

Bin Yuan Capital All China Strategy – April 2020

Performance Attribution

In April of 2020, Consumer Discretionary and Communication Services sectors were the top contributors. Compared to the benchmark, Consumer Discretionary outperformed while Consumer Staples underperformed.

At the stock level, a comics and games platform outperformed in April. Because of Covid-19, the demand for home entertainment rose rapidly. The company's monthly active users and user usage time have reached new highs, and new content such as online education has been launched. The company is an emerging video platform with more than 150 million monthly active users, 75% are under 24 years old, and the user retention rate remains above 80%, the daily video playback exceeds 100 million. Since this year, thanks to the New Year's Eve Gala, online education service and youth festival promotional video, the platform has gained national attention three times, and its high-quality content has been able to reach more people. The platform has now been regarded as a representative of the young Chinese group, we believe it will continue to be the favorite community among young people in China.

A funeral service company underperformed in April. Although the company's short-term performance is lower than expected, we still believe that the company has long-term investment value. The company's main business is funeral service which is a rigid demand. On the one hand, we believe that with the increase in number of aged people, the demand for funeral services will continue to grow. On the other hand, the market has started to expand to value-added services such as valet tomb-sweeping services, which will improve the company's profit margin. China's funeral industry is very fragmented, and the company is

constantly gaining market share through excellent management and sufficient capital.

Market Comments

The Shanghai Composite Index was up 3.99% and the Hang Seng China Enterprise Index was up 4.65% in April driven by the recovery of economic activities in China and the slow-down of new Coronavirus cases growth globally. The Manufacturing Purchasing Managers' Index (PMI) decreased from 52.0 in March to 50.8 in April and the Non-Manufacturing PMI rose from 52.3 in March to 53.3 in April, both were kept above the threshold of 50.

The epidemic is now under control in China. Coming into April, most new cases are from travelers coming from abroad. Domestic cases are very few (less than 20 in total in April) and all are close contacts of new diagnosed travelers.

The Chinese government are making efforts to restore economy activities. The financial support to small and medium enterprises that were negatively impacted by the epidemic and weak global demand, will serve as an important measure to tackle the issue of unemployment if there is any. Chinese cities have also cooperated with several enterprises to distribute vouchers, which will help to stimulate consumption demands for physical goods and services.

More than 80% of companies have resumed work, showing the strong resilience of the Chinese economy. From our local observations; ecommerce, offline services of resilient demand, and construction of both property and infrastructure, have recovered to normal level. The whole online shopping industry rebounded rapidly, and the number of express packages in March recorded a year-on-year (YoY) growth of 23%. Schools, including high schools and primary schools, started to open for the new semester in many provinces, and

offline training institutions, like TAL, have gradually resumed operations. The ophthalmology industry is also in the process of rapid recovery. The outpatient numbers of AIER eye hospital has climbed to the same level of last year in April. Property contracted sales of the top 100 real estate companies in China had a 0.6% YoY growth in April, picking up from -17% in March and -38% in February. The recovery is even more obvious in tier 1 cities; contracted sales of tier 1 cities in April recorded a 37% MoM growth. The real estate completion rate has also accelerated, the completed area space decreased slightly by 0.9% YoY in March and is expected to increase by around 10% by the end of 2020, which is good news for the home consumption industries. As of March 19th, 85% of the RMB1 trillion of special bonds issued were invested in infrastructure, which has driven the incremental demand of cement and construction machinery. New infrastructure investment such as 5G and cloud construction plans picked up quickly and the visibility of orders of ferrule, optical modules, and IT services are high.

Supply chain that are partially reliant on global vendors might be exposed to disruption risks if work resumption of global manufacturing is slower than expected in the second quarter, which will drive the progress of import substitution. Most of the consumption and service sectors are not affected, but the technology and auto industries, which are part of the global supply chain may suffer from disruption for the time being. For example, although the localization rate of China's automobiles has reached 95%, the balance still has to rely on overseas suppliers. Domestic players in the household healthcare equipment, semiconductors, and electronics components sectors will face vast opportunities to substitute foreign players. Domestic logistics providers are gaining market share of international businesses from foreign competitors as their services are suspended during the epidemic.

A total of 3,833 companies listed on the Shanghai and Shenzhen stock exchanges completed releasing their 2019 annual results and the first-quarter results of 2020 by the end of April. Due to the impact of the outbreak, the year-on-year (YoY) revenue growth of A-share listed companies decreased from 9.5% in 2019 to -7.9% in Q1 2020, while the YoY net profit growth decreased from 7.7% in 2019 to -24.4% in Q1 2020. Our holdings' YoY revenue growth decreased from 25% in 2019 to 4% in Q1 2020 and YoY net profit growth was down from 25% in 2019 to 12% in Q1 2020. Both were far above the universe averages.

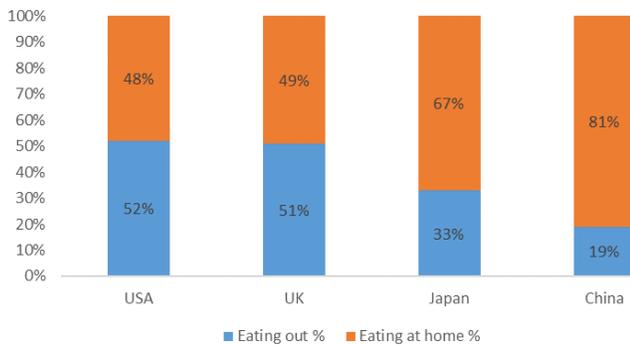
Our portfolio provided downside protection in the market downturn. In January, when the virus spread very rapidly in China, we believed there was a high risk that economic activities would slow down sharply, and the transparency of the situation was very low. We believed that the priority at that time was to safeguard our clients' financial assets. We spent most of our time, before the end of January and the lock down of Wuhan City, on balance sheet and cash flow analysis on our holdings to make sure that if the situation got worse, they still could survive, not go bust. Profit (P) and Loss was relatively less relevant as P at the time was very uncertain. As a result, daily life which needed staples and relevant medical equipment were the best sectors to be in, and we were benefited from allocating to those stocks. Starting from the end of March, the COVID-19 situation was improving in China, and we started to allocate to companies where stock prices have corrected, and where P will recover and get back to normal both in the short and long term. Catering related staples, healthcare services, online ecommerce and services, new urban investment related including healthcare investment and cloud/telecom investment, duty free and affordable auto will grow faster with higher certainty (one example of opportunities in the condiment industry will be discussed in the later). The long-term story in

China is still domestic consumption and technology that can replace foreign vendors.

Example of Long-Term Opportunities - China's Condiment

China is one of the countries that is famous for its cuisines, and Chinese condiments definitely play an important role in that reputation. As condiments are basic necessities and only account for a small part of the daily expenditure for a family, people will not cut their condiment budget regardless of their financial situations. The demand will be very stable in the long term and the relevant stock usually enjoys consistent growth, solid dividends and low volatility. Due to the fast-paced life in cities, the dining-out and food delivery ratio keeps increasing but is still at a low level compared to developed countries (Chart 1). Compared to home cooking, restaurants of course consume more condiments. Although the condiment industry seems to be a very traditional one, it is still expected to grow the fastest in China at a compound annual growth rate (CAGR) of 7% in the next five years, compared to around 5% growth of other sub-sectors in food and beverage, such as dairy, instant noodles, and soft drinks.

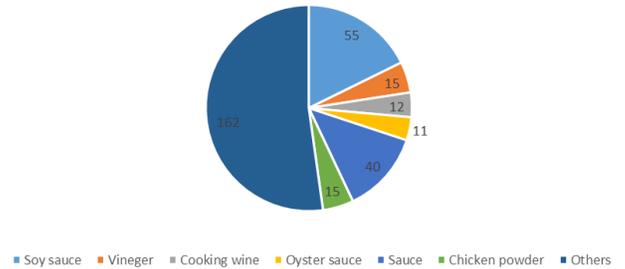
Chart 1: Eating-out Ratio



Source: Bin Yuan Estimate, Morgan Stanley

Besides long-lived items such soy sauce, vinegar, chicken essence, etc.; new form of condiments like oyster sauces, and Chinese compound sauces also emerged in recent years. The total market size reaches RMB310 billion (Chart 2), which is a big market being comprised of a number of fragmented sub-categories.

Chart 2: Segments of Condiment (Bn)

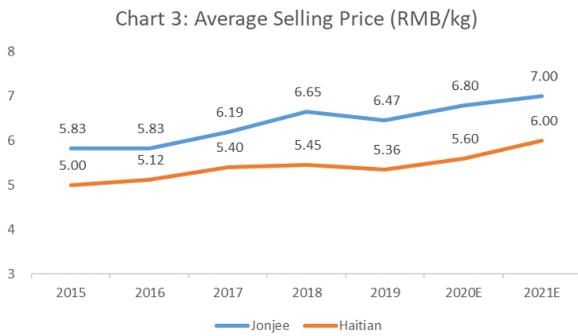


Source: Bin Yuan Estimate, Zhao Shang Securities

We believe the leaders in this industry will continue to benefit in the following ways:

Product Premiumization

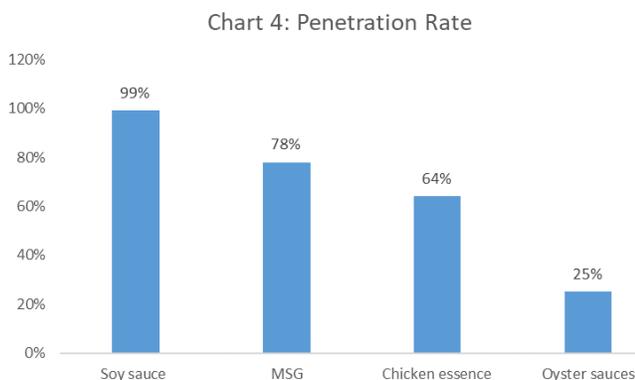
Consistent with the general consumption upgrade trend, Chinese consumers now prefer branded products with high quality in condiments. For example, Tou Dao soy sauce with higher amino acid by using yeast instead of MSG (Monosodium glutamate) are quite welcomed. So is the case of organic soy sauces. As a result, the mix of high:mid:low-end of soy source products improved from 1:6:3 to 4:5:1 during the past several years. This trend can also be evidenced by the average price hikes of products of top players like Haitian and Joyjee (Chart 3)



Source: Bin Yuan Estimate, Morgan Stanley

Category Expansion

New condiments such as oyster sauce, compound sauces and hot pot soup base, etc., which people could not afford in the past, have emerged to save time and improve the flavor. The compound sauces and hot pot soup base are still at their early stages of development, while the oyster sauce's fast penetration from 15% to 25% in the past six years has already set a good example for them (Chart 4). As all the condiments sell through similar channels, it is relatively easy for leaders to cross-sell new products in other sub-sectors by leveraging its current channels and brands.

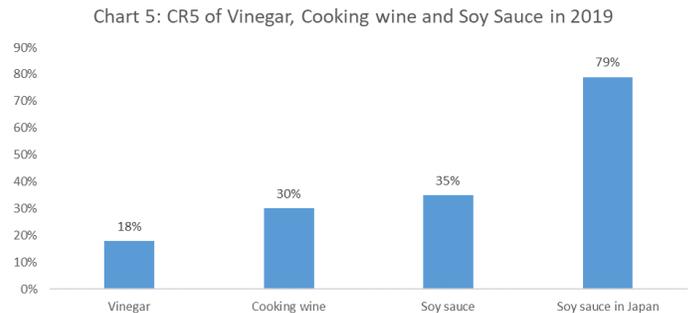


Source: Bin Yuan Estimate, Morgan Stanley

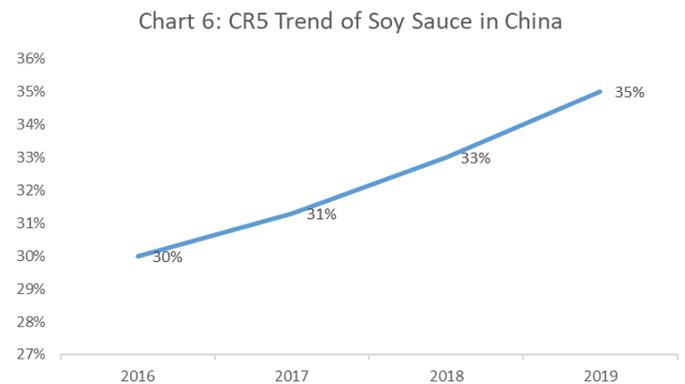
Accelerated Consolidation

China's condiment market is still highly fragmented, for instance the CR5 of soy sauce is only 35% in 2018, compared to around 79% in Japan (Chart 5). However,

with advantages in brand, product, economies of scale and distribution channels, the leading companies have consistently taken market share in the past few years (Chart 6). We expect that this trend will be a long-term growth driver for top companies in the industry.



Source: Bin Yuan Estimate, CICC



Source: Bin Yuan Estimate

Who do We Like the Best in the condiment industry?

We believe companies with the following traits will win in the long term:

- (a) Strong brands
- (b) A good portfolio of products
- (c) Extensive channels
- (d) Motivated management

While Haitian has been perceived as an established leading company, we see Jonjee and Yihai have greater potential.

Jonjee

Unlike Haitian, who has a large exposure to mass market products, Jonjee's brand "Chubang", as one of the most famous brands in China's soy sauce market, is positioned in the premium sector with over 5% market share in 2019. Currently, Jonjee's focus is in south China and east China and it is executing a national expansion plan. Compared to Haitian's circa 5800 distributors, Jonjee's around 1,000 distributors leave plenty of room to grow. In addition, Jonjee also starts to explore the catering channel, which represents almost 50% of the market size. Jonjee will further increase its sales volume and catch up Haitian in its scales advantage.



Yihai

Yihai is a compound sauce manufacturer which has integrated R&D, manufacturing, marketing and service.

On the one hand, Yihai supplies hot pot soup base to Haidilao, which will benefit from the fast development of Haidilao's restaurants. On the other hand, under the famous brand of Haidilao, Yihai enjoys a strong premium brand perception in retail channels among consumers, which saves the company a large amount of marketing effort. And just like Haidilao, Yihai is also very innovative in motivating its employees by adopting a unique profit-sharing scheme to incentivize channel expansion and new product innovation. By leveraging its brand, distribution channels and strong R&D capability, Yihai will keep increasing SKUs through developing new categories such as self-serve hot pot meals, instant bean noodles and other leisure snacks.



Sincerely,



Bin Yuan on the Road



April 30, 2020

One of our analysts visited Sanya Haitang Bay Duty-Free Store.

- Sanya Haitang Bay duty-free store has recovered 50% of customer flow. Retail stores has set traffic limits and customers are still very eager to do shopping there. The duty-free business in Hainan will continue to drive the growth of China International Travel Service

“Due to the epidemic, we choose to visit Hainan island instead of traveling abroad. It is very convenient that we can buy duty-free products in Hainan.” – A customer.



April 27, 2020

Bilibili posted the download link of its new mobile game on Bilibili headquarter building.

- Bilibili’s new game stayed at the top of app store list for a week after its release. As a key project, Bilibili also increased its publicity efforts on the new game, turning the office building into a download QR code.

“The huge QR code brings out my curiosity and makes me want to scan it.” – A passenger.

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