

## Bin Yuan Capital All China Strategy – First Quarter 2020

### Performance Attribution

In the first quarter of 2020, Health Care and Consumer Staples were the top contributors. Compared to the benchmark, Health Care outperformed while Information Technology underperformed.

At the stock level, a medical instrument manufacturer outperformed due to the spread of coronavirus 2019-nCoV globally. Many countries were in urgent need of respiratory equipment, 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 OMROM. 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.

An insurance company underperformed in the first quarter. Due to the outbreak, the insurance agents cannot meet customers face to face, so the premium income did not meet the market's expectations. In the long run, we believe that the company will keep delivering better-than-peer's performance. Global experience suggests that when the per capita GDP reaches US\$10,000, the demand for life insurance will increase dramatically. We believe the company will benefit from improving penetration rate of insurance.

### The Path of Coming out of the Mud

While the Coronavirus are getting seriously worse globally, China has achieved tremendous progress in containing the spread of the virus since the outbreak inception in January. From the mid-March, majority of new confirmed cases every day were those coming from abroad. By March 31, the accumulated confirmed cases were 82,545, with 76,225 cures and only 3,006 patients were still under treatment. Even Hubei province, the center of the outbreak in China, started to report 0 new cases. The control measures are gradually removed. From March 25, the control of the highway exit from Hubei Province (except Wuhan City) was released. Wuhan highway exit will open on April 8.

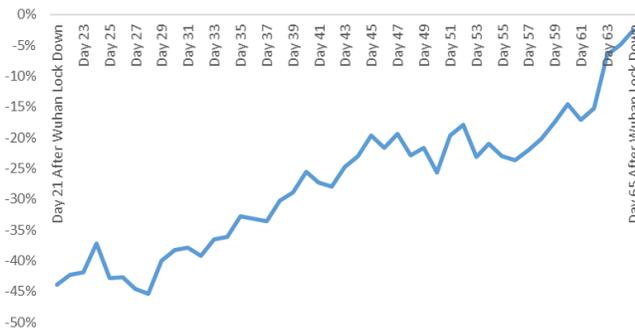
The focus of epidemic prevention work is shifted to quarantine and detection of international entry travelers. At present, all overseas entry people in Shanghai need to be quarantined in the assigned places for 14 days and be tested before their release.

Work resumption progress has been well on track. More than 80% of companies have resumed work, showing strong resilience of Chinese economy. Reported by the Ministry of Human Resources and Social Security, 120 million migrant workers, 70% of total migrant workers, have returned to their job locations.

Although the economy growth dropped significantly with data on industrial value-added declined by 25.87% in February due to the outbreak of coronavirus, strong month on month recovery trend is expected in March. Manufacturing Purchasing Managers' Index (PMI) increased from 35.7 in February to 52.0 in March and Non-Manufacturing PMI rose from 29.6 in February to 52.3 in March.

The daily coal consumption data in coastal power plants is a good indicator to monitor business activities. The negative growth has narrowed to -3% on March 27<sup>th</sup> (65 days after Wuhan city lock down) compared to more than 40% decline 2 months ago, indicating that enterprises in the coastal areas are ramping up their operations to close to normal level.

Chart 1: Coal Consumption Growth of Six Major Power Plants in Coastal Areas (2020 vs. 2019)



### **Global Epidemic Impact**

The coronavirus has spread to countries outside of China, which has changed our risk perspective compared to two months ago. The slow responses by most of the leadership in those countries have not helped to contain the virus and increased the worries on the global economy. It is obvious that the global economy will be badly hurt and based on China's experience, the situation will not get better until the end of the second quarter. China is the first country to get out of this mud, however, it is difficult for China to fully decouple from the epidemic impact of US and other countries.

Thanks to the fast development of the domestic economy, the net export only accounts for 1.5% of GDP. China will rely on domestic economy recovery to wait for the virus situation improving. Besides the tier one cities which have a higher risk of importing virus from travelers that need to be stay in high alert, the rest of the country is gradually becoming normal. The

strategy of the government is to balance the speed of the economic revival and at the same time, prevent the virus coming back.

The short-term challenge is more on the expected weakening global demand. If the global economy sharply declines and thus the consumption, some of the capacity for export will be idle. Even the domestic economy is dominant today, the number of employees involving in export sector is still large. It is estimated that 20-30% of manufacturing revenues in China are generated from overseas markets and around 8% (60 million employees out of 775mn total) labor force are direct export related. The short-term unemployment issue has to be handled.

In the long term, the outbreak will serve as the catalyst to restructure the global supply chain. The trend of the globalization will be slowed, as key manufacturing countries start to prepare for the potential supply chain disruption during times such as this epidemic situation. As we stated in the past letters, China will be more firm to invest in upstream technology on the manufacturing value chain.

### **Government Actions**

Lesson learned from 2008 monetary stimulus package that invested in massive infrastructure projects to boost economy which resulted in large overcapacity, the Chinese government, this time, has used both targeted monetary and expansive 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, delaying and exempting tax and social security fees for impacted industries and enterprises, local governments encouraging consumption of physical goods and services by distributing

vouchers...etc. China may expand fiscal deficit by 1-2% of GDP which is 1-2 trillion RMB to stabilize the situation of small and medium enterprises and their employment, the issuance of special Treasury bonds and the local government special bonds may potentially provide incremental liquidity of 2-3 trillion RMB to the economy.

Looking further out, the most positive result we see from this outbreak is that the central government will launch a series of reforms. Profits will be re-distributed from the treasury, banks and State-Owned Enterprise (SOE) to private enterprises. The capital market is being reformed to allocate capital more efficiently, which will boost investors' confidence and allocate liquidity to financial assets, especially stock market.

### **Portfolio Impact**

The volatility of the China stock market will continue to be influenced by the global headlines and liquidity flows. Domestic economy will still be our investment focus. We are in favor of consumer staples against discretionary. Stocks especially mid cap A share names that are less owned by foreign investors will be less affected by the global liquidity crunch if there is any. We will stay away from businesses that are highly related to international economy for now unless they are over sold in the future.

As of end of March, the companies in our portfolio has recovered operation to 88% of normal level, compared with 80% in February end. Breaking that down circa 28% of portfolio are working at full capacity, 60% are working at 85-90%, and the rest 5% at 40-70% (leaving circa 7% cash).

- ✓ The portfolio holds roughly 28% in healthcare, entertainment and personal care which are the top 3 beneficiaries. 40% of Yuyue Medical's business are in tight supply. After meeting domestic demand, they have recently obtained orders of ventilators and thermometers from

European countries, and they were also granted with emergency use authorization (EUA) by FDA to supply to US. C&S Paper's wet tissue and Yuyue's sanitizer are the most popular daily goods nowadays. Demand boom was also observed in online gaming and videos. In February, the Tencent game "PUBG MOBILE" attracted more than 191 million US dollars worldwide, five times that of the same period last year. The average daily usage time of Bilibili (online entertainment platform) users has reached 109 minutes, which is 36% higher than usual, and also higher than other platforms (Tik-tok 89 minutes, iQiyi 77 minutes).

- ✓ 5% of our holdings recover slower than others such as catering, lodging and offline service eye hospital, but they are catching up recently. 100% of Aier Eye Hospitals have reopened. Until the end of March, Outpatient volume has recovered to 70% of previous year, in which optometry business recovery is the fastest.
- ✓ 53% of our holdings are inevitably affected by the slowdown of domestic economy to a greater or lesser extent, but they are taking this chance to expand market share and gain stronger brand recognition. During the epidemic period, S.F's express business increased rapidly, with revenue growth of 77% and shipment growth of 118% in February. It was one of the only two logistic companies that can provide reliable services in virus outbreak.
- ✓ Less than 7% of our holdings' sales are generated outside China. Export business will be hurt as global epidemic situation becoming worse. However, their ability to service customers, together with improved technology, has increased their competitiveness in the global supply chain and could become beneficiary of import substitution. Hongfa, a relay manufacturer, and CCTC, a ceramic electronics producer, are

gaining increasing interest from big domestic clients as their foreign peers are experiencing production interruption.

Around more than 35% of our portfolio are associated with the trend of digital transformation accelerated by the epidemic. Traditional service businesses such as catering, and retail shifted fast to local no-contact delivery services. Remote working, online medical consultation and online education based on mobile platforms have also sprung up. The scale of the digital economy in China is estimated to hit RMB35 trillion in 2019, 35.4% of the total GDP, which is a must-have theme to invest in China in the next decade.

Weighted average revenue and earnings growth estimates of our holdings have been lowered from 20% to 15% and from 21% to 10% 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's revenue and earnings growth will be less significant, from 20% to 19% and from 21% to 17% respectively.

We are gradually putting money to work but continue to watch for the impact of weak global demand. We are also closely monitoring the new cases in China as import infections are on rise. Our concern could be reduced if China could control it well. Our portfolio will focus on domestic resilient demand and import substitution opportunities.

### **Bin Yuan Operation Updates**

Everyone and their families at Bin Yuan are healthy and safe. Bin Yuan team worked from home since Jan 23rd, 2020. After Shanghai reporting 0 domestic new cases in 14 consecutive days, half of Bin Yuan staff on rotation basis returned to office starting on March 23rd. Our office building now only allow entries of registered people with green "Health Code" which can be checked on Alipay or Wechat. This code is a government control measure, and the health status

identification is based on the big data gathered from public transportation and payment information of users to analyze if users have been to high risk regions.

Senior management would highlight below key points we have done 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 limited face to face meetings. Email box works well for documentation. Research team has at least two calls every day to communicate internally, and we have conducted 92 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.

Sincerely,



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## Bin Yuan on the Road

March 26, 2020



**We attended Huawei's online new product release conference.**

- During the conference, Huawei launched P40 series and ceramic back cover is used in the high-end version P40 Pro+. Ceramic materials are getting more and more widely used.

*"It is the first time that we introduced nano-tech ceramic with highly scratch resistant and durable characters." – CEO of consumer business, Mr. Yu.*

March 29, 2020



**We visited Shanghai Aier Eye Hospital.**

- Outpatient services has recovered to 70% year-on-year. Among the patients, 50% are teenagers. Eye treatment needs are delayed during the epidemic, but treatment recovery is on the way.

*"During the epidemic, children can only take online classes and lack outdoor activities. My child felt that her myopia symptoms are worsening, so we are here to have a visual examination." – A parent.*

March 30, 2020



**We went to supermarket named Century Lianhua and did market research on soy sauce in Shanghai.**

- Benefiting from people's cooking at home in the last 2 months during the outbreak of COVID-19, the sales of soy sauce increased dramatically. As customers getting less price sensitive and more conscious on quality and brand, mid-end and high-end brands benefited most.

*"The amino acid nitrogen of Chubang is above 1.3g/100ml, this is the best among all products." – Ms.Li, shop assistant of Century Lianhua.*