April 15, 2013

Dear Clients, Partners, and Friends,

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

	Mar 2013	Year-to-Date
Hong Kong Partners LP *	0.9%	8.0%*
Hang Seng Index **	-3.3%	-1.8%
MSCI HK Small Cap Index	1.1%	9.4%

Partnersô NAV for March $2.3984 after management fee and provisions*, but before annual incentive fees of 15% on appreciation.

Our portfolios of fast growth companies listed in Hong Kong, with earnings geared towards China, again out-performed last month. As the Dow Jones Average and S&P 500 mark new highs in the US, the Hang Seng Index of Hong Kong-listed blue chips remains far below historic highs.

Please feel free to review and share our letter below.

Sincerely,

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

Our newly established investment screening process, using an intrinsic value method similar to Warren Buffettõs system, is uncovering a much broader range/universe of compelling growth stocks in Hong Kong to own.

These companies are fundamentally strong businesses, as determined by return on equity, profit margin and debt analysis, cash-flow and net income growth.

To determine an intrinsic value for a company, our analysis projects into the future a conservatively derived growth of earnings per share and dividends, then discounts back a maximum price to pay today for that growth in the business (we utilize StarMine Smart Growth proprietary estimates, which systematically renders a 10 year growth in EPS estimate by removing overly optimistic biases in analyst estimates).

We then demand a large margin of safety (deeply discounted bargain price) to buy the shares (we want a 20% minimum annual return to reach our targeted intrinsic value share price).

Next, we get to know the company better with a visit to management (Hong Kong is the most condensed, efficient global financial center and is especially convenient for getting in to hear management and understanding listed companies).

We screen the entire Hong Kong stock market for fundamentally strong companies to begin our analysis. One example, of a recent purchase, can be viewed with the following chart: we bought a leading company in the very unpopular alternative energy sector in the fourth quarter last year; a wind farm energy producer China Datang Corp Renewable, (code 1798 hk, market cap US$1.4 billion). It became attractive on our screen when shareholders were abandoning the shares. From a high of $2.40, after the spin-off from its parent in 2011, the share price declined to attractive risk gain levels.

Datang Renewable benefits the most when Chinaôs electricity grid gets ôhooked-upô to the wind farmsô remote locations.

Itôs notable; our screening includes much larger capitalized values as well. In looking back, during the Sars epidemic in Hong Kong in the spring of 2003, we found over a half dozen blue chip/large cap stocks to own (nobody wanted to own Hong Kong then). But these highly analyzed large caps normally sell at premium valuations and are, consequently, of little interest.

For instance, based on our intrinsic valuation method of estimating the future worth of a company, one highly treasured property company in Hong Kong, which sells at ~HK$113 today, would only look interesting (on our screen) if it were to sell below $50 a share. Property stocks, in general, are usually perceived as asset plays, and are more often valued on book value/NAV analysis.

One blue chip, though, that has fallen in price sharply is global supply chain manager, Li and Fung (code 0494.hk, market cap US$11.6 billion). We bought shares of this outsourcing-for-high-volume, time-sensitive consumer goods company in the first quarter this year.

Last month, we attended the analyst briefing held at the Hong Kong Convention Centre to listen to management.

Similar to Warren Buffettôs required ómoatô (or a competitive edge) for his investments, nobody in the consumer goods trading and distribution sector can touch Li and Fungôs size and capabilities.

The company has an esteemed management team, great corporate governance, and substantial competitive advantages. As Li and Fungôs principal market in the US slowly recovers, its developing brand businesses in Asia and China are gaining as additional earnings drivers.

A dividend yield of 5% for 2013 and a P/E of 14.9x suggest favorable risk gain ratios for the company (even using depressed, conservative, even pessimistic estimates). Its historical P/E has averaged 30.7x over the past 5 years.

The company has no long term debt and Li and Fungôs net cash amounts to US$680 million. We have a 3% position at present in the shares and its major shareholders have reportedly been buyers after the results meeting.

Our biggest winner (and now largest holding because of the appreciation) is garment and leather bags manufacturer Luen Thai (311 HK, 8.7% position, HK$2.3 billion, US$296 million market cap). The company reported core earnings last year surged 71% from margin recovery and turnaround. Operating margins improved from increasing production outside of China. Recent expansion in the new, lower-cost Coach handbag plant in the Philippines helped swell profits. Luen Thai's customers include overseas brands such as Uniqlo, Coach, Esprit, Adidas, Mexx, and Polo.

The share price has increased 180% since we started buying a year ago, yet the shares sell at only 7 times expected earnings versus 12 times for peers. Luen Thaiôs balance sheet is strong, with no long term debt, with a steady and consistent dividend payout. Its recent acquisition of Ocean Sky Global, an apparel and accessories OEM manufacturer with production bases in Vietnam and Cambodia, (in line with management's strategy to diversify its production bases outside of China) is an additional earnings driver, (from The Gapôs children clothes lines of businesses and improving plant operating efficiencies).

We bought a leading oil service firm operating on the mainland the end of last December. China has the largest oil shale geological structures in the world and is just starting to tap into these reserves (China is desperate for new supplies). This major mainland oil service drilling company is the dominant provider in horizontal gas wells and fracturing, with a 50% market share. Global oil service giant, Schlumberger, acquired a 20% position in the company last year.

Using conservative calculations, with our intrinsic analysis system, we bought shares at HK$3.70, which are now trading at over HK$5.00 (a 2.7% position, US$1.4bn market cap). Our ten year target price is HK$33/share, an indicated market cap value of US$9bn compared to SLBôs US$110 billion capitalization.

We added a high growth, sewage and water treatment company to our holdings (2.7% holding, US$2.1 billion market cap). China and India together have 40% of the worldôs population but only 10% of the useable water supply.

This sewage treatment and water company, importantly, is 49.8%-owned by the Hong Kong-listed stock of the central governmentôs municipal capital (the main listed vehicle in Hong Kong for raising capital to fund public utility projects plays an important role for the municipal government). Previously privately-owned (with management still intact), the companyôs water treatment expansion program throughout China is augmented in conjunction with China Development Bankôs backing.

We also added small positions in two Macau gaming stocks in the first quarter.

One of these casino operators reported in March its net more than doubled in 2012 to hit a record. Its growth prospects are enviable, as it is the owner of largest land plot for development of future casinos, along the Cotai strip, in the enclave of Macau, the world's biggest gambling hub for mainland Chinese tourists.

Significantly, all of these newly acquired stocks have important ñBuffettò moats or competitive advantages.

What is important is we developed a software screening tool to find these top rated companies selling at very reasonable prices, with the help of the Reutersô database. Without going into too much detail, our software (that we developed in conjunction with the Reutersô programmers) screens for fundamentally great listed companies in Hong Kong selling at attractive valuations relative to their intrinsic values.

It is these types of exciting growth companies we spend our time analyzing.

With our cash holding of just over 20% of total portfolio value, we are positioned to buy into leading companies whose stocks meet our stringent requirements, in case of any potential market corrections.

"The way you lose money in the market is to start off with an economic picture."

"The very best way to make money in a market is in a small growth company that has been profitable for a couple of years and simply goes on growing."

Peter Lynch

In the NY Times best seller, SuperFreakonomics, the authors note the news mediaôs sometimes lopsided reporting that often contaminate the way we think.

They deduced, by examining how people respond to incentives, some common fallacies;
-that *walking* drunk is more dangerous than drunk-*driving.*
-highly acclaimed, Nobel Peace prizewinning academic researchers and preeminent scientist were all uprooted when a native born Wisconsin economist proved altruism was not an innate human behavior.
-that contrary to common beliefs by the press, volcanic eruptions are actually the most effective means of stopping the greenhouse effects of global weather changes and that instead of a global warming, average global temperaturesé have in fact *decreased*.
- Time Magazineôs front page report on an eight year old Florida boy ripped apart by a bull, a most chilling report to all ocean swimmers.

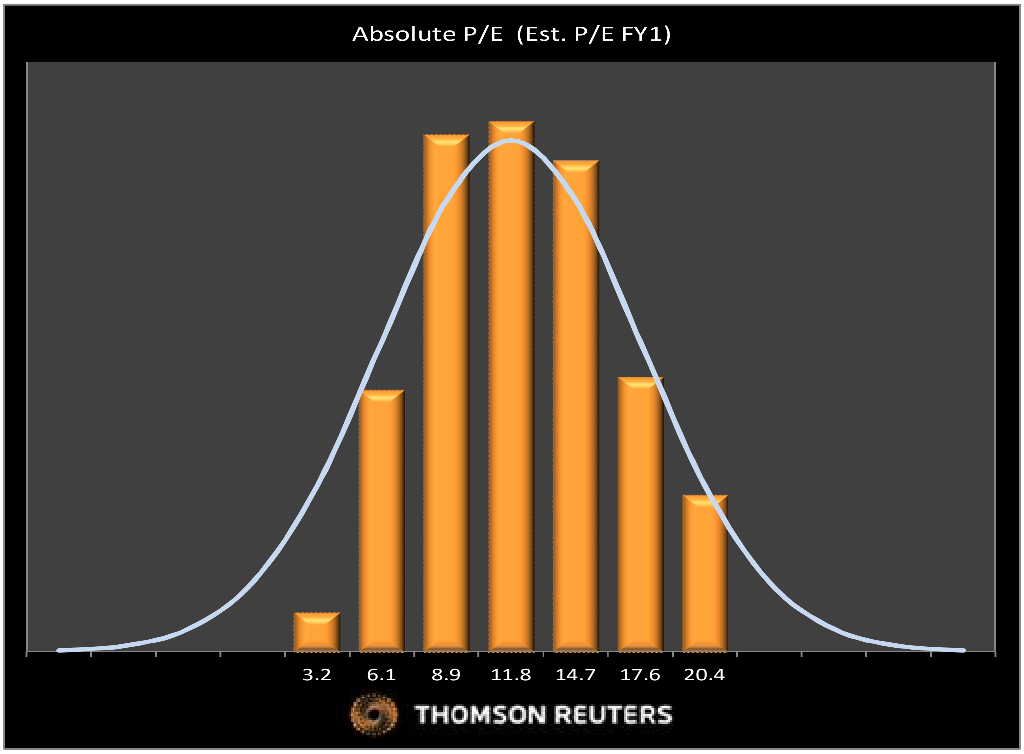
And though these events get massively reported by the press, the authors answer, ñé if you think like a cold-blooded economist instead of a warm-hearted humanist, the reasoning (often) doesnôt track.ò

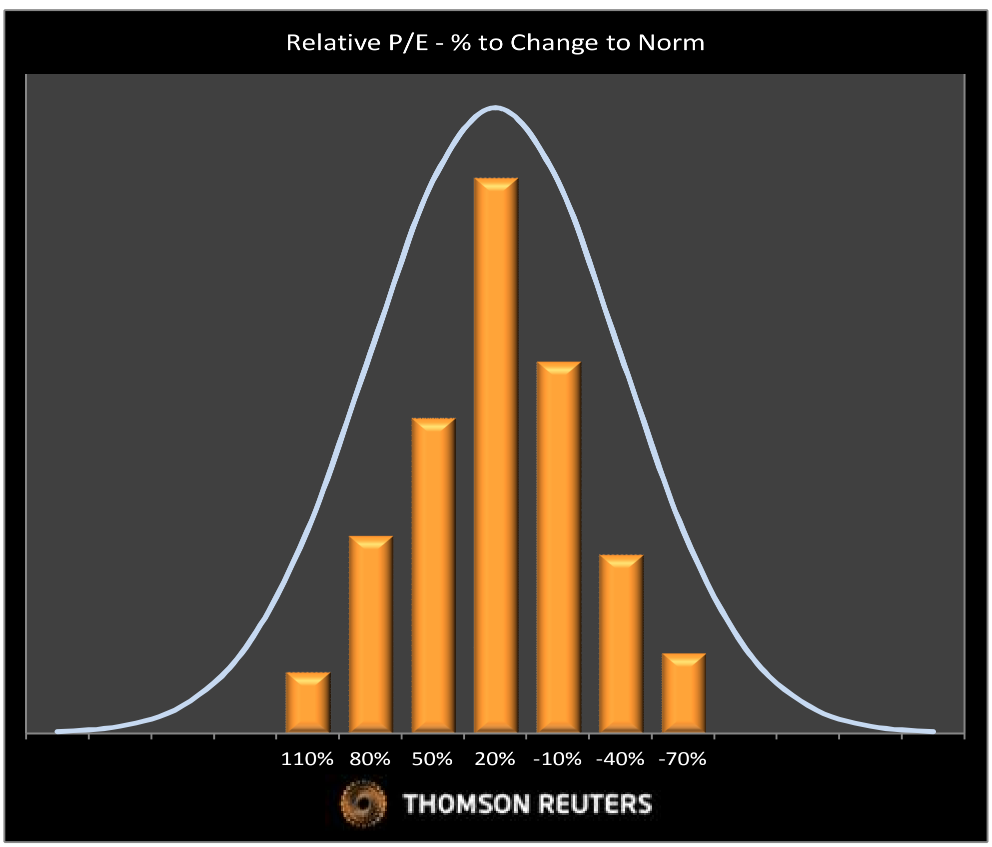
They concluded:

> "…while there are exceptions to every rule, it's also good to know the rule (for instance, lethal shark attacks numbered only 5.9 fatalities, on average, worldwide a year whereas elephants go, unreported, killing over 200 people a year, on average). In a complex world where people can be atypical in an infinite number of ways, there is great value in discovering the baseline. And knowing what happens on average is a good place to start. By so doing, we insulate ourselves from the tendency to build our thinking – our daily decisions, our laws, our governance – on exceptions and anomalies rather than on reality."

Along this line of reasoning, we also query what the average is or what is a typical, baseline value for all Hong Kong stock prices, after removing all the media hype and noise that can get in the way. (As noted above, we utilize conservative StarMineôs Smart Growth estimates to help determine a less biased baseline by which to forecast and analyze stock values).

One method we use to access that value of the market, overall, is to measure the price earnings ratios of each listed stock (with at least two analyst estimates forecast), in this manner:


Absolute P/E (Est. P/E FY1)
3.2
6.1
8.9
11.8
14.7
17.6
20.4
THOMSON REUTERS


Relative P/E - % to Change to Norm
110%
80%
50%
20%
-10%
-40%
-70%
THOMSON REUTERS

In other words, from the second chart above, a preponderance of stocks in Hong Kong today would increase 20% or more just to return to their typical/average price to earnings ratio/value on expected earnings.

We agree with the authors about knowing the baseline rules; it can be disadvantageous to oneǒs gains in the stock market to fervidly listen to all the media noise (the book was kindly given to me by one of our clients. SuperFreakonomics is an entertaining, easy and informative read).

And as Don Hays aptly commented:

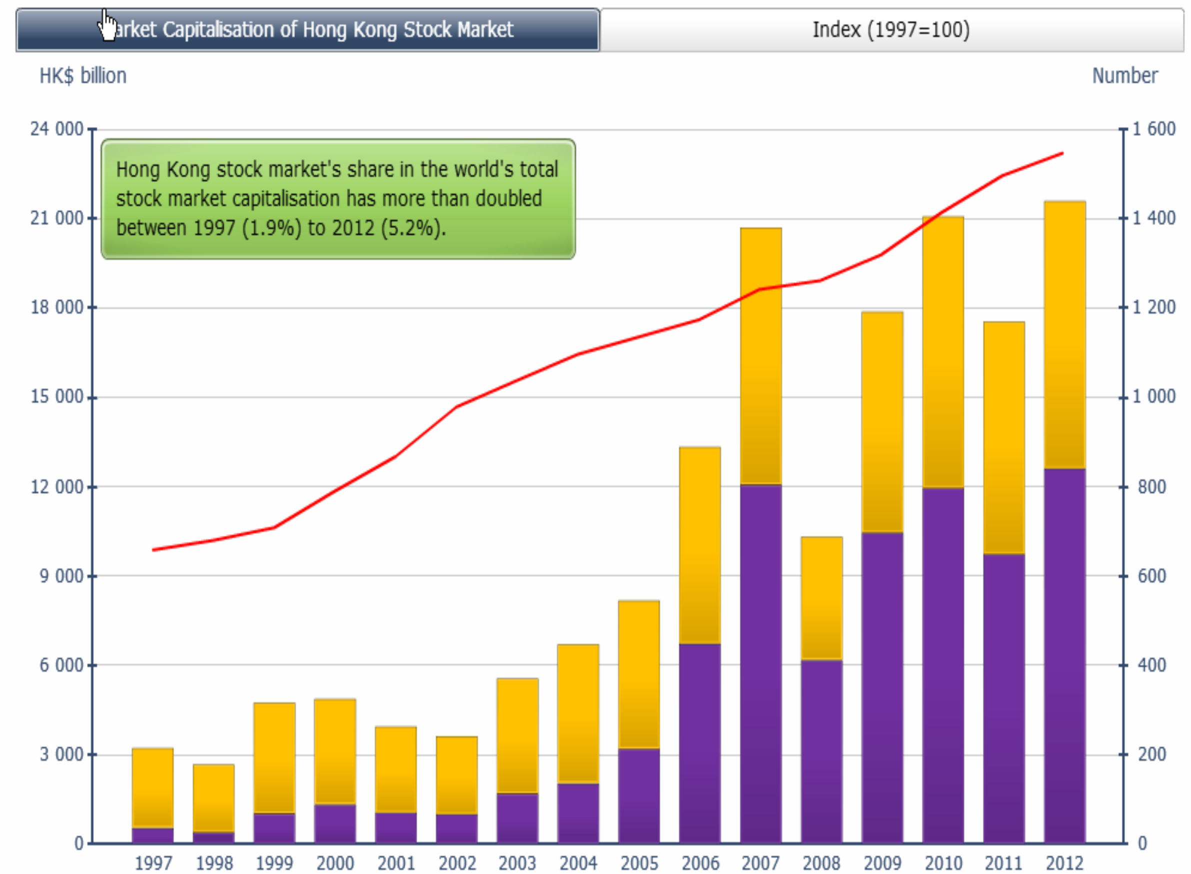
The mistaken methodology is to get all the economic, political, etc. information, process it, and then come up with your analysis of what the stock market will do based on that news. What an unbelievable mistaken methodology. You can look at history, and the truth is that no matter how smart you are, it is better to do exactly opposite of your analysis. If you think the future looks bright, SELL! If you think the future looks grim, BUY!!

Morgan Stanley shocked market commentators on financial news networks recently in a report that suggested the Hang Seng Index may rise to 50,000 (from just under the 22,000 Index level today) by the end of 2015, marking 121% growth against the current level.

The major reasons include the ultra-easing monetary policies adopted in the developing countries and the rapid economic growth in the global and Chinese markets. Secondly, the Hang Seng Index typically peaks once in every six to eight years, and may hit a new high in 2015. Third, the current valuation of 11 times in P/E and 1.52 times in P/B is below historic levels. Fourth, the Qualified Domestic Institutional Investor program from the Mainland and the control measures in the local property market may lift the transaction volume in the stock market.

Now, note what has been the ǒbaselineǒ for the growth of the Hong Kong market over a longer time frame:

Chart 2.4 Market Capitalisation of Hong Kong Stock Market



(Actually, when we started investing in Hong Kong, in 1992, the Hong Kong stock market capitalization was HK$1,332 million or US$170 billion. It exceeds US$2.7 trillion today).

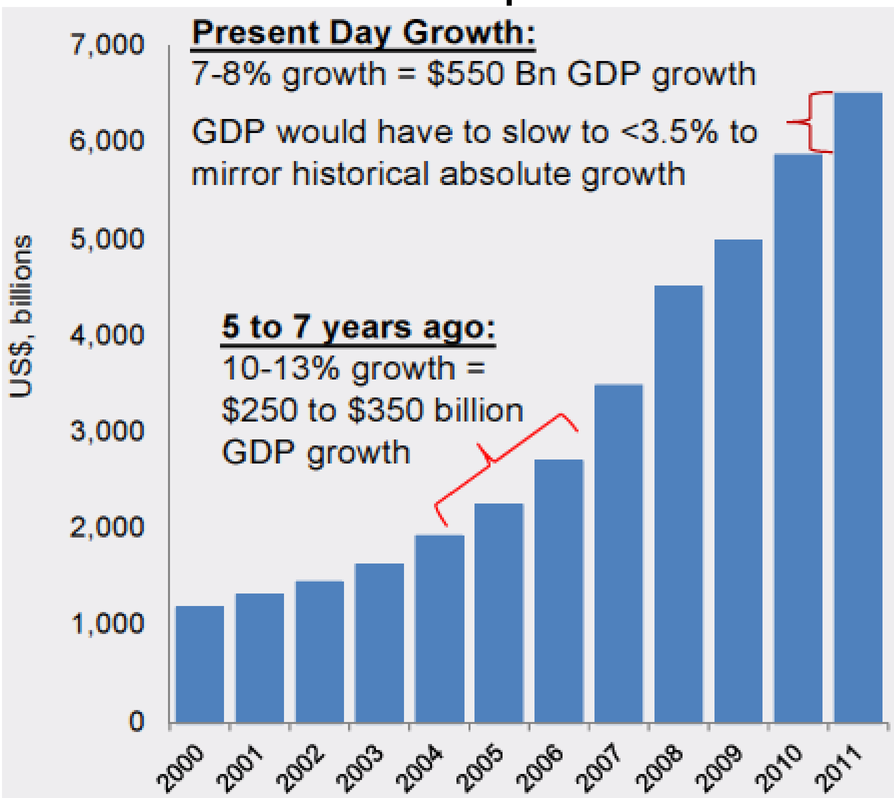
Morgan Stanleyôs 50,000 target level on the Hang Seng Index, therefore, is not totally out of the realm of probability.

Not all news appears as it first seems, after further ôcold-bloodedô reflection.

Talk of slowing growth/hard landing in numerous economic forecasts on China likewise needs to be put into perspective.

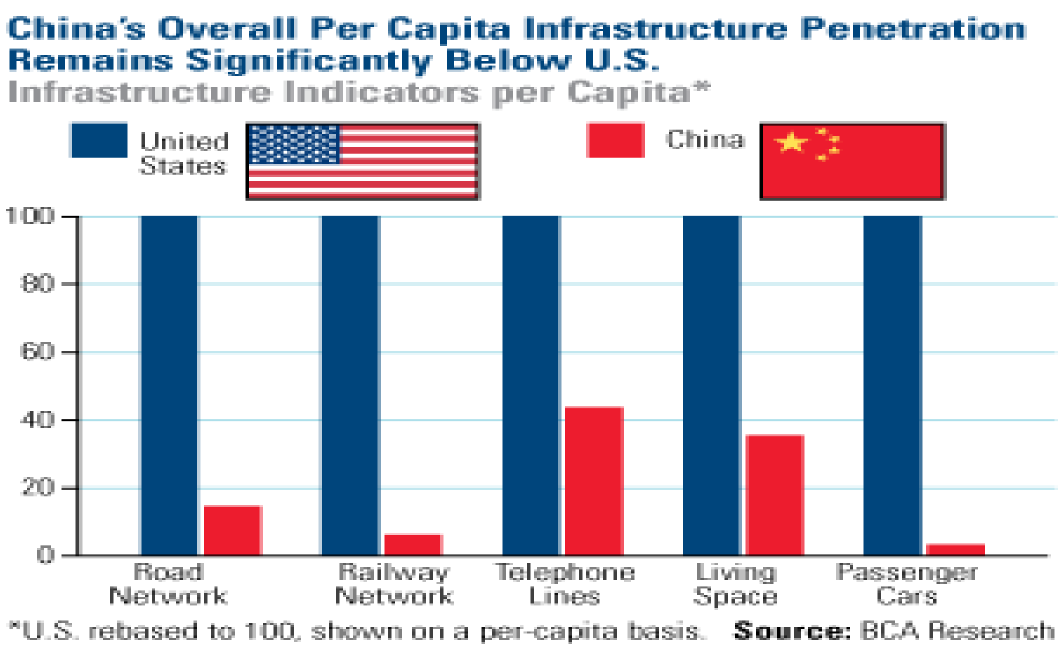
To get a better sense on where China is today, note, in the following chart, that even with economic growth slowing, ***absolute*** growth remains substantial;

China's GDP Growth in Perspective:



Source: Teck Resources from IMF data

There are always naysayers about China (Gordon G. Chan, California lawyer, who famously wrote the best seller, The Coming Collapse of Chinaé back in 2001!). But, China continues to grow and is still quite a ways from anywhere near USA standards of living. China still has a long, long way to go to catch upé



A last note, to Partners; we have carried two suspended share holdings we are making a provision for at the end of March; namely, vegetable producer Chaoda Modern Agriculture, code 0682 and leading scrap metal recycler, China Metal Recycle, code 0773, representing less than 12% of total overall value.

We have been carrying the value of those two holdings at the last traded price in our portfolios.

Both companies (each suspended at the request of the companies) were targets of short seller allegations and accusations (China Metal Recycle, a victim just in February this winter, categorically denies the allegations).

We are making provisions and reducing to zero the carrying value of these two holdings. We believe these actions ensure that each LP is treated equitably and fairly. The policy of redeeming partially in cash and partially in kind is fair to redeeming partners, as well as new investors, giving them the ability to gain on the upside, for the risk involved in illiquid shares.

Even with the improved prospects of the shares of Chaoda being released from suspension after the end of January announcement of a new auditor, our legal advisor, accountants/auditors and administrators have advised we go forward with these provisions, regardless. In actual fact, Chaodaôs new auditors have already finished some of their audit work and have proceeded to field work in Fuzhou, at the headquarters, for the two year financial reporting that is needed by the company for resumption of trading.

With both of these long time holdings, we remain optimistic of a reconciliation of issues surrounding the companies and resumption in trading later this year. As and when trading resumes, the increased value to the overall portfolio will be immediately reflected in our NAV.

	Mar 2013	Year-to-Date
Hong Kong Partners LP (net) before adjustment	0.9%	8.0%
Hong Kong Partners LP (net) after adjustment	-10.7%	-4.4%*

*After provisioningé

Brook McConnell
Hong Kong

*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.