PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Equity Income Fund

Quarterly Investment Report

31 December 2013

FOR PROFESSIONAL INVESTORS ONLY

4Q13 Review and Outlook

In the fourth quarter the fund returned 3.3% compared to a market return of 2.4%. The outperformance was driven by significant moves in larger holdings such as **Hutchison Whampoa**, **Beijing Capital Airport** and **Tata Motor** preference shares. The losing positions included **KT Corp**, **CNOOC** and **Huaneng Power**.

2013 Review

For 2013 overall, the fund returned 13.5% compared to a market return of 4.0%. Although the full year performance was within our target range of 5-10%, most of the alpha was achieved in the first four months of the year when the environment for equity income investing was particularly favourable. During this period almost all income stocks did well. However, since the advent of "tapering" in May it was considerably more difficult to generate alpha, although we did still generate performance very close to our 5-10% target range for May to December. Please see the table below for more details.

	PAEIF	MXAPJ	Outperformance	Outperformance (annualised)
Jan – Apr 2013	+11.0%	+4.6%	+6.4%	+22.6%
May – Dec 2013	+2.2%	-0.7%	+2.9%	+4.3%

Country contribution

One of the key aspects of our approach is the premise that it is possible to generate attractive returns in a directionless market. The table overleaf, which breaks down the fund's 2013 performance by geography, illustrates this approach in action. For example, we would agree with the consensus view that the Korean economy looks terrible and that many listed companies there have no interest in minority shareholders. However, we had a large weighting in Korea in 2013 and it was the fund's top contributor to performance, despite subdued returns for the Korean market overall. By identifying a handful of companies that have strong franchises, high growth and shareholder oriented management we can still generate good returns even if the overall market goes nowhere.

Other reflections on performance last year include that our alpha generation in China was much improved compared to the past 2 years and that, while we outperformed in Hong Kong, much of this was driven by just one stock, **Hutchison Whampoa**.

In India and Australia the need to improve our stock picking continues. India was a slight detractor from performance in 2013, although we would stress that the stocks we own here are mainly deep value cyclicals (**Coal India** and **Cairn Energy**), which was not an area that performed well last year. For Australia our struggle to generate alpha continues, which is one of the reasons why we do not have much capital employed in this market.

	Jan 13 % of NAV	Dec 13 % of NAV	Contribution (bps)	Total Return (USD)	Local Index return (USD)
Korea	17.8%	11.0%	+457	+30.7%	+2.9%
Hong Kong	19.8%	30.8%	+308	+13.1%	+10.6%
China	9.8%	17.2%	+237	+17.9%	+3.8%
Taiwan	4.7%	0%	+100	+76.1%	+9.8%
Singapore	9.9%	7.7%	+96	+7.7%	+0.4%
Indonesia	3.9%	2.4%	+55	-1.0%	-24.3%
Malaysia	4.0%	2.1%	+18	-0.4%	+8.0%
Thailand	15.0%	3.6%	-11	-7.3%	-14.3%
India	2.5%	6.2%	-17	-11.5%	-3.9%
Australia	0%	2.2%	-18	+1.5%	+4.2%

PAIEF 2.0

In our 3Q13 report we outlined some subtle changes we intended to make to our investment process, which included removing the minimum yield requirement, increasing the maximum position size and allowing the cash level to rise to 10-15%. So far these modifications have been very helpful in improving returns. When we implemented these changes we stated that we believed we were giving up "tens of basis points of short term yield for hundreds of basis points of potential outperformance". **We calculate that the changes added around 200bps (820bps annualised) to performance in 4Q13**[1], thus, so far, it seems that these small adjustments have been working.

3 Year Review

For the 3 year period ending December 2013 the fund's performance has been strong, outperforming the index by almost 14% on an annualised basis. This is ahead of our target range of 5-10% of annualised outperformance.

	PAEIF	MXAPJ	Outperformance
3 year return	+59.0%	+8.8%	+50.2%
3 year return (annualised)	+16.7%	+2.9%	+13.8%

[1] Comparing actual performance during 4Q 2013 to simulated performance using portfolio held on 30th June 2013

During this period the environment for our style of investing has been extremely fertile and so it's likely that our alpha for the next 3 years will be somewhat lower. However, from a bottom up perspective, we see as much upside for our portfolio today as we did 3 years ago. The portfolio is currently trading on a P/E of 11x forward earnings, while we continue to think that a mid teens P/E multiple is more reflective of the underlying holdings' true value. A low double digit portfolio multiple suggests the market is not pricing in any earnings growth for the fund for the next 5 years which, while not impossible, we believe is too pessimistic. Although it is harder today to find good ideas than it was 3 years ago, we think significant market inefficiencies remain.

Introduction of front end charge

In December we introduced a front end charge for reasons detailed in our November note to clients. We are pleased to say that this front end charge has had the desired effect of reducing inflows to almost zero and, therefore, allowing the fund to gradually decline as the natural attrition of the portfolio continues. Partly as a result of lower inflows we have been able to reduce our cash level to a more reasonable 3-4% at the time of writing.

Turnover

Turnover was approximately 40% during the year - we added 22 new positions and exited 20 existing positions. This level of turnover was lower than 2012 owing to the larger fund size (it takes longer to exit and enter positions) and the lower alpha achieved (turnover tends to be higher when stocks rise quickly and need to be replaced with more attractively valued assets). We assume that we will probably have to find 20-25 new investment ideas in 2014, which equates to around 2 per month.

Mistakes

In previous quarterlies we have talked about the fact that we regard the management of mistakes to be one of the key factors that determines success or failure in fund management. Often, 'good' fund management is regarded as being equivalent to 'good' stock picking, that is, if you can pick good stocks you can generate good returns. We do not believe that this is the case. As we see it the real skill in fund management is **avoiding**, **identifying**, **dealing with** and **learning from mistakes**.

So, what do we mean by a mistake? We would define a mistake in several ways:

- A position that loses money
- A position that underperforms the market
- Our original analysis was incorrect

Out of these three definitions, recognising when your original analysis is flawed is the most difficult to identify; however, when done correctly it is often the most accurate at alerting us to genuine errors.

In practice, we use a combination of all three definitions. We balance the practical and the measurable ("did it lose money?") and the intellectual ("was our original thesis wrong?") to reveal when and where we are making a mistake.

Overall, it is important to remember that mistakes will always happen and that the ultimate assessment of a mistake should be according to the process, not the outcome.

Part 1. Avoiding Mistakes

We attempt to avoid mistakes by applying the following processes. Firstly, we try and improve the odds by using the following checklist:

- **Valuation**: Try to avoid overpaying for stocks. Buy stocks that are close to 'worst case' valuations so that even if we are wrong the loss of capital should be modest.
- **Business risk**: Focus on stocks with simple, cash generating businesses that have high returns, high barriers to entry and strong balance sheets.
- **Cyclical risk**: Avoid stocks that are dependent on the economic cycle.
- **Balance sheet risk**: Avoid stocks with too much debt.
- **Stress testing analysis:** Explore scenarios where we might lose money in a stock and consider what might trigger these scenarios. For example, if China has a large chaotic banking and political collapse how would this impact a company's fundamentals and how should we factor this in to what we are willing to pay for a stock?

In addition to the above, quantitative data can be a useful way of avoiding mistakes, particularly value traps and credit issues. We use systems that monitor:

- **Earnings and price momentum**
- **Earnings quality**
- **Major shareholder sales of stock**
- **Credit risk** (including proprietary "text based" models which use a "big data" approach to analyse annual reports, conference call transcripts and broker research to predict which firms are likely to face financial distress)

Part 2. Identifying Mistakes

No matter how closely we follow the steps above, we will still make mistakes and so we need a mechanism for identifying errors that allows us to deal with them before they damage the overall portfolio. Importantly, one of the key advantages of working at a boutique fund management company is that we only run one fund and spend virtually all our time looking at that fund. Also, as it is a relatively concentrated portfolio of 40-50 stocks we will generally only have 5-10 stocks at any one time that require particular monitoring because there are aspects that are troubling us. Potential concerns can be anything from waning earnings momentum to a proposed acquisition to structural change in the industry which looks set to change the original investment thesis. We also have other tools and processes in place to help identify mistakes:

- **Price**: As we see it, the stock market provides a 'free mistake identification service' via the stock price. If a stock price is falling dramatically it can be a good indicator that you have not made a good decision. Although it is possible for stocks to fall a long way without the original investment thesis being challenged, we generally believe that this is not the case. Our default position is that if a stock price falls substantially then it is more likely that we have made a mistake rather than the stock is now much better value.

This places us at odds with many value managers but we believe it can be dangerous to think we always know more than the person selling a stock, especially in Asia.

- **Industry analysis focusing on structural change**
- **Industry analysis focusing on the regulatory environment**
- **Frequent meetings with management**

Part 3. Dealing with Mistakes

It will generally be the case that somewhere between 10% and 25% of all positions we buy will be mistakes. This means that in a portfolio of 40 stocks around 5-10 positions will be errors which need to be dealt with. The question is how best to deal with these positions. Normally, a rapid exit is a good idea. If you have realised it is a mistake, there is a good chance that others have also realised the same thing and so it is often best to exit before others.

Part 4. Learning from Mistakes

This is the only positive side of the process. Making mistakes is an essential part of the investment process and is the only way to improve performance. It helps fund managers understand their own weaknesses and reduces the likelihood of future mistakes.

If this sounds obvious, why then do fund managers spend so little time thinking about mistakes? Our view is that they prefer to think about stocks that are doing well as it makes them feel better. Looking at 'difficult' investments and in turn being forced to admit that a bad investment decision has been made creates cognitive dissonance where the fund manager is forced to admit that he or she is not as clever as they think they are. This is not a pleasant mental state to be in and it is far easier for them to spend time talking to their favourite companies and staring at "bottom left to top right" share price charts.

Making mistakes is an unavoidable part of the investment process. Spending time developing a process which allows us to avoid, deal with and learn from mistakes is essential. This is something that we constantly focus on improving and adapting to ensure that we minimise the impact that future mistakes have on the portfolio.

New Additions To The Portfolio in 4Q13

We added 3 new positions to the portfolio in 4Q13: **Power Assets**, **Goodpack** and **Asia Pay Television Trust**.

<u>**Power Assets**</u>

Power Assets is a Hong Kong based utility with electrical and gas assets in several countries including Hong Kong, Australia and the UK. Its original business was the generation, transmission and distribution of power to Hong Kong Island and Lamma Island. Historically, the Hong Kong electricity business had been one of the most profitable and stable businesses in the world. Operating under the so called 'Scheme of Control' it had very high guaranteed rates of returns. However, these guaranteed rates of return have been reduced over time (currently 9.99%) and, given lower interest rates, are expected to be reduced further at the next rebalancing. In a bid to protect the company from falling returns and profitability, management have been diversifying the business by investing in other international power markets. With management's recent decision to spin off the original Hong Kong electricity business as a business trust and recycle the capital raised to buy distressed assets in the European market, this process looks set to continue. According to our numbers, the business is worth around HK$70 per share compared to a current share price of HK$60. We believe the downside should be capped in the range of HK$50-55 or 10-11x forward earnings, similar to the levels it traded at in the global financial crisis.

We like the business for the following reasons:

- The company's earnings are regulated, predictable and non-cyclical.
- We can buy the company at a good price with an asymmetric risk / reward profile.
- It is a company that is using the current investor myopia over short term dividend yields to sell an ex-growth asset for more than it is worth to reinvest in more productive assets. This concept of investing in companies that are able to arbitrage short term investor sentiment to create "real value" is a recurrent theme in our portfolio.
- Post the deal, the percentage of assets exposed to the deteriorating Hong Kong regulatory regime is much reduced.
- There is an embedded put option in the stock on the basis that if there is a substantial market dislocation *after* they list Hong Kong Electric but *before* management invest in Europe, then they will have a very cashed up balance sheet to use for their and shareholders' benefit.

<u>Goodpack</u>

Goodpack is one of the world's largest owners of 'intermediate bulk containers' (IBCs). An IBC is a steel container measuring approximately 1.5m by 1.5m by 1.5m in size. It weighs 120kgs and costs around $250 to produce. These IBCs are leased to the rubber, tyre, food and auto industry to transport intermediate goods from suppliers (e.g. rubber producers) to customers (e.g. tyre manufacturers). Unlike pallets, IBCs can be stacked and folded down to save space and, when full, are designed to fit exactly 20 of them into standard sized containers used by shipping companies.

The company was started in 1991 by David Lam. Lam came up with the idea for IBCs on a visit to Thailand. During this time he saw wooden crates containing rubber bales fall from a lorry and then be painstakingly picked over by workers trying to remove the wood splinters from the rubber. At this point it became clear to him that the industry needed to move away from wooden boxes to transport these kinds of materials and goods.

Business model

Goodpack's business model is simple yet effective. The company delivers IBCs to its customers who then load the IBCs up and deliver them to their own clients (e.g. tyre companies). When the IBCs have been unloaded **Goodpack** picks them up from its customer's clients.

Goodpack charges its customers in two ways. Firstly, there is a fee for the distance **Goodpack** travels to drop off and collect the IBCs. Secondly, there is a fee for the distance over which the customers use the IBCs to transport their goods to their clients. On average customers pay US$0.25 per trip per container and pricing reviews are conducted every 3-5 years so that all cost increases are passed onto the customer.

Customers using **Goodpack's** service benefit from not having to buy, manage and dispose of their own crates, which generates cost savings. This system is also more environmentally friendly.

Why is this business model so attractive?

- **High barriers to entry**: Replicating **Goodpack's** IBC pool would require a significant amount of capital. Management estimate that it would cost US$750m to buy enough crates to match **Goodpack's** scale.
- **High quality, differentiated product**: There is no superior alternative to using IBCs – wood and cardboard crates are simply not acceptable to customers. Further, IBCs are the cheapest option for customers because customers only pay on a per trip basis. Finally, **Goodpack's** IBCs are 'nestable', meaning that they can be stacked and transported efficiently when empty.
- **Sticky customer base**: **Goodpack's** customers need to design their systems to fit and work with **Goodpack's** IBCs (e.g. robots need to be reprogrammed to stack **Goodpack's** containers) and so once they have signed up customers rarely switch to an alternative supplier.
- **High ROCE**: As **Goodpack's** pool of IBCs in circulation increases the pool becomes more valuable. The bigger the network, the less **Goodpack** needs to ship empty containers back from customers and so the higher the company's asset turns and ROCE. **Goodpack** can also increase returns further by raising prices. Typically the company depreciates its IBCs over 15 years but is able to use them for over 20 years. This also helps ensure high ROCE.

Market Size and Share

Goodpack's addressable market is around US$500m, with two thirds of the market made up of customers supplying synthetic rubber and one third of customers coming from the natural rubber market. From here the overall market is expected to grow by 5-10% pa. **Goodpack** is the market leader with around 35% market share.

The upside option for **Goodpack** is if it can successfully penetrate the auto parts industry. The addressable market for the auto parts industry is huge at US$2bn, or four times the size of **Goodpack's** core addressable market, and so successful expansion here would transform **Goodpack's** growth opportunity. **Goodpack** has 51 trials in process at the moment although it is yet to sign a major new customer to date. The company's current market share of the auto parts market is less than 1%. We believe it is only a matter of time though before a breakthrough in this market is achieved.

Financials

Goodpack is very profitable with net margins of 25% and ROE of 15-20%. Historically, operating income has been very stable, falling only slightly (5%) in the 2008-2009 downturn, and earnings have compounded at a high teens rate. Leverage is low with the company's net debt to equity ratio at 20%.

Valuation

Goodpack has an enterprise value of US$950m (US$1.70/share) compared to a replacement cost of the IBCs of US$750m (US$1.35/share). Given the high marginal value which the pool generates we do not believe the shares should trade below replacement cost. Taking into account the strength of the business we think the shares should trade on a 15-20x P/E, which would imply a price of $2.20-3.00 or 30-75% upside from our purchase of $1.70. Further upside could come from **Goodpack** successfully penetrating the auto parts market, which would lead to a step change impact on the valuation given the size of the auto parts market. The stock has a dividend yield of 3.5%.

Asia Pay Television Trust

Asia Pay Television Trust (**APTT**) is a single asset business trust which owns **Taiwan Broadband Communications**, one of the leading cable TV operators in Taiwan. In Taiwan, cable TV is preferred to free to air TV for cultural as well as weather related reasons and so historically this has proved to be a very stable, utility-like business. Content costs are low as many of the channels are dominated by locally produced soaps (premier league football does not feature highly!). There is upside potential for the business from converting subscribers to higher priced digital packages and rolling out broadband services.

APTT listed in early 2013 at S$0.97 at the peak of the equity income "bubble" and since then the shares have fallen by 25%. The stock pays a dividend of around S$0.082 so at current prices it yields just over 11%. Our estimate of the fair value for the shares is S$0.80-0.90. Should the shares trade at S$0.85 by end of 2015, then the annualised total return would be >20%, split roughly 50-50 between capital appreciation and dividend income. The key risks are competition from the internet, government driven price caps and rising interest rates in Taiwan increasing the cost of **APTT's** debt (a 200bps increase in interest rates would cut **APTT's** distributions by around 15%).

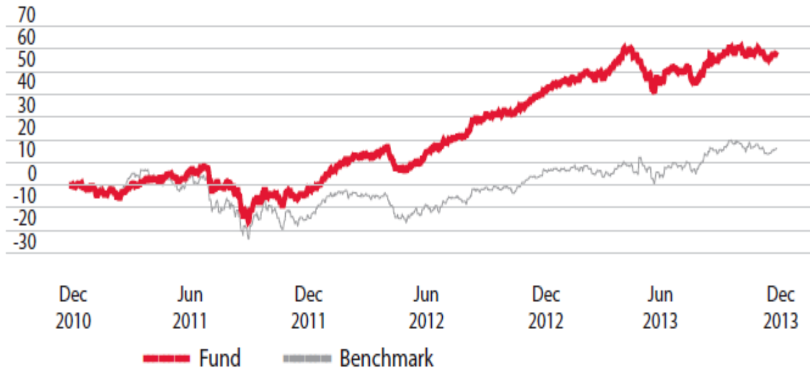
PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 31.12.2013

Class 1*	B USD	Benchmark **
1 Month	-0.25	-1.25
3 Months	3.31	2.39
Year to Date	13.45	3.95
2013	13.45	3.95
2012	45.90	22.96
2011	-3.96	-15.20
Since Launch+	53.88	6.28
Annualised since Inception	16.96	2.24

* 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 (%)

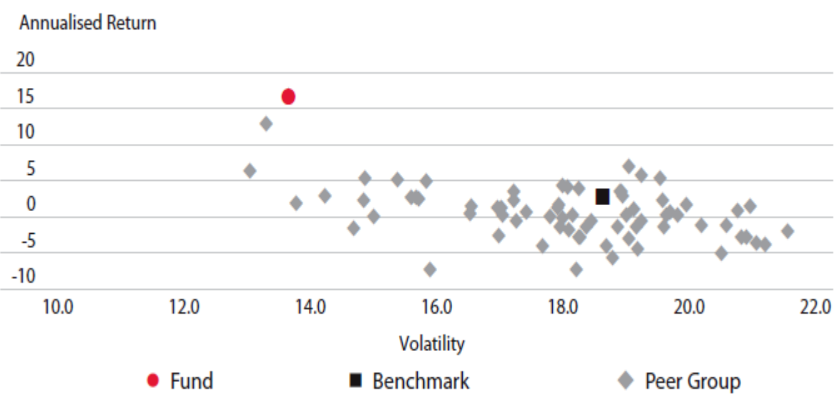
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2013	3.93	1.78	0.35	4.57	-0.53	-4.95	1.87	-2.24	5.07	4.15	-0.56	-0.25	13.45
2012	8.12	6.54	1.92	3.20	-7.67	3.84	6.72	1.92	6.36	1.97	2.76	3.63	45.90
2011	-2.68	-1.46	2.55	3.90	2.59	0.60	3.56	-6.06	-12.80	10.62	-3.52	1.79	-3.96

RISK ANALYSIS

Risk Metrics	Fund (%)
Tracking Error (% pa)	6.6
Beta	0.8
Alpha (%)	14.4
Volatility (%)	13.7

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 31.12.13

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

Cheung Kong Holdings	6.6
HSBC Holdings	5.7
Hutchison Whampoa Ltd	5.7
Beijing Capital Intl	3.3
SK Telecom Co Ltd	3.2
Total Number of Holdings	44

Portfolio Financial Ratios

Predicted Price/Earnings Ratio	10.6x
Predicted Return on Equity (%)	14.7
Predicted Dividend Yield (%)	4.1

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	915.8m
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 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	163.37
B USD	Unhedged	Distributing	B4QVD94	IE00B4QVD949	142.45
C GBP	Hedged	Distributing	B4Q6DB1	IE00B4Q6DB12	142.71
D SGD	Hedged	Distributing	B4NFJT1	IE00B4NFJT16	136.67

*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	130.91
Y GBP	Hedged	Distributing	B4TRL17	IE00B4TRL175	131.38
Z SGD	Hedged	Distributing	B6WDYZ1	IE00B6WDYZ18	130.61

* Class 2 shares were soft closed to new investors as of 30th November 2012

Class U*			SEDOL	ISIN	Month end NAV
U GBP	Unhedged	Distributing	BBP6LK6	IE00BBP6LK66	99.84

* 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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