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

October 15, 2012

Dear Clients, Partners, and Friends,

The results for South Ocean Managementôs Delaware LP, Kong Partnersô L.P., before incentive fees, were as follows:

	Sep 2012	Year-to-Date
Hong Kong Partners LP *	2.7%	-1.6%
Hang Seng Index **	7.0%	13.1%
MSCI HK Small Cap Index	4.9%	10.0%

Partnersô NAV for Sept $2.3155 after management fee, but before annual incentive fees of 15% on appreciation.

Thin trading volumes again prevailed in the Hong Kong stock market during September. Sentiment swung daily on the latest readings of the global economic crisis. For example, larger capitalized stocks were easily influenced, especially interest rate-sensitive property-related stocks, as when Fed Chairman Bernanke announced QE3 (the Hang Seng Index soared on the Fed announcement, gaining more than 3% in one day, but absent in the rally were many smaller capitalized shares where we focus our investment attention).

The market grinds higher under the central banksô stimulus programs, yet with the unprecedented impact of political risk hanging over the markets today, investor confidence is curtailed.

Last month, we were active visiting new companies, gleaning from mangers and executives their take on the economic landscape. At present, we are holding off buying any additional positions in our portfolios. The market has rallied 13% since early June so we are cautious (our cash holding is ~30% of total portfolio value).

This cash will be reinvested in either current holdings that have corrected (our holdings of strong balance sheet companies with above average growth prospects and low stock price valuations) or in new ideas we discover in our continuing company visits and analysis.

We wait to see how the fragile economic conditions today affect investor sentiment in the coming months before becoming fully invested. Hong Kong is an inefficient market, and with this cash buying power, we can take advantage of opportunities that may evolve (not that we like being on the sidelines, but itôs comforting being able to take advantage of lower priced shares should sentiment suddenly swing negative again).

Slowing economies have enabled us to initiate partial positions this summer in two companies with strong *Warren Buffett ‘moats*;ô namely, outsourcing giant Li and Fung and IT distributor Digital China. Li and Fung has become the worldôs largest sourcing agent. The company provides a full range of services, an unrivalled position in the sourcing industry with a global footprint of 15,000 suppliers in 40 countries.

Digital China (861hk) has 12,000 channels within China to distribute IT global brand products. No other company can possibly replicate this network in Chinaôs diverse market. As a spin-off of giant PC manufacturer, Lenovo, Digital Chinaôs leading position to service major China utilities and government departments gives it an unparalleled advantage. We bought shares trading at $12, down from a 52 week high of $17, at a single digit expected price earnings ratio. Digital China is debt free.

We attended global sourcing giant Li & Fungôs (494hk) first half financial results with management at the Grand Hyatt Hotel in Hong Kong. The company surprised the investment community by announcing lower than expected earnings, the first earnings decline we have witnessed since we began following the company in 1993.

In the early 90ôs, we bought shares when they traded at less than 10x expected earnings, no debt, when there was about HK$800 million in revenues. With our cost at an equivalent of 30 Hong Kong cents per share (adjusted for splits), we held until 2007. We sold at $25 after the company reported $0.89 in trailing earnings per share, or a relatively high price/earnings ratio of nearly 30 times.

After the results announcement this summer, the shares dropped sharply. The company has grown to US$21 billion in annual revenues and a market capitalization of US$12 billion. The shares trade at 15 times estimated earnings of $.80 per share for 2013.

More on the company given in the article following. We bought the cash-rich (US$200 million cash on hand) shares following the announcement, alongside company insiders including the majority owners, the Fung family, who reportedly made open market purchase of around 20mn shares.

Using conservative estimates for these two holdings, we can project longer term. Digital Chinaôs earnings per share growth in the last 5 years has been 37.2% annually. If we project it will grow in the next 5-10 years at a 9.8% earnings per share growth rate and sell at its historic P/E of 12 times, the shares would exceed $70. For Li and Fung, earnings have grown at 14.4% annually for the last 5 years (18% over the last 10 years), and the market is projecting 20 % annual growth for the next 5 years. If we project earnings to grow at a 10% projected rate for the next 10 years (and using its lowest historic P/E multiple of 19 times versus its average of 31 times P/E), the shares would sell at $118. We would accrue a >20% compound annual return under these scenarios with each of these positions.

Suspended holding Chaoda Modern Agriculture made an announcement on September 28th. The Company has not yet formally appointed its auditors and the process of identifying a suitable replacement to fill the vacancy is continuing. The Company is unable to predict at this stage the date by which the appointment can be made but will endeavour to make an appointment as soon as practicable and make an announcement when the appointment is made. Once the appointment of the Company's new auditors is made, an audit of the Group's financial statements would be carried out with a view to, among others, publishing all outstanding financial results and reports of the Group for the two financial years ended 30 June 2011 and 2012 together with the six months ended 31 December 2011 as soon as practicable.

We wait for further news.

Sincerely,

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Hong Kong

August 20, 2012, 1:31 p.m. ET

Li & Fung Faces Threat as Retail Supplier

KATHY CHU

Li & Fung supplies American retail giants like Walmart and Target, but amid

lackluster growth around the globe it's looking for more business in Asia. The

WSJ's Deborah Kan speaks to Li & Fung's President Bruce Rockowitz.

HONG KONGð For the past century, Li & Fung Ltd. 0494.HK 0.00%has been supplying everything from shoes to baby clothes for such global retailers as Target Corp. TGT -0.78%and Wal-Mart Stores Inc. WMT +0.43%But after decades of rapid expansion, the company is logging shrinking profit margins.

Now, an even greater threat looms: retailers working directly with factories and cutting out middlemen like Li & Fung.

Singer Coco Lee and Li & Fung CEO Bruce Rockowitz addressed the media at the couple's wedding in October.

The company's shares this month have posted their biggest drop since listing on the Hong Kong Stock Exchange in 1992, and several brokerage firms have downgraded the stock.

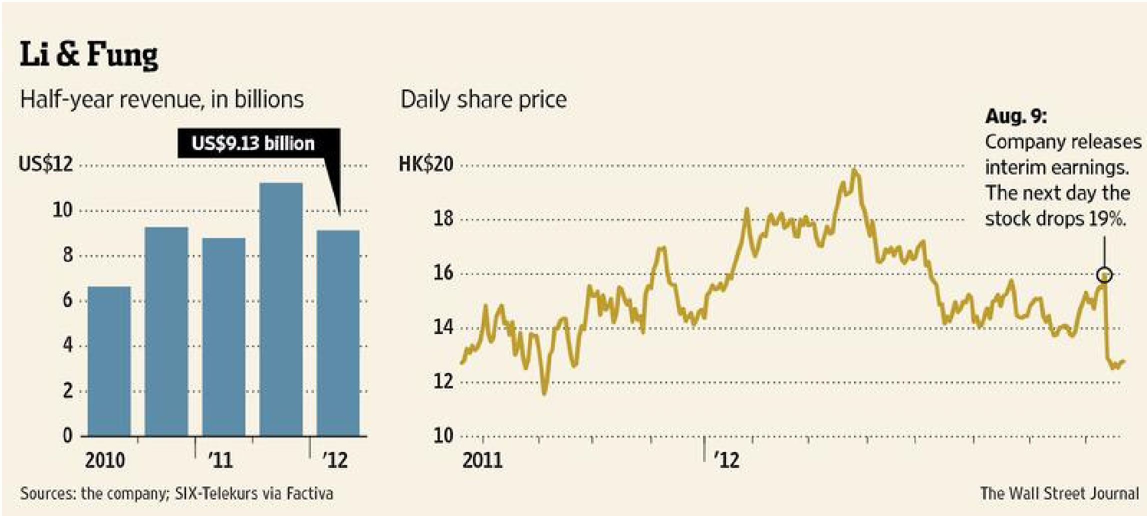
Despite making nearly two dozen acquisitions in the past 18 months, Li & Fung's revenue rose only 4% in the first half and expenses rose sharply, indicating that some of the companies Li & Fung acquired may be underperforming. Analysts estimate that the company's organic earnings, which excludes results from acquisitions, have declined.

Chief Executive Bruce Rockowitz blames the company's weak performance on a challenging global economy rather than internal operating problems.

"When the world is bad, of course your organic growth is going to slow down," says Mr. Rockowitz, a 53-year-old former tennis instructor from Canada. "If the world improved a lot, and we were still performing at a lower organic rate, then that's [a problem]. But that hasn't happened."

Li & Fung's original business model was to contract with factories to manufacture goods for retailers, but the company long ago expanded into a one-stop shop: It now designs, markets and transports products as well.

A weak global economy has given Li & Fung the opportunity to buy cheap assets, which helps offset slowing organic growth, says Mr. Rockowitz, who cruises around Hong Kong in a blue two-door Bentley with a license plate that says "Rock 8," a reference to his lucky number. He married Asian pop star Coco Lee last year in a ceremony attended by American singer-songwriter Bruno Mars and other celebrities.



Mr. Rockowitz says he expects profit margins in the company's distribution business, which are at a record low, to recover next year as raw-material costs ease and the company shifts jobs to countries such as China and Bangladesh from higher-cost countries.

"We feel good" about Li & Fung's ability to increase core operating profit to $1.5 billion in 2013 from $726.1 million in 2010, he says.

Barclays analyst Vineet Sharma believes the company will miss the target "by a significant margin," however.

But the main challenge facing Li & Fung is maintaining its role as a middleman.

"My biggest concern is that the margin deterioration we saw was not just cyclical but could be structural," says Gabriel Chan, director of Asian equity research at Credit Suisse. The bank downgraded Li & Fung's stock to "underperform" this month. "Li & Fung has to do more and more to keep their customers," which could hurt profit margins, Mr. Chan says.

Customers including Wal-Mart and children's apparel companies Carter's Inc. CRI -1.44%and Gymboree Corp. have said they plan to obtain more of their products directly in coming years.

But even when retailers decide to source directly, they will still need an intermediary to manage logistics, communications and quality checks with the factories, Mr. Rockowitz says.

He says retailers aren't moving away from Li & Fung; indeed the company has signed agreements to source products for retailers including Target Australia and Wal-Mart. Li & Fung gets 62% of its revenue from the U.S., 18% from Europe, and the rest from Canada, Asia, Central and Latin America, South Africa and the Mideast.

Li & Fung recorded an operating loss last year from its 2010 sourcing deal with Wal-Mart, a trend that UBS analyst Spencer Leung says will likely continue.

Large retailers often use a mix of direct sourcing and working with intermediaries, and as they grow, migrate toward the former to boost profits, says Peter Brown, vice chairman of Kurt Salmon, a retail consulting firm. The need to design, manufacture and get products in the store quicklyð a fast-retailing concept popularized by chains such as Inditex Group SA'sZarað also boosts the appeal of direct sourcing, he says.

When the global economy improves, the threat of retailers sourcing directly will increase, says Credit Suisse's Mr. Chan. During a weak economy, retailers may not want to pay the upfront costs for infrastructure and offices that allow them to source directly.

Mr. Rockowitz says Li & Fung will change with the times, if necessary.

"We're doing more for our customers today, not less," he says. "No one can say what's going to happen in the future, but we look at our business as a drumbeat, and we look every three years to see if we need to change."

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*Hong Kong Partners LP risk disclaimer:

- Hong Kong Partners LP (The "Fund") primarily invests in the Hong Kong equity market with a Greater China focus.
- The Fund invests in China-related companies which involve certain risks not typically associated with investment in more developed markets, such as greater political, tax, economic, foreign exchange, liquidity and regulatory risks.
- The Fund is also subject to concentration risk due to its concentration in Hong Kong, particularly China-related companies. The value of the Fund can be extremely volatile and could go down substantially within a short period of time. It is possible that a substantial value of your investment could be lost.
- You should not make investment decision on the basis of this material alone. Please read the explanatory private placement memorandum for details and risk factors.

**Index Descriptions: The Hang Seng Indexes are a widely recognized capitalization-weighted indexes that measures the performance of the three largest-capitalization sectors of the Hong Kong stock market in descending order. The Hang Seng Index measures the largest 52 market capitalized listed companies in Hong Kong's stock market. The Hang Seng Mid Cap Index represents the next 193 largest capitalized listed companies, the Hang Seng Small Cap Index represents the next 187 largest capitalized listed companies in Hong Kong.

The MSCI HK Small Cap Index is a free float-adjusted market cap weighted index designed to measure the performance of small cap equity securities in the bottom 15% of equity market capitalization in Hong Kong. With 69 constituents, the index represents approximately 14% of the free float-adjusted market capitalization of the Hong Kong equity universe.

The Hong Kong Partners LP (HKP) is benchmark agnostic and its corresponding portfolio may have significant noncorrelation to any index. The portfolios may invest in all sectors (within and/or on other stock markets) and the composition of securities in the portfolio may change periodically depending on market conditions at the time. Securities in the portfolio will not match those in any index.

Index returns are generally provided as an overall market indicator. You cannot invest directly in an index. Although reinvestment of dividend and interest payments is assumed, no expenses are netted against an index's returns. Index performance information was furnished by sources deemed reliable and is believed to be accurate, however, no warranty or representation is made as to the accuracy thereof and the information is subject to correction.

Before investing you should carefully consider the Partnership's investment objectives, risks, charges and expenses. This and other information are in the prospectus, a copy for Accredited Investors may be obtained by inquiring to info@south-ocean.com. Please read the prospectus carefully before you invest.

The principal risks of investing in HKP: Equity Securities Risk. The value of the equity securities the Fund holds may fall due to general market and economic conditions. Foreign Securities Risk. Investments in the securities of foreign issuers involve risks beyond those associated with investments in U.S. securities. Industrials Sector Risk. Companies in the industrials sector may be adversely affected by changes in government regulation, world events, economic conditions, environmental damages, product liability claims and exchange rates. Consumer Discretionary Risk. Companies in this sector may be adversely impacted by changes in domestic/international economies, exchange/interest rates, social trends and consumer preferences. Information Technology Sector Risk. Information technology companies face intense competition, both domestically and internationally, which may have an adverse effect on profit margins. Detailed information regarding the specific risks of Hong Kong Partners LP can be found in the prospectus. Additional risks of investing in HKP include equity, market, management and non-diversification risks, as well as fluctuations in market value and NAV. An investment in a private limited partnership is subject to risks and you can lose money on your investment in the limited partnership.

There can be no assurance that HKP will achieve its investment objective. The LP's portfolio is more volatile than broad market averages. Shares of HKP cannot be bought or sold publicly, there is no active market in the Units and there are restrictions imposed on Limited Partnership unit transfers. Partnership redemptions are handled by Authorized Administrators of the Partnership.