

Bin Yuan Capital All China Strategy – October 2020

Performance Attribution

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

At the stock level, an automobile battery company outperformed in October. After years of technology accumulation and expansion, the company is now one of the world's leading power cell suppliers, with a 55% market share in China. The company attaches great importance to product R&D and innovation. Recently the company launched its CTP (cell to pack) products, which can improve the capacity density and reduce costs. From Q4, the company will supply mainstream auto companies such as the Volkswagen MEB platform and the Tesla model 3. The company's global market share will continue to increase. As a leader in the new energy industry, the company will continue to benefit from development of new energy technology over the long term.

A leading seasonings manufacturer underperformed in October due to profit taking. As the exclusive hotpot soup flavoring product supplier of the well-known hotpot brand "Haidilao", the company enjoys a high-end brand awareness among consumers. With its brand, distribution channels and strong R&D capabilities, the company has gradually increased its product categories, expanding to different categories such as self-service hot pot meals, Chinese condiments and self-heating convenience foods. Also, its excellent management has adopted a profit-sharing incentive mechanism for the team to expand channels and strengthen new product innovation.

Market Comments

China's domestic economy has recovered strongly during the National Day and Mid-Autumn Festival holiday in October. The total number of domestic tourists during the holiday was 618 million, exceeding the expectation of 550 million. Average daily passenger flow recovered to 91% of the National holiday in 2019. Sales revenue of key Chinese retail and catering businesses reached RMB1.6 trillion, representing 4.9% YoY growth. The 2020 National Day box office reached RMB3.92 billion, which was the second largest National Day box office in the history. Hainan recorded RMB1.04 billion in offshore duty-free shopping, 146,800 tourist trips and 998,900 products, up respectively 148.7%, 43.9% and 97.2% year-on-year. The domestic consumption upgrade trend is well on track.

China is currently the safest place in the world for manufacturing with COVID-19 virus being well under control. China's stable production is helping support the global supply chain, evidenced by the good export growth data. Foreign trade with ASEAN countries, China's largest trading partner, increased 7% YoY to RMB2.93 trillion from January to August. China's trade with the EU, its second-largest trading partner, grew by 1.4% YoY during the same period. China's exports were up 9.9% YoY in September, the fourth consecutive month of positive growth this year.

China Securities Regulatory Commission (CSRC) has publicly released a clear signal that the IPO registration system reform will be fully implemented. In the future, the IPO system is expected to be fully liberalized with market-oriented pricing. At the same time, a more rigorous delisting mechanism will also be established. The reform will facilitate the financing of high-quality companies, accelerate the exit of low-quality

companies, which will improve the overall governance of A-share listed companies.

Bin Yuan Opinion

The Digitalization of Finance Industry

Digitalization has reshaped the traditional finance industry towards a more secure, efficient and scalable architecture in data collecting, information processing, business decision making and in controlling risk. The digitalization effort in the finance industry is expected to be significant in terms of the business scale, scope and complexity, which will drive tremendous investment opportunities. The technology sectors that provide software, system, solution and internet services to the financial industry, has a market size of RMB 1.5 trillion. The financial system is extremely complicated. The rigorous and diversified demands of financial institutions and retail users set high requirements on digitalization solution providers, which creates high barriers of entry.

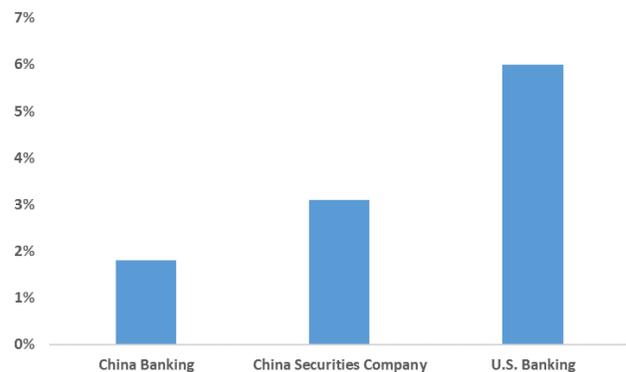
Based on different customer bases and business models, we classify companies in the financial technology industry into two categories: 1) Financial Information Technology (IT) companies (to B) that provide financial institutions with customized IT products or services; 2) Internet finance companies (to C), that leverage the internet platform to tap into the financial service area, especially in servicing retail users. **Both of them are well positioned to benefit from the flourishing digitalization demand of financial institutions and retail users.**

➤ Demand of Financial Institutions (2B)

Financial institutions in China are spending less on IT systems and software, but they have been accelerating their digitalization investment.

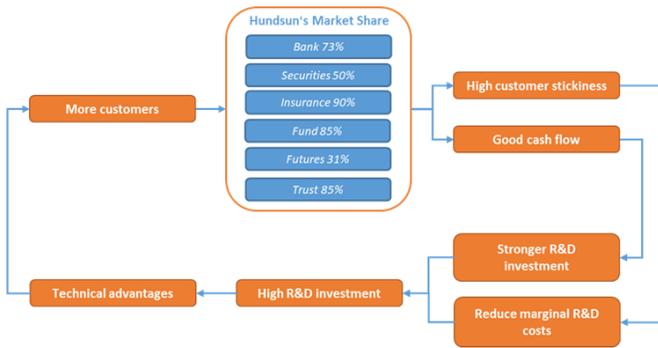
Information investment by Chinese financial institutions are lagging foreign peers. The proportion of IT expenditures to revenue of foreign banking institutions was circa 6% in 2018 compared to 2% for Chinese banking institutions and 3% for security companies. (Chart 1). Chinese financial institutions have a strong incentive to invest in IT infrastructure to improve competitiveness. The finance reform to tighten financial industry supervision also requires upgrading information systems. The investment in digitalization to meet new finance demand and regulatory requirements will grow rapidly in the future. All the IT systems of financial institutions need to be upgraded accordingly. **Hundsun Technology** is a leading Chinese financial IT system provider with a dominant market share (Chart 2). It provides the trading, asset management and risk control systems to securities firms, asset management companies, insurance firms and banks. Leveraging its strong technology capability, Hundsun continues to integrate new products into a total solution for its customers. The complexity of the financial system and diversified demands of users require constant interaction and cooperation with digitalization solution providers, which creates sticky users.

Chart 1: IT Expenditure/Revenue Ratio



Source: IDC, Wind, China Securities Industry Association

Chart 2: Hundsun Technology Business Barriers



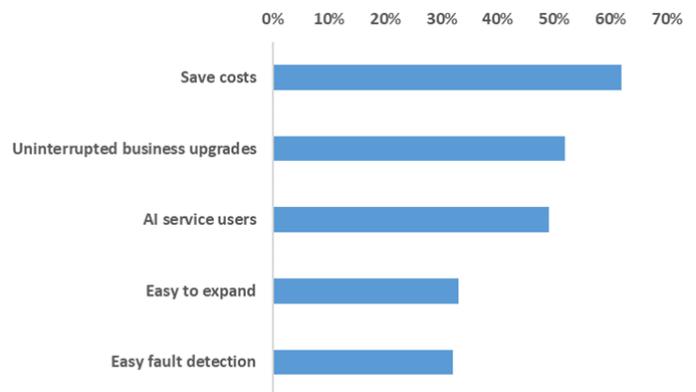
Source: Hundsun Technology Report, Bin Yuan Capital

Cloud computing, artificial intelligence, and blockchain technology will have a profound impact on the entire financial system to improve efficiency and user experiences, which are the potential revenue sources for financial IT companies like Hundsun. Taking cloud computing as an example, according to IDC's forecast, financial institutions using cloud computing can reduce their infrastructure expenditures by 25% in the next three years. With the increasing demand for service responsiveness and flexibility, financial institutions are accelerating the migration to the cloud (Chart 3). Instead of a one-time purchase, the regular subscription model of cloud computing further enhances customer stickiness by providing recurring revenue.

FIS (NYSE:FIS), a global financial IT company, has been the role model for Hundsun Technology to benchmark against. Since 2014, FIS has regarded cloud computing as the most important development strategy and has continued to carry out cloud-based architecture transformation. By 2018, FIS had migrated about 50% of its business in North America to the cloud and plan to migrate 65% of its global business this year. Hundsun Technology is also catching up and taking the lead in China in developing financial cloud computing

solutions for clients. Currently, cloud related services account for 5% of revenue, and we expect this to rise to 30% in the next few years driven by the migration and new cloud-based business. The addressable market size for Hundsun will expand by 3 times driven by the digitalization and innovation. With their strong market position, we expect Hundsun's growth to outperform the industry in the medium to long term.

Chart 3: The Purpose of Using Cloud in China's Financial Industry



Source: China Securities Regulatory Commission

➤ **Demand of Retail Users (2C)**

As the economy has grown rapidly over the past decades, 1.4 billion Chinese consumers have accumulated more than 70 trillion RMB deposits. This has spurred demand for various financial services to meet consumption upgrade and wealth management requirements. An Internet finance company like Ant Group can cover the full range of retail users by meeting their diversified financial needs in an economic and efficient way because of its large user base, huge data traffic and established ecosystem (Table 1). Supported by the ecommerce and daily life service businesses of its parent Alibaba, the Ant Group

has acquired more than 700mn MAU customers at low cost who use their high frequency payment services. Most of the financial demands of these users were not satisfied by traditional financial institutions. Ant Group provides a one stop service platform; such as wealth management, insurance products, individual credit rating, to the mass market retail users. This has greatly increased user stickiness and enhanced profitability. The ecosystem of Ant Group covers multiple counterparties including users, merchants, financial institutions, regulators, service providers. This offers a comprehensive and dynamic path for future growth. The channel value of internet finance companies to reach the mass retail market is tremendous given the large population and growing wealth. However, the sector is not sufficiently regulated and the risk of the financial leverage it creates in the economy needs to be further analyzed. Risk disclosure by companies such as the Ant Group is very limited. The suspension of Ant Group's IPO by the regulator was a reflection of concerns on information transparency and adequacy of capital. Ant Group is now required to disclose more detailed information, and the level of supervision on the industry, including required capital, will be greatly increased.

Table 1: Comparison of Alipay, WeChat Pay and China Merchants Banks

	Alipay	WeChat Pay	China Merchants Bank
Scene	All e-commerce Offline merchants Applet Utilities, etc	Tencent e-commerce Offline merchants Applet Utilities, etc	Signed merchants Applet
Payment Type	Business transaction Personal transaction	Business transaction Personal transaction	Large amount transfer Business transaction
Total Payment in 2019 (Trillion)	117	81	33
Numbers of Transactions	630 Million Per Day	1,500 Million Per Day	1,700 Million Per Year
Amount of Each Transaction (Yuan)	509	148	19,412
MAU 2019 (Million)	659	1,164	102
MAU 2020Q7 (Million)	780	994	43
Monthly activity Merchants 2019 (Million)	75	50	0.43

➤ **Conclusion**

The trial of the digital currency RMB has once again made financial technology a hot topic in China, which echoes the digitalization trend of the finance industry. The architecture needs to be digitalized to tailor to the robust financial demands of both financial institutions and retail users, which will create opportunities for both 2B and 2C companies. **Financial technology is a good space to invest due to its large market size, high barriers to entry, and strong customer stickiness. Total solution companies with strong scalabilities will benefit the most to fulfill diversified customer needs.**

Risks do remain in the financial technology industry. The growth of financial IT vendors is partly driven by financial policy reforms, so it is inevitable that the transparency of the business is relatively lower. Tightening regulatory supervision and potential changing policy on data privacy protection are major potential factors to watch for.

Sincerely,



Bin Yuan on the Road



October 23, 2020

We visited one of Bloomage Biotechnology's (a HA injection, skin care and HA raw materials manufacturer) R&D center in Shanghai, and had a meeting with CTO Mr. Li Huiliang.

- Actively investing in R&D can help improve product formula and production technology, and also supply sufficient formulas to quickly respond to diversified market needs.

"R&D is the foundation of a skin care brand. Bloomage Biotechnology values the importance of R&D, which is a step faster than its local peers." – CTO Mr. Li.



October 20, 2020

We visited the 4-day China International Medical Equipment Expo held at the Shanghai National Convention and Exhibition Center.

- Over 4,200 companies brought more than 30,000 products to the Expo, attracting more than 100,000 professional visitors. Some of medical equipment and consumable sectors are still highly dominant by imported equipment such as orthopedics and high-quality domestic manufacturers are expected to benefit from substitution trend.

"We are weak in the competition with domestic manufacturers. Our cost, after all, is too high." – A sales representative from Smith & Nephew.



October 29, 2020

We had a meeting with CATL's (a global automobile battery supplier) IR director Ms. Lin and visited its factory in Ningde City, Fujian Province.

- Based on the previous R&D innovation, CATL launched CTP (cell to pack) products recently, which can improve the capacity density and reduce the cost as well. In addition to the power battery, CATL also has layout in energy storage, recycling and other fields to create a low-carbon and environmentally friendly ecological system.

"In order to ensure the consistency of product quality, we use online quality control process for the whole production line so as to find and solve any problem in the first place." – A CATL engineer.

Disclaimer

The information, materials and whatsoever releases, views or opinions (together the "Information") contained herein are strictly for information and general circulation only and do not have regard to the specific objectives, financial situation and particular needs of any specific person. The Information does not constitute either an offer to sell or a solicitation of an offer to buy any interest in any fund and strategy associated with Bin Yuan Capital.

The information contained herein is subject to revision and completion. The historical performance information included herein may not be indicative of the performance of future results. Nothing contained herein should be relied upon by prospective investors as a promise or representation as to the future performance.

Bin Yuan Capital shall not be liable or responsible to you or any other party for any direct, indirect, consequential or incidental damages, losses, expenses or costs whatsoever arising in connection with your access to this newsletter, or reliance on any Information, regardless of the form of action.

Copyright and Trademark

Except as otherwise expressly stated herein, the copyright, all other intellectual properties, trademarks, service marks and logos used in the contents of this newsletter, are the property of Bin Yuan Capital. They should not be reproduced and distributed in whole or in part in any manner without the prior written consent of Bin Yuan Capital.