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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

September 2017 2017 年 9 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 is now in its 11th year of history-making performance. 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 net 195% to investors 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 (31 Mar 2017)	**20.1%**	16.0%	4.3%
Performance since 2007 inception (net of all fees)	**194.6%**	40.1%	22.3%
Volatility (standard deviation)	**5.8%**	6.4%	8.5%

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

Morgan Stanley Capital International (MSCI) decision this year to add Chinese stocks to its benchmark index matters to the world's second-largest economy and the investment community globally. The inclusion of domestically traded, Renminbi-denominated stocks, or the so-called A-shares listed on the Shanghai and Shenzhen stock exchanges, is another milestone towards China gaining full acceptance in the global economy. It is a welcome vote of confidence as China aims to make reforms that are amenable to international investors after years of delays. Such progress will be crucial for Beijing's effort to establish Shanghai and Shenzhen as regional or global financial centres, another milestone in China's journey to fully embrace economic globalisation.

It is also witnessed the strength of Renminbi, at least in part, due to weak USD, which fell 10% YTD in terms of the USD Index versus 5% appreciation of the RMB. The strength of RMB is also supported by fundamentals: China property sales were surging, prices grew steadily by 9%, with transaction volume increased by 12%, mainly in 3rd tier cities. Passenger cars sales recorded year-on-year growth rate of 2.4% to 12.9 million cars for 7M16, making China

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the largest passenger car market in the world. Commodity prices went through the roof. Copper, aluminium, steel prices jumped by 17%, 27%, 45% in 2017, and corporate earnings remain well supported by better margins. 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!

Source: China Automotive Information Net

Source: National Bureau of Statistics of China

New cars rolling out from factories

Crowds queuing up for property project launch

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

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Let's recap the companies we mentioned in the 2017 March issue of the Fund semi-annual review:

- ***Yongda Automobile*** continued to shine and beat market and our expectations. 1H17 revenue & earnings grew 19% & 58% yoy, which is stronger than guidance as well as its positive profit alert. Solid recovery was driven by stronger than expected new vehicle sales volume and better margins from manufacturers. Management is guiding for a strong finish in 2H17, supported by launch of new BMW series, which accounts for around 40% of Yongda's new car sales. The stock has appreciated 50% in value from March to end of August 2017, and is still trading arguably cheap at 10.6x 2017 PE.

- ***Hua Hong Semiconductor*** delivered 2Q17 results just as management guided, though slightly under our estimates. Top and bottom line grew 8.1% & 0.8% qoq, driven by both product mix & ASP improvement across super junction MOSFET and IGBT, as well as strong utilisation at 99.4%. Company is guiding 5% qoq revenue growth, with gross profit margin at 33% for 3Q17. Despite solid operations, the stock dropped in value by 2% from March to end of August 2017. It currently trades at an attractive valuation of 0.9x PB with 3.1% dividend yield.

- ***CSPC Pharmaceutical*** performance was in line with expectations. Revenue and net profit in 1H17 grew 17% and 27% yoy respectively. Sales from innovative drugs kept growing by 30% yoy in 1H17, while gross profit margin reached 57%, rising from 49% in 1H16. We expect it to sustain growth through its innovative and oncology drugs sales in years ahead. The stock has increased in value by 21% from March to end of August 2017.

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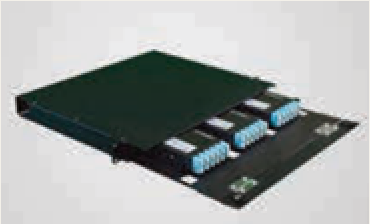
- ***Yangtze Optical Fibre***'s 1H17 results surprised market. Revenue and earnings managed to jump by 26% and 60% yoy despite market's concern over Chinese telecoms' capital spending reduction. Substantial ramp up of 4G infrastructure construction in China is feeding businesses right into the company's new optic fibre preform capacity rolled out in 2017, and management expects margins to see further expansion. The strong results and guidance sent its shares up by 33% in August. Now trading at 12.3x PE, the company is still cheap with strong earnings growth momentum, and it was also included in the Hang Seng Mid Cap Index and the Shenzhen-Hong Kong stock connect program in September.


Yangtze Optical Fibre & Cable manufactures fibres, cables, specialty fibres, and related equipment.

During the preceding 6 months to September 2017, we also added an interesting stock to the portfolio, Hutchison Telecom.

Hutchison Telecom's business itself is not the most exciting, as Hong Kong's telecom industry is seen by many as fairly saturated, and market expects limited growth prospect. However we saw its value earlier this year, especially when valuing Hutchison's fixed line and mobile business separately. Referring to other recently transacted telecom disposals, the fixed line business shall be valued at 8.6x – 12.6x EV/EBITDA, while the mobile business at 5.0-5.5x. The sum of the parts (after netting debt and cash) shows a 34% upside versus its share price in June 2017. We see good potential with limited downside risk, supported by very stable free cash flow and dividend payout ratio of 75% (yields above 4%). With a bit of luck of timing, at the end of July, the company confirmed to sell out the fixed line business at a valuation that falls into the high-end of our estimate. Paying out special dividend or not, we believe the stock is still undervalued. The current valuation is implying a $0 value on the mobile business, which is unfair as the mobile business is positively generating earnings.

Shops of Hutchison Telecom

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Hopefully, you 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

We have seen an increase in investor inquiries into our China Strategy from both Chinese and US / European investors, 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 have launched a QDII product by partnering with China Credit Trust Co. Ltd (one of the top 3 trust companies in China with AUM RMB357 billion or US$51.9 billion) targeting at mainland Chinese investors. We are also working with Chinese and Hong Kong institutions to launch a Hong Kong domiciled authorised version of our China fund, as its strong 10+ years outstanding performance have caught much attention it deserves.

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

Yours faithfully,

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

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