PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Equity Income Fund

Quarterly Investment Report
31 March 2019

FOR PROFESSIONAL INVESTORS ONLY

1Q19 Review and Outlook

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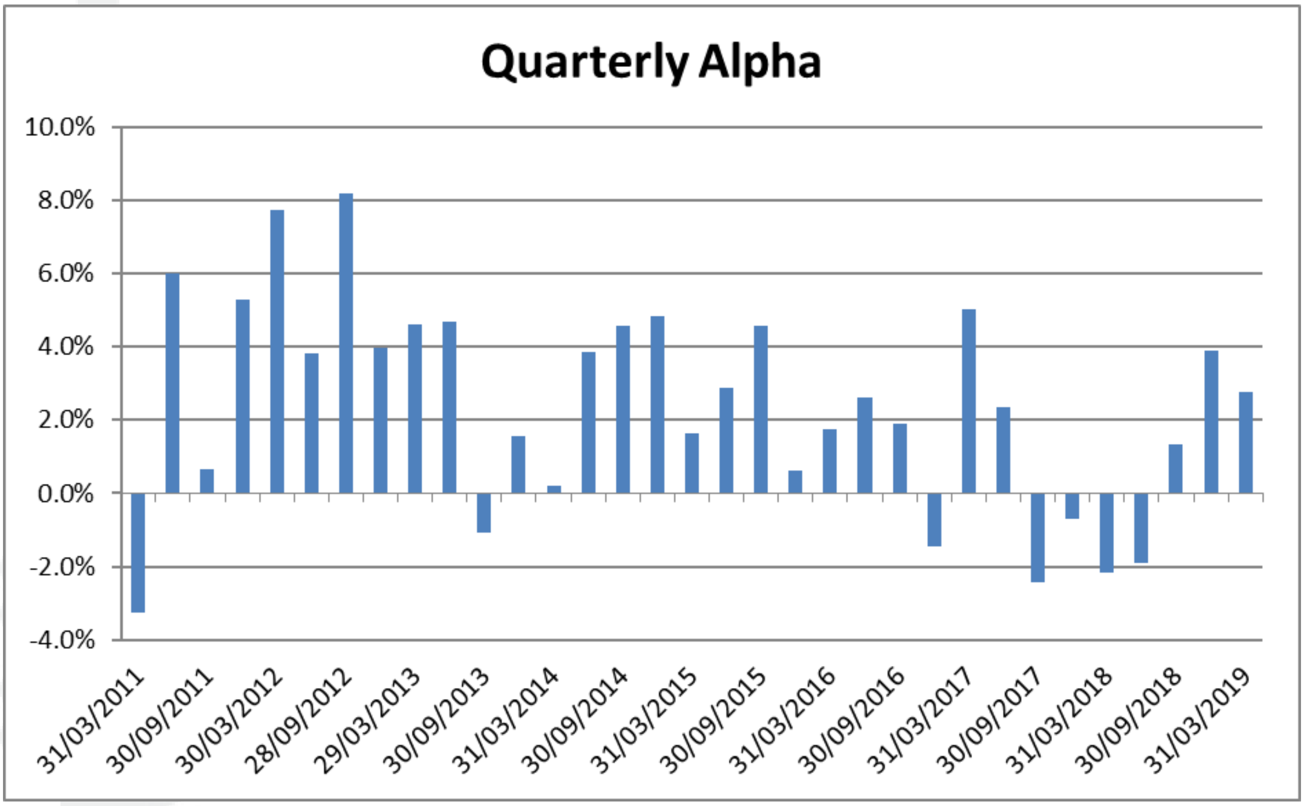
The fund rose by 11.6% in the first quarter of 2019 which was marginally ahead of the market which returned +11.5%. Despite the microscopically small outperformance, we are very pleased with the how the fund behaved given the fact that the beta of our fund is much lower than the market, implying the *alpha* this quarter was much better than the raw numbers suggest. More on this subject in the next section.

Although we don't spend that much time on attribution analysis given how concentrated our portfolio is, stock picking was generally very good in China, Australia and Korea with only India lagging. The top 3 contributors to returns were **Zhejiang Expressway**, **Wuliangye Yibin** and **Swire Pacific**. The bottom 3 contributors were **First Pacific**, **Link Net** and **Beijing Capital Airport.**

Quarterly Alpha Analysis

In the table below we show the alpha[1] on a quarterly basis since inception. The average alpha since inception has been 2.4% and over the past 5 years has been 1.8%[2].

What can be seen from the table below is how unusually poor the period between June 2017 and June 2018 was. We have had seven quarters of negative alpha since the launch of the fund of which four of those occurred in that 12-month period! We are hoping (as I'm sure are you) that this will prove to have been a temporary issue and we can return to our long-term average rate of alpha generation.



Source: Prusik/Bloomberg

[1] We assume a constant beta of 0.77 to calculate the alpha

[2] We consider the 5-year performance as the fund was "closed" to investors in November 2013 and so the assets have been very stable since that point (they were much lower in 2011/2012)

What is also interesting to note is that although the *outperformance* of PAEIF is quite dependent on the direction of the market, the *alpha* is not[3]. The table below highlights that our outperformance (which doesn't adjust for the lower beta of our portfolio) is much stronger in quarters when the markets fall as compared to when the market rises. This makes sense intuitively because as we own mainly non-cyclical, defensive companies when the market is falling, we tend to perform better than the market and vice versa when markets are rising. However, our alpha is 1.8% regardless of whether the market rises of falls. This is important as it shows our stock picking is relatively consistent and is not dependent on particular market conditions.

	Outperformance	**Alpha**
5-year average	+1.4%	+1.8%
5-year average (in quarters when MXAPJ rises)	+0.2%	+1.8%
5-year average (in quarters when MXAPJ falls)	+2.9%	+1.8%

Source: Prusik/Bloomberg

China

Our decision to increase exposure to Chinese related stocks in the fourth quarter last year (and January of 2019) proved helpful with a strong rally in the prices of those stocks since then. In the table below we show the performance of the stocks that we purchased since the market lows of late October[4].

Security	Total Return 29/10/18 to 31/3/19 (USD)
Wuliangye Yibin (sold)	+105%
Sun Hung Kai Properties (sold)	+38%
CK Assets	+37%
BHP Group (sold)	+29%
Rio Tinto (sold)	+29%
Sands China	+31%
Wynn Macau	+14%

Source: Prusik/Bloomberg

Increasing our weighting in these stocks was a significant contributor to performance as, over this time period, PAEIF returned 17.1% compared to +15.3% for the index. Because of the rise in share prices over this period (with relatively little change in fundamentals) the risk/reward is no longer as attractive and so we have sold half of these positions (as indicated in the table above).

Hong Kong Conglomerates

One of the good things about Emerging Markets, and in particular Asia, is that there are almost always popular and unpopular parts of the market. Last quarter, it was China that was unpopular (and therefore cheap) but this quarter, in our opinion, the best value opportunities are to be found in the Hong Kong conglomerate sector and we now have 22% of the fund's NAV invested in these companies. Even though the underlying business mix of these companies is very varied and so the combined risk is not particularly high, they do they have several things in common:

[3] Outperformance being defined as "fund return minus market return" and alpha being defined as "fund return minus beta adjusted market return"

[4] We didn't own all of these stocks over the entire time period but the purpose is to show how significant the rerating has been

- Long operating histories (John Samuel Swire began trading with China in 1861).
- Family owned.
- Stable businesses with low (but generally predictable) growth.
- Limited ability of minority investors to force change.
- Their shares trade at large discounts to net asset valuation.

The stocks we own (as well as a brief description) are listed below:

- **CK Hutchison**
    - Operates in the ports, infrastructure, telecom and retail business.
    - An opportunistic trader of assets – happy to sell almost any business if the price is right and always on the look out for distressed sellers and cheap companies.
    - Preference for non-cyclical, cash generating assets in markets with rule of law.
    - The company does care about discount to NAV and has restructured the business in 2015 in an attempt to close the gap between the share price.

- **Swire Pacific**
    - Operates in the real estate, airline, oil services and beverage business.
    - The last several years have been marked by poor capital allocation which is now improving under revamped board and new chairman.
    - Swire's is less opportunistic than CK Hutch and so sudden changes are unlikely but recent 40% increase in dividends and focus on ROE bodes well for future returns.
    - We own the voting shares which trade at a 20% discount to the non-voting shares (due to lower liquidity).

- **First Pacific**
    - Owns controlling stakes in three listed businesses which operate in the telecoms, infrastructure and food business in Indonesia and the Philippines.
    - Capital allocation in recent years has been woeful with disastrous acquisition of Australian food producer Goodman Fielder but the board have since decided to focus on slimming down the group and returning cash to shareholders.
    - High USD debt at corporate level is not ideal but underlying cash flows are non-cyclical which reduces risk.

- **PCCW**
    - Operates in the telecom, media and IT outsourcing business.
    - Its main asset is a 52% stake in Hong Kong Telecom which provides a stable dividend stream but it has continued to invest in loss making OTT businesses.
    - Management and board have not been as disciplined as they should have been on generating returns on reinvested cash flow but high dividend yield and commitment to return 90% of Hong Kong Telecom's dividends to PCCW shareholders provides somewhat of a floor to valuations.

- **CK Assets**
    - Operates in the real estate and infrastructure business.
    - Part of the same group as CK Hutchison (ultimately controlled by the Li family), CK Assets is a real estate company but one that has been very negative on real estate for many years.
    - As a result, it has invested in infrastructure businesses while waiting for a collapse in property prices, which it believes are unsustainably high (in Hong Kong, China in particular).
    - Recently sold an office building in Hong Kong at a 2.5% cap rate and has been active in buying back shares.
    - Strong capital allocation skills have not yet been rewarded by the market.

Valuation Analysis

In the table below, we list the stocks and show their current discount to NAV[5] and dividend yield. We show the upside potential if valuations revert to the 25% discount to NAV (which is the long-term average for most Hong Kong conglomerates) as well as a more optimistic scenario where the stocks trade in line with their NAVs.

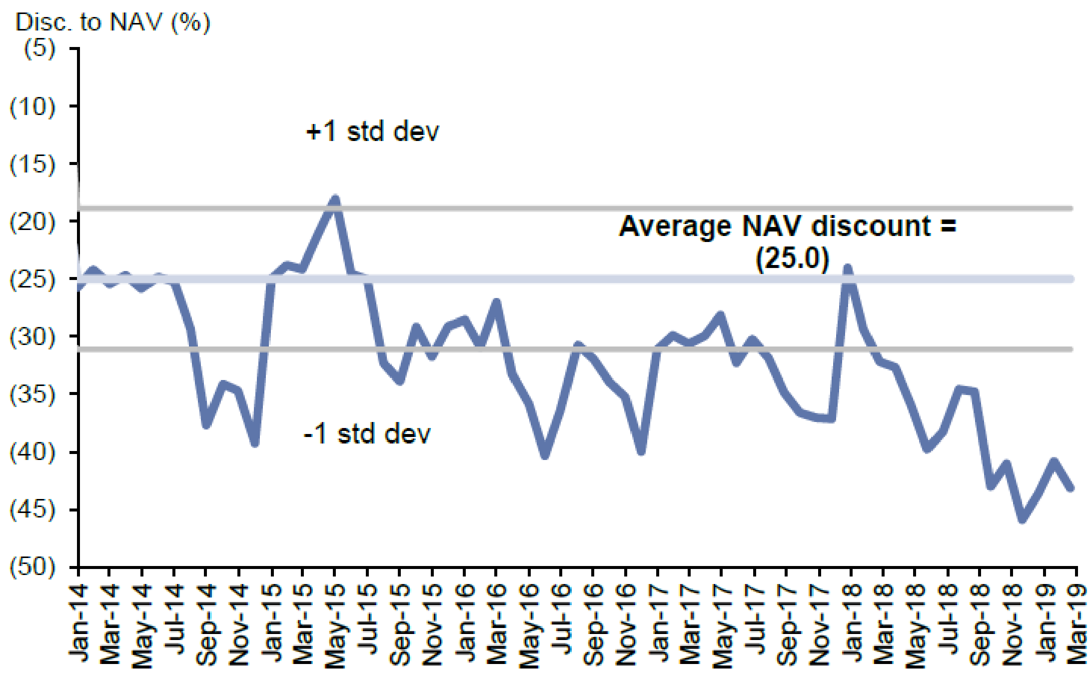
If these stocks were listed in the UK or US then we would expect activist investors to force the share prices towards these net asset valuations by agitating for management to sell assets to close the valuation gap. However, in Hong Kong that is unlikely (although not impossible) given the family ownership and different investment culture.

	Discount to NAV	**Dividend yield**	**Upside (assuming 25% discount to NAV)**	**Upside (assuming 0% discount to NAV)**
CK Hutchison	-43%	4.2%	+33%	+77%
Swire Pacific B-shares	-57%	4.4%	+74%	+132%
First Pacific	-64%	5.2%	+111%	+181%
PCCW	-44%	6.8%	+35%	+80%
CK Assets	-46%	3.0%	+40%	+86%

Source: Prusik/Bloomberg

Below, we show the discount to NAV chart for CK Hutchison and CK Assets to give some idea of how the discounts compare to history. The other stocks have very similar looking charts.

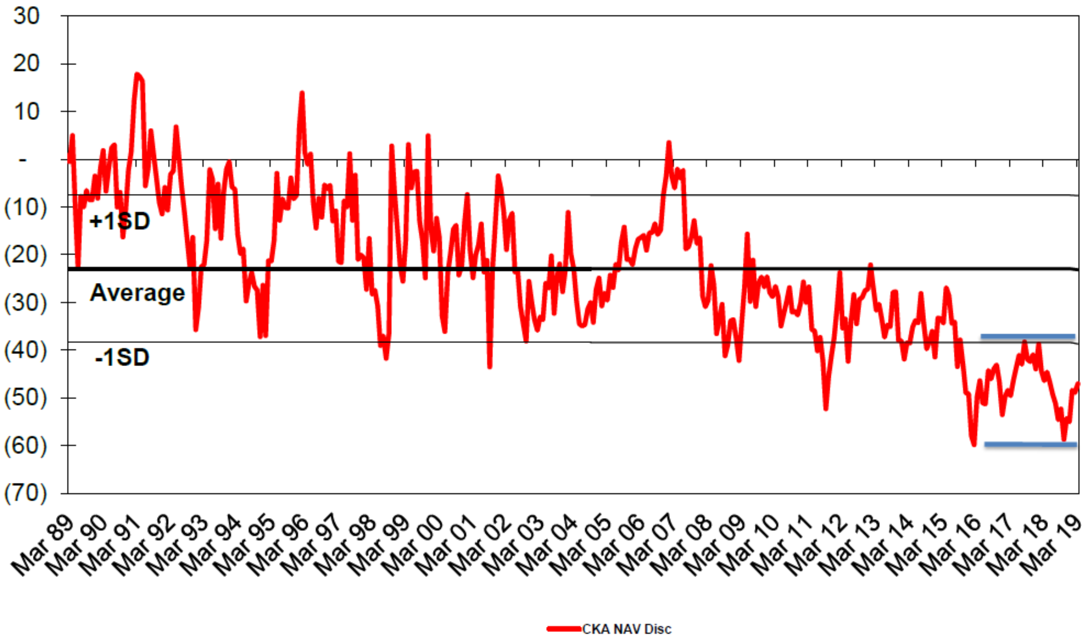
Exhibit 5: CKH historical NAV discount chart



Source: Datastream, Company data, Goldman Sachs Global Investment Research

[5] We calculate the NAV in different ways for different businesses. For operating businesses such as ports, infrastructure we use comparable multiples for similar businesses, private market valuations and discounted cash flow analysis. For real estate valuations we use a capitalisation rate analysis

Figure 7. CKA - Discount to NAV (21 Mar 2019)



Source: Datastream; Citi Research Estimates;

Why is the discount so large?

- **Unfashionable businesses**. In an era of focus on growth stocks, these assets are very unfashionable. Real estate, ports, telecoms and infrastructure are not where investors want to be exposed as they are often only growing at 5% per year.
- **Lack of immediate catalysts**. Because the companies are family owned, they have little incentive to pursue short-term, market pleasing tactics such as buy-backs and spin offs. Because they will pass the company on to their children (who will pass it on to their children), it is of no concern to them what the current share price is.
- **"Immune" to hostile M&A, activist investors.** Because the families still have a controlling stake and also the culture in Hong Kong does not favour hostile activity, it is unlikely that an activist could force change. That said, Elliott International, an activist fund, has owned a stake in Guoco Group (another Hong Kong conglomerate) for many years and has forced them to attempt to privatise the company.

Why might this change?

- **Privatisation**. We have seen Gordon Wu successfully bid to take Hopewell Holdings private. Although many families like having a listed company for reasons of prestige, the increasing regulatory burden of being a listed company – together with the very cheap valuations, makes delisting an increasingly attractive option.
- **Reversion to the mean.** We are buying high quality assets with owners that are aligned with us and eventually, the stocks will return to more "normal" discounts.
- **Greater payments of cash to shareholders via either buybacks or special dividends. CK Hutch**, **CK Assets**, **First Pacific** have all been buying back shares recently which is accretive to valuations.
- **Management change, handing over of ownership to younger family members.** Li Ka Shing has recently handed over control to his son Victor. Merlin Swire has taken up chairmanship of **Swire Pacific**. First Pacific's "founder" and senior management team are in their 70s. **As younger members take over – will they seek to adopt more modern capital allocation techniques?**

What are the risks?

- Other than general business risks, the concern is that because these companies operate in low growth areas, the management might choose to invest in value destructive acquisitions to generate new business areas rather than return cash to shareholders.

Given current valuations, we believe the risk/reward in this group of companies is very attractive. We own a collection of stable businesses with good yields, solid balance sheets and cheap valuations. We also have significant upside potential if the gap between the share prices and their intrinsic value closes.

New Positions

Cromwell European REIT

Cromwell European REIT (CREIT) is a Singapore listed REIT managing a portfolio of secondary assets (i.e. non-prime assets) in Europe. The assets are in the office and light industrial sectors in France, Germany, Poland, Italy, Denmark and Netherlands. Rental agreements are linked to inflation and the leases are of relatively long duration (average lease expiry of 5.1 years). Management have a strong track record in opportunistic acquisitions.

We took part in a placement by one of the IPO investors (Cerberus) at a steep discount to market price and would regard this investment as relatively opportunistic in nature. The attraction to us was the cheap valuation (9.0% dividend yield compared to bond yields of <1%) and strong management team. Because it is a Singapore listed company with European assets, it is very poorly understood by the local market which leads to the cheap valuation. As the company executes on its strategy, we expect the stock to trade closer to fair value.

Sands China

We will avoid repeating the attractions of the Macau gaming market which we discussed in last quarter's report with regards to Wynn Macau. In many ways, **Sands China** is a very similar investment opportunity but with some important differences. It is exposed to the same growth opportunity as Wynn but is more exposed to the mass market versus the VIP market. This means that its margin is higher and earnings volatility is lower but it also trades at a valuation premium to Wynn.

Sands has one of the best brands in the mass market segment with a 34% share of mass market EBITDA and a 50% share of hotel room capacity. It has the highest EBITDA margins of 36% due to lack of VIP business. It has a "hungry" parent company (70% owner) which likes to upstream cash, meaning it pays out 100% of its free cash flow as dividends (leading to a 6% dividend yield). We expect 10% revenue growth driven by mass market growth and the P/E of 15.5x is a premium to sector reflecting lower risk business mix and less volatile earnings stream.

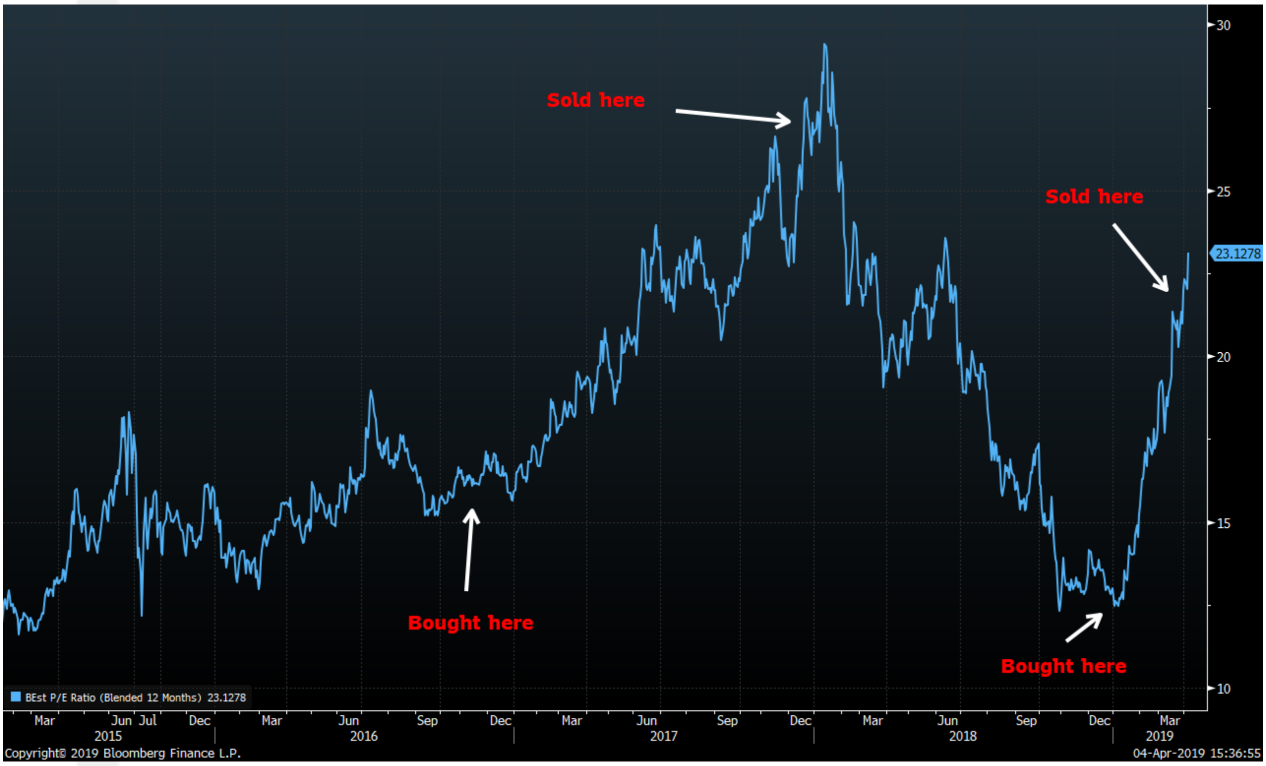
Wuliangye Yibin

Wuliangye Yibin is well known Chinese Baijiu[6] producer which generates high returns on capital due its strong brand and the significant barriers to entry that are present in this industry. The growth potential in this sector is strong due to increasing demand for premium and ultra-premium products as consumers become wealthier which should result in "mid-teens" revenue growth. Because of their brand strength they are able to generate operating profit margins of more than 50% and the capital requirements of the business are low. Although the business is relatively straightforward, the volatility of the stock price is extremely high because the company is perceived to be exposed to Chinese "luxury spending" and therefore any change in sentiment with regards to the Chinese economy, tends to be magnified in the stock price of **Wuliangye**. Because it is an A-share listed stock, domestic Chinese retail investors represent the bulk of trading activity and they tend to be very short-term focused and have relatively little time for valuation analysis. As our approach is diametrically opposed to theirs, it often happens that, at times when they are very pessimistic (perhaps due to fears over the economy), they drive the stock down to very cheap valuation levels (P/Es in the "low double-digits") and at other times they become euphoric and drive the stock towards 25-30x P/E.

In the chart below showing the forward P/E ratio, we note the two times we have bought and sold the stock. In 2016 we initiated a position for the first time at a P/E of 15x and sold the last of our holding in January 2018 at a P/E of near

[6] https://en.wikipedia.org/wiki/Baijiu

30x. Following the correction in 2018, we bought into the stock again at a P/E of 12x earnings and recently sold out at 22x earnings.



Embassy Office Property Trust (new issue)

We recently bought a position in India's first REIT IPO – **Embassy Office Parks**. Listed with a dividend yield of 8.2%, we believe this is a very attractive investment which has the potential for strong dividend growth in the future. It is a mixture of office park and tier 1 CBD office properties but the biggest asset, representing 40% of their portfolio, is the Manyata Business Park in Bangalore. Growth is likely to come both from built in rent escalations and also the fact that the portfolio is currently under rented in the order of 35%[7]. Because rents are ultimately a function of underlying revenues that their tenants generate, as Indian wages rise it is likely that rents will rise with them. The barriers to entry in the business park market are high as it takes many years to construct new projects and the community environment which a park such as Manyata has created, takes even longer to create.

Exited Positions

Beijing Capital Airport

In January, the Civil Aviation Administration of China published its plan for moving flights from **Beijing Capital International Airport** (BCIA)to Beijing Daxing International Airport (the new airport which is due to open later this year). The plan was more negative than we had anticipated because it does not allow BCIA to reallocate capacity from domestic flights to international and therefore the hit to future revenues is significant. Our new valuation is approximately in line with the current share price implying a poor risk/reward profile.

BHP Group & Rio Tinto

We had purchased these positions in 4Q18 during a time of great pessimism with regards to the Chinese economy. Since then, sentiment towards China has improved significantly and the iron ore price, in particular, has been boosted

[7] In other words, market rents are 30-35% higher than contracted rents. As tenancies are renewed, rents will increase towards the market level

by Vale's supply disruptions. Given the rally in share prices, the risk/reward in these positions is no longer attractive in our opinion.

Fortune REIT & Sun Hung Kai Properties

Both stocks reached our target price and we exited the position.

Wuliangye Yibin

Discussed in previous section.

PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 31.03.2018

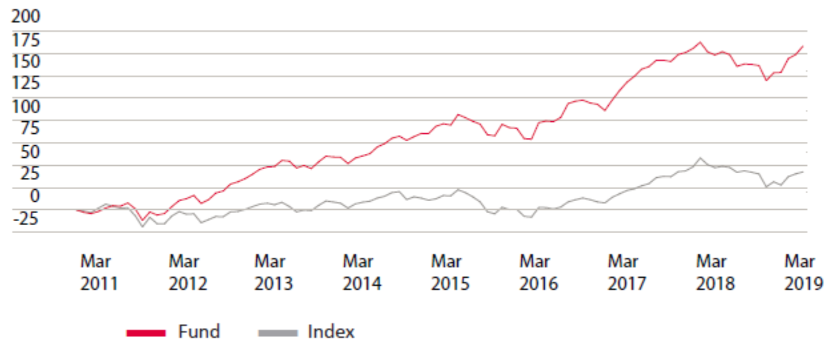
Class 1*	B USD	Benchmark **
1 Month	3.47	1.55
3 Months	11.59	11.48
2018	-9.52	-13.68
2017	32.79	37.32
2016	10.36	7.06
2015	3.17	-9.12
2014	16.79	3.09
Since Launch+	183.14	42.56
Annualised since Inception	13.45	4.39

* 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.

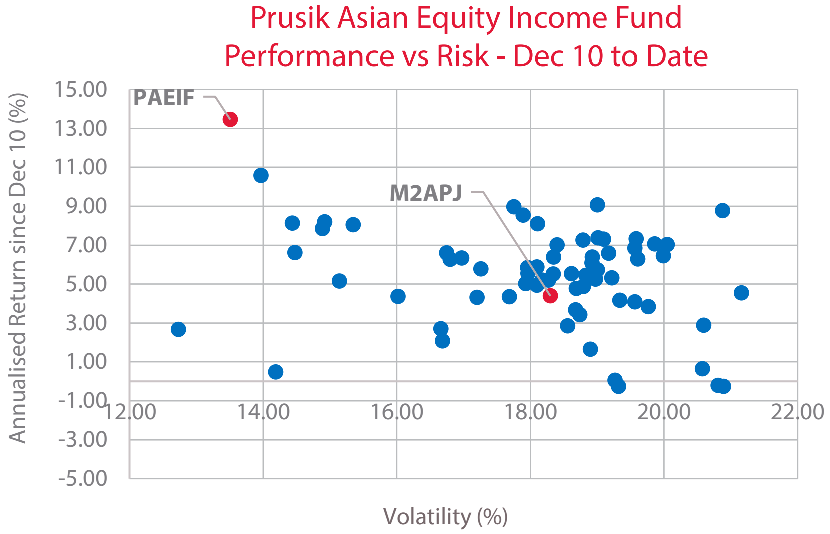
Class 1 B, USD Monthly Performance Summary (%)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2019	6.09	1.66	3.47										
2018	2.51	-3.76	-1.26	1.34	-1.18	-4.76	0.96	-0.13	-0.52	-6.38	3.49	0.21	-9.52
2017	5.49	4.77	3.98	2.69	3.25	1.11	2.71	0.06	-0.54	2.91	0.85	1.61	32.79
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)	9.28
Beta	0.77
Alpha (%)	9.34
Volatility (%)	13.51

Source: Morningstar
Since inception: B 31.12.2010



Source: Morningstar

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

CK HUTCHISON HOLDINGS LTD	6.2
ZHEJIANG EXPRESSWAY CO-H	6.2
SAMSUNG ELECTRONICS-PREF	5.5
SWIRE PACIFIC LTD-CL B	5.3
POWER GRID CORP OF INDIA LTD	5.2
Total Number of Holdings	31

Portfolio Financial Ratios

Predicted Price/Earnings Ratio	11.0x
Predicted Dividend Yield (%)	5.2

Thematic Breakdown (%)

Real Estate	18.0
Transport Infrastructure	15.5
Communications Infrastructure	15.0
Financials	12.4
Power Utilities	11.9
Cash	6.6
Cheung Kong / Hutchison	6.2
Consumer	5.9
Technology	5.5
Resources	3.2

Geographical Breakdown (%)

Hong Kong	30.9
India	13.5
China	13.3
Australia	8.2
Korea	7.2
Cash	6.6
Indonesia	5.9
Macau	4.6
Singapore	4.0
Thailand	3.0
Philippines	3.0

All data as at 29.03.19. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size USD	930.40
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	291.26
B USD	Unhedged	Distributing	B4QVD94	IE00B4QVD949	204.14
C GBP	Hedged	Distributing	B4Q6DB1	IE00B4Q6DB12	196.97
D SGD	Hedged	Distributing	B4NFJT1	IE00B4NFJT16	193.90

*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	182.37
Y GBP	Hedged	Distributing	B4TRL17	IE00B4TRL175	176.56
Z SGD	Hedged	Distributing	B6WDYZ1	IE00B6WDYZ18	179.90

*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	175.50

*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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