Bin Yuan Capital All China Strategy – May 2024

Performance Attribution and Bin Yuan Comment

May saw a highly volatile market. The month started strongly fueled by government stimulus policies in the property sector, the resumption of foreign capital inflows into China's offshore markets, and the expectation of further reforms to revitalize the Chinese economy. However, momentum faltered in the final 10 days as investors took profits amidst escalating tensions with Taiwan and other geopolitical uncertainties.

Despite the rollercoaster ride, the market closed May with a modest gain of 1.17%. Our portfolio also posted a positive return of 38 basis points (bps), but 79 bps below the benchmark. Our underperformance was primarily attributed to our underweight position in the energy and mega cap internet sectors and overweight position in the underperforming healthcare segment. Our investments in undervalued sectors like property chain consumption and clean power operations contributed positively, partially offsetting overall underperformance.

Looking ahead, our portfolio is well positioned, supported by attractive valuations, strong earnings potential, and upcoming catalysts:

1. We anticipate a reversal in healthcare sector performance driven by resilient demand, attractive valuations, and accelerated earnings growth post the normalization of anti-corruption measures.

2. The potential economic reforms that may be unveiled in the July Party Plenum aimed at enhancing long-term fundamentals and removing growth barriers.

3. The Government is moving on the right track to support the economy including stabilizing the property market, navigating geopolitical challenges, and upgrading infrastructure that enable highly competitive companies to excel both domestically and internationally:

   a) Guangzhou, Shenzhen and Shanghai eased house-purchase restrictions, including lowering down payments and lower loan rates, marking a positive step towards reducing the household financial burden and stabilizing the real estate sector. By making housing more accessible and affordable, these cities foster an environment that supports urban development and enhances the quality of life for residents.

   b) China is demonstrating its open stance by issuing free-entry visas to several countries and allowing Tesla to operate smart-drive technology in China. These measures are likely to encourage and attract more foreign investment, fostering a positive environment for China's foreign relations.

   c) The National Bureau of Statistics reported a turnaround in industrial profits. Companies with annual revenues over 20 million yuan reported a 4% YoY increase in total profits for April, rebounding from a 3.5% decrease in March. The high-tech and equipment manufacturing sectors stood out with their impressive gains of more than 30%, indicating a positive trend of domestic infrastructure upgrades.

Confidence in fundamental investing should return, emphasizing long term stock selection over sector rotation trading.

Increasing ESG awareness both domestically and overseas, stricter market regulations, and higher shareholder returns through buybacks and dividends further bolster our outlook.

Overall, these factors collectively should create a more favorable environment for our portfolio to capitalize on opportunities and deliver sustainable returns.

Other comments

CGN Power outperformed in May as China released its electricity market reform and nuclear power development plans. CGN is the largest nuclear power plant operator in China with more than 50% market share and it should benefit the most from repaid development of nuclear power in China over the next few years. Additionally, CGN power is committed to distribute more than 40% of its profit annually, which should boost the stock's performance as well. We expect CGN power's revenue and net income will rise as it deploys more nuclear power stations.

Jereh Oilfield Services Group outperformed in May due to a decent quarterly report and a surprising deal with Petro Iraq. Jereh is a leading oilfield equipment manufacturer and service provider, with significant footprints in the North America and the Middle East. The Middle East is especially promising for the company with a potential market size of RMB 30-50 billion as it takes market share from Western companies. As one of the top oil companies in the region, Petro Iraq recognized Jereh's service quality and granted the company a 25-year contract. Additionally, Jereh also has great long-term relationships with other top oil companies such as Abu Dhabi National Oil Company and Kuwait Oil Company. Looking forward, the lucrative global market should provide sustainable opportunities for Jereh's long-term growth.

An Emerging Dark Horse in the Sanitary Products Industry

The consumer market in 2024 is showing several noteworthy trends that reflect shifts in the market dynamics. Domestic brands are catching up with foreign brands in quality and innovation, thus increasing market share by providing better value-for-money products. Domestic brands have also been more successful in leveraging digital marketing to connect with consumers, creating brand loyalty and influencing preferences. Companies with strong management strategies and team execution capabilities should continue to increase their market share in this round of market changes. We believe Baiya Sanitary, a dark horse that has only recently stood out in the industry, is an example of seizing the opportunity amidst the channel changes.

The Sanitary Pads Industry

China has a large sanitary pad market with annual sales of 70 billion pads. The country's 350 million women within their reproductive years use around 20 pads each month. The total market value is RMB 70 billion, with annualized growth of 4% driven by ASP (average selling price) increases. This is attributed to consumption upgrades, including higher quality products, premium brands and advancements in technology and materials.

Chart 1. Chinese Sanitary Pads Market Size

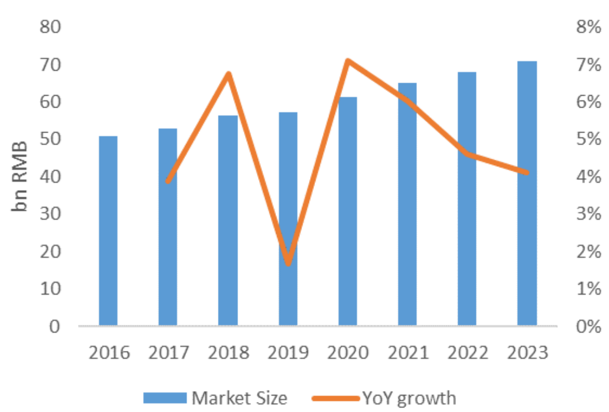
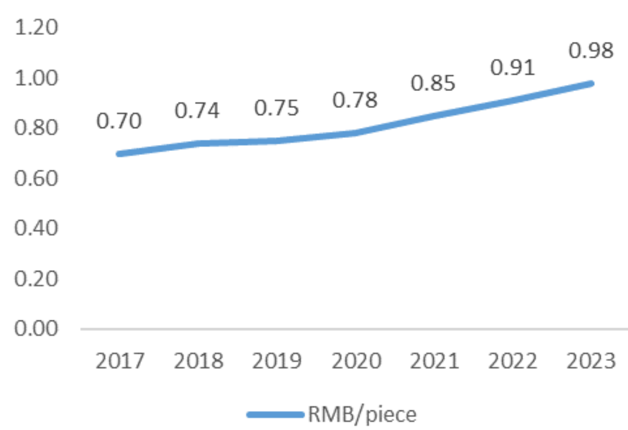


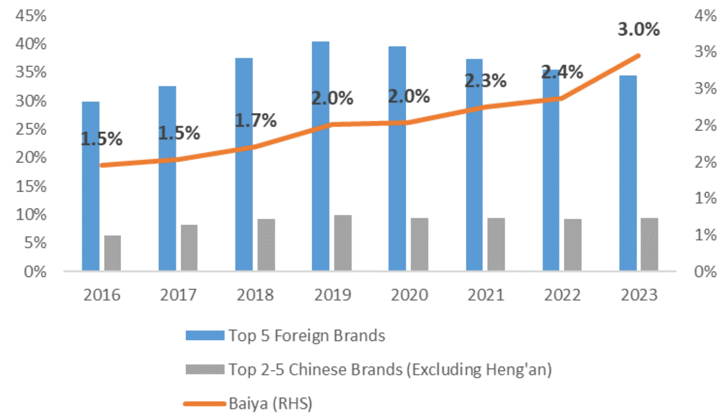
Chart 2. Sanitary Pad Unit Price



Source: Euromonitor, Bin Yuan Capital

Foreign brands are losing their dominant positions, and in recent years the market share of second-tier sanitary pad brands has steadily increased.

Table 1. Domestic and Foreign Brands' Market Share in Chinese Sanitary Pad Market



Source: Euromonitor, Bin Yuan Capital

The emergence of e-commerce channels has changed the way fast moving consumer goods reach and interact with consumers. R&D, brand positioning, channel management, brand promotion has all become critical.

Baiya Sanitary (003006:CH) has successfully leveraged e-commerce and offline channel expansion to become the fastest growing domestic player. Their domestic market share is expected to reach 4.2% in 2024.

They have a strong management team. The founder and controller of the company has over 30 years of operational experience in the sanitary products industry with constantly-learning mindset. He built an organization with an alignment of interests. The company's employee stock ownership platform holds 8.2% of the company's shares. At the end of 2021, the company introduced a stock incentive plan, which set differentiated incentive targets for their online and offline businesses. It is expected that after the first phase of the stock incentive plan ends in 2024, the company will launch a new round of incentive plans, continuing to share profits with employees and bind the interests of employees with those of the company.

Baiya's Growth Potential

Baiya Sanitary is gaining wider recognition among consumers due to its innovative products and brand exposure via the e-commerce channel. It is estimated that the company will continue to increase market share, showing at least 200% sales increase potential.

1. New Product Development and Brand Upgrading

In 2022 the company updated its R&D approach, adopting a beauty-product mindset for new product development, and emphasizing high aesthetic packaging and effective ingredients.

In 2022, the company launched a series of new products for sensitive skin and an organic cotton series, followed by the introduction of a probiotic series in mid-2023. These products quickly became bestsellers.

Their higher-end product positioning has helped attract younger and higher-spending consumers. This has bolstered the overall image of their Freemore brand (which accounts for 88% of total sales) and also increased the company's overall gross margin.

In 2023, new products increased to 26% of total sales with gross margins of 55-60% compared to gross margins of traditional products of 45-50%. This led to 5 percentage point overall YoY gross margin increase in 2023.

2. E-commerce channels rapidly increasing in volume

In 2019, the company established an e-commerce team in Hangzhou to focus on their e-commerce business. This led to a rapid increase in e-commerce revenue. From 2019 to 2022, the CAGR of their e-commerce revenue was 50%. In 2023, e-commerce revenue reached RMB 748 million + 102% Y/Y, accounting for 35% of total revenue. This continued in Q124 and during the 618-shopping festival.

E-commerce sales play a dual role in both sales and brand advertising, especially with significant new customer acquisitions via TikTok. The online customer flow provides a good complement to the company's traditional offline consumer market. In addition to the 10% of consumers on Freemore's TikTok video channel from their core market in Sichuan, they saw good growth from non-core offline markets such as Guangdong, Henan, Shaanxi, and Zhejiang, where the local economies are relatively strong with robust consumer purchasing power. These provinces (with a total population of more than 400 million people) are the target markets for the company's mid- to high-end products launched in recent years.

The increase in online brand exposure has boosted the proportion of proactive searches, leading to an overall increase in profits for the e-commerce segment and fostering a virtuous cycle of profitability within the e-commerce segment. The gross margin of Baiya's e-commerce business continues to increase, from 43.9% in 2022 to 52.5% in 2023. We estimate with the continued improvement of gross margins that the company's e-commerce channels will start to contribute meaningfully to the company’s profits, reaching breakeven in 2024, and by 2027 account for 43% of net income.

3. Reorganization of offline channels will be extended to provinces beyond their Southwest core market

Freemore has the top market share in Chongqing and Sichuan, second in Yunnan, Guizhou, and Shaanxi, and seventh in the national market. The company defines Chongqing, Sichuan, Yunnan, Guizhou, and Shaanxi as core markets, with the strategy in core markets being to maintain a high market share. Markets outside the core markets are defined as non-core markets.

In mid-2023, the company restructured their organizational framework for non-core markets, deploying strong sales teams from mature markets to non-core markets They started initially in Guangdong, Hunan, and Shandong, three provinces with large populations, strong consumption capabilities, and consumption habits similar to the Southwest core market. We expect rising volumes and improving profit margins in these three provinces. This provides a solid base for subsequent national expansion.

Baiya’s net margin in core markets is 25%+, and the net margin in non-core markets is expected to increase from the current 10% as sales increase and fixed costs are amortized.

Baiya's expansion in the offline market has been achieved not only through proactive internal management reforms but also by seizing opportunities where competitors have relatively weaker management. According to our offline grassroots research and interviews with franchisers of other brands, international brands do not have a comprehensive management system for China's offline distribution network, leading to severe cross-channel dumping between online and offline. This results in offline franchisers making no profit from selling international brands, thereby reducing the sale of international brands and turning to domestic brands with stronger management capabilities. At the same time, the product strength of Baiya's new products in recent years has caught up with first-tier international brands, which can meet the offline franchisers' sales needs for high-end products.

Summary:

Despite the overall low growth rate of the sanitary pad market, due to the measures described above, we estimate that Baiya will increase their market share from 4.2% in 2024 to 8.3% by 2027.

We expect revenues will increase from RMB 2.9 billion in 2024 to RMB 5.8 billion in 2027, a CAGR of 25%; and that net income will increase from RMB 301 million in 2024 to RMB 713 million in 2027, a CAGR of 33%. Assuming a PE of 22x, we see 80% upside by 2027.

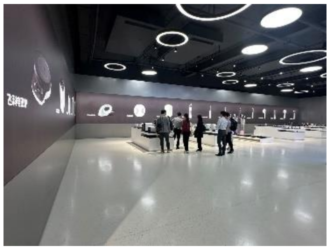
Sincerely,

Ping and the Team

June 7, 2024

Bin Yuan on the Road

May 8, 2024



We visited a small home appliance company in Shanghai, which mainly produces electric shavers, hair dryers, and electric toothbrushes to get an update of both the company and the industry.

The company is the largest maker of electric shavers in China, and the whole market share is still increasing. The launch of high-quality products with higher prices supported growth in recent years. Its new product, a high-speed hair dryer, has been well received in the offline sales channels. The company is expected to benefit from the shift from traditional to high-speed hair dryers with a series of value-for-money products and strong supply chain. Our field trips also confirmed the good sales of its new products offline.

" Our R&D starts with the details of materials to manufacture household appliances with better quality, design, and lower costs " – Board Secretary Mr. Guo.

May 15, 2024

We visited AMEC's and Piotech's factories in May to learn about the semiconductor equipment production process as well as the latest progress in the industry.

As the leading players in etching and thin film deposition equipment, respectively, in China, AMEC and Piotech should benefit the most from industry growth and domestic substitution. We made the visit to check if the industry prosperity can be sustained as forecasted. The factories were operating at full capacity to fulfill orders. Management remains optimistic about the industry's growth over the next few years. They are confident to achieve breakthroughs in high-end equipment and to take more market share from foreign firms as the localization trend continues.

" Advanced process technology must and will be broken through in future." – Chairman of the board, Dr. GERALD ZHEYAO YIN

May 31, 2024

We attended Beike's Investor Day in Beijing, to develop a better understanding of the largest property transaction platform in China and get an update of the country's real estate industry.

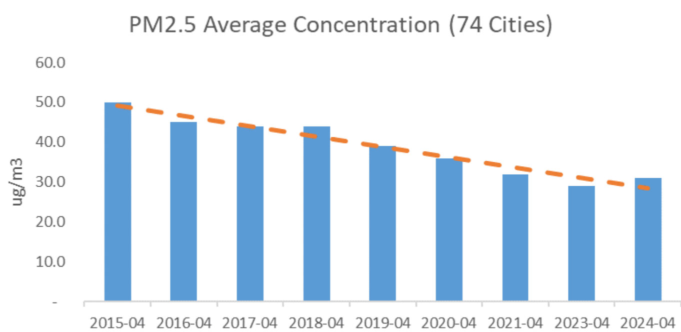
The largest property transaction platform is expanding into a more comprehensive platform around various residential services like rental, furnishing and eldercare. Countrywide network of stores and agents will be a good leverage. After months of decline, the country's real estate market is gradually stabilizing following continuous policy stimuli. Trillions RMB market has been developed around various residential demand. Beike is expected to grow and benefit as a leading player with its large amount of data and visitors traffic.

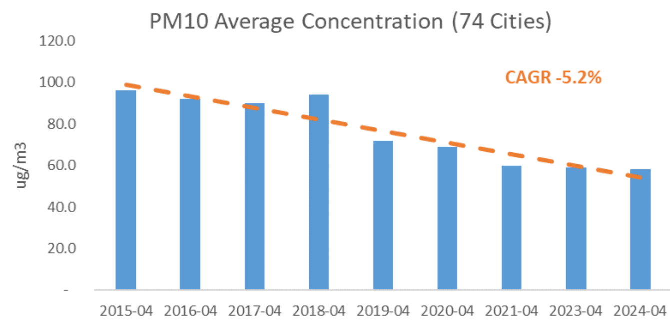
"Our stores and professional agents will be the core asset in our future development into a comprehensive platform of various residential services. " – CEO of Beike

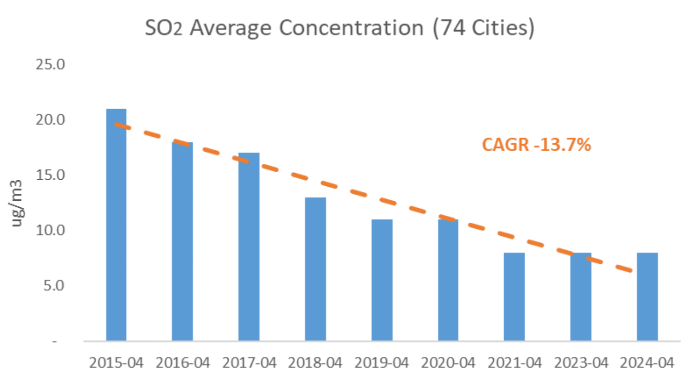
Bin Yuan Environment Tracking

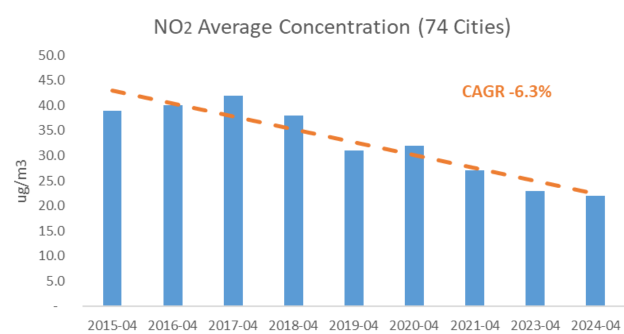
This tracking includes monthly air and water quality data, both showed steady improving trend in the last 5 years. Air pollution concentration dropped due to reduced coal combustion, increased proportion of new energy vehicles, and tightened emission control measures. Water quality improved mainly from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

China air pollutant concentration data February 2015-2024



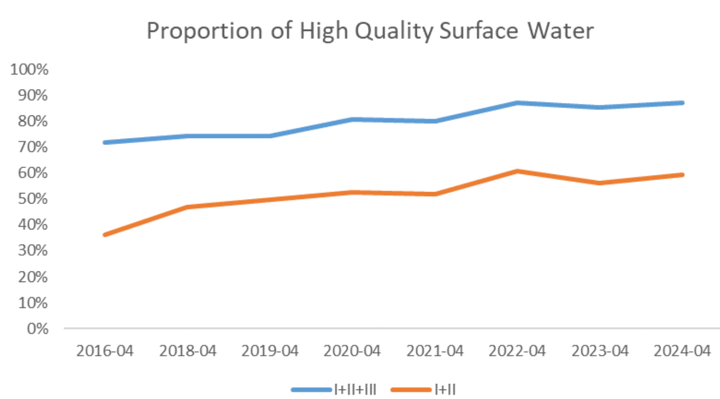






**PM2.5, PM10 and SO_2 are mainly from fossil fuel combustion, and NO_2 is mainly from vehicle emissions.*

The proportion of high-quality water in China data February 2016-2024



**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.*

Disclaimer

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

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

This document is strictly for information and illustrative purposes only and should not be considered to be an offer, or solicitation of an offer, to buy or sell any securities or funds or to enter into any investment agreements.

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

According to the SFC climate-related disclosure requirement, please find our disclosure of Management and Disclosure of Climate-related Risks by Fund Managers.