Imperial Capital

Imperial Asian Franchise Fund

Feb 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	-2.73											-6.90

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

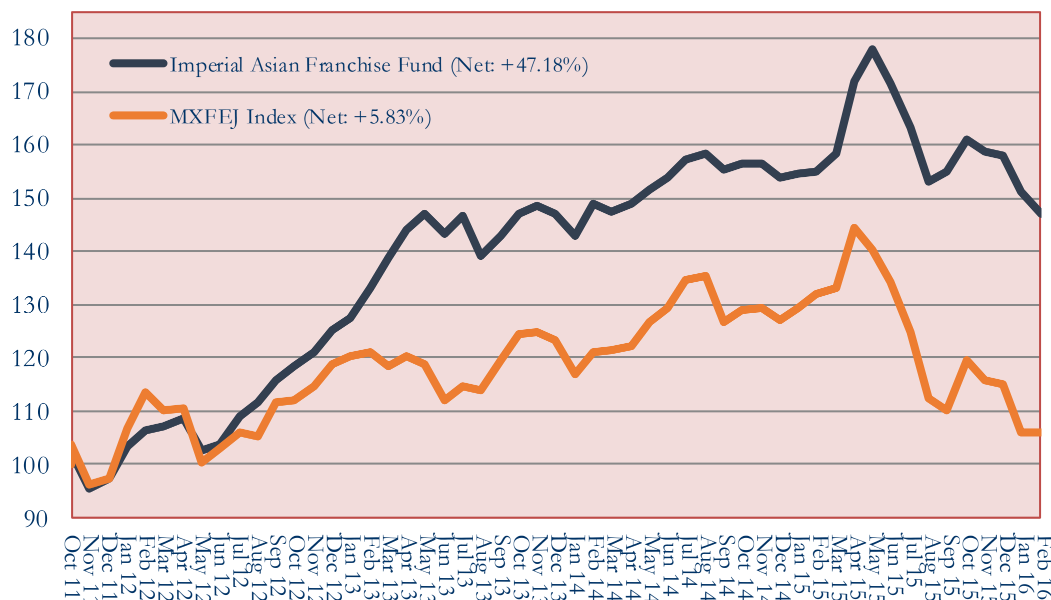
FUND OBJECTIVE

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)#	23.69
# of Positions	31
Weighted Avg. Mkt Cap.($bn)	15.70
Average Volatility %	11.17
VAR 99%	1.65
Sharpe Ratio	-0.43

#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

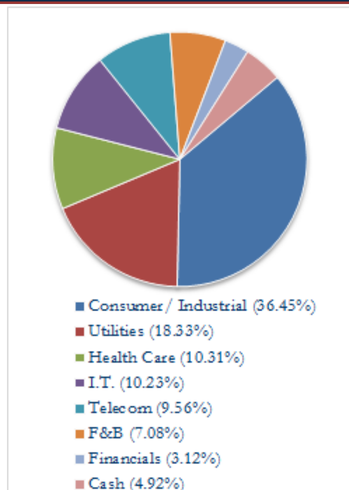
QUANTITATIVE ANALYSIS (Since Incep.)

	Imperial
Number of Positive Months	37
Number of Negative Months	16
% of Profitable Months	70%
Average Perf. (Positive Months)	2.6%
Average Perf. (Negative Months)	-3.2%
Average Monthly Return	0.8%
Monthly Largest Drawdown	-13.96%

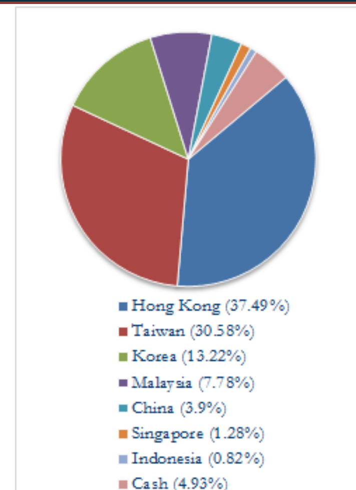
PORTFOLIO SNAPSHOT

Beta	0.66
Top Ten Holdings	45.89%

SECTOR BREAKDOWN



MARKET BREAKDOWN



Address: 21Fl, Suite A, Kingswell Commercial Tower, 171-173 Lockhart Road, Wan Chai, HK T: +852 3679 3163 F: +852 3679 3120 www.imperialcap.com.hk bshan@imperialcap.com.hk

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Portfolio Review

The Fund had a difficult month due to substantial fall in one of our top holdings that erased 1.5% of our NAV. This has dwarfed other ups and downs in our portfolio, which primarily reflect volatility of the broader markets.

The 30% drop in KEPCO Plant Service (KPS) in February (including a 20% fall on the day after its 4Q results announcement) was responsible for 1.5% negative return to our portfolio for the month. The key culprit for the price collapse was the unexpected jump in labour cost, attributable to (1) the 540 newly hired engineers vs 200 new hires in 2014, (2) temporary increase in annual incentive payment, (3) rise in wage, and (4) low base wage cost effect from 4Q14 due to a retroactive change in retirement benefit in 4Q14 which lowered labor costs. 4Q15 sales was up 6%YoY, slightly below market expectations due to overseas project delay. We believe the aggressive hiring should be interpreted as the company's high confidence in potential growth in overseas markets because as a state-owned company, all new employment requires pre-approval from the Korean government and cannot be done in haste.

The company has obviously underestimated the risk of an IR void in 4Q15 because the previous IR person was transferred to the Audit Team in 4Q15, while the new IR, a 10 year veteran with the company who was heading the Corporate Finance department, did not assume the IR role until the end of January. Although we believe the share price movement is more a reflection of retail panic selling, and that the higher overheads is but a prelude to more earnings to come, we updated KPS fundamentals with the new IR and concluded that notwithstanding the delay in the first UAE nuclear reactor project, we do not see any risk of the 4-nuclear reactor maintenance business to be lost. As a matter of fact, through our independent searches, we learned that taking cost and practicality into consideration, there is virtually no comparable technology at this time, not even France or Russia; KPS's parent company, KEPCO's 1,450 MWe is likely to be the world's most advanced and applicable nuclear reactor technology for power plants. We do not see any change to KPS franchise qualities, including high entry barrier, non-cyclical earning pattern, high free cash flow on recurrent maintenance revenue and oligopolistic operating environment. On the back of promising oversees projects outlook, which will enable the company to continue to grow regardless of global economic conditions, and solid domestic business with sufficient order backlog, we retain our high conviction on the company and have rebalanced our exposure.

Following months of trading suspension, Qingdao Haier, China's leading home appliances maker, finally resumed trading and confirmed the acquisition of General Electric's home appliance unit. The consideration of US$5.4bn is hefty and represents a significant premium to the US$3.3bn bid that Electrolux made two years ago. We have counted on M&A as a catalyst, primarily attractively priced asset injections from parent co., rather than an expensive foreign brand that has no dominant market share. While the deal appears to be earnings accretive on paper, the amount of goodwill and the likelihood of impairment are a concern, as is the execution risk of integrating two culturally very different companies. The company is also turning from a cash rich to an indebted company which is also facing a challenging sales outlook that may undermine its debt financing ability; all in all, moving beyond our metrics of a quality franchise. Based on our revised DCF valuation to Rmb$7, which is well below the traded price upon resumption of trading, we exited the position. Having realized some profit when share surged ahead of bonus adjustment in July 2015, we are more or less break even on the investment.

We have raised the issue of sugar tax earlier, and it now seems imminent that some Asean countries are preparing to impose taxes on sugary drinks in a movement reminiscent of the anit-tobacco campaign. A tax on sugary drinks and 'junk food' in Mexico has reportedly

cut the consumption of sugary drinks by an estimated 12% and raised billions of USD in tax receipts; the country has since become a benchmark for other emerging markets. Based on our search, the Governments of Indonesia, India, Vietnam and the Philippines are looking to implement some form of sugar tax. Proposal seems most advanced in the Philippines where the House of Representatives is set to rule on introducing a 10% excise tax on all sugar-sweetened drinks. Local opposition parties pointed out that 5 million Filipino's livelihood is dependent on the sugar related industries. We have held the company Universal Robina Corp (URC), maker of snack food and sugary drinks as far back as the launch of the Fund and the long term development of the company remains bright. However, the materialization of such a tax would most certainly cast doubt on the company's ability to meet sales expectations and threaten shareholder's return. Some governments may try to impose duty to only target foreign brands, in other words, the likes of Pepsi and Coca Cola, in which case, URC's Ready-to-Drink tea sales in Vietnam can be at risk as the no. 1 foreign brand. Given (1) the share is close to our intrinsic value, (2) the new JVs and acquisitions with Danone, Calbee and Griffins need time to become cash cows, and (3) the lack of track record of the impact on the company and share price if/when such a tax materializes, we decided to leave the table early and completely exit our holding in URC, even though we still seem to the only one worrying about this in our part of the world.

Some good news, we were happy to see 10% rebound in our elevator stock this month, thanks to improved optimism on China property sector, on the back of specific property market boosting measures from the Chinese government. At the recent 13th Five Year Plan, property market again seems to be targeted to help jump start the economy as there are reportedly over 40 industries that can directly and indirectly benefit from recovery of the property market.

In the past months, we have made a number of small investments in the auto component sector. We like the companies because of the high entry barriers and non-cyclical income due to their contribution from after-sales market segment compare with auto stocks. Their structural growth stories originate from (1) outsourcing trend from US and Europe, (2) China's rising orders, particularly amidst auto tax reduction that is driving efficient car sales, (3) increasing digitization of cars that require more components, and (4) the trend of increasingly stringent government policies to ensure car safety.

Outlook

China's 13th Five Year Plan (1) put growth before reform, (2) presented a pro-growth plan that will be funded by fiscal deficit and monetary policy easing, and (3) assures stability of the Yuan. It is clear that the leaders are opting to slowly, rather than quickly, remove the 'Band-Aid' on the wounded economy, and hope that the country will grow out of its problems. As such, we shall not see a boom bust cycle as some predict, but the current two steps forward, one step back type of growth will become the 'new norm', making short term investing that much more challenging. We continue to view China's long term outlook positively on the back of rising household and per capita income, and believe a system flush with liquidity will have to find an exit at some point.

At the time of writing, quality seems to have become out of favour and became the source of funding for risk assets. Again, we can only view this as buying opportunity for quality companies in our universe.

- End -

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