Bin Yuan Capital All China Strategy – December 2023

Performance Attribution

The Chinese market had a lackluster December marked by the absence of positive catalysts and active buyers ahead of the holiday season. The market declined by 1.98% in December, resulting in a quarterly loss of 3.82%. Despite these challenges, our portfolio posted a 3.01% increase in December and a 0.27% gain for the Q4, outperforming the market index by 4.99% and 4.09%, respectively. The outperformance in December and Q4 was driven by our stock selections in the Health Care and Information Technology sectors, which significantly contributed to our overall gains. However, the Financials and Consumer Discretionary sectors adversely impacted relative performance during this period.

For the full year, the market underwent a correction of 11.53%, while our portfolio incurred a loss of 21.2%, representing an 9.64% underperformance compared to the market. In 2023, sectors such as Industrials and Health Care added value to our portfolio, while the Financials and Consumer Discretionary sectors weighed down overall performance. For a detailed performance analysis, please refer to the year-end review section below.

At the stock level, iRay Technology outperformed significantly in December on the receding impact from previous medical anti-corruption campaign. iRay's products are key components for medical image clarity and industrial inspection accuracy. Upgraded products and a more comprehensive product offering are expected to bolster growth in 2024. The trend of import substitution in the domestic market with product expansion in dental, industrial and non-detector products, and breakthroughs in overseas markets will act as growth drivers.

China's largest domestic MISIA (Minimally Invasive Surgical Instrument and Accessories) manufacturer, Kangji, underperformed in December. We believe the impact of the campaign on the country’s healthcare system is easing, and the demand for surgeries is relatively resilient. The stock price rebounded in the last week of December, and has moved up 20% from the bottom, although still posting a loss of 11% for the whole year of 2023 (versus Hang Seng Index’s loss of 14%). The company stands out for its quick response model and deep market knowledge. Its brand has been recognized by surgeons from top-tier hospitals. It should continue to gain market share from imported brands amid fast industry growth.

From Rabbit to Dragon

KEY POINTS:

- The market now has priced in the poor geopolitical environment, sluggish local economy, bursting of the property market bubble, and market-unfriendly government policies. We are optimistic about the coming year.
- We have revised and reinforced our Downside Risk Management and Portfolio Positioning processes following a thorough review of our process and execution in the bear market over the last two years.
- Our portfolio is now very cheap, has strong earnings growth, and represents good value.
- We see a number of positive catalysts - the expected returns on equity investments are at a historically high premium of close to 6% compared to risk-free assets like 10-year government treasury bonds. Historically, when the risk premium reaches such levels, the market has shown positive performance.
- **We remain very confident in the portfolio's potential in 2024, which is the year of the Wood Dragon in China**

At the end of 2022, after the year of the unlucky Tiger that impacted the economy and the stock market after a three-year lockdown due to Covid, we had higher hopes for the Year of Rabbit. Unfortunately, the Rabbit struggled and failed to reverse the causes of the weak economy, which resulted in another disappointing year for investors. In 2023, the Chinese equity market delivered another year of negative returns, with the China A market CSI 300 index dropping by 11.4% and the Hong Kong market by 13.8%. These declines made both markets the worst performers in global capital markets. Investor patience has been severely tested this year. At Bin Yuan we experienced the same frustration as we saw the weakest sentiment towards China in our 30-year history of investing. We questioned whether "Is this time really different?", "what are the differences" and "How should we invest in China in the future to generate superior returns?"

The Chinese government had many meetings and conferences to discuss how to revive the economy. We saw policies such as the relaxation of property purchase restrictions, lower interest rates and lowered bank required reserve ratios, but the economy did not respond. The Chinese economy has some key constraints that have accumulated even prior to the pandemic that have made the government's short-term policies less effective at stimulating growth. In this year-end letter, we will discuss the three questions above and provide our analysis.

Is this time really different? If so, what are the differences?

This time is different. The root problems started pre-COVID:

Domestic issues:

1. The Property bubble that had in part driven high GDP growth was already deflating. Infrastructure investment and the property sector (urbanization) contributed more than half of GDP growth over the previous decades. As with any economic bubble before it bursts, the balance sheet of the private property development sector had been overstretched with the expectation of selling houses at higher prices. Local governments were complicit as tax revenue received from land sales were their major source of income. The oversupply and excessive leverage became more visible. In 2016, the central government issued policies to prevent the problems getting bigger but when this failed to stop the momentum, they issued The Three Red Lines Rule in 2020. The construction of new housing continued to grow with the expectation that property prices would continue rising. The growth in the supply of new housing nationwide, supported by rising leverage, continued into the COVID period. COVID slowed the economy and diminished affordability for incremental buyers, which proved to be the last straw for highly over-extended developers.

The end of the property development cycle will be long term this time, potentially casting a negative impact on confidence within the related consumption sphere.

2. The current leader's ideology believes that the state-owned corporate sector is better than the private sector at redistributing wealth to aid less developed areas and low-income people. Policies have been initiated favoring the public sector over the private sector. These policies have caused confusion among different government departments as to which sectors of the economy should be prioritized for the public sector and which should be emphasized for the private sector. These policies discouraged private sector investment and negatively impacted confidence and overall business activity.

The pandemic period made all of this worse. Strong voices have criticized these policies and these voices have been heard by the government but reversing some of the policies will take time.

International factors:

Geopolitical conflict between China and the US has been the major driver of reduced FDI into China. The fundamental differences between China and the US are their ideologies and different government systems. China greatly benefited from US corporate-led globalization. China was a very attractive low-cost country to outsource manufacturing and the local consumer market was also growing. China built a highly efficient manufacturing value chain, and during this period Chinese companies moved into higher value-added technology areas which created US government concerns. US tension rose when China was perceived as getting stronger. Disagreements with the US over international affairs, only a partially open domestic consumer market, and rapid improvements in advanced technology and in the military are key reasons why the US classifies China as a strategic competitor. The US has been taking steps to prevent China gaining high-end technology.

As a result, capital allocators in North America have redeemed aggressively from China over the past three years, not just because of slower economic growth and US dollar appreciation. To reduce geopolitical risks that may disrupt supply chains, major global corporations started to strategically reposition their factories. Costs were not the only consideration. The restructuring of the global supply chains has led to a shift away from low-end manufacturing capacity in China. The domestic market has to absorb the capacity and capital that was prepared for a global market. The overcapacity has led to intense price competition and consequently, poor corporate earnings.

This situation will not be reversed in the foreseeable future.

Bin Yuan Investment Performance

While Bin Yuan has delivered strong long-term performance, our underperformance against the market in 2023 triggered a detailed review by the team in Q4 to identify what we have done well and what mistakes could have been avoided. Our review included Bin Yuan's proprietary fundamental research process that has been developed, executed, and improved continuously over the past 28 years, the execution of the process, and a more philosophical review that includes the dynamics of business cycles and the stages of the long- and short-term cycles. We carefully examined our methodology and concluded that our thorough research, deep in-depth knowledge of portfolio companies, and early identification of future winners is sound.

Historically, we have tended to buy and hold companies as long as their fundamentals remain intact. We have therefore bolstered our Downside Risk Management and Portfolio Positioning process. In the past a 5% loss for a stock triggered a review of the stock's fundamentals. We will now conduct *a deeper dive* after a 10% loss that includes the combination of both company fundamentals and market sentiment factors analysis:

a) The research team will reassess the fundamentals, and if the fundamentals have changed significantly, we will sell immediately.

b) The portfolio managers will also review the position with the trading team, and based on the stock's prior trading patterns, volume, technical position and momentum, and decide whether to adjust the portfolio position assuming the fundamentals (and valuation outlook) remain intact. As a general principal, if we believe a core position has become overbought and likely to suffer from negative momentum over a sustained period, we will decide whether to sell the position or reduce the position to a standard size or to a smaller size.

c) We have implemented a robust mechanism to look at that the relationship between share price appreciation against the expected return and fundamental factors. When we see a share price has moved much higher than our expected return, the position of that holding will be adjusted.

Our strong performance in 2020 and 2021 led us to be less critical and overconfident that our views on certain sectors and stocks would remain valid for a longer period of time. We paid less attention to the dynamics of market participants whose investment behavior clearly impacted the short-term performance of sectors and stocks. In this bear market, the short-term performance objective of local investors increased their sector rotation which led to some sectors outperforming and other sectors underperforming, despite the underlying fundamentals of the sectors. We gave back 9.64% of relative performance in 2023, 1% of that from green tech and 8% from the consumer sector. These were stocks that had strong returns in previous years. Overall sentiment in the consumer sector was so negative in 2023 that share prices underperformed and partially gave back previous gains. Examples of our consumer holdings that were affected include **Anjoy Foods (603345.SH)**, **Huazhu Hotel (1179.HK)**, and **Fenjiu (600809.SH)**.

In the green tech sector, we have realized strong capital gains in the past years. It is a long-term trend globally to improve the environment that people live in. Bin Yuan has invested profitably in Chinese companies that are not just leaders in China but dominate globally in their areas of expertise. However, the growth rate of incremental demand declined even while capacity continued to increase. Those stocks that had strong returns in 2020 and 2021 gave back some of their gains in 2023. Our buy and hold strategy, with less emphasis on the short-term cycle, hurt the fund's performance. Our holdings: **Autowell (688516.SH)**, **Sinofuse (301031.SZ)**, **iRay (688301.SH)** are such examples even as they continued to deliver stronger results than we expected. The sector led to a 1.5% negative return contribution, despite the fact that our stock selection in green tech was better than the broader market.

Looking top down, we thought that consumer demand and the Chinese economy would rebound after the down cycle during the COVID pandemic, just as it did in the global economy. It would have been helpful if we had been more sensitive to the following factors:

1. The three-year battle to contain COVID consumed significant government financial resources which made a massive stimulus program difficult.

2. We believe that the property bubble bust will not bring down the financial system, but it has reduced investment, income, consumer confidence and consumption. As an industry, property contributed circa 14% to GDP. The impact has persisted longer than we expected.

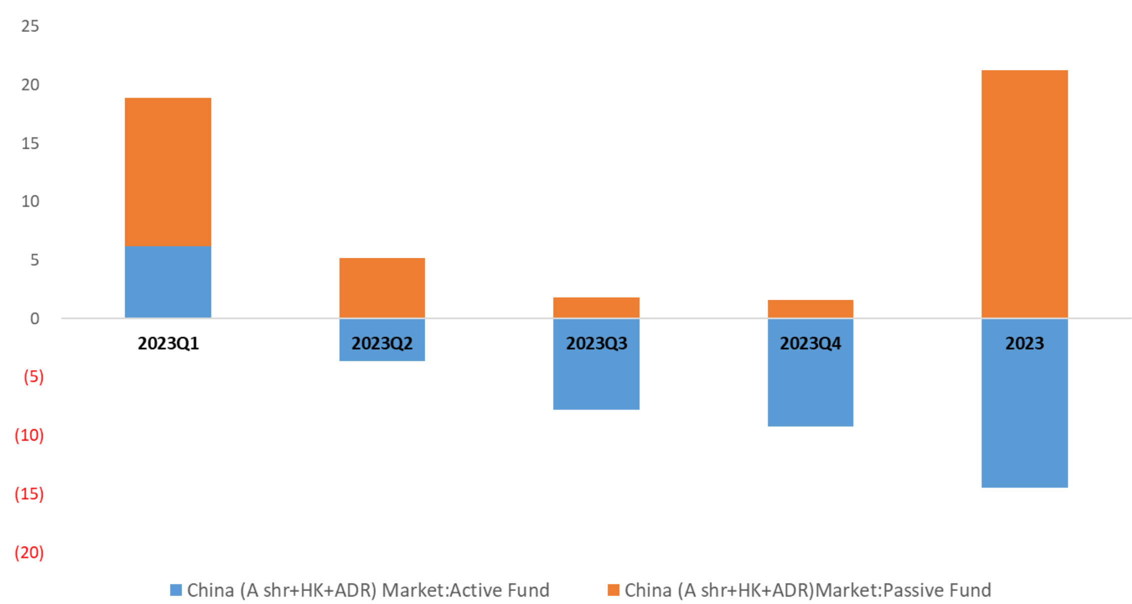
3. The promotion of the public sector over the private sector reduced social and economic activity. The private sector is the major contributor to economic productivity and hired 70% of employees. This misguided policy reduced overall economic vitality and caused a slower economic recovery, increased unemployment, reduced household income and lowered consumer confidence.

Fund flows and the trading-oriented market did not help us. Despite the majority of our holdings delivering in-line or better-than-expected earnings growth in 2023, the market was rotated out of those of previously outperforming stocks. The **Chinese market prioritized trading momentum over fundamental factors.**

The following market factors were also not helpful:

First, global investors have been net sellers of Chinese equities since Q2 2023, while those who continued to trade China over shorter time horizons increasingly used passive ETF products (as shown in Chart 1 below indicating fund flow). Foreign investors historically held more high-quality stocks – so foreign selling was a clear negative.

Chart 1: Fund Flow Active vs. Passive USD billion



Source: Huatai Securities, Bin Yuan Capital

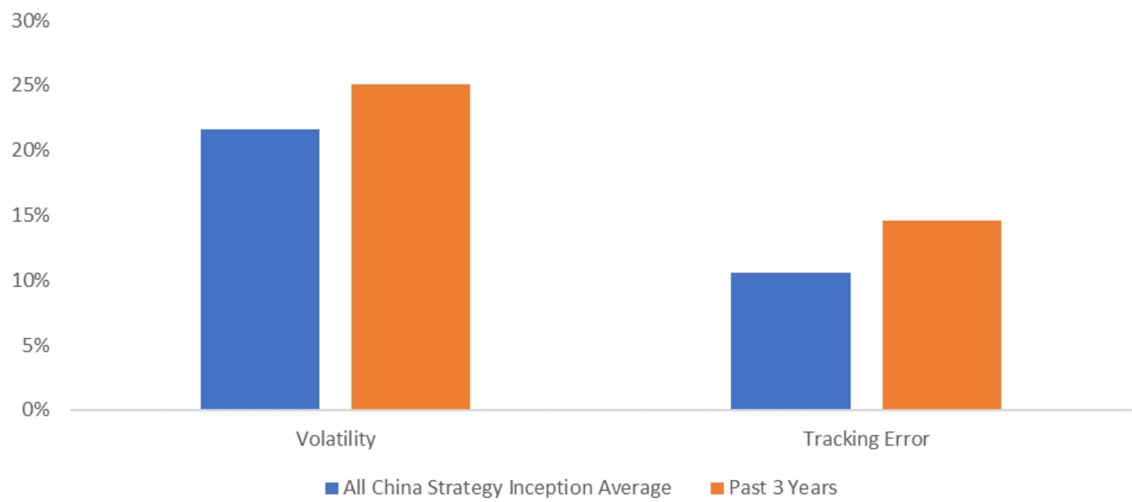
Secondly, momentum and sector rotation trading were dominated by local institutional investors – and even more so in 2023. The market has been predominantly influenced by short-term "hot" themes, including the revaluation of state-owned enterprises, cyclical commodities, and speculative investments related to the ChatGPT concept. The surge in momentum trading amplified market volatility and the market became a haven for quantitative trading which now accounts for 30% of the total trading volume in China, up from low single digit in 2019.

Thirdly, the government promoted the so called “Chinese Characteristics Valuation (CCV)”, aimed at encouraging domestic funds to buy SOEs (State-owned Enterprises) to raise their valuations above book value. Large caps are mostly state owned and had been trading at much lower PEs and PBs. As a result, large-cap SOEs with lower multiples have generally outperformed mid-cap stocks in 2023, regardless of their underlying fundamentals.

In the current fragile market environment, the tendency for overshooting and dramatic volatility has become more pronounced.

All these factors contributed to increased volatility in our concentrated portfolio (Chart 2). We are committed to continuously improving our process and execution in order to strike a better balance between capturing long-term value and navigating short-term market dynamics so as to achieve a more stable and consistent performance for our investors.

Chart 2: Portfolio Volatility and Tracking Error (Average since inception vs. Past 3 years)



Source: Bin Yuan Capital

Our strength in investing in long term winners has been proven while less attention has been paid to avoid short term negative market sentiment. We believe that the modifications to our Downside Risk Management and Portfolio Positioning Policy will significantly reduce volatility and enhance our relative and absolute performance.

How should we invest in China for the future to generate superior returns.

We now look at how to make money in investing in China. **Investing in technology and selective consumption sectors are still the long-term themes.**

What will not change and what will be better?

➢ **Technology (healthcare is incorporated in both technology and consumption)**

We do not see Geopolitical issues improving in the foreseeable future. Chinese government officials and academic advisers have been behind the curve in understanding that US politicians are determined to decouple with China. Influenced by complacent thinking, the Chinese side believes that the US always puts economic interests first. They believed that the US economy would be negatively impacted if it decoupled from China. The firm steps the US has been taking to block China gaining high technology has awakened the Chinese leaders. **The positive outcome from this is that China will be dealing with the US in a smarter way than before to soften the unfavorable impact.**

Technology will continue to be a core area as we believe innovation in technology will lift productivity and create financial value. The management and research talents accumulated along with technology upgrades throughout the past 30 years has enabled China to climb to a higher level of the manufacturing value chain. More and more very competitive high-quality companies have emerged. The visible positive development from the US blocking technology sales to China is that the advancement of Chinese technology to replace the foreign components has accelerated. We maintain our view that it is too late for the US to stop China developing manufacturing capability as China possesses a broad based, highly developed and sophisticated production value chain supported by a large domestic market. It is very difficult for another country to fully replicated it except in certain fragmented sectors. As an example, we visited Vietnam in mid-2023 and found that they will not be able to replicate China's success in developing high end manufacturing (please see our report "*Will Vietnam Become the Next China?*").

The combination of entrepreneurship, abundant, experienced research talent, sufficient capital and a large local market will help China stay on course. As we have highlighted in our investment letters since 2018, Chinese companies are poised to increasingly replace imports and expand their market share.

Private technology companies are supported by the government as it understands that technology improves productivity. The government's recent preference for the public sector over the private sector is selective. The government dislikes monopolistic platform companies developing business models over investing in technology, and the private sector trying to control natural resources.

Our preferred investment targets are higher value-added activities, upstream companies that **possess competitive advantages, either by showcasing capabilities to construct vertically integrated business models that secure the supply chain, faster response time to customers, save costs, or by demonstrating the potential to transition from single-product entities to comprehensive platform solution providers.** These companies manifest higher profit margins, higher ROE and strong cash flow. We avoid the lower end which can be a value trap where there is sufficient capital to compete on margins and selling prices.

Our portfolio includes companies like **iRay (688301.SH)**, **Sinofuse (301031.SZ)**, **CCTC (300408.SZ)**, **Maxcend (300782.SZ)** and **Hengli (601100.SH)**, which have successfully executed the vertical integration strategy and accumulated value.

While downstream operations often attract more players and result in fierce competition, companies operating in the upstream that provide the necessary tools to downstream customers to compete effectively are expected to benefit. These upstream companies also have the potential to broaden their product applications and extend their range, without confining themselves to specific areas. Specific categories that fall into this category include key materials (such as limited suppliers of nylon 66 material for downstream yoga and outdoor brands), advanced equipment (where frequent replacement is necessary for maintaining competitiveness in the solar equipment industry), core components (X-ray technology with wide applications), and software systems (laser control systems have much higher industry concentration compared to downstream laser equipment).

The detailed investment opportunities in Chinese technologies will be attached in an appendix.

What will emerge?

- **Consumption**

Referring to the domestic issues illustrated above, the recovery will be gradual and not broad based in the short term. Consumer confidence remains low, leading individuals to prioritize saving over spending. Consumers are likely to **place a greater emphasis on obtaining value for their money while still aspiring to maintain a high-quality lifestyle.**

Consequently, there is likely to be demand for goods or services that enhance experiences or functionality at a minimal cost. The table below illustrates some examples of these affordable items that are poised for high demand.

Experiences or Function	**Products & Services**	**Incremental Cost Hike (RMB)**	**Examples**
Comfort	Nylon 66	RMB 10 for a yoga pants	Taihua New Materials
Safety	Profuse	RMB 50 for a car	Sinofuse
Intelligence	AI-powered software	RMB 20-30 per year	Kingsoft
Recreation	Ocean Park ticket	RMB 250 per adult vs. RMB 475 for Disneyland	Haichang

For products and services that have reached a relative level of maturity, engaging in a pricing war may become inevitable to attract buyers, especially in an environment characterized by abundant supply. The electric vehicle (EV) market is a clear example of overcapacity and intense competition. There are currently a multitude of EV brands vying for customers, with close to 100 new models scheduled to be launched in 2024. In this case, industry consolidation is desperately needed and likely to come.

Certain sectors find themselves in a more favorable position, having already seen indications of industry consolidation. Leaders in these sectors enjoy significant advantages in terms of scale and cost, enabling them to deliver the most cost-effective and high-quality solutions to customers without compromising profitability. Consolidation is midway in sectors like hotels, pre-made food in restaurants, and customized furniture. Market leaders in these sectors are consistently expanding their market share at the expense of smaller competitors, positioning themselves for strong and stable growth in the future.

With the above analysis in mind, our emphasis will be on those stocks that have lower valuations, high dividend yields, visible and stable cash flows.

Please refer to the appendix on consumer investment opportunities.

What are the catalysts?

Near term we are optimistic on the China equity market for 2024. Our portfolio will regain momentum and deliver improved performance. There are several catalysts that we anticipate will drive positive outcomes:

1. The market is at the tail end of selling. Investors, both domestic and international, are very pessimistic following two years of negative returns. The diminished expectations for economic growth and better geopolitical relations create an environment where any positive surprises or improvements can drive the market up. Based on previous cycles our portfolio should outperform the market.

2. Recognizing the limitations of the current policy approach of balancing financial safety and growth, the top leadership may potentially consider a shift towards prioritizing growth in order to meet the economy's targets. Both monetary and fiscal policies will be applied in favor of economic growth.

3. The visible hand (the government) has been too active in the past three years issuing policies that from a government standpoint of view were good for the society. These include reducing healthcare costs, anti-corruption, etc., but these confused and damaged confidence among private companies and investors. A more market driven approach will be implemented in 2024. Recent policies implemented by the government reflect these indications.

4. In terms of fund flows, the current Chinese market is highly attractive for long-term local investors, including social security and insurance funds, as the expected returns on equity investments are at a historically high premium of close to 6% compared to risk-free assets like 10-year government treasury bonds (Earnings/Price % of CSI 300 index - yield of 10-year government treasury bond). Historically, whenever the risk premium has reached such levels, the market has shown positive performance (Chart 3).

Chart 3: CSI 300 Index Risk Premium vs. CSI 300 Index Performance

Source: Bin Yuan Capital, Wind

5. The onset of the innovation cycle is expected to support the upward trend in technology, particularly benefiting companies that are at the forefront of technological advancements. While industry leaders have faced challenges in recent years due to the lack of significant innovation (such as Apple's new models lacking revolutionary changes), the emergence of game-changing technologies like MR (Mixed Reality), robotics, smart driving, artificial intelligence, and Huawei's high-end processors and systems are expected to drive a surge in demand for upgrades. This aligns perfectly with our focus on high end technology investment.

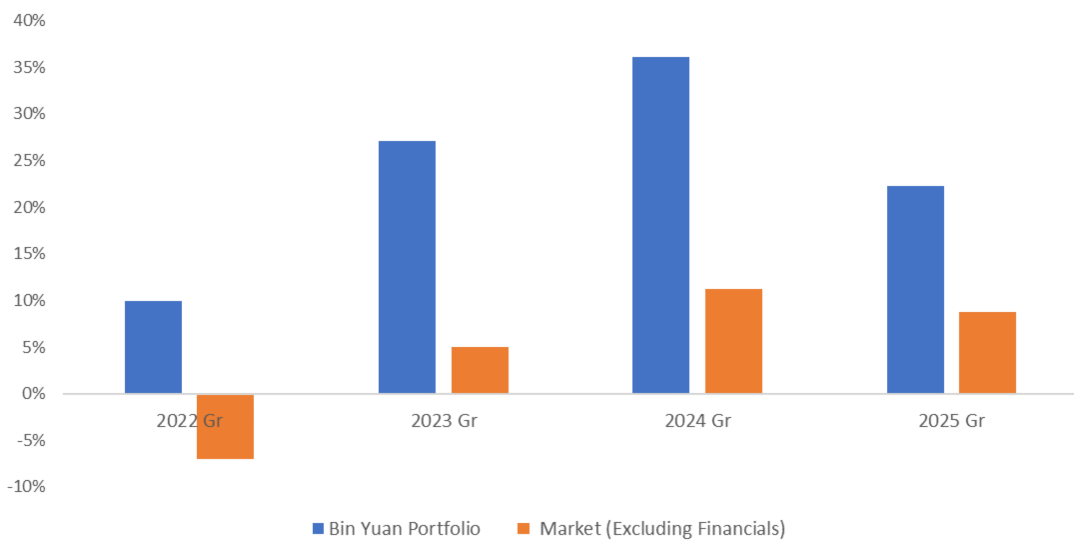
6. Our portfolio is strategically balanced between capitalizing on growth opportunities and investing in contrarian undervalued stocks (market rotation). We find high conviction names particularly appealing as they offer attractive valuations compared to their growth potential and international peers. The earnings growth of our portfolio outpaces that of the broader market. **With the recent price declines, the valuation of our portfolio has decreased to a 12x 2024 PE ratio (Harmonic Method) with a 2.4% dividend yield, 2.6% free cash flow yield, and 23% growth rate (Chart 4).**

Chart 4a: For Holdings Reporting Q3 Results

	Bin Yuan		Market excluding financials	
	Revenue	**Earnings**	**Revenue**	**Earnings**
Q3	24.5%	28.1%	2.6%	4.4%
Q1-Q3	22.2%	22.7%	2.9%	-4.9%

Sources: Bin Yuan Capital, Wind, Bloomberg

Chart 4b: Bin Yuan Portfolio Earnings Forecast vs. Market



Sources: Bin Yuan Capital, Wind, Bloomberg

Chart 4c: Bin Yuan Portfolio Valuation vs. Market

Valuation	Portfolio	Benchmark (excluding Financials)	Benchmark
Period	**12/31/2023**	**12/31/2023**	**12/31/2023**
2024 PE (X) - Harmonic Avg. Method*	12.0	12.6	9.7
2024 PE(X) - Weighted Avg. Method	17.7	17.0	15.2
2024 PB(X)	1.8	2.4	1.6
2024 Div Yield (%)	2.4	1.9	2.6
2024 ROE (%)	17.6	10.4	10.4
Earning Growth (%) Forward 3 YR	22.7	7.9	6.2
2024 PEGY	0.7	1.7	1.7
FCF Yield (%)	2.6	-1.2	1.9

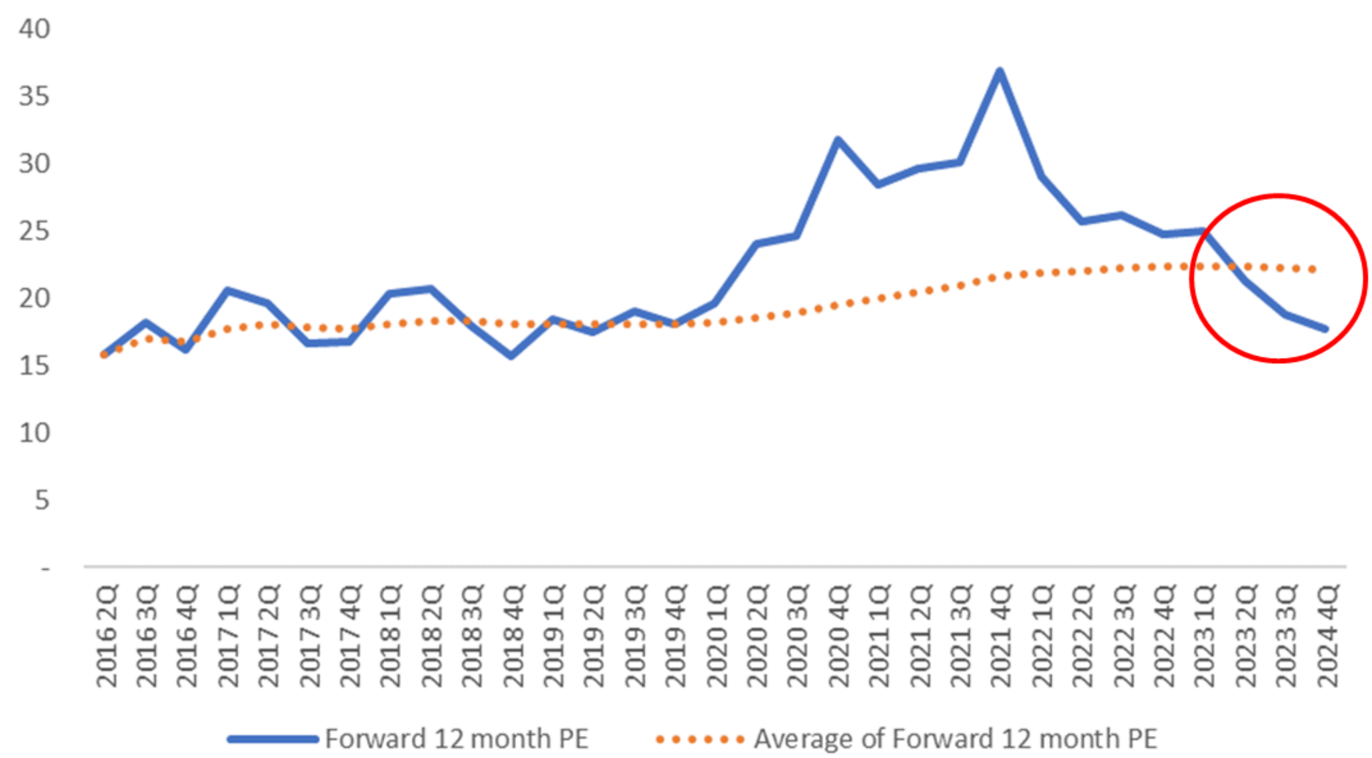
Note: The harmonic average, also known as the harmonic mean, is a type of average that is useful in situations where calculating an average rate or ratio. It's particularly effective when the values we are averaging are defined in terms of a ratio of two quantities (like speed, which is distance per unit of time).

The formula for the harmonic average is: Harmonic Mean = N / sum of (1/Value_i)

Where: (N) is the total number of values; (Value_i) is each individual value in the set.

Sources: Bin Yuan Capital, Wind, Bloomberg

Chart 4d: Portfolio 12 Month Forward PE (Weighted Average Method)



Sources: Bin Yuan Capital

Our holdings present investors with appealing contrarian buying opportunities. We have focused on sectors such as healthcare, high end technology, green initiatives, and value-for-money consumption, which exhibit strong underlying fundamentals, resilience, and attractive valuations. These sectors are less susceptible to the broader macro environment, making them robust investment choices. **With close to trough valuation of 12x 2024 PE (Harmonic Method) and 23% visible growth, approximately 20% annualized return over the next three-year cycle should be expected.** If you believe in **the principle of "reverse to the mean",** you can expect a performance turnaround to occur in 2024.

Despite our portfolio underperforming over the past two years, we remain very confident in its potential in 2024, which is the year of the Wood Dragon in China. We have carefully selected our investments and conducted thorough research to position ourselves for success. While the overall macroeconomic conditions may not have a powerful rebound, and external factors may impact the broader market, our portfolio represents the best possible Chinese companies to deliver good returns over the upcoming year.

Appendix – Investment opportunities in Healthcare, Consumption and Technology Space:

Healthcare – Resilient Demand + Productivity Improvement.

The ageing population in China over the next 15 years should drive highly resilient demand for healthcare services. The ageing population is an unavoidable issue. By 2037 the number of elderly people aged 60 and above in China will reach 355 million, a net increase of 91 million compared to 264 million at the end of 2022. The proportion of elderly people aged 60 and above will increase from 19% at the end of 2022 to 30% by 2037.

As people get older, healthcare related expenses increase. Young people in their twenties and thirties rarely go to a hospital, but after the age of 60, going to the hospital becomes almost a common occurrence.

While ongoing investment in 'Healthcare' will continue to grow in line with demand, **investing in cutting edge technologies is particularly important to improve productivity and cost efficiencies.**

1) *Import substitution is irreversible.*

In our past investment letters, we emphasized our firm view that import substitution is one of the key trends in the healthcare sector. Unlike the market consensus, we have always been less concerned that the VBP (volume-based purchasing) policy would negatively impact globally competitive companies. VBP underscores the emphasis for cost-effective products which is more an opportunity than risk for leading domestic companies. The rapid acceleration of import substitution in the past few years confirms our view.

2) More advanced technology and products emerging out to scale up productivity

In addition to the drive for cost-effectiveness, hospitals are committed to improving productivity through advanced technology. For example, more advanced testing methods can help doctors detect conditions much earlier, rather than when the patient is already critically ill, which can significantly improve the efficiency and effectiveness of the entire treatment cycle.

IVD (In-vitro diagnostic testing) is often the initial step for medical staff to understand a patient's condition, so the efficiency of testing is crucial. In addition to an increasing number of early diagnostic projects, Chinese IVD equipment vendors have been pushing for increased speed in recent years, with **Snibe's (300832.SZ)** X8 boosting chemiluminescence testing from 300 T/h to 600 T/h. **Mindray (300760.SZ)** broke its own speed record with the CX-9000, accelerating coagulation testing to 450 T/h.



Source: Snibe website

Medical imaging is the key to medical diagnosis and is crucial for doctors to decide on the next treatment step. While large medical imaging machines such as CT (Computed Tomography) and MRI (Magnetic Resonance Imaging) are extremely expensive, we estimate strong, ongoing demand from hospitals. Leading domestic companies not only have price advantages, but also have made considerable advances to increase diagnostic efficiency. For example, **United Imaging's (688271.SH)** MRI equipment has reduced a 10-minute abdominal scan to just over 10 seconds.

Source: United Imaging website

The emergence of minimally invasive surgery has also made a huge difference. Compared with standard open surgery, minimally invasive surgery can reduce the amount of bleeding, after-effects, and reduce the patient's hospitalization time from two weeks or more to one week or even less, thus increasing the utilization rate of hospital beds. **Kangji (9997.HK)** provides related consumables for surgical robots. **MedBot's (2252.HK)** and **Wiseking's (subsidiary of Kanji)** laparoscopic surgical robots can further reduce surgeon fatigue and helps surgeons complete more surgeries in the same amount of time.

Source: MedBot website

The efficiency of patient monitoring has also improved. The digital monitors from Mindray have freed up healthcare professionals and can provide critical information immediately with limited staff input. Nurses can remotely obtain real-time data on patients, including blood pressure, blood oxygen, electrocardiogram, etc.

Source: Mindray website

3) Reshaping of distribution channels and processes also help improve efficiency

Channel and process improvements also help improve efficiency.

Historically, hospitals worked with a large number of distributors to gain access to a wide range of vendors, which not only required a lot of experience, but also entailed significant costs. With the consolidation of distribution channels, hospitals can streamline their communication and payment processes with distributors. Large distributors like **Sinopharm (1099.HK)** offer a comprehensive range of products and distribution services and can provide more cost-effective solutions. Their market share has increased to 19% this year from 5% in 2010.

With strong medical demand, many general hospitals are becoming increasingly saturated, which has given rise to a demand for **specialty hospitals** in some categories. The queuing time required for medical treatment in these specialty hospitals is shorter, making medical treatment more convenient. The rapid growth of companies such as **Aier Eye Hospital (300015.SZ)** has allowed for the diversion of patients with specific needs, reducing the load on large general hospitals while still ensuring that patients have access to specialized care.

More efficient **Homecare** is becoming increasingly popular. For example, diabetic patients using **Yuwell's (002223.SZ)** CGM (Continuous Glucose Monitoring) device can measure their blood glucose in real time at home and communicate with their doctors online to confirm their treatment plans.

In summary, the long-term trend of the ageing population will support China's Healthcare demand. Our investment focus is on those companies offering advanced technology and simplified processes which will improve productivity and drive cost efficiencies.

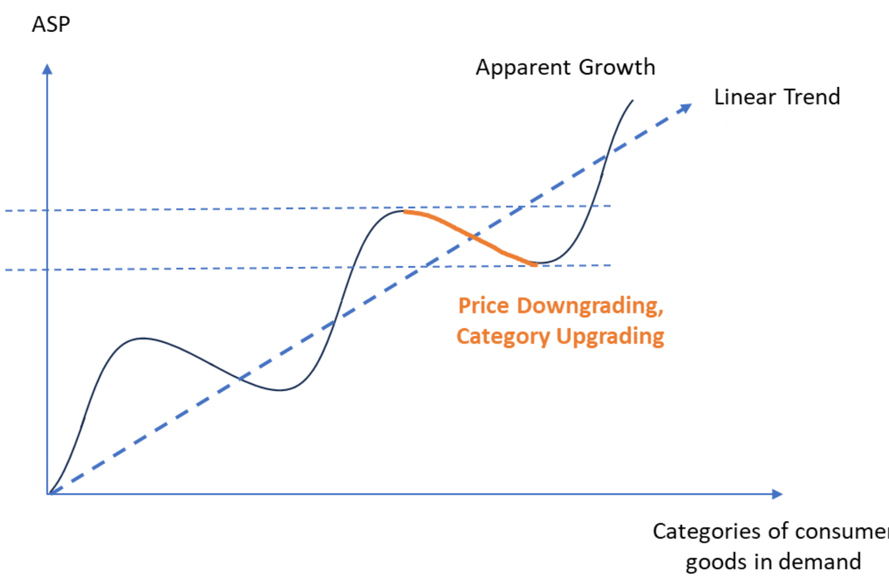
Consumption – Value for Money + Lifestyle Upgrade.

There are mixed views regarding the investment value of the Chinese consumer market. We believe that the long-term logic of the Chinese consumer market remains unchanged, and the consumption upgrade driven by income growth will continue to lead the overall growth of the consumer market for a considerable period. China is an economy of 1.4 billion people with diverse income structures and living environments. The income growth rate of rural residents is higher than that of urban residents. Lower-income groups still have a strong motivation to upgrade their lives and consume a greater variety of higher-quality goods. Meanwhile, the basic material needs of urban residents have already been adequately met, and future incremental consumption will focus on more personalized and differentiated consumption experiences in various sub-sectors.

In the short term, the slowdown in income confidence due to pandemic-related lockdowns has led to a marginal deceleration in consumer spending tendencies. We have observed that consumers are becoming more rational, with longer decision cycles and more cautious decision making. Products with high premiums and high selling expenses are no longer favored, and consumers are shifting towards products with better cost efficiency. But in new categories of products, demand is still robust, and product innovation is continuously driving the improvement of consumer companies' gross margins.

We believe that consumers' marginal demand for a greater variety of consumption categories and higher product quality is rigid. It's just that during the short-term volatility caused by the decline in confidence in future income growth due to the pandemic, consumers will satisfy incremental demand through more cost-effective means. This is what we refer to as "price downgrading, category upgrading" in the current stage (Chart 5).

Chart 5. Consumer demand growth and price growth in the Chinese market

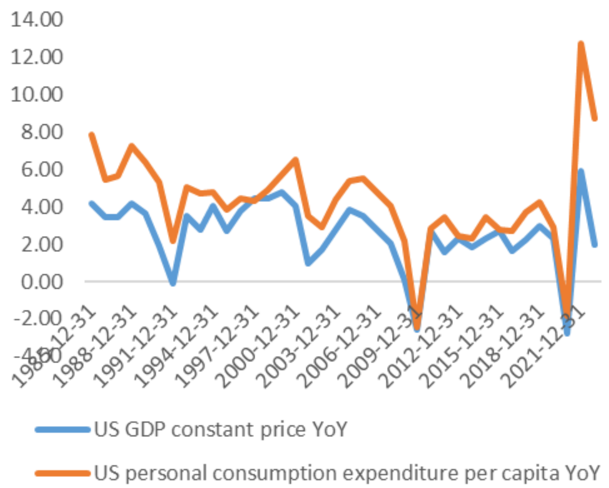


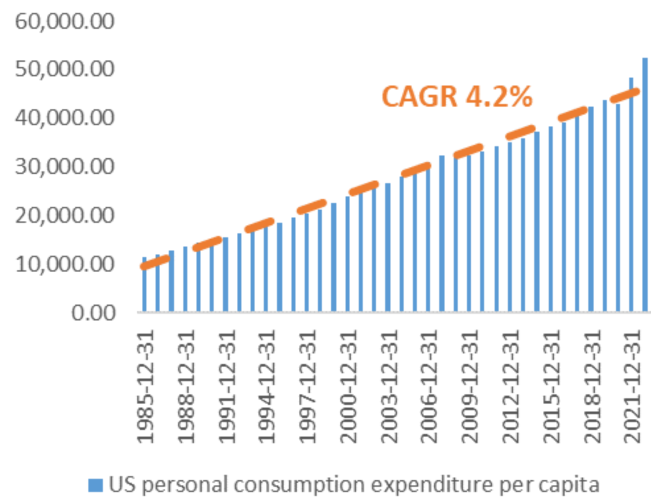
Source: Bin Yuan Capital

From a historical perspective, the United States has experienced several instances of negative consumption growth, which were often related to short-term macroeconomic fluctuations. However, in the long term, the U.S. consumer market has maintained a stable annualized growth in line with GDP growth (Chart 6a and Chart 6b).

Chart 6a. US GDP YoY growth vs US personal consumption expenditure per capita growth

Chart 6b. US personal consumption expenditure per capita annualized growth





Source: Bin Yuan Capital, iFind

We remain confident in the long-term growth of the Chinese consumer market, which will leverage the vast scale of the economy and multi-level consumption behavior, and still possesses extensive room for development.

Potential investment opportunities:

Value for money in industries where homogeneity among products is high. Consumers are still pursuing quality but want to pay less for brand premiums:

- **Higher circulation efficiency:** To make products more cost effective when they reach the hands of consumers, the selling channels that can increase supply chain operational efficiency and reduce circulation costs will capture more customer interest. For example, **Pinduoduo (PDD.O)** uses bulk purchasing and shipping through group buying, connecting suppliers directly with consumers. This eliminates intermediaries in the distribution channel, reducing the middleman costs associated with traditional e-commerce. White label/private label products are also getting more recognition because they diminish additional markups in the supply chain and deliver more value to consumers.

- **Industry consolidation:** Consumer demands for cost effectiveness are driving manufacturers to enhance their supply chain and management capabilities, reducing production costs and retail prices. In this process, the competitiveness of leading enterprises is further strengthened, leading to an increase in industry concentration. Examples of such industries include **customized home furniture (Suofeiya 002572.SZ), premade food (Anjoy 603345.SH)** and the **hotels (Huazhu 1179.HK) industry**. When selling at similar prices, small, customized furniture manufacturers barely reach their breakeven point while leaders still have a 10% net margin. Small manufacturers exit the industry and leaders take more market share. The situation is similar in the premade food industry selling to business customers. For the hotel industry, individual operators tend to join a hotel chain, because chain brands will generate customer flow other than solely relying on OTAs (online travelling agency) and give guidance on improving management efficiency, thus improving their profit margin.

Consumption upgrade: category leads, price increases follow:

- **New demand:** While becoming more cautious in budgeting for consumption, consumers' demands for more varieties of goods and quality are still increasing. Niche markets such as outdoor sports, yoga and other indoor sports have grown to a market size of tens of billions of RMB. These sports, compared to traditional mainstream activities like running, are more specialized, thus demanding products with superior functional performance to support corresponding athletic requirements. Chemical fiber manufacturer **Taihua New Materials (603055.SH)** provides high-function nylon to replace polyester in outdoor & yoga clothing with a cost increase of only around RMB 10 for a pair of yoga pants, and consumers are willing to accept the certain degree of budget growth to enjoy quality improvements and higher cost-effectiveness.

- **Spending for personal experiences:** In addition to focusing on the practicality of products, consumers also desire to gain richer personalized experiences from their consumption. For example, theme parks, within the same visiting time, can offer consumers a more diverse touring experience compared to traditional parks. **Haichang Ocean Park (2255.HK)** is a good example of a domestic brand theme park, providing a one-stop experience with marine animal exhibits, amusement rides, and interactions with well-known animated characters. This allows visitors of different age groups to find content of interest during their visit. The scarcity of both marine animal conservation capabilities and IP resources should continuously attract more visitor traffic to Haichang. Another example of spending for personal interest is the **pet economy**. The number of single people in China is expanding, leading to a continuous increase in pet ownership. People are willing to pay for the companionship provided by pets, resulting in a RMB 200 billion pet market. Pet food manufacturers, supplies manufacturers and service providers will benefit in the long term from the increasing number of pets.

Defensive positions:

- **Strong cash flow and high dividends**: We believe that the trend of cautious and value-for-money consumption will continue for some time. During this period, it is also necessary to position in defensive industries. Essential goods such as milk and beer are expected to be less affected by changes in consumer budgets. The demand for essential services, such as higher education, with longer consumption cycles and price insensitivity, are also expected to maintain stable revenue. At the company level, we believe that companies like **Yili (600887.SH)**, **Chongqing Brewery (600132.CH),** and **China Education Group (839.HK)** are likely to maintain their stable performance and sustain high dividend payouts.

Technology – Import Substitution + Innovation Driven Demand.

In our previous newsletters and the year-end review above, we emphasized the theme of import substitution. Now, we aim to focus on the emerging wave of innovation—a pivotal driver of productivity in the coming decade.

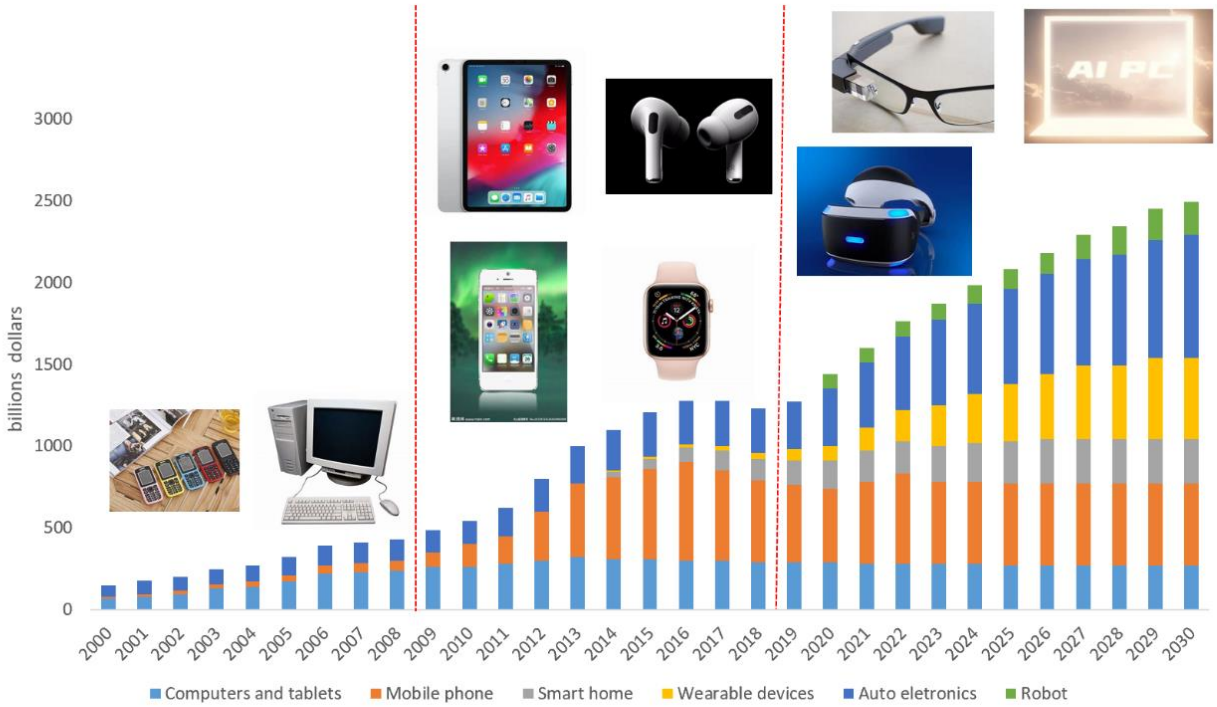
After a decade of remarkable advancements in the smartphone industry, innovation in consumer electronics hit a ceiling in the past few years. Mere enhancements in design or screen size are no longer enough to motivate consumers to upgrade. This same "involution" is happening in other industries as a lack of innovation drives fierce competition. Fortunately, the emergence of generative AI, like ChatGPT, offers a lifeline. It is poised to bring transformative changes across various industries. As highlighted in our July 2023 investment letter, the infusion of artificial intelligence into robots has endowed them with greater 'intelligence' and 'creativity', expanding their application scenarios. The September 2023 letter explored AI's potential to empower autonomous driving, addressing corner cases and catalyzing the industry's exponential growth. Similarly, we expect tremendous investment opportunities from consumer electronics and other beleaguered industries such as new materials, software, and intelligent equipment. As investors, we try to avoid areas that are too "hot" and have been searching for potential investment opportunities that are currently not yet receiving market attention.

China will continue to be the main beneficiary of application development. It should be acknowledged that leading technological innovation from scratch is not a strength of Chinese companies. However, the advantage of Chinese companies lies in their engineering capabilities, which determine whether a new technology can quickly open up a wider market. Because of its complete and efficient supply chain and rapid response capability, Chinese players possess a cost advantage, and they will become key cooperators to ensure the speed of downstream terminal manufacturers' product iteration. Looking forward, such advantages will create value for the whole society in the next round of the cycle of technological revolution, like AR/VR (Augmented Reality/Virtual Reality), AIPC (Artificial Intelligence PCs) and other fields.

- **Consumer Electronics Industry**

From a historical perspective, every technological innovation has brought about sustained growth in the consumer electronics industry. With the empowerment of AI, AR/VR and AIPC will become the next generation of consumer electronics products after the smartphone era. And it will bring in another growth cycle for the whole industry over the next decade.

Chart 7: Global Consumer Electronics Development Trends



Source: Bin Yuan Capital

China is one of the largest markets for new consumer electronic products, allowing the nimble supply chain providers to quickly reach downstream demand. Three main downstream applications for AR/VR or AIPC are: entertainment, office and industrial manufacturing, which are precisely where China's advantages lie.

1). Entertainment: China is the world's largest gaming market. In 2023, with the economic recovery, the Chinese gaming market also resumed growth, with a year-on-year growth of 14% and volume exceeding RMB 300 billion for the first time, still maintaining China as the world's largest gaming market. In addition, China also has an online video market of over RMB 100 billion, which brings huge potential growth momentum to the AR/VR industry.

2). Office: China has 200 million white collar workers, ranking first in the world. Such a large number of white-collar workers has given rise to a large demand for personal PCs and collaborative office work. AIPCs pre-installed with large models and various office software empowered by large models will greatly improve their work efficiency. Based on a per capita price of RMB 5,000 and a three-year replacement cycle, the market size of office PCs exceeds RMB 300 billion. In addition, according to iMedia Consulting, the market size of collaborative office software in China exceeded RMB 30 billion in 2023.

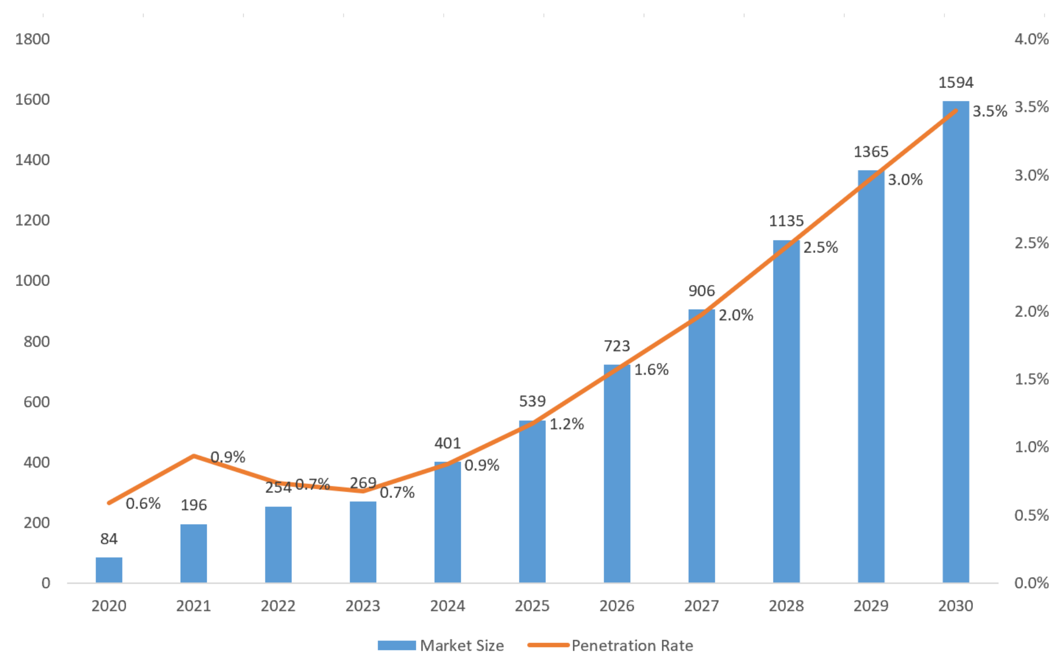
3). Industrial: China's industrial added value ranks first in the world. With the continuous upgrading of China's manufacturing industry and the increasing demand for workers' production skills, AR/VR offers the prospect of very broad applications in the industrial field. According to the forecasts of "EqualOcean Intelligence", the industrial manufacturing sector will become one of the most important markets in 2025, with a market size exceeding RMB 29 billion.

1）AR/VR Industry

✓ On June 6, 2023, at the Apple WWDC Developer Conference, Apple unveiled what could be its most significant product in a decade - the Vision Pro, slated for release in February 2024. This product amalgamates interaction methods from the iPhone, Mac, iPad, and Apple Watch. Following the release of Apple MR, its augmented reality capabilities and visual experience are anticipated to shift the device's focus from gaming to office and lifestyle applications, positioning it as a successor to PCs and smartphones in the realm of office and entertainment electronics.

✓ A recent IDC report forecasts that global shipments of AR and VR headsets will reach 8.1 million units in 2023, compared to 1.2 billion units for smartphones. With a 0.7% penetration rate in the AR/VR market and a projected market value of RMB 269 billion, Apple is expected to spearhead technological advancements in the industry, potentially increasing the penetration rate. By 2030, the market size could surge to RMB 1,600 billion, with a global penetration rate of 3.5% (Chart 8).

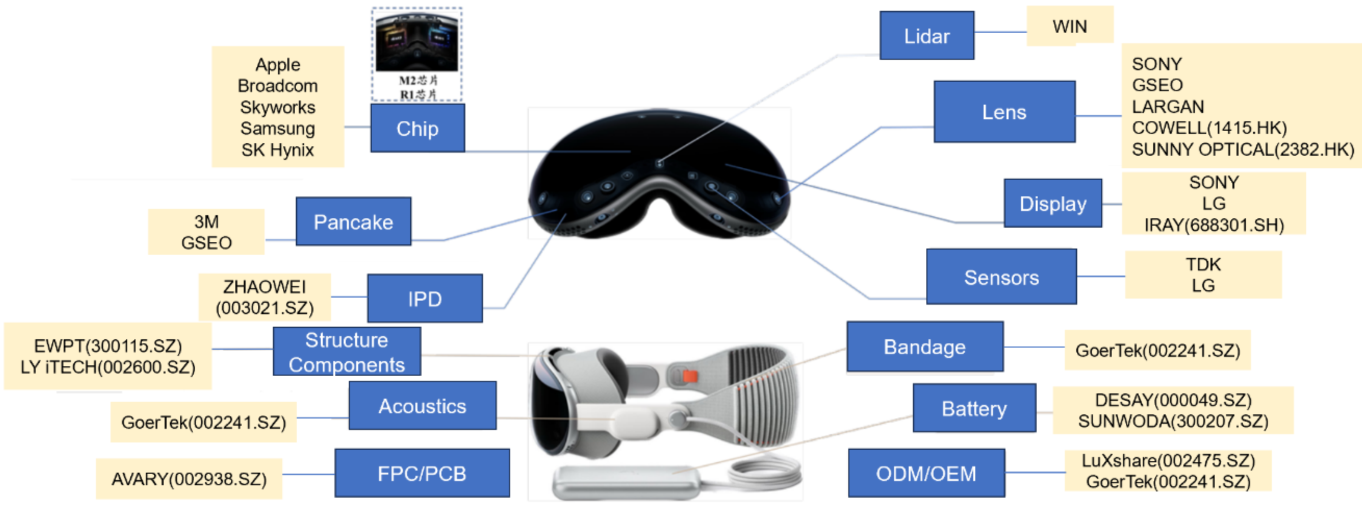
Chart 8: Market Size and Penetration Rate of AR/VR Industry (RMB billions)



Source: Bin Yuan Capital

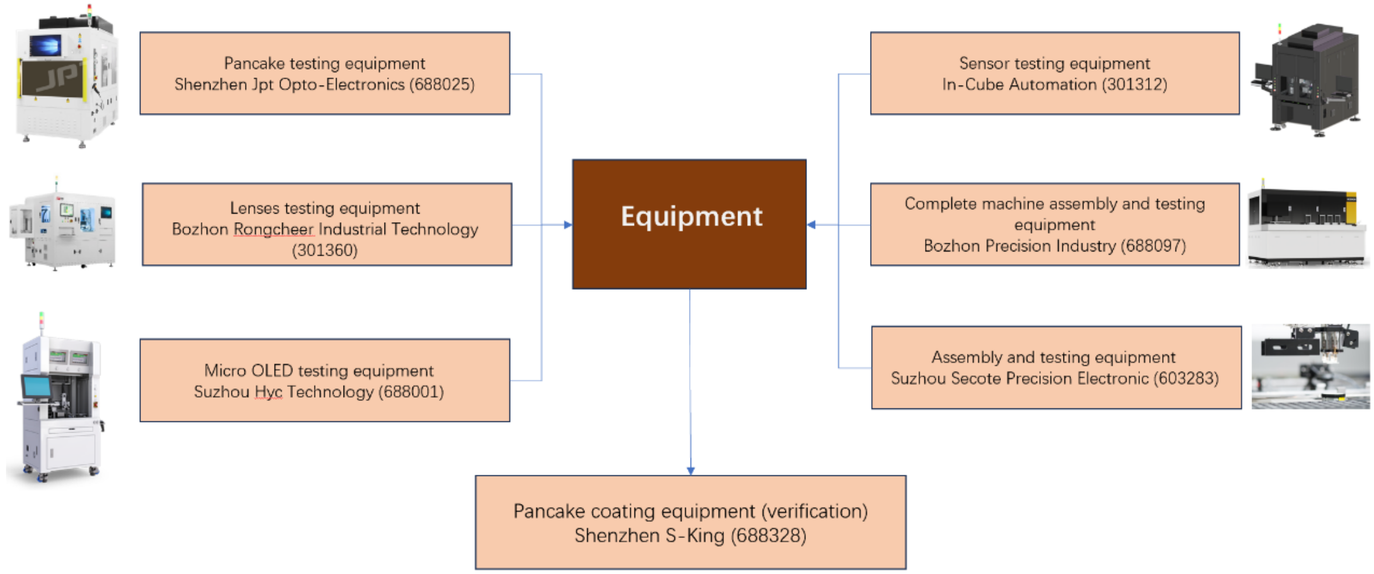
✓ Value chain/opportunity. Due to the cost advantage and fast iteration advantages mentioned above, China has many excellent listed companies in various segments of the AR/VR supply chain that are expected to directly benefit from the rapid growth of this industry.

Chart 9: Supply Chain of AR/VR Device



Source: Bin Yuan Capital

Chart 10: Supply Chain of AR/VR Testing Equipment



Source: Bin Yuan Capital

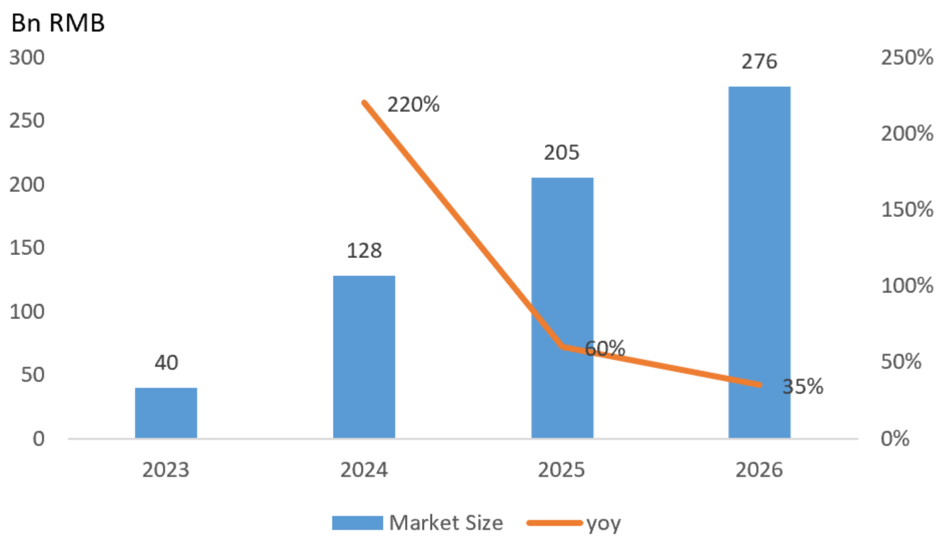
Sunny Optical (2382.HK). Sunny Optical Technology is a leading Chinese manufacturer of optical products, based on three core technologies. It develops optical, instrument, and photoelectricity businesses. Its high precision cameras have been widely applied to various AR/VR devices as an important visual sensing component.

GoerTek (002241.SZ). As the AR/VR leader, Goertek has abundant hardware and software integration technology, combined with the mature automation and precision manufacturing capabilities to provide global customers with multiform VR/AR HMD (Head-Mounted Display) and other related solutions such as pancake modules, diffractive optical waveguide,etc. It should benefit from the trend towards AR/VR.

2）AIPC Industry

The first AIPC Industry Innovation Forum on December 7th marked the release of the inaugural AIPC Industry (China) White Paper by Lenovo Group and IDC. This paper provides a comprehensive framework for developing the industry's ecosystem, encompassing its historical mission, definition, value, and product features. Concurrently, AMD announced its upcoming Ryzen 8040 series processors at the "Advancing AI" event in San Jose, California, promising enhanced AI capabilities for PCs and heralding a new era in AIPC innovation. On December 14th, Intel introduced its first AI PC processor, the Core Ultra processor Meteor Lake, at the "AI Everywhere" event. Driven by these technological advancements from leading global companies, the AIPC industry is expected to enter a phase of rapid growth. The market size is projected to reach RMB 276 billion, with a three-year CAGR of 90%.

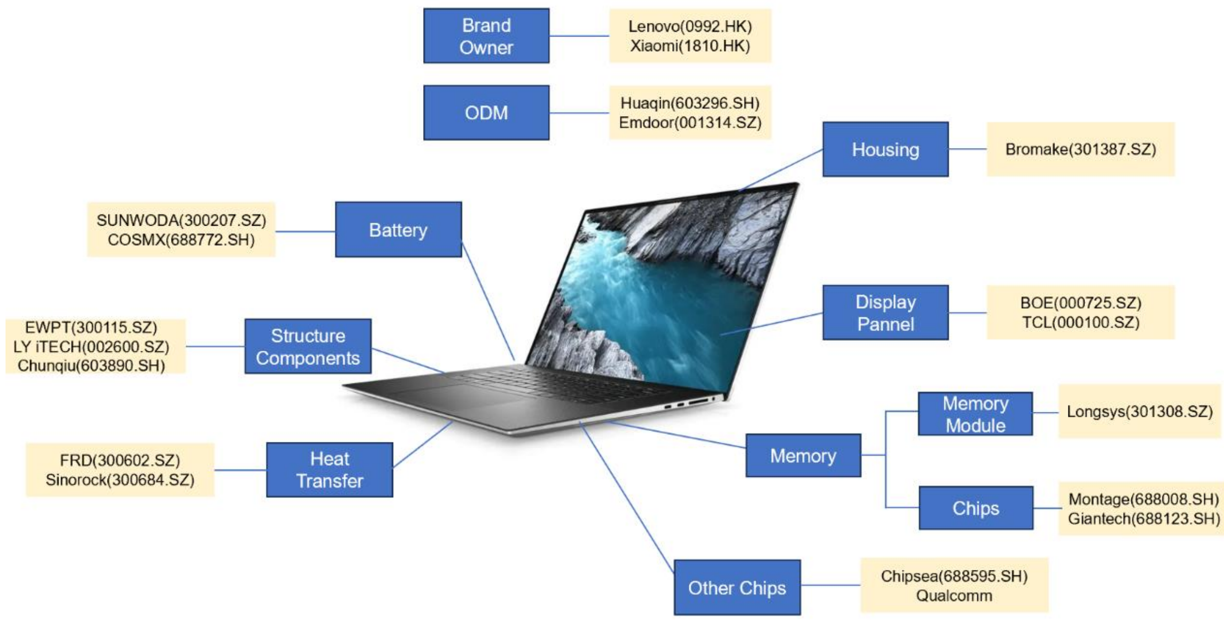
Chart 11: Market Size and Penetration Rate of AIPC Industry



Source: Bin Yuan Capital

Value chain/opportunity. According to our research, many Chinese companies have already started cooperating with global technology giants and have made sufficient advances in the related supply chain.

Chart 12: Supply Chain of AIPC Device



Source: Bin Yuan Capital

Montage (688008.SH). Montage Technology is a leading IC design company dedicated to providing high-performance, low-power IC solutions for cloud computing, data centers and PC markets. AIPC will drive the upgrade of memory in personal computers from DDR4 to DDR5, and the value and quantity of the company's interface chips will be increased. Therefore, the rapid growth of AIPC should bring significant revenue growth to the company in the future.

Giantec (688123.SH). The company is committed to providing customers with memory, analog and mixed-signal integrated circuits as well as application solutions and technical support services. Similar to Montage, Giantec will also benefit from the DDR4 to DDR5 upgrade trend with the emergence of AIPC. The company has also expanded its application of new memory products for automobiles, which is expected to bring new growth to the company in the future with the rapid development of autonomous driving.

Chipsea (688595.SH). Chipsea Technologies Corp. is a signal chain integrated circuit design enterprise integrating perception, calculation, control and connection. It focuses on the R&D and design of high-precision ADCs, high-reliability MCUs, measurement algorithms and AIoT one-stop solutions. Its new product-EC chip which is used in personal notebooks to connect the CPU and other types of peripherals, such as keyboards, batteries, temperature sensors, touchpads, keys, LEDs, and fans has been certified by Intel in 2022, and should contribute significant earnings to the company in the next several years.

Robot Industry

As highlighted in our July letter, intelligent robots represented by humanoid robots are a promising technology with multiple applications. With the rapid development of artificial intelligence technology, robots will become more intelligent in the future, featuring greater autonomy and adaptability. They will be widely applied in sectors such as manufacturing, healthcare, households, and services, becoming important partners in human production and life. Although the stock prices of many companies have risen significantly in recent months, we still find some contrarian opportunities in the supply chain.

JSHL (601100.SH) Hengli Hydraulics is a leading Chinese manufacturer of hydraulic products. With its strong technical team, research and development center, and advanced manufacturing technology, it is capable of producing high-quality and highly reliable hydraulic products that are widely used in various fields, including robotics. The company's new product-roller screw is a core component of humanoid robots which is an important terminal of AI technology and should bring new growth to the company in the future.

New Material Industry

Every technological revolution is closely related to the development of materials, and artificial intelligence can serve as a powerful auxiliary tool, utilizing data sharing to predict and screen the physical and chemical properties of advanced materials, thereby accelerating the synthesis and production of new materials. Some companies can narrow the gap with international giants by using AI tools, thereby accelerating the process of import substitution.

RAL (300596.SZ) Rianlon is a major solution provider of anti-aging additives and application technologies for polymer materials. Its product portfolio includes antioxidants (RIANOX), light stabilizers (RIASORB) and U-pack which is customized blending formulation to provide a one-stop anti-aging solution. Its new product can be applied in AR/VR or the automotive industry, which should bring additional new growth for the company.

Solartron (688299.SH) The company is mainly engaged in the research & development, production and sales of various special functional films such as reflective films, optical base films, and backplane base films. The products are widely used in the fields of display and electronics, batteries, and solar energy. The company utilized AI technology to optimize formulas and processes, continuously reducing manufacturing costs while improving product performance, and maintaining its long-term competitiveness.

Software Industry

Software, especially industrial software, has always been a highly competitive industry that requires the accumulation of long-term industry experience. This is why industrial software worldwide has long been monopolized by several international companies. However, with the assistance of AI, Chinese companies are expected to accelerate product iteration and achieve localization.

BIDU (9888.HK) Baidu, a leading AI company with strong internet gene, is among the few companies around the globe that offers a comprehensive AI technology stack, including AI chips, software architecture, applications etc. International organizations have named it as one of the world's top four AI companies. Since its launch on October 17th this year, Baidu's AI big model - ERNIE Bot 4.0 - has attracted over 70 million users, engaging more than 64,000 developers. It has covered over 4300 scenarios and been applied in 2,492 applications. We believe that AI applications will drive Baidu's future growth.

- **Intelligent Equipment Industry**

We believe that generative AI will bring a new way of interaction to most kinds of equipment, thereby reducing the difficulty of use and improving production efficiency.

Liugong (000528.SZ) As the first publicly listed company in China's construction machinery sector, Liugong Machinery has become a comprehensive machinery provider, offering a range of products including wheel loaders, excavators, etc. The company has been turning to battery-driven products with the help of China's leading lithium battery supply chain, and rapidly expanding its global footprint.

KDT (002833.SZ) KDT is a leading company of machinery for high-end furniture in China. Its sales network covers more than 70 countries with core products such as edge bander, panel saw, CNC machining center, NC drilling center, flexible automation line and packaging solutions etc., which have been recognized by customers both at home and abroad. Empowerment by AI, the intelligence level of the company's new products has significantly improved, which will further improve production efficiency and reduce costs for customers. The company will fully benefit from this equipment replacement cycle.

NARI (600406.SH) NARI is a leading global provider of software and hardware development and system integration services for power automation. With the vigorous construction of renewable energy in China in the past few years, the demand for the power grid in the entire power system has greatly increased, especially the demand for DC ultra-high voltage. NARI has obvious advantages in the fields of converter valves and related DC equipments and should benefit from the trend significantly.

Looking into the rest of 2024, we have identified many companies, in a variety of sectors, that we believe will outperform the market despite the domestic and international issues discussed earlier. We summarize them here to give you a sense of the breadth of opportunities we see in the market.

Sector	Company	Market Cap	Forward 3-year Earnings CAGR + Dividend Yield	Forward PE
Consumption	China Education Group	1.7	20%	7
	Suofeiya	2.1	14%	13
	Yili	23.4	13%	13
	Anjoy Foods	3.9	21%	15
	Chongqing Brewery	4.2	20%	17
	Huazhu	12.6	18%	18
	Taihua New Materials	1.4	30%	18
	Pinduoduo	197	35%	20
	Haichang Ocean Park	1	200+%	24
Healthcare	Sinopharm Group	7.8	12%	5
	Kangji	1.1	20%	12
	Yuwell	4.9	18%	18
	Mindray	48.2	23%	24
	Snibe	8.2	30%	28
Technology	Autowell	2.6	15%	8.5
	Liugong	1.9	30%	10
	KTD	1.1	15%	11
	BIDU	44.3	12%	12
	RAL	1	21%	14
	Solartron	0.5	25%	19
	NARI	25	17%	20
	JSHL	10.2	20%	25
	Sunny Optical	8.8	50%	22
	Sinofuse	1.2	35%	34
	iRay	4.1	36%	33

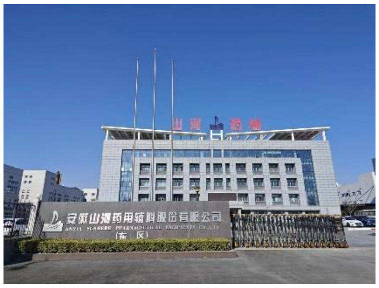
As we stated above, our portfolio is now very cheap, has strong earnings growth, and represents good value. We believe that our current portfolio is set to deliver superior returns in 2024 and going forward.

Happy New Year,

Ping and the Team

January 8, 2024

Bin Yuan on the Road



December 7, 2023

We visited Sunhere Pharmaceutical Excipients in Anhui Province to get an update on the company's business operation and visit their factories.

The management confirmed that the volume-based purchasing (VBP) policy has little impact on their business, and that the price for 95% for Pharmaceutical Excipient's orders will not be cut. Capacity expansions for some products should contribute to revenue growth in the future, and new products in the medical aesthetics sector are being planned. We also visited their new factory with upgraded wastewater treatment system. The new equipment will increase its advantages in industry competition amid rising standards of environmental

"Large pharmaceutical excipient companies with comprehensive product portfolio will gain more market share. " – The company's IR, Mr. Jiang.

December 29, 2023

We made a field trip to Sheyang county in Yancheng city of Jiangsu province, to visit the newly opened mall of Jiangsu Phoenix and get more information on consumption in lower-tier cities.

The well-designed new mall attracted many residents with fascinating furnishings & decorations, better composition and a complex of high-quality shops, stores, restaurants, etc. The modern bookstore was very popular among students too. We learned from local agencies that housing prices there are relatively stable there because of less speculation than in some previously hot cities. The hit on consumption was very modest as living costs are relatively low and most households still follow the tradition of saving for the future.

"The location of Phoenix Plaza was very good in the CBD of the country, supporting strong rental income in the next few years." – Store employee of Phoenix Plaza.

December 30, 2023

We visited a shopping mall in Pudong, Shanghai, to keep up with the latest offline consumption trends.

Demand is strong for professional sports such as skiing, outdoor, yoga, and cycling. Sportswear stores occupied the best locations in the mall, and the number of brands is still increasing. All brands reported good sales but there is not yet a leading brand for these sports.

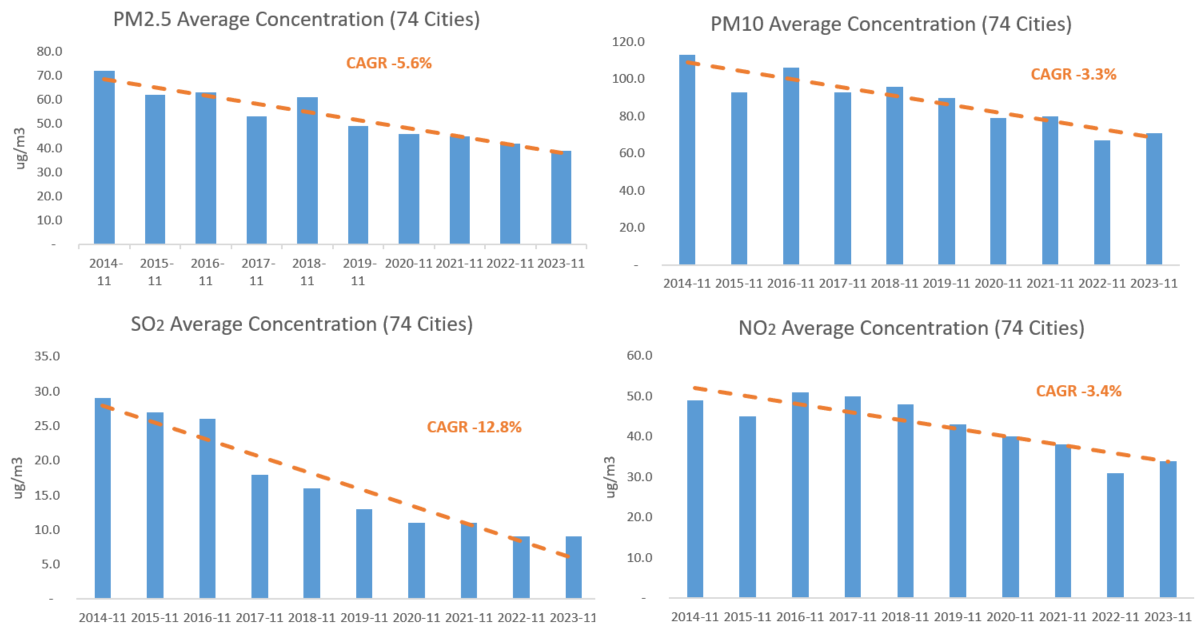
The professional sportswear market is increasing but competition is intense too. We expect that upstream fabric providers may see more consolidation and will garner more benefits from the growth of the sportwear market.

" These functional sportswear brands are more comfortable than leisure wear, so I plan to spend more on sportswear with good quality." – A customer in the mall

Bin Yuan Environment Tracking

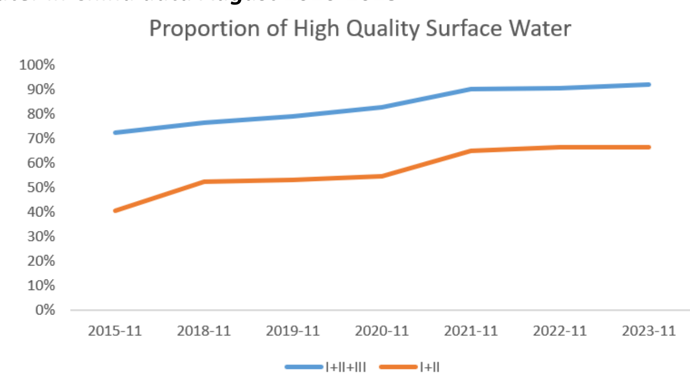
This tracking includes monthly air and water quality data, both showed steady improving trend in the last 5 years. Air pollution concentration dropped due to reduced coal combustion, increased proportion of new energy vehicles, and tightened emission control measures. Water quality improved mainly from the strengthen control of wastewater emissions since 2017.

China air pollutant concentration data August 2015-2023



**PM2.5, PM10 and SO_2 are mainly from fossil fuel combustion, and NO_2 is mainly from vehicle emissions.*

The proportion of high-quality water in China data August 2016-2023



**Water quality in China breaks down to 5 levels, with level I being the best and level V being the worst. Level I+II represents water that can be used for drinking purpose. Level I+II+III represents water that can directly contact human body.*
**Source: Ministry of Ecological Environment in China.*

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