Overseas Asset Management

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OAM Asian Recovery Fund

Dear Fellow Shareholder,

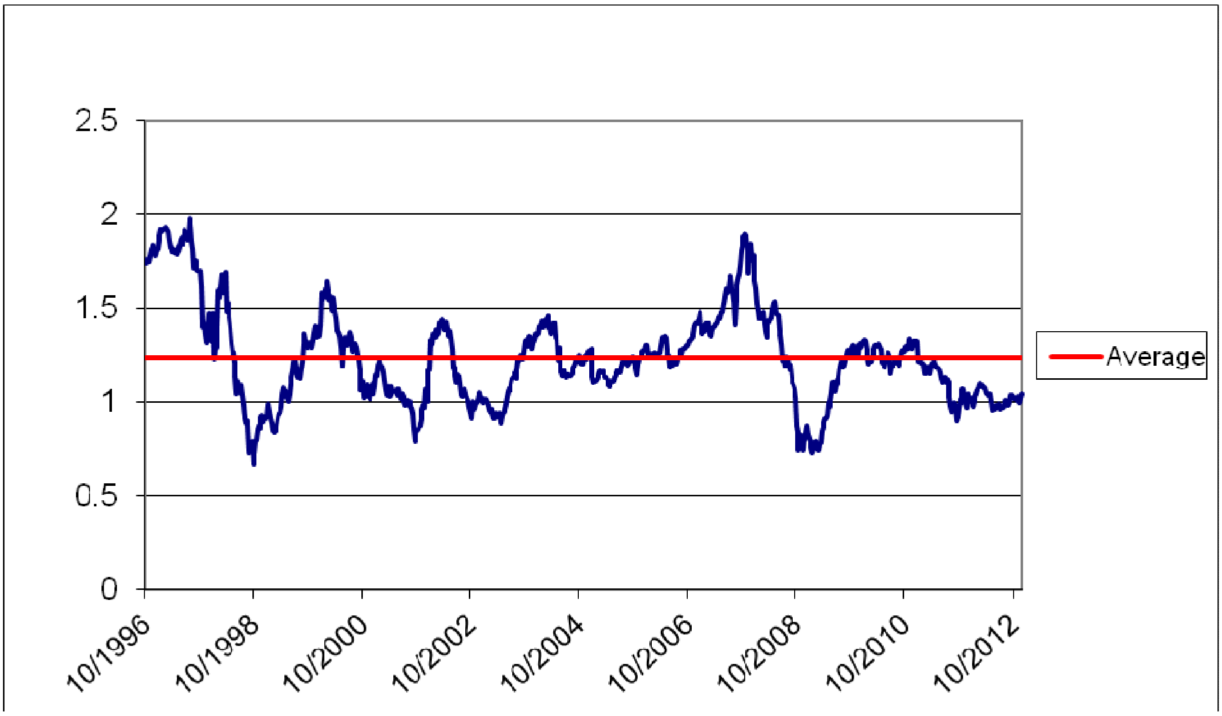
2012 was a good year for Asian markets. The MSCI Asia free Japan (US$) index rose by 19.4%. It is important to bear in mind that the rise in 2012 only reversed most of the decline in 2011. In fact, over the past two years, the index is still down 3.5%. Meanwhile, the Fund's NAV per share increased by 24.3%. This marks the eleventh year of positive returns in the Fund's 14 year history. During its 14 year history, the Fund returned 769% or 16.7% per annum to shareholders compared with a return of 167% or 7.3% per annum for its benchmark, the MSCI Asia free Japan (US$) index. We are very proud of the Fund's track record and aim to deliver more of the same, albeit probably not as high absolute returns or relative outperformance as we have achieved to date.

A discussion on valuations

Sharp-eyed observers will have noticed from our quarterly fund fact sheet the rise in the average P/E ratio of the Fund's holding to an estimated 17 times estimated 2012 earnings. Although we pay close attention to valuations, we are not overly concerned by this fact for the following reasons:

1. This figure almost certainly overstates the actual P/E by around 1 ½ -2 because we only have the P/E data for about three-quarters of the Fund's portfolio; the balance of funds are closed-end funds that do not provide such data, or they tend to be deep discount to NAV investments. Our sense is that, where applicable, the average P/E ratio of the remaining Fund investments is just over half the stated valuation of the Fund's portfolio.
2. Given our bias towards managers who focus on investing in companies that serve the Asian consumer, we would expect the P/E of our Fund to be higher than the market average. Growth is hard to find today and with many of the Fund's underlying holdings delivering steady, dependable earnings growth of 15-20% per annum, we think that these companies deserve to sell at a premium valuation, and increasingly so does the rest of the market.

Overall, we think that the current valuation of Asia ex Japan equity markets is reasonably attractive. We favour using the Price/Sales ratio to evaluate where we currently are in the market cycle. As I mentioned in the past, this valuation measure eliminates the cyclicality of profit margins and has tended to be a better indicator than other measures for determining when markets are cheap or expensive. As the chart below shows, Asia ex Japan equity markets are trading at the bottom end of their historic valuation range over the past 17 years, and about 15% below the historic average.



Within Asia, there are huge divergences in valuations, bigger than we can remember for some time. In broad terms, Hong Kong and China look cheap and ASEAN looks fully valued. Within ASEAN, we think that Vietnam's market looks cheap. The market has drifted lower since the third quarter of 2009 and, in US Dollar terms, is now 75% below its early 2007 peak. A smaller company Asian fund manager who we have been evaluating for some time regularly screens the universe of Asia ex Japan listed smaller companies to find investment opportunities. Recently, they reported that the median Price/Book valuation of their Hong Kong universe was 0.9 times compared with South Korea, Singapore, and Malaysia at 1.1-1.3 times, and Thailand, the Philippines and Indonesia at 2.2-2.5 times.

Portfolio activity

Early in 2012, we received $9 million from redeeming our shares in Clairvoyance Asia Fund. As I also mentioned in last year's Chairman's statement, we allocated $5 million of the proceeds to a new fund, CC Asian Evolution Fund which is managed by Rory Dickson who I knew from his days as head of research at Arisaig Partners in Singapore. At the time of our subscription at the start of 2012, CC Asian Evolution Fund managed only $10 million. Later in the year, we increased our investment in the fund by

$3 million. By year end, the fund had assets of $220 million and is now closed to subscription by new investors. In 2012, the NAV per share of the Fund's Class C shares which we own increased 43%.

We received redemption proceeds from three other funds that were liquidated during the year: $2 million from DAC China, $11 million from Hidden Jewels, and $5 million from QAM Asian Equities. The Fund realised large gains on these investments, other than DAC China where we roughly got back our investment cost after several years. Hidden Jewels was a particularly good investment, guided by Rob Lewis who decided to retire from his gruelling travel regime of visiting companies around Asia and instead spend more time with his young family. We also sold the Fund's investment in Prospect Japan Fund for about $5 million as its discount to NAV narrowed and we became increasingly worried about Japan's huge government debt which may be reaching a "tipping point". Japan is not a core market for the Fund and we have virtually no exposure to that stock market now.

During the year, opportunities arose to add to what was a modest size holding in ARC Capital, a London-listed closed-end fund that makes private equity investments in companies serving the Chinese consumer. We have followed the fund for about four years and when its share price discount to NAV widened to what we considered absurdly wide levels, we added significantly to our investment. We invested a net $9 million in the fund's shares during the year and think we will earn a very attractive return on our 7% shareholding in this fund as it liquidates its assets during the next 2 ½ years.

We also made an investment of about $2 million in a London-listed closed-end fund that makes private equity investments in India. This fund is also being liquidated over the next three years and we were able to acquire shares at a very attractive discount to NAV.

Although Vietnam looks like a cheap market, there are not that many high quality companies listed there that are worth buying. However, we think there are great opportunities in some of the Vietnam closed-end funds which are trading at attractive discounts to NAV. Many of them also have catalysts in place to eliminate or narrow their discounts to NAV over the next year or two. We invested $7 million in four closed-end Vietnam funds, in many cases adding to existing small holdings that were bought in the prior year. We now have $12 million by market value invested in four Vietnam closed-end funds.

During my trip to Asia in November, I met a new manager who has compiled an impressive but relatively short track record of investing in Asian smaller companies. The manager consists of two Singaporeans in their thirties who have most of their savings invested in the fund alongside their investors. The fund has assets of only $32 million. We made an initial investment of $5 million and may add to our holding. About 70% of the fund's assets are invested in Hong Kong-listed smaller companies. The average P/E of the fund's portfolio is 6 and the average dividend yield is 5%. Their investment process is one I can identify with and the opportunity they have reminds me of the opportunities that confronted the likes of Value Partners in the late 1990's following the Asian financial crisis when bargain equity valuations in the smaller company segment of Asian equity markets were plentiful.

The Asian consumer

In last year's Chairman's statement, I used the example of Nestle Pakistan to illustrate why the S curve is important to understanding the rapid growth of spending by Asian consumers on everyday products that we in the West take for granted. This secular growth trend is likely to last at least another 20 years and it is being more widely understood by investors. This has led to a re-rating of most Asian consumer stocks. The re-rating has been gradual and we think it is warranted in most cases.

A significant contributor to the average P/E of the Fund's holdings being 17 times 2012 estimated earnings is the Fund's $30 million investment in Arisaig Asia Consumer Fund. Our cost is $4 million with the shares being accumulated starting from the Fund's inception at the start of 1999. Arisaig Asia Consumer Fund owns shares in 31 Asian companies that are market leaders in food and beverage branded goods, fast moving consumer goods, supermarket retailing, and fast food restaurant chains. The average return on capital employed (ROCE) of these businesses is 35%. They are highly profitable, rapidly growing, free cash flow generative businesses. In December 2010, the average P/E of Arisaig Asia Consumer Fund's investments was 31 times that year's estimated earnings. At the end of December 2011, it was 29 and at the end of 2012, it was 31. Even though the Fund's P/E remained unchanged over the past two years, the fund's NAV per share increased by 32%. That was a result of the companies in the portfolio increasing their earnings on average by about 15% annually during the period. Arisaig Asia Consumer Fund is now closed to new investors and any subscriptions by existing investors will only be allowed if there are redemptions that make shares available. We think that there is no other manager globally that has done as much research on companies serving the Asian consumer. Nevertheless, we may trim the size of the Fund's holding slightly as it is now such a large investment.

The Fund also has investments in two other purely Asian consumer-focused funds which are managed by two former heads of research at Arisaig. One is CC Asian Evolution Fund, managed by Rory Dickson. This is a $10 million investment and its average P/E of 23 times 2012 estimated earnings is also a major contributor to the Fund's relatively high average P/E. This fund is also no longer available to subscription by new investors. The other fund is a $13 million investment by OAM Asian Recovery Fund. We have been the largest investor in this fund since inception. In 2012, its NAV per share increased by 62%. It also has an average P/E of 24. Excluding these three funds with high average P/E ratios, the average P/E of the Fund's remaining investments declines to about 12 times 2012 estimated earnings.

We find it interesting that some of the world's leading multinational food and beverage companies are willing to pay very high multiples of earnings to buy shares in their listed Asian subsidiaries, shares of which are owned by Arisaig Asia Consumer Fund and CC Asian Evolution Fund. They clearly think that the price they are paying is worth it in a world where the rapid growth prospects that these businesses offer is scarce. In August, Heineken announced an offer to buy the remaining 40% of Asia Pacific Breweries, the largest investment in CC Asian Evolution Fund, at a 50% premium. The price equated to 27 times earnings. In November, GlaxoSmithKline offered a 28% premium to buy shares in GlaxoSmithKline Consumer Healthcare in India to increase its stake from 43% to 75%. The price equated to 37 times earnings. Both Arisaig Asia Consumer Fund and CC Asian Evolution Fund owned shares in GlaxoSmithKline Consumer Healthcare. In November, Unilever announced a takeover for the remaining

25% of Unilever Pakistan that is listed at a P/E of 26. Arisaig Asia Consumer Fund spent the best part of nine years accumulating a 6% shareholding in Unilever Pakistan and is not happy with the privatisation offer. This illustrates how difficult it is to accumulate decent sized investments in these Asian gems that are sought after, not just by stock market investors, but by industry buyers.

Bargains in Hong Kong and China

In last year's Chairman's statement, I wrote:

"The other big risk in my view is China. My concerns are somewhat tempered by the fact that I have been reiterating these same China risks for the past nine years – go back and read past annual Chairman's statements. … This risk appears to be partially discounted in share prices."

Though we remain wary of investing in most of China's state-controlled companies and its entire banking sector, we think there are selective opportunities to invest in China, particularly through smaller companies listed in Hong Kong that do most of their business in China. These companies are usually run by successful entrepreneurs who have a large shareholding in the company, although there are certainly a significant number that are run by less than honest individuals. This is a minefield and not for the faint of heart as Anthony Bolton discovered.

We have exposure to this sector through experienced hands like Value Partners where our investment in the A shares of their Value Partners Classic Fund has increased from our cost of $2 million to $25 million. The Class A shares that we own pay a reduced management fee and are no longer available for subscription. Other exposure to the sector comes from Target Value Fund in which we have a $9 million investment. That fund is managed by N.L.Teng who as I mentioned in my 2010 Chairman's statement, wound up Target Asia Fund that year, returning about $2 billion to its shareholders. We initially invested in Target Asia Fund at the start of 1999 when it had net assets of less than $10 million and added to our investment over time. We received $21.4 million back from Target Asia Fund, realising a gain of more than $15 million for the Fund's shareholders. Mr. Teng's new fund is about to be closed to further subscriptions and we will be shortly making an additional subscription to the fund of $3 million before it closes to subscriptions in about two months. Both Mr. Teng and Cheah Cheng Hye, the founder of Value Partners, are featured in a new book "The Value Investors: Lessons from the World's Top Fund Managers" which I highly recommend. They are both wonderful people and remain humble in spite of their incredible success. I get together with each of them every year when I am in Hong Kong and Singapore for lunch or dinner to exchange views and investment ideas.

As mentioned earlier, we are excited that we may have discovered a new manager who by virtue of managing such a small pool of money may be capable of posting stellar results for several years given how low valuations are in the Hong Kong smaller company market which comprises 70% of that fund's assets. We are likely to add to our $5 million investment in the fund this year.

In this segment of the Fund's portfolio, we are also excited by our investment in ARC Capital. This closed-end fund's shares are trading at a 45% discount to NAV. We think that is ludicrous given that the fund is likely to liquidate its assets and return all capital to shareholders in stages over the next 2 ½ years. The share price discount to NAV suggests that investors believe that the NAV is unrealistic. We do not think that is the case. In fact, last month, ARC Capital sold one of its investments for $25 million which was more than double its carrying value. The fund's largest investment, accounting for a quarter of the fund's net assets, is a shareholding in Funtalk, the largest independent retailer of mobile phones in China. That investment is carried by ARC Capital at what we think is a very conservative valuation of 7 times estimated earnings for the year ending March 2013.

Negotiated terms

As the Fund has built an enviable track record investing in boutique fund managers back in the late 1990s which are now some of the largest hedge fund managers in Asia, we have been able to use this to our advantage. We have a good network of fund managers in Asia who we use as a sounding board when investigating new managers, and sometimes they are a source of new investment managers. Three of our managers previously worked in senior positions for other funds in which we had a longstanding investment.

In a number of cases, we have been investors in smaller funds shortly after inception and our investment in these relatively new funds has made a big difference to the manager. We are not a believer in trying to negotiate a stake in a manager in return for backing them. However, we have negotiated preferential terms, usually in the form of lower management fees, in return for backing a new manager in the "early years". These preferential terms or rebates are always passed on to the Fund for the benefit of its shareholders, something that seems to be alien to some of Switzerland's banks! The terms of any negotiated preferential terms are almost always subject to confidentiality agreements so we cannot share the details other than to say that you benefit, not us, from these terms. This is not something that I have mentioned before, but it is adds incrementally to returns so it is worth sharing with shareholders.

Conclusion

The Fund now has about $260 million in net assets after receiving $14 million in subscriptions and $16 million in redemptions during the year. This is the third consecutive year of net redemptions from the Fund which I find slightly surprising given its performance. About 1% of the Fund's assets are currently in cash. The low level of cash reflects our confidence in the Fund's future prospects.

In last year's Chairman's statement I wrote:

"When we launched the Fund at the end of 1998 at a NAV/share of $10, I told clients that my personal objective was to increase the NAV/share to $50 in ten years. As it turned out, we did it in eight years. In my Chairman's statement written in January 2006, a year before reaching the $50/share target, I wrote: "Going forward, I think that a return similar to last year's return of 13.8% is a more realistic objective than the 21.4% compound rate of return that has been achieved over the past seven years since the Fund's inception. If the Fund achieves a return of 12.5% per annum going forward, the NAV would reach $100.00 per share in 8 years." The $100 target that I set six years ago means that the Fund's NAV/share would have to increase by 43% over the next two years for the target to be achieved.

Though this is an ambitious target and one that should not form the basis for your return expectations over the next two years, I still believe that it is a realistic personal objective given the current level of valuations and my expectations for earnings growth."

I am sticking to my $100 NAV target by the end of this year. If it takes a year to achieve, that would imply a 15% return this year. We make no promises, but we aim to please!

Desmond Kinch, CFA

Chairman