

Bin Yuan Capital All China Strategy – October 2019

Market Update

Shanghai Composite Index was up 0.82% and Hang Seng China Enterprise Index was up 3.26% in October. The economy data remained weak in October while consumers and services delivered better performance than manufacturing segments. The Producer Price Index (PPI) was -1.2% in September 2019, 0.4 percentage point lower than in August. And the official manufacturing Purchasing Managers' Index (PMI) was down from 49.8 in September to 49.3 in October, which was still below the threshold of expansion/contraction, primarily dragged by orders in hand and finished goods inventory. The official Non-Manufacturing PMI dropped from 53.7 in September to 52.8 in October, primarily dragged by finance and property sector. We believe this is not necessarily a bad thing as the capital resources will flow from finance and property to real economy. The Consumer Price Index (CPI) was 3.0% in September, up from 2.8% in August, which was partly contributed by the increase of the pork price due to the outbreaks of African swine fever in China. Rail cargo volume increased 5.8% YoY in September to 362 million tons.

On October 23, 2019, a new draft regulation was signed to optimize Chinese business environment to further open up its economy, spur market vitality and foster high-quality development. The draft focuses on the demand from market players and establishes basic institutional norms in business environment that give equal treatment to domestic and foreign enterprises. The government is taking solid steps towards fostering an open, transparent and fair business environment, which we believe will bring more capital into China and force China domestic players to reform to stay competitive.

A total of 3,706 companies listed on the Shanghai and Shenzhen stock exchanges completed releasing their Q3 2019 results by the end of October. Due to the slow-down economy, the year-on-year (YoY) revenue growth of A-share listed companies decreased from 14.7% in Q3 2018 to 7.9% in Q3 2019 and the YoY net profit growth decreased from 17.8% in Q3 2018 to 7.7% in Q3 2019. However, our holdings' weighted YoY revenue growth kept stable from 13.9% in Q3 2018 to 13.7% in Q3 2019, and weighted YoY net profit growth was up from 13.9% in Q3 2018 to 16.1% in Q3 2019. We keep focusing on structural opportunities in China despite overall weaker economy environment.

Performance Attribution

At the stock level, a smart grid company outperformed in October. Construction of 'Ubiquitous Power Internet of Things' (UPIOT) has been initiated in October and over 10 billion RMB will be invested in the industry. The company, as the top supplier, will benefit from it. We believe that the grid investment will be focused on UPIOT and Ultra-High-Voltage Direct Current (UHVDC) Transmission. As a software and equipment supplier with a dominant position in the power industry, the company will be the leader in the construction of UPIOT. National Energy

Administration announced a document about accelerating the construction of UHVDC Transmission, and the company will have a stronger growth in the next couple of years.

A death care service provider underperformed in October. Although the company's short-term performance is lower than market expectation, we still believe that the company has long-term investment value. The company's main business is death care service which is a rigid demand. We believe that with the aging population increasing, the demand for death care services will continue to grow. In addition, Chinese death care industry is very fragmented, and the company is expected to continuously gain market share through excellent management and abundant capital.

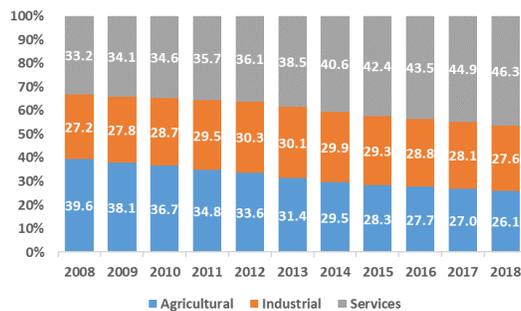
Local Observation and Portfolio Positioning

Have you ever thought of your daily consumption scenarios? Payment, commute, three meals a day, afternoon tea with friends, logistics, tickets and hotels booking, etc. These services were mostly connected to online in China in the past few years. Internet has infiltrated into the daily life of the Chinese people and almost everything can be solved with just a tap on the smart phone. Forgetting to bring your phone is more problematic than forgetting to bring your wallet in China nowadays. This online consumption habit not only drives the demand of the market, but also stimulates the merchants to restructure their supply chain to match the needs of consumers more efficiently. The online service market mainly consists of food-related services and travel-related services, which accounted for 43% and 36% of the market in 2017 respectively.

Consumption Upgrade Shifting from Physical Goods to Services

With the continuous rapid growth of China's economy, GDP per capita has risen to around USD9,770 in 2018, the level that consumers paying more attention to services and experiences. Driven by the demands, the country's labor force also moved radically from agriculture and manufacturing industries to services sectors to seek better opportunities (Chart 1). Abundant labor supply accelerated the development of the consumer service industry in the past few years. (Chart 1)

Chart 1: Labor Supply by Industry

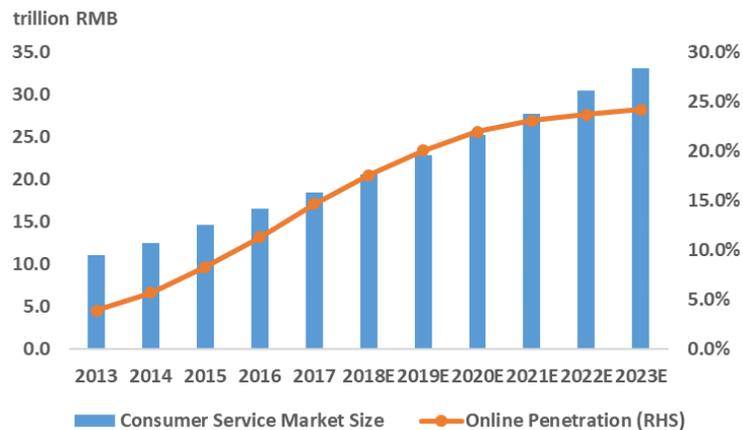


Source: Wind, Bin Yuan Capital

More Consumer Service Merchants Connecting to Online

Consumer service merchants have been encouraged to connect offline to online, which is perceived as a more efficient marketing channel to attract more traffics. (Chart 2). The merchants have been also in the process of restructuring their supply chain to better satisfy the online needs of customers with the help of internet leaders, including launching order management system, optimizing menu, centralizing kitchen, efficiently utilizing space and smart pricing by applying big data technology...etc.

Chart 2: Online Penetration of China Consumer Service Market



Source: iResearch, Bin Yuan Capital

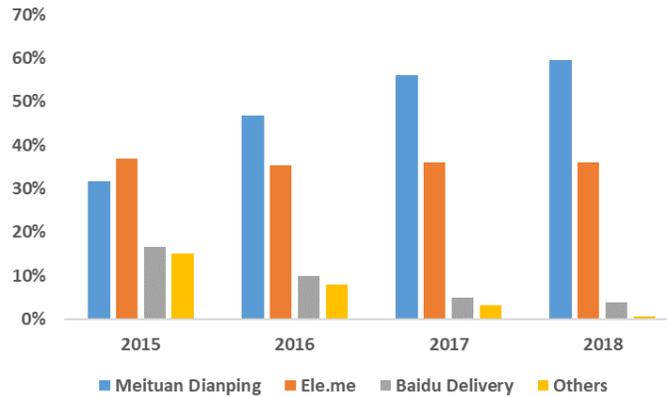
Investment Beneficiaries

Among China’s many Super-Apps, Meituan is a promising star which integrated features of Apps like Uber, Groupon, GrubHub, Tripadvisor, Booking.com, Airbnb and Yelp, etc.

1. Starting from high frequency food related services

After a multi-year industry consolidation, the food delivery and in-store dining market have been highly concentrated, led by two dominant players (Chart 3). In terms of GTV (Gross Transaction Volume), Meituan’s market share in the food delivery industry increased significantly from 31.7% in 2015 to 59.6% in 2018. Meituan facilitated RMB280 billion worth of food delivery transactions for more than 300 million people in over 2,800 cities in 2018. That’s 18 million Meituan-enabled transactions every day. The customers used Meituan 30% more often than the prior year on average. With the highest order density, Meituan’s delivery network works more efficiently than its competitors’, which ensures lower cost and better user experiences.

Chart 3: Food Delivery Platform Market Share

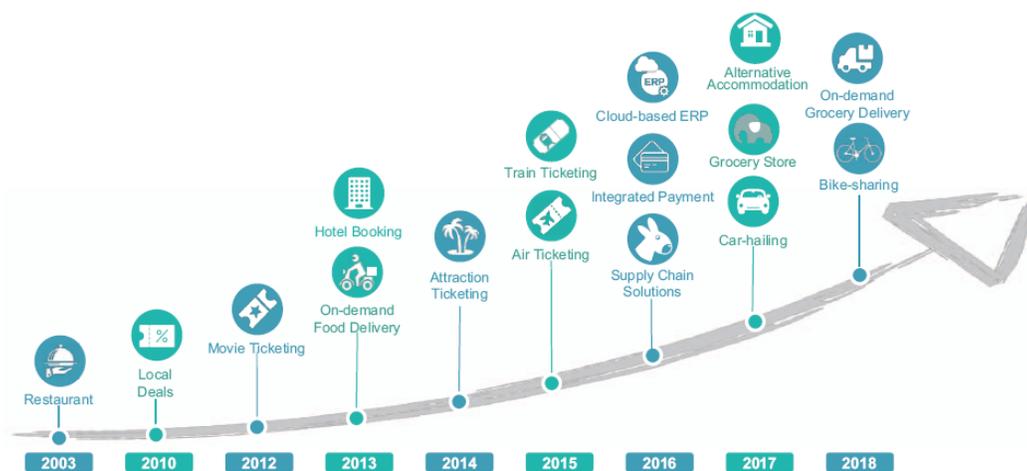


Source: iResearch, Bin Yuan Capital

2. Leveraging high frequency businesses' traffic to expand into other business

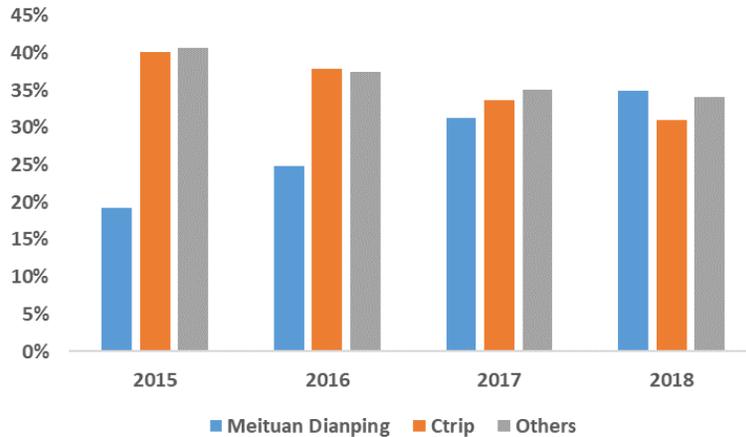
Food delivery and in-store dining review make up Meituan's core high-frequency businesses, which enables Meituan to build a large and sticky user base. In order to leverage its traffic to cross sell, Meituan is striving to cover as many service categories as possible, such as travel related services, movie tickets booking, etc.(Chart 4). The most recent success is Meituan's hotel booking business. In 2015, Ctrip acquired Qunar and invested in Tongcheng and eLong, becoming the dominant player in the hotel booking market. Considering Ctrip's 40% market share and its well-known brand in the hotel booking industry, Meituan had little chance to win. But due to Meituan's strategy of focusing on lower tier cities, which were not well serviced by Ctrip, and the strong cross-sell effect, Meituan finally surpassed Ctrip in 2017. In terms of domestic room nights, Meituan captured 34.9% market share in 2018, while Ctrip's was only 31% (Chart 5).

Chart 4: Closed-Loop Ecosystem of Meituan



Source: Meituan IPO Prospectus

Chart 5: Online Travel Agency Platform Market Share



Source: iResearch, Bin Yuan Capital

Meituan is now gradually expanding its business further based on its location-based algorithm. Through Meituan’s platform, these services combine online and offline to form a closed-loop ecosystem of life services. For instance, when you book a hotel on Meituan, you will also receive recommendations and coupons of nearby restaurants, which often are just what you need.

3. Empowering merchants and riders with Technology-based Infrastructures

Apart from attracting high quality traffic for merchants, Meituan also uses its big data and AI technology to support the merchants and riders. Meituan’s Smart Dispatch System is able to perform around 2.9 billion route-planning algorithm per hour and calculate as many as 97% of the optimized delivery routes in an average of 0.552 milli-seconds. This helps the merchants to fulfill delivery services generated on Meituan through Meituan’s riders or crowd-sourced riders. Since the Smart Dispatch System launched in 2015, it has reduced average delivery time by more than 30%, and riders can complete 50% more orders a day, increasing their income and lowering the delivery cost. What is more, the company is currently developing the technology to use unmanned vehicle to deliver the food.

Meituan is also providing cloud-based restaurant management systems to small and medium merchants, who cannot afford a traditional version by themselves. By using Meituan’s system, customers can order food on their own by scanning the QR-code on the table, which, on the one hand, ensures the accuracy and completeness of the orders and on the other hand, saves the labor cost.

4. Strengthening Network Effect Advantage as a result



To sum up, Meituan's comprehensive life services platform enjoys the network effect and economies of scale driven by below three aspects.

- 1) Network Breadth: The platform integrates various online services to cover all aspects of life;
- 2) Network Density: The platform adds great value to all the participants in the transaction loop - including consumers, merchants, riders, etc., thus form a high-density trading network;
- 3) Network Stickiness: With the accumulation of data, Meituan's service accuracy will also be increased, which will further enhance the stickiness of users and merchants.

5. Running on track to generate profit

The most concerning issue about Meituan is that the company is still making losses. However, Meituan's strategy is to attract a large and loyal user base with high-frequency services, and then push forward some low- and medium-frequency ones like hotel and air-ticket booking services, etc. through its AI technology. As Meituan provides in-app multi-category closed-loop transaction capabilities, there is a much higher chance of converting interest- or discovery-based traffic into transactions and increase user stickiness in the same time. We believe for a temporarily loss-making company but leading in the tremendous E-commerce service market in China with a user base of around 1/3 of the population, making profit is just a matter of time. We expect in the long term, the annual gross transaction volume of Meituan platform could reach around RMB1.8 trillion. Assuming a total take rate of 16% (18% for food delivery service mostly to cover the riders' cost, 10% for in-store service and 8% for hotel booking service, respectively) and a 15% net margin, the annual net profit is expected to reach about RMB45 billion. Assuming a 25 x P/E, the estimated market value will surpass RMB1 trillion.

Bin Yuan on the Road

October 31, 2019



Invited by UNPRI (United Nations' Principles for Responsible Investment), we attended the ESG (Environmental, Social and Governance) forum held by EY in Shanghai.

- More and more financial institutions in China have realized the importance of ESG and are taking actions. As a pioneer in ESG engagement among Chinese investors, we are glad to see the investors and regulators reach a consensus over the necessity of ESG practice.

“ESG rating is getting more and more attention from Chinese investment institutions.” – An analyst from an ESG rating institution.

October 24, 2019



We visited China Food and Drinks Fair in Tianjin.

- The popularity of Moutai attracts more consumers to taste sauce flavor baijiu. In Tianjin, we found that many visitors are getting more interested in sauce flavor baijiu. Thus, we predict that the market size of sauce flavor baijiu will increase in the future, and Moutai, as the no-doubt leader in this aroma segment, will benefit most from this trend.

“The market share of sauce flavor baijiu will increase from 5% to 30% in the next ten years.” – A baijiu distributor.

October 30, 2019



We attended Aier Eye Hospital (a private hospital chain) Investor Opening Day in Shanghai and Jiaxing, Zhejiang.

- In addition to the rapid development of nearsightedness laser business, Aier's optometry business, which focuses on young users, has great potential in the future and is expected to become a new round of growth driver for the company.

“Nowadays, students are under great pressure from studying, many of them are shortsighted. We parents are very concerned about children's eye health problems, and we need professional hospitals to provide effective treatment suggestions.” – A patient's parent.

Sincerely,



Bin Yuan Capital

Specialized China Manager

- Shanghai/Hong Kong-based, value focused China manager
- Long only absolute return mindset
- \$600M+ 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%

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