邦德資產管理
FOUNDATION
ASSET MANAGEMENT

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Foundation China Opportunity Fund
邦德大中华机遇基金

Semi-Annual Review **半年度總結**

April 2017 **2017 年 4 月**

Dear Investors,

We are pleased to report to you our investment results and recent developments at our firm and to share our latest thoughts and strategy. We hope you will find it both interesting and informative.

Foundation China Opportunity Fund now marks its 10th anniversary since launch. This means that the Fund now has a decade of solid track record and has delivered 10 full years of great returns to our investors and shareholders. The Fund has outperformed the market, returning by 145% since inception. More remarkably, the Fund achieved good performance without adding volatility.

	Foundation China Opportunity Fund	Hang Seng Index	Shanghai Comp Index
Performance since last semi-annual review (30 Sep 2016)	**+10.3%**	+3.5%	+7.2%
Performance since 2007 inception (net of all fees)	**+145%**	+21%	+20%
Volatility (standard deviation)	**5.8%**	6.5%	8.7%

Source: Bloomberg, Foundation Asset Management; as at end of March 2017

The Chinese economy produced respectable growth in 2016 (6.7% GDP growth), boosted by the government's pro-growth fiscal and monetary policies. Scepticism around this figure remains, as the economy is still very much at the rebalancing stage from investment driven to consumption driven. Among the reform agendas, the biggest evidence of discipline on the supply side has been in the coal sector which has seen consolidation. The recently concluded Central Economic Work Conference stressed the need to promote state-owned enterprise (SOE) mixed-ownership reform and identified specific SOEs to carry out the agenda in 2017. This gives some hope of a reacceleration of SOE reform, but few concrete steps were taken.

Key financial liberalization measures have been achieved over the last two years, including the Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect programs, and elimination of approval requirements for foreign institutions. Admittedly, processes had mostly moved in fits and starts, as the authorities focused on addressing broader issues like disinflationary pressures, the US rate hike cycle, etc. As these challenges become more manageable, we think that we'll see an acceleration in the pace of market reforms.

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Our investment team have been busy: attending meeting or conference calls with company management (most companies report in March, blackout period one month before that). Here are some photos of busy March:

Let's recap the companies we mentioned in the 2016 September issue of the Fund semi-annual review:

- ***Hopewell Highway Infrastructure*** continued its solid performance, seeing 1H 16/17 toll revenue and earnings growth of 7% and 6% yoy. Backed by healthy financial position, interim dividend payout ratio was again maintain at very high level of 99.1%, and we agree with the management that this is sustainable going forward. The stock has appreciated 2.3% in value and dividend from September 2016 to March 2017, and is now trading at 4.6% dividend yield.

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- ***Yangtsz Optical Fibre***'s FY 2016 earnings was slightly below forecast with low self-production rate dragged down margin, but still grew decently by 20.4% yoy. Despite China's big 3 telecom operators announced decreasing capex budget which can bring some risks on demand situation, but with the capacity expansion completed and ramping up in 2Q 2017, we expect to see margin improvements. The stock has increased in value by 15% from September 2016 to March 2017, and is still trading arguably cheap at 9.8x 2017 PE.

- ***Qingdao Port*** delivered strong set of FY 2016 results that beat consensus. Revenue and net profit grew by 17.8% and 16.2% respectively, driven by its leading position and emerging logistics business, and the management expects logistic business to grow no slower than 2016. Despite solid operations, the stock dropped in value by 5.3% from September 2016 to March 2017. It currently trades at an attractive valuation of 7.9x 2017 PE with 4.6% dividend yield.

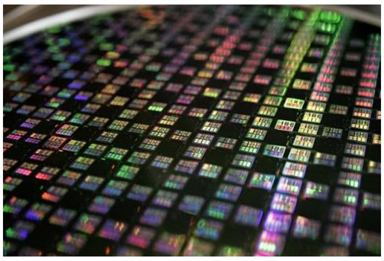
During the preceding 6 months to March 2017, we also added a few interesting stocks to the portfolio, namely China Yongda Automobile, Hua Hong Semiconductor, and CSPC Pharmaceutical. CP Pokphand was sold out of the portfolio with concerns of animal feed demand in China, which was proven right as it announced profit warning of 1Q17 two months later.

Yongda Automobile's 2017 PE of 8x may appear to be in line with auto dealers in the US peers, yet the outlook in China is very different. The average vehicle age in China is around 3.7 years, compares to that of 11.4 years in the USA, or 7.9 years in Japan and Germany. This means cars in China are relatively new, and shall only require more maintenance in years to come. Yongda has a very solid after-sales servicing business, which accounts for 60% of gross profit, that is double the contribution of its primary passenger car sales. The auto dealer industry has suffered from over expansion and fierce competition in primary car sales in around 2014 – 2015, which lead to inventory overstocking. These issues gradually fade away as car makers and dealers became more realistic when looking for growth, with 2 listed auto dealers announced positive profit alert for 2016 results, and we observed sustainable business turnaround. Share price rallied by almost 80% in Jan-Feb 2017 even before results announcement, yet in terms of PE was still around 8x. Yongda results beat forecast, revenue & net profit beat consensus by 5% & 8%, growing 21% & 62% yoy. Going forward into 2017, management hinted strong guidance to see revenue continue to grow at 20-25% yoy, while overall gross profit margin can expand to 11% from current 10.3%.



Hua Hong Semiconductor is an interesting pure play in 200mm (8") foundry. A few years ago, 200mm fab was seen as low-tech. As semiconductor technology advances, the industry is constantly under waves of transitions from smaller wafer to larger wafer size. 300mm was seen to become the mainstream, due to its ability to roughly accommodate twice as many dice per wafer as 200mm wafers. The boom of smart cards, smartphones, and wearable devices has made 200mm wafers economically viable again.

Hua Hong is one rare semi foundry to trade below book value, plus solid dividend policy to payout no less than 30% earnings. Its banking card can potentially gain market share in China, alongside the recovery of 200mm demand shall trigger rerating of the stock.



CSPC Pharmaceutical, unlike other drug mass producers, have 5 of its innovative drugs listed on China National Reimbursement Drugs List, which is widely adopted by hospitals and experienced strong sales performance. The core business focus has switched from bulk medicine manufacturing to innovative drug manufacturing a few years ago. We expected to see sustainable strong growth in future years in its innovative drugs and oncology medicine sales due to China's aging population, as the company's focus on research and developing new drugs.

Hopefully, you now agree with us that China is not as bleak as market thought it would be, and its valuations are seriously depressed. In terms of price to book ratio, Hang Seng Index has only been cheaper back in 1997 Asian Financial Crisis and 2008 Global Credit Crisis. This could lead to great opportunities for diligent value-oriented investors. We genuinely find value in this market, our solid ground work is once again yielding dividend.

Source: Bloomberg, Foundation Asset Management

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We believe China is the only country that is able to reflate global economy. Whenever China stimulates, it is usually a large injection, completed within a relatively short period of time and funded by brand new money. This is completely opposite to most other countries where any stimulus tends to be small and spread over time (or slow) and funded by borrowed money. What makes China different to any other major economy is that China does not have an independent Central Bank and there is no difference between its fiscal and monetary policies. Thus, unlike Western economies that are trying to present various QE policies as something other than monetization while attempting to portray their fiscal policies as being responsible, China does not need to pretend. The state has a much greater than average degree of flexibility to stimulate, re-structure and re-capitalize. China's two-pronged economies – transitional SOEs and prospering private sectors – will provide savvy investors rewarding opportunities, so much more work still ahead of us!

We have seen an increase in investor inquiries into our China Strategy from European investors albeit at an early stage, our experience tells us that it may lead to a more sustained rerating of China markets, hence even better fund performance for the next couple of years.

Last but not least, we are pleased and proud to report that we are in the final stage of partnering with a large Chinese financial institution to launch QDII products targeting at mainland Chinese investors. We are also working with European institutions to launch a UCITS version of our China fund, as its strong 10+ years outstanding performance may have finally convinced some investors.

We thank you for your continuous support, and wish you fruitful investing!

Yours faithfully,

Research Team, Foundation Asset Management (HK) Limited
April 2017 in Hong Kong

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