Hereford Funds

Signatory of:

Bin Yuan Healthcare Fund

SFDR status as of March 2021: Article 8

August 2023

Investment Review

The Hereford Funds – Bin Yuan Healthcare Fund (share class L1) depreciated 7.54% for the month of August (net of fees) compared with a -7.04% return for the benchmark. As of the end of August, the Sub Fund was mainly invested in Healthcare Equipment & Parts and Services, with few positions in the Pharmaceuticals sector.

For the month, the Fund underperformed the benchmark by 50 bps. Positions that contributed most to the portfolio were WUXI APPTEC, ASYMCHEM LABOR and APT MEDICAL. Positions that contributed least were KANGJI MEDICAL, SHANGHAI UNITE and AK MEDICAL HOLDING.

Manager's Commentary

The anti-corruption campaign in the healthcare system dragged stocks in the sector sharply lower. In the short term, the campaign is getting some doctors, nurses and companies questioning how to adjust their work in the industry, and where the red line is. The uncertainty is always the worst part. Based on our experience, we believe that the growth of industry demand and the trend of import substitution will not be reversed, and that it will benefit companies that are more innovation-driven and undertaking distribution and promotion in a regulated way. *(Please see comments on positioning)*

We evaluate the portfolio's short term risk exposure in two ways. **The first is channel risk.** In China, the majority of healthcare companies connect with hospitals through distributors to build a 'firewall', rather than selling directly to hospitals. Even if there are problems with some individual distributors, the listed company won't be affected too much. So, the overall risk is limited, especially for those who don't sell products directly to hospitals. **The second is order delay risk.** The tenders of large machines and new products to enter hospitals this year may see short term delays. But demand is not disappearing. The trend of import substitution continues and been increasing. As long as the products are qualified, hospitals are 'safer' to purchase domestic equipment. According to the analysis below for our top 10 holdings (Table 1), all can benefit from the import substitution trend and the overall impact is limited.

Table 1: Top 10 holdings' risk exposure

Name	Sub-segment	Import substitution	Channel risk	New products exposure	Lengthen purchasing cycle	Other risks
KANGJI MEDICAL	Consumables	Yes	Medium	Low	Low	
IRAY	Equipment	Yes	Low	Low	Low to Medium	
WUXI BIO	Services	Yes	Low	Low	Low to Medium	Geopolitical risk
WUXI APPTEC	Services	Yes	Low	Low	Low to Medium	Geopolitical risk
MINDRAY	Equipment	Yes	Medium	Low	Medium	
AK MEDICAL	Consumables	Yes	Medium	Low	Low	
ASYMCHEM	Services	Yes	Low	Low	Low to Medium	Geopolitical risk
INNOVENT BIO	Pharm	Yes	Medium	Medium	Medium	
APT MEDICAL	Consumables	Yes	Medium	Medium-to-high	Low	
NEW INDUSTRIALS	Consumables	Yes	Medium	Medium	Low to Medium	

The Q2 earnings season came to a close at the end of August, and our holdings posted much stronger earnings than the market. The portfolio's earnings grew by 26% in H1, and for those reporting Q2 results, 24% Y/Y (Table 2). X-ray detector supplier, **iRay**, recorded Q2 sales growth of 31% Y/Y and core earnings growth of 27% Y/Y. Post-pandemic recovery of the medical businesses, upgraded products and a more comprehensive products offering are expected to boost growth in the second half. The continuous trend of import substitution in the domestic market with product expansion, especially in dental, industrial and non-detector products, and breakthroughs in overseas markets will act as long-term growth drivers in the future. China's largest domestic MISIA (Minimally Invasive Surgical Instrument and Accessories) manufacturer, **Kangji** posted H1 earnings growth of 62% Y/Y on recovering surgical volumes in hospitals and good performance of new products. The company stands out for its quick response model and accumulation of know-hows. Its brand has been recognized by surgeons from top-tier hospitals. The company is expected to gain market shares from imported brands amid fast industry growth.

We have a great portfolio for the future market recovery.

Table 2: Performance of all A+H shares Healthcare Companies vs Bin Yuan Portfolio

	2022A		**2023A**	
	Q2 Revenues	Q2 Earnings	Q2 Revenues	Q2 Earnings
All A share Healthcare companies	12.6%	13.5%	6.0%	-6.0%
Bin Yuan Healthcare Portfolio	**30.7%**	**36.6%**	**19.0%**	**24.0%**
	H1 Revenues	H1 Earnings	H1 Revenues	H1 Earnings
All A+H Healthcare companies	14.5%	7.0%	11.0%	5.0%
Bin Yuan Healthcare Portfolio	**35.4%**	**34.1%**	**22.0%**	**26.0%**

POSITIONING

Changes in policy (such as centralized procurement and anti-corruption campaigns), some leading indicators (including private-equity fund raising market), and even the news of some leading companies (such as the sales of blockbuster drugs) can all become catalysts for sudden changes in industry preferences. However, from the perspective of a long-term investor like us, we aim for a portfolio that can produce long-term returns through different economic cycles with lower volatility.

From a strategic perspective, if we look back the past two decades, China's healthcare expenditures have seen consistent growth at more than two times that of GDP growth, despite various changes and fluctuations. We anticipate this trend to continue over the next 10 years, still at a growth rate double that of GDP growth. This growth rate indicates that China’s healthcare industry offers strong investment opportunities.

Our focus is the following:

1. **Preference for Devices and Consumables vs Pharmaceuticals:** Compared with developed countries, a larger portion of healthcare expenditure is allocated to purchasing drugs. But going forward, equipment and consumables related to diagnostics and treatments will have bigger potential.

2. **Import substitution potential is critical:** The progress of import substitution varies for different segments within devices and consumables. Some segments have already been dominated by local brands, such as thermometers and biochemical testing, while others remain in the early stages of localization. We invest in segments where domestic alternatives are at the inflection point to take market share, often with a market share ranging from 20-30%. Examples include surgical consumables, joint-related products, and chemiluminescence assays. Back to pharmaceuticals, the majority of generic drugs face fierce competition and possess low technological barriers, whereas innovative drugs still exhibit significant gaps compared to international standards. This is why we approach pharmaceuticals more cautiously.

3. **Self-Sufficient Cash Flow for Sustainable Growth:** We firmly believe that relying on external financing for growth is unsustainable. Therefore, we assess whether listed companies can generate sufficient free cash flow. Even in the case of innovative pharmaceutical companies, having cash cow products to support other pipeline development is crucial. Companies focused solely on innovative drugs pose higher risks for secondary market investors.

4. **Upstream Companies in the Industry Chain:** The pharmaceutical industry chain is extensive. While downstream pharmaceutical companies are facing higher uncertainties, certain upstream suppliers can benefit from the entire industry growth. Taking the recent headline GLP-1s as an example, many domestic companies have followed suit with generic versions due to upbeat sales of overseas leaders. We can expect downstream competition to intensify in the near future, coupled with government price controls. In contrast, upstream firms involved in critical production processes like solid-phase synthesis carriers and chromatography media, acting as ‘weapon suppliers for the war’, will offer more certainty. *(Please refer to the August Monthly section on the ‘Next Blockbuster Drug? – GLP-1s’)*

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5. Global Expansion Opportunities: Beyond import substitution opportunities domestically, some companies have the potential to become core global suppliers. For instance, some leading CRO (Contract Research Organization) companies now offer attractive valuations. Compared to global competitors, they enjoy cost efficiency and advantages.

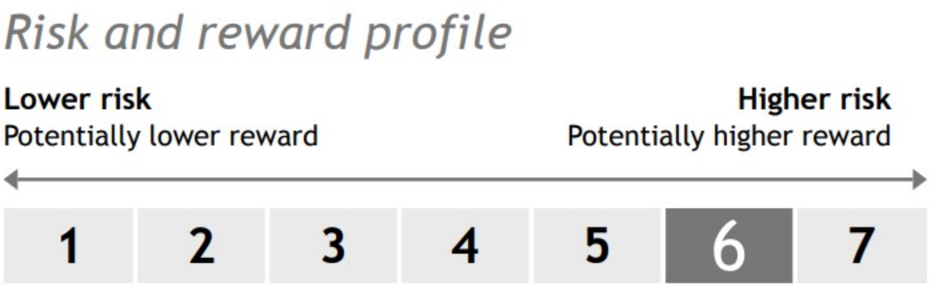
In brief, large market presence, high technological barriers, and exceptional management remain the three key factors we deem essential for companies to weather economic downturns. Bin Yuan continues targeting these great companies to yields long-term returns.

Key Information

NAV (31/08/23)	US$ 67.2 (L1)	Strategy Assets	US$ 10.7 m[a]
Total Fund Size	US$ 10.7 m	Fund Launch Date	03-Dec-21

Monthly Performance (%) data from FPS/Pictet

	2022					2023									ITD
	Sep	Oct	Nov	Dec	YTD	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	YTD	
Bin Yuan HC Fund	-6.87	4.63	5.02	5.54	-17.07	7.72	-5.48	-4.80	-2.51	-7.60	-4.98	4.34	-7.54	-19.96	-32.80
Index[b]	-18.60	-3.10	22.05	6.02	-25.50	9.11	-9.91	-4.72	2.99	-10.21	-6.15	8.44	-7.04	-18.07	-43.87



Top Ten Holding

1	KANGJI MEDICAL H	8.95%	2	IRAY TECHNOLOG-A	8.53%
3	WUXI BIOLOGICS C	7.81%	4	WUXI APPTEC CO-A	7.13%
5	SHENZHEN MINDR-A	4.62%	6	AK MEDICAL HOLDI	4.14%
7	ASYMCHEM LABOR-A	4.10%	8	INNOVENT BIOLOGI	3.67%
9	APT MEDICLA IN-A	3.49%	10	NEW INDUSTRIALS	3.26%

Investment Objective

The investment objective of the Compartment is to provide long term capital growth, measured in USD, primarily through investment in equities and equity-linked securities of Greater China Companies, as defined hereafter.

Market Breakdown	% of Assets
A Share	64
Hong Kong (Discounted Dual Listing)	2
Hong Kong	31

Sectoral Breakdown	% of Assets
Healthcare Equipment & Parts	51
Services	33
Biotechnology	7
Pharmaceuticals	6

Valuation	Portfolio	Benchmark
Period	**8/31/2023**	**8/31/2023**
2023 PE (X) – Weighted Avg. Method	22.9	19.6
2023 PE (X) – Integral Method	23.3	32.7
2023 PB (X)	4.6	1.1
2023 Div. Yield (%)	1.1	1.1
2023 ROE (%)	19.9	5.4
Earning Growth (%) Forward 3 YR	26.0	14.0
2023 PEGY	0.8	1.3
FCF Yield	3.0	0.9

Annual Management Charge | TERs as at end September 2021	
Share Class L1	0.50% | NA
Share Class A	1.00% | NA
Share Class P	0.50% with 10% Performance Fee | NA
Minimum Investment	
Share Class L1	$100,000 Minimum initial subscription & holding
Share Class A	$100,000 Minimum initial subscription & holding
Share Class P	$100,000 Minimum initial subscription & holding

Fund Codes	
Share Class	L1
Bloomberg	HEFYHUA LX
TK	
ISIN	LU2413982427
Lipper ID	
Sedol	BLBHZ45

Fund Details	
Dealing Day	Daily
Dividends	None – income accumulated within the fund
Investment Manager	Bin Yuan Capital Room 1505, 15/F, 299QRC 287-299 Queen's Road Central Sheung Wan, Hong Kong
Management Company	FundPartner Solutions (Europe) S.A. 15, Avenue John F Kennedy , L-1855 Luxembourg
Custodian	Pictet & Cie (Europe) S.A. 15, Avenue John F Kennedy, L-1855 Luxembourg
Legal Advisors	Elvinger Hoss Prussen S.A. 2, Place Winston Churchill, L-1340 Luxembourg
Auditor	Deloitte Audit S.à r.l. 560, route de Neudorf, L-2220 Luxembourg

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Footnote:

(a) This refers to the total assets invested in the reference strategy managed by the Investment Manager.
(b) MSCI China Health Care Index (Bloomberg Ticker MXCN0HC Index).

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- This document should be read as as a marketing communication.
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