Bin Yuan Capital – January 2018

Market Update

Chinese stocks resumed the uptrend in January. Shanghai Composite Index was up 5.25% and Hang Seng China Enterprise Index performed even better by surging 9.92% in January, surpassing the all-time high of 31,958 set 11 years ago in October 2007.

China's economy was generally in line with the expectation in January. The producer price index (PPI) rose 4.3% year on year (YoY) in January 2018, down from 4.9% in December 2017. The consumer price index (CPI) moved in the same direction by dropping 0.3 percentage point, rising 1.5% YoY. The official manufacturing Purchasing Managers' Index (PMI) dropped to 51.3 in January 2018 from 51.6 in December 2017 and the official non-manufacturing PMI in January, on the other hand, was up to 55.3 from 55.0 in December primarily due to the accelerated growth of the service sector. Both manufacturing and non-manufacturing PMI was well above the expansion/contraction threshold of 50. We shall continue to monitor the sustainability of the recovery of the economy.

China's continuous effort to deleverage to contain financial risks has seen some good results. According to the official data released by the State-owned Assets Supervision and Administration Commission (SASAC), the average debt-to-asset ratio of China's central state-owned enterprises came in at 66.3% by the end of 2017, which was 0.4 percentage points lower than last year. SASAC aimed to further cut the ratio by 2 percentage points by 2020. We expect that the deleverage process will contribute to China's sustainable growth in the long run.

The Hong Kong Stock Exchange began to draft rule changes to allow for the issuance of dual-class shares which was allowed by many of the bourses around the world. The rules are expected to be finalized by June 2018 and will help the Hong Kong Stock Exchange to attract more new economy companies in future. On the other side, the new rules will also facilitate the IPOs of China's fast growing new economy companies.

Performance Attribution

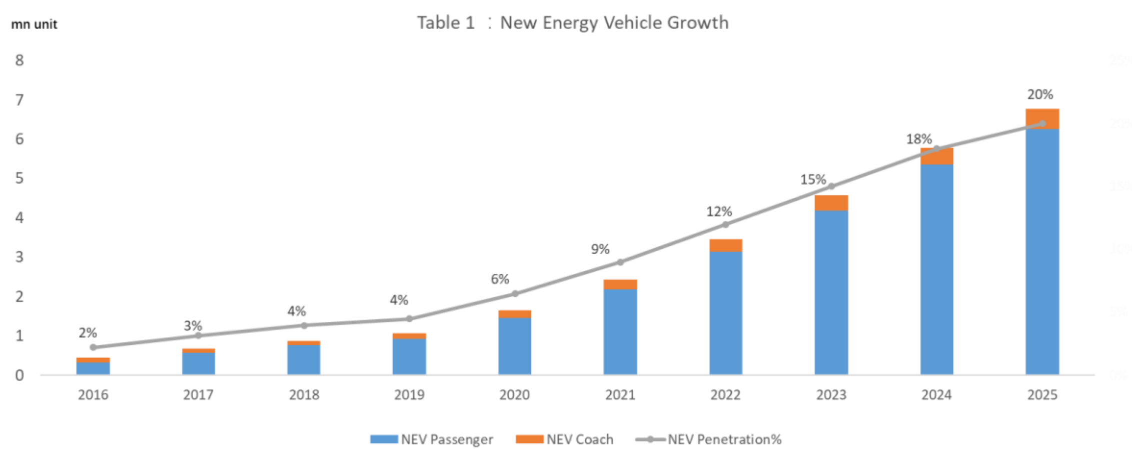
At the stock level, a commercial bank outperformed in January because according to the latest quarterly report, both non-performing loan ("NPL") ratio and NPL balance fell compared to that of the first half of 2017. In addition, the company has higher exposure to retail banking compared to its competitors. We prefer retail banking to corporate banking because the retail channel will create substantial value in wealth management business with Chinese people getting richer.

A company focusing on renewable energy business underperformed in January. The company is a leader of the photovoltaic tracking system market. The product can improve generation efficiency by 20%, which is attracting increasing operators to procure amid the pressure of cost hike. Tracking system is nearly 0% penetration in China compared with 20% in overseas markets. The company has a strong market position and almost dominant in this area with technology patent.

Local Insights and Portfolio Positioning

With the development of China’s economy, the automobile ownership in China was growing continuously in the past few years. According to the National Bureau of Statistics’ data, the automobile ownership increased at a compound annual growth rate (“CAGR”) of 21% from 2005 to 2016. However, this also brought the problems of oil consumption, environmental pollution and urban congestion. To solve these problems, the Chinese government is now developing new energy vehicles (“NEV”) or smart vehicles with an unprecedented determination and confidence.

We believe that China will be one of the leading drivers in this global auto revolution with the support of the policymaker. In 2016, the NEV sales volume in China jumped to almost 500,000, representing about 40% of the world’s total, and more than twice the size of the second-biggest NEV market, the US. In light of the “2025 NEV Plan” released by the Ministry of Industry and Information Technology, the sales volume of China's NEVs will reach around 1.7 million in 2020 and 7 million in 2025, representing a CARG of 28% (Table 1). According to this plan, almost half of the world's NEVs will be produced in China by 2020. We believe that some excellent enterprises will have the potential to become the industry leaders worldwide.



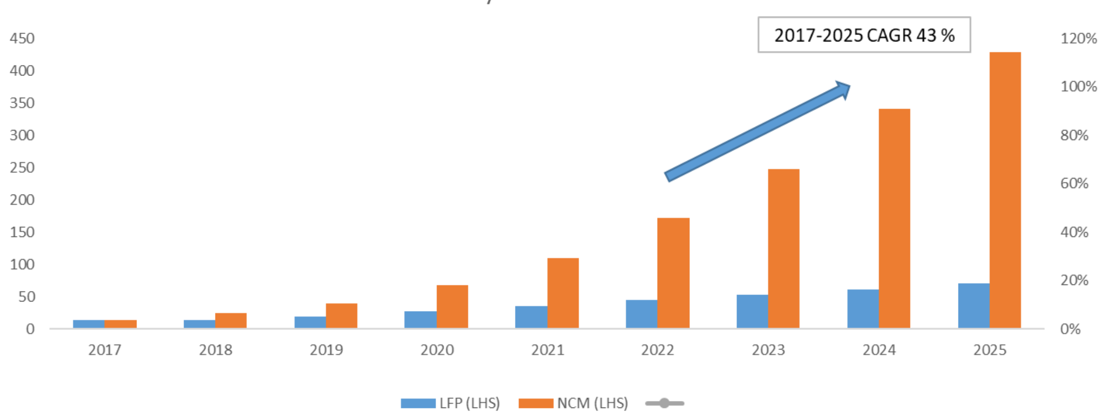
Source: The Ministry of Industry and Information Technology ,Binyuan Capital

Although the industry enjoys a strong growth, not every player along the value chain can earn a decent profit due to different market positions. We believe the companies that can accumulate first-mover advantages and have its own core technologies will benefit most. They might even be globally competitive partly driven by the fast-growing China NEV market. We will continue to focus on those companies with great bargaining power and good cashflow.

New Energy Batteries

Compared with conventional fuel vehicles, NEVs replace engines and transmissions with batteries, motors and electric control parts. With the increase of the output of NEVs and the increase of the power installed by each vehicle, the demand for new energy batteries made of $LiFePO_4$ (“LFP”) and NiCoMo (“NCM”) will show tremendous growth (Table 2).

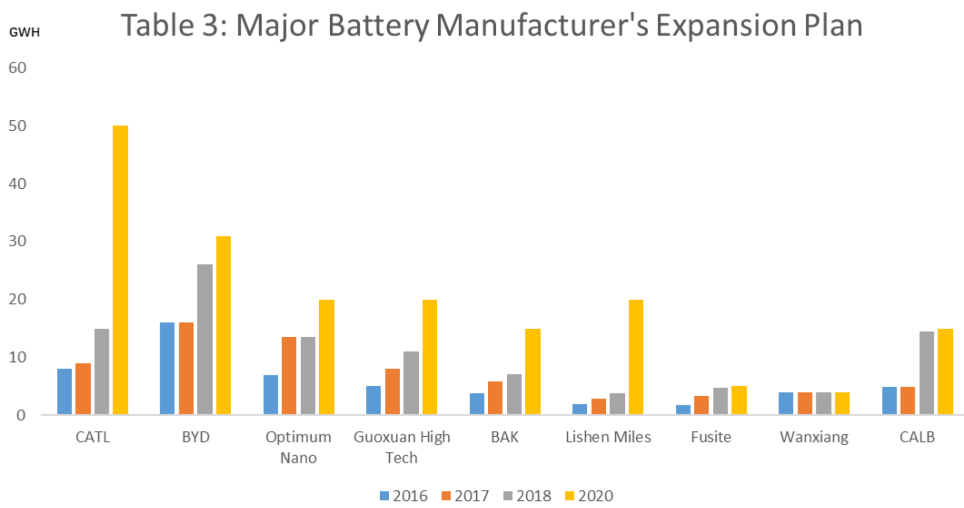
Table 2 : Battery Growth 2017 - 2025



Source: Wind, Binyuan Capital

New Energy Battery Manufacturing Equipment

In order to meet the fast-increasing demand for the new energy batteries and to achieve the greatest economies of scale, the major battery plants will aggressively build up their capacities. According to the current standard, the CAPEX for 1GWH power battery capacity is around RMB300 million. Therefore, according to the capacity plan of 500GWH in 2025, the market size of battery manufacturing equipment will be at least RMB150 Bn. In this series of expansion, the Matthew effect or the accumulated advantage will play a decisive role which will increase the concentration rate the industry and help the excellent manufacturing enterprises to become the final winners.



Source: Wind, Binyuan Capital

Core Components for NEV

In addition to the battery system, we believe that with the improvement of electrification degree of the automobile, the value of some core components will also greatly improve. Such as high voltage relay, film capacitor, electric compressor, thermal management system, etc. Taking the thermal management system component as an example, the component value of a traditional fuel vehicle is around RMB2,000, while that of an NEV will increase to RMB6,500. Therefore, core component companies are also one of our focuses.

Industry Leaders

In the trend of NEV development, only the best companies can win through the continuous competition. These companies must have its unique core competitiveness such as great quality, cost leadership, good after-sales service and so on. Some potential winners are listed as follows.

Leading Intelligent is a global leader in the battery coil equipment industry. The company's key product is the lithium battery winding machine. The linear speed of the machine can reach 800 mm per second with a winding efficiency of six parts per minute, which means that the overall efficiency is 1.5 to 2 times of its international competitors' products. In addition to NEV battery, the company also has the chances to extend its competitiveness to other areas, such as energy storage batteries, solid state batteries and so on. Therefore, with the dual drive of the rapid growth and the consolidation trend of the industry, we expect that the CAGR of the company's revenue will reach over 40% in the next 4 years.

Hongfa is a leading provider of relay in the world. The company has over 30 years of technical accumulation with its continuous R&D investment. Through the layout over the whole value chain, it is now highly vertically integrated and is far superior to its domestic peers in both cost and quality.

Sanhua is a provider specialized in the manufacture of refrigeration components. In the valve industry, the company has ranked the first in market share in the world for many years. With a rich technical accumulation, the company has successfully extended into the NEV thermal management area, which is expected to record a growth at CAGR of 20% in the next 5 years.

CATL is a leading new energy battery company in China. Through the company's continuous R&D investment, the energy density of a single battery has already exceeded 300wh/kg, becoming the technology benchmark in China. With an excellent product quality at a competitive price, the company's domestic market share increased from 5% in 2014 to 30% in 2017. We expect that the market share of the company will further expand and the company will eventually become a global leader in the new energy battery industry driven by the fast-growing value chain in China.

Therefore, we will keep focusing on those outstanding companies with core competitiveness, which have the potential to be global winners in the value chain of NEV in future.

Sincerely,

Bin Yuan Capital

Specialized China Manager	• Shanghai/Hong Kong-based, value focused China manager • Long only absolute return mindset • $500M+ AUM invested in All China and China A share strategies
Experienced Team	• Founders with 35+ years combined investment experience • Core team formerly with GE Asset Management ("GEAM") managing $5B across 3 funds; EM, Greater China & China A Shares
Fund Fee Structure	• Class A – Management Fee 1.5% • Class B – Management Fee 1%, Performance Fee 10% • Class C – Management Fee 2%, Performance Fee 20%