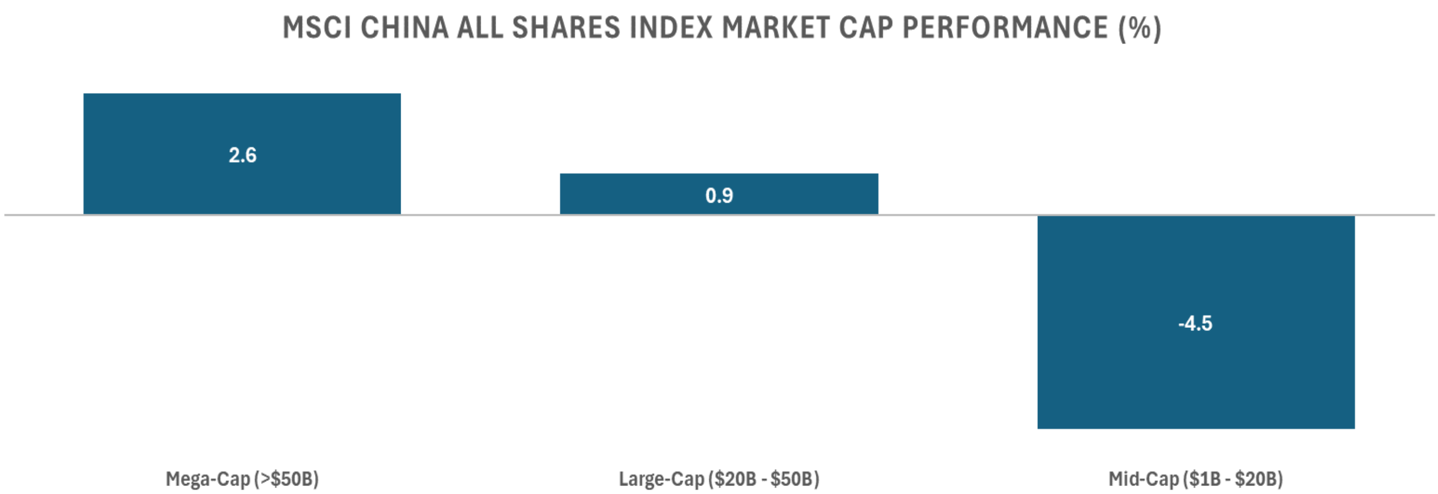
Bin Yuan Capital All China Strategy – March 2024

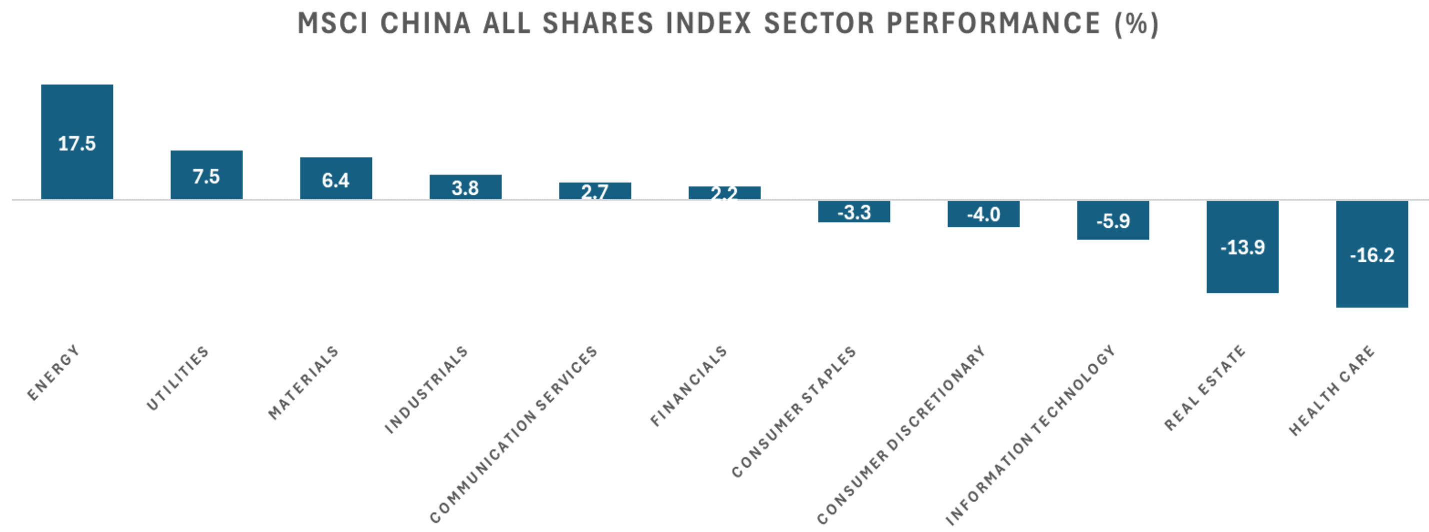
Performance Attribution

In the first quarter of 2024, our underperformance for the quarter can be attributed to the following three factors:

1. The index performance was distorted by government intervention. Our underweight position in large caps contributed roughly 3.7% to our underperformance driven by several factors. First, government funds intervened to support the market which had dropped sharply in January caused by panic selling. The objective of the government funds was to maintain the level of the index. It selectively bought those stocks that have a bigger impact in the index which were large caps and state owned (SOEs). Second, the government put a "no net sell" restriction on mutual funds. To protect fund performance and maintain liquidity, mutual funds bought those stocks that government funds were buying, and sold mid and small caps, most of which are not SOEs. Third, foreign passive funds had continued net inflows while active funds were selling, reinforcing the outperformance of large-cap stocks in the index. These factors disadvantaged our mostly mid-cap stocks. In the MSCI China All Share index, mid-cap names corrected by an average of 4.53% year to date, compared to gains of 2.58% and 0.89% for mega-cap and large-cap stocks, respectively (see chart below).



2. Related to the above, sector allocations accounted for approximately 3.4% of our underperformance. The top three performing sectors in the market YTD were mostly SOE heavy sectors that include Energy, Utilities, and Materials, with gains of 17.5%, 7.4%, and 6.4%, respectively, sectors in which we are underweight. Sectors that we are focus on, such as Healthcare, Information Technology, and Consumer Goods, which are mostly in the private sector, experienced declines of 16.2%, 5.8%, and 3.8%, respectively (see chart below).



3. Finally, our relative concentration hurt us as well. Our strong conviction in holdings like iRay, Haichang, Maxscend, and Anjoy were not in focus during the quarter and did not benefit from some of the hot theme rotations, even though their fundamentals remain intact and very attractive (see earning details below). Collectively, these stocks contributed to an impact of approximately -5%. iRay alone accounted for an impact of more than -3%.

Recognizing the less favorable market conditions for our investment style, our team has devoted significant effort to thoroughly scrutinize our mid-cap holdings. We've heightened our sensitivity to changes in the competitive landscape and industry uncertainties to ensure our investments are aligned for long-term value creation. Currently, our portfolio of long-term, high conviction names remains unchanged. We remain confident that these long-term winners will drive strong performance throughout the year, providing us with increased upward momentum in the coming quarters.

Bin Yuan Comments

The country's economy showed signs of recovery with a series of better-than-expected macro data. Both official and private PMI, following the export and retail sales data, beat consensus in March, with the official manufacturing PMI climbing to its strongest reading, 50.8, since March last year. Despite the drag of the real estate sector, investment in infrastructure and manufacturing sectors both came in stronger than expected. Encouragingly, there were positive developments in the property markets in top-tier cities. For instance, in Shanghai, a new residential property offering approximately 514 units witnessed overwhelming demand, with 510 units sold within just two hours, pricing around USD 6 million per unit, surprising many observers. Moreover, property developers bid record-high land prices in cities like Suzhou and Xiamen, indicating growing stability in the market and no signs of collapse.

In the overall economy, our field research revealed improved foot traffic in stores and restaurants, signaling a gradual recovery in consumer activity, and we saw increased demand for travel and tourism. There were also attractive events injecting new vitality into the tech sector, such as the release of a "Low-altitude Economy" action plan to accelerate the development of flying cars。

The high-quality fundamentals of our portfolio holdings stood out as they released their annual and quarterly earnings results. The annual results season ends April 30th, and we will comment in the April monthly letter on the portfolio's 2023 earnings and outlook and how they compare to the market. The results seen so far have been encouraging and ahead of our expectations. These underpin the strong fundamentals of the portfolio and provide a solid foundation for good performance as the market stabilizes.

- ✓ Trip.com Group (a leading travel service provider)
  - ➢ 2023 revenue RMB 44.5 bn, +122% YoY
  - ➢ 2023 net income RMB 9.9 bn, +607% YoY
  - ➢ Revenue and net income grew by 25% and 42%, respectively, over 2019 levels, demonstrating larger market share and increased economies of scale reflected in reduced SG&A costs. We expect the company will continue to take more market share from its domestic and global peers.
- ✓ H World Group (a leading hotel chain operator)
  - ➢ 2023 revenue RMB 22 bn, 58% YoY increase.
  - ➢ 2023 net income RMB 4.1 bn, reversing from a RMB 1.8 bn loss in 2022.
  - ➢ 23Q4 revenue RMB 5.6 bn, 51% YoY increase.
  - ➢ 23Q4 net income RMB 743 mn, reversing from a RMB 717 mn loss in 22Q4.
  - ➢ H World offers its franchisers the highest hotel operation profitability, so more and more franchisers join H World brands, and the company steadily increases its market share. We expect this trend will continue as H World enriches its hotel brand portfolio to facilitate needs from a wider range of customers, from economy-needs to luxury-needs.
- ✓ Haichang Ocean Park (a leading entertainment park operator)
  - ✓ 2023 revenue RMB 1.8 bn, +129% YoY
  - ✓ 2023 EBITDA RMB 542 mn, reversing from a loss in 2022
  - ✓ Adjusted EBITDA RMB 4.59 mn, OCF RMB 530 mn
  - ✓ EV/EBITDA in 2024 5.9X

- ✓ Haichang continues its recovery momentum. Shanghai Park visitor flow exceeded 2019 levels during the New Year and spring festival in 2024. Visitor flow in the newly opened park in Zhengzhou is expected to ramp up in 2024 and 2025 to contribute RMB 1 bn in 2026.

- ✓ iRay Technology (a manufacturer of image detectors)
  - 2023 revenue RMB 1.89 bn, +22% YoY
  - 2023 core net profit RMB 600 mm, +16% YoY
  - The proportion of overseas revenue reached 35% in 2023, and the growth rate of overseas revenue continues to be higher than that of domestic revenue. iRay has gained recognition from global first-tier customers in the medical and dental area.
  - On the industrial side, iRay completed product upgrades in 2023, and products with higher cost-effectiveness are expected to drive revenue growth this year.
  - Customer recognition in the new product CT industry chain has entered a critical point, and we expect to see an increase in volume in the second half of this year.
  - The impact of China's healthcare anti-corruption is easing. iRay should recover quarter by quarter in 2024. Their annual profit growth rate in 2024 is expected to exceed 25%.

- ✓ Kangji Medical (China's largest manufacturer of minimally invasive surgical instrument and robots)
  - 2023 revenue RMB 930 mm, +17.8% YoY
  - 2023 export revenue RMB 86.5 mm, +20.6% YoY
  - New products sales growth: Ultrasonic Scalpels +109%, 4K Endoscope System +57%, Disposable Electrocoagulation Forceps +30%
  - 2023 operating profit RMB 668 mm, +13.2% YoY, excluding the Wiseking investment loss
  - 2023-end OCF RMB 420 mm, +31.4% YoY
  - With RMB 3 bn cash on hand, Kangji offered a dividend of RMB 1.4 per share, for a dividend yield of 22%. It announced that its annual dividend payout ratio will be maintained at a level of 50-70% in the future, and it will continue 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 in the second half of this year.
  - The impact of China's healthcare anti-corruption is easing. Kangji's earnings' growth rate is expected to exceed 15% in the next three years with a 20% ROE. The valuation is very attractive at 12X 2024 PE.

- ✓ Jereh (an Oil & Gas equipment manufacturer)

- 2023 revenue RMB 13.9 bn, +21.9% YoY
- 2023 net profit RMB 2.5 bn, +9.3% YoY
- 2023 overseas GM 31.8%, +3.18 ppts YoY
- 2023Q4 revenue RMB 5.2 bn, +20% YoY
- 2023Q4 net profit RMB 890 mn, +18. 8% YoY
- These results were driven by strong growth in the overseas market, especially in the US and Middle East. In the US, Jereh sold their first battery-driven fracturing equipment with significantly higher margins. In the Middle East, Jereh completed a huge project worth RMB 2 bn for Kuwait Oil Company.
- Order growth from the overseas market is still growing strongly.

✓ Guangdong Hongda (the leading mining service provider)

- 2023 revenue RMB 11.5 bn, +13.5% YoY
- 2023 net profit RMB 716 mn, +27.68% YoY
- 2023Q4 revenue RMB 3.6 bn, +9.0% YoY
- 2023Q4 net profit RMB 219 mn, +29.2% YoY
- 2023 Dividend payout ratio 56.7% +16.71 ppts.
- Hongda's decent revenue growth was due to robust demand from the mining sector, which in turn was driven by strong prices of copper and gold. Even stronger profit growth resulted from higher margins in the overseas market and continuously decreasing cost of materials.

✓ Autowell (a solar equipment manufacturer)

- 2023 revenue RMB 6.3 bn, +78.1% YoY
- 2023 net profit RMB 1.3 bn, +76.1% YoY
- These were 7% higher than the market expected, mainly due to the company's expansion of product categories, which brought additional growth in 2023 and should continue to drive growth in the next several years.
- Order growth in the first two months of 2024 continued with positive momentum.
- Based on our research and cross check with related companies in the industry, the shipment and production scheduling of photovoltaic modules in the first quarter have greatly exceeded market expectations, with high growth maintained both domestically and overseas.

- ✓ Joyson Electronic (an auto intelligence and safety solution provider)
  - 2023 revenue RMB 55.6 bn, +12% YoY
  - 2023 Net profits RMB 989 mn, +215% YoY
  - Q4 2023 Net profits were RMB 318 mn, +420% YoY.
  - These results demonstrated steady revenue growth and the positive effects from economies of scale with cost reduction and increasing efficiency. As the company systematically delivers its current orders on hand and continuously improves its order structure within its safety business, profitability should progressively rise.
- ✓ BOCHU (previously Friendess, a laser-processing solution provider)
  - 2023 revenue RMB 1.4 bn, +56.6% YoY
  - 2023 net profit RMB 824 mn, +50.9% YoY
  - These were 10% higher than the market expected, mainly due to the strong demand for laser equipment from downstream manufacturing customers as BOCHU takes more market share from foreign peers.
- ✓ Maxscend Microelectronics (a RF solution provider)
  - 2023 revenue RMB 4.4 bn, +19.06% YoY
  - 2023 net profit RMB 1.2 bn, +8.9% YoY, which was 10-20% better than expected.
  - Q4 revenue RMB 1.3 bn, +97.6% YoY
  - Q4 net profit RMB 346 mn, + 310% YoY
  - These results show that the company has taken market share from foreign players due to their strong product competitiveness.
- ✓ Chaozhou Three Circle (CCTC) (electronic component and advanced material)
  - Q4 23 reported YoY net income growth of close to 40%
  - This was due to the recovery of demand in the electronics industry, and the company’s increasing competitiveness with new product breakthroughs.
- ✓ Semiconductor equipment manufacturers delivered strong earnings growth benefiting from the import substitution trend.
  - AMEC: 2023 net profits RMB 1.7 bn, +52.6% YoY, 2023 etching equipment revenues RMB 4.7 bn, +49.4% YoY

- Pio Tech: 2023 net profits RMB 0.66 bn, +80.3% YoY, 2023 revenues RMB 2.7 bn, +58.6% YoY

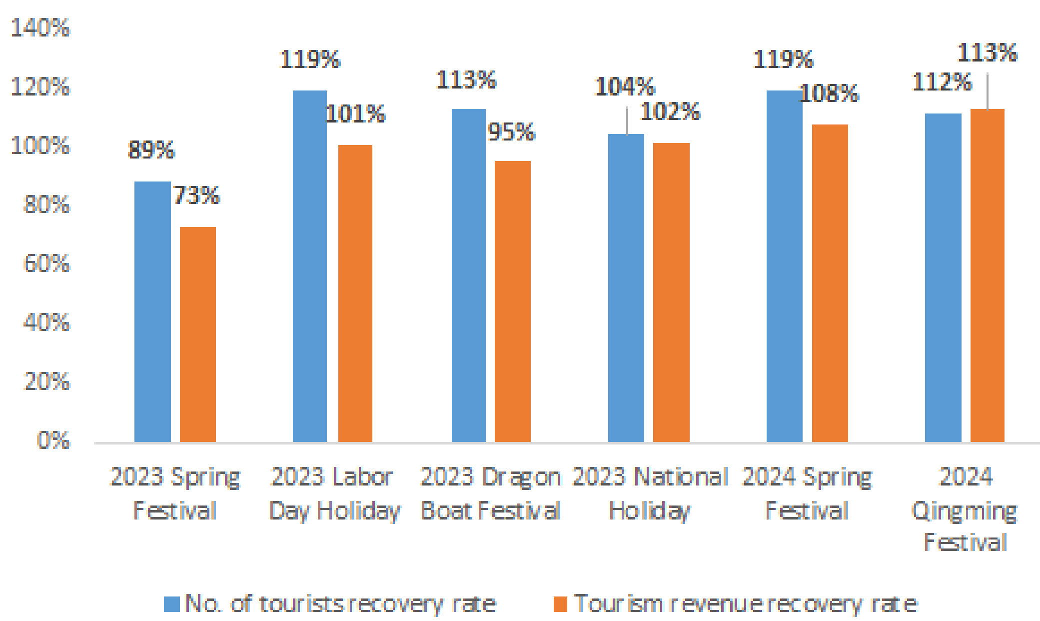
Embracing the Rebound in the Chinese Tourism Market

Strong recovery continues in Chinese tourism market.

1. Domestic Market

Since the beginning of 2023, there has been a strong recovery in domestic tourism demand in China. Tourism revenues and the number of travelers has surpassed pre-pandemic levels, and the momentum continues in 2024.

Chart 1. Recovery of Domestic Tourism & Revenue during Major Holidays Since 2023 (vs 2019)

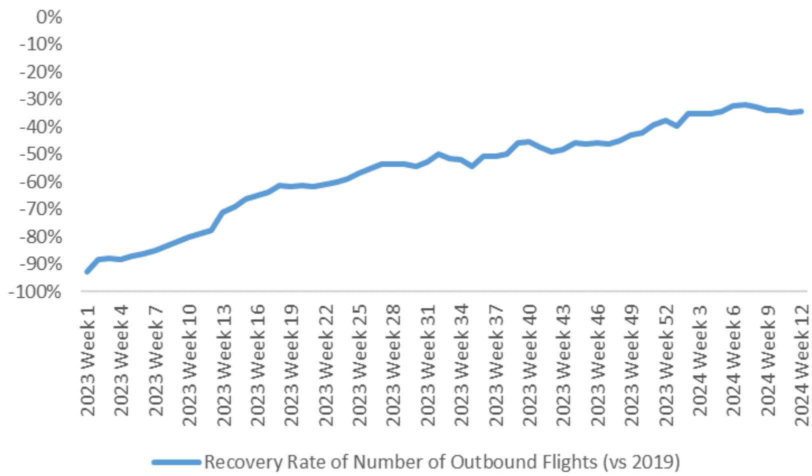


Source: Ministry of Culture and Tourism

2. Outbound Travel

Currently, outbound travel is restricted by limited airline seat capacity mostly due to some foreign airlines redirecting their capacity that was originally destined for China to other markets during the pandemic, causing a lag in the recovery of the Chinese market. Although the recovery in the volume of outbound flights is only 70% of 2019 levels, we are seeing a gradual recovery. We expect that by the end of 2024, the volume of outbound flights will recover to 80% of the level seen in 2019, and that represents a 33% increase by the end of 2024 compared to the same time in 2023.

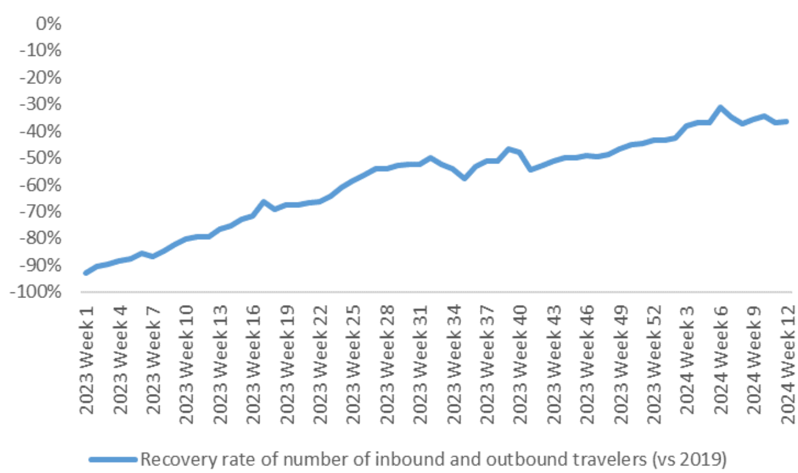
Chart 2. Recovery Rate of Number of outbound Flights (vs 2019)



Source: Ctrip, SWSResearch

At the same time, **entry and exit visa restrictions are gradually being eased.** As various countries have eased their visa requirements for Chinese citizens, China has reciprocated by expanding its in-bound visa-free policy. As of the end of January 2024, China has implemented comprehensive reciprocal visa exemptions with 23 countries, including Thailand, Singapore, Maldives, and the United Arab Emirates – all popular destinations for Chinese citizens. In addition, more than 60 countries and regions offer visa-free or visa-on-arrival facilities to Chinese tourists. This will save time and money spent on visa applications, increase regional tourism, and also benefits the tourism industry chain.

Chart 3. Recovery rate of number of inbound and outbound travelers (vs 2019)



Source: Ctrip, SWSResearch

Online Travel Agency (OTA) platforms are the beneficiaries of the recovery in tourism.

The Chinese OTA market size is around RMB 800 bn, of which Trip.com Group (formerly Ctrip) maintains around 50% market share. **It leverages the overall growth of the tourism industry and the increased online penetration.** Airline tickets and hotel bookings are the two major sources of revenue.

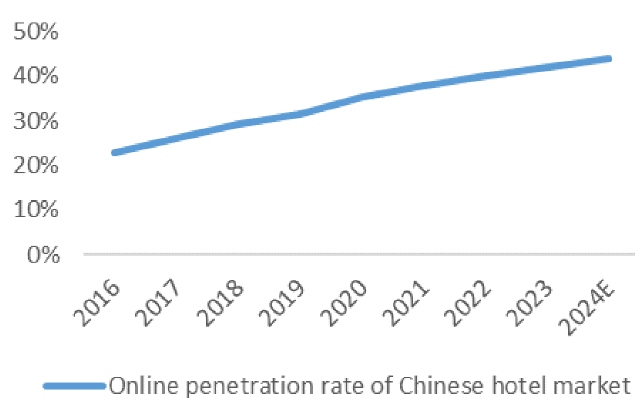
OTA platforms benefit from economies of scale, relying on the mutual promotion between the demand side (tourists) and the supply side (airlines, hotels, etc.):

- Arich array of products and services on the supply side often attracts more platform users and more spending.
- A large number of high-quality users tend to attract more high-quality suppliers.
- OTA platforms can continuously optimize and retain users based on user feedback, thereby enhancing suppliers' dependence on the platform.

The overall online penetration rate of the Chinese tourism market is 44.3%, and the remaining 55.7% is shared by offline travel agencies and direct sales by airlines and hotels. When divided by user region, only 37.3% of users come from lower-tier markets. At the same time, users from lower-tier markets make up 60.6% of internet users, indicating that the penetration rate of online tourism among internet users in lower-tier markets is only about 50% of that in higher-tier cities. **There is still considerable room for improvement in online tourism penetration in lower-tier markets and the increased penetration is expected to contribute to a 30% revenue increase in the size of the OTA market.**

As for hotel bookings, the online penetration rate is also steadily improving. We expect the online penetration rate of the tourism market to continue to increase, as consumers are expected to continue the online booking behaviors they developed during the pandemic. Compared with ~60% penetration rate in developed countries, **the Chinese online hotel reservations currently have a penetration rate of around 40%, implying growth potential of 50% over the next 10 years**, which should contribute to the growth of the overall OTA market.

Chart 4. Online Penetration Rate of Chinese Tourism Market and Chinese Hotel Market



Source: iMedia Research, Bin Yuan Capital

Among Chinese OTA platforms, Trip.com Group flies above its peers

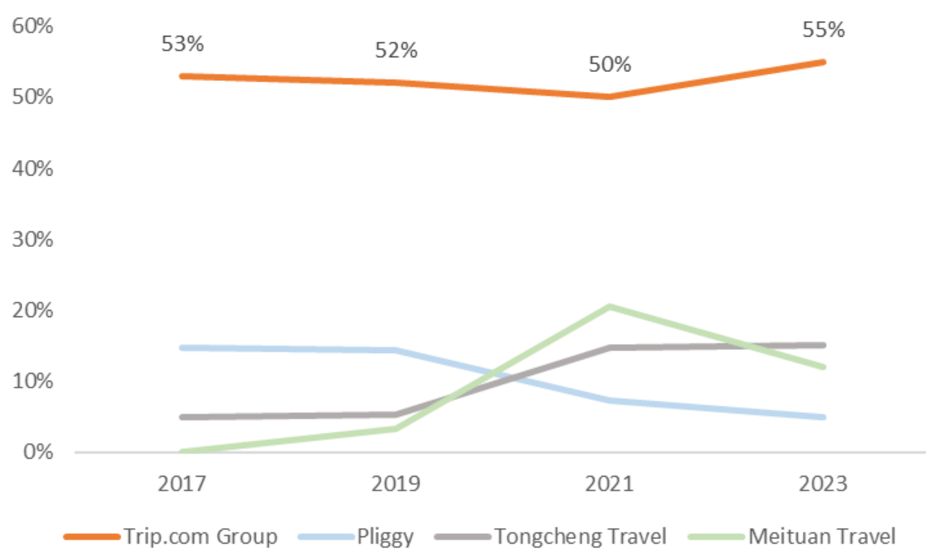
Among domestic OTA platforms, Trip.com leverages the most extensive overseas supply chain network, offering the most comprehensive outbound travel categories and the widest range of product choices. We believe that the accumulation of supply chain resources cannot be achieved in a short period of time, making it difficult for competitors to quickly enter the market. Trip.com's advantage in the supply chain end is expected to be maintained by continuously expanding the service variety and quality of both online and offline resources.

Trip.com's growth engines:

1. **Trip.com has maintained its dominant market position in the domestic market, which makes it a proxy beneficiary of rising online market penetration rate.**

In the **domestic market**, as the leading OTA, the company maintains very steady market share despite market fluctuations. Its wide range of products and services has enabled it to keep its market share even during the pandemic when user demand changed significantly from long distance travel to domestic and local travel.

Chart 5. Trip.com and peers' market share



Source: Chyxx.com, Bin Yuan Capital

2. **Chinese tourists travelling abroad:** The continuous recovery of outbound tourist flows drives growth in the company's outbound bookings and group travel.

Airline tickets: As mentioned above, we expect outbound ticket supply to grow 33% YoY in 2024, which should support outbound ticket sales. Compared to purchasing tickets directly from airlines, Trip.com aggregates information from multiple airlines, covering a wider range of time slots and flights, providing users with a greater variety of choices. Therefore, it has built strong user loyalty. **Trip.com's market share in the Chinese online flight ticket market has long been stable at around 35%,** which means airlines still need to provide competitive prices and ticket availability to Trip.com to sell tickets.

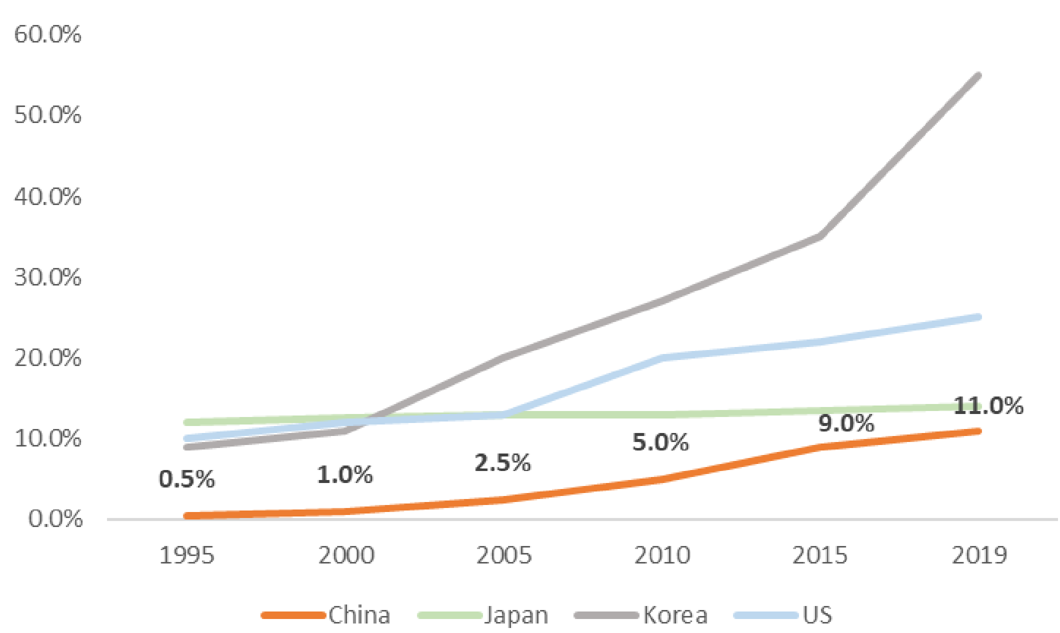
Overseas hotels & other local services: Trip.com possesses stronger supply chain resources than its peers. The outbound tourism industry chain is extensive, involving numerous components such as hotels, transportation, attractions, local tour operators, visas, wholesalers, and more. **It is challenging for newcomers to establish such large-scale distribution channels or to directly procure tourism resources.** Trip.com has already established advantages in terms of available services and flexible inventory control through flight and hotel bookings, and direct procurement requires maintaining long-term cooperative relationships with diverse international resources, presenting high demands on enterprises.

Before the pandemic, the proportion of outbound travel as a percentage of total travel in China was lower than neighboring countries but we **expect outbound tourism to continue to be an important component of China's tourism market revenue and continue to grow in the long term** (Chart 6). Trip.com has advantages in the outbound tourism business for Chinese travelers, mainly reflected in:

1) Pricing compared to international OTA platforms is competitive.

2) A focus on service models reduces Chinese travelers' uncertainty about post-outbound services, enhancing user satisfaction.

Chart 6. Proportion of outbound travel as a percentage of total travel in China, Japan, Korea and the US.



Source: iMedia Research, Bin Yuan Capital

3. **International business**: Skyscanner sees steady growth while Trip.com's international business reduces its losses.

In 2016, Ctrip acquired the British online travel website, Skyscanner, entering the international airline ticketing market. In 2017, it acquired the global online travel platform website Trip.com and Ctrip started to use Trip.com as its global brand website.

Trip.com expects that over the next 3-5 years, its international business (Skyscanner + legacy Trip.com) will contribute 15% to 20% of the group's total revenue and achieve a compounded growth rate in the mid-to-high double digits. At the same time, legacy Trip.com should achieve profitability.

The rapid growth in legacy Trip.com's user base is primarily due to operational advantages:

- Its mobile app provides a smoother and more user-friendly experience than website-oriented competitors. It also utilizes AI-assisted personalized recommendations and discounts, enhancing user satisfaction.
- It offers one-stop service, covering most travel needs, which is particularly convenient for mobile users.
- It provides 24/7 customer service, promptly addressing user issues.

For overseas service providers, such as hotels, **cooperating with Trip.com means bringing in more Chinese travelers**, which also facilitates a smoother promotion of local tourism resources for Trip.com's overseas development.

Finally, **Trip.com is more price competitive than overseas OTA platforms**:

- Overseas OTA platforms have commission rates of 15-16%, while Trip.com's commission rates range from 9-10%.
- Trip.com offers flight ticket products in the Asia-Pacific region, while Booking.com and other large global competitors do not. Trip.com's market share in flight ticket sales is the highest globally, with 35% share in China and 4-5% share overseas (currently mostly booked via Skyscanner), so it is able to offer very competitive prices.

<u>Conclusion:</u>

As the leading OTA in China, Trip.com has a strong brand advantage and a solid foundation in the domestic tourism business. There is significant upside potential in the outbound tourism sector. By applying its competitive advantages in "supply chain resources + service advantages", Trip.com's global expansion should deliver development opportunities in the future.

We expect Trip.com will earn RMB 11.5-12 bn in net income in 2024 and have 15+% annualized net income growth over 2024-2027, representing a PE of less than 20x, PEG of 1.2x, which is attractive compared to global peers such as Booking Holdings, Expedia and Tongcheng Travel, which trade at PE of 22-28x and PEG of 2.0x.

Sincerely,

Ping and the Team

April 8, 2024

Bin Yuan on the Road

March 8, 2024

We visited iRay's fab in Hefei, Anhui province, and met with the management team.

Half of the new factory's production capacity will be used for the X-ray detector businesses, and the other half will be used for intelligent headwear products. Most of the equipment was provided by domestic manufacturers, which will form a significant competitive advantage in manufacturing costs. iRay's independent R&D and manufacturing capabilities for core components can help extend its products from the healthcare industry to other industries such as consumer electronics. The demand from downstream consumer electronics customers should bring great growth opportunities to the company in the future.

"Our vertical integration strategy will bring significant competitive advantages to the company in the future " – Secretary of the Board of Directors, Mr. Liu.

March 29, 2024

We visited Shinva Medical Instrument, a domestic healthcare equipment company in Zi Bo, Shandong and met with Secretary of the Board Mr. Li.

Over the past year, the medical device industry has experienced significant growth, largely due to the advancement of the import substitution process. In 2024, as the short-term negative impacts of anti-corruption efforts diminish, the process of import substitution continues to gain momentum. This not only promotes domestic production and consumption but also helps to enhance the technological level and market competitiveness of domestic enterprises. With domestic manufacturers continuously optimizing product quality and services, import substitution has become a key factor in driving the development of the industry.

"Downstream hospitals are beginning to introduce high-end automated disinfection and sterilization systems. This will significantly boost our business in this category." – Board Secretary.

March 30, 2024

We visited Anjoy Foods' Xiamen factory and met with CEO and board secretary to discuss the business focus in 2024.

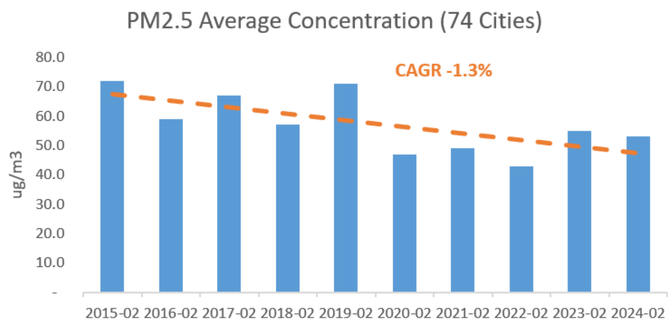
Anjoy has given local factories more freedom to develop locally- flavored products. This can increase Anjoy's market share in local markets as there are still many small brands in the market. The company will also start to provide customized products to large business customers.

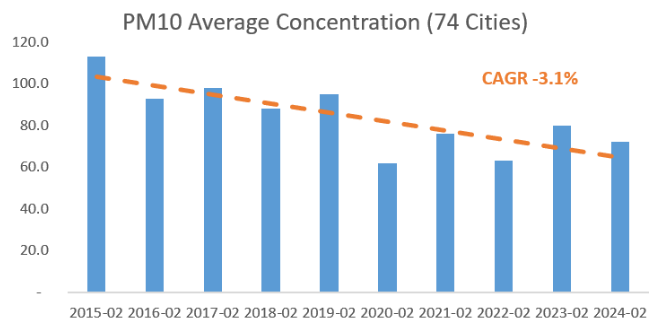
"The current market environment demands that companies respond quickly to changes in consumer demand. Therefore, Anjoy Foods, which tightly integrates R&D, sales, and production, will have a greater advantage." – CEO Mr. Zhang Qingmiao.

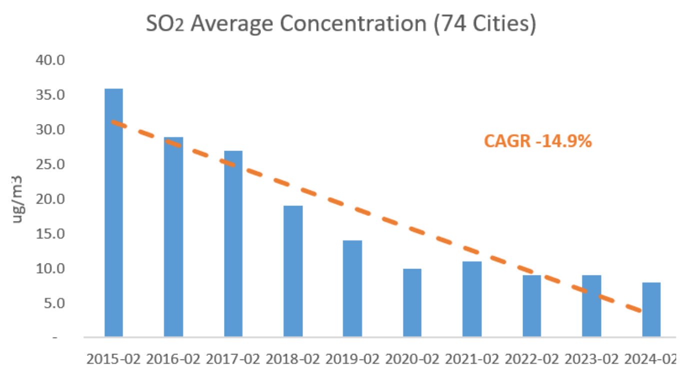
Bin Yuan Environment Tracking

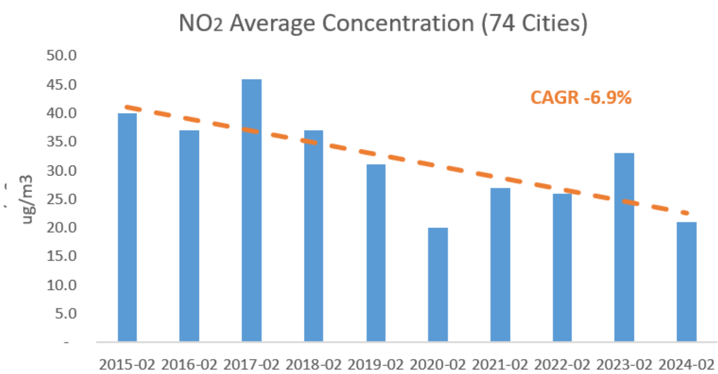
This tracking includes monthly air and water quality data, both showed steady improving trend in the last 5 years. Air pollution concentration dropped due to reduced coal combustion, increased proportion of new energy vehicles, and tightened emission control measures. Water quality improved mainly from the strengthen control of wastewater emissions since 2017.

China air pollutant concentration data February 2015-2024



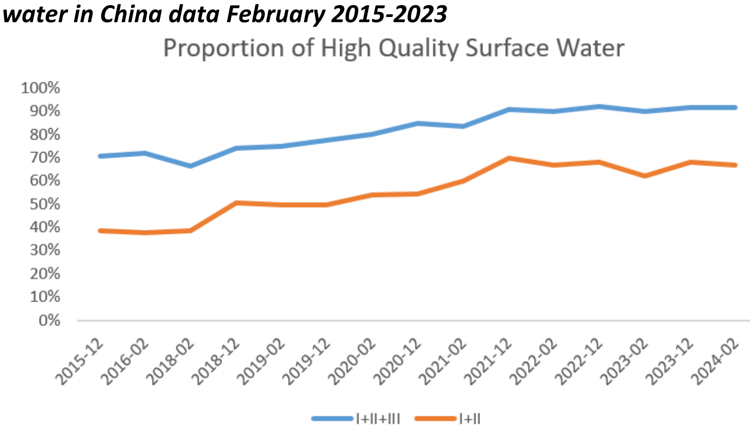






**PM2.5, PM10 and SO_2 are mainly from fossil fuel combustion, and NO_2 is mainly from vehicle emissions.*

The proportion of high-quality water in China data February 2015-2023



**Water quality in China breaks down to 5 levels, with level I being the best and level V being the worst. Level I+II represents water that can be used for drinking purpose. Level I+II+III represents water that can directly contact human body.*

**Source: Ministry of Ecological Environment in China.*

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