



10 Feb 2012

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>Jan 2011</u>
Hong Kong Partners LP (net)	3.2%
Hang Seng Index	10.6 %
MSCI HK Small Cap Index	6.2%

Partners' NAV for Jan was \$2.4296, after management fee, but before annual incentive fees of 15% on appreciation.

In January (a holiday-shortened month), trading in our holdings of Hong Kong-listed stocks, with rapidly growing businesses in China, was lackluster. Liquidity and trading volumes remained low. A few constituents in the blue chip Hang Seng index accounted for most of the robust gain, over just a few trading sessions.

Our portfolios are concentrated in holdings of primarily small/mid capitalized, cash-rich stocks. The trailing, estimated price earnings ratio (weighted average) is approximately 4 times today.

That is very much undervalued!

For instance, one of our long term holdings, leading audio headset manufacturer, Fujikon, sells at ~HK\$1.00/share in the market today, about one half its net equity/book value. As of Sept 2011, Fujikon has a net cash position of HK\$379.6 million, versus a current market cap of HK\$404 million. Cash is just slightly less than the total market cap of the shares! We get the business, then, essentially for free. Ex-cash (there's no long term debt), the price earnings ratio is effectively zero, with an 8% dividend yield.

Our largest holding, Chaoda Modern Agriculture, remains suspended on the Hong Kong exchange, with no news to shareholders. We have extra cash (from the recent takeover of our Asian retailer holding, Hang Ten Group) available for re-investing. We continue to visit new companies to invest (see my recent note below). With many companies expected to report financial results within the next month, we are in a black-out period for most of

February and into March. We expect corporate news to pick up after the 30-day quiet period.

Sincerely,

Brook McConnell

President

Email: brook@south-ocean.com Website: www.south-ocean.com

Company visit note, translated into Chinese for a local financial weekly...

There were near riots last month in China the day the new Apple iPhone 4S went on sale due to overwhelming demand. That was good news for leading IT product distributor in Asia Pacific, VST Holdings Limited (code 0856 hk).

VST's main revenue driver (80% of total revenues) is the distribution of IT products such as desktop personal computers, notebooks, tablets, handhelds, printers, central processing units (CPUs), hard disk and memory device. The remaining two segments of the business are enterprise systems tools (middleware and operating systems for IT infrastructure) and general IT services, such as IT infrastructure design.

The company has distribution networks encompassing over 24,000 business partners, through its 32 offices in China, Thailand, Malaysia, Singapore, Indonesia, and the Philippines.

It has developed long-term, established partnerships with major tech companies such as HP, Seagate, Apple, Microsoft, AMD, Western Digital, Maxtor, IBM Thinkpad and Dell, where the company plays an integral part of the supply chain for these technology giants.

As a distributor, especially for fast-moving technology products, VST normally keeps a large supply of products on hand in its distribution warehouses. With low gross margins on sales of these products (less than 5%, which is typical in the distribution sector), the aim of the company is to turn inventory as efficiently as possible.

The latest financial interims showed sales grew strongly. Turnover for the six months ended 30 June 2011 amounted to approximately HK\$15,154,698,000 (2010: approximately HK\$12,291,511,000), representing an increase of approximately 23.3%.

Sales growth for VST should continue to be robust. The China division registered a 48% year-over-year increase for the third quarter last year. Although this growth is from lower margin product distribution business, VST has managed to control operating expenses well, improving its balance sheet and lowering overall debt levels (net gearing ratio currently at 0.56x, an improvement from 0.8x last June).

The shares are depressed, trading at only 3.8 times estimated 2012 expected earnings of \$0.37 per share, due to several concerns. The Japanese tsunami caused a slight increase in average inventory to sales days in the first half. Another concern was a fire in its Shanghai warehouse last November. The company claims to be fully insured and net losses will be immaterial.

Thailand's floods late last year destroyed almost all of one vendor's disk drive products. The company claims the resulting loss of supply lifted prices of existing inventory of disk drives by 50%, offsetting loss of top line sales. It is expected that there will be a gradual improvement in the Hard Disk supply chain (Thailand produces 40% of all hard drives), with normalization expected in the second quarter this year.

Lastly, the founder, a 37% owner of the company, has been embroiled in a stock manipulation investigation by the securities regulator. Though the outcome of this case may have a short term impact for the company in the future, business continues as usual today.

VST continues to see healthy momentum in its China distribution business. Robust top line performance was largely due to the strong performance of products like iPad, notebooks and desktops.

VST has participated in a series of share buybacks in the past several months. The dividend may be reinstated to an approximate 15% payout ratio, \$0.06 per share for a 4.2% yield. Also, the shares sell below net worth, or roughly 30% below net book value.

We see this valuation as an attractive level where the risk gain ratios are in favor, especially should there be a return to normal business conditions for the company.