

# Neutron Fund Limited – Neutron A Monthly Newsletter (August 2015)

## NAV & Returns

Neutron Fund Limited	NAV/Share (HK\$)	MoM	YTD	Since Investment
Neutron A (“NFA”)	1061.8156	↓ 4.22 %	↑ 4.01%	↑ 6.79%

## Historical Net Monthly Returns

MoM	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
<b>2015</b>	+2.26	-2.12	+5.02	+13.59	+0.41	-4.31	-5.33	-4.22					<b>+4.01</b>
<b>2014</b>	-0.88	+1.23	-2.34	-1.79	+0.49	+4.41	+1.98	+0.98	-2.46	+2.00	+4.43	-6.37	<b>+1.14</b>
<b>2013</b>	-	-	-	-	-	-	-	-	-	+1.68	+1.24	-1.37	<b>+1.52</b>
<b>Hall Park Capital*</b>											Neutron A		
<b>2013</b>	+11.98	+1.76	+2.87	+6.79	+9.71	-7.19	+2.83	-1.79	+2.08				<b>+31.39</b>
<b>2012</b>	+2.45	+6.61	-4.36	-1.41	-2.89	+1.28	+3.28	+1.30	+0.63	+3.89	+2.11	+4.24	<b>+16.61</b>
<b>2011</b>	-3.10	-4.20	+5.57	+0.28	-0.87	-1.56	-1.53	+3.11	+1.29	-3.73	-0.27	-1.10	<b>-6.11</b>
<b>2010</b>	-0.72	-0.29	+1.53	+4.44	-2.93	-0.53	+1.81	+3.26	+11.89	+4.23	+0.96	+8.39	<b>+29.82</b>
<b>2009</b>	+1.12	+2.88	+3.77	+1.19	+7.92	+1.26	+1.89	-3.40	+0.86	+0.07	+4.22	+6.91	<b>+28.36</b>

\*The Strategy was previously expressed through Hall Park Capital from January 2009 to September 2013. This was run as a smaller managed account gross of fees.

## Fund Information

**Investment Objective** The investment objective of Neutron A is to focus on but not limited to Asia ex Japan and aims to generate positive returns in all market conditions.

**Investment Style** It is a concentrated portfolio of stock picks employing a fundamental value approach seeking to take advantage of trading opportunities from both the long and the short side.

**Investment Launch Date** 2 October 2013

**Domicile** Cayman Islands

**Fund Size** HK\$150 million

**Dealing** Monthly

**Administrator & Custodian** DBS Bank Ltd.,  
Hong Kong Branch

**Auditor** Ernst & Young Limited

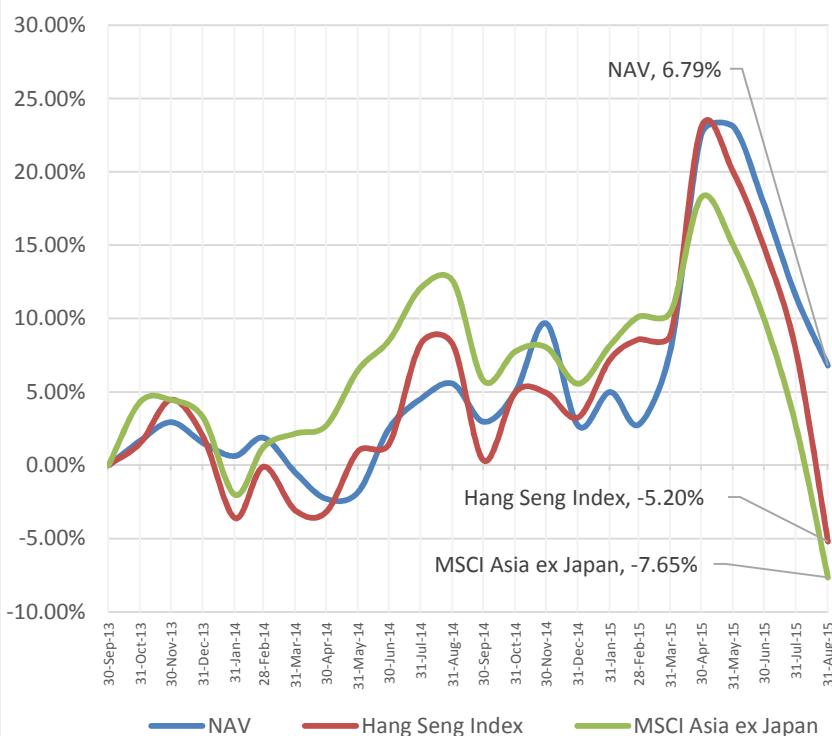
**Directors** Vincent Leung  
Patrick Harrigan (Independent)  
Sean Flynn (Independent)

**Portfolio Manager** Jonathan Garrick  
[jonathan@bricneutron.com](mailto:jonathan@bricneutron.com)

**Management Fee** 1.5% p.a.

**Performance Fee** 15% of profits above hurdle

Neutron A - performance since commencement of investment



For further information, please visit Bloomberg ticker: BNNEUTA:KY



## ***Neutron Fund Limited – Neutron A Monthly Newsletter (August 2015)***

The fund lost -4.22% net of fees in August. The NAV was 1061.8156 as of August 31<sup>st</sup>. Over the month, the Hang Seng index fell -12.04% and the H share index dropped a further -12.49%. The fund remains up +4.01% year to date. In comparison, the Hang Seng and HSCEI are down -8.2% ytd and -18.72% ytd respectively.

Financial market turmoil and volatility continued unabated in August with emerging market currencies and stock markets plunging further. For China, the incredible and historic events in July extended into August with hundreds of companies still suspended from trading and the bank/broker financed ‘National team’ (China Securities Finance Corporation, CSFC) persevering to buy stocks in an attempt to prop up the Shanghai Composite Index. The economic data points remained weak and the policy response was clearly underwhelming. Then on August 11th, China devalued their currency by 1.9% in a ‘one off action.’ That sent equities into a tailspin. The market speculated that this was the start of a new devaluation policy. The Chinese offshore forward contracts began to price in almost a 5% decline by the end of the year. This created further financial instability.

For many commentators, a cornerstone of the bullish argument on China was that the government had substantial policy tools at their immediate disposal with plenty of room to maneuver. Domestically, there was an unwavering belief that the government was all powerful and could address any economic issue. Over the last two months, that unwavering belief has been broken. This is a significant event. As if to compound the issue, only a day after the devaluation the Chinese public had to deal with horrendous chemical warehouse explosion in Tianjin. The incident appears to be a case of high level corruption and abuse of power to be able to bypass permits and regulations and store hazardous material close to residential homes. This included 700 tonnes of highly toxic sodium cyanide. The final death toll was 173 including 104 firefighters. This intensified the scrutiny over the integrity of the communist party and government control.

For the portfolio, August was disheartening. Our lower exposure and positioning in defensive names with stable earnings together with more substantial short positions still yielded a negative outcome. Two long positions made positive contributions, one remained flat whilst seven weighed on performance. The bulk of the negative attribution came from heavyweight holdings in internet, telecoms and travel. Our short book consisted of an erratic performance in index futures, however, all but one of short stock positions made positive returns with oil and tech companies making up the lion’s share of gains. With regards rotation, we exited eight holdings, but reinitiated on two of them and made two new additions. Both the gross and net exposure was further reduced.

August is 2Q results reporting season. For long time holding, Netease (NTES US, mkt cap U\$15.3bn) expectations were running high as their hit mobile game ‘Fantasy Westward Journey’ had already been the number one gross ranking game in China iOS for the last four months. In addition, there is the exciting prospect of a substantial pipeline of PC and mobile games to come. From the headlines, the 2Q15 results exceeded consensus with revenue growing +65% yoy and earnings +24% yoy. All three business lines - gaming, advertising and e-commerce – exhibited strong growth of 66%, 22% and 127% respectively. However, on the conference call some investors questioned the falling margins. Netease’s adj. operating margin had dropped to 35% vs 40% in 1Q15 and 45% in 2Q14. Some softening was expected due to the increased contribution from mobile games. Even with that taken into account, certain investors took issue with the expenditure on new businesses such as the cross border e-commerce platform, Kaola.com. The tone was concerning. They believed Netease was straying from core competencies and pouring money into a risky, highly competitive, lower margin venture. The stock fell over 10% in two days. We significantly reduced our position and over the subsequent days sold out completely. By the end of the month, the stock had fallen over 20% to close at U\$111.18 per share. We view this move as an overreaction. The new e-commerce venture remains comparatively small in the face of an accelerating online games business that generates huge cash flow. The company has U\$30 per share net cash and is trading on 12.1x p/e FY16. The management has a favourable track record, paying quarterly dividends and subsequently announcing a U\$500m share buyback



## *Neutron Fund Limited – Neutron A Monthly Newsletter (August 2015)*

program. Looking ahead, we would not be surprised to hear talk of a spin off the e-commerce business. We re-initiated a smaller position by the end of the month.

One positive surprise came from the 1H15 results for Guangdong Investment (GDI, 270 HK, mkt cap US\$8.6bn), a holding first mentioned back in Nov 2013's newsletter. We still like the water distribution company for its net cash, strong free cash flows, inexpensive valuation of x14 p/e especially given its low risk to earnings. Two thirds of profit is secured by water supply to Hong Kong. The problem has been that they have been talking about buying assets off the parent for two years and to no avail. The 1H15 results saw recurrent net profit gain +10% yoy which was above expectations. The main surprise was they announced the acquisition of toll road and water projects from their parent to be transacted in October. Details on the deals were sparse, but management indicated their attractive valuations. Analysts reacted positively by raising earnings and citing a low investment risk in infrastructure projects with long track records. Looking ahead we expect more acquisitions to drive earnings as GDI still has HK\$794m net cash. An extra driver may materialize in a corporate reorganization or disposal of non-core assets such as properties, hotels or department stores. Progress here has slow.

For investors, the concerns and instability have intensified. August follows on from July with the outflows from funds and ETFs accelerating. We continue to see cheap stocks become cheaper and the irrational moves often caused by blanket redemptions weaken confidence and conviction. We recognize the turmoil within China and other emerging markets and have positioned accordingly. The overcapacity in many heavy industries is a difficult structural problem. We are definitely not 'all in' on China, but we are not 'all out' either. China is the world's second largest economy and is not going away. The structural growth industries will continue to develop and value will emerge. We are confident that opportunities will arise.



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