

Neutron Asia Absolute Return Fund

Monthly Newsletter (August 2017)

NAV & Returns

Neutron Fund Limited	NAV/Share (HK\$)	MoM	YTD	Since Investment
Neutron Asia Absolute Return Fund ("NFA")	1,307.6278	↑ 1.55%	↑ 18.89%	↑ 31.52%

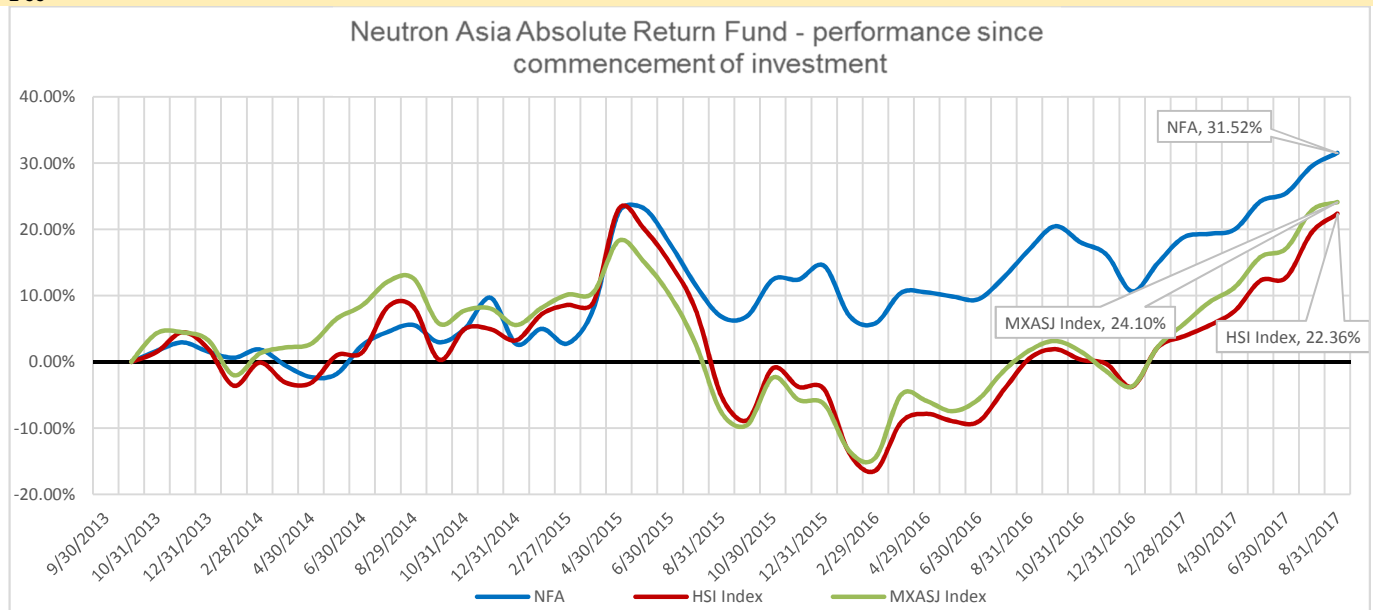
Historical Net Monthly Returns

MoM	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2017	+3.86	+3.37	+0.47	+0.56	+3.51	+1.01	+3.23	+1.55					+18.89
2016	-6.64	-0.96	+4.32	+0.04	-0.53	-0.39	+3.04	+3.73	+2.98	-2.03	-1.55	-4.79	-3.37
2015	+2.26	-2.12	+5.02	+13.59	+0.41	-4.31	-5.33	-4.22	+0.12	+5.14	+0.00	+1.83	+11.49
2014	-0.88	+1.23	-2.34	-1.79	+0.49	+4.41	+1.98	+0.98	-2.46	+2.00	+4.43	-6.37	+1.14
2013	+11.98	+1.76	+2.87	+6.79	+9.71	-7.19	+2.83	-1.79	+2.08	+1.68	+1.24	-1.37	+31.39* +1.52
2012	+2.45	+6.61	-4.36	-1.41	-2.89	+1.28	+3.28	+1.30	+0.63	+3.89	+2.11	+4.24	+16.61
2011	-3.10	-4.20	+5.57	+0.28	-0.87	-1.56	-1.53	+3.11	+1.29	-3.73	-0.27	-1.10	-6.11
2010	-0.72	-0.29	+1.53	+4.44	-2.93	-0.53	+1.81	+3.26	+11.89	+4.23	+0.96	+8.39	+29.82
2009	+1.12	+2.88	+3.77	+1.19	+7.92	+1.26	+1.89	-3.40	+0.86	+0.07	+4.22	+6.91	+28.36

* Hall Park Capital, 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 Asia Absolute Return Fund 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\$480 million Approx. US\$62 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
Management Fee	1.5% p.a.	Performance Fee	15% of profits above hurdle



For further information, please visit Bloomberg ticker: BNNEUTA:KY or website <http://neutronasiaabsolute.bricneutron.com/>



Neutron Asia Absolute Return Fund *Monthly Newsletter (August 2017)*

In August, the fund gained +1.55% net of fees. The NAV is 1,307.6278 as of August 31st. As a consequence, the fund has gained +18.89% year to date.

For the portfolio, August is an important month as many of our companies report results. We were broadly encouraged by the announcements and across the month we further raised both the gross and net exposure to the highest levels of the year. Our portfolio rotation meant that we initiated two new long positions and sold out of three. There was an active theme of rotation within existing holdings as we increased the size of our position in nine companies whilst reducing the size in eight. With regards to performance attribution, fifteen long positions made a positive contribution whilst five detracted. On the plus side, we saw the majority of holdings move higher led by our China industrial names and domestic plays. By far the main portfolio deduction came from one of our main holdings, Netease (NTES US) which beat revenue forecasts, but disappointed on margins due to higher revenue contribution from the lower margin business. The adverse price reaction weighed notably on the portfolio. We will discuss this more below. On the short side, we ended the month with no single stock shorts positions, whilst our futures positions contributed a small deduction to performance.

Despite the broad gains in the portfolio, the largest swing factor came from one of our major holdings Netease (NTES US, mkt cap US\$35bn) which released 2Q results. Despite beating forecasts and growing revenue +49% yoy (-2% qoq), the non-GAAP net profit grew only +8% yoy (-20% qoq) as margins contracted by 6pts to 26%. This was due to higher than expected marketing costs and aggressive promotions in e-commerce. The online games revenue grew +46% yoy (-12% qoq) in spite of the decline of existing titles and disappointment in recent releases. However, on the conference call analysts focused on the sharp decline in the e-commerce gross margin to 11% from 15% in Q1 and from 23% in 4Q16. Management made it clear that the current strategy was to focus on size and scalability and not near term profitability. Indeed, revenues surged +69% yoy (+35% qoq) to RMB 3.4bn (US\$525m), but the deterioration in margins was a negative surprise. The management seemed frustrated with the analyst's short termism versus their growth strategy and longer term goals. In a move to improve the understanding, they expect to release more disclosures on the ecommerce business next quarter. It was inferred that these metrics would be positively received by the market. The stock fell -12% from results and expectations have been lowered. We have reduced our holding in the company, but remain positive on the upcoming games pipeline and the management's ability in the ecommerce business.

As mentioned previously, we were broadly encouraged by the company results this month. Many corporates are beating expectations, growing revenues, expanding margins and raising dividends. Arguably, the most notable surprises came from special or increased dividends from State Owned Enterprises (SOEs). China Shenhua was the first to announce then followed this month by heavyweights PetroChina and China Mobile amongst others. In previous newsletters, we noted China's securities regulator (CSRC) had stepped up the pressure on SOEs to raise dividends, however these payouts now represent a legitimate change in corporate policy. If this is a deliberate drive for increasing shareholder returns, there are some easy wins ahead in reorganizing and restructuring their companies. This month's results brought further evidence that the government is cutting capacity in many industries although most prominently in heavy industries as steel and coal. The recent restrictions on capacity in industries we follow has help to bring back pricing power and firm up margins. It also improves the companies' competitive position which should result in a re-rating. Mainland investors have taken note. The Shanghai Composite index broke above 3,300 for the first time since 2016 with average daily volumes and margin financing increasing. The MMA southbound net flows into H.K. surged to US\$3.4bn in August with financials and tech names the main destinations. So far this year, the net southbound inflows have been Rmb273bn (US\$36bn) compared to Rmb117bn (US\$18bn) in 2016. In addition, the macro economic data is on an improving trend and the continued weakness in the US dollar provides an ongoing tailwind. Looking ahead, we still see evidence that the positioning of global equity investors remain underweight and that fund inflows will continue to support the market. Valuations remain relatively attractive and we believe the portfolio is well positioned to benefit. We are confident in our selective strategy with a focus on structural growth and value with catalyst.



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