



July 11, 2014

Dear Clients, Partners, and Friends,

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

	<u>June 2014</u>	<u>Year-to-Date</u>
Hong Kong Partners LP *	-0.3%	6.0%
Hang Seng Index **	0.5%	-0.5%
Hang Seng Small Cap Index	1.3%	-6.9%

Partners' NAV \$3.0224 after management fees, but before annual incentive fees of 15% on appreciation.

South Ocean's portfolios of small/mid cap, Hong Kong-listed companies, benefitting from operations in China, gained in the first half of 2014.

In June, three utility holdings (China Power, code 2380, Huadian Power, code 1071hk and Beijing Enterprise Water, code 371hk) were out-performing positions, gaining 5.7% to 11.7% in price.

Macau gaming stocks were generally weak last month. We sold, earlier in the quarter, two profitable holdings (Galaxy Entertainment and Sands China) and kept Live Multi Game operator, Paradise Entertainment (code 1180hk) in our portfolios. Paradise, which broadcasts live baccarat and 21 games to gamblers throughout all Macau casinos, proposes to enter the US market with its patented gaming technology. We added to our position after the share price, which had appreciated strongly since August last year, declined in June.

Our suspended holding in vegetable grower, Chaoda Modern Agriculture, announced its auditor and independent land appraiser had yet to finish their work, and promised an update to shareholders on the company's operations by end of July. If the company can finally produce the delayed audited accounts, the share price suspension should be lifted by the stock exchange.

Our proprietary value software screen (which was written incorporating similar investment methods as Warren Buffett), identifies sound companies selling at undervalued prices. This system enhances our core philosophy of Price-to-Growth (PEG) which we've followed since our early 1992 founding in Hong Kong. It is a powerful screen that determines an intrinsic value of a business and a maximum price to pay.

For instance, we bought a 3% position earlier this year in a neglected stock that is the leader in the non-glamorous business of manufacturing high-intensity utility cables. As

China's electric consumption remains quite low, a primary objective is to accelerate construction of the power grids throughout the country.

The shares were selling at 4.5 times projected earnings, a 3.3% dividend yield, no long term debt and a record of 5 continuous years of net income growth.

Though not a "flavor-of-the-month" stock, we added to our position on price weakness shortly after our initial purchase.

Our time horizons for purchases are long-term oriented. We bought the shares near HK\$1.09/share, with a ten year target price of HK\$8/share. However, this US\$433 million market cap stock rose sharply (+80%) after an upbeat article in the local press outlined the company's attractive prospects. We took partial profits, thereafter, and remain holders today, after the stock's strong re-rating.

Finding gems to own, like this one, validates the strength behind our fundamental value approach.

A final, general thought about the longer term trends;

There's been much handwringing over China's slowing economy and downturn (a list of which is too long to itemize).

Certainly, China has its work cut out for it.

But, unlike in the US, EU or Japan (which are undergoing quantitative easing economic policies), credit conditions in China have been the opposite, or very tight.

The 'Reserve Ratio,' or that portion (expressed as a percent) of depositors' balances banks must have on hand as cash, as determined by the China's central bank, is now 18-20%. In the US, the reserve ratio is 0-3% (in [many cases](#)).

When the cycle eventually turns and China begins to loosen policy, it will generate a pronounced effect on the depressed stock markets, likely greater than what the US's loose economic policies have had on the S&P 500's performance returns.

Sincerely,

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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](mailto: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.