PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Equity Income Fund

Quarterly Investment Report

30 June 2014

FOR PROFESSIONAL INVESTORS ONLY

LIPPER
FUND AWARDS 2014
UNITED KINGDOM

Q2 2014 Review & Outlook

2Q14 Report

In 2Q14 the fund returned 8.6% compared to a market return of 6.3%. This outperformance was achieved with a low beta portfolio and a cash position which averaged 12%, implying that the alpha of the invested portion of the portfolio was more than 400bps during the quarter. This strength was not led by any one country or sector in particular, although Hong Kong and China provided the bulk of returns owing to their significant weighting in the portfolio. Also of help was the lack of losing positions - only two stocks detracted more than 10bps from NAV.

Cheung Kong Holdings and **Hutchison Whampoa** deserve a special mention as they contributed almost 20% of the total return during the quarter. We have begun to reduce the position in **Cheung Kong** as it now has less potential upside following a positive return of nearly 50% over the past 12 months. However, we still think that the risk / return potential for the group is excellent.

Our biggest error of the quarter was the premature sale of our Indian portfolio. Owing to a mixture of concerns over valuations and caution about the bullish market sentiment going into the elections, we exited all of our Indian positions shortly before the election results. However, following Modi's landslide election victory, the positions we sold went on to rally sharply and we estimate that this cost us 50 to 100 bps in performance. In honesty, our decision to sell was driven more by emotional rather than rational factors. The Indian stocks we owned were cyclical and therefore our confidence in these positions was always going to be lower. They had performed well and so we fell prey to the "disposition effect"[1] and allowed a view on the elections to enter the investment process. On a purely logical basis we should have ignored these feelings and continued to own the stocks. Buying and selling always involves a mixture of judgement as well as pure quantitative analysis but in this case we believe we would not have made the same decision had cooler heads prevailed. Such is investment – even when we are aware of our own behavioural weaknesses as investors it is not always possible to control them.

Valuations now compared to valuations at the fund's inception

In the table below we have set out how the stocks we own today are valued on a dividend yield basis compared to where those same stocks traded at the inception of the fund in December 2010[2]. As a reference we also look at how Asian and global markets have changed and the major conventional and index linked government bond market yields have moved over the same period.

This shows that on average our portfolio positions have yields that are 40bps *higher* than they were in December 2010, whereas both US and UK government bonds offer yields that are 70-90bps *lower* than they were at the time. Although it could well be argued that the current levels of bond yields are unsustainable, it does perhaps highlight that there is a degree of protection built into the

[1] The **disposition effect** is an anomaly discovered in behavioural finance. It relates to the tendency of investors to sell shares whose price has increased, while keeping assets that have dropped in value (source: Wikipedia)
[2] Note that this analysis looks at how the *current* portfolio is valued relative to where those same stocks were valued when the fund was launched. As such, we can only analyse those stocks that were listed or had forecasts in December 2010. The reason for doing this is that it more accurately shows what the change in rating has been over that period. We are not considering the *actual* portfolio that we owned in 2010.

portfolio as the yield gap between dividend yields and bond yields is 110-130bps higher than it was at the inception of the fund.

	December 2010	June 2014	Difference
Average yield	4.5%	4.9%	+0.4%
MXAPJ	3.1%	3.3%	+0.2%
MSCI World	2.6%	2.6%	+0.0%
US 10 year index linked	1.0%	0.3%	-0.7%
US 10 year conventional	3.3%	2.5%	-0.8%
UK 10 year index linked	3.4%	2.7%	-0.7%
UK 10 year conventional	0.6%	-0.3%	-0.9%

Exited positions

India

As mentioned, we exited our entire Indian portfolio (**Coal India**, **Cairn Energy**, **IRB Infrastructure** and **Indiabulls Housing Finance**) during the quarter on a mixture of reduced valuation upside, concerns over cyclical risks and sentiment going into the election. This was a mistake and one that should not have been made. That said, we believe the current valuations are far too sanguine about the challenges that lie ahead for the government. Although Modi has a powerful mandate for change, it will be instructive to see if the various interest groups, including consumers, are willing to put their hands into their pockets to pay for these changes such as increasing power prices, deregulating diesel prices). That said, do not confuse this with cynicism about the longer term outlook in India where we are in agreement with the bulls that this could be a highly significant turning point for the market. However, just like the Philippines where we can be very bullish on a market but not own any stocks there, we need to find the right combination of asset quality, management and valuation before we increase our weighting again.

Hong Kong/China

As part of an effort to upgrade the portfolio we exited the following names

- **CNOOC** (poor results and lack of confidence that management are in control of their destiny)
- **Guangshen Railway** (a change of view in the likely ability of the company to increase prices)
- **Shun Tak** (reducing Macau exposure plus failure of company to pay a dividend)

These could all be classified as mistakes. We were not unlucky in losing money, rather our original research was flawed in some way for these positions and the only saving grace is that only CNOOC cost the fund a meaningful amount of capital (approximately 40bps of NAV). CNOOC highlights a particular issue with regards to investing in China where one part of the business is high growth, highly profitable and cash generative and another is low growth, high cost and cash consuming. It is a question of judgement as to whether the poor business will drag down the good business or not, which typically involves an assessment of how financially aware management are. Our mistake with **CNOOC** was not understanding the US acquisition in enough detail and failing to understand the destructive impact that it could have on the overall valuation.

New positions

Travelsky Technology

We discussed this position in a recent monthly note. It is performing well and we remain comfortable with the position, accepting that the risk level of the position remains higher than average owing to the relatively opaque nature of the business and the importance of the market structure remaining favourable. Nonetheless, having this annuity like income stream correlated to increasing China travel demand is attractive and the valuation of these cash flows is very conservative. We are always searching for businesses in Asia which have “financial scalability”, meaning that they can increase profits without having to increase capital. **Travelsky** is potentially such a business. Every time a flight is booked in China, **Travelsky** charges a fee, yet it does not need to increase capital as demand for flights in China grows and **Travelsky** handles more flight bookings. This means that the company can grow as rapidly as the overall market but, unlike airlines for example, it does not need to invest more capital to do so.

Genesis Energy

This was the last of the New Zealand power companies to be listed as part of the government’s privatisation programme. In the months running up to the **Genesis** IPO the sector had de-rated for two main reasons:

- The market had been forced to digest a large amount of paper coming to the market owing to the significant size of the privatisation programme
- The Labour opposition party’s plan to intervene in the power market to tax “excess” profitability (sound familiar?) should they win the election in September

As a result of this, the IPO was priced at a very attractive dividend yield of 10%. Since then, the stock has rallied sharply. It currently offers close to a 9% yield, which we expect to increase in real terms over the medium term.

True Telecommunications Growth Infrastructure Fund (TRUEIF)

TRUEIF owns mobile phone towers, fibre backhaul transmission and a nationwide fibre backbone network which it leases to **TRUE Corp**, the manager of the fund. It is a relatively low risk business as most of the revenues are contractually agreed and the main risk is the credit rating of **TRUE Corp** which, up until recently, had been relatively stretched due to a high capex programme and low levels of profitability. In fact, the reason that **TRUEIF** exists is that **TRUE Corp** was forced to sell off some of its assets to avoid becoming financially distressed. The market viewed the yield on **TRUIEF** at 9% to be relatively unattractive given that the approximate rate that **TRUE Corp** would have had to have paid if it had wanted to raise debt instead of injecting their assets into a fund. However, this assessment fails to take into account the credit enhancement that fund holders achieve by actually owning the assets. As the towers are essential to the business, companies are very reluctant to default on these obligations. Indeed, we saw mobile phone companies in Indonesia default on debt during the global financial crisis but continue to pay their mobile tower leases as these businesses can run without paying their bond holders but they cannot operate if their mobile networks cease to function. Since we purchased the position, **TRUE Corp**, the parent company, has conducted a large rights issue and simultaneously sold a stake to **China Mobile**, which effectively underwrites the company from a credit standpoint. In light of this, we believe the risk premium attached to **TRUEIF** will gradually reduce.

MTR Corp

MTR Corporation is a mass transit operator owned by the Hong Kong government. It has two main businesses:

- It operates railway lines in Hong Kong, China and overseas, including the London Overground
- It also owns and develops property projects, typically those connected with the railway stations it runs

The attraction of the business is that it combines a very strong Hong Kong infrastructure business, which has built in inflation protection, with interesting growth options in China and a very high quality investment property portfolio. The company is very committed to a progressive dividend policy.

The stock has suffered from a misunderstanding of its property business. In Hong Kong, the government has a unique way of structuring railway developments in order to help ensure **MTR** is financially robust enough to build and operate its Hong Kong railway assets. When **MTR** wins a bid for a new station the Hong Kong government *gives* the company the land around the station. There are several important points to highlight here. Firstly, the fact that **MTR** is given the land means that the company does not take on any land banking price risk - the land premium is fixed and paid for by the developers. In turn, **MTR's** carrying cost for keeping the land on its balance sheet is low. Importantly, this structure allows **MTR** to be very flexible as to when it releases projects for tender, so it can wait until conditions are good. Further, when it releases projects for tender **MTR** has a choice between selling the land upfront and receiving cash immediately, or allowing a property company to develop the land and then splitting the profits with the developer when the assets are sold in the future. **MTR** generally opts for a mixture of upfront cash from land sales and profit share with the developers in the future. Management can use some of the upfront cash to fund capital expenditure in **MTR's** infrastructure business. Alternatively, when management are particularly bullish on property prices, they can opt to sell less land upfront and monetise more of the land via profit sharing with the developers. **The current weak property market in Hong Kong means that this division is not generating significant value but it retains large optionality if the market improves. It is worth noting that after the government MTR is the biggest landowner in Hong Kong.**

Man Wah Holdings

Man Wah is not a typical holding for us. It is a sofa manufacturer, specialising in recliner products. Beginning as a typical "no brand / low cost" China manufacturer it has steadily improved its product quality and sales efforts so that it is now a formidable global competitor with strong operations in US, Europe and China. Quick to realise that branding means very little in this area of the market, it focuses on producing high quality, low priced products. A key aspect of **Man Wah's** competitive edge is its proprietary recliner mechanism which needs to be reliable, quiet, smooth, safe and able to handle large amounts of weight. Unlike its competitors, it has developed its own mechanisms, enabling the company to capture more margin.

In the US market, **Man Wah's** major competitors are either going bankrupt or losing market share. In China the company is five times bigger than its next competitor. Through a combination of its leading market position and scale, plus its low cost structure, **Man Wah** can price its products at a 25% discount to the market and still enjoy very high margins.

Admittedly, we do have some concerns about the governance of the company given management's decision to "maximise the value of the company's cash" by investing in Chinese wealth management products. We have questioned management on this point and encouraged them to pay excess cash back to shareholders instead. Time will tell if the company's financial management improves to match its operational management. The company is in a net cash position, enjoys a 20%+ ROE, pays a 4% dividend yield and trades on 10x earnings.

eMemory Technology

eMemory is, as far as we know, the only "pure Intellectual Property (IP)" company in Taiwan and perhaps the whole of Asia. Being a "pure IP" company means that the company does not actually produce anything itself, instead customers licence its technology and pay a licence fee and a royalty fee to use its designs in their chips. It is very similar in this regard to the UK company, **ARM. It is a high risk / high potential return company and therefore is sized as a 1-1.5% position.**

eMemory's technology relates to non-volatile memory (NVM) which is a basic building block of the semiconductor industry. Non-volatile means that it "remembers" information even when it is not receiving any power as opposed to volatile memory, such as DRAM, which needs to be constantly refreshed in order to retain data. What **eMemory** has done is develop a NVM solution which can be "fabricated concurrently with the logic circuit fabrication with no extra fabrication mask". This makes it cheaper, simpler, smaller and lighter to produce as memory and logic chips no longer need to be separated. In simple terms it is a "built in" NVM function as opposed to having to add one on later. Currently 5% of wafers use **eMemory's** process but this is expected to rise to 20% over the next several years.

The company is exposed to several high growth areas in the semiconductor market including:

- **Smartphones** – there was only one chip in the iPhone 5 that used **eMemory's** technology but this will likely increase to three chips for the iPhone 6
- **Near field communication (NFC)** – as more people use smartphones for payments, the need for NFC to facilitate mobile payments will increase; all three approaches to NFC require **eMemory** technology
- **Fingerprint sensors**
- **Wearable devices**
- **"Internet of Things"**

Depending on how fast the overall market grows and how quickly **eMemory** can penetrate the market, sales growth is expected to be 30% to 50% a year over the next 5 years.

What makes **e-Memory** particularly attractive is that it has a very profitable, cash flow generative business that can grow rapidly without the need for capital. If its revenue goes up by 10x then it does not need to build more factories or hire more staff to do so, it just collects more cash. As a result, the company pays out >100% of earnings as dividends. A combination of very high growth, very low capital intensity and a high payout ratio means that the theoretical P/E that the company should trade at is substantial.

A note on Pakistan investments

During the quarter we have initiated two new positions in Pakistan, a country which we have not invested in since the inception of the fund. Before we go into detail on these new holdings, a brief comment on our decision to invest in this market.

Early investors in PAEIF will remember that we invested in a Cambodian company called **Nagacorp** before it became well known by investors. At the time, a big question concerned the political risk in Cambodia and whether that market was investable. As a result of these concerns, the stock traded at a 14% dividend yield and a P/E of 5x earnings. Now, three years later, the stock trades at a premium to the Macau stocks and very little attention is paid to the political risk. Although Pakistan is of course very different, we are happy to have small amounts of the portfolio in markets which are perceived to have very high political risk if we feel the risk / return profile of the stocks that we own justifies it.

Hub Power Company

Hub Power Company (**HUBCO**) operates an oil fired power station in Pakistan. As mentioned, Pakistan has a relatively high risk profile and is very dependent on foreign aid to avoid a balance of payments crisis. Owing to this, the credit risk on the Kingdom's US dollar bonds trades at around 750bps, which is in line with the Ukraine. Somewhat surprisingly, it is not the security issues that keep investors out but the corruption and power shortages that concern them. It is estimated that power shortages cost the country two percentage points of annual GDP growth. The need for Pakistan to improve the power industry means that the government (and multinational institutions such as the World Bank) are keen to lend to companies that are building fuel efficient power stations in Pakistan. This bodes well for **HUBCO** returns.

HUBCO's business model is relatively simple. It earns a guaranteed USD return on its power assets and can pass on all of its fuel costs via higher tariffs. Given that its customer is the government, its business can be thought of as an inflation linked USD government bond. With a current dividend yield of 13% this is a high risk / high return investment.

United Bank Ltd

United Bank is a high ROE (+25%) and – in the context of Pakistan – a low risk bank, yet it trades on a P/E multiple of just 8x with an 8% dividend yield. We recently participated in the placement by the Pakistan Government of its residual 19.8% stake in the bank which was conducted as part of the government's privatisation programme. The majority owner is Bestway Group of the UK.

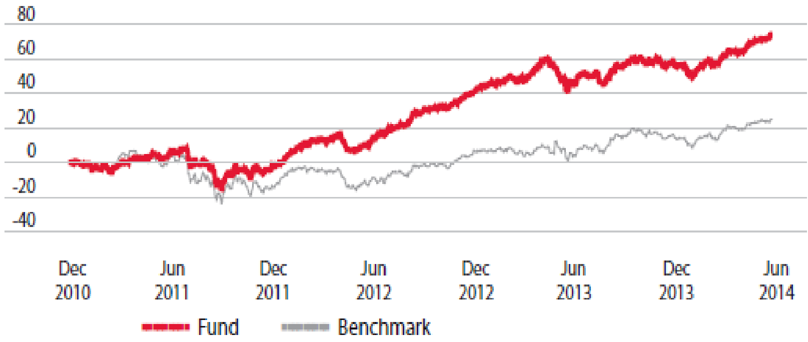
PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 30.06.2014

Class 1*	B USD	Benchmark **
1 Month	2.14	1.73
3 Months	8.55	6.29
Year to Date	9.64	7.35
2013	13.45	3.95
2012	45.90	22.96
2011	-3.96	-15.20
Since Launch+	74.29	17.00
Annualised since Inception	17.21	4.59

* 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 (%)

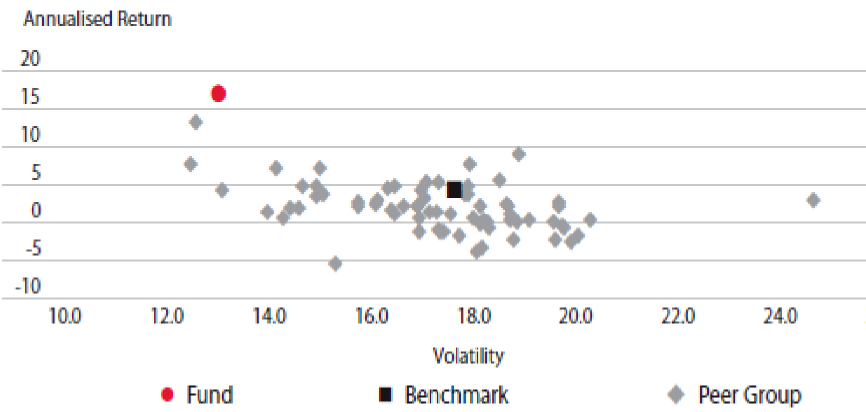
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2014	-4.34	4.03	1.50	1.58	4.63	2.14							
2013	3.93	1.78	0.35	4.57	-0.53	-4.95	1.87	-2.24	5.07	4.15	-0.56	-0.25	13.45
2012	8.12	6.54	1.92	3.20	-7.67	3.84	6.72	1.92	6.36	1.97	2.76	3.63	45.90
2011	-2.68	-1.46	2.55	3.90	2.59	0.60	3.56	-6.06	-12.80	10.62	-3.52	1.79	-3.96

RISK ANALYSIS

Risk Metrics	Fund (%)
Tracking Error (% pa)	6.8
Beta	0.81
Alpha (%)	13.5
Volatility (%)	13.0

Source: Bloomberg
Since inception: B 31.12.2010

Risk Adjusted Performance - Class B USD (%)



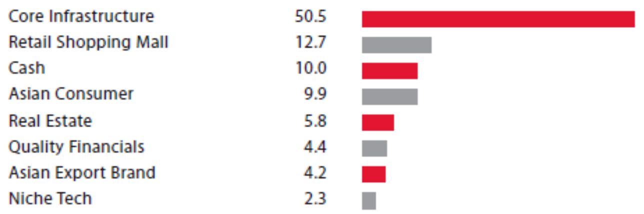
Source: Bloomberg. Annualised return and 1 year volatility versus the peer group (o| ended offshore Asia Pacific ex Japan Equity Fund Index), 31.12.10 to 30.06.14

THEMATIC & GEOGRAPHICAL BREAKDOWN

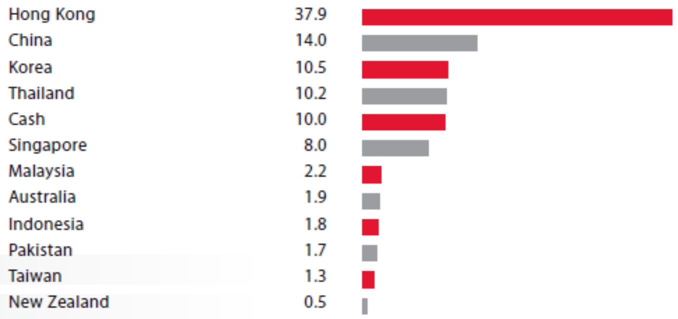
Top 5 Holdings (%)

Cheung Kong Holdings	5.8
Hutchison Whampoa Ltd	4.8
Link REIT	3.9
SK Telecom Co Ltd	3.5
Television Broadcasts Ltd	3.3
Total Number of Holdings	45

Thematic Breakdown (%)



Geographical Breakdown (%)



Portfolio Financial Ratios

Predicted Price/Earnings Ratio	12.2x
Predicted Return on Equity (%)	13.8
Predicted Dividend Yield (%)	4.7

All data as at 30.06.14. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size USD	851.4m
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	179.12
B USD	Unhedged	Distributing	B4QVD94	IE00B4QVD949	153.83
C GBP	Hedged	Distributing	B4Q6DB1	IE00B4Q6DB12	154.06
D SGD	Hedged	Distributing	B4NFJT1	IE00B4NFJT16	147.45

*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	141.27
Y GBP	Hedged	Distributing	B4TRL17	IE00B4TRL175	141.86
Z SGD	Hedged	Distributing	B6WDYZ1	IE00B6WDYZ18	140.90

* 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	104.55

* 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

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

Nazinna Douglas
Tel: +44 (0)20 7493 1331
Fax: +44 (0)20 7493 1770
Email: nazinna.douglas@prusikim.com

Prusik Investment Management LLP
1st Floor 46 Hays Mews
London W1J 5QD

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