

Bin Yuan Capital All China Strategy – February 2020

Performance Attribution

In February, Health Care and Industrials were the top contributors. Compared to the benchmark, Health Care outperformed while Consumer Discretionary underperformed.

At the stock level, a medical instrument manufacturer outperformed in February due to the spread of coronavirus 2019-nCoV in China. Many primary hospitals in lower cities lack medical instruments and were in urgent need of respiratory equipment from the company, like Continuous Positive Airway Pressure (CPAP) and Oxygenator. As a high-value healthcare equipment manufacturer, the company's brand has been highly recognized during the outbreak and it will continue to take market share from global leaders such as Phillips and OMRON. From a long-term point of view, the company will benefit from aging population, upgrading consumption, and increasing medical equipment investment in China by providing a rich portfolio of products with good quality-to-price ratio.

A home appliance manufacturer underperformed in February, primarily affected by the epidemic in the short term. However, the air-conditioner penetration is still low at 1 per household compared to 2.5 per household in Japan. As the leading air conditioner manufacturer in China, the company has the advantages of strong brand, better distribution channel and lower cost. The company ownership reform will also optimize corporate governance and motivate the management. It is traded at attractive valuation with only 13x PE.

Virus Outbreak Updates

With nationwide efforts, the coronavirus outbreak is under control in late February, especially outside of Wuhan City where the outbreak started. New confirmed cases in China kept dropping and are now at less than 400 in the most recent week from the peak of 15,152 on Feb. 12 (Chart 1). Outside Hubei province, the number of new confirmed cases has declined to a several cases each day (Chart 2) from the peak of 890 on Feb. 3.

Chart 1: Number of New Confirmed Cases in China

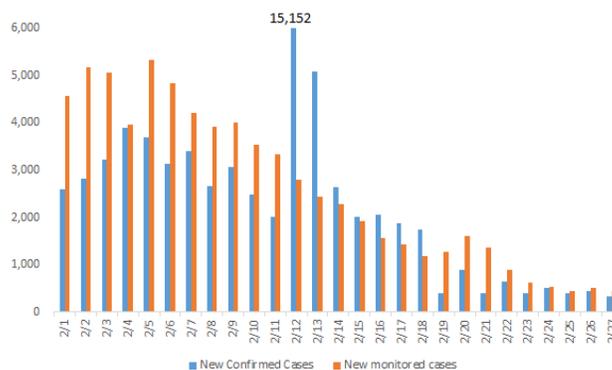
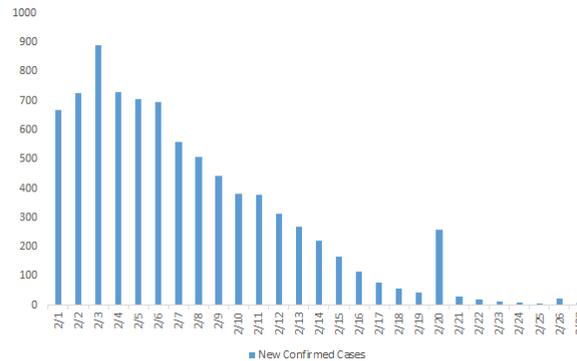


Chart 2. Number of New Confirmed Cases in China – outside Hubei Province.



However, the situation of COVID-19 transmission is getting worse in other countries including Korea, Italy and Iran, with 4,335, 1,694, 1,501 total confirmed cases by 2 March, respectively. WHO increased COVID-19 global outbreak risk from “high” to “very high”. China is taking measures to quarantine inbound travelers from those high-risk countries.

Chinese government has recently shifted its focus on restoring the economy. Five provinces include Inner Mongolia, Xinjiang, Sichuan, Jilin and Hainan province have lowered their emergency alert levels as the number of the new cases has decreased. In the first half of February, enterprises in key fields such as medical, energy, grain, transportation and logistics resumed operation. According to China Unicom big data statistics, as of February 23, 2020, nearly 70% people have returned to their regular resident places. More than 70% of the large enterprises are back to normal operations. The rate for small and medium enterprises is still low at 30%.

Government Supporting Measures

The Chinese government has used both monetary and fiscal tools to provide liquidity to the economy to support the most vulnerable sectors such as smaller enterprises. The supportive measures include lowering reserve ratios, requesting banks to postpone debt payment charges for those that impacted by the event, encouraging banks to lend with favorable rates, exempting toll road charges, and delaying and exempting tax and social security fees for impacted industries and enterprises...etc. These measures have helped to boost investors’ confidence.

Looking further out, the most positive result we see from this outbreak is that the central government will launch a series of reforms. These reforms include improving the efficiency of government functions and promoting private sectors as the private sector has provided more effective support to deal with the event during the outbreak than the public sector. For the year 2020, the government have the following cards to play to resume economic growth.

- Re-distribute profits from the treasury, banks and State-Owned Enterprise (SOE) to private enterprises. The interest rate cut of 50 bps could help to relieve the interest burden by 1 trillion RMB. The balance sheets of SOEs have been largely improved in the past de-leveraging campaign, which reserved room for this redistribution.
- Reform Capital Market to allocate capital more efficiently. A special purpose Bond with incremental 1 trillion RMB will be issued to support the economy, which could drive GDP by more than 1%. Market driven equity financing will be favorable to SMEs. We expect 1 trillion RMB placements to issue potentially in the A share market to fund growth of listed companies. Chinese households have 100 trillion RMB in deposits and 50-60 trillion RMB in securities investments. The potential of increasing allocation to financial assets is huge.

Portfolio Impact

The coronavirus has penetrated to countries outside of China, which has changed our risk perspective compared to a month ago. The slow responses by most of the leadership in those countries did not help to reduce the worries on the global economy. There is no transparency how the situation will be evolving, but if China case is a lesson learned, slacking on dealing with the virus may significantly increase the risk of global economy.

If the coronavirus is continually getting worse outside of China, the cycle of this outbreak will last longer and thus it will negatively impact the global supply chain. China may become the first country to get out of this mud. Domestic economy will still be our investment focus. Less than 7% of sales in our portfolio are generated outside of China.

The companies in our portfolio have recovered operation to 83% of normal level on average. For example, Yuyue Medical production lines are working at 90% utilization rate. Online service companies are the first to achieve full operation. Manufacturing warehouses outside Hubei province have returned to normal operation as well. Business with more close people to people contact is recovering slower like Meituan and Huazhu.

The portfolio holds roughly 30% in healthcare, entertainment and personal care which are the top 3 beneficiaries during the outbreak. We have a 4.5% weight in the worst impacted sectors, airport, catering and hotels. The balance of 60% of holdings are negatively affected to a greater or lesser extent in the first quarter. Weighted average revenue and earnings growth estimates of our holdings have been lowered from 19% to 16% and from 20% to 12% respectively in the first quarter. Due to the low season nature, and recovered demand in the following months, we expect the impact on the full year revenue and earnings growth will be less significant, from 20% to 19% and from 21% to 17% respectively. Healthcare and Information Technology space remain as the key areas of investment. Most of our consumption, logistics and technology holdings will benefit from the industry consolidation after the event in the long term.

We added AIER eye hospital in February on weakness as we believe its offline service demand is just delayed not disappeared. In China, excessive use of eyes leads to various eye diseases, boosting the demand for ophthalmic services. As the largest private eye hospital chain company in China, AIER should benefit from the sustained high growth of the industry due to its core competitiveness of well-known brand and a large talent pool with attractive incentive scheme.

For detailed analysis, please refer to the appendix.

Bin Yuan Operation Updates

Everyone and their families at Bin Yuan are healthy and safe. Bin Yuan team is currently working from home according to “Bin Yuan Business Continuity Plan”. Our policy only allows people to return to office after consecutive 14 days without new confirmed cases in Shanghai.

Senior management would highlight below key points to ensure smooth operation during remote office period:

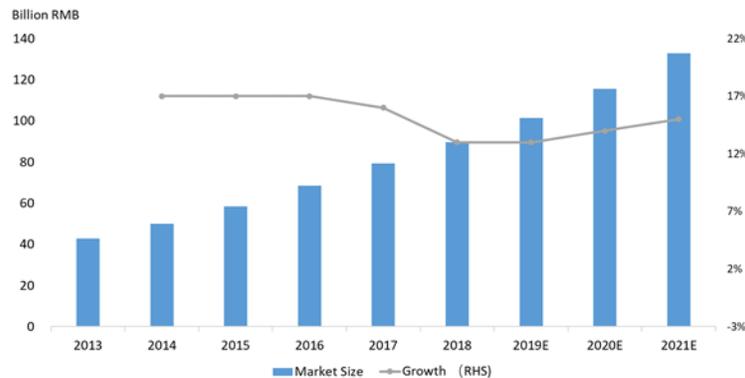
1. IT infrastructure including email, server, firewall and VPN...etc. operate normally.
2. Trading system, order management system and performance management system function well.
3. Daily verbal communication mechanism is in place for all the staff.

Everything remains normal except no face to face meetings. Email box works well for documentation. Research team has at least two Wechat calls every day to communicate internally, and we have conducted 63 conference calls with listed companies and other contacts for cross check and monitoring purpose during the outbreak period. All the trading, risk control, operation systems, VPN and servers function normally without any disruption. Bin Yuan traders locate in Hong Kong office so there should be no issues on trading activities.

APPENDIX AIER EYE HOSPITAL

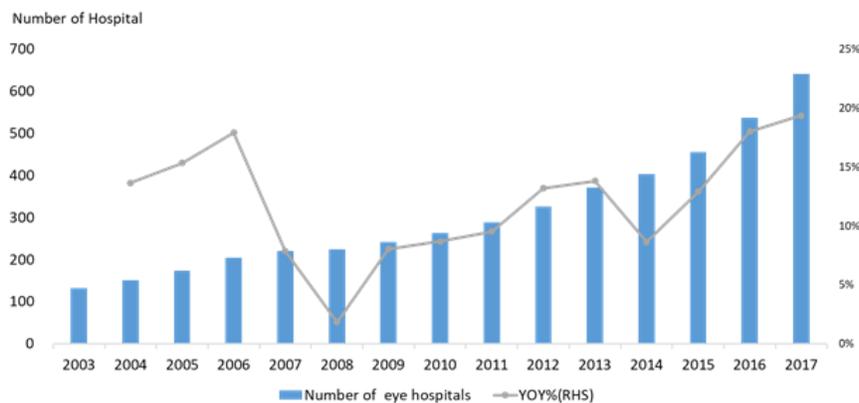
In China, excessive use of eyes leads to various eye diseases, boosting the demand for ophthalmic services. The market size of ophthalmology in China surged from RMB43 billion in 2013 to RMB101 billion in 2019 (Chart 1), growing at a compound annual growth rate (CAGR) of 15%. Eye hospitals numbered 371 in 2013; while in 2017 it was 641. (Chart 2).

Chart 1: Market Size of Ophthalmology in China



Source: Wind, Bin Yuan Capital

Chart 2: The Number of Eye Hospitals in China



Source: China Health Statistics Yearbook, Bin Yuan Capital

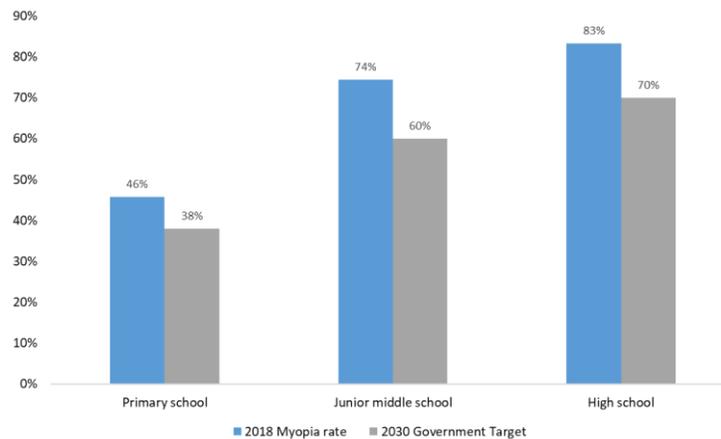
Core Drivers

Although the industry is much larger than before, it still has enough room to grow given the huge population and high incidence rate in China. The ophthalmology market will continue to be driven by the following factors:

➤ **Increasing Needs of Eye Care in All Age Groups in China**

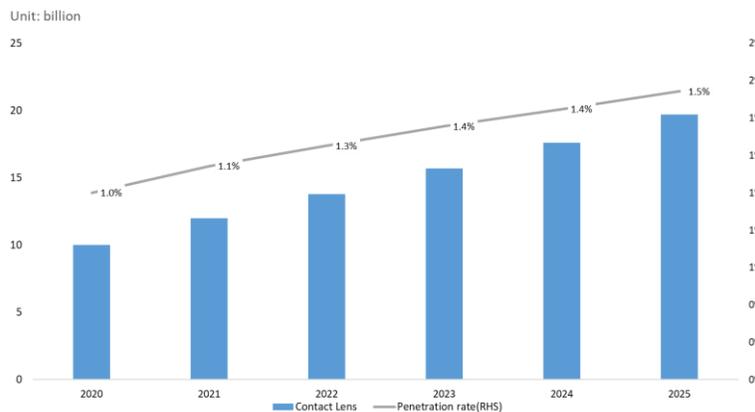
1. **Children - Optometry Service**, due to the ultra-competitive education system and the over-use of the electronic products, the school-aged children’s myopia incidence rate in different grades has reached 46%, 74% and 83% respectively (Chart 3). Parents are trying to prevent children’s myopia by taking measures such as OK lens (Ortho-K contact lens). The current penetration of OK lens is less than 1% and they have much room for growth in future. (Chart 4).

Chart 3: The Myopia Rate in Different Education Grades & 2030 Controlling Target in China



Source: China Health Statistics Yearbook, Bin Yuan Capital

Chart 4: The Forecast of Contact Lens (OK lens) Market 2020-2025

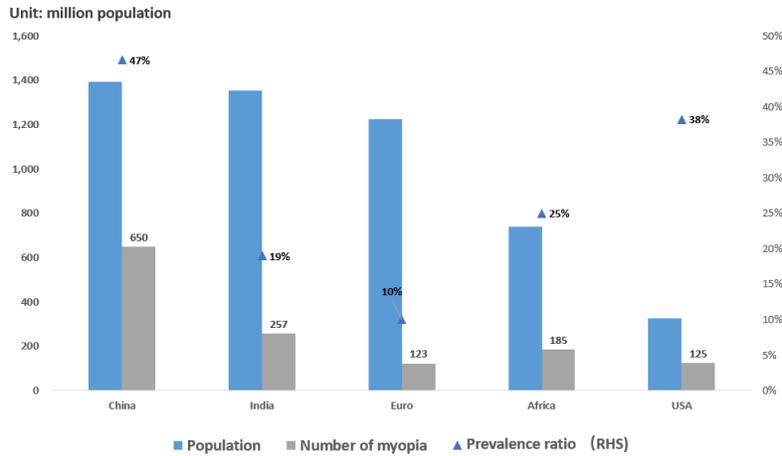


Source: AIER Annual Report, Bin Yuan Capital

2. **Adults - Laser Surgery**, by 2020, the number of adult myopia patients is expected to reach 700 million in China, with a prevalence rate of nearly 50% (Chart 5). As the laser surgery remains the most effective way to correct myopia, we believe it will be accepted by more people. The surgery

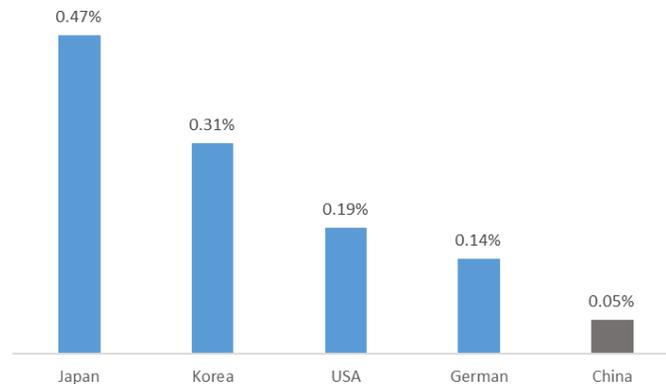
penetration rate in China is only 0.05%, with at least 4-10 times room to increase compared to developed countries. (Chart 6).

Chart 5: Global Prevalence of Myopia



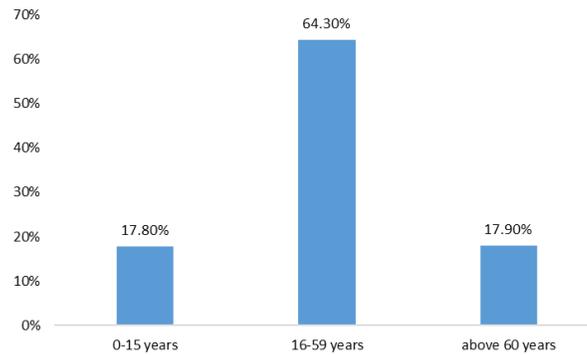
Source: World Health Organization, Bin Yuan Capital

Chart 6: Femto Surgical penetration rate

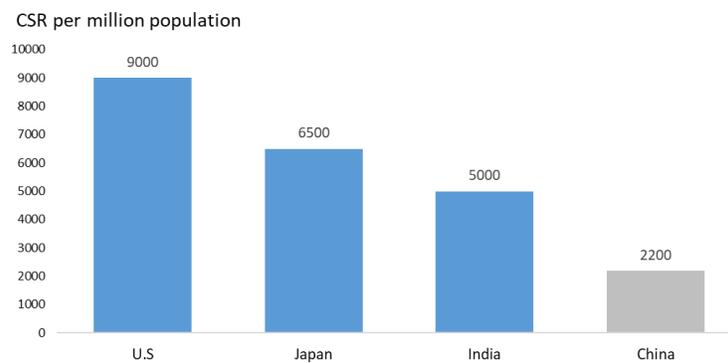


Source: World Health Organization, Bin Yuan Capital

3. Aged people – Eye Disease Treatment, the proportion of the population over 60 years old reached 17% in 2018 (Chart 7). As a result, the demand for medical care for senile eye diseases such as cataracts, presbyopia, retinopathy will increase rapidly. Cataracts, for instance, the CSR (cataract surgery rate) per million people in China was only 2,200 in 2018, much lower than in developed countries and in developing countries like India (Chart 8). Assuming the same CSR as in India, the potential market size of CSR in China will reach RMB42 billion.

Chart 7: Age Structure of Chinese Population in 2018


Source: Wind, Bin Yuan Capital

Chart 8: CSR (cataract surgery rate) per Million People


Source: Investigative Ophthalmology & Visual Science, Bin Yuan Capital

Combining the three factors above, the ophthalmic market is illustrated as follows with 510bn market size potentially in the long term (Table 1).

Table 1: Summary of All Age Groups Demand & Market Size

Age Group	Major Demand	Major Disease	Population Base (million)	2019 Market Size (bn RMB)	Last 3 Years Growth	Penetration China vs Global (per million population)	Potential Market Size (bn RMB)
5-19	Optometry Service	Myopia, Hyperopia, Amblyopia	223	12	20%	0.05% vs 4.7% ≈ 10x	120
19-50	Laser Eye Surgery	Myopia, Dry Eye	654	25	19%	0.5‰ vs 3‰ ≈ 6x	150
50+	Eye Disease Treatment	Cataracts, Presbyopia, Retinopathy	431	60	8%	0.015‰ vs 0.05‰ ≈ 4x	240
Total				97			510

Source: AIER 2018 Annual Report, Bin Yuan Capital

➤ **Continuous Upgrading of Medical Treatment**

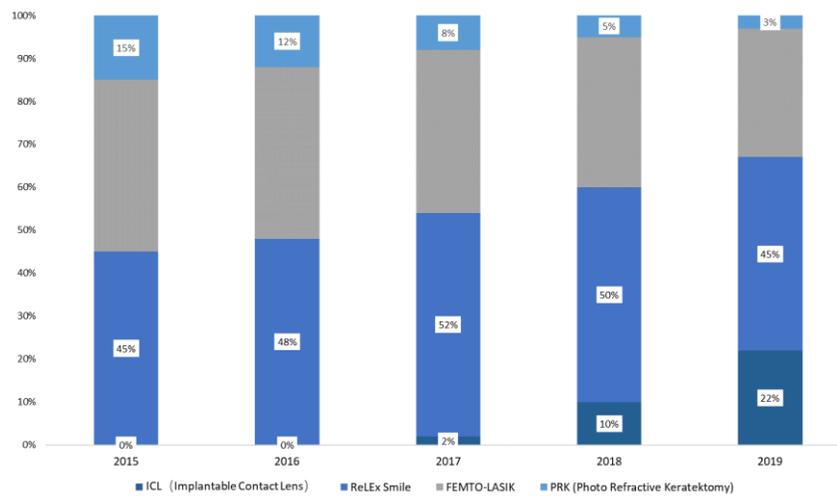
With the continuous upgrading of medical technology and equipment, the treatment effect has been improving continuously. So is the treatment fee (Table 2 and Chart 9). Therefore, the selling price hike will also contribute to the increase of the market (Chart 10).

Table 2: Comparison between different types of eye disease surgeries

Classification of Diseases	Item	Average Selling Price (RMB)
Laser Eye Surgery	PRK (Photo Refractive Keratektomy)	7,800
	FEMTO-LASIK	14,000
	ReLEx Smile	20,000
	ICL (Implantable Contact Lens)	30,000-34,000
Cataract	Traditional Cataract Surgery	3050-10,080
	FEMTO-LASIK Cataract	10,000-18,000
	FEMTO-LASIK + Lens (Customized)	18,000-25,000

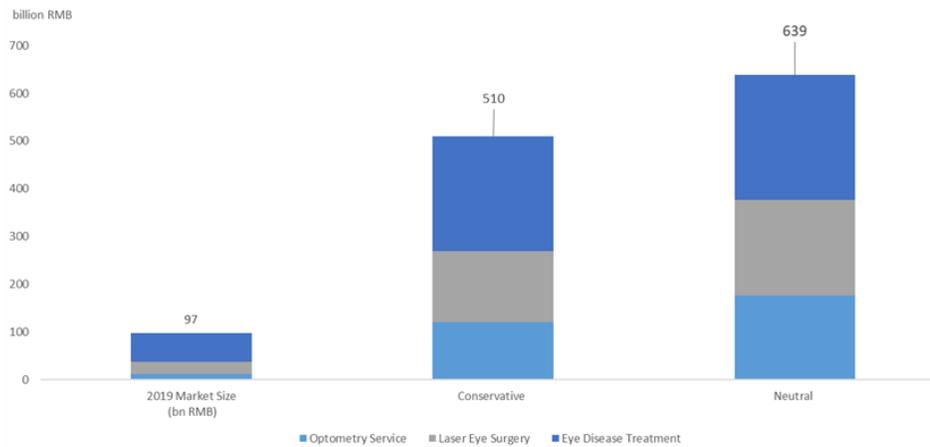
Source: AIER 2018 Annual Report, Bin Yuan Capital

Chart 9: AIER's Laser Eye Surgery Breakdown by Surgery Type



Source: AIER 2018 Annual Report, Wind, Bin Yuan Capital

Chart 10: Market Size of Ophthalmology Market Based on Different Price Assumptions



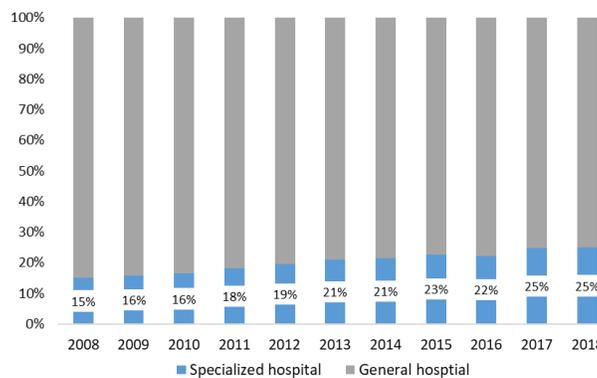
*Conservative: Without price hike Neutral: With price hike of 25% compared with 2019

Source: AIER 2018 Annual Report, Wind, Bin Yuan Capital

➤ **From General to Specialized & Public to Private**

Compared to general hospitals, usually, ophthalmic specialized hospitals are able to provide more advanced equipment and more qualified professionals with superior services. In the past 10 years, the market share of ophthalmic specialized hospital grew from 15% to 25% (Chart 11).

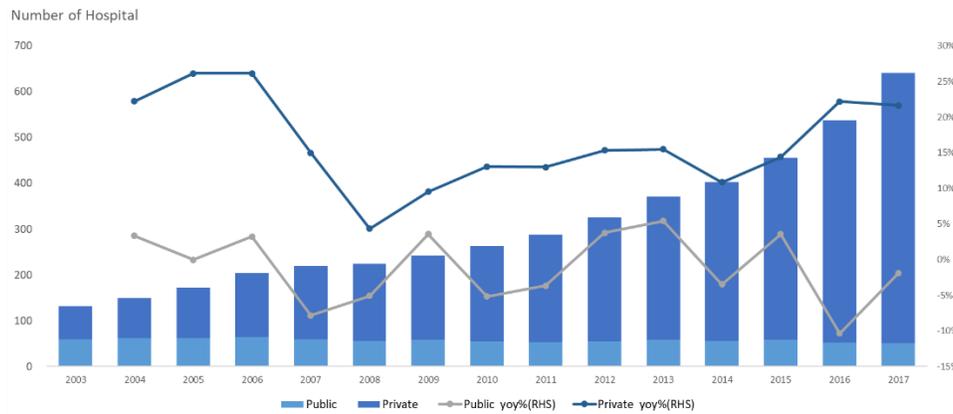
Chart 11: Ophthalmic Market by Hospital Nature



Source: Wind, Bin Yuan Capital

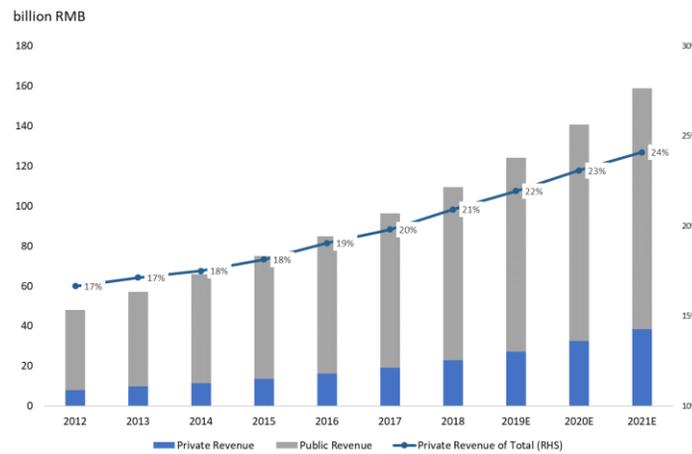
In China, specialized hospitals are further divided into two categories: public and private. Private hospitals have more flexibility and are motivated to expand (Chart 12 and Chart 13).

Chart 12: Number of Ophthalmic Hospitals: Public vs Private 2003-2017



Source: Wind, Bin Yuan Capital

Chart 13: Sales of Ophthalmic Hospitals Comparison Public vs Private 2012-2021E



Source: Wind, Bin Yuan Capital

Who Will Benefit

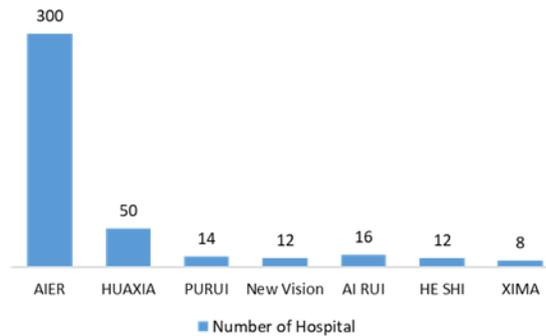
As the largest private eye hospital chain company in China, AIER should benefit from the sustained high growth of the industry due to the following core competitiveness.

➤ **First-mover advantage with a well-known brand:**

Through 16 years of development, AIER has a network of over 300 ophthalmic hospitals across 23 provinces in China, accounting for around 50% of the number of private eye hospitals in China (Chart 14). After completing 1.7 million laser eye surgeries and 1.5 million cataract surgeries since

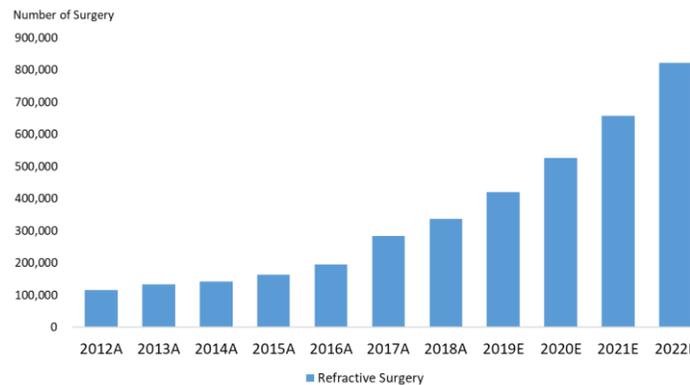
its establishment, AIER has accumulated unparalleled experience and prestigious reputation for good track records (Chart 15).

Chart 14: Domestic Chain Ophthalmology Hospital Comparison



Source: Wind, Bin Yuan Capital

Chart 15: Number of Refractive Surgery 2012-2022E



Source: AIER 2018 Annual Report, Bin Yuan Capital

➤ **A large talent pool and well incentive scheme**

AIER has a team of over 4,000 ophthalmologists, accounting for approximately 11% of eye doctors in China. This has laid a good foundation for its further development. As a listed company, AIER has diversified methods to retain talents, for instance, salary, stock option plan, etc.

Conclusion

Driven by the aging trend and increasing incidence rate of myopia patients, the ophthalmic market will keep growing at a rapid pace. Meanwhile, AIER will benefit from the fast industry growth by leveraging its unparalleled experience accumulation and brand image.

Note: "Bin Yuan on the Road" Section will be suspended for 1-2 months due to outbreak of the virus. We continue to call our contacts extensively and watch for the development online.

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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