SOUTH OCEAN MANAGEMENT, LTD. 南海管理有限公司
HONG KONG

June 19, 2017

Dear Clients, Partners, and Friends,

The results for South Ocean Management's Delaware LP, Hong Kong Partners' L.P., before incentive fees, were as follows:

	May 2017	Year-to-date
Hong Kong Partners LP	-3.0%	5.1%
Hang Seng Index	4.2%	16.6%
Hang Seng Small Cap Index	-1.1%	5.9%
MSCI HK Small Cap Index	3.6%	9.1%

Partners' NAV $3.1363 after management fee and provisions, but before annual incentive fees of 15% on appreciation.

> **Superior results don't come from buying high quality assets, but from buying assets – regardless of quality – for less than they're worth. It's essential to understand the difference between buying good things and buying things well.**
> **A low purchase price not only creates the potential for gain; it also limits downside risk.** The bigger the discount from fair value, the greater the "margin of safety" an investment provides.
> - Howard Marks, Oaktree

> *Because security prices can change for any number of reasons and because it is impossible to know what expectations are reflected in any given price level, investors must look beyond security prices to underlying business value, always comparing the two as part of the investment process.*
> - Seth Klarman's Margin of Safety

South Ocean's portfolios are invested in small/mid cap, Hong Kong-listed companies with earnings benefiting from growth in China. Chinese money flows this year have been favoring Hong Kong large cap stocks, particularly Chinese tech, property, and financials, as valuations are more attractive than mainland, A-shares. We are not positioned in these sectors with our portfolios (as our intrinsic value screen doesn't show these sectors as *out-of-favor* enough to buy).

The month of May was very busy as trading in our largest holding, smartphone casing manufacturer, Tongda Holdings (code 0698hk, 9.9% holding) was volatile.

In early May, the company announced a 6% placement of shares at a discounted price to several long-only investment funds, taking the Chairman's position from 45% to 40% of total shares outstanding. The broadening shareholders' base was the primary reason behind the placement, based on discussions with management.

Soon after the placement, rumors emerged of a loss of orders from Huawei and OPPO, two major smartphone customers. The share price fell 10%. The company promptly held an analyst teleconference to assure the rumors were unfounded. Most analysts were satisfied with the explanation.

Shortly thereafter, another rumor hit of a pending short-seller report on the company (short sellers have been active in the Hong Kong market this year), which also proved false.

Sentiment, despite the unfounded, speculative rumors, remained weak and depressed the share price throughout the period, even as the company was aggressively buying back shares daily in the market during the turmoil.

The sharp decline in our largest holding challenged our results in the short term. Yet, we believe the poor sentiment will pass shortly, possibly as soon after the company reports interim financial results in August. Tongda has strong fundamentals and an undervalued, highly rated stock.

Overall, there have been increased inflows of investment funds this year into large and mid-cap stocks, sending the Hang Seng blue chip index to multi-year highs. The Hong Kong market has witnessed both mainland Chinese and foreign investors buying these sectors. Both sets of investors invest primarily in the larger, more liquid stocks. In fact, mainland investors are prohibited from investing outside of these sectors, as is required by the two Shanghai and Shenzhen/Hong Kong stock connect programs.

Hong Kong smaller cap stocks have not participated in the fund inflows, and, in fact, have performed very modestly, to-date. Nevertheless, we have often witnessed small caps 'catch-up' strongly as the cycle of fund inflows lengthens and broadens into the overall market. The Hong Kong market tends to attract more foreign capital, too, as the US dollar declines.

Our holdings of non-index, less followed, smaller companies are of outstanding quality and our patience can be very rewarding, holding these underrated stocks long term until they are 'discovered' by the market.

Since we have adhered to a discipline of buying good businesses cheaply (our intrinsic value screen demands a high return, 20%/year, and maximum price to pay for all holdings), we are generally able to weather any sudden 'storms' with a fair margin of safety for our capital. We remain quite comfortable with all our undervalued holdings.

Sincerely,

Brook McConnell
President
Email*:* *brook@south-ocean.com* Website: *www.south-ocean.com*

Hong Kong