

## Bin Yuan Capital All China Strategy – July 2020

### Performance Attribution

In July 2020, Consumer Discretionary and Consumer Staples were the top contributors. Compared to the benchmark, Consumer Discretionary outperformed while Health Care underperformed.

At the stock level, a duty-free goods retailer outperformed in July, still driven by a series of duty-free policies in Hainan released in June, including removal of single purchase limit, expansion of product categories and no volume limit for most products. These stronger than expected policies will significantly increase the consumption cap of travelers to Hainan. The high sales growth in Hainan in June and July also contributed to market's confidence. In the long term, as the leading duty-free shop operator in China with dominant supply chain advantages, the most dynamic and efficient operations team and the large exposure in Hainan Province, the company will continue to benefit from the trend of the overseas consumption flowing back and the consumption upgrade in China.

A comics and games platform underperformed due to the profit-taking effect. In the long run, the Internet has entered the video age and a video community with social attributes becomes very attractive. The company is a video platform with a large number of Generation Z users (youngsters) with strong stickiness. Because Internet companies have extremely strong expansion capabilities, we believe that as the best video platform, the company can provide services that are more than just watching videos. It will become a lifestyle community for young people.

### Market Comments

China's economy rebounded in the second quarter with GDP growth of 3.2% YoY. PMI increased slightly from 50.8 in April to 50.9 in June, and non-manufacturing PMI increased from 53.2 in April to 54.4

in June. Since March, as work and production have gradually resumed, net export of goods and services have rebounded, and the decline of domestic demand has narrowed.

China took over the premises of the US consulate in Chengdu on July 27, in retaliation for the closing of the Chinese consulate in Houston on July 24. We do not expect the tension between China and US to be reversed in the near term. The Chinese government will continue to keep an open stance and focus on the domestic demand. Fiscal policies will remain expansive by cutting taxes on Small and Median Enterprises and individuals to alleviate the COVID impact, stabilize employment and boost consumption. Policies in favor of foreign investment will be issued, and imports will be actively boosted. A variety of innovative policies are on the way to stimulate consumption, such as selling foreign trade goods in domestic markets, opening duty-free stores in cities, and replacing public transportation vehicles with new energy vehicles.

Recently, a batch of domestic new economy digitalization companies, such as Ant Financial, SMIC (Semiconductor Manufacturing International Corporation) and Cambricon, have been or plan to be listed on the China A share market. Those new economy companies represent the new development direction of China's economy, and the listings shows the effectiveness of China's market-oriented reforms. China capital markets have acted as an important channel and tool for capital allocation. The expansion of financing channels can effectively help enterprises obtain more efficient financing and seek faster development. High quality listed companies generate higher returns to investors in the long run and attract more long-term money to participate in the Chinese market, making it a virtuous circle. With a prosperous stock market, share based payments have also become an important means of employee motivation,

which further realizes human capital value. In all, we expect China's capital markets will continue to strengthen supervision and protect the interests of minority shareholders, so as to achieve an all-win situation for companies, management, employees and investors.

### *Bin Yuan Opinion*

#### **Value Proposition and Investment Opportunities – Sophisticated Manufacturing**

The miniaturization trend of electronics products is changing peoples' lifestyle with increased convenience and portability. Nowadays, if you travel with a smartphone, you can make phone calls, take pictures very close in quality to a professional camera, and post online after editing like using desktop software.

Miniaturized components are essential for miniaturized electronic products and making components smaller is not an easy job. The manufacturing system needs to be restructured, which requires a higher standard of precision, integration and automation, namely “Sophisticated Manufacturing Service”. China has accumulated advanced know how and skilled engineers to be able to accomplish this transformation from traditional Electronics Manufacturing Service (EMS) to the sophisticated manufacturing, which is one of the most important investment opportunities we have revealed.

#### **Drivers of Sophisticated Manufacturing**

The miniaturization, trends of wireless mobile communication and vigorous development of Internet of Things (IoT) are important driving forces for sophisticated manufacturing.

Sophisticated manufacturing allows people to reduce the size of electronic products and components to increase convenience and portability. Traditional digital cameras usually require a scale of more than 10 centimeters to achieve the autofocus function, while sophisticated manufacturing allows component suppliers to manufacture and assemble smaller camera modules within 1 centimeter.

Picture 1&2: Sophisticated manufacturing reduces the size of a complex camera and put it into a smartphone.



Source: OPPO, Canon, Bin Yuan Capital

Increasing popularity of wireless functions and booming of IoT products with communication modules increases the demand of sophisticated manufacturing for integration. Cables or other connectors used to play an important role in transmitting power and data, but with the development of wireless technology and miniaturization, components that perform communication functions can be integrated into the small size electronic products such as IoT. For example,

Airpods have successfully removed the need for cables with an H1 chip. Communication modules are now well integrated in shared bicycles and watches. Some IoT products such as AR glasses or smart locks need to fetch data which requires the integration of more sensors.

Picture 3&4: Wearables like Airpods and Jawbone already have a high degree of integration.



Source: iFixit, Bin Yuan Capital

**Sophisticated Manufacturing Service Replacing Traditional EMS**

Being required to upgrade to a more precise micron scale manufacturing process, or even nanometer scale in the future, Sophisticated Manufacturing Service is taking the place of traditional millimeter scale Electronics Manufacturing Service (EMS):

Picture 5: Traditional EMS is unable to meet micron-scale requirements.

Process	Scale	Company	Process	Scale	Company
Semiconductor Manufacturing	Nanometer	TSMC	Semiconductor Manufacturing	Nanometer	TSMC
Semiconductor Packaging	Micron	ASE	Semiconductor Packaging	Micron	ASE
Electronics Manufacturing Service	Millimeter	Foxconn	Sophisticated Manufacturing Service	Micron	Luxshare

Manufacturing Process

Source: Bin Yuan Capital

Some specific technologies that fall into the category of Sophisticated Manufacturing have enjoyed rapid development. For example, System in a Package (SiP) technology is growing at a CAGR of more than 40% and becoming popular in the electronics manufacturing industry including the Apple supply chain. As a combination of semiconductor packaging and surface mounting technology (SMT), SiP technology has been applied to the assembly of Airpods Pro, reducing its size by more than 40%. These new technologies set higher standards for comprehensive production management and customer centric service rather than counting on the cost of labor resources.

China has accumulated advanced know how and skilled engineers to be able to accomplish the transformation from traditional EMS to the Sophisticated Manufacturing. Although low end EMS companies may choose to move to other South East Asian countries due to labor cost considerations, China’s sophisticated manufacturing service industry will deliver very strong growth over the next decade.

**Investment Implications**

Electronics companies who can actively embrace with sophisticated manufacturing will ride the wave for a long sustainable period. Luxshare is the SMT supplier of Airpods and will also be the SiP supplier of Apple

Watch. It keeps developing advanced equipment and improving production management to expand its platform. By responding to Apple's latest demands on electronics manufacturing, Luxshare has accumulated the most advanced know how on sophisticated manufacturing and has become the best electronics manufacturing platform in mainland China. As the penetration of sophisticated manufacturing service increases, Luxshare will benefit from this trend. The traditional EMS industry has a market size of US\$400 billion, and sophisticated manufacturing service will occupy the market with a higher profit margin.

As consumers, we expect to enjoy a better life through more miniaturized electronic products. As investors, of course, we should not miss this opportunity.

Sincerely,



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## Bin Yuan on the Road



July 14, 2020

**We visited Piano's (a customized furniture manufacturer) warehouse and display center in Zhongshan city, Guangdong Province and had a meeting with company's president Mr. Ma.**

- Piano is the largest customized kitchen cabinet supplier to real estate developers. As sound, dust and waste generated during home furnishing becoming more and more a concern to urban residents, the Chinese government is actively pushing developers to furnish apartments, thus to reduce pollution and increase efficiency. Piano has been in the developer channel for 4 years and is the largest beneficiary in this trend.

*"Sales to developers is expected to exceed retail and accounts for 60-70% of Piano's total revenue in 3 years."* – President Mr. Ma.



July 15, 2020

**We visited Changhong's (a medical consumable company) manufacturing warehouse in Shenzhen city, Guangdong Province.**

- Changhong is a leading domestic ODM manufacturer which supplies high-end medical plastic consumables, and focuses on IVD (In Vitro Diagnostic), Genetic Sequencing, Assisted Reproduction areas. Due to the outbreak of COVID-2019, global medical leaders are starting to shift their supply chain from overseas to China, and Changhong will continue to benefit from this trend.

*"We can help clients shorten the project development cycle by 2/3, while our prices are only a quarter of those of overseas companies."* – Mr. Li, Chairman of Changhong.



July 17, 2020

**We visited the site of Baili Engineering Sci&Tech (a lithium battery company) "Dangsheng Cathode Material Project" in Changzhou City, Jiangsu Province.**

- Baili Engineering Sci&Tech is a company engaged in EPC (Engineering Procurement Construction) business of lithium battery materials. With the rapid development of new energy vehicles, the capacity of lithium batteries and corresponding upstream materials is expanding rapidly. High efficiency and high-quality EPC service suppliers are more and more favored by downstream customers.

*"Dangsheng Cathode Project Phase I has a capacity of 20,000 tons per year and the overall planning is 100,000 tons per year, which can meet the demand of cathode materials for 1 million new energy vehicles."* – Baili Technology Project Manager.