SN VALUATION
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Sung Nam

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China Fund (CHN)

The fund is selling at a discount to NAV – NAV $24.50 (as of Oct 31, 2012; the latest CSR) and market price $21.18 (as of May 30, 2013). Listed in 1992 and has a 10 year NAV annualized return of 18.76%, which means $1,000 invested 10 years ago would be $5,580.87 today. These closed end funds pay out dividends from 2 sources: 1) interest income and 2) gain on security sales, so essentially coupon + principal gain. The Fund classifies net interest income, or interest income minus operating expenses, as dividend and realized gains from investment as distributions. Non-controlled affiliates are companies where the fund holds more than 5% of the companies' shares, and the CSR separated the income from these affiliates from the investment holdings.

The fund is managed by RCM and invests in Chinese and Taiwanese equity, as well as direct investments, or what we presume to be private equity investments. We noticed these funds use a lot of REPOs, which are essentially collateralized loans where the fund uses the securities as collateral and borrows funds with the promise to repurchase the securities from the "lender" at a set maturity date. The difference in the buy/sell is considered the loan rate. The fund had $430 MM in investments but has a repo balance of $50 MM, so is it true, $50 of the $430 was financed by the repo?

So the CSR goes into more detail related to their securities lending activity. They lend their securities to brokers for a fee, which means they sell at let's say 100, then repurchase the securities at 99, thereby netting a slim margin. In the CSR, they lent $62MM, received $68MM in collateral, and over the course of the year, made an additional $2MM through their securities lending practice, which is really slim, but covers a majority of the administrative costs for the fund. We assume funds will not participate in such activity when the market is going on a downtrend, since they may hold on to collateral which is a fraction of the face value of the securities lent out, exposing the fund to principal loss risk.

Dividend is $10MM on $376MM in securities, or a 2.6% annual yield. In the financial websites, it states the dividend yield as 1.7%, or something very low. **However, this figure disregards the distributions from the net realized gains. In 2012, $2.99 in dividend + distribution yields a figure close to 14%.**

We advise investors who are interested to purchase the fund for the long haul, as the key investment point is to receive the dividends and distributions, rather than an increase in NAV. The distributions are actually dilutive to the NAV, and is unreliable. Think of this as a bond which is selling at 95 and has a current yield of +5% in dividend/distributions.