CEDERBERG CAPITAL

1Q2015 NEWSLETTER

Review

Dear friends and co-investors,

Due to a combination of fund inflows and strong investment returns in April, the fund recently broke through the $100mn mark. We thank all our clients, old and new, for entrusting us with your capital.

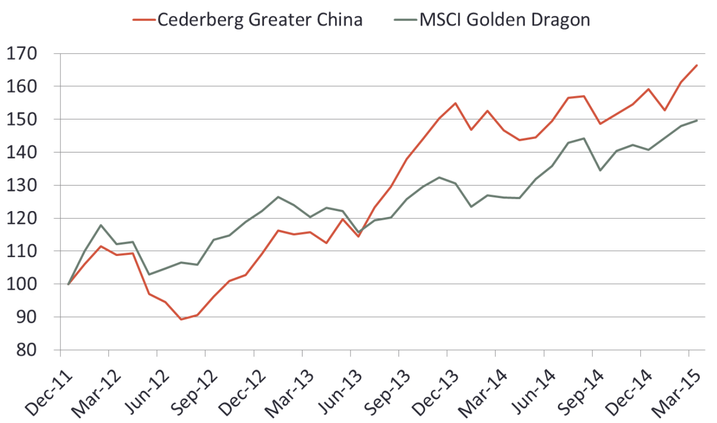
During the first quarter, Greater Chinese markets strengthened; the MSCI Golden Dragon index rose 6%. China (+8%) outperformed Hong Kong (+6%) and Taiwan (+4%). The Cederberg Greater China Equity Fund gained 5%, slightly lagging the index.

Texhong, the cotton yarn producer, rallied 48% due to the more stable outlook for yarn and cotton prices. **Nu Skin**, the personal care and nutrition company, rose 38% as signs of a recovery in its key China business emerged (for more information please see the Case Study section). **Straco**, the owner and operator of prime tourism assets, produced a strong set of results due to better than expected performance at its newly acquired Singapore Ferris wheel; its share price gained 25% during the quarter. **Phoenix New Media**, the online portal of Phoenix TV, declined 27%; despite decent results, near term earnings will be impacted by an investment plan to grow its user numbers. **Luk Fook**, the Hong Kong jeweller, fell 23% as concerns mounted over rising anti-Chinese sentiment in Hong Kong and the potential impact it could have on high spending Chinese visitors to the city. **Home Inns**, the budget hotel operator, dropped 21% as its fourth quarter results were impacted by the slowing Chinese economy.

We recently sold out of **Osim**, the Singaporean retailer of high-end wellbeing and nutrition products. Osim is a capital light business with strong brands, excellent management and decent growth potential within its niches. However we've been disappointed with the company's attempts to establish its brands in China, where it is facing a number of aggressive copy cat competitors. We made a modest return on the investment over the past two and a half years. We have subsequently distributed the sale proceeds into more compelling existing ideas.

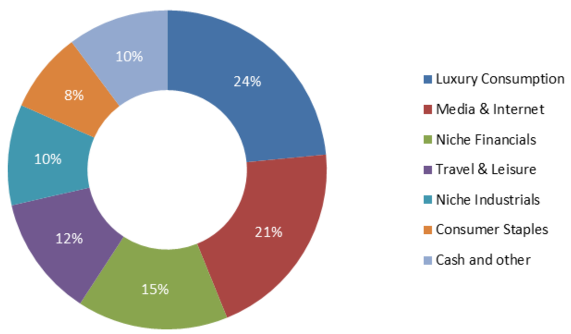
Performance & Positioning

USD Returns net of fees[1]	3m	6m	9m	1yr	Since Jan 2012	Since Jan 2012 (p.a.)
Cederberg	5%	12%	11%	13%	66%	17.0%
MSCI Golden Dragon[2]	6%	11%	10%	18%	50%	13.2%

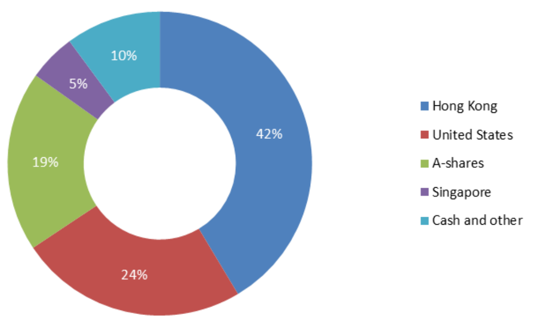


Key Characteristics[3]			
Price/Earnings Ratio (2015)	13.1	Fund Assets	$107mn
Price/Book Ratio	2.9	Total Assets	$157mn
Dividend Yield	2.8%	Number of Holdings	19
Return on Equity	19%	Top 10 Holdings	68%
Median Market Cap	$1.8bn	Upside Capture[4]	93%
Net Cash to Market Cap	8%	Downside Capture[4]	50%

Exposure by Category[5]



Exposure by Listing[6]



Top 5 Holdings (in alphabetical order)	
Clear Media	Value Partners
Kweichow Moutai	Wuliangye Yibin
Nu Skin	

1Q2015 NEWSLETTER

Outlook: Return Expectations

In our spartan London office, we have a "wall of fame" with pictures of some of our favourite investors. One of these investors, Peter Lynch, generated returns of 29% per annum in 1977-90 when he managed the multi-billion dollar Fidelity Magellan fund. Lynch generated these returns as a "bottom up" investor, ie by finding great businesses trading cheaply as opposed to "top down" investors who tend to invest based on their outlook for the economy. 'I spend about 15 minutes a year on economic analysis,' he said, going on, 'The way you lose money in the stock market is to start off with an economic picture.'

We take a very similar approach at Cederberg: find good businesses that are not particularly sensitive to a certain economic outcome and buy them when their valuations offer a significant margin of safety. Simple as that.

Thus when people ask us for our return expectations for Greater Chinese equities based on our macro outlook, we tend to draw the discussion back to valuations. After all, our old professors at London Business School (Dimson, Marsh and Staunton) have shown that economic growth and equity returns have historically been uncorrelated, while numerous academic studies have demonstrated the importance of starting valuations for future returns.

So how do China's valuations compare with those of other equity markets? The table below shows two valuation metrics (price/earnings or "P/E" ratio, and price/book or "P/B" ratio) for the Greater Chinese markets, as well as for other major regions (we've included South Africa for our clients based there). It shows that China H shares (Chinese companies listed in Hong Kong) and Hong Kong companies appear attractive when compared with the major developed markets, with Taiwan less so. China A shares (Chinese companies listed in Shanghai and Shenzhen) appear expensive after its recent strong rally.

Market	P/E	P/B
China H Shares	9.0	1.3
China A Shares	18.4	2.6
Hong Kong	10.6	1.4
Taiwan	15.1	1.7
Japan	18.0	1.4
US	18.4	2.9
Europe	24.4	2.1
UK	23.6	2.0
South Africa	20.3	2.3

Green indicates relative cheapness, while red indicates relative dearness

Source: Bloomberg, Cederberg Capital[7]

To provide some historical context, we've compared current metrics for these markets to their respective 10-year averages in the table below. For example, in the case of the H share market, its current P/E ratio of 9 times is at a 30% discount to its average P/E ratio of 13 times over the past decade. As before, both H shares and Hong Kong appear attractive when compared with the multiples one typically had to pay for them over the past decade, which is not the case for any of the other markets in our analysis.

Market	P/E vs. 10yr mean	P/B vs. 10yr mean
China H Shares	-30%	-35%
China A Shares	-1%	0%
Hong Kong	-18%	-21%
Taiwan	-34%	2%
Japan	-9%	6%
US	12%	19%
Europe	60%	34%
UK	22%	0%
South Africa	37%	-3%

Source: Bloomberg, Cederberg Capital[7]

Of course, one should be circumspect when using index-level valuation metrics to assess whether a market might offer value or not. For example, both H and A shares have a large weighting to banks, which are trading at very modest multiples, thus skewing the overall index valuation metrics. But even adjusted for this, China H shares appear significantly undervalued, which bodes well for their return potential over the next three to four years.

It is in this undervalued universe of stocks that we continue to find wonderful companies trading at bargain prices. Our portfolio of high quality names is trading on 13 times earnings, which are forecasted to grow 15% this year. Furthermore, they have strong balance sheets and decent dividend yield support. If Mr Lynch were still managing money today, he might very well have been interested in these investments.

No doubt I am starting to sound like a broken record, and some might even compare me with the stereotypical barber that always recommends a haircut. Rest assured that I won't always be singing this tune: there will be years when I will advise against an investment in Chinese equities because of rich valuations. There will also likely come a time when the fund will be closed to new investors because the strategy has reached its full capacity. Right now neither of these applies, but recent moves in Chinese equities suggest the window might not last forever.

1Q2015 NEWSLETTER

Case Study: Nu Skin

In the fourth quarter of last year we made an investment in Nu Skin, the personal care and nutrition company that sells its products through a direct sales channel (also known as a multi-level marketer, or “MLM”). Nu Skin is a global business selling to over one million customers in 52 countries. It is headquartered in Utah in the United States, but since over 40% of its revenue comes from Greater China it is eligible for an investment in our fund.

‘Wait a minute’, you say, ‘aren’t all MLMs Ponzi schemes selling useless products to the poor?’. Warren Buffett doesn’t think so: in 2002 his company Berkshire Hathaway bought The Pampered Chef, an MLM that sells cooking-related items at dinner parties hosted by its distributors in people’s homes. Likewise, we believe Nu Skin is a legitimate business with legitimate customers: over 60% of their revenue get shipped directly to the end-consumer, new distributors have virtually zero initial capital outlay, and the company has a generous return policy for any unsold inventory.

Not only is Nu Skin a legitimate business, but we believe it is a good business with a wide moat. This moat stems from two things. Firstly, the company has established a strong brand image due to the quality of its innovative products, which has led to customer captivity that is reinforced through daily consumption of its skincare and supplement products. Secondly, the company boasts a highly incentivised network of distributors, which rely heavily on their interpersonal relationships and “word of mouth” marketing, leaving it relatively immune to the threat of ecommerce (which can’t be said of many retailers these days).

The quality of the business shines through in the numbers that Nu Skin has generated in the 19 years since its IPO:

- Average return on equity of 28%
- Operating margins consistently in the mid-teens
- Profitable every year, free cash flow positive in all but one
- Revenue and earnings per share have grown tenfold
- Virtually debt free
- Bought back c. 30% of its shares over the past decade.

Despite Nu Skin’s stellar long term track record, its share price fell 70% last year as it experienced a series of setbacks: a short seller alleged it was operating an illegal “pyramid scheme” in China; it launched a new weight management program that didn’t meet expectations; and Herbalife (a prominent MLM) got investigated by the US regulator, which weakened investor sentiment towards the sector.

The most disruptive of these issues was the short seller’s attack, which led to a regulatory investigation in China in the first quarter of last year. It was concluded that some of Nu Skin’s salespeople breached certain regulations, which led to a slap on the wrist for the company. Nu Skin, however, took an extremely conservative approach to ensure full compliance by ceasing all marketing and recruitment activity for over three months, which severely impacted their China sales in 2014.

When Nu Skin’s share price dropped below $50 last year, Charles and I dropped everything in order to focus on the name. Over the course of the next few weeks, I did most of the desk-based analysis on the company and the MLM industry to better understand its long term track record and future drivers. I also looked at a number of other MLMs to better understand the fortunes of companies like Avon, Tupperware and Amway. Charles, meanwhile, spoke with a dozen industry experts all over China including distributors from Nu Skin and other MLMs, and legal experts to better understand the regulatory framework. Together, we visited two of the company’s factories and its China headquarters. Subsequently I also visited Nu Skin’s global headquarters in Provo to witness their Mormon work ethic first hand.

The conclusion of our research was that, despite its near term headwinds, Nu Skin’s competitive advantages (its brand and its distribution network) remained intact. Furthermore, the company has significant growth potential in China: Amway, the worlds largest MLM, achieves c. $5bn in annual revenue from the region versus Nu Skin’s $1bn even though the two companies are of a similar size in many Asian markets. Since we invested in September last year, its share have rallied by 40% yet we continue to find its valuation highly attractive: Nu Skin is currently a top 5 holding.

Conclusion:

We see significant upside potential in our portfolio of quality companies from Greater China. This leaves us optimistic about the outlook for returns over the next three to four years.

Warm regards,

Dawid Krige

Dawid Krige, Managing Director

Disclosure

[1] Performance is for an investment made at the fund’s inception; individual investors might experience different performance. Source: Charter Group Admin

[2] MSCI Golden Dragon Total Return Index, including dividends reinvested. Source: Bloomberg

[3] Portfolio characteristics are quoted as of 7 April 2015. Source: Bloomberg, Cederberg

[4] Upside Capture is calculated by dividing the fund’s average GAV return during months in which the index had a positive return by the average index return during those months. Downside Capture is calculated by dividing the fund’s average GAV return during months in which the index had a negative return by the average index return during those months.

[5] Category definitions as per Cederberg Capital

[6] Source: Bloomberg

[7] Data as of 7 April 2015. Indices used: HSCEI, CSI300, Hang Seng, Taiex, Topix, S&P500, STOXX Europe 600, FTSE UK All Share, FTSE/JSE Africa All Share. Source: Bloomberg

CEDERBERG CAPITAL

CEDERBERG GREATER CHINA EQUITY FUND - KEY FEATURES

Investment Objective

To provide significant long term capital growth by investing in listed companies operating in China, Hong Kong and Taiwan ("Greater China"). The fund aims to outperform the MSCI Golden Dragon Index (including income) over a 3-5 year period, without greater risk of loss.

Investment Approach

The fund utilises a **Quality Value** approach in order to protect capital during periods of market declines and to maximize returns in the long run. In short, we invest in good companies when they are cheap relative to their long-term cash earnings. We seek the following:

1. *Right business:* with entry-barriers that are both high and durable
2. *Right management:* skilled capital allocators with their interests aligned to ours
3. *Right price:* significant margin of safety, often due to temporary issues or neglect

Investment ideas are identified through our own fundamental research and on-the-ground due diligence. The portfolio is constructed based on a series of individual stock selections and will typically consist of 15-20 securities. Cash is held when undervalued securities become hard to find, and derivatives may also be used to protect the portfolio against adverse outcomes. The portfolio typically has a 70-100% exposure to equities.

Why invest in Greater China?

1. *Valuations:* Greater China stocks are currently significantly undervalued
2. *Growth Outlook:* consumption and urbanisation will drive growth for many years to come
3. *Inefficient Markets:* investors' short-termism create opportunities for long term investors
4. *Diversification*: China does not face the same structural issues that the developed world has to deal with e.g. deficits, deleveraging and pension liabilities

KEY FACTS

Legal status
Cayman Mutual Fund

Dealing
Monthly with 30 days notice

Share classes
US$

Launch date
1 January 2012

Minimum investment
US$100,000

Benchmark
MSCI Golden Dragon Index

Management fee
1.5% p.a.

Performance fee
20% of returns above Index;
Payable after 3 years if fund beats both Index and 6% p.a.

Investment manager
Cederberg Capital UK LLP

Custodian
Bank of America Merrill Lynch

Auditor
Deloitte

Administrator
Charter Group Admin

Cayman counsel
Maples & Calder

UK & US counsel
Schulte Roth & Zabel

Contact
info@cederbergcap.com
Tel. +44 203 689 1984