Imperial Capital

Imperial Asian Franchise Fund

May 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	5.88	0.70	-2.38								-3.10

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

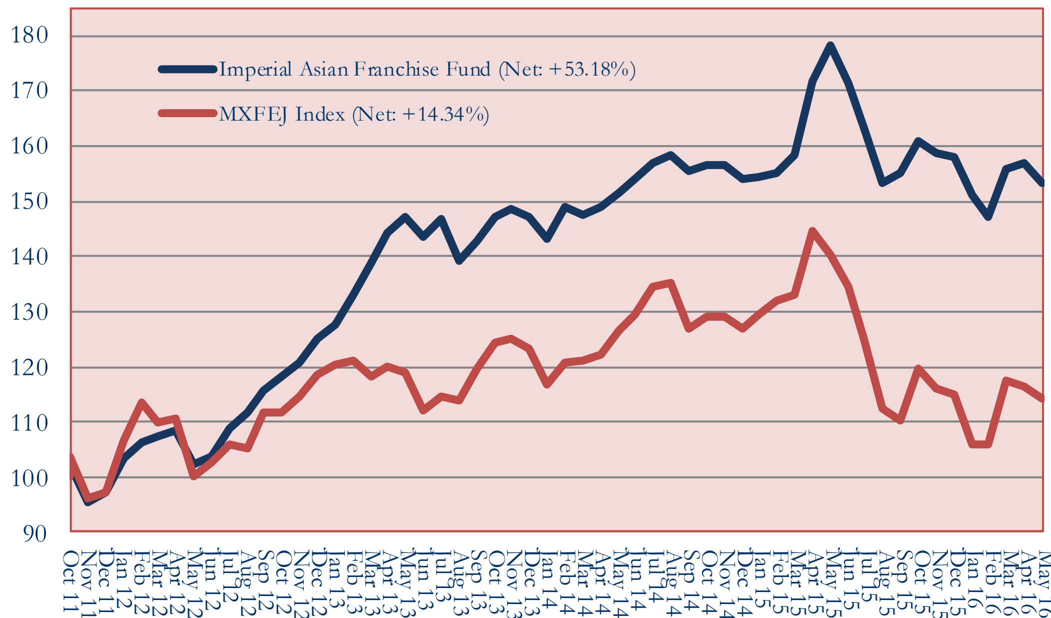
FUND OBJECTIVE

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)#	24.79
# of Positions	28
Weighted Avg. Mkt Cap.($bn)	17.75
Average Volatility %	11.09
VAR 99%	1.63
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)
Administrator	FundBPO
Auditor	KPMG
Domicile	Cayman Island

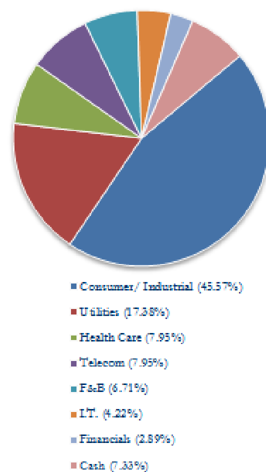
QUANTITATIVE ANALYSIS (Since Incep.)

	Imperial
Number of Positive Months	39
Number of Negative Months	17
% of Profitable Months	70%
Average Perf. (Positive Months)	2.6%
Average Perf. (Negative Months)	-3.2%
Average Monthly Return	0.8%
Maximum Drawdown	-13.96%

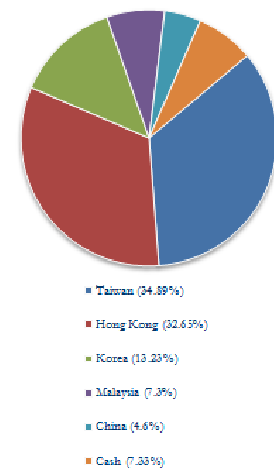
PORTFOLIO SNAPSHOT

Beta	0.68
Top Ten Holdings	45.66%

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* *bshaw@imperialcap.com.hk*

Imperial Capital

Imperial Asian Franchise Fund

May 2016 Monthly Report

Portfolio Review

Our portfolio declined 2.38% for the month of May. 15 of our companies reported quarterly results in May; they all came in within or above expectations with the exception of two companies, Hartalega and Ginko.

Our contact lens brand owner Ginko reported inline revenue, but net earnings were lower than expected due to higher than expected marketing expenses. Despite concerns about China's economic conditions, the import value/volume of contact lens, one of the best demand indicator, still grew 24% in 11M15, maintaining the average over 2012-14. China contact lens market size was reportedly only >450m pieces in 2014, vs 386m in Taiwan and over 3b in Japan leaving significant room for structural growth of contact lens market still. The Street on average forecasts the market and Ginko to grow 10-15% in coming years. Ginko has worked through the impact of the government crackdown on illegal channels, with 13-17% sales growth yoy in September to November. Despite the favourable backdrop and Ginko's solid #1 position in China's contact lens market, the fact that Ginko generates approximately 87% of its revenue in Rmb subjects the stock to substantial volatility, or negativity, at times of Yuan devaluation scare. The share has fallen close to 20% YTD while the turnaround in industry dynamics in the past months puts our 2016 and 2017 free cash flow yield to close to 5%.

Having posted one of the best returns within our portfolio in 2015 (up 40%), our Malaysian healthcare glove maker, Hartalega gave back most of the gain YTD on a combination of (1) reversal of currency trend between USD and the Malaysian Ringgit so far 2016, (2) higher trending raw material price as commodities price recovers, as well as (3) a disappointing 4Q 16 results (year end March). The company's 4Q16 result collapsed due to reported loss of inventory which the management decided to do most of the write-off in the immediate quarter. The management has yet to address details of the loss of inventory. Given the management has accumulated significant goodwill through the past decades of superior execution of business, posting consistently higher than industry average margin and growth rate, we regard the event as one-off and continue to focus on (1) Volume: the new capacity that is coming on stream will more than double Hartalega's revenue and continue to drive double digit growth, (2) Stable margin: the balanced supply-demand dynamics despite global new supplies coming on stream. We also observe Malaysia glove exports record two year cycles: 2013 13% growth, 2014 9%, 2015 17% and expected growth for the Malaysian export industry for 2016 is currently low double digit on a continually higher base.

The HK broadband market has been dominated by 2 players, HK Telecom (no.1) and our HK Broadband (HKBN) (no.2) which jointly amass a market share of >80% with HKBN taking approximately 35%. The other two players 3HK and i-Cable have been sidelined with little incentive to invest more to enhance the network. As such, the 4-player market is very much a duopoly. In the meantime, i-Cable, the smallest player, has been loosing money for 8 consecutive years since 2008 with a cumulative loss of HK$1.34bn. The company is trading at premium to book and replacement cost would be the only plausible valuation angle. The most valuable would be the 'lowest tech' part of the company – the territory-wide network of cable ducts as well as the access rights to literally all residential building and many of the commercial buildings in HK. Upgrading i-Cable's network requires CAPEX because last mile is coaxial not fiber optic, which is a large burden relative to i-Cable's current financial position. Given the insignificant scale of the i-Cable operations within the Wharf group, the street expects very much the status quo to continue. Recently i-Cable's parent Wharf group announced that it is conducting a strate

Imperial Capital

gic review of the communications segment, inviting speculation of whether they may be interested buyer. Even if we assume there is a plausible interested new player, who is offered attractive terms by i-Cable, willing to plough in CAPEX and do some heavy discounting and/or equipment subsidies to start attracting users, meaningful impact would be at least two years away. The possible change of competitive landscape had driven the share of HKBN to fall over 10% to hover around IPO price level. Although the share is trading at attractive valuations, given the possible threat to a duopoly operating environment, no matter how far fetched, we reduced our terminal value of the company; in view our positive total return on the stock, we have reduced the weighting of the stock as the moat may face risk of erosion down the path. In the foreseeable future, the economics of incremental customer gain remains attractive given the leverage of its well depreciated network.

In the past month, our newly acquired auto component stocks went through a sector wide correction in Taiwan on the back of slower sales data coming from China auto industry, sparking concerns that Chinese auto makers are adjusting inventory in preparation for a slow season in 3Q16. We note that inventory levels are relatively low and restock demand should keep apprehension towards China auto sector in check. Taiwan stocks tend to undergo monthly swings with the release of monthly sales data but the related short term volatility should not derail the long term structural tail wind from supportive government policies and the trend towards ADAS. Taiwan supply chain is ostensibly gaining dominance from US and European, much like their way into the IT and smartphone value chain.

We are pleased to report that our weighting in the Taiwanese 'Starbucks' franchise, Gourmet Master, has become one of our top ten holdings this year through a combination of share price rise and our additional purchases. Successful rollout of central kitchens and continual increase in the number of stores in the US and China, would ensure growth in both revenue and margin. The franchise is built on its ability to produce a vast variety of fresh cakes and pastries, a Taiwanese niche, rather merely a brand equity, as in the case of Starbucks. Given its geographical diversification between US and Asia, and the uniqueness of the business model compares with other coffee shop franchises, the company is expected to become a high quality franchise in the coming years and already witnessing re-rating as its growth potential unfolds.

Notwithstanding our strong performance in 2015, our portfolio's YTD return has been disappointing on both absolute and relative grounds. This has been largely due to negative returns in some of our top holdings, including KPS, HKBN, and Hartalega. Strong returns YTD from our Kweichou Moutai, President China Store Corp, Taiwan Mobile as well as Gourmet Master have helped to limit declines at the portfolio level. Investment climate has also been unfavourable for our strategy, as investment theme moved from January's 'trash rally' to chasing cyclicals in the 2nd quarter to shadow the recovery of oil price.

At the equity levels, we also see a more perilous investment environment as there have been more, rather than less, government interventions, particularly from China in our region, interpreted as heightened policy risks in some key sectors, from utility to telecom to gaming to even F&B stocks. The auto parts sector is a rare industry which we see as a solid beneficiary of government policies, thanks to safety concerns and successive reports of auto makers' malpractices. Many quality moats are already richly valued by our fair value calculations, and their share prices have more or less stagnated, and we have reduced our stake and lock in profits in some of them, including Vitasoy, URC and LG H&H. Focusing on the best of breed, each of our portfolio's top ten holdings account for 4 to 6.5% of the Fund while we continue to build up our conviction on new investment ideas from our stock screen.

Imperial Capital

Imperial Capital

Imperial Asian Franchise Fund

May 2016 Monthly Report

OUTLOOK

Near term sentiments will be dictated by China debt crisis management news flow and MSCI decision whether to include China A-shares, and to a lesser degree, the timing of the 2nd round of US rate rise. Given Yellen's caution to date, it seems unlikely a move will be made prior to Br-exit decision, so it is likely to be an overhang that carries in July. The latest trend has been difficult for bottom up stock pickers as (1) some asset allocators are increasingly finding shelter in fixed income instruments and (2) the increasing popularity of index linked equity instruments, so called cheap beta, gives rise to superior liquidity of index constituents and to some extent, their relative overvaluation. Bottom up investing not only require more patience for earnings to drive valuations, lacking the tailwind of index related buying, but also more caution as liquidity is shrinking even for our quality franchises. Until the market sees or experiences the peril of index related investing, the trend is unlikely to reverse in the foreseeable future.

\- End -

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.