Hereford Funds

Signatory of:

Bin Yuan Healthcare Fund

SFDR status as of March 2021: Article 8

September 2023

Investment Review

The Hereford Funds – Bin Yuan Healthcare Fund (share class L1) appreciated 1.56% for the month of August (net of fees) compared with a 0.34% return for the benchmark. As of the end of September, the Sub Fund was mainly invested in Healthcare Equipment & Parts and Services, with few positions in the Pharmaceuticals sector.

For the month, the Fund outperformed the benchmark by 1.23%. Positions that contributed most to the portfolio were ASYMCHEM LABOR, WUXI APPTEC and INNOVENT BIOLOGI. Positions that contributed least were BEIGENE LTD, KANGJI MEDICAL and SHANGHAI UNITE.

Manager's Commentary

There is no doubt that after nearly three years of correction, the valuation of the entire healthcare sector has become attractive, while China's healthcare industry continues to see strong and resilient demand. The current issue is when market sentiment can improve under changing policies. As we mentioned in last month's newsletter, the latest event that affected market sentiment is anti-corruption in the healthcare industry. Since the start of the campaign in July, some negative impact was seen in July and August. But medical services cannot be stagnant for too long (this is completely different from the previous crackdown in the education industry). We have observed that the campaign has significantly weakened in September in hospitals. More importantly, many academic conferences and commercial activities have resumed in September, and the emotions of doctors have also greatly improved. We believe all of them show very positive signs.

Considering the current valuation and solid fundamentals, we believe this is the bottom of the entire industry, and that it won't be long before a rebound. We have a great portfolio for the future market recovery. We are confident that the weighted average profit growth of the entire portfolio can reach 20.3% over the next 5 years, thereby ensuring the entire portfolio achieving an annualized return of **17.9%**. (Please review the attachment for our fund positioning updates)

Key Information

NAV (28/09/23)	US$ 68.3 (L1)	Strategy Assets	US$ 10.8 m[(a)]
Total Fund Size	US$ 10.8 m	Fund Launch Date	03-Dec-21

Monthly Performance (%) data from FPS/Pictet

	2022				2023										ITD
	Oct	Nov	Dec	YTD	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	YTD	
Bin Yuan HC Fund	4.63	5.02	5.54	-17.07	7.72	-5.48	-4.80	-2.51	-7.60	-4.98	4.34	-7.54	1.56	-18.71	-31.75
Index[(b)]	-3.10	22.05	6.02	-25.50	9.11	-9.91	-4.72	2.99	-10.21	-6.15	8.44	-7.04	0.34	-17.79	-43.68

Risk and reward profile

Lower risk Potentially lower reward						Higher risk Potentially higher reward
1	2	3	4	5	**6**	7

Top Ten Holding

1	KANGJI MEDICAL H	8.73%	2	IRAY TECHNOLOG-A	8.36%
3	WUXI BIOLOGICS C	8.01%	4	WUXI APPTEC CO-A	7.42%
5	SHENZHEN MINDR-A	4.54%	6	AK MEDICAL HOLDI	4.30%
7	ASYMCHEM LABOR-A	3.99%	8	INNOVENT BIOLOGI	3.72%
9	APT MEDICLA IN-A	3.66%	10	NEW INDUSTRIALS	3.35%

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	66
Hong Kong (Discounted Dual Listing)	2
Hong Kong	30

Sectoral Breakdown	% of Assets
Healthcare Equipment & Parts	52
Services	33
Biotechnology	7
Pharmaceuticals	6

Valuation	Portfolio	Benchmark
Period	**9/30/2023**	**9/30/2023**
2024 PE (X) – Weighted Avg. Method	21.0	26.1
2024 PE (X) – Integral Method	22.0	17.7
2024 PB (X)	4.0	1.5
2024 Div. Yield (%)	1.4	1.0
2024 ROE (%)	18.9	5.8
Earning Growth (%) Forward 3 YR	22.6	14.2
2024 PEGY	0.9	1.7
FCF Yield	2.2	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

HEALTHCARE FUND POSITIONING UPDATES

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 (52% weights in our portfolio) 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. Moreover, there are more opportunities for import substitution and even export in medical devices at this stage, thanks to their possession of global competitiveness. 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.

a) Import substitution potential is critical (38%+ position): 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 at 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. Here are the market patterns, global peers, and upsides of all our medical device holdings.

Ticker B	English Name	Theme	Sub-segments	Domestic players' shares (2022)	Domestic players' shares (2030E)	Company’s position in China	Global peers	Upside potential (till 2028)	2024 PEG
9997 HK Equity	KANGJI MEDICAL	Consumables	Minimally invasive surgical parts	33%	49%	No.1 in domestic players No.3 in all players	Metronic, JNJ	316%	0.58
1789 HK Equity	AK MEDICAL	Consumables	Joint implants	28%	46%	No.1 in all players	JNJ, Stryker, Medtronic, Smith & Nephew	136%	0.86
688617 CH Equity	APT MEDICAL	Consumables	Interventional Consumables electrophysiological Consumables	10%	40%	No. 1 in domestic players No.4 in all players	Abott, Medtronic, Boston Scientific	103%	1.31
688050 CH Equity	EYEBRIGHT	Consumables	Ophthalmic consumables	40%	70%	No.2 in domestic players No.5 in all players	Euclid, Airefa , Lucid	54%	1.43
300595 CH Equity	AUTEK	Consumables	Ophthalmic consumables	40%	70%	No.1 in domestic players No.1 in all players	Euclid, Airefa , Lucid	162%	0.75
300760 CH Equity	MINDRAY	Equipment	Medical Image Chemiluminescence Life Support	40%	48%	No.1-3 in domestic players No.3-6 in all players	GE, Siemens, Phillips, Roche, Abbott, Beckman	103%	1.01
688271 CH Equity	UNITED IMAGING	Equipment	Medical Image	68%	75%	No.1 in all players	GE, Siemens, Phillips	44%	1.81
002223 CH Equity	YUYUE MEDICAL	Equipment	household healthcare products	35%	60%	No.1-3 in domestic players No.3-6 in all players	ResMed, Phillips, JNJ,Roche, Abott, Bayer	149%	0.66
2252 HK Equity	MEDBOT-B	Equipment	Surgical robot	22%	40%	No.1 in domectic players No.2 in all players	Intuitive Surgical		
300633 CH Equity	SONOSCAPE	Equipment	Soft endoscope	5%	22%	No.3 in domectic players No.7 in all players	Olympus, Fuji, Pantax	143%	1.10
300832 CH Equity	SNIBE	IVD	Chemiluminescence	26%	65%	No.2 in domestic players(Mindry NO.1) No.6 in all players	Roche, Abbott, Beckman, Siemens	130%	0.99
603658 CH Equity	AUTOBIO	IVD	Chemiluminescence	26%	65%	No.3 in domestic players(Mindry NO.1) No.7 in all players	Roche, Abbott, Beckman, Siemens	160%	0.82

Several of our top holdings are good representatives:

Kangji Medical (9997.HK) is the third largest minimally invasive surgical instrument and accessories (MISIA) platform in China, following Medtronic and Johnson & Johnson closely. The company has built a strong sales network, with more than 200 independent distributors, and products have covered more than 1,000 “Class-3” hospitals, accounting for more than 70% of hospitals with minimally invasive and minimally invasive surgery capabilities in China. After volume-based procurement policy (VBP) was implemented, the company's domestic market share is increasing, intensifying market consolidation. The number of overseas sales countries/regions is also on the rise. After establishing brand influence, the company is poised to capture more market share. In terms of business expansion, Kangji acquired Wiseking Surgical Robotics in 2022, thus expanding its layout in the field of laparoscopic surgical robotics and creating synergies with its existing laparoscopic consumables. Kangji is expected to grow its revenue at CAGR of 27% and earnings at a CAGR of 20% in 2022-2028. Earning can reach 208 million USD in 2028. Applying a value of 20x PE, the stock has more than 3X upside by 2028 (33% expected annualized return), with current/estimated market cap of 1.0/4.1 billion USD.

Mindray (300760.SZ) is one of the leading global providers of medical devices and solutions. The company is firmly committed to employ advanced technologies and transform them into innovative products to adapt to clinical scenarios, bringing healthcare within reach with global R&D, marketing and service network. While improving the quality of care, the company also makes itself more accessible to a larger part of the world. In life support, the company's market share for monitors is No. 1 in China and No. 3 globally; defibrillators are No. 2 in China and No. 5 globally; and anaesthetics are No. 3 in China and No. 3 globally. In medical imaging, the company is third in China and sixth globally. In IVD, the company's Chemiluminescence is No. 1 in China. With the obvious cost advantage and rich product lines, more products under Mindray will become global leaders. Mindray is expected to grow its revenue at CAGR of 19% and earnings at a CAGR of 21% in 2022-2028. The earning can reach 4.13 billion USD in 2028. Applying a proper value of 25X PE, the stock has double upside by 2028 (15% expected annualized return), with current/estimated market cap of 45/90.5 billion USD.

AK Medical (1789.HK) is China's largest joint implants manufacturer in China, offering a complete line of orthopedic products, including hip implants, knee implants, and 3D printed products. Before 2021, the localization rate of joints implants is 30%, of which AK Medical accounts for about 12%. After the VBP, AK Medical took the opportunity of import substitution and increased its market share in the joints market to 20%. The company continues to develop and produce 3D printing products, catching up with foreign peers. In the future, with established cost advantages and the continuous promotion of VBP, AK Medical is expected to take more market share. AK Medical is expected to grow its revenue at CAGR of 27% and earnings at a CAGR of 23% in 2022-2028. The earning can reach 103 million USD in 2028. Applying a proper value of 20X PE, the stock has an upside over 135% by 2028 (18.7% expected annualized return), with current/estimated market cap of 0.87/2.05 billion USD.

b) Upstream Companies in the Industry Chain (15% position): The healthcare industry chain is extensive. While downstream pharmaceutical or equipment companies are facing higher uncertainties, certain upstream parts suppliers are still able to 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. We are investing a couple of these opportunities:

iRay Technology (688301.SH) is a supplier of X-ray detectors. The company is strengthening its global competitiveness and introducing new products in order to become a comprehensive solutions provider in the X-ray field. X-ray detectors are key components for medical image clarity and industrial inspection. Among the few global players, iRay is the top player (No.1 in domestic players, No.4 in all players) of X-ray detectors. iRay's manufacturing cost is only 1/5 of GE and 1/3 of Varex Imaging (global No.1 player), helping the downstream assembling plants make the whole machine more affordable to end users. The company is expected to continue growing its market share on price advantage and domestic substitution in the industry. iRay is also actively developing core X-ray components beyond X-ray detectors, and accelerating the development of CT-related products and expanding its customer base in the medical and industrial sectors. iRay is expected to grow its revenue at CAGR of 31% and earnings at a CAGR of 23% in 2022-2028. The earning can reach 305 million USD in 2028. Applying a proper value of 25X PE, the stock has an upside over 120% by 2028 (17.4% expected annualized return), with current/estimated market cap of 3.4/7.5 billion USD.

Novelbeam Tech (688677.SH) is a leading rigid endoscope core components supplier in China. Its products include 4K fluorescence/white light laparoscope, endoscope light source module, camera adapter/adaptation lens, etc. Rigid endoscopes are widely used for detection and treatment in many departments of hospitals, such as laparoscopic surgery. Novelbeam Tech is the main supplier of Stryker, a top global rigid endoscope company. At present, the localization rate of rigid endoscopes is only about 15%, Novelbeam Tech can help domestic players to take market share gradually by using its high-quality and high-performance components. Leveraging its technology in the field of optics, Novelbeam Tech also provides optical products and optical devices for applications such as medical optics, industrial lasers and biometrics based on technical capabilities such as optical design, optical processing, optical coating, optical integration, and inspection. Novelbeam Tech is expected to grow its revenue at CAGR of 23% and earnings at a CAGR of 25% in 2022-2028. The earning can reach 95 million USD in 2028. Applying a proper value of 25X PE, the stock has an upside over 150% by 2028 (20% expected annualized return), with current/estimated market cap of 0.95/2.4 billion USD.

NanoMicro (688690.SH) is a leading chromatographic filler company in China. Chromatographic fillers are necessary products for drug production, and have a huge market space after entering the industrial chain of large downstream pharmaceutical companies. Although NanoMicro is far ahead of domestic companies, its market share is only 10%, and the other 80% of the market is still occupied by Cytiva (previously GE Healthcare). The quality of the NanoMicro's chromatographic products is getting close to that of foreign imported products, but with more cost advantage, so that it has a huge import substitution opportunity. NanoMicro is expected to grow its revenue at CAGR of 23% and earnings at a CAGR of 25% in 2022-2028. The earning can reach 144 million USD in 2028. Applying a proper value of 28X PE, the stock has an upside over 120% by 2028 (17.7% expected annualized return), with current/estimated market cap of 1.8/4.0 billion USD.

Sunresin (300487.SZ) is a special resin manufacturer in China, providing core materials and complete sets of equipment. The adsorption and separation resins provided by the company play a unique function of selective adsorption, separation, and purification in the process flow of downstream users, and are widely used in hydrometallurgy, pharmaceutical, food processing, environmental protection, chemical and industrial water treatment, and other fields. In the field of biomedicine, Sunresin's peptide solid-phase carrier is a necessary raw material to produce GLP-1 drugs using chemical pathways, and the company's solid-phase carriers currently account for about 40% of GLP-1 drug production. At present, Sunresin's solid phase carrier is mainly used to produce Tirzepatide by Eli Lilly, which will maintain a CAGR of 35% in the next 5 years. Moreover, with the expiration of the patent period of Semaglutide, the supply of products using chemical synthesis methods will further boost revenue to the company. Sunresin is expected to grow its revenue and earnings at CAGR of 25% in 2022-2028. The earning can reach 280 million USD in 2028. Applying a proper value of 28X PE, the stock has a double upside by 2028 (15% expected annualized return), with current/estimated market cap of 4.0/8.0 billion USD.

2. Beneficiaries from consolidation trend with strong cash flow in service sector (33% weights in our portfolio): Unlike medical device companies, the barrier for medical service companies lies not in technology, but in operational capabilities. In some traditional medical service industries, some leading companies rely on their extraordinary cost control capabilities, high asset turnover strategies, and stable customer channels to continuously erode small businesses in the industry, thereby increasing their market share. They usually have stable cash flow and dividend policies, so that they can provide relatively high visibility returns to investors in a volatile market. Leading distributors and pharmacies are like this.

Sinopharm (1099.HK) is a leading distributor of pharmaceuticals, healthcare products, and medical devices in China, serving as a key supply chain service provider. The company occupies 18% market share in pharmaceutical distribution and 16% share in medical device distribution in China. Recent policy headlines such as anti-corruption campaign and volume-based procurement policy are reshaping the medical distribution sector. Smaller distributors are struggling to fulfill the customers' demands, leaving room for leading companies like Sinopharm to expand their market share. Currently, the CR5 (Concentration Ratio of the top 5 firms) in the domestic medical distribution industry is below 40%. In the future, as industry consolidation advances, the CR5 is expected to exceed 75%, with Sinopharm maintaining its top position and a market share of over 25%. Sinopharm is expected to grow its revenue at CAGR of 12% and earnings at a CAGR of 8% in 2022-2028, with circa 4% high dividend yield. The earning can reach 2.1 billion USD in 2028. Applying a proper value of 11X PE, the stock has an upside over 110% by 2028 (17% expected annualized return), with current/estimated market cap of 9.5/20.8 billion USD.

Yifeng Pharmacy (603939.SH) is a leading chain pharmacy brand with modern pharmaceutical logistics centers featuring advanced automation and informatization systems. As of 2022, the company had over 10,000 chain pharmacies and ranked among the top 3 in China, but only with a market share of 3.2%. China's chained-drugstores currently has less than 10% market share, relatively low compared with the nearly 90% in developed countries like the U.S. and Japan. Similar to distributors, the recent policies have been conducive to the leading enterprises' consolidation to the market. Yifeng Pharmacy is expected to grow its revenue and earnings at CAGR of 20% in 2022-2028, with circa 1.2% dividend yield. The earning can reach 518 million USD in 2028. Applying a proper value of 20X PE, the stock has an upside over 110% by 2028 (16.4% expected annualized return), with current/estimated market cap of 4.8/10.3bn USD.

To sum up, we have picked high quality companies with import substitution opportunities and upstream core technologies in our portfolio. In addition, medical service companies with stable cash flow and integration opportunities are also our main focus. We are confident that the weighted average profit growth of the entire portfolio can reach 20.3% over the next 5 years, thereby ensuring the entire portfolio achieves an annualized return of 17.9%.

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
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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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