Imperial Capital

Imperial Asian Franchise Fund

Jan 2016 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	0.30	2.21	8.44	3.67	-3.78	-4.80	-6.07	1.16	3.86	-1.43	-0.42	2.73
2016	-4.28												-4.28

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

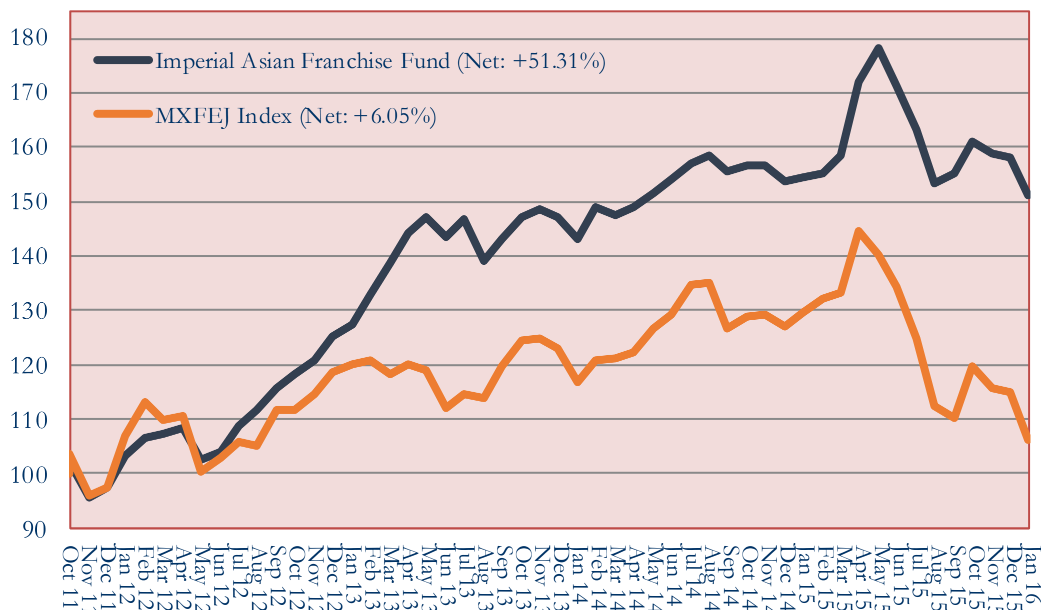
FUND OBJECTIVE

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.

MONTHLY PERFORMANCE CHART (Since Inception)



PORTFOLIO DETAILS

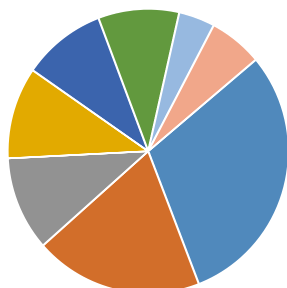
Total AUM(USD in Mil)#	24.25
# of Positions	28
Weighted Avg. Mkt Cap.($bn)	20.49
Average Volatility %	11.07
VAR 99%	1.63
Sharpe Ratio	-0.22

#Includes managed account

QUANTITATIVE ANALYSIS (Since Incep.)

	Imperial
Number of Positive Months	37
Number of Negative Months	15
% of Profitable Months	71%
Average Perf. (Positive Months)	2.6%
Average Perf. (Negative Months)	-3.3%
Average Monthly Return	0.8%
Monthly Largest Drawdown	-6.5%

SECTOR BREAKDOWN



- Consumer/ Industrial (30.24%)
- Utilities (19.35%)
- F&B (10.72%)
- Telecom (10.43%)
- I.T. (9.61%)
- Health Care (9.32%)
- Financials (4.17%)
- Cash (6.16%)

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

PORTFOLIO SNAPSHOT

Beta	0.75
Top Ten Holdings	45.00%

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

Jan 2016 Monthly Report

Portfolio Review

The portfolio fell 4.28% for the month. Companies that generate all or a significant part of their revenue from the Chinese Yuan tumbled in January, including Guangdong Investment, Beijing Enterprise Medical, Ginko and Yungtay, to adjust for lower translated EPS from potentially weaker Rmb. We do not see threatened translated EPS loss to be a reason for divestment.

Guangdong Investment (GDI) in particular, generates 46% of its total earnings in HK dollar with the rest in Rmb, and the company is also sitting on over US$600m equivalent in cash and can easily gear and fund a >US$1bn acquisition to potentially enhance recurring EPS by 20%. Given the high likelihood of further acquisitions in China, it makes sense for the company to continue to hold most its cash in Rmb and we believe potential new assets can more than make up for the translation loss from Rmb to HK dollar in the form of enhanced earnings and increased dividend payout given the company has been maintaining 10% dividend per share growth in the past years.

We have been monitoring the industrial counter, VTech, that is one of the two cordless phone makers in the world and (2) also makes electronic learning products under its own brand and (3) provides contract manufacturing services, making it a very stable cash generator with minimal cyclicality in its earnings pattern. Although we like the fundamentals of the company, in the past, we either found the company on the wrong side of the currency dial, having to endure an expensive Rmb cost center and double digit rise in China wages, or the share price level provided inadequate margin of safety. The share price dropped over 30% in the past year, most of which in only the last three months on news of its clients' (primarily children) database being hacked in the US. To date, the hacker has been arrested and no material damage or loss was reported by any of its users, although class action has been filed against the company. Notwithstanding the fact that the ultimate liability is still unknown, and a larger than expected legal cost can threaten dividend as the company habitually pays out 90-95% of its earnings, some provision will likely be made in 2015 earnings, and we find valuations too attractive not to make a decisive entry at this level, and we are leaving room to average down if necessary. At the time of writing, the company just announced acquisition of LeapFrog, its largest education learning toy product competitor. We believe it is a great move and cost of US$1/share is much smaller than it seems as Leapfrog has US.74/share cash. We will discuss more in due course as more details become available.

Holding the lifeline of multiple related industries, the auto and property sectors shall continue to see strong supportive measures from the Chinese government. We have discussed in our August 2015 monthly report that China is expected to have more highway than the US by 2018 while the number of cars is only less than 30% of that of US's 250m. We have decided to bring our position in the auto component company that makes transmission connectors to a core position, to leverage on the (1) expected growth of auto demand in China, (2) outsourcing trend from the West to lower cost Asia manufacturers, (3) increasing digitization of autos that require more connectors and (4) secular growth of electric vehicles. An auto component maker that caters not only to brand owners but also to after-market (AM) segment is like the last piece of puzzle in our portfolio, in terms of the risk reward mix that is added to our franchise portfolio given AM sales are recession proof and provides a strong non-cyclical revenue base, on top of which, the company can also ride the favourable structural trends that underscore our investment thesis.

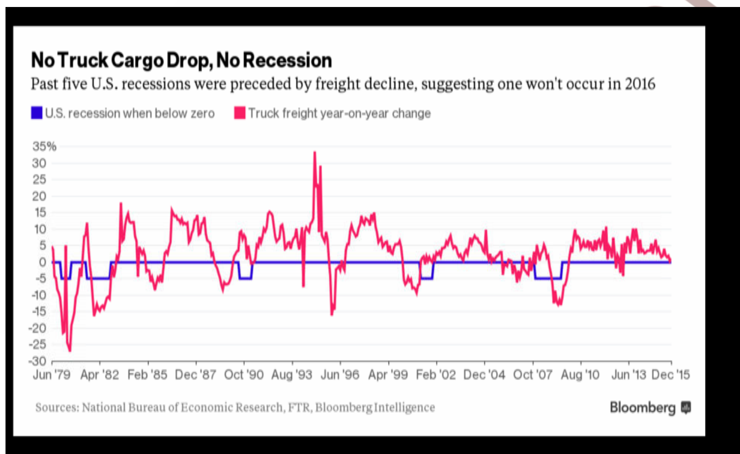
Outlook

Market routs that have been prompted by USD strength and tumbling fuel price can be running out of steam at their respective levels, while the downward pressure on the Rmb, continues to gather pace and becomes the single largest threat to our N. Asia centric portfolio, followed by fear of the US economy reversing its growth

Imperial Capital

course amidst global macro headwinds.

There is inadequate data at this stage to support a US recession scenario. We came across an interesting piece that cited US truck cargo data to be a reliable predictor of future economic activity, with a steady string of monthly freight declines preceding *each* of the past 5 US recessions. In fact, since 1980's, there has not been a recession without a decline in truck freight beforehand while there has been a drop in truck cargo without a recession that follows. On the other hand, there goes an old joke that the stock market has predicted 9 of the last 5 recessions which underscores how off the mark it can be to gauge economic conditions with market behaviour. Current forecast is for truck freight to grow in low single digit in 2016. That said, ongoing industrial weakness can leach through to consumers and show up in truck cargo data down the path, although this is not apparent from indications from trucking business owners in the US at this point.



Although markets' panic seems incongruent with economic reality at this stage, the financial panic itself, can well produce a crisis or recession down the path. Fear of contagion effects of further Yuan devaluation in particular, continues to unnerve investors, although the Chinese government seems determined to maintain currency stability. To err on the safe side, we are tilting towards companies with cost center denominated in Rmb and a more diversified revenue source as it is difficult to argue for a strong Rmb in the foreseeable future even if the greenback will not strengthen further.

From our bottom up perspective, we see few reasons to become pessimistic about China as long as we do not get sucked into the 'shortermism' investment horizon. With 415m Chinese millennials entering their prime spending age and overall middle class set to approach some 600m by 2020 (twice the size of the current US population), China continues to hold immense spending power, driving our investment thesis for the region.

2015 should help provide a glimpse of where the source of growth may come from in China in 2016: secondary home sales grew 83% YoY (14 cities), primary home sales grew 7%, overall home mortgages grew 20%. Auto sales grew 11% YoY. Movie box office grew 48% YoY, outbound travel via air grew 34% YoY, cosmetics import volume grew 56% YoY, and wine important value grew 21% YoY.

We are positioned for recovery in Spirits and auto segments in China. Our Korean cosmetics and contact lens franchises shall continue to ride structural growth of these underpenetrated categories, as shall our sportswear/sports shoe fabric maker, Shenzhou, riding on the gym-to-street / global "athleisure" apparel trend, being key supplier to Nike, where its high level of value add commands superior profitability, and generate franchise quantitative and qualitative characteristics. Our investments play to the structural demand growth in sectors that improve the utility level of the burgeoning middle class, with price points that are not far from those of FMCGs (fast moving consumer goods), or at most, categorized as 'affordable luxuries'.

Falling markets seldom last long, and there can often be fierce bear market rallies to catch investors off guard. We are quite happy to stay invested at current stock valuations. Our quality portfolio should continue to play well to this volatile economic environment.

- End -

Imperial Capital

Imperial Capital

Imperial Asian Franchise Fund

Jan 2016 Monthly Report

Imperial Capital

IMPORTANT DISCLOSURE

Imperial Capital Ltd and its principals are licensed and regulated by the Securities and Futures Commission in Hong Kong. All the funds and investment portfolios (the "Funds") advised and managed by Imperial Capital Ltd are not retail funds. As such, the Funds and the Private Placement Memoranda ("PPM") issued by the Funds from time to time are not registered and authorized by the Securities and Futures Commission in Hong Kong. The information and data on the Funds are furnished on a confidential basis solely for the purpose of information. The relevant private placement memoranda ("PPM") can be made available to potential investors upon request and they should be read carefully to make an evaluation for investment in the Funds. Investment in the Funds requires the financial ability and willingness to accept certain risks inherent in investing in the portfolios. The "Risk Factors" section in the PPM outlines the said risks in details. No person has been authorized to make any representations concerning the Funds which are inconsistent with those contained in the relevant PPM.