# Imperial Asian Franchise Fund

Imperial Capital

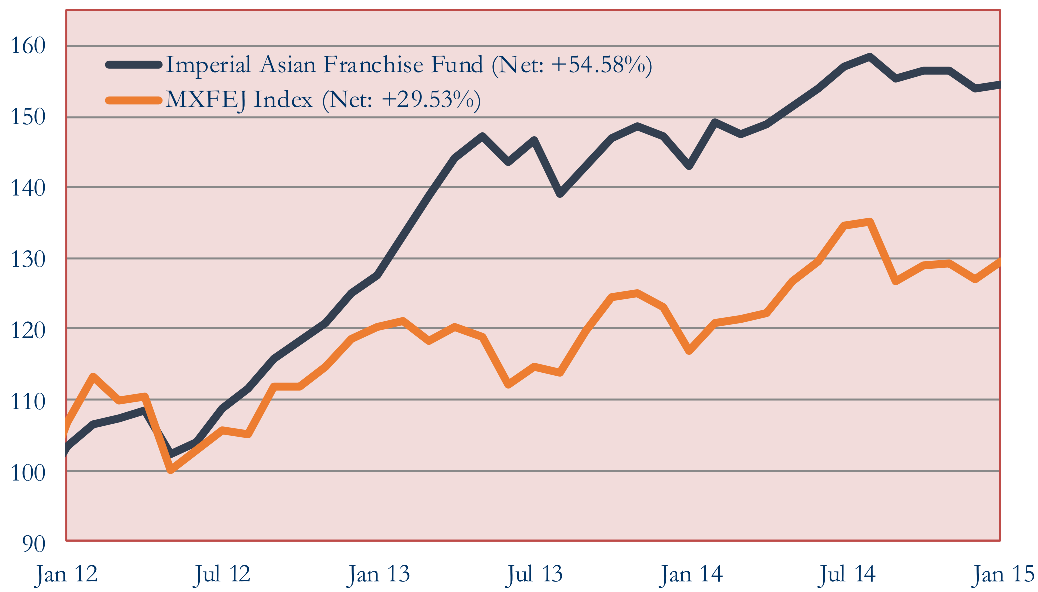
## January 2015 Monthly Report

### Net Monthly Return (%)

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2011 | | | | | | | | | | 2.12^ | -6.51 | 1.87 | -2.74 |
| 2012 | 6.31 | 2.91 | 0.75 | 1.13 | -5.55 | 1.43 | 4.79 | 2.53 | 3.64 | 2.33 | 2.13 | 3.48 | 28.59 |
| 2013 | 1.99 | 4.28 | 4.24 | 3.96 | 2.15 | -2.60 | 2.31 | -5.25 | 2.82 | 2.85 | 0.97 | -0.86 | 17.69 |
| 2014 | -2.83 | 4.25 | -1.02 | 0.84 | 1.75 | 1.68 | 2.02 | 0.78 | -1.84 | 0.77 | 0.00 | -1.73 | 4.53 |
| 2015 | 0.46 | | | | | | | | | | | | 0.46 |

^Performance for period 25/10/2011 to 31/10/2011

### MONTHLY PERFORMANCE CHART (Since Inception)




### FUND OBJECTIVE

This is a high conviction Asia ex-Japan long only equity strategy.

The objective of the Fund is to employ a disciplined investment process to identify companies with durable competitive advantage, particularly intangible assets, and to capture their superior returns as they grow into dominant Asian Franchise operators in the Asia Pacific region.

ESG considerations are embedded in our process to reflect our preference for sustainable enterprises.

### PORTFOLIO DETAILS

| | |
|---|---|
| Total AUM(USD in Mil)# | 22.13 |
| # of Positions | 26 |
| Weighted Avg. Mkt Cap.($bn) | 25.00 |
| Average Volatility % | 9.43 |
| VAR 99% | 1.39 |
| Sharpe Ratio | 1.29 |

#Includes managed account

### FUND DETAILS

| | |
|---|---|
| Strategy | Long only |
| Mandate | Asia ex Japan |
| Mgt. fee | 1.38% per annum |
| Perf. fee | 13.8% HWM |
| Custodian | Bank of China (HK) |
| Administration | Alter Domus |
| Auditor | KPMG |
| Domicile | Cayman Island |

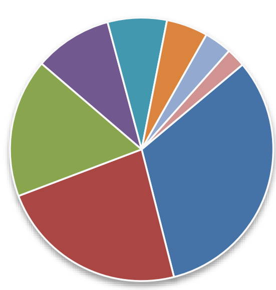
### QUANTITATIVE ANALYSIS (Since Incep.)

| | Imperial |
|---|---|
| Number of Positive Months | 31 |
| Number of Negative Months | 9 |
| % of Profitable Months | 78% |
| Average Perf. (Positive Months) | 2.4% |
| Average Perf. (Negative Months) | -3.1% |
| Average Monthly Return | 1.1% |
| Monthly Largest Drawdown | -6.5% |

### PORTFOLIO SNAPSHOT

| | |
|---|---|
| Beta | 0.75 |
| Top Ten Holdings | 44.10% |

### SECTOR BREAKDOWN



- Consumer/ Industrial (32.15%)
- Utility (23.2%)
- Cash (17.03%)
- I.T. (9.56%)
- Telecom (7.26%)
- F&B (5.1%)
- Health Care (3.37%)
- Internet (2.33%)

### CONTACT INFORMATION


21Fl, Suite A,
Kingswell Commercial Tower,
171-173 Lockhart Road,
Wan Chai, Hong Kong

+852 3679 3163

+852 3679 3120

bshaw@imperialcap.com.hk

www.imperialcap.com.hk

Imperial Capital

# Imperial Asian Franchise Fund

## January 2015 Monthly Report

### Portfolio Review

With the permission from our client who employs the Asset Consultant (CA), Cambridge Associates, to monitor our segregated portfolio, we have the pleasure in this newsletter to share CA's analysis of our investment performance. Our portfolio's performance was ranked in the 0th percentile for the past two years against peer group and index.

| Manager (Inception Data) | Qtr to Date 09/30/14-12/31/14 | CYTD 12/31/13-12/31/14 | Annualized Since 1st Full Qtr. |
|---|---|---|---|
| | | | |
| HFI Imperial, LP (02/13) | -0.4 | 8.1 | 11 |
| MSCI All Country Far East ex JP (02/13) | 0.2 | 3.5 | 4.4 |
| Value added | -0.7 | 4.6 | 6.5 |
| CA Far East ex Japan Equity Mgr. Median (Net) | -2.2 | 1.6 | 0.4 |
| CA Percentile Ranking | 28 | 11 | 0 |

Source ： Cambridge Associates Singapore

This month, the portfolio registered a return of 46bp., underperforming the regional index performance for January for a number of reasons.

Our strategy does not invest in finance and property counters which contributed to HK market's 3.9% gain in January. The widening of trading band for the Singapore dollar led to 1.7% decline of SGD and the Malaysian Ringgit also tumbled 3.55% in January. This hurt our portfolio due to our large exposure to Silverlake and Singapore Post in Singapore.

The portfolio only had one Malaysian stock going into January, and we decided to lock in profit from Bursa Malaysia (Malaysia stock exchange) as well, given the resource based Malaysian economy is likely to be most vulnerable to continual weak commodity prices within our region.

We spent some time looking at the tobacco industry development and their implications for Huabao, the dominant tobacco flavour manufacturer in China and one of our top holdings. Late last year, the Korean government approved a new excise tax hike of over 100%, which will translate into a rise of approximately 80% per pack. The share of KT&G dropped over 20% on the news. The last time China raised its cigarette tax was in 2009 and the cigarette companies didn't raise their prices at all. Tax makes up approximately 40% of ASP compares with 'a minimum of 70% of retail price' as recommended by WHO to reduce tobacco use. China is clearly behind the curve. In order to curb smoking, the tax hike needs to be large enough to force the brands to pass on the hike to the smokers. The tobacco industry contributed approximately Rmb 900bn or ~8% of the nation's total in 2013. Direct healthcare costs is approx.. Rmb 60bn and indirect economic costs related to smoking is roughly Rmb250bn. In other words, cost erodes roughly 1/3 of cigarette tax, resulting in less significant contribution. Of the 301m smokers, 2/3 are in the rural areas, primarily farmers and low income citizens. Faced with an economic slowdown that may impact the living standards of the middle class, the govt's priority would be to short circuit any potential large-scale unrest, thus, it is unlikely to see a huge one off tax hike like Korea's. The Macau government just announced a full ban on smoking in the casinos and proposal to hike tax rate from 30% to 70%. This anti-smoking measure indeed singled out the affluent mainland population vis-à-vis Macau casinos. A researcher at the Research Institute of the State Tobacco Monopoly Administration also publicly cautions about tax hike, stating 'unquantifiable' risk of tobacco trafficking. Previous hike in 2009 has not moved the needle at all for Huabao in terms of profit margin. That said, any hike this time would likely be large enough to force the brands to increase retail

price although we expect impact at Huabao's level to be more muted given it is higher up on the supply chain and the dominant supplier. Upon weighing the risks of tax hike against the broader deflationary threat, we conclude that Huabao's valuation and defensive business model still represents an unrivalled cash proxy by any measure. Upcoming special interim dividend represents 100% pay out and 5% yield. Its discount to fair value and strong profitability provide a reasonable buffer to any negative news on the tax front.

We have put together a brief report on how we see the ongoing SOE reform and its implication for our SOE companies, namely China Mobile and Guangdong Investments. See Link: http://www.imperialcap.com.hk/file/Special%20project%20SOE%20reform%2020150128.pdf for full report. The outcome of the analysis have led us to become more bullish on the fundamental outlook of China Mobile, which is now our 6th largest holding. In addition to its head start in 4G rollout and the impending spinoff of tower operation, it is also expected to benefit from the current round of SOE reform measures. See Link for detailed analysis.

**Outlook**

The continual strength of the USD and corresponding weakness of commodity prices are rendering the threat of deflation more real and it is worrying to see global investors opting for negative yielding USD bonds as long dated as ten years. We have been preparing for this scenario and we continue to aim not only to preserve capital in USD terms but to continue to generate meaningful inflation adjusted returns. There remain such opportunities within our high quality growth franchise space. We have reasonable confidence that Asia is unlikely to experience 1997 or 2008 GFC type of meltdown as our EMs have much more manageable USD debt compare to other GEMs. This time, we expect markets to be judged on individual merits rather than a blanket withdrawal of capital from GEMs. Malaysia is the only market we chose to exit on macro concerns at this time.

Currency movements will add challenge to our fundamental analysis, reported earnings and share price returns at the portfolio level. China loosening monetary policy will be supportive of equity valuations. The injection of liquidity to reflate the economy and reverse the credit crunch will likely result in meaningful depreciation of the Rmb, first time since 2006. We are building an exchange rate of 6.50 to the greenback into our models at this stage.

We have made adjustments to our portfolio resulting in more concentrated bets, more focus towards liquid and even stronger cash flow companies, as well as higher composition of TMT plays which satisfy our more stringent franchise requirements. These companies provide quality growth characteristics, and shall be able to preserve shareholder's return, and display low correlation to economic environment. Our track record so far also showed that our high conviction bets consistently yield the highest returns within the portfolio.

**- End -**