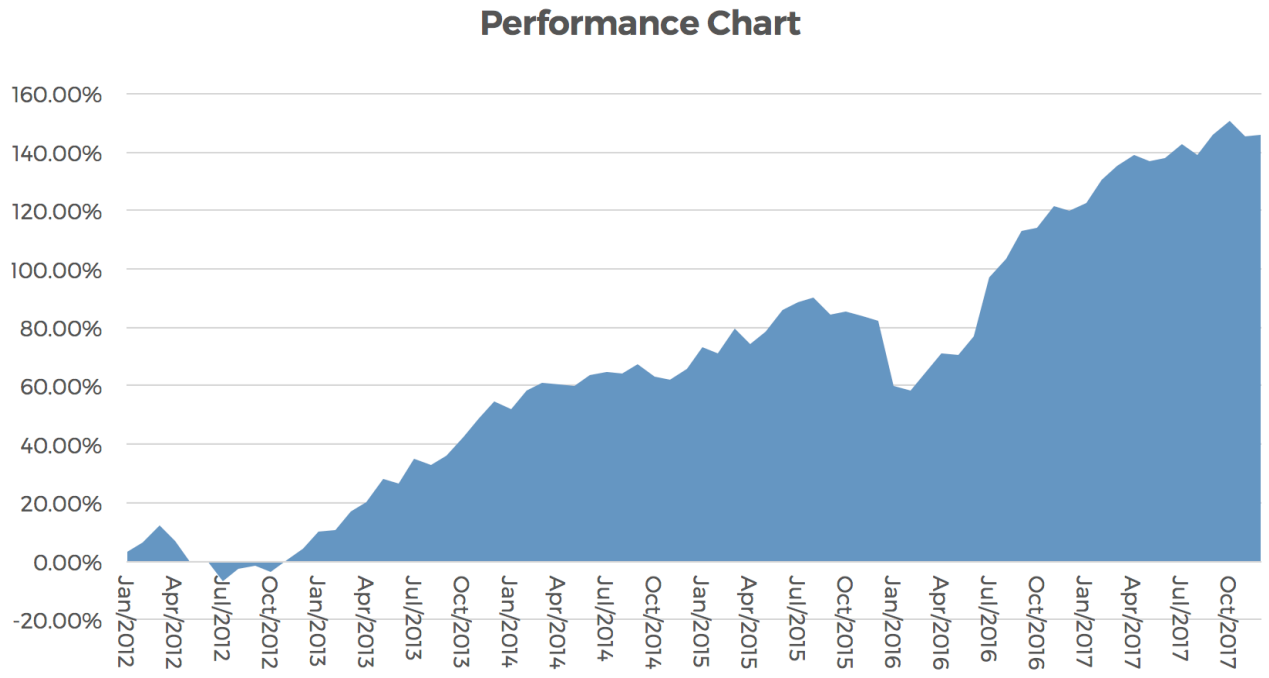
Year End Letter



Year	Heritage Global Capital Fund	MSCI World Index (SGD, Dividends Reinvested)
2012	+4.58%	+9.74%
2013	+47.98%	+31.57%
2014	+7.09%	+10.68%
2015	+9.91%	+6.63%
2016	+20.73%	+10.37%
YTD	+11.80%	+13.64%
Cumulative	**+145.88%**	**+113.72%**
Annualised	**+16.18%**	**+13.49%**

For the year ending December 2017, Heritage Global Capital Fund has returned +11.80% in SGD terms. Our benchmark, the MSCI World Index (Rebased to SGD with dividends reinvested) returned +13.64%.

Since January 2012, the fund's investment strategy has generated a cumulative return of +145.88% and an annualised return of +16.18% net of fees. This compares with the MSCI World Index (rebased in SGD terms) which has returned a cumulative return of +113.72% and an annualised return of +13.49%.

Review of Divestments

Genting Singapore PLC

Genting Singapore was the first operator of an integrated resort in Singapore when Resorts World Sentosa opened its doors in January 2010. Although initial operating results were encouraging, it was soon beset by multiple operating problems – chief among those was its inability to collect money due from overseas customers.

Genting Singapore

in SGD millions	2016	2015	2014	2013
Net Profit For The Year	$385	$193	$635	$708
Net Cash from Operations	$1,165	$1,262	$996	$821
Capital Expenditure	-$70	-$174	-$195	-$392
Free Cash Flow	**$1,095**	**$1,088**	**$801**	**$429**
Net Repayment of Borrowings	**-$475**	**-$89**	**-$525**	**-$469**
Outstanding Bank Borrowings	**$1,161**	**$1,625**	**$2,218**	**$2,697**

This led to a write-down in trade receivables and consequentially an overhang of its profits. Still even with these problems, Genting was generating considerable amounts of free cash flow having completed the main bulk of its CAPEX program in building the casino.

Crucially, Genting Singapore was using the considerable cash flow generated to reduce its considerable debt load (which it had taken to fund the construction of the Integrated Resort).

Our thesis was simple when we initiated our position – the market was under-appreciating the free cash flow generation capabilities of its casino operations and improved credit policies would lead to a reduction in future bad debt write-offs.

The reduction in debt load would eventually cumulate in a dividend being paid in the future to its largest shareholder Genting Berhad, majority controlled by the Lim family in Malaysia.

This eventually came to pass as a dividend was announced. A timely exit from its Jeju project led to an influx of cash. Finally, in late 2017, Genting Singapore redeemed its widely held perpetual bonds.

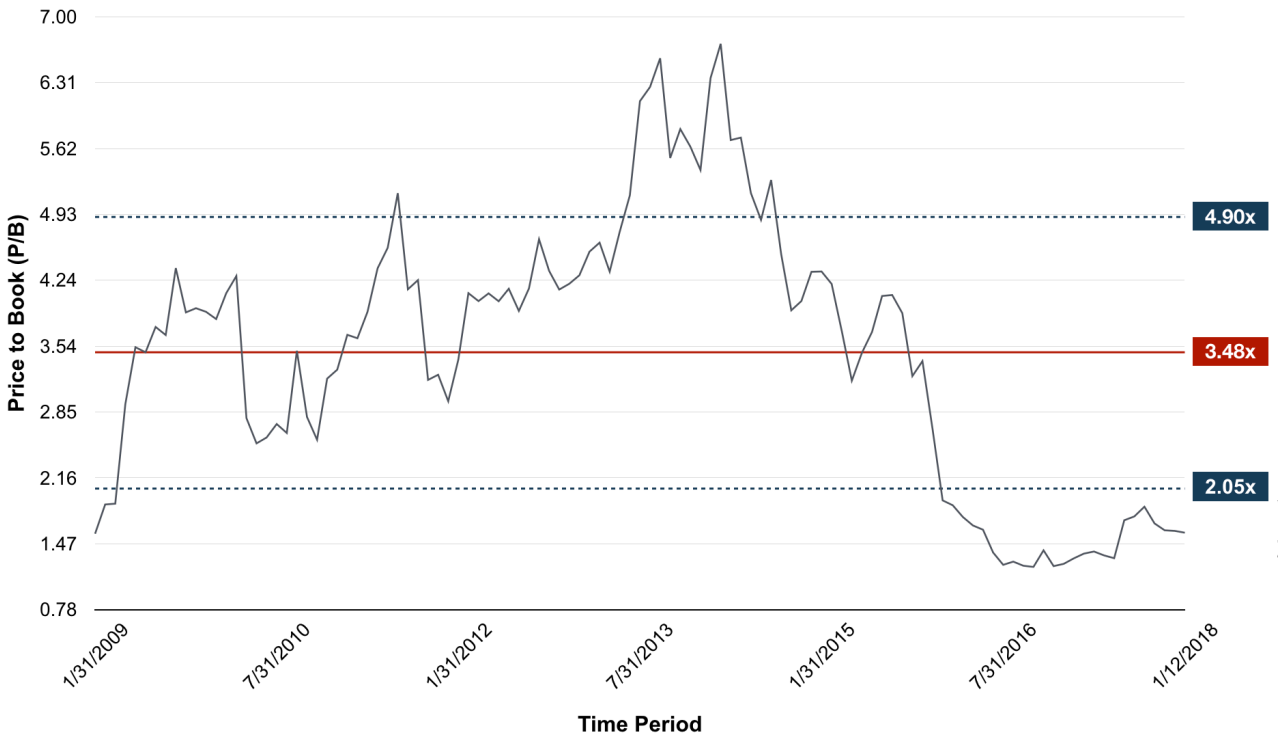
We acquired our position in Genting Singapore PLC at an average price of S$0.797. These shares were sold at an average price of S$1.15 from April 2017 to August 2017, realising for the fund a gain of **+49.3%** including dividends.

Sports Direct Plc.

Sports Direct is the United Kingdom's largest sports-goods retailer and operates roughly 670 stores worldwide.

Over the past two years, Sports Direct has grappled with declining growth, a plunging share price and an investigation into poor work practices that eventually cumulated into a parliamentary grilling of its CEO, Mike Ashely.

Amidst all this gloom, it is worthwhile to note that Sports Direct was once a stock market darling. Mike Ashley, a billionaire in his own right had built the company up from scratch since it was established in 1982.



We acquired our position in Sports Direct at an average price of GBP 2.90. These shares were sold at an average price of GBP 3.97 from August 2017 to September 2017, realising for the fund a gain of **+36.9%.**

City Developments Limited

City Developments Limited ("CDL") is a Singapore-listed international real estate operating company with a global presence. It is one of Singapore's largest companies by market capitalisation. It has a geographically-diversified portfolio comprising of residences, offices, hotels, serviced apartments, integrated developments and shopping malls.

When we first initiated our position in CDL, the local property market was in doldrums. Real estate prices in Singapore had experienced a "cold winter" for several years and sentiment was poor.

While CDL was located in Singapore, it had a geographically diverse footprint. It was conservatively financed and well positioned to ride out the downturn. More importantly, valuations were extremely cheap. Shares in CDL were trading at all-time lows and at valuations comparable to that of the 2008 Global Financial Crisis.

When it comes to sourcing for ideas, we look for investments with favourable risk/reward ratios or optionality. Optionality is the property of asymmetric upside (preferably unlimited) with correspondingly limited downside (preferably tiny).

In other words, we are looking for investments that have little downside and large upside potential.

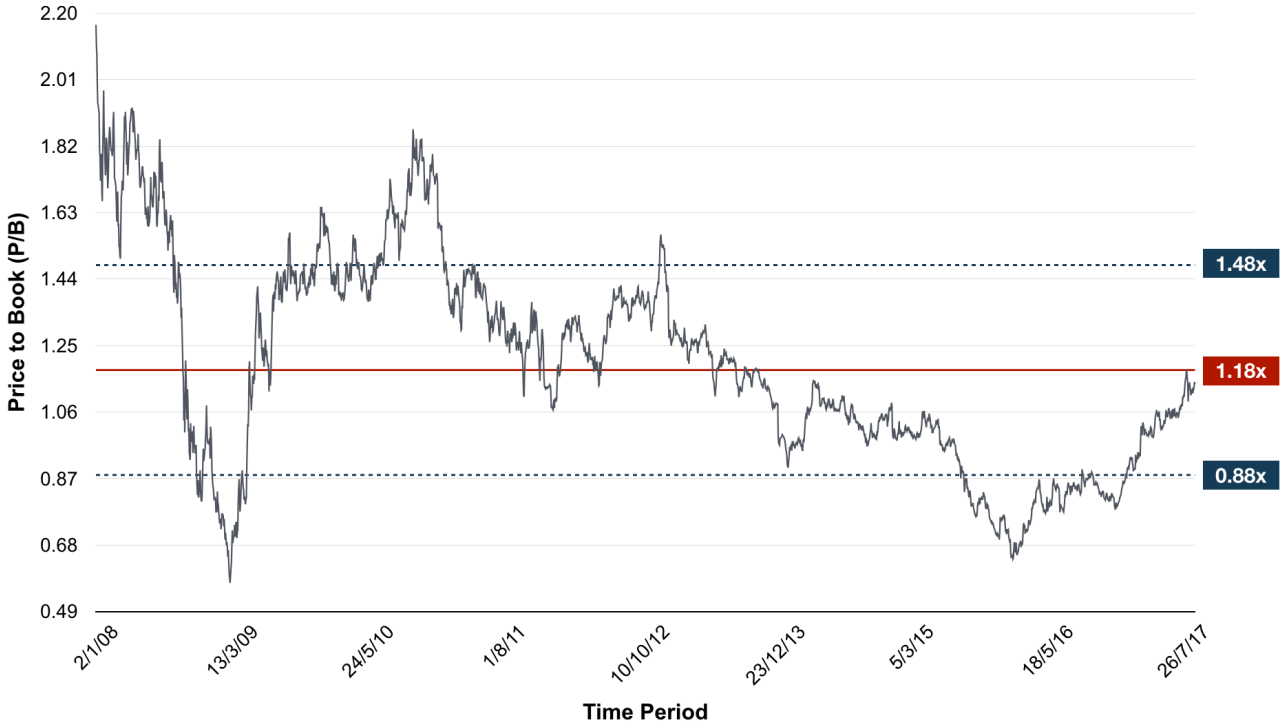
Rule 1: most things will prove to be cyclical.

Rule 2: some of the greatest opportunities for gain and loss come when other people forget rule number 1.

— Howard Marks

In the case of CDL, we were buying shares in a well-run property conglomerate below book value with substantial upside when the property market turned. Our downside was limited as shares were already trading at extremely depressed valuations.

CDL had one additional layer of safety – its investment properties were recorded at cost instead of being revalued to fair market values. In other words, the stated book values erred on the side of conservatism thereby further protecting our downside in the case of a protracted downturn or economic crisis.



We acquired our position in City Developments Limited at an average price of SGD $8.44. These shares were sold at an average price of SGD $11.28 in August 2017, realising for the fund a gain of **+35.1%** including dividends.

The Swatch Group AG

The Swatch Group AG, is a Switzerland based watch company. Investors will probably be more familiar with the brands it owns - Harry Winston, Blancpain, Omega, Longines, Rado and Tissot among many others.

When we first initiated the position, the company was beset by multiple woes - including but not limited to:

- Multiple terrorist attacks in Europe
- Dampening of sentiment from Brexit
- Anti-graft campaign in China affecting all luxury brands
- Fall in mainland tourists visiting Hong Kong
- Strengthening of the Swiss Franc

Our favoured investment strategy is to seek out high-quality businesses with enduring competitive advantages that are temporarily out of favour. Such companies are rarely cheap, and moments to acquire stakes in such businesses are rare absent a full blown financial crisis.

Swatch has had a fortress-like balance sheet with no net debt, and had paid a dividend throughout the last two decades. Free cash flow generation continued to be robust even during poor economic climates.

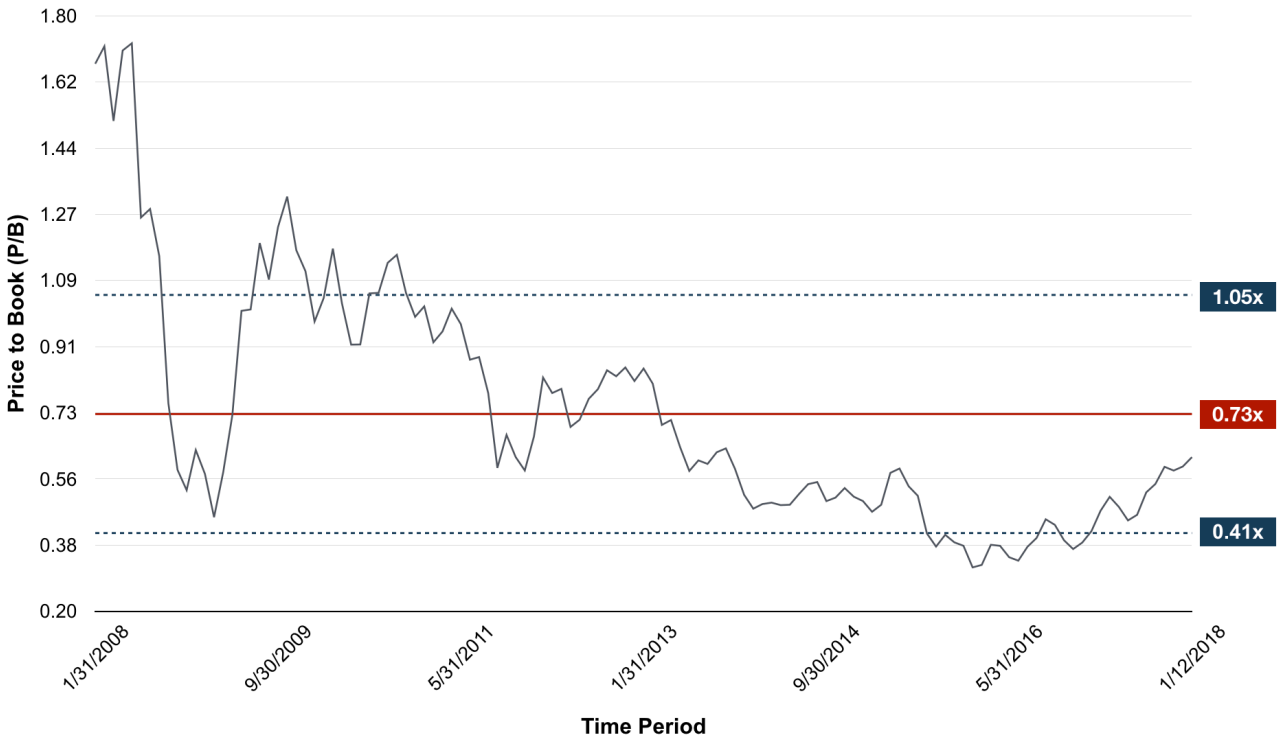
Our own experience is that such companies bounce back quickly after the storm has passed, often stronger and more robust than before as their weaker competitors get weeded out or acquired.

We acquired our position in The Swatch Group AG at an average price of CHF 290.61. These shares were sold at an average price of CHF 378.00 in September 2017, realising for the fund a gain of **+33.4%** including dividends.

Kerry Properties Ltd

Kerry Properties Ltd is engaged in property development in Hong Kong, Mainland China and Asia Pacific region; infrastructure projects in Hong Kong and Mainland China; and hotel ownership and operations in Mainland China. It is majority controlled by billionaire tycoon Robert Kuok – although he is no longer involved in day to day operations.

When we first initiated our position in the company, it was trading at a substantial discount to its NAV at a Price-to-Book of 0.40x and offering a generous dividend yield of 3.8%.



Most Hong Kong property conglomerates share similar characteristics and Kerry Properties is no exception. Earlier in April 2017, we wrote a memo entitled "**Property or Equities for The Long Run?".**

We covered extensively some of the points that led us to make Hang Lung Properties one of our holdings (we still own it today, adding to the position during the recent price decline). The points raised then in the memo are also relevant to Kerry Properties.

We acquired our position in Kerry Properties Limited at an average price of HK$23.09. These shares were sold at an average price of HK$30.52 from April 2017 to September 2017, realising for the fund a gain of **+33.2%** including dividends.

Standard Life Aberdeen (formerly Aberdeen Asset Management plc)

Aberdeen Asset Management plc is a well-known asset management firm (the same firm that advertises regularly on MRTs in Singapore) with a niche focus on global emerging equities and emerging market debt.

In 2015, Aberdeen Asset Management was facing a series of headwinds after riding high previously. Performance of its funds was lacklustre across the board and the firm suffered from fund outflows as a result. The deteriorating sentiment in the APAC region and forecasted interest rate hikes did little to help.

At one point, Martin Gilbert (co-founder and CEO was forced to deny the firm was for sale. Share prices languished and the outlook was bleak.

Still, prices of Aberdeen were exceptionally cheap, sporting a dividend yield of 7.3%. Asset management firms are exceptional free cash flow generators and Aberdeen proved to be no exception.

Although fund performance was lacklustre, valuations in emerging equities and the APAC region were at record lows, providing a future tailwind when things turned the corner.

Although the situation was dire, Martin Gilbert had faced down worst circumstances before.

"The rise of Gilbert and Aberdeen was one of the great success stories in British finance.

And yet over the company's 35-year history, it's lurched from one crisis to another—from the crippling departure of its largest client, Aberdeen Trust, in 1985 to the so-called taper tantrum in 2013 that led to the barrage of client redemptions that still persists.

Gilbert's lowest moment came when he was summoned to appear before the U.K. Parliament's Treasury Select Committee in 2002 after the dot-com bubble burst, wreaking havoc on Aberdeen's funds. John McFall, committee chairman at the time, said Gilbert and Aberdeen, the largest purveyor of split capital trusts, were no better than "sophisticated snake-oil salesmen."

— The Scotsman Who Can't Stop Making Deals

Earlier in 2017, the merger of Aberdeen and Standard Life was announced. While we had no doubts in backing Martin Gilbert, the same could not be said for Standard Life – a firm in which we had no superior insight into. The newly merged firm was an altogether different beast from the specialist emerging equities firm that Aberdeen was.

It is our firm policy that when the thesis of our investment changes, we will move to liquidate the shares in a timely fashion instead of formulating a new thesis.

In this case, the markets reacted favourably to the tie up and we took the opportunity to realise a profit on our initial investment.

We initially acquired our position in Aberdeen Asset Management at an average price of GBP 266.00. An all-share merger of Standard Life plc and Aberdeen Asset Management was announced and completed in August 2017.

Under the terms of the merger, we received 0.757 of new Standard Life Aberdeen shares in exchange for each share we held of Aberdeen. The fund's shares in Standard Life Aberdeen were eventually liquidated at a price of GBP 419.00 realising for the fund a gain of **+27.8%** including dividends.

Shun Tak Holdings

Shun Tak is part of the corporate empire of billionaire tycoon Stanley Ho - and is active in shipping, property, hospitality and investments businesses.

It has an interesting mix of assets of which the most interesting are:

- Its indirect investment in publicly listed SJM Holdings through their ownership of Sociedade de Turismo e Diversoes de Macau (STDM). SJM Holdings is one of the six companies authorised to operate casino games of fortune and other games of chance in casinos in Macau. Shun Tak owns 11.5% of Sociedade de Turismo e Diversoes de Macau (STDM) which in turns owns 55% of SJM Holdings.

- Over HK$10 billion of investment properties and hospitality related assets that includes:

    1. One Central in Macau, which houses a 400,000 square feet luxury mall and the Mandarin Oriental, the Shun Tak Centre in Sheung Wan and SkyCity Marriot Hotel in Hong Kong.

    2. Recently acquired prime freehold site located at No. 9 Cuscaden Road in Singapore.

    3. 61% of 111 Somerset Road, a leasehold commercial property near Orchard Road.

- The company is also active in property development in Macau. Macau Nova Grand is slated to be completed in 2018 and has been well received by residential buyers. It is also active in Hengqin where it is involved in the development of the Hengqin Integrated Project.

It will be a key hub connecting Guangzhou-Zhuhai Intercity Rail, Macau Light Rail Transit and Hengqin Light Rail.

It enjoys an exceptionally cheap land cost of RMB 5,500 per square metre. Current residential selling prices are RMB 55,000 per square metre.

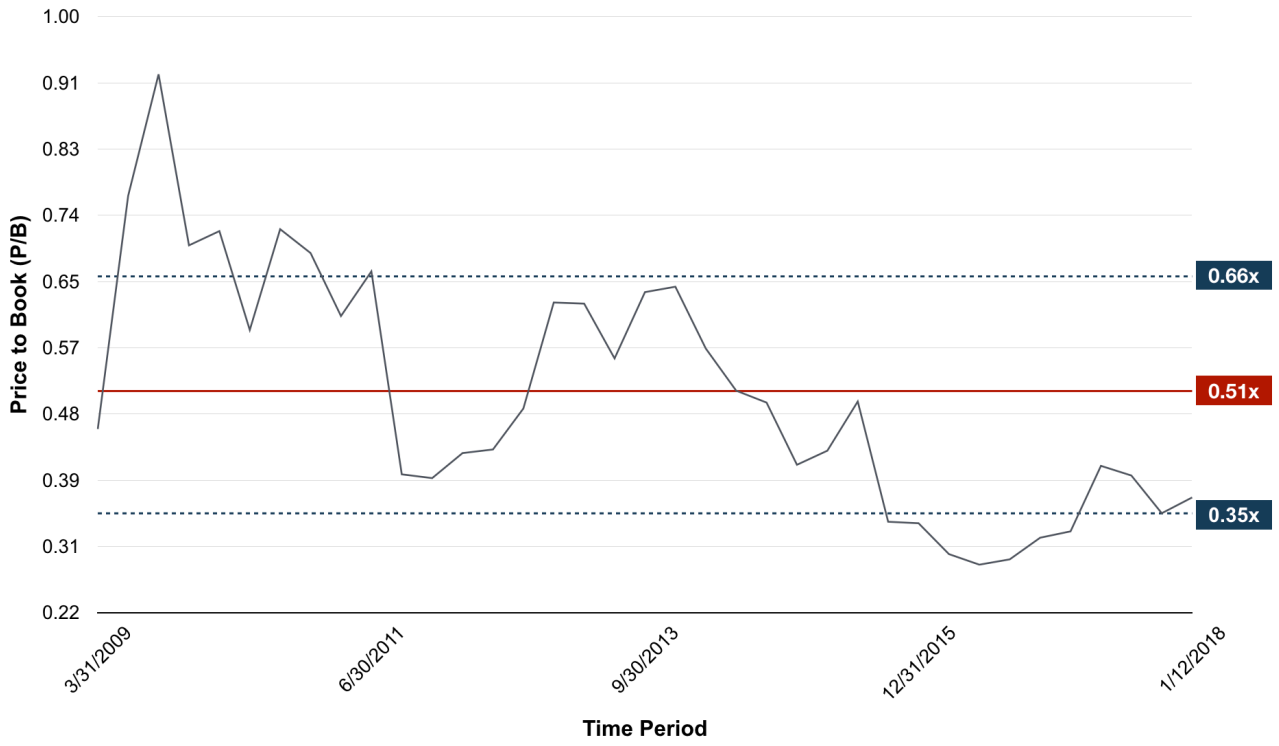
One notable point is that the shares in STDM are valued at cost at HK$815 million. The fair market value of its equivalent stake in SJM Holding shares are worth at least HK$2.5 billion.

When we first initiated coverage of the company, it was facing depressed economic conditions. The corruption clampdown and opening of new casinos in the Cotai Strip in Macau led to decreased revenues for SJM (work on a new casino in the Cotai Strip, the Lisboa Palace was delayed and is only slated to open later this year or next). As a result, the once generous dividend paid by SJM to STDM and consequentially Shun Tak had been reduced significantly.

Due to a lag time in revenue recognition from sale of properties, the property division reported significantly lower revenues in 2016. A substantial revaluation loss in one of its investment properties added to its woes.

Still, the long-term outlook of the business is intact. Property development is notoriously lumpy and the value of its shares in SJM via STDM had been conservatively. Furthermore, it had significant new property projects that were selling well from our own due diligence checks.

Although the near-term outlook was not particularly rosy, Shun Tak was still stood poised to benefit from the development of the Pearl Delta Region with the Macau-Hong Kong Bridge and the Guangzhou–Shenzhen–Hong Kong Express High Speed Rail slated to open.



The shares were exceptionally cheap when we first acquired them, providing significantly upside when the prospects of the company improved. News of Stanley Ho's retirement lifted Shun Tak dramatically in a short period of time, and we took the opportunity to sell our shares with a view of reinitiating a position.

We acquired our position in Shun Tak Holdings at an average price of HK$2.74. These shares were sold at an average price of HK$3.43 from July 2017 to September 2017, realising for the fund a gain of **+25.2%**.

Other Divestments:

Over the course of the last six months, we also divested our positions in

1. **SOHO China.** We acquired our position in SOHO China at an average price of HK$4.03. These shares were sold at an average price of HK$4.74 in September 2017, realising for the fund a gain of **+19.4%**.

2. **Affiliated Management Group (an alternative asset management group).** We acquired our position in Affiliated Managers Group, Inc. at an average price of US$153.71. These shares were sold at an average price of US$172.88 in September 2017, realising for the fund a gain of +12.5%.

3. **OUE Holdings (diversified property conglomerate).** We acquired our position in OUE Limited at an average price of SGD $1.76. These shares were sold at an average price of SGD $1.94 in September 2017, realising for the fund a gain of +11.4% including dividends.

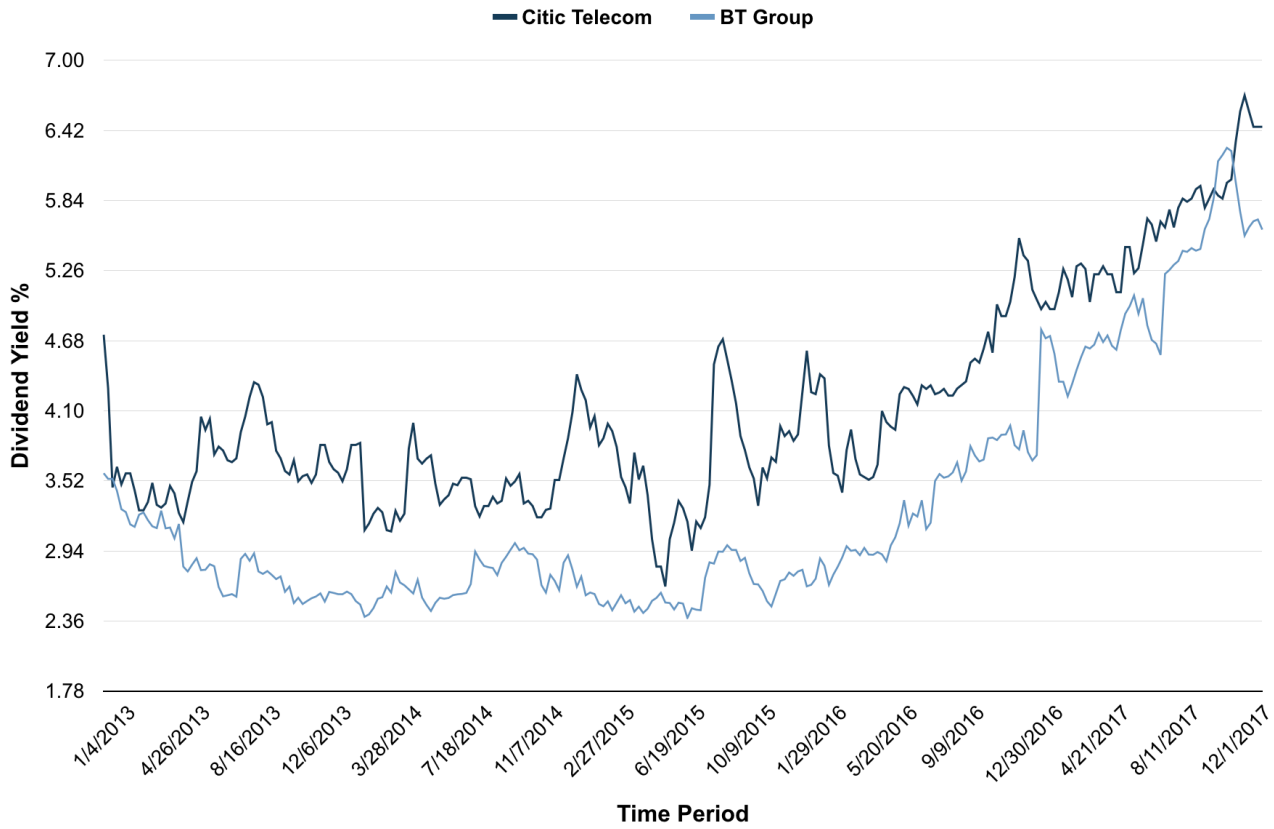
4. **Tesco plc (supermarket).** We acquired our position in Tesco plc. at an average price of GBP 1.77. These shares were sold at an average price of GBP 1.84 in September 2017, realising for the fund a gain of **+12.5%**.

These positions were not significant in size (the average fund position is 2.5% to 4%) They were divested to free up funds for investments into positions with more favourable risk/ reward ratios.

Prospective Areas of Opportunity:

Over the past months, we have been making select investments in two telco operators – BT Group (British Telecommunications plc) based and listed in the UK and Citic Telecom based in Macau and listed in Hong Kong.

Both telcos are trading at multi-year lows and are priced at exceedingly attractive valuations. They offer generous dividend yields at current prices with well space out debt maturities over the coming years. More importantly, they generate ample amounts of free cash flow to support both interest payments and dividend pay-outs.



Citic Telecom

in HKD millions	2016	2015	2014
Net Cash Generated from Operating Activities	$ 1,882	$ 1,776	$ 1,628
Capital Expenditure	$ (609)	$ (734)	$ (719)
Borrowing Cost	$ (288)	$ (313)	$ (308)
Free Cash Flow net of Borrowing Cost	$ 985	$ 729	$ 601
Dividends Paid	$ (425)	$ (384)	$ (344)
Surplus Cash Retained	$ 560	$ 345	$ 257

BT Group

in GBP millions	2016	2015	2014
Net Cash Generated from Operating Activities	$ 6,174	$ 5,151	$ 4,788
Capital Expenditure	$ (3,145)	$ (2,438)	$ (2,410)
Borrowing Cost	$ (629)	$ (558)	$ (590)
Free Cash Flow net of Borrowing Cost	$ 2,400	$ 2,155	$ 1,788
Dividends Paid	$ (1,435)	$ (1,075)	$ (924)
Surplus Cash Retained	$ 965	$ 1,080	$ 864

Investors in the local telcos (namely **Starhub** and **M1**) have of late suffered significant drops in share prices. It is important to note that screening for high dividend paying stocks is not a sustainable investment strategy. This is especially so if investors do not concurrently analyse whether the said firm's free cash flow can support such payouts.

Starhub

in SGD millions	**2016**	**2015**	**2014**	**2013**
Net Profit For The Year	$341	$372	$371	$380
Net Cash from Operations	$551	$545	$655	$595
Capital Expenditure	-$367	-$329	-$322	-$303
Finance Expenses	-$25	-$20	-$23	-$19
Free Cash Flow net of Finance Expenses	**$159**	**$196**	**$311**	**$273**
Dividends Paid	**$346**	**$346**	**$345**	**$344**
Shortfall	**-$187**	**-$150**	**-$34**	**-$71**
Money Raised from Medium Term Notes	**$300**	**n/a**	**n/a**	**n/a**

Shares of the local telcos were driven up by investors chasing for yield (not an unusual response given the paltry deposit rates offered by banks and the lacklustre property market). For many years, the local telcos were able to oblige with generous dividend payouts nearing or exceeding their annual free cash flow.

A shift in government policy led to the entrant of a 4th telco operator in Singapore. The ensuing price war had a deleterious impact on the existing market players. Coupled with increase capital expenditure requirements, dividends which were once seen as sacred cows were slashed. The market was caught off guard, and the resulting sell-off was dramatic.

There are two important learning points to be drawn here.

Firstly, investors must always ensure that dividend payouts are well supported by free cash flow net of interest payments to debt holders (this is especially true for businesses which rely on substantial amounts of debt such as telco operators or port operators).

Secondly, it is still crucial to pay attention to valuations even when dealing with "defensive and safe" businesses with supposedly strong competitive moats. Paying too high a price (or in this case chasing high dividend yields alone) can lead to significant capital losses down the road that may very well exceed any dividend payments in the intermediate time.

Value in Oil & Gas

It's been almost three years since oil prices began their perilous descent. The ensuing carnage that followed has led to a significant change in fortunes for the oil and gas industry. The consolidation that followed presented itself attractive investment opportunities with favourable risk/reward ratios.

One such opportunity your fund has invested in is Baker Technology Ltd – a low key player helmed by industry veteran Dr. Benety Chang.

The company has a track record of treating minority shareholders fairly. In the last five years alone, it has cumulatively distributed more in dividends to shareholders than the current market capitalisation of the firm.

In an industry mired with debt, they boast a rock solid fortress balance sheet with S$91 million of cash and no borrowings - representing 45% of its shareholder's equity value. Shares are exceptionally cheap, trading at a price-to-book of only 0.65x.

For more information of the dire straits for the industry – we recommend reading "What is the future of Singapore's offshore equity market".

Baker Technology is not sitting idle in this downturn. It is currently working on a proposed deal to invest into the restructuring of EMAS Offshore.

The proposed restructuring of EMAS Offshore involves a court approved scheme of arrangement to deal with the settlement and discharge of outstanding debt, and the issue of new shares to Baker Technology.

Another opportunity we have invested in is Penguin International. The company is conservatively run and financed. When we first initiated coverage of Penguin, we were concerned about the overbuilding of boats and overhang from unsold inventory.

Our concerns were later allayed upon the release of its Q1 results in 2017. The company had sold a significant bulk of its completed crew-boat inventory, thereby improving its working capital position.

Cash balances rose significantly from S$18.7 mil (12.8% of Net Tangible Assets) to S$34.4 mil (23.9% of Net Tangible Assets). The company had a negligible debt position, putting it in good stead to ride out the storm. Valuations were undemanding at a Price-to-book of 0.5x.

Like Baker Technology, the company was not sitting still. It recently joined a consortium of investors investing in the proposed restructuring of Marco Polo Marine with a proposed S$10mil investment.

The terms of the restructuring were extremely favourable to Penguin with a slated write-down of existing debt owed to creditors by almost 90%. The proposed investment would lead to a 10% equity ownership of Marco Polo Marine with substantial assets without the debt burden that it once carried.

As part of the proposed restructuring, Marco Polo Marine would start off with a debt load of no more than S$12 million.

We view the proposed investment into Marco Polo Marine favourably and regard it as a judicious use of capital. It should provide for an attractive investment return and maybe even provide future business synergies down the road.

Final Comments:

Equity markets continue their advance, oblivious to a whole host of worries. High valuations, escalating geopolitical tensions and increased risk taking behaviour give us pause.

While valuations in our core markets continue to remain reasonable, we remain cautiously optimistic on the outlook in the coming months. As we end the first year of the fund's operations, we will like to express our gratitude to all investors for your support.