Review: Bin Yuan Healthcare Fund July 2024

The Bin Yuan Healthcare Strategy and UCITS Fund which we launched at the beginning of December 2021 has outperformed its benchmark by 30% - but suffered from very poor absolute performance.

The operating environment for Healthcare has been very difficult and many investors have given up on healthcare. In this update we review the causes and why we think the Healthcare sector deserves a rerating:

- WHAT HAPPENED: the 2021 VBP initiatives (Volume Based Purchasing Policy), 2022 Covid lockdown, the 2023 anti-corruption campaign, and increased geopolitical risks impacted business activity, profitability and investment sentiment.
- VALUATIONS: The relative valuation is at historical lows (1.5x premium vs 2.3x). We will explore whether the sector still deserves a premium rating.
- FUNDAMENTALS: We will review the opportunities. The massive demand and the short supply for healthcare services in China has not changed. We estimate China will add approximately 5,000 private hospitals by 2030.
- IMPORT SUBSTITUTION: we estimate that the overall localization rate of medical equipment & consumables will increase from the current 42% to 55% in 2030. By 2030, the market for Chinese medical equipment & consumables companies will be RMB 1.24 trillion+ vs RMB 0.45 trillion in 2023.
- PORTFOLIO POSITIONING: we will focus the portfolio on 18-20 stocks with a core 10 names which we believe offer investors substantial return opportunities as the sector get rerated.

In summary we strongly believe that the sector is due for a rerating driven by strong and resilient domestic healthcare demand. We estimate our top 10 stocks on conservative numbers will achieve 26% annualized absolute returns over the next 3 years.

WHAT HAS HAPPENED:

At the launch of the strategy, the China A-share Healthcare Index and Hang Seng Healthcare Index had fallen 17% and 35% from their highs in early 2021. The overall valuation was 29 times forward PE vs the average of 33 times for the previous eleven years (Chart 1). We believed this was attractive in the largest growing healthcare market.

Chart 1: PE Band of A-share Healthcare Sector (801150.SL)

Sources: iFinD, CSSW, Bin Yuan Capital

However, a series of incrementally negative events including the 2021 VBP initiatives, 2022 covid lockdown, the 2023 anti-corruption campaign, and rising geopolitical risks impacted business activity, profitability and investment sentiment.

This update will review the outlook and investment potential. We strongly believe this is not the right time to give up on the sector. The market has fully discounted the negatives which has driven the stock prices of some of the highest quality companies below their intrinsic value by a large margin.

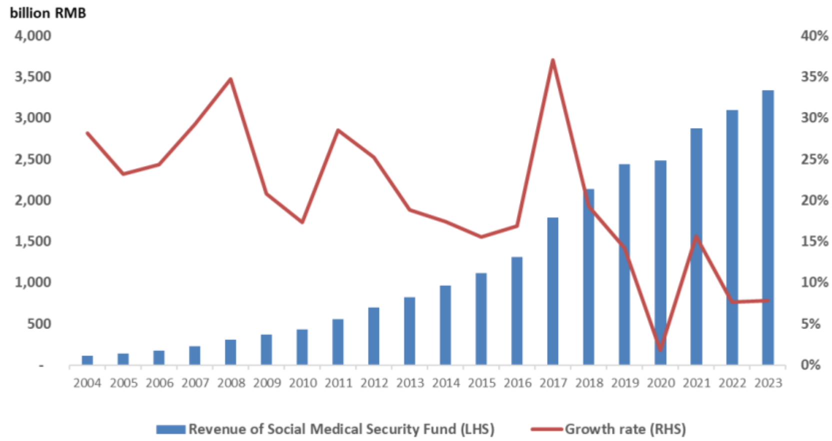
THE HEADWINDS

1) <u>The prolonged covid lockdown brought enormous pressure on the social medical security fund</u>

The covid epidemic which broke out in early 2020 disrupted regular healthcare services. With the gradual reopening of countries around the world from 2021, China had misjudged the consequences of the spread of the Omicron variant virus in 2022. The government implemented a very strict prevention and control measures, including a full-scale lockdown. These policies disrupted economic activity and put great pressure on the Social Medical Security Fund (SMSF) and consequentially reduced normal medical expenditures. 3 trillion RMB (2020-2022) was spent on virus testing, vaccine injections etc., which impacted the remaining SMSF budget.

SMSF's revenues were 2.44 trillion RMB in 2019, and reached 3.34 trillion RMB in 2023, an annual growth rate of only 8.1% compared to the annual growth rate of 20.3% in the five years 2014 to 2019 (Chart 2).

Chart 2: Revenue of Social Medical Security Fund



Sources: iFinD, China National Healthcare Security Administration, Bin Yuan Capital

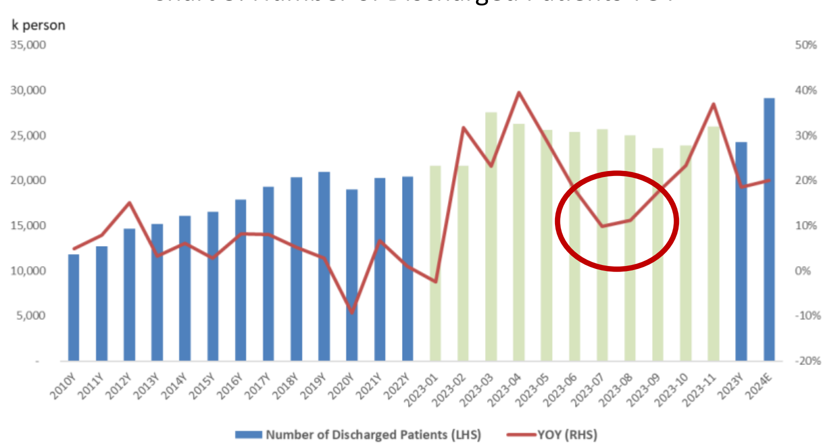
This significantly reduced healthcare sector related activities. This disruption carried on as the economy recovered in 2023 with the government anti-corruption campaign.

2) <u>The anti-corruption campaign impacted sentiment and postponed hospital equipment orders</u>

To deal with the enormous funding pressure on SMSF, the corruption and dereliction of duty among some hospitals and doctors became targets. A series of high-profile arrests of doctors and management of hospitals were announced. This impacted medical service demand and supply that should have been recovering post pandemic.

Chart 3 shows that the number of discharged patients recovered strongly at the beginning of 2023. This momentum slowed as the anti-corruption campaign started in July 2023. With healthcare demand pretty rigid, the growth of discharged patients was gradually recovering by the end of 2023. This trend will continue as healthcare services move back to the normal trend line.

Chart 3: Number of Discharged Patients YOY



Sources: iFinD, Bin Yuan Capital

3) Geopolitical risks

Chinese biotech has been aggressively targeted by the US government. CXO companies, represented by WuXi Biologics (2269.HK) and WuXi AppTec (603259.SH/2359.HK), were severely impacted. WuXi Biologics, a great CXO firm declined 77% over the past two and half years, due to these concerns (Chart 4).

Chart 4: Stock Performance of WuXi Biologics

The Chinese CXOs are very competitive and should be able to reposition themselves and integrate into the new global competitive landscape over the long run. We do not expect geopolitical risks to ease, so we have adjusted our portfolio to ensure that it can perform well even in the face of the most extreme decoupling. The China Healthcare sector is not just CXOs. The sector has much broader segments that include equipment, consumables, domestic services, etc., which are less impacted by geopolitical risks and our portfolio focus.

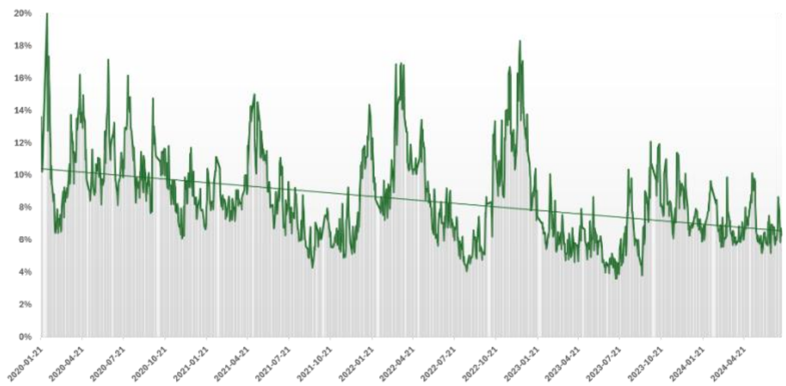
4) Healthcare sector out of favor

Local institutional investors are momentum investors using active sector rotation to achieve their short term performance objectives. The annual ranking of the mutual funds is important for increasing AUM. This year the top funds are heavily concentrated (more than 50%) in banks, energy, and resource based commodities.

As an example, we joined an iRay (688301.SH) conference last week, and only about 10 investors attended the conference. In contrast, three years ago when the stock price of iRay reached its peak, at a similar conference at iRay there were over 100 attendees. This reinforces our conviction that we have hit the bottom.

We have seen a decline of the daily transaction volumes from an average of 10.8% pre 2022 to 6.8% in 2023 and 2024 (Chart 5).

Chart 5: Healthcare Trading Volume as % of Total



Sources: iFinD, Bin Yuan Capital

The valuation of the healthcare sector vs. the general market has also declined to historical lows (Chart 6). The sector had been trading at 2.3X premium compared to the general market. Currently, it is at 1.5X premium, but the industry growth rate has been maintained at twice the market level. We feel the premium is therefore justified. Compared with global peers, Chinese Healthcare Equipment and Consumables also seem very attractive (Appendix 1).

Chart 6: TTM PE Premium of Healthcare Sector vs. A-share Market (excl. Banks)

Sources: iFinD, CSSW, Bin Yuan Capital

OPPORTUNITIES

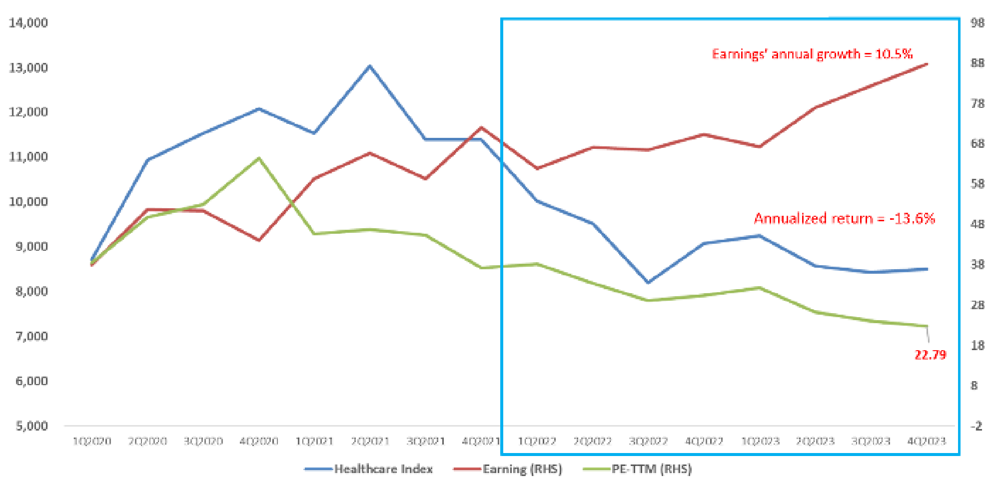
The annualized compound earnings growth rate for the healthcare sector 2013 to 2021 was 11.5%. Stock prices mirrored this and delivered 11.3% annualized returns (Chart 7).

Chart 7: Stock Prices and Earnings are Highly Synchronized (2013-2021)

Sources: Wind, Bin Yuan Capital

From 2022 to 2023, the compound growth rate for the healthcare sector was approximately 10.5% even with the series of negative events. The sector was down 25% over this period (Chart 8). The huge discrepancy (almost 50%) between growth and the performance of stock prices indicates the sector is now dramatically oversold.

Chart 8: the Gap between Index Performance and Solid Earnings' growth (2022-2023)



Sources: Wind, Bin Yuan Capital

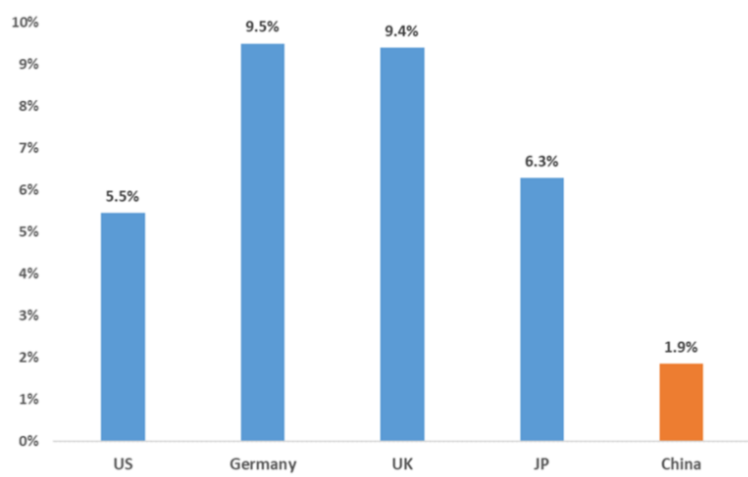
We believe the sector will recover its relative rating to the market.

The anti-corruption campaign has now largely run its course. Previously suspended equipment bids have restarted. Hospitals are actively reporting equipment replacement requirements. Doctors are getting back to their regular jobs.

Chinese entrepreneurs, including those in the healthcare business, are fully aware of and taking action to deal with the geopolitical risks, which we call the movement of competitiveness replacement. Chinese manufacturing capability is very competitive today and we believe the leading healthcare companies will not only survive in the global supply chain, but some of them will take global market share and become global leaders.

Fundamentally, the massive demand and the short supply for healthcare services in China has not changed. Living standards have seen dramatic improvement benefiting from the past 40 years of fast economic growth. Yet the healthcare sector and healthcare equipment has been a notable laggard (examples in Appendix 2). The government has allocated only 1.9% of its annual budget in the healthcare sector compared to 5-10% for developed countries (Chart 9). The widening gap between the demand and supply will drive future growth.

Chart 9: Government Healthcare Budget / GDP



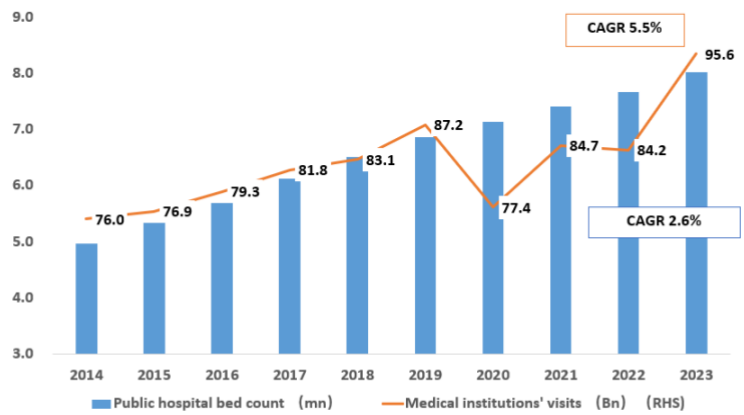
Sources: iFinD, Bin Yuan Capital

Structural opportunities:

1) <u>Private capital to drive hospital growth</u>

Government run hospitals face tight capacity due to fiscal constraints. Over the past decade, the number of hospital visits has increased from 76 million in 2014 to 95.6 million in 2023, a CAGR of 5.5%. In contrast, the number of beds in public hospitals has grown at a CAGR of 2.6% (Chart 10). In China, a 1,000-bed public hospital requires investment of 2.5 billion RMB. The approval process takes 1-2 years followed by 2 years of construction. High costs and lengthy timelines hinder rapid expansion. Therefore, despite increased government investment, these efforts have been outpaced by the large population and growing medical needs.

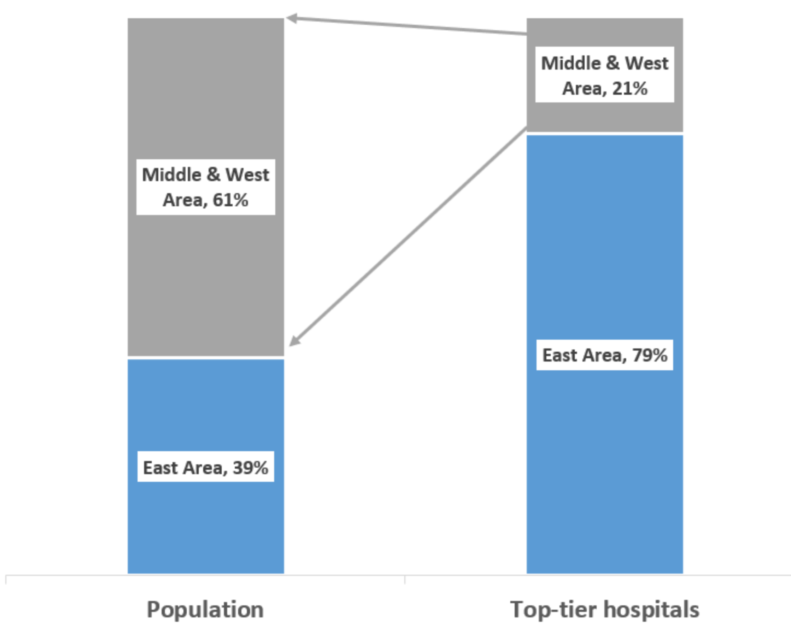
Chart 10: Public Hospital Beds vs. Medical Visits in China



Source: ifinD, Bin Yuan Capital

Misallocation is another key issue for the sector. Medical resources are concentrated in major cities, leaving lower-tier cities and rural areas underserved. Large tertiary hospitals and top medical experts are predominantly located in first- and second-tier cities. According to statistics, 80% of top-tier hospitals in China are concentrated in the eastern region covering 39% of the population. The remaining 20% of top-tier hospitals covers 61% of the population (Chart 11) with less advanced medical facilities.

Chart 11: Population vs. Top-Tier Hospital Allocation in China

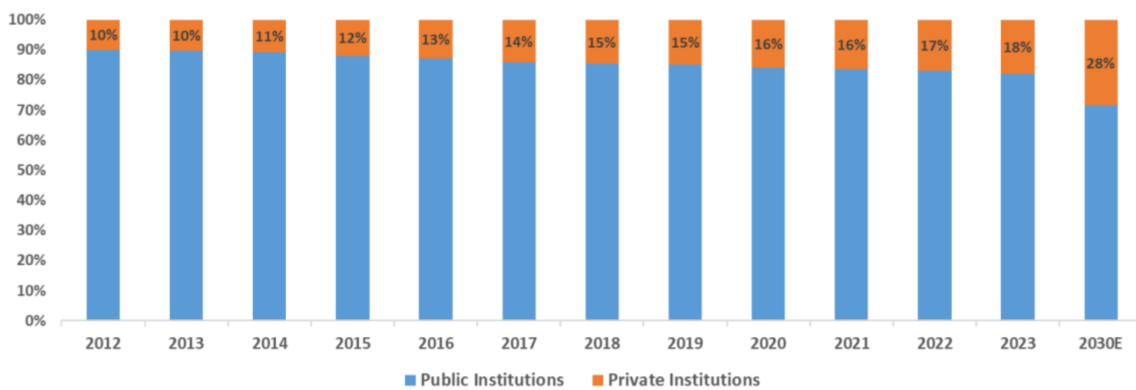


Source: ifinD, Bin Yuan Capital

To solve these supply-demand imbalances, encouraging private capital investment to participate is the most effective solution. Some long term private capital has always been interested in the operation of private hospitals. Once private hospitals are built, there are no issues about demand, and a long-term 15% EBITDA margin is very attractive. In the past, private capital faced many policy barriers when entering this field. Now, regulatory authorities have implemented numerous reforms over the decades to establish a more equitable and sustainable healthcare service system, including streamlining of admission processes, encouraging doctors to implement *Multi-site Practice*[1], and expanding Medical Insurance Coverage to private services.

Although government run hospitals still dominate in China, private hospitals are rapidly increasing. In terms of outpatient volume, the proportion of private hospitals has increased from 10% in 2012 to 18% in 2023 (Chart 12).

Chart 12: Hospital Visits for Diagnosis and Treatment



Sources: iFinD, China National Healthcare Security Administration, Bin Yuan Capital

The better experience encourages consumers with purchasing power to choose private hospitals, which in turn alleviates the pressure on public hospitals (Picture 1). We estimate China will add approximately 5000 private hospitals by 2030. Total investment will reach 12.5 trillion RMB. 2.5 trillion RMB will be allocated in equipment procurement, 5.5 times the equipment market size in 2023.

The majority of the equipment procurement budget will be allocated to domestic companies. We believe that over the next decade, private hospitals in China have great potential. Some large medical service groups will emerge.

[1] In the past, only public hospitals had established doctor ranking systems and operated in a relatively closed manner, preventing the sharing of doctor resources. As a result, the shortage of doctors in private hospitals became a significant bottleneck limiting their development. However, with the introduction of the multi-site practice system by the government, coupled with improvements in the ranking systems of private hospitals, the resource imbalances and shortages has been greatly mitigated. This flexibility enhances doctors' skills and ensures more patients receive quality healthcare, particularly in remote areas, thus alleviating supply-demand imbalances.

Picture 1: Patient Experience in Public vs. Private Medical Institutions

2) <u>Import substitution growing strongly</u>

In our past investment letters we have emphasized that import substitution is one of the key trends in the healthcare sector. While the VBP negatively impacts global companies, the local qualified suppliers will benefit. VBP underscores the emphasis for cost effective products which is an opportunity for the leading domestic companies.

The price differential between domestic and international manufacturers are listed below in Table 1.

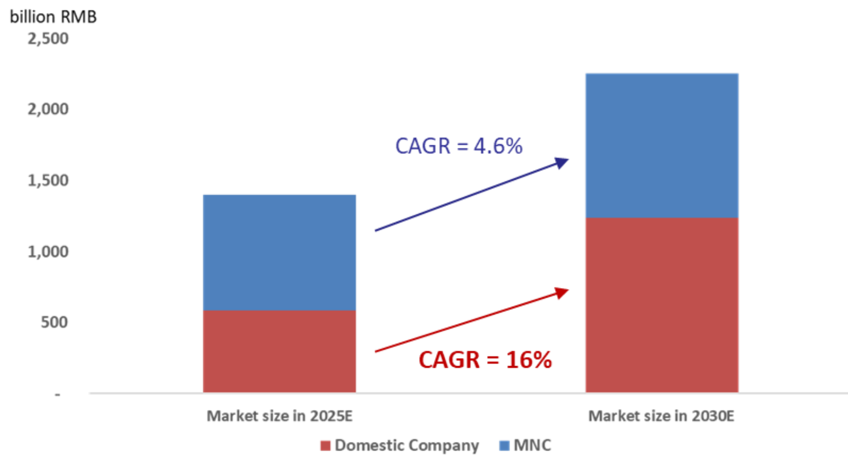
In terms of product quality, the local products are catching up very fast against products from the international giants. Some of the sophisticated machines are even better in certain parameters and user experience. Last week the weather in Shanghai was very hot. We received feedback from one of the largest hospitals in Shanghai that the CT and MR equipment made by two major global firms experienced overheating and shutdown after several days of continuous use. However, the Chinese products by United Imaging (688271.SH) continued to operate normally. In our conversations with surgeons, some surgical consumables produced domestically are more convenient and suitable for Chinese patients to use. In addition to help control social medical security costs, import substitution will accelerate.

Table 1: Price Differences & Localization Rate

	Price of Imported (thousand RMB)	Price of Domestic (thousand RMB)	Price Gap	Localization Rate
64~Row CT	6,000~15,000	3,000~6,000	2x	18%
320~Row CT	24,000	15,000	1.6x	7%
1.5T MRI	15,000	8,000~9,000	1.7x	29%
3.0T MRI	27,000~48,000	15,000~17,000	2.8x	7%
Laparoscopic Surgical Robot	24,000	9,000~18,000	1.3x	6%
Ultrasound Knife	12	1.4~1.8	6.7x	19%
Chemiluminescent Test Divice	300	40-100	3x	24%
Artificial Hip Joint	70	7	10x	59%
Artificial Knee Joint	60	5	12x	44%

We estimate that the overall localization rate of medical equipment & consumables will increase from the current 42% to 55% in 2030. This will support medical equipment companies to achieve annualized growth rates of at least 16% over the next 5 years, surpassing the industry growth of 10% and the 4.6% growth rate of global companies in China. By 2030, the market for Chinese medical equipment & consumables companies will be worth over 1.24 trillion RMB (Chart 13).

Chart 13: Market Potential for Chinese Medical Equipment Companies



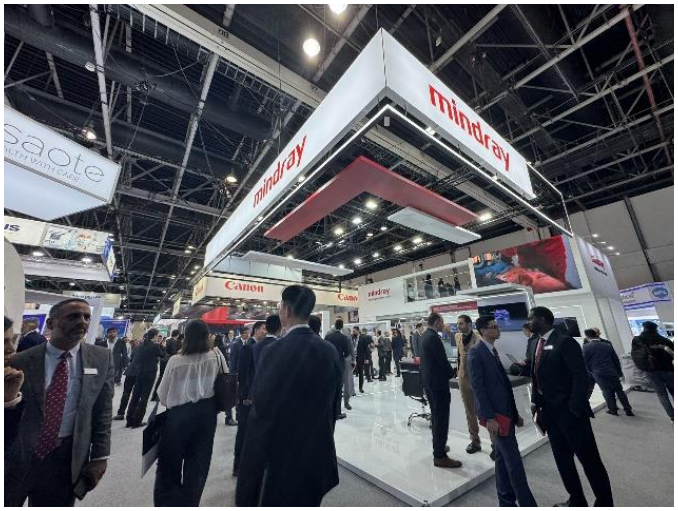
Sources: iFinD, Bin Yuan Capital

3) <u>Even with trade friction there are offshore opportunities for Chinese companies</u>

In line with improving Chinese manufacturing capability, Chinese medical components producers are supplying products to global players in the global supply network. Many Chinese healthcare companies have developed strategies to mitigate trade tariffs by rebalancing their position in the global supply network. Many are building production capacity outside of China to sell their products locally. Chinese manufacturing technology is highly advanced compared to most less developed countries.

To improve brand awareness, we see more Chinese firms attending major global exhibitions. At the beginning of this year, we went to the ARAB Health Exhibition in Dubai where many Chinese companies were active (picture 2).

Picture 2: Mindray & BMC Showcase in ARAB Health Exhibition



While we focus on opportunities in the domestic market and those companies benefiting from import substitution, globalization remains an important long term strategy for many Chinese healthcare companies. Those companies that have a globally competitive advantage and first mover advantage will also do well.

Based on the above analysis, we have decided to focus the healthcare fund on circa 20 names (vs the current circa 35). Within this we have picked 10 shocks as core investments which we believe will achieve high returns over the next three years. The key criteria for the selection are:

- Leading position in their segment
- Strong moat
- Technology on track to catch up with global standards
- High barriers to entry
- High ROE, sustainable margin, strong cash flow, and good payout ratios

Table 2 represents the 10 stocks we believe will achieve 26% annualized absolute returns over the next 3 years (earnings' growth plus rerating). Even in the *bear case scenario*[2], the portfolio will achieve 16% annualized absolute returns (Table 3). The key points of each company are listed in the Appendix 3.

[2] Bear case scenario assumption: 1) Anti-corruption campaign becomes stricter and impacts normal treatment activities. The annual number of hospital visits and surgeries grows at a rate of only 0-5%. 2) The procurement of large equipment becomes very sensitive. Expenditures on healthcare is just similar as GDP growth per year (5%). 3) Volume based procurement (VBP) becomes more intense. The price cut on manufacturers' ex-factory prices is more than 25%. 4) Extreme situations happen due to geopolitical reasons, such as the customers from the United States and European cannot purchase products from companies whose biggest shareholders are Chinese.

Table 2: Core Healthcare Holdings for 3 years

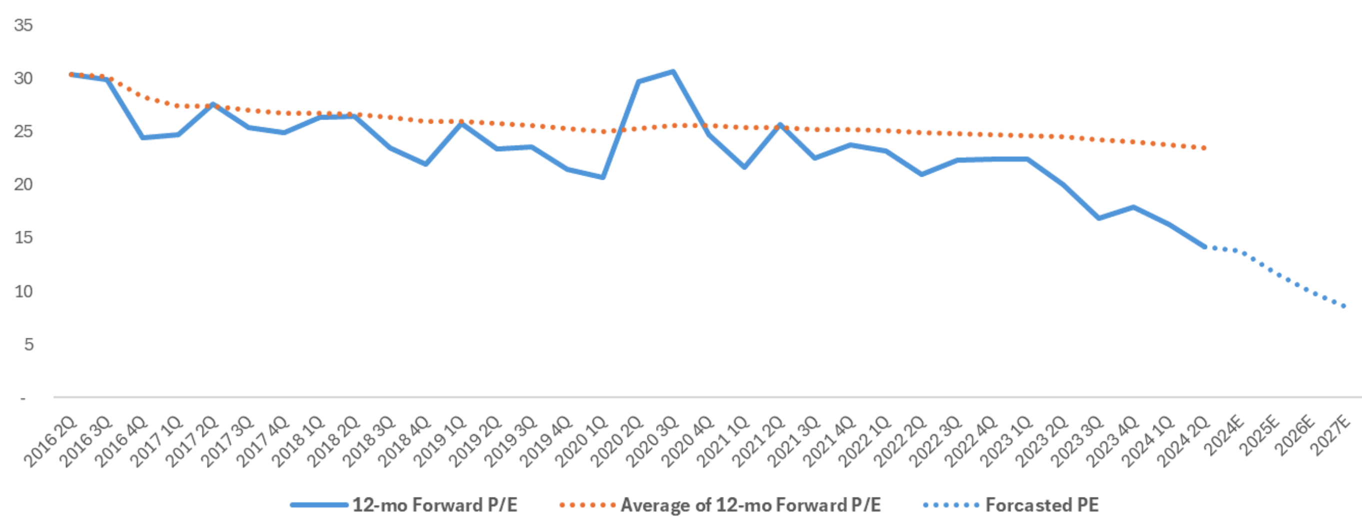
Ticker	Name	Segment	Market cap (million RMB)	2019-2023 Earnings' CAGR	2024-2027 Earnings' CAGR	2024 ROE	2027 ROE	2024 Yield	2024 PB	2024 PE	2027 PE	PEGY	Expected Annualized Return
688301.SH	IRAY TECHNOLOGY	Upstream	15,593	58%	25%	16.3%	21.1%	1.7%	3.21	19.5	10.0	0.74	31.7%
9997.HK	Kangji Medical	Consumables	6,394	25%	22%	19.3%	26.0%	4.3%	1.67	11.2	6.2	0.43	29.2%
1099.HK	Sinopharm	Services	53,837	10%	9%	12.4%	12.3%	4.6%	0.66	5.5	4.2	0.40	28.9%
300452.SZ	Sunhere Pharm	Upstream	2,534	18%	21%	16.6%	20.3%	2.7%	2.59	13.5	7.7	0.58	27.9%
600750.SH	Jiang Zhong Pharm	Pharm	14,206	11%	15%	19.8%	24.1%	7.2%	3.71	17.4	11.6	0.80	27.6%
603939.SH	Yifeng Pharmacy	Services	26,832	27%	19%	15.6%	18.8%	2.3%	2.52	15.7	9.3	0.73	27.1%
3320.HK	China Resources	Services	30,943	7%	9%	8.8%	9.2%	2.8%	0.63	7.6	5.9	0.67	26.2%
300653.SZ	Zhenghai Bio-Tech	Consumables	3,942	15%	20%	19.7%	20.2%	3.1%	3.93	18.3	10.5	0.78	22.8%
002737.SZ	Sunflower Pharm	Pharm	13,146	19%	12%	20.7%	22.0%	6.2%	2.60	10.9	7.8	0.61	21.6%
002223.SZ	Yuyue Medical	Equipment	36,941	34%	16%	16.5%	17.8%	1.9%	2.96	18.1	11.7	1.04	17.3%
Average			**-14.8%**	**14%**	**12%**	**16.6%**	**19.2%**	**3.7%**	**2.45**	**10.3**	**6.8**	**0.65**	**26.0%**

Table 3: Core Healthcare Holdings - Most Likely & Bear case scenarios next 3 years

Company	Valuation		1 Yr Return - Most Likely				3 Year Total Return - Most Likely				1 Yr Return - Bear Case				3 Year Total Return - Bear Case			
	2024 PE	2024 Dividend Yield	Target 2025 PE	PE Expansion / Detraction	2025 Earnings Growth	Most Likely Return	Target 2027 PE	PE Expansion / Detraction	Annualized Earnings Growth to 2027	Most Likely Total Return	Target 2025 PE	PE Expansion / Detraction	2025 Earnings Growth	Bear Case Return	Target 2027 PE	PE Expansion / Detraction	Annualized Earnings Growth to 2027	Bear Case Total Return
Healthcare	**12.9**	**3.6%**	**16.3**	**27%**	**17.4%**	**56.7%**	**15.1**	**17%**	**17.1%**	**112.0%**	**12.9**	**0%**	**14.1%**	**17.7%**	**12.5**	**-3%**	**14.1%**	**59.5%**
IRAY TECHNOLOGY	18.6	1.7%	25.0	34%	23.5%	67.6%	22.0	18%	24.7%	138.8%	18.6	0%	20.7%	22.4%	18.6	0%	20.7%	83.3%
Kangji Medical	11.1	4.3%	13.0	18%	23.4%	49.4%	12.0	8%	22.1%	119.2%	11.1	0%	16.1%	20.4%	11.2	1%	16.1%	76.8%
Sinopharm	5.4	4.6%	8.5	57%	9.6%	76.2%	8.0	47%	9.2%	117.0%	5.4	0%	7.2%	11.8%	5.4	0%	7.2%	39.7%
Sunhere Pharm	13.2	2.7%	16.0	21%	20.2%	47.9%	15.0	13%	20.8%	112.9%	13.2	0%	18.8%	21.4%	13.0	-2%	18.8%	75.7%
Jiang Zhong Pharm	17.1	7.2%	22.0	29%	14.7%	54.7%	20.0	17%	14.6%	111.4%	17.1	0%	12.6%	19.8%	15.0	-12%	12.6%	50.9%
Yifeng Pharmacy	15.2	2.3%	18.0	18%	18.2%	42.1%	18.0	18%	19.2%	112.1%	15.2	0%	17.2%	19.5%	15.0	-1%	17.2%	68.2%
China Resources	7.4	2.8%	12.0	62%	12.6%	85.3%	11.0	49%	8.6%	105.2%	7.4	0%	6.6%	9.4%	7.4	0%	6.6%	30.8%
Zhenghai Bio-Tech	18.1	3.1%	19.0	5%	20.8%	30.0%	18.0	-1%	20.2%	86.6%	18.1	0%	15.2%	18.3%	16.0	-12%	15.2%	46.5%
Sunflower Pharm	10.8	6.2%	13.0	21%	11.2%	40.5%	12.0	12%	11.7%	82.7%	10.8	0%	9.7%	15.9%	10.0	-7%	9.7%	44.7%
Yuyue Medical	18.0	1.9%	19.0	6%	15.0%	23.2%	18.0	0%	15.6%	61.9%	18.0	0%	14.6%	16.4%	17.0	-6%	14.6%	49.1%

Chart 14 illustrates the deviation of the current valuation relative to the historical mean. When the companies deliver expected earning and the market sentiment reverses to normal, this gap will be closed.

Chart 14: Healthcare Portfolio 12 Month Forward P/E (Weighted Average Method)



Source: Wind, Bin Yuan Capital

SUMMARY

Taking a cautious view, China's healthcare industry can achieve a long-term growth rate at least 2 times higher than GDP. We believe the sector will be rerated and justifies a premium rating.

The massive imbalance between supply & demand for healthcare services in China has not changed. This creates massive opportunities for domestic healthcare equipment companies. With a projection of 5,000 additional private hospitals by 2030, total investment will reach 12.5 trillion RMB. The 2.5 trillion RMB to be allocated in equipment procurement is 5.5 times the equipment market size in 2023. And the majority of this will be allocated to domestic companies where we see the overall localization rate increasing from the current 42% to 55% in 2030.

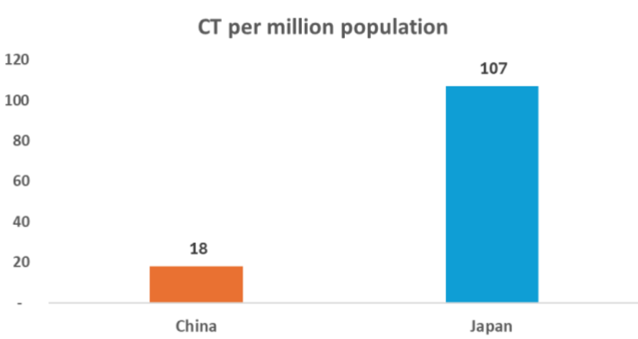
By 2030, the market for Chinese medical equipment & consumables companies will be RMB 1.24 trillion+ vs RMB 0.45 trillion in 2024.

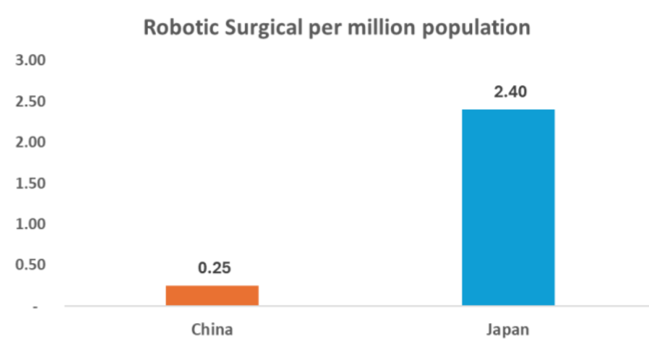
We are focusing the portfolio on 18-20 stocks with a core 10 names. Our most likely forecast is based on conservative assumptions including severe ongoing trade friction - and here we estimate this portfolio will deliver 26% annualized returns over the next 3 years. Our bear case scenario assumes slightly lower revenue growth and some margin pressure. In the bear case scenario, we estimate the portfolio will deliver 16% annualized returns over the next 3 years. This assumes no increase in valuations from the current levels.

Appendix 1: Earnings Valuation Comparison vs Global Peers

			20240715	Revenue	OP income	Net Income	Net Margin	2024-2027	2025E	2025E
Bloomberg Ticker	NAME	Regic	Market Cap (MN USD)	2023A	2023A	2023A	2023A	NI CAGR	PEG	PE
Healthcare Equipment										
300760 CH Equity	MR	CN	46,407	4,818	1,803	1,598	33.1%	21%	0.9	20.3
GEHC US Equity	GE HEALTHCARE TECHNOLOGIES	US	36,645	19,552	2,435	1,568	8.0%	13%	1.3	16.8
RMD US Equity	RESMED	US	30,091	4,223	1,143	898	21.3%	13%	1.8	24.5
BDX US Equity	BECTON DICKINSON	US	66,214	19,372	2,214	1,484	7.7%	9%	1.5	15.9
ROG SE Equity	ROCHE HOLDING AG-GENUSSS	CH	230,492	71,839	17,832	13,666	19.0%	9%	1.1	13.8
HOLX US Equity	HOLOGIC	US	18,131	4,030	762	456	11.3%	8%	2.3	17.4
Healthcare Component										
688301 CH Equity	IRAY TECHNOLOGY	CN	2,063	257	94	84	32.4%	23%	0.6	15.1
VREX US Equity	VAREX IMAGING	US	595	893	77	48	5.4%	5%	2.9	14.5
4901 JP Equity	FUJIFILM	JP	30,140	21,507	2,054	1,651	7.7%	12%	1.5	19.3
4902 JP Equity	KONICA MINOLTA	JP	1,480	8,504	-765	-776	-9.1%	11%	2.7	29.8
DHR US Equity	DANAHER	US	182,727	23,890	5,202	4,764	19.9%	18%	1.7	31.5
7733 JP Equity	OLYMPUS	JP	19,848	6,634	1,326	1,079	16.3%	8%	1.6	12.8
Medical Consumables										
9997 HK Equity	Kangji Medical	HK	884	130	83	71	48.8%	19%	0.4	9.4
MDT US Equity	MEDTRONIC	US	99,953	31,227	5,830	3,758	12.0%	15%	0.8	14.0
ISRG US Equity	INTUITIVE SURGICAL	US	157,546	7,124	1,767	1,798	25.2%	20%	3.4	70.2
4543 JP Equity	TERUMO	JP	25,849	6,170	884	672	10.9%	17%	2.6	47.0

Appendix 2: Examples of large penetration gap of Healthcare Infrastructure between China and Japan





Appendix 3: 10 Core holdings:

Kangji Medical (China's largest manufacturer of minimally invasive surgical instrument (MISIA) and robots, Market Cap USD 0.9 billion):

✓ In 2023, the penetration rate of minimally invasive surgery was 18%. This is predicted to reach 26% by 2027. The total domestic market size is 40 billion RMB in 2024E.

- ✓ The Localization rate of MISIA is less than 10%. Kangji's products on average are one third the price of Medtronic and J&J. The market share of Kangji has increased from 1.8% in 2017 to 3.6% in 2023. We estimate this will grow to 5.5% by 2027.
- ✓ New products drive revenue growth: Ultrasonic Scalpels +109%, 4K Endoscope System +57%, Disposable Electrocoagulation Forceps +30%.
- ✓ With RMB 3 billion in cash on hand, Kangji will maintain its annual dividend payout ratio at a level of 50-70%. It continues to engage in a stock repurchasing plan.
- ✓ Wiseking (surgical robots) has made good progress. The four-arm robot is undergoing phase three clinical trials and is expected to apply for product registration this year.

IRAY TECHNOLOGY (Leading manufacturer of image detectors, Market Cap USD 2.2 billion):

- ✓ Increasing the addressable market by expanding downstream applications, from in medical, dental, veterinary, to industrial imaging, and chip testing. The detectors' market size is 35 billion RMB.
- ✓ Continue import substitution by price advantage (manufacturing cost is only 1/5 of GE and 1/3 of Varex Imaging)
- ✓ Market share globally will increase from 10% in 2023 to 45% by 2030.
- ✓ Vertical integration, from upstream CMOS chips, to downstream ODM. From Q4 last year, iRay has been providing mobile Dental X-ray equipment ODM for GE, and will collaborate with GE on additional products going forward.
- ✓ Customer recognition in the new product CT industry chain has entered a critical point, and we expect to see 70 million RMB revenue contribution this year.
- ✓ The impact of China's healthcare anti-corruption is easing.

Sinopharm (China's largest distributor of pharmaceuticals, healthcare products, and medical devices, Market Cap USD 7.5 billion):

- ✓ Sinopharm Group has 20% market share in pharmaceutical distribution and 16% share in medical device distribution in China. The total domestic market size is 3.3 trillion RMB in 2024E.
- ✓ Their Nationwide comprehensive distribution channel cannot be duplicated, covering 98% top hospitals. Leveraging its advantages of scale, Sinopharm continues to displace small and medium-sized distributors.
- ✓ Offering one-stop total solution for customers, including warehouse, distribution, marketing, and even manufacturing, to boost their addressable market. Net attributable profit has been growing since 2006 with high

correlation with the development of China’s healthcare market, providing continuous cash flow for dividend distribution (4.5% dividend yield).

Sunhere Pharmaceutical (Leading pharmaceutical excipients manufacturer, Market Cap USD 0.4 billion):

✓ Product price is 1/3 to 1/2 of imported products, prompting Chinese drug companies to make rapid import substitutions. The company's production capacity has been tight. New production capacity was gradually discharged from last year and the total capacity will have doubled by 2025E. The domestic market size of microcrystalline cellulose and hydroxypropyl methylcellulose in China is 700 million RMB and 1.2 billion RMB respectively, and Sunhere accounts has 20% market share. The total pharmaceutical excipients market in China is 83 billion RMB.

✓ In terms of value contribution in drugs, pharmaceutical excipients only account for 3%-5% in China vs 10-20% globally. With the increased use of advanced pharmaceutical excipients, the ratio will continue to converge with international levels.

✓ New products driving revenue growth: Sodium Stearyl Fumarate +100%, CMC excipients for injection +80%.

Jiangzhong Pharmaceutical (Largest OTC gastrointestinal pharma, Market Cap USD 2.1 billion):

✓ With the shift in Chinese lifestyle and the increasing aging population, the number of gastrointestinal patients is rising, driving up demand for OTC gastrointestinal medications. The market size for OTC gastrointestinal drugs in China was 22.3 billion RMB in 2023.

✓ Mature products can create 372 million RMB stable cash flow per year. New products drive other revenue growth, including Compound Sarsaparilla Lozenges +20%, health products +50%.

✓ With RMB 1.3 billion in cash on hand. The dividend payout ratio for the past 3 years (2021-2023) is 100%+ (7.2% dividend yield).

Yifeng Pharmacy (Leading Chain Pharmacies in China, Market Cap USD 3.7 billion):

✓ The market share of pharmacy chains in China is only 58%, offering substantial room for growth compared to the policy target of 70% and nearly 80% market share in Western markets. Pharmacy chains are also integrating. As a top 5 pharmacy chain operator, Yifeng continues to acquire local pharmacy chains these years, and had a 5% market share in the 600 billion RMB market in 2023.

✓ China's aging population, with 250 million people over 60, drives a projected 5% CAGR in the medicine retail market. The flow to outpatient pharmacy departments from hospitals is expected to channel an additional 600 billion RMB in prescription drug sales to retail pharmacies over the next five years, boosting growth by a further 2% per year.

- ✓ Pharmacy Chains are a relatively asset light operation model. In addition to putting some cash aside for potential mergers and acquisitions, the company can return its partial stable annual cash flow of 4 billion RMB to shareholders. Yifeng holds 5 billion RMB in cash and has a dividend payout ratio of 40% (2.3% dividend yield).

China Resources Pharmaceutical Group (Leading healthcare group company, Market Cap USD 4.4 billion):

- ✓ China's leading healthcare manufacturer and distributor, ranking third in the country in terms of scale in the distribution sector, with a market share of 7%. The addressable market size is 3.3 trillion RMB.
- ✓ China Resources Pharmaceutical Group owns a series of well-known pharmaceutical brands in China, including Dong-E-E-Jiao, CR Sanjiu, CR Jiangzhong and etc., Among them, CR Sanjiu is the No.1 over-the-counter (OTC) pharmaceutical company in China.
- ✓ Offering one-stop total solution for customers, including warehouse, distribution, marketing, and even manufacturing, to boost its addressable market. High visibility profit can secure stable cash flow for dividend distribution (2.7% dividend yield).

Zhenghai Bio-Tech (China's leading regenerative medicine company for dental restorations and dural defects, Market Cap USD 0.6 billion):

- ✓ As China's population ages, the demand for dental implants continue to increase driving demand for dental related materials. The current penetration rate of dental implants in China is less than 0.25%, vs 1%+ in developed countries. The domestic market size is 2 billion RMB for oral products in 2023.
- ✓ Zhenghai's dental implants are 1/2 the price of Geistlich, which has more than a 70% market share in China. Zhenghai has a large import substitution opportunity over the next few years.
- ✓ Zhenghai's additional product line of active bone products has covered 80% of provinces and will continue to increase sales volume. The active bone market is relatively new for China, and the domestic market size is estimated to grow to 3 billion RMB in 2030E.

Sunflower Pharmaceutical (Largest pediatric pharma in China, Market Cap USD 1.9 billion):

- ✓ China is the second largest pediatric drug market globally. After the pandemic, the incidence and consultation rates for children have risen, leading to steady growth in the pediatric medication market. The national market size for pediatric drugs was 119 billion RMB in 2023.

- ✓ Sunflower Pharmaceutical had a 14% market share in the OTC pediatric traditional Chinese medicine sector in 2023 and we estimate this will grow to 17% by 2027. The company has developed several major products in pediatrics, adult digestive, and gynecology, with 14 products achieving over 100 million RMB in sales.
- ✓ The company actively promotes dividend distribution, with healthy and stable cash flow, holding 3.5 billion RMB in cash and a dividend payout ratio of 78% (6.2% dividend yield).

Yuyue Medical Equipment (China's leading household medical equipment manufacturer, Market Cap USD 5.1 billion):

- ✓ As the population ages and people's medical knowledge improves, some medical products that used to be used only in hospitals now also appear in households, such as oxygen generators, nebulizers, etc. The domestic household medical equipment market grew to 220 billion RMB in 2023.
- ✓ Many household medical devices in China have low penetration rates and high growth rates. Usage per person in developed countries is 10X+ than that in China. For example, the penetration rate of Continuous Glucose Monitoring (CGM) is only 6.9%, 1.1% and 0.3% in the areas of type I diabetes, type II diabetes and gestational diabetes (26%, 9% and 4% in US); and the penetration rate of Continuous Positive Airway Pressure (CPAP) is only 2% in China (20% in US).
- ✓ Yuyue has established a very strong brand awareness and recognition in households, especially during the covid period and for online channels. It can leverage its well-established channels to commercialize and promote its new products and rapidly increase the scale of sales. Yuyue is taking market share from global leaders such as Roche and OMRON by its high price-to-quality products.