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LIGHTHOUSE ADVISORS

Keeping Your Capital Safe

Client Newsletter for the period ended 30 September 2013

1. Foreword

Fellow Investors,

Welcome to the Lighthouse Advisors newsletter for September 2013.

Due to complications with the stockbrokers, asset transfers from existing accounts into the Lighthouse Fund are only now taking place. As a result, the Lighthouse Fund was not active in the markets up to 30 September 2013. Consequently, your manager waived the management fees up to 30 September 2013.

As the Fund was holding only cash up to 30 September 2013, a portfolio discussion is not meaningful. Therefore, this newsletter will discuss the Reference Account one last time.

This newsletter follows the same format as previous issues. The special topic for this issue is **For-Profit Education**.

2. Market Commentary

Major stock markets worldwide made gains in the third quarter as investors cheered the continuation of the US Federal Reserve's low-interest rate policy and shrugged off concerns over the US government shutdown. As it turns out, they were right: the US government has reached a deal to restore normal operations.

The following table shows how developed-market investors had essentially decided in advance that the US government was "crying wolf" over its budget and debt issues:

Market	3rd Qtr	YTD
US DJIA	+1.5%	+15.5%
US S&P 500	+4.7%	+17.9%
UK FTSE 100	+4.0%	+9.5%
Europe Stoxx 50	+11.2%	+9.8%
ASX 200	+8.7%	+12.3%
Nikkei 225	+5.7%	+39.1%

In emerging Asian markets, things looked different:

Market	3rd Qtr	YTD
Shanghai Composite	+9.9%	-4.2%
Hang Seng Index	+9.9%	+0.9%
India Nifty Index	-1.8%	-2.9%
Jakarta Composite	-10.4%	+0.0%
Philippines PSEi	-4.2%	+6.5%
Malaysia KLCI	-0.3%	+4.7%
Singapore STI	+0.6%	+0.0%

It seems that in emerging markets the stock markets are driven less by global issues and more by market-specific news.

The Shanghai Composite Index and the Hang Seng Index are dominated by banks and real estate companies, so they gyrate in tune with Chinese economic data. Their weak year-to-date performance may be due to the weak economic data being reported out of China, as well as worries over the shadow banking system. Of course, "weak" data for China is relative: the World Bank projects that China will grow 7.5% this year, which is still way ahead of any other major economy.

India, Indonesia, and the Philippines have done somewhat poorly as investors realized the great potential of these countries remains just that – potential – and that the current account deficit issues remain as current as ever. The valuation bubble is deflating, but there is a long way to go before their equities become attractive on any large scale.

Meanwhile, the persistent low-interest rate environment has fueled a massive increase in debt issuance, especially by non-investment grade companies. There is unlikely to be a happy ending for investors buying such unsecured junk bonds at par today.

Your manager continues to focus on equities for investment value, and will write again when the 31 December 2013 report is ready.

Benjamin Koh
Investment Manager
Lighthouse Advisors
17 October 2013

3. Portfolio Review

As at 30 September 2013, the Net Asset Value (NAV) of the Reference Account was $257.83 per unit, net of all fees, and above the highwater mark of $228.60. Against the end-2012 NAV of $204.67, the year-to-date return, net of all fees, was 26.0%.

For reference, the 2 key markets for the Account, Singapore and Hong Kong, posted year-to-date returns of 0.0% and 0.9% respectively.

20 securities made up 94.0% of the Reference Account, with the balance in cash. A pie chart is in Annex I, while NAV values are tabled in Annex II.

Divestments

SIA Engineering was sold as significant price appreciation eroded the margin of safety. It was first bought in March 2009 for 11 times estimated FY10 earnings and a forward yield of about 7%. FY13 earnings were about 20% higher than in FY10, representing a compounded growth rate of less than 5%. In other words, the company did not benefit greatly from the post-crisis recovery.

However, the stock price rose considerably. Valuations rose to over 20 times earnings, and yield fell to just over 4%. As a result, the margin of safety shrank. Your manager decided to sell in order to raise cash for other investments offering a better risk/reward ratio.

Your manager came across SIA Engineering back in 2002. Back then, it was already clearly an excellent business. But for 7 years it sold at the wrong price. In 2009 it was finally selling at the right price, so it was bought for the portfolio. Today it is again the wrong price, so it has been sold. In future, at the right price, the company may return to the portfolio. For now, we bid it a fond farewell.

Including dividends received over the years, the gains on divestment were about 270% for the shares bought in early 2009, and about 50% for the shares bought in late 2011.

New Investments

There were no new investments for the quarter ended 30 September 2013.

Other Significant Events

ARA Asset Management reported that for the quarter ended 30 June 2013, profits increased marginally, by 1%. The interim dividend was maintained at SGD 2.3 cents per share. Its Asia Dragon Fund is planning to divest its Malaysian assets in the first quarter of 2014; ARA hopes to achieve an internal rate of return of at least 20% p.a. on these assets.

Bonjour reported that profits for the half-year ended 30 June 2013 increased 47%. However 1H12 was depressed by share-based payments; after adjustment the actual increase was 19%. Interim dividend was HKD 2.5 cents per share versus HKD 2.3 cents per share previously.

Chow Sang Sang announced that for the half-year ended 30 June 2013, profits were up 40%. It declared a dividend of HKD 14 cents per share, versus HKD 10 cents per share for the same period last year.

CITIC Telecom reported its half-yearly results for 30 June 2013. Adjusted for share-based payments and transaction-related items, EBITDA increased 3%. Interim dividends were unchanged at HKD 2.4 cents per share, albeit over an enlarged share base following the rights issue to buy CTM.

CSE Global disclosed that profits for the second quarter, adjusted for one-time items, rose 12%. Interim dividends were maintained at SGD 1.5 cents per share. It also announced that it intends to divest its UK unit in an IPO in London. The proceeds will be used for special dividends, loan repayments and future acquisitions. The listing is expected to complete by the end of 2013.

Greatview Aseptic Packaging reported that its first-half sales were up 14%, but profits were down 10%, due to higher depreciation charges from the new plant in Germany which was still in the ramp-up stage.

Jaya Holdings reported its full-year results for FY13. Profits increased only 5% but a final dividend of SGD 3.5 cents was declared, signaling a return to normal trading conditions compared to last year, when dividends were omitted. The current charter order book is US$255m versus US$195m a year ago.

k1 Ventures declared a final dividend of SGD 2 cents per share. This is clearly funded by its recent disposal of McMoRan Exploration. Also, k1's Knowledge Universe unit is in talks to sell its UK-based *Busy Bees* nursery chain to Ontario Teachers' Pension Plan for £220m. Finally, China Grant Auto, one of k1's other investments, is planning to list in Hong Kong.

Nera Telecommunications reported second-quarter results that were 174% higher, but adjusted for negative goodwill, the increase was only 2.5%. It declared an interim dividend of SGD 2 cents per share, a change from previous years when dividends were paid only once a year.

Overseas Education reported that profits for the second quarter were up 26%. No interim dividend was declared, the same as last year. Tuition fees have increased by 8.5% on average for the academic year starting in August 2013. Also, it paid an extra $9m in land premiums to the Singapore Land Authority for its new campus in Pasir Ris.

Sa Sa announced that for the quarter ended 30 June 2013, sales rose 20.1%. In Hong Kong and Macau, same store sales growth was 17%.

Sarin Technologies booked a 26% increase in profits for the second quarter, and declared an interim dividend of USD 1.5 cents per share, plus a special interim dividend of USD 2.5 cents per share. This is an increase over the previous year, when the total interim dividend was USD 1.25 cents per share.

Straco reported results for the second quarter; profits were up 31%. No dividends were declared, the same as for last year.

Trinity reported that profits for the second quarter dropped 43%. Your manager expected poor results, so this was not a surprise. The interim dividend was HKD 4.5 cents per share, versus HKD 8 cents per share last year.

4. For-Profit Education

The private for-profit education sector has received a lot of bad press in the US, where operators such as Apollo Group's University of Phoenix have been accused of using deceptive methods to recruit students, especially military veterans, in order to claim reimbursements from the US government.

Many such schools have been shown to provide education of little value, while saddling students with crippling levels of debt. A recent **USA Today** analysis shows that over 260 colleges and universities across 40 states, the District of Columbia and Puerto Rico were "red flag schools" whose students had higher loan default rates than graduation rates.[1]

Default rates ranged from 6% for the City University of Seattle, which posted a *zero* graduation rate in 2009-2010, to 49.1% for the Lincoln Technical Institute, which had a 45% graduation rate. The University of Phoenix had 7 campuses in the study; the collective default rate was 26.4%, while graduation rates

[1] *College default rates higher than grad rates*, **USA Today**, 2 July 2013

were 10% to 21%. Another prime offender was ITT Educational Services with 45 red-flagged campuses. Its groupwide default rate was 34.1%, while graduation rates varied from 14% to 34%.

It would be safe to conclude that students who graduated from such “red flag schools” had trouble finding gainful employment, as defined by jobs that paid enough to allow servicing of their loans. It is thus questionable whether these students got anything resembling a *bona fide* education at all, since, apart from education for its own sake, the main premise for these students was that, net of the time and money invested, an education would improve their future earning power.

Given the mess at for-profit universities, one might ask how for-profit high schools seem to have avoided such scandals. One answer is that high schools provide secondary pre-university schooling, rather than tertiary university degrees. This is important because before students reach university, there are standardized tests which serve as an independent gauge of the students’ achievements, and by implication also endorse the schools where they studied.

These tests include, among many others, the British A-levels, the European International Baccalaureate, the American Scholastic Aptitude Test, and the Chinese National College Entrance Examination (高考, “*gao kao*”). As a result, high schools do not need to advertise or recruit aggressively. Their students’ exam results, and the universities they subsequently enroll at, already serve as *de facto* indicators of the schools’ merits.

A “good” high school can thus quickly establish a reputation in as little as a decade, building a track record off its students’ examination results. In contrast, universities can take up to a *century* to establish themselves as premier institutions with the attendant pricing power, because it takes decades for their graduates to enter society and ultimately make a meaningful contribution.

There are not very many world-renowned universities which are less than 50 years old. Many famous colleges are over a century old. England’s Cambridge University goes back 800 years, and archrival Oxford over 900.

In other words, a profitable university is mostly a paradox. By the time the university is famous enough to charge a premium and make a healthy profit, its original sponsors would be long dead. But if the university focuses on profits over pedagogical excellence, the poor quality of its graduates eventually comes to light, and the business collapses as student enrolment vanishes, as the US for-profit sector is now learning (pun intended).

In contrast, a high school can acquire a stellar reputation and begin charging accordingly within a decade, thus becoming successful both financially *and* pedagogically.

A second factor in favour of high schools is that fees are paid by parents and not students. Given parental instincts, many sacrifices will be made before children are withdrawn for want of money. But at tertiary institutions, working adult students are at risk of layoffs, which affect their ability to pay, while parental pressure to stay enrolled is lower or absent.

Thus, enrolment at for-profit high schools is more stable than at for-profit universities, which yields better operating leverage given the high fixed-cost nature of education.

In short, all for-profit schools are not alike. Those that focus on delivering a high school education to young students, whose academic achievements can be easily measured by standardized tests, are far more likely to succeed than those that provide tertiary education to working adults, whose achievements may only be evident via indirect observation over decades.

End

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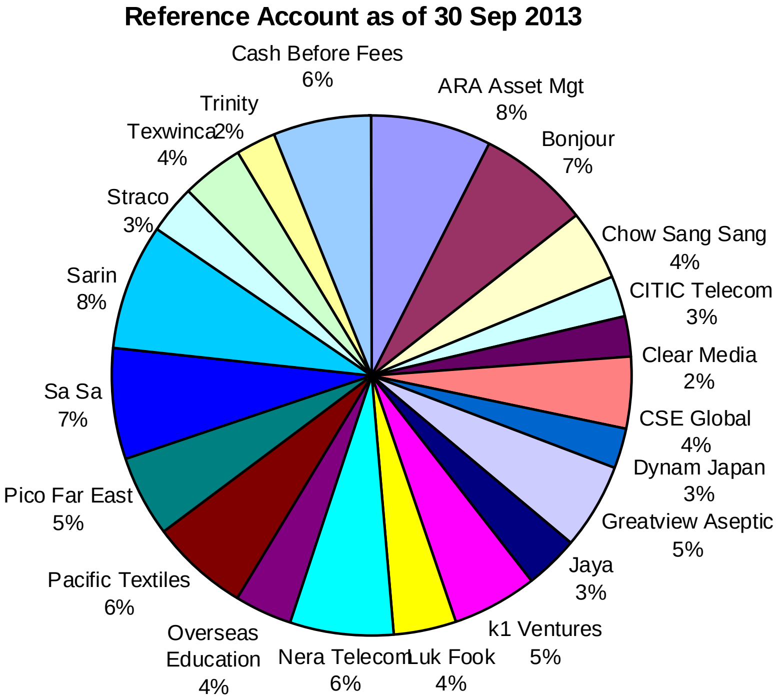
Annex I



Annex II

2008	NAV ($)	Invested (Gross)
31 Jan		
28 Feb		
31 Mar		
30 Apr		
31 May		
30 Jun		
31 Jul		
31 Aug		
30 Sep		
31 Oct		
30 Nov	100.00	16.19%
31 Dec	101.02	52.56%
YTD		**+1.0%**

2009	NAV ($)	Invested (Gross)
31 Jan	103.03	52.48%
28 Feb	102.42	69.23%
31 Mar	100.11	51.25%
30 Apr	106.95	67.37%
31 May	131.61	73.01%
30 Jun	131.39	78.62%
31 Jul	142.18	80.00%
31 Aug	141.28	86.22%
30 Sep	146.38	88.44%
31 Oct	149.29	90.70%
30 Nov	154.88	87.41%
31 Dec	166.03	79.26%
YTD		**+64.4%**

2010	NAV ($)	Invested (Gross)
31 Jan	163.97	83.91%
28 Feb	169.35	93.00%
31 Mar	179.88	93.26%
30 Apr	184.58	90.31%
31 May	177.16	80.77%
30 Jun	180.97	84.17%
31 Jul	189.62	86.50%
31 Aug	193.05	92.43%
30 Sep	210.53	99.04%
31 Oct	213.32	95.13%
30 Nov	221.65	92.52%
31 Dec	228.60	85.71%
YTD		**+37.7%**

2011	NAV ($)	Invested (Gross)
31 Jan	220.13	86.53%
28 Feb	216.56	93.66%
31 Mar	219.13	85.79%
30 Apr	224.22	86.13%
31 May	221.20	87.01%
30 Jun	221.25	86.70%
31 Jul	216.53	83.65%
31 Aug	198.69	82.60%
30 Sep	177.28	84.05%
31 Oct	193.17	83.38%
30 Nov	184.76	83.96%
31 Dec	186.42	76.01%
YTD		**-18.5%**

2012	NAV ($)	Invested (Gross)
31 Jan	192.15	73.35%
28 Feb	204.12	79.44%
31 Mar	204.78	79.53%
30 Apr	203.33	84.41%
31 May	194.22	82.27%
30 Jun	192.88	81.41%
31 Jul	189.64	84.69%
31 Aug	191.78	86.68%
30 Sep	195.10	89.06%
31 Oct	191.28	88.43%
30 Nov	199.18	84.26%
31 Dec	204.67	88.35%
YTD		**+9.8%**

2013	NAV ($)	Invested (Gross)
31 Jan	223.32	95.63%
28 Feb	237.63	95.12%
31 Mar	244.72	95.24%
30 Apr	243.67	90.83%
31 May	247.30	95.19%
30 Jun	237.83	96.75%
31 Jul	247.72	94.70%
31 Aug	251.54	94.69%
30 Sep	257.83	93.98%
31 Oct		
30 Nov		
31 Dec		
YTD		**+25.97%**

Updated 17 October 2013