LUMIERE VALUE FUND

Letter to Investors

2008 Half Year Review

July 2008

Dear Investors,

The first half of 2008 has been marked by declining markets around the world. The S&P500 started the year at 1,468 and fell 13% to 1,280 at end June. Over the same period, London's FTSE 100 fell 13% from 6,457 to 5,626. In Asia, Hong Kong's Hang Seng Index fell 21% from 27,813 to 22,102, and Singapore's Straits Times Index (STI) fell 15% from 3,482 to 2,948 over the past 6 months. From their respective peaks in October 2007, S&P500 is down 18%, FTSE 100 is down 16%, Hang Seng is down 30%, and STI is down 24%.

Lumiere Value Fund Updates

Since the Lumiere Value Fund commenced operations in October 2007, we have received additional subscriptions of $1.6 million from both existing investors, as well as new ones. Against this backdrop of abundant business value and battered down stock prices, we have been keeping ourselves busy putting these assets to good use. As a result of the recent sharp corrections, many fantastic companies which were once out of our reach due to their lofty valuations, have now either found their way into our portfolio, or are within striking distance.

While we expect our portfolio of undervalued stocks to outperform the market over the long run, its short-term performance will move in tandem with the market. Hence, against the backdrop of falling stock markets around the world, our portfolio has declined. Below is a table summarising how we fared:

Year	**Lumiere Value Fund**	**NAV per unit (S$)**	**Total Fund Assets (S$ million)**
4th Quarter 2007	-6%	0.94	4.6
1st Half 2008	-16%	0.79	5.4

Benjamin Graham, widely known as the father of value investing, as well as the mentor of Warren Buffett, often said that the market is a "voting machine" in the short term, but a "weighing machine" in the long run. Hence, although the market has "voted" against our portfolio in the last 9 months, we are confident that our stocks - all purchased at steep discounts to their intrinsic value – will fare much better when placed on the "weighing machine". But just how heavy is this "weight" of our portfolio? To give a clue, stocks in our portfolio represent excellent companies with average ROEs of 20% and are growing their earnings at 20% and above. Yet, these very same companies are trading at an average price-to-current year earnings ratio of 5 times and price-to-net tangible assets ratio of 1.2 times. To top it off, 85% of the companies in the portfolio are in a net cash position. Thus, we have very strong reasons to believe the scales are tipped heavily in our favour.

Our mode of operations

We feel that it is imperative to clarify that the Lumiere Value Fund is not a hedge fund, since we do not short stocks nor make use of exotic derivatives. Neither do we charge outrageous hedge fund fees – the typical hedge fund charges a management fee of 2% of assets, plus a performance fee of 20% of profits – which means even if the hedge fund loses money, investors will still have to pay fees amounting to 2% of their investment assets every year. Our fee structure does not include any management fee, but only includes a performance fee of 20% of profits, which means we will only

be remunerated when we deliver. While we are allowed to employ leverage up to 50 percent of the fund's net assets, we have not yet done so and will only do so sparingly in times of severe market capitulation and extreme undervaluation, when available business value far exceeds the amount of investible funds we have at our disposal.

Although our fund structure is more akin to that of a mutual fund/unit trust, our mode of investment operations differ due to several advantages we believe we possess over the typical mutual fund/unit trust. The Lumiere Value Fund is allowed to hold a more concentrated portfolio (consisting of 20 – 25 stocks) so that we can invest our funds in our top ideas, rather than diversification for its own sake. Virtually all the investors in the Lumiere Value Fund are in it for the long-term, so we can expect minimal disruptions arising from redemptions. The long-term orientation of our investors also allows us to look beyond the short-term fluctuations and focus only on making decisions that will affect the fund's long-term performance. Last but not least, your two fund managers have significant vested interests in the fund, amounting to over half of the fund's assets.

Once again, we would like to highlight our investment philosophy, for the benefit of new investors who have joined us. To most of our long-time investors this portion will seem unduly repetitive, but we would rather have nine investors out of ten mildly bored than one investor out of ten having misconceptions about how we operate. The fund's main mode of operation is to invest in undervalued securities with the belief that over the long-term, a carefully selected portfolio of strong, growing companies trading at low price multiples, would deliver good returns. Sometimes, these investments work out very fast; but more often than not, they take years. At the point of purchase, it is usually difficult to identify any specific catalyst which would cause the investment to appreciate in price. But it is precisely this lack of visibility and perception of instant gratification that makes these securities available at bargain prices. In our fast-paced world that demands instant results, market participants have grown accustomed to expect no less than instant price appreciation – hence any security that falls short of this expectation is likely to be neglected by the market, resulting in a low stock price. Thus, the long-term investor who is prepared to take a diversity of positions in such undervalued securities would have gained the distinct advantage of being able to purchase a huge amount of business value at low prices.

Because of the lack of a specific catalyst, these generally undervalued securities tend to move very much in sympathy with the overall market. Just because something is cheap does not mean that there is no downside. In fact, things frequently get worse before they get better. Thus, performance when measured over a short time period (generally defined as less than three years) will likely be lumpy and quite possibly, ugly. However, we believe that a portfolio of these carefully selected securities will outperform the general market in the long-term. While we much prefer a five-year test, we feel that three years is the absolute minimum for judging performance.

The importance of having a long-term view cannot be overemphasized – investors in the fund are likely to get the best results if their holding period is at least three years and above. Let's take a look at empirical evidence on how having a long term view benefits the value investor - In one of the most famous speeches ever given on value investing, "The Superinvestors of Graham-and-Doddsville", Warren Buffett profiles the track records of six investors who have done exceedingly well over long periods of time using a value-based investment strategy similar to what we employ at

the Lumiere Value Fund, that is, to buy stocks worth a dollar for 40 cents. The following table shows their performance track record:

Performance of the Superinvestors of Graham-and-Doddsville

Year	Walter Schloss	Tweedy, Browne Inc.	Sequoia Fund, Inc.	Charles Munger	Pacific Partners, Ltd.	Perlmeter Investments
1956	5.1%					
1957	-4.7%					
1958	42.1%					
1959	17.5%					
1960	7.0%					
1961	21.6%					
1962	8.3%			30.1%		
1963	15.1%			71.7%		
1964	17.1%			49.7%		
1965	26.8%			8.4%	32.0%	40.6%
1966	0.5%			12.4%	36.7%	6.4%
1967	25.8%			56.2%	180.1%	73.5%
1968	26.6%	27.6%		40.4%	171.9%	65.0%
1969	-9.0%	12.7%		28.3%	97.1%	-13.8%
1970	-8.2%	-1.3%		-0.1%	-7.2%	-6.0%
1971	25.5%	20.9%	13.5%	25.4%	16.4%	55.7%
1972	11.6%	14.6%	3.7%	8.3%	17.1%	23.6%
1973	-8.0%	8.3%	-24.0%	-31.9%	-42.1%	-28.1%
1974	-6.2%	1.5%	-15.7%	-31.5%	-34.4%	-12.0%
1975	42.7%	28.8%	60.5%	73.2%	31.2%	38.5%
1976	29.4%	40.2%	72.3%		127.8%	38.2%
1977	25.8%	23.4%	19.9%		27.1%	30.3%
1978	36.6%	41.0%	23.9%		37.9%	31.8%
1979	29.8%	25.5%	12.1%		48.2%	34.7%
1980	23.3%	21.4%	12.6%		24.1%	41.8%
1981	18.4%	14.4%	21.5%		8.0%	4.0%
1982	24.1%	10.2%	31.2%		32.0%	29.8%
1983	38.4%	35.0%	27.3%		24.8%	22.2%
Annual Compounded return	**21.3%**	**20.0%**	**18.2%**	**19.8%**	**32.9%**	**23.0%**
Cumulative gain	23,104% (28 yrs)	1,661% (16 yrs)	775% (13 yrs)	1,157% (14 yrs)	22,200% (19 yrs)	4,277% (19 yrs)

Source: "The Superinvestors of Graham-and-Doddsville" by Warren E. Buffett

A look at the performance numbers tells us even these investment superstars have periods where they underperformed or lost money (as highlighted in red). Suppose if someone had invested in Pacific Partners at the start of 1973. He would have lost 42% of his investment value in 1973, and a further 34% in 1974. If he had been measuring performance based on a short term period of 2 years, he would probably have sold out of the fund in 1974, which coincided with a year where stocks were trading at one of the most undervalued levels in the entire history of the American stock market. This short term investor would have missed out on the huge future returns reaped by staying invested in the fund over the next 9 years (1975-1983), where the value of his investments would have grown by *17 times*!

On a broad overview of the performance numbers, it seems that even most of these superinvestors had money-losing periods stretching over 2 years – hence empirically, it seems 3 years is the absolute minimum holding period for one to reap the attractive benefits of value investing, and a holding period of 5 years and above would be optimal.

Albert Einstein once declared that the most powerful force in the universe is *compounding*. This, we believe, is the next big reason why investors should take the long term view – to let compounding work its magic for them. This "magic" can be seen in a famous business transaction that occurred in America in the 17th Century. In 1626, the indigenous Indians in America sold an island to the Dutch in exchange for some trinkets and beads worth US$24. This island happened to be what is today called Manhattan, in New York City. What a terrible investment blunder the Indians made! However, what would have happened if the Indians somehow decided to invest the money they received from the sale into the stock market? A study by Jeremy Siegel shows that the total returns from the stock market averaged an annual compounded rate of 8.3% over the 200-year period from 1802-2001. Let's assume the Indians compounded their money at 8% per year in the stock market.

First, let's examine what the Indians have *lost* in the deal – the value of all the real estate sitting on the 640 million sq ft. of land that makes up the island of Manhattan. According to the New York City department of finance's annual assessment roll of 2007, the total market value of real estate in New York City is US$802 billion. Manhattan accounts for 64% of the total tax assessed value of real estate in New York. Hence, by simple calculation, the total value of all real estate in Manhattan is worth about US$513 billion in 2007.

We then go on to determine what the Indians would have gained by investing in the stock market? At 8% return per year, compounded over 382 years from 1626 to 2007, their initial US$24 investment would have grown to *US$141 trillion,* which amounts to *275 times* the entire value of real estate in Manhattan! The Indians would have come out way ahead by just letting compounding work its magic in the stock market.

Unless medical science makes a quantum leap, it is unlikely we would ever see US$24 compound into US$141 trillion in our lifetimes. We can, however, look at how compounding works for us over more realistic investment timeframes, using different rates of returns, as shown on the next page:

Compounded Annual Return	Initial Investment	Value after 10 years	Value after 20 years	Value after 30 years	Value after 40 years
5%	$100,000	$162,889	$265,330	$432,194	$703,999
10%	$100,000	$259,374	$672,750	$1,744,940	$4,525,926
15%	$100,000	$404,556	$1,636,654	$6,621,177	$26,786,355
20%	$100,000	$619,174	$3,833,760	$23,737,631	$146,977,157

As we can see, even with investment timeframes constrained by the duration of one's lifespan, compounding richly rewards the patient investor who takes a long term view.

Famed investor John Templeton once said, "Bull markets are born on pessimism, grow on scepticism, mature on optimism, and die on euphoria." We believe the substantial drop in stock markets around the world over the last 9 months, coupled with the current pessimistic economic sentiment, have started this birthing process. Whether this process is now in its first trimester or third trimester – it is hard to tell. What we do know is, after enduring the labour pains suffered during this period, a new bull market will be born. Both your fund managers, unable to resist the allure of cheap valuations of stocks in the market, have invested an additional $500,000 into the fund in total during the last 6 months. The both of us now have a combined direct investment of close to $3 million in the fund, which amounts to more than 80% of our personal investible assets.

Company Commentary

Again, our usual disclaimer: What you're about to read should not be misconstrued as investment advice. Instead, our intention for devoting this entire section on company commentary is so that readers can understand the thought process underlying our investment philosophy. We now take you through two companies which have impressed us with their investment merits:

Cacola

Cacola is a sizeable player in the Chinese home furnishing industry and has fully-integrated operations, encompassing the design, manufacturing and distribution of a wide range of modern-style home and office furniture. Key products include panel furniture (such as display cabinets, dining furniture, wardrobes, etc), sofas and mattresses. Besides a self-operated 8,000 square metre flagship furniture superstore in Dongguan, Guangdong Province, its furniture is sold via an extensive network of 130 exclusive Cacola retail outlets in 66 cities throughout China. These outlets are largely financed and operated by a handful of third-party distributors, allowing Cacola to stay asset-light and focused on the design, manufacturing and marketing aspects. Its emphasis on advertising and promotion coupled with its consistently reliable product quality throughout these years has led to strong brand recognition for its two flagship furniture brands; Cacola and Kelog.

Unlike the majority of furniture manufacturers whose business model revolves around producing cheaply in China and selling at higher prices abroad (typically to United States and Europe), Cacola's success depends very much on domestic demand in China as only 20% of its sales are from exports. Thus, the trend of an increasingly affluent middle-class and rising urban home ownership in China

will no doubt bode well for the prospects of a well-positioned branded player like Cacola. Furthermore, its domestic focus would also insulate it from the weakening export demand faced by many of its peers today.

The success of Cacola's business model is evident in its track record, whereby sales grew at a compounded annual rate of 26% from RMB 282 million in 2004 to RMB 564 million in 2007. Profit before tax grew at a similar rate of 26% from RMB 66 million in 2004 to RMB 133 million. Besides spotting good earnings growth, it also possesses a very strong balance sheet with net cash of RMB 233 million out of an equity base of RMB 355 million and zero bank borrowings. Furthermore, the business generates an attractive pre-tax profit margin of 23.7% and return on equity of 39%.

Based on its first quarter results for 2008, its business momentum showed no sign of slowing down. Turnover and pre-tax profit continued to grow 38% and 33% respectively year-on-year, led by ongoing expansion of its distributor network and a substantial increase in export sales to South Africa, Spain, Australia and United States. Margins also held up well despite facing rising raw material and labour costs, as it was able to sell more premium furniture and increase selling prices. To cope with the strong demand, it intends to sign up more distributors, as well as open a second 6,000 square metre mega store within a prime shopping mall in Chongqing later this year.

Despite good growth prospects, the market rout over the past few months caused Cacola's share price to drop over 40 percent from its recent high in November 2007, giving us the opportunity to purchase it at 4.9 times historic earnings or 3 times ex-cash earnings.

Sunvic Chemical Group

Sunvic is one of the largest manufacturers of acrylic acid (AA) and acrylate esters (AE) in China, with annual production capacity of 205,000 tonnes of AA and 250,000 tonnes of AE commanding a 20 percent market share. AA and AE are commonly used in the production of many everyday industrial and consumer products such as coatings, adhesives, sealants, textiles and even for water treatment. It also produces and sells N-phosphonomethyl Iminodiacetic Acid (PMIDA), an intermediate chemical product used mainly in the production of herbicide. It has a diversified client base of over 500 customers located in China and overseas markets spanning across Asia, Middle East, Europe as well as North and South America.

The emergence of China as a low-cost manufacturing hub a decade ago led to a significant increase in demand for AA and AE due to its wide industrial and consumer applications. This brought about massive new investment in AA and AE capacity by both domestic chemical companies, as well as multi-national players like BASF and Dow Chemical, culminating in a huge supply glut in 2006. Unfortunately, Sunvic also embarked on some pretty aggressive expansion plans of its own during this period and increased AA and AE capacity by over 100 percent in 2006. In the face of falling prices and lower plant utilisation, net profits tanked 47 percent from a peak of RMB 175 million in 2005 to RMB 93 million in 2006.

Selling prices for AA and AE continued to stay weak for the first nine months of 2007, thus affecting Sunvic's profitability for the larger part of the year. It only managed to regain pricing power and find its footing towards the last quarter of 2007, after nearly two years of painful adjustment. While the

AA and AE division worked its way towards recovery, catalysts for sharply improved performance started to surface for its PMIDA division.

PMIDA, which had traditionally contributed less than ten percent of Sunvic's turnover, was largely unnoticed by investors up till then. However, raging food price inflation and greater demand for biofuels have led to increased cultivation of transgenic corn and soya bean in North and South America. This in turn spurred demand for PMIDA, which is used to produce herbicide. Affirmation of the improved outlook for PMIDA came in November 2007, when Sunvic announced that it had secured orders to supply 25,200 tonnes of PMIDA to its existing customers from the United States, Brazil and Argentina. This huge order will soak up 84 percent of Sunvic's available production capacity and also have the potential to contribute almost RMB 700 million to sales in 2008 (based on prevailing price of US$3,900 per ton in November 2007). To put this into perspective, this order alone amounted to almost 40 percent of the company's turnover of RMB 1.82 billion for 2007. With demand for agricultural commodities expected to stay strong for the foreseeable future, Sunvic's PMIDA business puts it in a very favourable position.

Fortunately for us, this positive inflexion point for Sunvic came amidst the global stock market turmoil, which caused its share price to tumble over 80 percent from its peak of $1.11 in February 2007. Notwithstanding the strong prospects, we were able to take a stake in Sunvic at 0.9x NTA and 3x forward earnings.

With that, we come to the end of this year's investment round-up. If you have any questions or clarifications relating to your investments, be sure to let us know.

Yours truly,

Wong Yu Liang

Victor Khoo

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