APS ASIA PACIFIC MARKET NEUTRAL FUND (UCITS)

FUND DETAILS

Structure	Open ended Sub-Fund (SICAV)
Domicile	Luxembourg
Inception date	3 July 2017
Base currency	USD
Fund size	USD28 million
Strategy size	USD418 million
Number of Holdings	118
Lead Manager	Wong Kok Hoi

STRATEGY DESCRIPTION

The APS Asia Pacific Market Neutral Fund (APMN) invests in stocks of companies in the Asia Pacific region including Japan. The Fund is a dollar neutral variant of the flagship APS Asia Pacific Long Short strategy, and seeks to generate alpha from both its long as well as short positions. Our emphasis is on risk-adjusted returns, and avoiding a permanent loss of capital when we make our investment decisions. We invest in companies with strong management teams and durable growth prospects at attractive valuations. The fund sells short stocks of companies with dubious or weak business franchises, and yet are over-valued, especially if they are run by incompetent or dishonest management. We conduct primary research on company fundamentals, which includes members of the management teams, and adopt a strong investigative slant. Site visits and meetings with management form an important part of our research work.

PERFORMANCE AS 30 SEPTEMBER 2018

	Annualized Returns (%)*				
	1M	3Q	YTD	1Y	Since Incept.
APMN Net Returns	0.60	-0.84	-2.48	-5.90	-5.45
Eurekahedge Equity Market Neutral Hedge Fund Index*	-0.27	-0.46	0.13	1.20	2.46
Difference	0.86	-0.38	-2.61	-7.10	-7.92

The Fund is not managed against a benchmark, and the Index is only shown as an illustration. All performance quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the return figures quoted. The fund returns are net of all fees and charges.

** Based on 21.13% of funds which have reported September 2018 returns as at 5th October 2018*

COMMENTARY

The Fund gained 0.60% net-of-fees in September, while the Eurekahedge Equity Market Neutral Hedge Fund Index was down 0.27% during the same period. As of end September 2018, the Fund has achieved an annualized -5.45% net return since inception.

In September, the Fund's gross and net exposures were 102.5% and 0.6% respectively, compared with 102.5% and 0.6% respectively a month ago. The Fund's top net long exposure by country was China at 20.0%, Japan at 4.4% followed by South Korea at 1.6%, and Taiwan at 1.3%.

Our short position in a **Chinese e-commerce company** with ADRs was one of the top contributors in 3Q18. The company's 1Q and 2Q18 results were below street estimates as its margins remained depressed and it struggled to generate profits. Analysts are now expecting continued margin pressure due to the company's investments and the sustained industry-wide pricing pressure from incumbents like Alibaba and new players like Pinduoduo. In early September, the company's CEO was briefly held in custody on suspicion of criminal sexual misconduct in the US. No charges have been filed yet, and US authorities have not announced the outcome of investigations. The stock price has come under considerable pressure since the story broke. We are closely monitoring developments on this front, which has brought into focus some of the corporate governance issues that we have highlighted in the past.

Our short position in the premium-focused **Macau gaming operator** was a top contributor 3Q2018, as the share prices dropped while industry GGR continued to miss expectations. This trend started in May amidst market's concern over the slowing GGR arising from the stock market crash, a slowing property market, and the deteriorating business environment in some sectors. Investors are beginning to worry about the public tender for the casino concession, which is a huge risk. The company has absolutely no equity, as the dividend payout ratio had been about 100% in recent years

Our short position in a **Chinese F&B Company** contributed strongly to the portfolio, mainly driven by the significant share price correction in August. This was led by an overall correction in the sector due to market fears of an economic slowdown in China and continued weak fundamentals at the company.

We think the sector correction was somewhat healthy, as valuations were pricing in unrealistic growth expectations. Fundamentally, we believe the market has realised the company's price-hike- led margin improvements are not sustainable. We note the company continues to lose market share to key competitors like Uni-President China in premium noodles and beverages, specifically Ready-To-Drink (RTD) Tea. This reinforces our view that the company is not yet participating in the longer term premiumisation trend. We hold on to our investment thesis that the company is currently exposed to the mature mass segment as well as declining segments of the noodle markets. It is unable to grow and defend its RTD tea franchise in the face of stiff competition from its peers.

The company recently shared their beverage strategy of focusing on their loss-making bottled water franchise, which we feel is structurally challenged. This is a poor allocation of the company's resources given its much lower returns on invested capital. This is not the first time the company has tried to turn this business around, and we therefore remain less sanguine on its success. We will continue to track the company's strategy closely to look for signs of change, but for now, our investment view on the company remains.

Beijing Orient National detracted from performance during the quarter, dragged lower largely by weak 2Q earnings. Its 1H results showed topline growth of 5.78%, and bottom line growth of only 2.48%, which was at the low end of company guidance. This was mainly the result of delay in revenue recognition and the initial startup cost of about CNY50 mn for its industrial internet business. Many investors have high growth expectations for this segment as well as the government sector, but both showed sluggish growth during 1H due to a delay in revenue recognition. The growth rates for both segments are expected to recover during the second half.

BJ Oriental can look forward to a boost in winning orders due to its inclusion in the cross-industry national platform that has strong backing from the central

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TOP FIVE HOLDINGS (%)

LONG	
Shenzhen International	4.9
China International Travel	4.8
Venustech Group	4.6
Beijing Orient National	4.5
Kweichow Moutai	3.5
SHORT	
China Con. Staples	-5.0
Australia Energy	-5.0
Australia Con. Discretionary	-5.0
China Con. Staples	-4.9
Hong Kong Con. Discretionary	-4.8

COUNTRY WEIGHTS (%)

China A	25.7
China Others	-5.6
Japan	4.4
South Korea	1.6
Taiwan	1.3
Vietnam	1.2
Philippines	1.2
Indonesia	0.5
Singapore	0.4
United States	-1.3
Australia	-13.6
Hong Kong	-14.8

SECTOR WEIGHTS (%)

Information Technology	19.4
Industrials	7.9
Materials	3.8
Financials	2.7
Health Care	1.8
Real Estate	1.3
Communication Services	1.3
APS Fund*	1.2
Energy	-5.1
Consumer Staples	-7.5
Consumer Discretionary	-17.0
Futures	-9.1

MARKET CAP (%)

> USD 5 Bn	-8.7
USD 2 – USD 5 Bn	-3.3
USD 1 – USD 2 Bn	13.4
< USD 1 Bn	7.4
APS Fund*	1.2
Futures	-9.1

EXPOSURE SNAPSHOT (%)

Gross	120.6
Net	0.9
Long	60.7
Short	-59.9

** APS Vietnam Alpha Fund*
Sources: APS, Bloomberg and Wilshire

government. With some help from Huawei, the company is already booking new orders in Beijing, Shanghai and Zhongshan. We are staying invested as we expect BJ Oriental to meet its earnings growth guidance of around 30%, which makes the 23x 2018E P/E valuation reasonable, on top of its entrenched position in the rapidly growing market of big data application software.

Jupai Holdings was a detractor during the period as concerns from fears surrounding deleveraging and private investment risks were exacerbated by defaults of fraudulent online lenders in June and July. Skittish investors held off investing in private investment products across the board regardless of risk-return characteristics, negatively impacting short-term transaction volumes. Given Jupai is one of the larger distributors of private equity and fixed income products, its 3Q results will likely be negatively impacted. Longer-term, we see Jupai likely gaining market share as stronger regulations weed out competitors. It will likely also benefit as the growing pool of private capital in China that is restricted from accessing investment property and offshore investments seek higher-yielding investments, which Jupai can provide.

Venustech Group's share underperformed the CSI 300 Index by about 9 percentage points in 3Q 2018 after the company clarified that its FY earnings growth guidance was only around 8%, instead of an expected 30% increase mentioned in an earlier announcement that included one-off elements. This revised figure was below market expectations. Its 1H earnings report also showed that after stripping out the accounting gain from the change in accounting methodology for equity investments, its recurring net loss was CNY68 mn, deteriorating from CNY24 mn a year ago. While orders from some other sectors grew an aggregate 35% YoY, new orders from the military did not improve in 1H. However, revenue from high entry barrier urban security operations surged to CNY50 mn, and could contribute CNY200 mn to the 2018 topline. We expect this service offering to make a meaningful contribution to the company's topline growth in coming years, as well as improve the company's overall cash flow profile.

RECENT NEW POSITIONS

We established a position in **Global Unichip Corp (GUC)**, a Taiwanese provider of customised design services for Application Specific Integrated Circuits (ASIC). GUC also helps clients develop silicon intellectual properties, as well as providing licenses for existing IP. The strong management team, mostly ex-TSMC staff, has positioned the company well to tap on growth trends in high-performance computing and AI. This has led to strong revenue growth and improving return on equity, which we believe will persist.

KWG Property is a nationwide property developer in China, focused primarily in Tier 1 & 2 cities. The company had CNY38 bn of contract sales in 2017, and currently has saleable landbank resources of CNY500 bn. Due to current fears over deleveraging and property price controls, KWG shares have fallen -40% to reach what we judge to be very attractive levels at just 4.0x 2018E P/E.

KWG underwent a significant transformation in 2016-17, with founder Kong Jianmin acquiring landbank at attractive price levels, changing its previously slow-moving management and implementing a firm-wide project profit-share scheme. We believe on saleable resources of CNY500 bn, equivalent to over 40x its 2017 revenue of just CNY11.5 bn, KWG's profit has the potential to grow 40% CAGR over the next 4-5 years. KWG staff are also now fully incentivized and aligned to achieve profitability in addition to sales growth. Furthermore, the company will be completing a series of investment property projects built over the past 5 years – 12 offices, 7 malls, and 10 hotels - in prime Tier 1 & 2 locations that will provide recurring rental profit that is expected to be equivalent to up to half of 2017's profit by 2020.

CIFI Holdings is a mid-sized property developer in China focused on tier 1 and tier 2 cities nationwide. Founded by three brothers in 2000 in Shanghai, Cifi today is developing 130 projects across 25 cities, with project values in excess of CNY300 bn. The market sold down Cifi -48% in the past 5 months as fears of the government keeping a tight lid on property prices has spooked the market. We believe that at this price, the stock is very undervalued at just 3.7x 2019E P/E and -65% discount to NAV, with an attractive 10% dividend yield. Firstly, this downcycle is slightly different from the previous one in that primary prices are -15% cheaper than secondary prices due to government price-caps, driving large first-time buyers into the primary market. Secondly, sales volumes in tier 1 and tier 2 cities are already at 12-to-24-month troughs, amid an accumulation of first-time buyers and upgraders who will soon enter the market. Lastly, land prices have started to fall, which will support developer margins going forward. Cifi's chairman has also started to buy back shares in the market in fairly substantially.

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RECENT EXITS

Takara Bio focuses on the supply of biotechnology research reagents and scientific instruments, as well as various contracted services which include the AgriBio Business, and the Gene Therapy Business. The latter develops and commercializes gene therapies for cancer. The company announced better than expected FY17 results and an agreement for collaboration in product development with Otsuka, one of Japan's largest pharmaceutical firms. These factors helped the stock outperform the market and it had reached our target price, so we liquidated our position.

SCSK is one of Japan's largest system integrators, which is traditionally a business with modest margins and relatively labour intensive in a country that is facing manpower shortages. We originally expected the company to transition towards a higher-margin, less labour-intensive business model of selling software packages to companies developing higher-level Advanced Driver-Assistance Systems (ADAS) and autonomous vehicles over the next 2 to 3 years. However, that now seems unlikely in the near future because automakers have pushed back those plans. Although the stock price rose after stronger 4Q results, partly boosted by temporary factors, we exited the position as the investment thesis isn't unfolding as expected. We will continue to track the company, and will revisit this stock when carmakers are closer to building higher-level ADAS and autonomous vehicles.

We initiated a short position in a **Hong Kong-listed maker of miniaturized acoustic parts** used in mobile devices. We expect it to face stronger than expected competition from rivals such as Luxshare and Goertek. Its dominant position in acoustic and haptic parts may face market share losses and margin erosion due to price wars. Its 1H results also showed a bottom line that shrank 16.3%, mainly due to depreciation of the Chinese yuan and increased cost of manufacturing inputs. We remain cautious on this stock over the mid to long term.

Source: APS

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SUBSCRIPTION

	Class A	Class B	Class C	Class D	Class E
NAV Prices as at 30th September 2018	USD93.23	N.A.	N.A.	N.A.	N.A.
Bloomberg	APAPAAU LX	APAPBAU LX	APAPCHE LX	APAPDHA LX	APAPEAU LX
Initial investment	USD1,000,000	USD50,000	EUR50,000	JPY5,000,000	USD50,000
Management fee	1.50%				
Performance fee	20% with High Water Mark				
Liquidity	Weekly				
Dealing deadline	5:00 pm CET 4 Business Days prior to the relevant Dealing Day				
Redemption fee	Up to 5%				
Subscription fee	Up to 5%				
Legal advisers	Arendt & Medemach SA				
Auditor	Pricewaterhouse Coopers				
Administrator	Northern Trust Luxembourg Management Company SA				
Prime Broker	Goldman Sachs				

Unless otherwise stated, all information is as of 30th September 2018 and sourced internally from APS

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