banks we believe that the deteriorating credit environment in Asia – most specifically China but also the region as a whole – will present headwinds for earnings. Both banks are operating with relatively low levels of provisioning, which we believe might rise as the economies slow and non-performing loans rise. Although we don't believe either bank has significant exposure to China, a meltdown in the China economy may lead to rising NPLs for companies in other regions which supply China (e.g. resources, Indonesian coal companies). **Standard Chartered** is more affected than **HSBC** in this regard but both companies have significant exposure to the region.

- The issue with **HSBC** is that they are unlikely to achieve a double digit ROE due in part to some structural weaknesses in their business model. The US business in particular is struggling with a virtual 100% cost-income ratio and it is not immediately clear what they can do to solve this problem. In addition, they still generate 40% of their operating profit from Hong Kong which is facing falling property prices and questions being asked over the banking sector's exposure to China. Although the downside to **HSBC** is small, we believe that investors are too bullish on dividend growth for the bank and do not see enough upside to continue to hold the bank in our portfolio.

- With regards to **Standard Chartered** the challenges are more cyclical than structural in nature. They have a relatively simple business model but are more exposed to the emerging market slowdown. Our discussions with contacts in the region suggest that the bank has been aggressive in pursuing growth over the past several years and this may come back to haunt the bank in a downturn. Whether it is exposure to the resource sector, their rapid growth in USD lending to Indian corporate or the US$1bn exposure to the troubled Bumi Group, it will be instructive to see how the bank copes with a more challenging environment.

  The valuation argument is less clear cut in the case of **Standard Chartered** as the valuation arguably discounts much of this, however we have learnt from experience that value based investing can come unstuck when applied to emerging market bank securities. I prefer to wait until the bank has passed through the period of risk unscathed before buying shares, even if it means paying a higher price to avoid the risk that the credit downturn causes a more substantial fall in earnings than the market is discounting.

Other sales included:

<u>LG Uplus</u>

We sold our stake in this Korean mobile operator due to a concern that the increase in planned capital expenditure, would lead to reduced dividends and might not generate returns above the cost of capital.

<u>OSIM</u>

Although we continue to like the company, we felt that the valuation no longer offered an attractive risk /reward profile.

<u>Tata Motors</u>

We believe that cash flow is being pressured by both the domestic business (which is losing money and therefore a drain on resources) and the Jaguar Land Rover business (which is seeing a substantial increase in capital spending due to high growth). This will constrain the dividend paying ability of the company for several years. We are also somewhat concerned that we are approaching the “as good as it gets” situation for Land Rover sales in China – a market in which they make most of their profits. Premium car sales have been growing at 37% a year for the past 5 years and on some measures the market is now relatively saturated (compared to income levels).

New Positions

We added several positions in Thailand – all of which we had owned in the past but had sold due to valuation concerns. However, due to the fall in the market they have now become attractively valued again.

Bangkok Expressway

Operates toll roads in Bangkok. As will be no surprise to those that have visited, the road is full and has virtually no volume risk due to the traffic situation. Tolls increase with inflation and growth upside comes from expanding the current road network. Trades at a P/E of 10x (down from 15x a year ago) and offers a 5% dividend yield.

CPN Retail Growth Fund

CPN Retail Growth Fund operates a number of retail shopping malls in Thailand. Although most of the malls are in Bangkok, they have recently acquired a mall in the Chiang Mai Airport which is benefiting from tourism growth of 14% from 2009-2011. The fund (essentially a REIT) has virtually no debt, yet offers an 8.5% dividend yield which should grow above inflation as the Thai consumer market continues to perform strongly.

Samui Airport Fund

Samui Airport Fund operates the only airport on the resort island of Koh Samui. Offering a 8.6% dividend yield with no debt, we expect high single digit dividend growth driven by tourism growth. Chinese visitation to Thailand grew by 62% in 2012 and it is expected to be the most popular destination for Chinese tourists by 2020, outside Hong Kong/Macau, with tourist numbers increasing from 2.8m in 2012 to 10.7m by 2010[3].

[3] Source: Euromonitor, CLSA

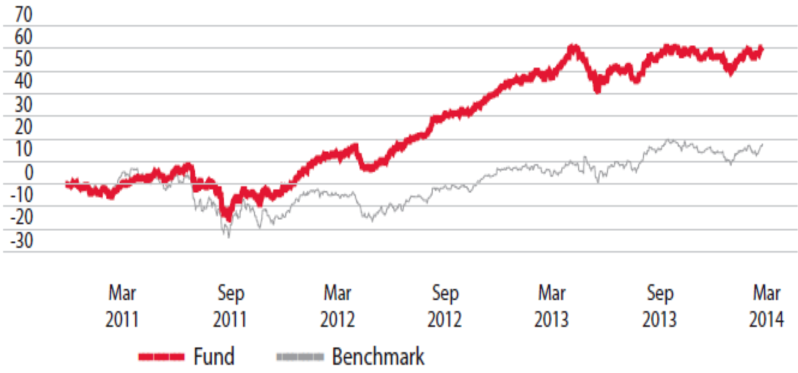
PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 31.03.2014

Class 1*	B USD	Benchmark **
1 Month	1.50	1.83
3 Months	1.00	1.00
Year to Date	1.00	1.00
2013	13.45	3.95
2012	45.90	22.96
2011	-3.96	-15.20
Since Launch+	60.56	10.08
Annualised since Inception	15.69	3.00

* 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 (%)

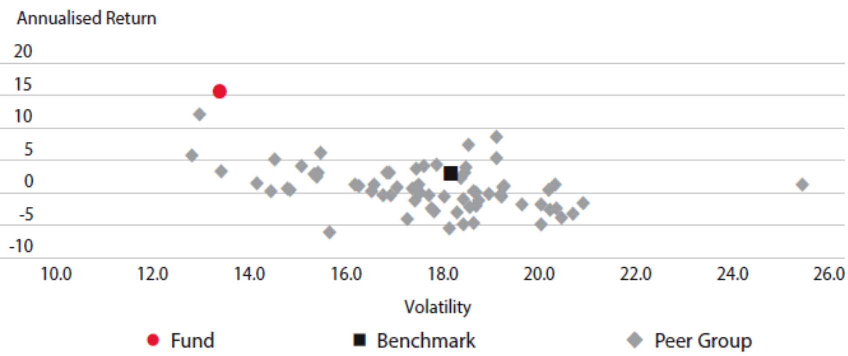
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2014	-4.34	4.03	1.50										
2013	3.93	1.78	0.35	4.57	-0.53	-4.95	1.87	-2.24	5.07	4.15	-0.56	-0.25	13.45
2012	8.12	6.54	1.92	3.20	-7.67	3.84	6.72	1.92	6.36	1.97	2.76	3.63	45.90
2011	-2.68	-1.46	2.55	3.90	2.59	0.60	3.56	-6.06	-12.80	10.62	-3.52	1.79	-3.96

RISK ANALYSIS

Risk Metrics	Fund (%)
Tracking Error (% pa)	6.6
Beta	0.8
Alpha (%)	13.27
Volatility (%)	13.42

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 31.03.14

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

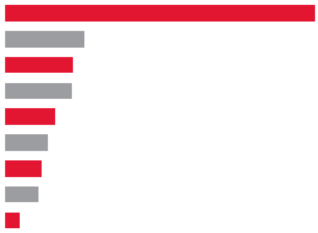
Cheung Kong Holdings	6.9
Hutchison Whampoa Ltd	4.7
The Link REIT	4.3
SK Telecom Co Ltd	3.7
Zhejiang Expressway	3.1
Total Number of Holdings	46

Portfolio Financial Ratios

Predicted Price/Earnings Ratio	11.0x
Predicted Return on Equity (%)	14.1
Predicted Dividend Yield (%)	4.6

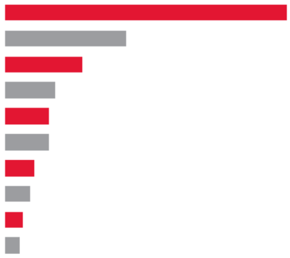
Thematic Breakdown (%)

Core Infrastructure	44.5
Quality Financials	11.4
Real Estate	9.6
Asian Consumer	9.5
Cash	7.1
Retail Shopping Mall	6.1
Energy	5.1
Asian Export Brand	4.7
Niche Tech	2.0



Geographical Breakdown (%)

Hong Kong	40.2
China	17.2
Korea	10.9
Cash	7.1
Singapore	6.3
India	6.2
Australia	4.2
Thailand	3.6
Indonesia	2.4
Malaysia	2.0



FUND PARTICULARS

Fund Facts

Fund Size USD	792.3m
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	165.01
B USD	Unhedged	Distributing	B4QVD94	IE00B4QVD949	141.72
C GBP	Hedged	Distributing	B4Q6DB1	IE00B4Q6DB12	141.97
D SGD	Hedged	Distributing	B4NFJT1	IE00B4NFJT16	135.92

*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	130.23
Y GBP	Hedged	Distributing	B4TRL17	IE00B4TRL175	130.69
Z SGD	Hedged	Distributing	B6WDYZ1	IE00B6WDYZ18	129.95

* 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	98.58

* 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 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

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