



**GUINNESS
ATKINSON**
FUNDS

Asia
brief



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**Commentary and Review by
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Analyst Mark Hammonds**



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The Guinness Atkinson Asia Pacific Dividend Fund invests in a universe of high quality companies listed in the Asia Pacific region or those that have more than 50% of their assets or revenues directly related to the region. Our universe of quality companies is distinguished by companies whose debt does not exceed their equity base (in the case on non-financials) and more importantly by their history of generating a real return on investment of over 8% (after stripping out the effects of inflation) for eight years. Companies that have achieved this have done so across at least one business cycle, possibly more, and we believe are more likely than not to sustain these levels. From this universe we select companies that offer value, profit momentum and a commitment to dividend payments. The quality universe gives exposure across all parts of the Asia Pacific region as well as across structural themes of export manufacturing, consumption, household wealth and innovation.

From handbags to broadband

We invest in companies across the Asia Pacific region that have demonstrated consistently high returns on capital that have persisted over time. While the companies in our universe are unified by this common characteristic, they are exposed to different underlying structural trends.

In this update we look at two of the companies in our portfolio: Li & Fung and iiNet. Both have demonstrated strong returns on capital, but they operate in very different sectors, and go about achieving high returns in different ways.

Li & Fung

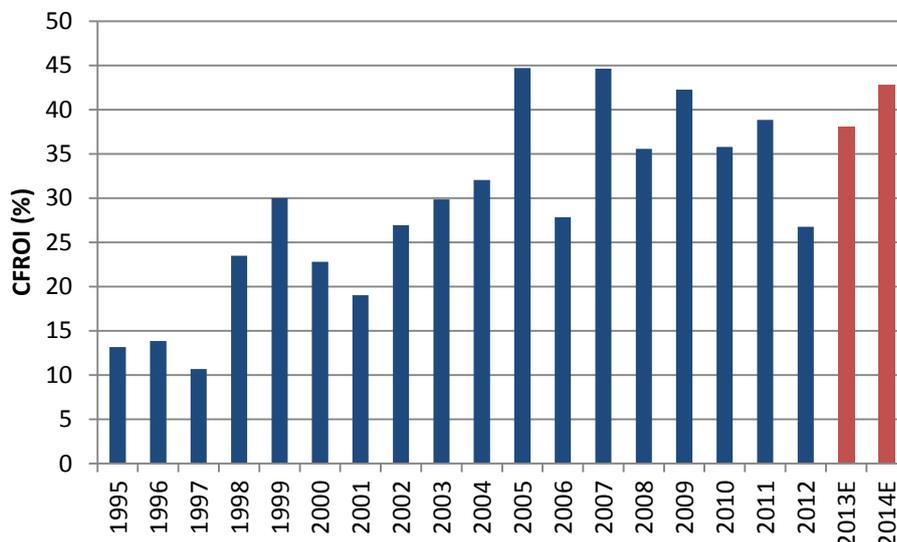
One of the consequences of globalization is our ability in the Western World to obtain almost any of the products we desire – clothes, shoes, toys, electronics goods, cosmetics, etc. – at relatively low prices. The fundamental shift that has allowed this to happen is the movement of production from West to East. Asian companies are producing and sourcing goods for Western companies, and both regions have benefitted.

Profiting from this trend, Li & Fung is a Hong Kong listed company with a market capitalization of \$13billion(bn). The majority of Li & Fung’s revenues and profits (62% of operating profit) come from the company’s trading division, which connects global retailers, for example Wal-Mart and Target, with manufacturers in Asia, South America, Mexico and emerging European countries. Retailers maximize cost efficiency by sourcing products from these suppliers, taking advantage of trade blocs, such as the North American Free Trade Agreement, or the free movement of goods within the European Union.

The other large part of Li & Fung’s business is its wholesale distribution division, which operates distribution networks across the USA, Europe and Asia. The wholesale business designs and produces goods under licenced brands, for example, clothing for the Michael Kors and Juicy Couture brands. Products are also produced under private label or in-house brands.

The specific measure we use to assess a company’s return on capital is Cash Flow Return on Investment (CFROI), a metric developed by Credit Suisse HOLT.

CFROI for Li & Fung for the period since 1995



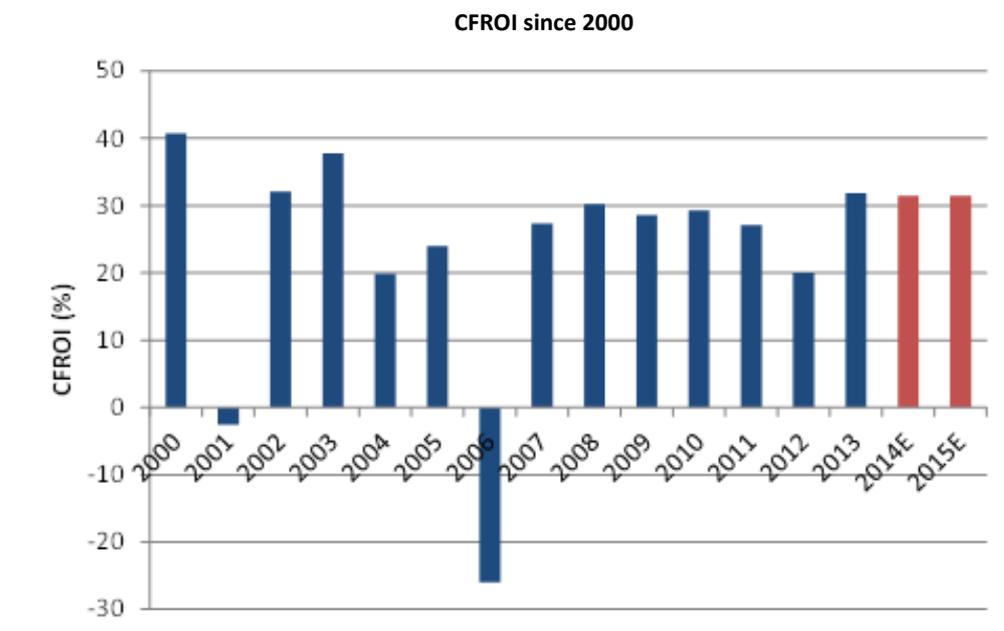
As the previous chart shows, CFROI has risen over this period to around 30-40% in recent years (falling slightly below in 2012). Returns of the magnitude are relatively rare and significantly exceed the company's cost of capital.

While recent trading conditions have been challenging, we are hopeful that the company can continue to benefit from a recovering US economy and that the high levels of returns achieved in the past could be sustained in the future.

iiNet

iiNet is a 'new economy' company that has benefitted from a pervasive technological change over the past two decades – the growth of the internet. The company is one of Australia's leading internet service providers, and provides high speed broadband, telephone and Internet Protocol Television (IPTV) services to over 900,000 customers.

The company has built up by making significant acquisitions of smaller companies over the past few years, demonstrating that its business is scalable. By being one of the pioneers to roll out new technologies in Australia – it was the first to introduce ADSL broadband and IPTV – iiNet has earned excellent returns on capital, well in excess of the company's cost of capital.



Source: Credit Suisse HOLT, Guinness Atkinson Asset Management

In 2006 the company incurred a significant write-down of intangible assets, mainly relating to subscriber bases, which were written down following the introduction of a new IT system, and goodwill, which was written down following a rise in costs due to increased wholesale prices, and a strategic review of the company's New Zealand business, which was subsequently sold.

With the exception of 2006, iiNet has earned consistently high returns in recent years, which have combined favorably with growth from acquisitions to create value for shareholders.

We are optimistic the company will continue to benefit from increasing demand for data, as more and more aspects of our everyday lives shift online.

Conclusion

Both Li & Fung and iiNet have demonstrated consistently high returns on capital. The former has benefitted from the outsourcing of production to Asia, while the latter has been a beneficiary of the rapid growth of the internet. Within the Asia Pacific region, we continually look for companies that are well positioned to gain from fundamental trends such as these.

About the Fund

The Guinness Atkinson Asia Pacific Dividend Fund invests in quality, dividend-paying companies listed in the Asia Pacific region. We believe that such companies will outperform over the long run, due to: the favorable growth prospects of the region, the companies' track record of producing attractive returns on capital and the contribution to returns provided by cash dividends. The Fund is invested across sectors and holds approximately 35 stocks in an equally weighted portfolio.

About the investment team

Edmund Harriss – Portfolio Manager

Edmund has managed Asian Funds since 1994 both from London and from Hong Kong.

Edmund worked for ten years from 1993 for Guinness Flight, which became Investec after the merger in 1998. After joining the Far East Investment Desk in 1994, he served as a member of the investment team managing the China & Hong Kong Fund (now the Guinness Atkinson China & Hong Kong Fund, for US investors), becoming the fund's lead manager in 1998. In addition, Edmund has managed the Guinness Atkinson Asia Focus Fund (for US investors) since 2003, and the Guinness Atkinson Asia Pacific Dividend Fund (for US investors) since its inception in 2006.

Edmund graduated from Christ Church, University of Oxford, with a Master's degree in Management Studies and has a Bachelor's degree in History from the University of York. He is also an Associate of the Society of Investment Professionals.

Mark Hammonds – Analyst

Mark joined Guinness Asset Management in September 2012. Previously, he worked at Ernst & Young, where he qualified as a Chartered Accountant. Mark graduated from Corpus Christi College, Cambridge with a First Class degree in Management Studies in 2007. He holds the Investment Management Certificate.

Commentary for our views on Dividends, China and Energy markets is available on our website. Please [click here](#) to view.

Performance data quoted represents past performance and does not guarantee future results. Index performance is not illustrative of Guinness Atkinson fund performance and an investment cannot be made in an index. For Guinness Atkinson Fund performance, visit [gafunds.com](#).

Mutual fund investing involves risk and loss of principal is possible. Investments in foreign securities involve greater volatility, political, economic and currency risks and differences in accounting methods. Non-diversified funds concentrate assets in fewer holdings than diversified funds. Therefore, nondiversified funds are more exposed to individual stock volatility than diversified funds. Investments in smaller companies involve additional risks such as limited liquidity and greater volatility. The Fund may invest in derivatives which involves risks different from, and in certain cases, greater than the risks presented by traditional investments. Funds concentrated in a specific sector or geographic region may be subject to more volatility than a more diversified investment. Investments focused in a single geographic region may be exposed to greater risk than investments diversified among various geographies.

Return on Investment or ROI, is the most common profitability ratio. There are several ways to determine ROI, but the most frequently used method is to divide net profit by total assets.

Return on capital is a return from an investment that is not considered income. The return of capital is when some or all of the money an investor has in an investment is paid back to him or her, thus decreasing the value of the investment.

Cash Flow Return on Investment is a valuation model that assumes the stock market sets prices on cash flow, not on corporate earnings. It is determined by dividing a company's gross cash flow by its gross investment

ADSL, or asymmetric digital subscriber line, is a type of DSL broadband communications technology used for connecting to the Internet.

IPTV, or Internet Protocol television, is a system through which television services are delivered using the Internet protocol suite over a packet-switched network such as a LAN or the Internet

Fund holdings and sector allocation are subject to change and should not be considered a recommendation to buy or sell any security.

[Click for a list of current holdings for the Guinness Atkinson Asia Pacific Dividend Fund.](#)

This information is authorized for use when preceded or accompanied by a [prospectus](#) for the Guinness Atkinson Funds. The prospectus contains more complete information, including investment objectives, risks, fees and expenses related to an ongoing investment in the Funds. Please read the prospectus carefully before investing.

Opinions expressed are subject to change, are not guaranteed and should not be considered invest

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