LIGHTHOUSE ADVISORS
Keeping Your Capital Safe

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Client Newsletter for the period ended 30 June 2016

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1. Foreword

Fellow Investors,

Welcome to the Lighthouse Advisors newsletter for June 2016.

This newsletter follows the same format as previous issues. The special topic for this issue is **Power Is Nothing Without Control**.

2. Market Commentary

The last 3 months have seen great upheavals. It has not just been about Iceland beating England in the Euro 2016 football tournament, although that was also a big surprise.

On the 23rd of June, the citizens of the United Kingdom voted to leave the European Union[1]. Soon after, they belatedly realized that they had been fed misinformation and outright lies during the 4-month campaign period. As a reference, Scotland took over *2 years* to prepare for its own vote in 2014 on whether to stay in the UK or leave (they voted to stay).

Without accurate information about the real-life consequences of staying or leaving, the UK referendum morphed into a protest vote by the downtrodden about their discontent with the status quo. Outside of London, much of England has not done very well in recent years. Ironically, the worst-hit places, *which had been receiving the most EU development aid*, voted to leave, thus placing their fates back into the very hands at Westminster which had all along ignored their decline.

The political fallout has taken on a Shakespearean feel, with then-Prime Minister David Cameron, his heir apparent Boris Johnson, and the usurper Michael Gove, all falling on their swords in quick succession. The new Prime Minister Theresa May, who now surely holds the record for the quickest and most successful election campaign in a modern Western democracy[2], is from the "Remain" camp but has promised to work towards an orderly exit. It remains to be seen whether this is possible. Other members of the EU have called for the UK to quickly invoke the Article 50 “exit clause” while Scottish leader Nicola Sturgeon has warned that a second referendum for Scotland to leave the UK could be tabled if the UK begins negotiations without safeguarding Scotland[3].

It is not at all clear what the longer-term consequences of leaving the EU will be. In the short term, the pound has fallen to 31-year lows against the US dollar, and London property has suddenly become much less attractive to foreign investors who can no longer count on a continued influx of money and talent to drive up prices. Theresa May will have her hands full trying to steer the UK through this transition period – that is, if the UK actually ends up leaving at all.

In Asia, most countries have little direct trade with the UK, so attention has mainly been focused on the developments in the South China Sea.

On 12th July, the Philippines “defeated” China. The Permanent Court of Arbitration ruled that none of the features in the South China Sea that are claimed by various parties qualify as

[1] *UK votes to leave EU after dramatic night divides nation*, **The Guardian**, 24 June 2016.

[2] *And then there was one: Theresa May is the last candidate standing for PM*, **Independent**, 11 July 2016.

[3] *Sturgeon: Second independence referendum could be next year*, **BBC News**, 17 July 2016.

islands, and that these features are therefore not entitled to exclusive economic zones[4]. The ruling is final and legally binding. Both China and the Philippines are signatories to the United Nations Convention on the Law of the Sea (UNCLOS) and are thus bound to recognize the outcome.

However, China refused from the outset to participate in the arbitration, and stated that it would not accept and would ignore any unfavourable ruling. This is not unexpected, since accepting a loss would have damaged the Chinese government's standing at home. As the ruling is fundamentally unenforceable, China suffers no repercussions apart from continued criticism abroad, which it can easily censor at home. A political observer might also point out that the Court made a strategic error in having a Japanese judge select the 5 arbitrators, thus giving China a convenient basis to claim anti-China bias in the judgment. Post-ruling, to nobody's surprise, China has continued its activity in the South China Sea[5].

The Philippines has wisely refrained from trumpeting its win in China's face. This is also not unexpected, as it can ill afford to offend a powerful neighbour. China is its largest trading partner, accounting for one quarter of the Philippines' exports in 2015. Also, significant numbers of Filipinos are based in Hong Kong as foreign domestic workers. It seems likely that both countries will attempt to reach an accommodation, whereby each acknowledges the other's historic presence without referring to claims of sovereignty. The fishermen of both countries have historically had a presence in the waters; this is not disputed. What the Philippines disputed was China's insistence on *exclusive* control.

With the law on its side, the Philippines could propose that the two countries "share" the resources in the area as a gesture of goodwill and friendship. If this occurs, the obvious short-term outcome will be a rapid increase in fishing, as each side races to harvest the season's catch before the other, resulting in a catastrophic fishery collapse. Even if both sides agree to quotas to manage the fishery, cheating is almost guaranteed. This is an entirely foreseeable – yet unpreventable – tragedy of the commons.

The history of commercial fisheries is depressing: the proportion of fish stocks assessed to be overfished has steadily increased from 10% in 1974 to 31% in 2013[6]. For the region in question, which lies within the Western Central Pacific region, the FAO assessment is very clear: "Most stocks are either fully fished or overfished, particularly in the western part of the South China Sea."

Longer-term, there may be joint exploration for oil and gas deposits. One model may be the Malaysia-Thailand Joint Development Area, whereby both countries, without extinguishing their legal claims to the disputed territory, agreed to jointly explore and exploit mineral resources in the target area. A memorandum of understanding was signed in 1979, an agreement was signed in 1990, and production began in 2005.

At home, China continues to face enormous challenges. The need to overhaul ailing state-owned enterprises to curb overcapacity and stem financial losses has to be balanced against the social upheaval that will surely follow large-scale layoffs. 10 years ago, the freed-up workers would have easily found jobs in the booming private sector, but today many private companies are themselves struggling amidst intense competition.

What is undeniable is that even as China's costs have risen, its innovative capabilities still lag behind. There are parallels between today's China and early 80s Japan, when the

[4] *In the Matter of the South China Sea Arbitration*, **Permanent Court of Arbitration**, 12 July 2016.

[5] *China to Continue Construction on Disputed Islands*, **Wall Street Journal**, 18 July 2016.

[6] *The State of World Fisheries and Aquaculture*, **Food and Agriculture Organization of the United Nations**, 2016.

aging population created economic headwinds as the workforce and tax base shrank.

Yet, by the time Japan entered its 20-year economic stasis, it was a global leader in important fields, including semiconductors, consumer electronics and automobiles. This technological pole position allowed it to command premium prices for its exports, and thus stay rich throughout the long recession.

For all of China's achievements, much of its current technical capabilities are derivatives of foreign technology. Chinese airlines fly planes made in America and Europe. Most cars driven by Chinese consumers are based on American, Japanese, European or Korean technology. Chinese-made electronics use chips based on American, Japanese, European or Korean designs. Even the Shenzhou space program, which undoubtedly achieved a Chinese first when it put a man into space in 2003, is fundamentally based on Russian designs from the 1960s. And so on.

Until China can develop genuinely indigenous technology, it will continue to pay a heavy price to import technology. Ironically, its ascension to the World Trade Organization in 2001 made it harder for China to develop indigenous capabilities. The reason is that WTO requirements to lower trade barriers made it more difficult to protect and help domestic companies. In the short run, Chinese consumers benefit from cheaper imported goods. In the long run, competition from imported goods lowers profits for domestic manufacturers, increasing the time it will take for them to become globally competitive.

The automotive industry is often viewed as the foundation for large-scale industrialization and development of indigenous technology. The experiences of Japan and South Korea are instructive. Toyota entered the US market in 1965, and in 2007 it passed Ford to become the second largest automaker in the US. This achievement took 32 years. Likewise, Hyundai made its first indigenous car – the Pony – in 1975, and in 1998 it offered a ten-year, 100,000-mile warranty, the most generous in the industry. Such confidence was 23 years in the making.

One might hope that China, with its enormous domestic market, could make such leaps more quickly. But both Japan and South Korea protected their domestic markets against imports during the crucial maturation period. China, in contrast, has welcomed foreign automakers since the early 1980s, with the result that its largest and most successful automakers today are foreign joint ventures which are largely dependent on their foreign partners for technology. This dependence continues to frustrate the Chinese government. Trading market access for technology transfer has not been truly successful: while the joint ventures are making a great deal of money today, they have yet to secure China's technological future.

So the doom and gloom continues. No major economy apart from China is posting any meaningful growth. And while China's economy reportedly grew 6.9% in 2015, few observers believe the official data. Certainly not Chinese officials themselves: it has often been noted that current Premier Li Keqiang stated at a meeting with US diplomats in 2007 that GDP statistics were "for reference only". On the Hong Kong Exchange, profit warnings from Chinese companies have been commonplace for at least the last 18 months.

The generally poor economic news continues to foster an atmosphere of great uncertainty, which in turn weighs on market sentiment. The continued "flight to safety" has left sovereign bonds dangerously overvalued. Negative yields are simply the most obvious indicator of a horrendously crowded trade with a high chance of a very unhappy ending.

The sour mood has depressed stock prices in Asia, to the point that many private operators have decided to take matters into their own hands and delist their companies. Although the action is confined to relatively small companies for now, if the low prices persist, eventually enough courage and funds will be mustered for larger companies as well.

A brief scan in Singapore yields at least 3 names going private: traditional medicines retailer **Eu Yan Sang,** health and wellness company **Osim**, and shipyard **Otto Marine**. In Hong Kong, the delisting queue includes dissolving wood pulp producer **Bracell**, industrial automation company **China Automation**, ceramic tile maker **Dongpeng**, handbag manufacturer **Lee & Man Handbags**, property developer **New World China Land**, cemetery operator **Nirvana Asia**, and sportswear brandowner **Peak Sport**.

Most of the deals mentioned above are being executed by controlling shareholders together with private equity firms. In a minority of the cases, the controlling shareholders or private equity firms are going it alone.

Private equity firms only do deals for the money, so extensive due diligence and a large margin of safety are required. Meanwhile, controlling shareholders are the ultimate insiders, with more information than anyone else. Neither group is likely to overpay. If anything, they will seek to pay as little as possible, in order to maximize future profits. For the companies that are currently "in play" there is little or no froth in their stock prices.

This flurry of activity by profit-minded actors suggests that, negative short-term news notwithstanding, the environment is actually very good for investing. **Investors should be buying, not selling.** While strong companies continue to sell for higher prices than their weak counterparts, they are far better positioned to survive any upcoming downturn and emerge stronger, at which time their inherent strengths are likely to be recognized, and the patient investor can expect to be amply compensated. In the meantime, one can collect dividends and be paid to wait.

Starting in July, the Fund has begun to invest in the Chinese A-share market. Many strong blue-chip companies have fallen out of favour, and after persistent price declines, their shares now trade at reasonable or even bargain valuations. Despite sound management and good long-term growth prospects, retail investors in China find them unattractive, simply because they do not have a sexy story about how their profits will double next year, or how the company will create and dominate a whole new industry.

Historically, investing in strong companies at reasonable prices has been rewarding over the long term. Your manager is confident that over time, China will be no different. The Fund is now running low on cash, and welcomes fresh subscriptions from new and existing investors alike.

The next newsletter will be published for the quarter ended 30 September 2016.

Benjamin Koh
Investment Manager
Lighthouse Advisors
27 July 2016

3. Portfolio Review

As at 30 June 2016, the Net Asset Value (NAV) of the Fund was USD 91.52. Net of all fees, the return for the second quarter was 3.1%, bringing the year-to-date return for 2016 to 6.0%.

For reference, in the first 6 months of 2016, the indices in the Fund's key markets of Singapore and Hong Kong returned -1.5% and -5.1% respectively.

21 securities made up 92% of the Fund's holdings, with the balance in cash. A pie chart is in Annex I, while NAV values are tabled in Annex II.

Winners and Losers

Bracell, a new holding, was the largest contributor to the Fund's returns in the second quarter. Shortly after purchase, the stock jumped 47% on two announcements: a large increase in profits for the period ended 30 June 2016, and an intention by the controlling shareholder to privatize the company.

I.T. appreciated 23% in the second quarter after announcing better-than-expected full-year results for the year ended 28 Feb 2016.

Nera Telecom rose 12% after it announced a sale of its payments business to Ingenico, the world's largest payments solutions company. The deal will need shareholders' approval.

CIMC Enric fell 13% after it announced the termination of agreements to provide financial aid to, and eventually acquire, Sinopacific Offshore and Engineering.

Pacific Textiles lost 13% as full-year results for the year ended 31 Mar 2016 showed that sales and profits dropped in the second half.

Other holdings were not material contributors to changes in the Fund's NAV.

New Investments

Bracell is a producer of dissolving pulp, a key ingredient in rayon, a cotton substitute. It is based in Brazil, where it owns a eucalyptus plantation which supplies the required wood. It exports the dissolving pulp to viscose staple fibre (VSF) producers worldwide, who in turn convert the pulp into rayon. The company was originally vertically integrated with its own VSF plants in China, but poor profitability led the company to sell these plants back to the controlling shareholder.

Without a need to supply its own VSF plants, the pulp operation can sell to the highest bidder. As its costs are in Brazilian reals, while its revenues are in US dollars, the depreciation of the Brazilian real has boosted the company's profitability. The shares were acquired at about 8 times trailing earnings and less than half of book value. EV/EBITDA was 3.4 times, and forward yield was 4%.

As noted above, the controlling shareholder has announced an intention to privatize the company, sparking a large increase in the share price to near the indicated offer price, so further upside will be limited.

COSCO International is part of the Chinese state-owned shipping conglomerate COSCO Group. COSCO International's businesses fall into two main categories: shipping-related services, such as ship-broking, marine insurance brokerage and equipment procurement, and paint manufacturing, via joint ventures with Kansai Paint for container paints and Jotun Group for marine paints.

COSCO International holds over HKD 6bn of cash, most of which came from the sale of a 17% stake in Sino-Ocean Land in Dec 2010. The money was earmarked for buying a bunker supply company, China Marine Bunker (Petro China), a 50/50 joint venture between COSCO Group and Petro China. The deal was aborted in 2014, and the company is now looking for another business to acquire.

COSCO International is a "special situation" investment predicated on the company making an acquisition on accretive terms. This is not difficult: in 2015 the idle cash earned roughly 2% in interest income. If the acquisition is of merely average quality and earns 7% on the purchase price, post-deal, earnings will nearly double over 2015.

The shares were acquired at about 80% of book value, or less than the net cash holdings of the company. Essentially, the purchase price reflected only the value of the cash in the company's bank accounts, with no value assigned to the existing businesses, which are profitable and fund the 4% dividend yield.

QAF is a food conglomerate involved in bakeries, pork production, and trading and logistics. Bakeries and pork production are the key contributors to earnings.

In bakeries, QAF owns *Gardenia*, the best-selling brand of bread in Singapore, Malaysia and the Philippines. Recent expansion efforts include a new plant in the Philippines, which began operating in November 2015, and a new plant in Johor, Malaysia which is scheduled for completion in the first quarter of 2017.

QAF's Rivalea pork production plant is the largest fully integrated operation in Australia, accounting for about 20% of the country's meat production. Recent declines in commodity costs and a depreciation of the Australian dollar have boosted profits. With continued consolidation due to regulatory pressures, large producers should continue gaining market share, with improved margins from economies of scale.

The shares were purchased at about 11 times trailing earnings and 1.4 times book value, with a yield of about 5%.

Divestments

Dongpeng was sold as the price approached the buyout price offered by chairman He Xinming and pre-IPO investor Sequoia Capital. As the sale price was close to the Fund's cost, the gain on exit was not material.

Other Significant Events

Nera Telecom announced a sale of its payments business to Ingenico for S$88m. It is likely that most or all of the proceeds will be returned to shareholders as a special dividend.

4. Power Is Nothing Without Control

"Power Is Nothing Without Control" is the famous slogan of Italian tyremaker Pirelli. But it also describes quite well the situation in the corporate world. The size and influence of even the largest enterprise is useless to the person who cannot control it. Yet, the traditional corporate structure is highly democratic: one share, one vote. This is anathema to many entrepreneurs, who prefer to retain control even as they dilute their ownership, whether from equity financing to grow the business, or from divestments to create liquidity and reduce the percentage of personal wealth tied up in company stock.

In the history of modern capitalism, there are two key methods used to retain control: multi-class share structures, and corporate pyramids.

Multi-class share structures essentially divide shareholders into two or more groups by using multiple classes of shares. The "control" share class has votes that count for high multiples of the votes of the "non-control" classes of shares. It is not uncommon for control-class shares to count for 10 times the vote of non-control shares. Such structures are obviously unfair since they grant one group of shareholders disproportionate power. As a result, non-control shares will typically trade at a discount to reflect this disparity.

For their part, controlling shareholders argue that entrenching them in power allows them to make long-term decisions for the good of the company, rather than pandering to short-term interests. While this sounds good in theory, in practice, if the controlling shareholders do a poor job, they cannot easily be ejected, which necessarily means that over the long term, such a structure is actually *less* efficient than a standard "one share, one vote" system. Without the risk of a hostile takeover, over time, management discipline decays, and shareholder returns erode. Of course, in the short and medium term, with enough at stake, a dedicated controlling shareholder can still create value for all shareholders.

Examples of multi-class structures abound. Some widely admired companies such as Alphabet (the parent of Google), Nike and Berkshire Hathaway use such structures.

Families often use multi-class structures to stay in power over generations. For example, at US automaker Ford, the founding Ford family continues to hold large blocks of Class B stock, which make up less than 2% of the total shares but hold 40% of the voting power. At Swiss luxury brand owner Richemont, Johan Rupert and his family own all the B shares, which comprise 9.1% of the equity, but 50% of the votes. Similarly, the Hong Kong conglomerate Swire Pacific is controlled by John Swire & Sons using Class A shares, whose votes each count as 5 Class B shares.

While founding families often have noble intentions for using multi-class structures to

preserve and protect their legacy, these same share structures also lend themselves to abuse.

A notable "dual-class disgrace" is publishing company Hollinger International, whose key executives Conrad Black and David Radler engaged in what a special committee called a "corporate kleptocracy" which diverted virtually all of the company's US$400m in earnings to themselves over a 7-year period[7]. Mr Black's super-voting shares gave him an 18.2% economic interest, but 68% of the vote.

Of course, many companies with normal class structures have been run into the ground by controlling shareholders. But because multi-class structures allow controlling shareholders to do the same damage with much less at risk, investors need to pay special attention when buying into such companies. It is not that such companies cannot be run well, but because the incumbents face little or no risk of a shareholder revolt, there is a higher chance that the companies will be badly run.

Corporate pyramids are another common means of retaining control. Financial pyramids are not new: nearly a century ago, in the 1920s, holding companies and investment trusts were formed to invest into other companies. These investee companies themselves in turn invested into still other companies. At each level, bonds and preferred stock were sold.

The resulting pyramids could be 5 or even 10 levels deep. When things went well, the extreme leverage benefited the shareholders at the top. When they did not, the companies rapidly became worthless, some within the space of a week. The blue-chip investment bank Goldman Sachs also rode the wave, forming the Goldman Sachs Trading Corporation in December 1928, which launched the Shenandoah Corporation in July 1929, which in turn launched the Blue Ridge Corporation in August 1929.

[7] *Hollinger Files Stinging Report on Ex-Officials*, **The New York Times**, 1 Sep 2004.

After repeated financial crises, the notable financial pyramids that survive today are the ones structured to retain control.

In Hong Kong, one can find a few simple pyramids which allow the founding families to retain control despite an effective minority economic ownership. For example, the main asset of **Hang Lung Group** is its 54% stake in **Hang Lung Properties**. The Chan family maintains overall control via a 37% stake in Hang Lung Group held by the founder's widow. The effective economic interest in Hang Lung Properties is thus about 20%.

Similarly, the key asset of the Wheelock Group is **Wharf Holding**, which is 59%-owned by **Wheelock & Co**, where the Woo family has a 61% interest. The effective interest in Wharf is therefore 36%.

The 2-tier ownership structure can also provide a useful financial buffer. In 2011, Wharf conducted a 1-for-10 rights issue. Wheelock & Co funded its share of the rights from borrowings, which meant that the Woo family did not have to directly pay any money to maintain its underlying interest in Wharf.

An interesting chain of control can be found in France, where the Bolloré family controls Bolloré Group through a cascade of holding companies that also includes circular control loops. Specifically, the family controls Bolloré Participations, which owns 50.2% of Omnium Bolloré, which owns 50.3% of Financiere V, which owns 51.1% of Sofibol, which owns 55.3% of Financière de l'Odet, which owns 63.8% of Bolloré. Both l'Odet and Bolloré are listed on Euronext Paris, with respective public ownership levels of 9.2% and 35.7%.

On the face of it, the family maintains control of Bolloré with an economic stake of just 4.6%. However, in each of the intermediate holding companies mentioned above (Omnium, Financiere, Sofibol and l'Odet), *Bolloré itself* is the only meaningful minority shareholder. Unlike the relatively simple pyramids used by Hang Lung and Wheelock, the circular structure used by Bolloré allows

the chain of control to be maintained with minimal financial leakage to minorities, since the dominant (or only) minority shareholder is Bolloré itself. Bolloré helpfully lays out this structure in its own registration documents.

The circular control loops have excited some investors, who reason that since Bolloré owns the key minority stakes in its holding companies, these quasi-treasury shares can be cancelled by unwinding the circular control loops, leaving minority investors with a much larger share of Bolloré. Therefore, the reported net asset value per share undervalues Bolloré.

There are three big questions that need to be addressed with such reasoning. First, what is the true net asset value of Bolloré? Second, what is the actual percentage of Bolloré owned by minority shareholders? Third, what are the odds of unwinding the circular ownership?

The *reported* net asset value of Bolloré includes the value of the holding companies, whose accounting policies value their stakes in Financière de l'Odet and Bolloré based on their respective share prices. When the share prices of Financière de l'Odet and Bolloré go up or down, the value of the holding companies – and therefore the value of any stakes in them – goes up or down accordingly.

Indeed, from its 2015 financial statements:

"About 50% of the Group's portfolio is comprised of securities of the Group holding companies (Financière de l'Odet, Omnium Bolloré, Financière V and Sofibol), **the value of which depends on Bolloré and Financière de l'Odet stock prices**." (emphasis added)

In other words, the reported net asset value of Bolloré is at least partly *a function of its own share price*. Therefore, buying Bolloré on the basis of a discount to its reported net asset value is a fool's errand: as the share price goes up and down, so does reported net asset value.

The *true* net asset value of Bolloré can be estimated by simply eliminating the holding company securities. As of 31 Dec 2015, the entire portfolio was € 8.94bn. 50% of this was holding company securities, so net asset value must be reduced by about € 4.5bn, which cuts shareholders' equity from € 9.9bn to € 5.4bn.

The actual percentage of Bolloré owned by minority shareholders can be computed by noting that there are only 3 groups of external shareholders: the Bolloré family, the minority owners of Financière de l'Odet, and the minority owners of Bolloré. An accurate breakdown requires iteratively unwinding the circular holdings one by one. This is exhaustive and clearly meant to discourage anyone from even trying. However, in the current as-presented structure, the family's effective interest is 4.6%, l'Odet minorities have 5.9%, and Bolloré minorities 35.7%. The balance 53.8% is held by Bolloré itself. Cancelling this quasi-treasury stock as a crude first approximation, the adjusted ownership is: Bolloré family 10.0%, l'Odet minorities 12.8% and Bolloré minorities 77.2%.

So unwinding the control loops brings both good news and bad news. The good news is that, based on the approximation used, Bolloré minority shareholders actually own over twice as much of Bolloré as officially reported; they are in fact the majority owners! The bad news is that the true net asset value of Bolloré is merely just over half of what is reported on the consolidated balance sheet. Using the numbers above, unwinding the control loops would result in a 19% increase in attributable net asset value for Bolloré minority shareholders.

A 19% gain is not small, but the effort needed to realize it must be considered. This brings up the third and final question: what is the likelihood that the circular shareholding structure will be unwound? This is actually *the* critical question, and investors bullish on Bolloré are missing the entire point of the circular structure: **unwinding the circular ownership would cause the family to lose control of Bolloré Group**.

Since the family's priority is to retain control, rather than to create value for minority shareholders, the circular structure will *not* be

unwound unless it is forced by regulators. It then becomes clear that the analysis for the first two questions is primarily academic. Minority shareholders have essentially no hope of realizing value in this way, unless they can somehow convince French regulators that the circular shareholding structure is prejudicial to the public interest.

To be fair, such a hope is not entirely in vain, but it has to be acknowledged that the odds are very poor. Even if the laws change, it is likely that existing structures will either be grandfathered in, or be given a generous timeline to be unwound. One can look at South Korea for hints of what may happen.

Family-owned conglomerates in South Korea and Japan can have complicated shareholding structures. One reason is that the high inheritance taxes force entrepreneurial families into restructuring exercises designed to maximize cash proceeds to fund tax bills while retaining control. The families that did not use such methods lost control of their empires long ago. Toyota, Honda, Mitsubishi and Mitsui are just a few of the names where the founding families are no longer meaningful shareholders.

South Korea's leading *chaebol* Samsung is an oft-cited example of a complex shareholding structure designed to maintain control. The founding Lee family owns shares in Samsung C&T, which owns shares in Samsung Life Insurance, which owns shares in Samsung Electronics, which owns shares in Samsung SDI, which owns shares in Samsung C&T. This is just one of many interlocking chains of ownership within Samsung Group.

Since July 2014, the South Korean government has banned transactions that create or strengthen cross-holdings between large *chaebol* affiliates. This has led to attempts to simplify shareholding structures.

Samsung in particular has been active in restructuring, because founder Lee Kun Hee is ill, and his heir Lee Jae Yong faces an enormous inheritance tax bill, estimated at some US$ 6bn. Clearly, stakes in various entities will need to be sold in order to raise cash. At the same time, corporate restructuring will be used to maintain control even as economic ownership is diluted.

Investors looking to benefit from such restructuring events would do well to bet on the outcome that will allow the controlling shareholders to comply with the law, maintain control, or free up cash for inheritance taxes, as in each case there is a clear alignment of interest. Taking a confrontational stance, as Elliot Associates did with respect to the merger of Samsung group companies Cheil Industries and Samsung C&T, is not for the faint-hearted, and is best left to those with both the resources and the resolve to take on entrenched interests. For the record, the merger went through i.e. Elliot lost.

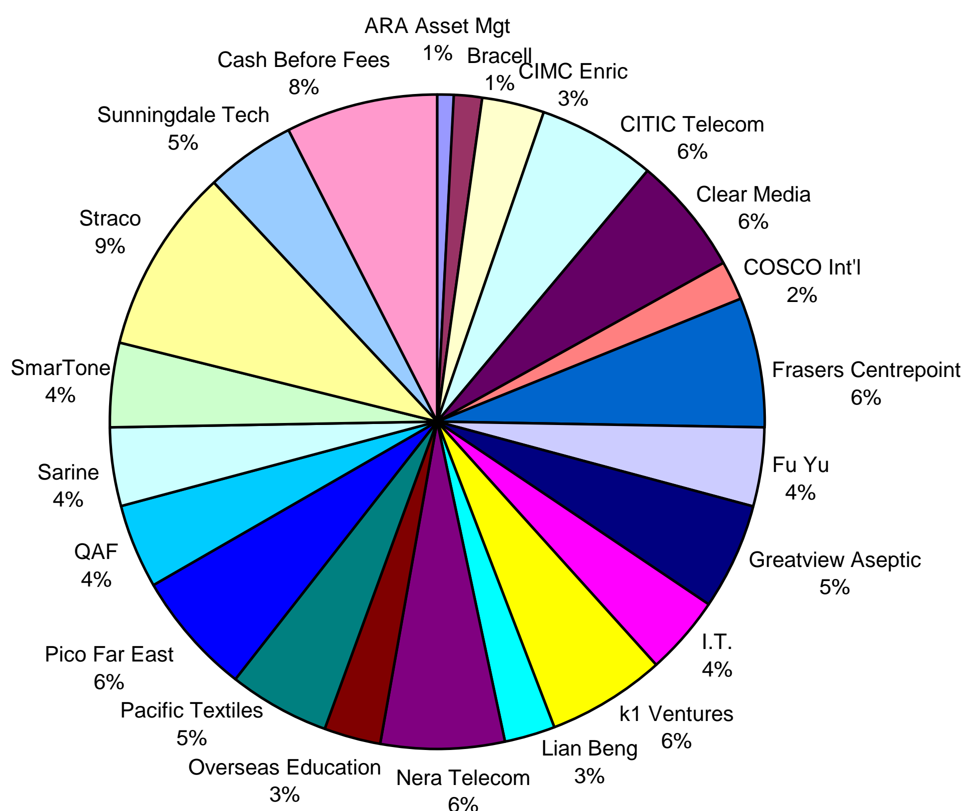
☙ End ❧

LIGHTHOUSE ADVISORS

Keeping Your Capital Safe

Annex I

Fund Holdings as of 30 Jun 2016



Annex II

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2008										34.16	33.49	35.62	**+4.3%**
2009	34.57	33.52	33.37	36.69	46.20	46.00	50.06	49.68	52.66	54.17	56.68	59.94	**+68.3%**
2010	59.05	61.09	65.17	68.27	64.14	65.69	70.65	72.24	81.06	83.56	85.10	90.30	**+50.6%**
2011	87.21	86.29	88.13	92.81	90.85	91.35	91.17	83.69	69.04	78.23	73.00	72.88	**-19.3%**
2012	77.40	82.90	82.52	83.32	76.36	77.25	77.27	77.91	80.57	79.44	82.70	84.92	**+16.5%**
2013	91.43	97.36	99.96	100.24	99.14	95.09	98.50	100.00	100.86	102.24	102.63	102.93	**+21.2%**
2014	99.15	101.78	99.80	101.84	105.45	106.57	109.05	108.58	103.60	103.91	101.87	99.94	**-2.9%**
2015	97.97	98.16	97.74	103.80	103.69	100.99	96.17	85.91	84.17	88.91	86.20	86.35	**-13.6%**
2016	81.56	83.81	88.82	92.18	91.50	91.52							**+6.0%**

Note: The Net Asset Value of the Fund has been linked to the rebased NAV of the Reference Account, which had the same investment style. Until the launch of the Fund, the Reference Account served as the model portfolio for all the separately-managed client accounts. Its trading records were distributed to clients as proof that the Manager's interests were fully aligned with those of the clients. The Reference Account was started at the end of 2008 and became inactive following the launch of the fund on 1 September 2013.

Updated 29 July 2016