

Asia Pacific UCITS Fund Commentary 3Q18

For Professional Investors Only

For the quarter ending September 2018, the Asia Pacific UCITS Fund declined 5.28%, underperforming the MSCI AC Asia Pacific Index. While we are bottom-up stock pickers, our significant underweight to Japan, the best performing market during the quarter, and our overweight to Hong Kong (HK) and China, among the worst performing markets, and to consumer discretionary, the worst performing sector, hurt our relative performance and drove negative absolute performance in the quarter. Adverse foreign currency movements were also a headwind during the quarter.

Portfolio Returns at 30/09/18 – Net of Fees

	3Q18	YTD	1 Year	2 Year	3 Year	Since Inception 2/12/2014
APAC UCITS (Class I USD)	-5.28%	-10.69%	-3.91%	9.09%	15.50%	7.69%
MSCI AC Asia Pacific Index	0.50%	-2.87%	5.05%	11.37%	12.78%	7.03%
Relative Returns	-5.78%	-7.82%	-8.96%	-2.28%	+2.72%	+0.66%

Selected Indices	3Q18	YTD	1 Year	2 Year	3 Year
Hang Seng Index*	-2.60%	-4.24%	4.23%	13.12%	14.03%
TOPIX Index (JPY)*	5.72%	1.67%	10.48%	19.33%	10.79%
TOPIX Index (USD)*	3.19%	0.84%	9.62%	12.80%	12.76%
MSCI Emerging Markets*	-1.10%	-7.68%	-0.81%	10.22%	12.36%

*Source: Factset; Periods longer than 1 year have been annualized

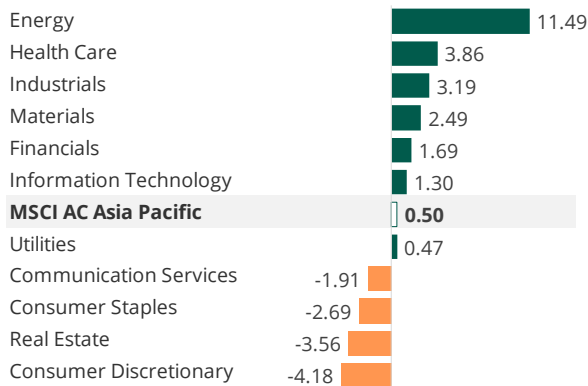
Market Commentary

While the MSCI AC Asia Pacific Index did better this quarter (+0.5%) than the previous quarter (-3.3%), the slightly positive performance masks the high volatility in the region, as well as the high dispersion of market and stock specific returns in the quarter. In the second quarter, the worst performers were the South and Southeast Asian markets, while Hong Kong and Japan declined about 3% and China was slightly negative. In the third quarter, China was the worst performing region, returning -13%, and Chinese ADRs returning -18% and HK returning -4%. Japan, which accounts for about 38% of the index, was one of the top performers (+3.7%) and was the top regional contributor to the index in the quarter. The sell-off in China and HK appears to be driven

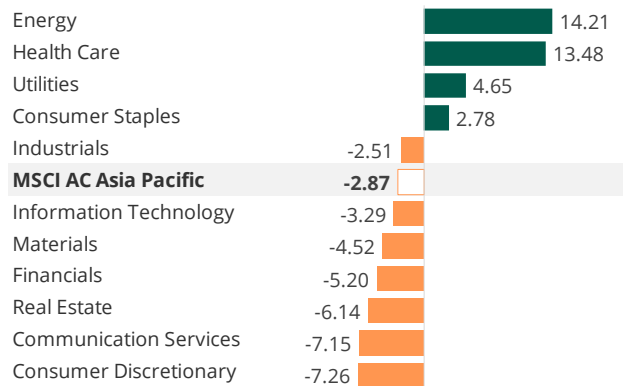
by U.S.–China trade tensions and government-induced deleveraging of the financial system. In addition, rising U.S. interest rates and U.S. dollar (USD) strength are driving capital out of emerging markets. The biggest detractors to index performance in the quarter were the former tech darlings Tencent (-18%), Alibaba (-11%), JD.Com (-33%) and SK Hynix (-14%), continuing the underperformance of the Information Technology (IT) sector this year. In a sharp reversal from 2017, the consumer discretionary sector was the worst performer in the index YTD in 2018, followed by the Communication Services and Real Estate sectors.

MSCI AC Asia Pacific Q3 and YTD Return Profile

3Q Total Return (%)



Year To Date Total Return (%)



Source: FactSet

For the third time since launching the Fund in December 2014, market sentiment has turned sharply negative in HK and China. And, for the third time, we have significantly increased our weighting in these markets, while trimming some of our winners in Japan, which continues to be out of sync with China. We were somewhat early in increasing our Chinese investments. These businesses that seemed highly undervalued got even cheaper during the quarter, as the U.S.–China trade war escalated. Our bottom up, opportunistic portfolio construction looks very different from the index, which can result in near-term underperformance.

We have taken this opportunity to upgrade the quality of our investment holdings and increase our margin of safety. We were able to buy competitively entrenched, value-compounding businesses at steep discounts to our conservative appraisal of intrinsic value. The majority of the Chinese businesses we own today are domestic consumption focused and are not directly exposed to higher trade tariffs, yet they have sold off alongside and, at times, more than the A-share market on fears of a potential slowdown in consumer spending due to a declining wealth effect.

Trade Wars

During the quarter, the initial salvo of the trade war between China and the U.S. was launched. In July and August, the U.S. levied tariffs on \$50 billion of Chinese imports, and China swiftly retaliated with tariffs on \$50 billion of U.S. imports. In September, the U.S. levied tariffs on an additional \$200 billion of Chinese imports, and China responded by levying tariffs on \$60 billion of U.S. imports.

Chinese exports to the U.S. may decline, but continued domestic growth and shifting exports elsewhere should help compensate, as China is actively forging deeper trading relationships with other regions. President Trump's shift away from long-term allies, such as the European Union (EU) and Japan, should benefit China's efforts to develop better trading relationships with them. While Trump has named the EU as a "foe", China's relationship with the economic engine of the EU – Germany – has continued to strengthen.

Only 2% of China's industrial output is exported to the U.S., and about 3% is consumed domestically by the supply chains supporting exports to the U.S. While only 5% of China's total industrial output is exported to the U.S., the CSI 300 index is down almost 13% YTD in local currency and 17% in U.S. dollars. Although trade tensions between China and the U.S. will likely negatively impact companies exposed to higher tariffs, there are plenty of cases where we feel that the bark is much worse than the bite, and we have actively allocated capital to businesses that we believe have been unduly punished by fear.

It is difficult to predict the winners and losers of trade wars, and sometimes it creates unintended consequences. Consider the auto sector, which is a key battle ground in the trade wars. German automaker BMW is one of the unintended victims of China's decision to increase import duties from 25% to 40% on U.S. car imports. BMW issued a profit warning in September, given its significant exposure to higher Chinese tariffs on U.S. imports, as they ship high margin X5 SUVs to China from their South Carolina plant. On the other hand, tariffs on auto imports from other countries to China have been reduced from 25% to 15%. Changes in tariffs will encourage a shift in the supply chain to adjust towards more cost efficient locations. Our portfolio company Toyota Motor, is brushed with tariff concerns, as they export significant car volumes to the U.S. However, Toyota Motors also produces its high margin Lexus cars in Japan, and the lower Chinese import tariffs are driving higher Chinese demand, with Lexus sales in China up 59% year-over-year (YOY) in August.

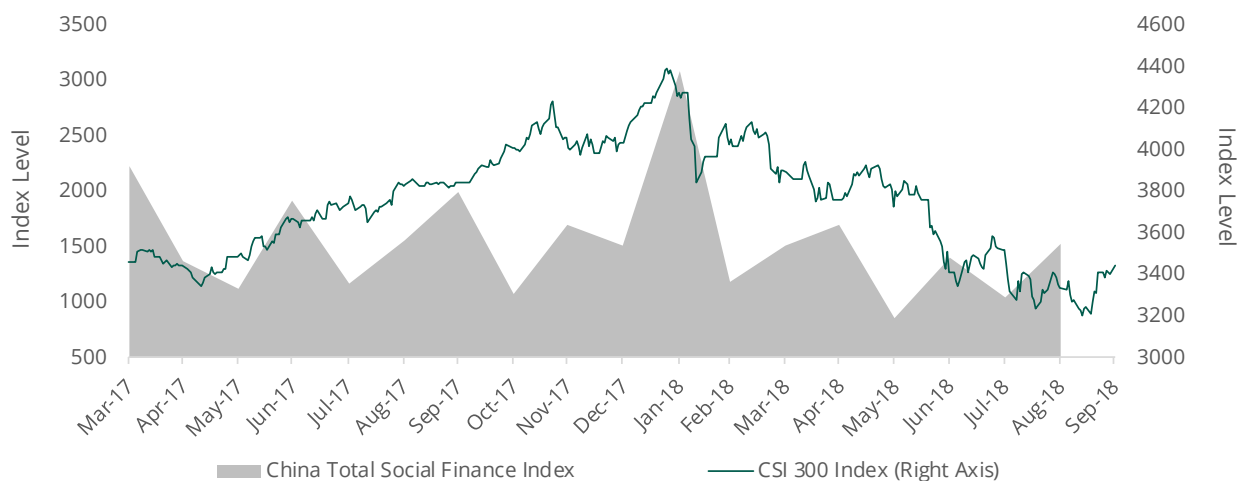
Although trade war fears have had a large market impact, we believe the weakness that we are seeing in China and the broader Asian markets runs deeper than tariff concerns. We see broad emerging markets weakness in the face of increasing U.S. bond yields and weaker Asian currencies. Ironically, both the U.S. and Asian countries are aligned, in that they could benefit from a weaker USD. The weakness in China, however, is about more than just trade wars. After all, Taiwan, whose

market is most exposed to US trade with about 18% of revenues coming from the US, was one of the strongest performers in the last quarter and YTD.

We are beginning to see some signs of weakness in consumer spending in China, as one would expect with the Chinese stock markets down significantly YTD. In the automotive sector in particular, we are seeing weak new car sales figures with some exceptions like Lexus. Declining new car sales tends to be a leading indicator of an economic slowdown. New car sales have turned negative since March and were down 10.3% YOY in August and demand has fallen. As a result, market values for Chinese automobile companies sold off sharply – down as much as 45% YTD. Some of this slowdown is due to liquidity being taken out of the system, in addition to trade war fears.

Online peer-to-peer (P2P) lending, which increased rapidly in the last few years, has shrunk even more rapidly this year, as some P2P platforms defaulted, and regulators stepped in to control the growth of this industry. Bank lending has been cut back, regulators stepped in to control liquidity and the growing unregulated financing activity. Total Social Financing (TSF) flow – a broad measure of credit and liquidity in the economy – was RMB 1.04 trillion in July, down 25% month-over-month (MOM) and down 11% YOY. As the liquidity in the system got cut back, flows into the A-share market and southbound flows to the HK markets decreased, automobile sales – especially in lower tier cities – also fell, and we are beginning to see this weakness reflected in gross gaming revenues (GGR) in Macau. Southbound stock connect turnover in September was markedly down 44% YOY, and down 50% MOM, reflecting the pullback in liquidity going to the capital markets.

CSI 300 Index vs. China Total Social Finance Index



Source: Bloomberg

Volatility Creating Opportunity

In Macau, September GGR growth of 2.8% was down sharply from 17% in August. Although September GGR was unusually low because of Typhoon Manghut, which hit Macau in mid-September, we are clearly seeing a slowdown in GGR growth. As a result, Macau stock prices have sold off significantly in the quarter and YTD, led by MGM China -47% YTD and Melco International -32% YTD.

Our Macau exposure accounted for 60% of the negative absolute returns for the quarter, as market prices dropped further after we had meaningfully increased our exposure by initiating a new investment in MGM China and adding to Melco International. Our total Macau exposure is over 10% today, which is more than double our exposure at the beginning of the year, reflecting our view that the sector has been punished significantly more than any potential economic appraisal damage. As opposed to the last Macau downturn in 2015-16, when industry GGRs were declining, we are still seeing positive growth today. More importantly, free cash flow (FCF) at Melco International and MGM China should be much higher going forward, as the bulk of their capital expenditures is behind them, with Melco having completed Morpheus and MGM China having completed MGM Cotai in the first half of the year.

We believe that Macau is suffering not only from a liquidity-induced slowdown, but also from trade war fears. Located adjacent to Guangdong province, the export capital of China, Macau is perceived to be highly susceptible to any tariff-related slowdown in exports. Visitors from the neighbouring Guangdong province account for about half of all Chinese visitors, which is down significantly from a few years ago, as high speed rail and transport infrastructure has been built, connecting Macau with cities further north.

As we have seen before, macro factors disproportionately impact the VIP segment of the market, where the margins are much lower than the Mass segment. The Mass business has continued to grow double digits, even throughout the disruptions brought about by Typhoon Manghut. Visitor arrivals to Macau continue to be healthy, with August visitors up 18.7% YOY, and visitors from China up 25.3% YOY. Both of our Macau companies earn over 85% of their EBITDA from the non-VIP segment. Ongoing improvements in infrastructure and an increase in supply of hotel rooms will support long-term growth in the higher margin Mass business.

MGM China is one of the six concessionaires in Macau and is 56% held by MGM Resorts and 22% owned by Pansy Ho, the elder sister of Lawrence Ho, the Chairman and CEO of Melco International. During times of high volatility, the capital markets do not properly value non-earning assets (NEAs); if there are no earnings to capitalize, the market will not give credit for it. This is the case with MGM China, which invested \$3.6 billion dollars in their new Cotai casino, MGM Cotai, which opened in

February this year. It has the highest ratio of NEAs-to-market capitalization among Macau casinos at roughly 60%. MGM Cotai lost \$21 million dollars of EBITDA in the first half, as the facility is still in ramp-up mode and suffered from lower-than-average table win percentages and slot hold percentages. Furthermore, MGM Cotai is under-earning because the VIP gaming rooms only opened in September. We believe that MGM Cotai will generate \$450-500mm of EBITDA once fully ramped up (within two years), delivering a low-to-mid-teens EBITDA return on investment. MGM China should nearly double the EBITDA it produced last year by 2020 without incurring any significant incremental capital expenditure. MGM China is trading at around 8.5x FCF on a normalized basis.

In the third quarter, we initiated an investment in WH Group, the largest packaged meat company in China, Shuanghui, and the U.S., Smithfield. This is a business that we previously owned, exiting in 2016 after the price reached our appraisal value. In the last six months, it has been hit by a trifecta of bad news, namely trade war fears between U.S., China and Mexico, African swine fever incidents in China and Hurricane Florence in North Carolina, where Smithfield has some production facilities. As a result, the stock has sold off over 40% from its highs reached in Q1, giving us an opportunity to own this franchise again with an attractive margin of safety. WH Group's balance sheet is conservatively capitalized and significantly less levered than in 2015, when we first invested in the company, as it has repaid the debt raised for the acquisition of Smithfield in 2013.

WH's U.S.-based Smithfield unit is the largest pork processor and exporter from the U.S. to China and Mexico. In retaliation to U.S.-imposed tariffs, Chinese and Mexican authorities have imposed tariffs on pork coming from the U.S. This hurts Smithfield's export business, while exacerbating the demand-supply imbalance in the U.S. By our estimate, even if the U.S.-China tariffs prove permanent, the impact would be contained to around 5% of WH's value versus the 40% pullback from its highs in the share price. The value impact is small because 55% of sales, 80% of operating profit and 85% of our appraisal value comes from the packaged meat business, which is largely a domestic business in both China and the U.S. Unlike fresh pork and hog production, which are commodity businesses, packaged meat is a branded business with pricing power and attractive margins. WH Group has the largest market share in packaged meat in the two biggest pork markets in the world, with 30% share in China, and 40% share in ham and 18-20% share in bacon in the U.S.

After the recent sell-off, we were able to buy this dominant consumer franchise for around 9x FCF, with a 5% dividend yield. At the current WH Group market value, using Shuanghui value at market, the implied value of Smithfield is less than 2.5x EV/EBITDA vs. its U.S. peers, like Hormel and Tyson Foods, trading at 8-15x EBITDA. CEO and Chairman Wan Long and other insiders own over 35% of the company and have a solid track record of operations and capital allocation.

3Q18 Performance Review

	Contribution to Portfolio Return (%)	Total Return (%)
Top Five		
Softbank	+1.81	+40
Vocus	+1.55	+38
CK Hutchison	+0.58	+10
L'Occitane	+0.42	+9
MinebeaMitsumi	+0.36	+7
Bottom Five		
Vipshop	-2.58	-42
Melco International	-1.98	-34
Speedcast	-1.22	-28
MGM China	-1.08	-29
Man Wah	-1.01	-22

Top Contributors

Japanese telecom, tech and venture investment holding company Softbank (+40%) was the largest contributor to returns in the quarter. News flow over a potential initial public offering of Softbank's Japanese telecom business, which produces over \$5 billion dollars of free cash flow a year, picked up over the quarter. Furthermore, the potential merger of its U.S. telecom subsidiary, Sprint, with competitor T-Mobile, which they announced in April, continues to progress, while waiting for regulatory approval from the FCC. A few weeks ago, T-Mobile hired CenturyLink CFO Sunit Patel to lead its merger and integration strategy, which signals T-Mobile's confidence in obtaining regulatory approval for the merger with Sprint. These transactions, if completed, will significantly lower the debt on Softbank's consolidated balance sheet and help further narrow the discount to intrinsic value.

Vocus (+38%), a full service telecommunications operator providing fixed-network services to Enterprise, Wholesale and Retail customers in Australia and New Zealand, was one of the top contributors in the quarter. Vocus reported FY18 results in line with our expectations, and cash conversion improved significantly to 88%, up 70% YOY. Debt refinancing was completed in a cost effective manner, giving the company enough headroom to invest in the business, while comfortably meeting their bank covenants. We welcome new CEO Kevin Russell with a proven 20-year track record at Hutchison Three UK, Telstra and Optus. He targets doubling the revenue in the higher margin Enterprise, Government and Wholesale segment within five years (much higher than our projections). On the industry front, the third and fourth largest telecommunications operators, TPG Telecom and Vodafone-Hutch, announced plans to merge, igniting consolidation in the sector, which should help drive margins higher for all competitors.

CK Hutchison (+10%), a conglomerate of global ports, health & beauty, infrastructure, energy and telecommunications, was a contributor in the quarter. CK Hutchison reported strong first half results, with YOY revenue and EBITDA up 16% and 19%, respectively. Interim dividend per share increased by 11.5%, the first double-digit increase in the past decade. The company highlighted the strength of its Retail segment, which is the largest health and beauty retailer in the world with over 14,000 stores, 12 brands, and 130 million loyalty members that contributes over 62% of sales. Oil price recovery added to Husky results; in the first half, revenue increased by 37% YOY and EBITDA by 47%. In the quarter, CK Hutchison announced the sale of its interests in several infrastructure projects at a 12X earnings and redeployed the proceeds to acquire an Italian telecom joint venture at 5x earnings. Management also repurchased the company's discounted shares in the quarter for the first time in almost two years, demonstrating confidence in the company's future prospects.

L'Occitane (+9%), a global, natural, organic, ingredient-based skincare and fragrance manufacturer and retailer with regional roots in Provence, France, was a contributor in the quarter. Same store sales growth (SSSG) was +0.6% in the quarter, up from -0.6% in the same quarter last year. The U.S. market turnaround seems to be gaining traction, and the Greater China market continues to post strong growth. HK achieved SSSG of 11%, followed by China with 8% SSSG. With stronger marketing investments and product launches in the second half, we expect to see stronger momentum in the rest of the fiscal year (FY). Management has reiterated their goal of increasing operating margins for the core L'Occitane business to 13-15% by March 2022 by rationalizing their offline store network (especially in the U.S.), enhancing cost reduction efforts, growing margin-accretive online and Asia sales and achieving breakeven in Melvita, the organic skincare beauty line.

MinebeaMitsumi (+7%), the Japanese manufacturer of high precision equipment and components, was a contributor in the quarter. The company delivered strong quarterly results and revised up the operating profit forecast for the full year. Ball bearings revenue increased 21% YOY, driven by both bolt-on M&A, as well as organic growth, and external shipment and production reached a new record high in July 2018. The company expects to see benefits from increased ball bearing pricing from October. While the mobile phone back light unit sales in the quarter were down YOY, this was expected, as production for new models typically ramps up in the second half of the year. Since the quarter end, the company has overcome all major technical difficulties, and the production of backlights for the new iPhone models has been smooth. MinebeaMitsumi is the sole supplier of the LCD back light unit for new iPhone Xr model.

Top Detractors

Vipshop (-42%), a leading online discount retailer for brands in China, was the largest detractor for the quarter. Reported Q2 +18% YOY revenue growth was on the lower end of its prior guidance, and margins were weaker than expected due to major promotion events in the second quarter. While 24% of new customers added were from the Tencent/JD channel, the initial order size of those new customers was small, limiting the revenue contribution in the short term. The market was further disappointed with Q3 revenue guidance. Vipshop recognized it was distracted by the in-season apparel market, which faces intense competition from offline retailers and Tmall. Management is now focused on its core expertise off-season, discounted apparel and profitability improvement. While Vipshop is facing some near-term challenges, the market is pricing this double-digit grower at 10x PE with trough margins.

Melco International (-34%), the Asian casino and resort holding company, alongside MGM China (-29%), were two of the top detractors for the quarter, as discussed above.

Speedcast (-28%), a leading global satellite communications and IT service provider headquartered in HK and listed in Australia, was one of the top detractors for the quarter, after being a top contributor last quarter and last year. First half results missed street expectations, and management lowered its 2018 EBITDA forecast by around 10%. Management attributed the lowered forecast primarily to a delay in energy sector recovery and a one-off investment in a pilot project for a major cruise customer. Energy accounts for 25% of Speedcast's revenues. With WTI crude hovering over \$75 per barrel, we expect deep water offshore rigs to come back into operation over time, which will benefit Speedcast. The company also announced the acquisition of Globecom at less than 5x EBITDA, in an industry where most M&A transactions occur at 9-10x. The acquisition was funded by debt and increases Speedcast's debt/EBITDA ratio to 3.3x. We are comfortable with the financial leverage, as over 90% of total revenues are recurring, and this business has low capital intensity. As we have discussed in past letters, Australian small cap stocks tend to be overly punished for earnings misses and leverage ratio increases. We meaningfully increased our investment in Speedcast after CEO P.J. Beylier and multiple board members personally bought more shares.

Man Wah (-22%), the leading recliner sofa manufacturer in China, was a detractor in the quarter, driven by U.S.-China tariff headlines. While the U.S. is a major export destination for Man Wah, the market is not accounting for the company's healthy mix shift. Five years ago, over 55% of the company's sales were from North America, down to only 36% today, with China contributing over 48% of sales. Furthermore, Man Wah exports unbranded products with lower margins to the U.S., but in China, Man Wah dominates the recliner market with its branded product line, capturing higher margins and benefiting from pricing power. In 2017, its market share in China increased to

45%, up from 38% the prior year, with a commanding lead over the second player's 9% share. The branded Chinese business comprises the majority of our Man Wah appraisal value. In June, Man Wah acquired a manufacturing plant in Vietnam with low existing capacity utilization and vacant land. Man Wah could expand and export from Vietnam if trade relations between U.S. and China worsen further.

Portfolio Changes

During the quarter, we added three new investments, WH Group, and two other undisclosed investments. We also added meaningfully to our investment in MGM China. We exited Inchcape, Pandora, Ardent Leisure and JINS, as we recycled capital into more compelling opportunities.

Outlook

September is the tenth anniversary of Lehman's demise, a date permanently seared in the memory of one of your PMs, a Lehman Asia alumni. It has also been approximately 20 years since the Asian Financial Crisis (AFC), which began in Thailand in mid-July 1997, and spread throughout the region in 1998. In early 1998, Peregrine Investment Holdings, the high flying HK investment bank whose fixed income department was run by an ex-Lehman Asia bond salesman, went into liquidation, as a large loan to Indonesian taxi company Steady Safe defaulted. Steady Safe, which turned out to not be so steady, earned revenues in local currency but could not meet its foreign currency obligations when the Indonesian Rupiah collapsed.

In recent meetings, we have been asked to compare the current situation in emerging markets to the AFC. While on the surface there may be similarities – increasing local bond yields, emerging market currencies and equities weakness and high oil prices – we believe the situation is different this time around. Today, Asian countries and companies are much less exposed to the foreign currency debt mismatch that caused the AFC and have developed large and liquid domestic bond markets to help finance growth. Asian countries are much better positioned today given the improved foreign currency reserve position relative to foreign liabilities. Twenty years ago, the IT sector was a very small component of the MSCI Asia ex Japan index; today, this sector, which is composed of dominant, typically net cash companies that are capital-light compounders, accounts for around 31% of the index.

We have invested in companies that are well capitalized and can opportunistically act to take advantage of distressed opportunities. We believe that there is extreme pessimism regarding emerging markets today, which will give us the opportunity to capture excess returns similar to the times when capital was put to work in Asia in 1998 and, more recently, in 2015. Southeastern established an on-the ground research effort in Asia in 1998, when we opened our first international office in Japan, and seeded the International (non-US) Fund with partner capital in

1998 to take advantage of the many bargains that we saw in Asia then. The subsequent years were very profitable. We believe a similarly attractive opportunity exists in Asia today, with potentially better downside protection. Price-to-value ratio of our portfolio today is close to the lowest level it ever hit (in Q1 2016, towards the end of last Chinese market meltdown) since this fund's inception. Furthermore, the quality of our investment holdings (balance sheet, growth prospects) is better today than in Q1 2016. We believe our current portfolio can pave the way for strong, uncorrelated long-term alpha. We are excited about what we own today, and we have added more personal capital to the Funds again this quarter.

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