

## Bin Yuan Capital All China Strategy – September 2024

### Bin Yuan Opinion

#### The Rise of China's NEV Auto and Auto-Component Sectors:

#### China's Tire Industry

**On January 7, 2019, Tesla's Shanghai Giga Factory officially broke ground in the Pudong New Area**, launching a new chapter in China's automotive industry. This development was significant for the global electric vehicle industry. The land was transformed from a dusty construction site into a symbol of the global New Energy Vehicle (NEV) wave in just 12 months (Picture 1).

Picture 1 TESLA Shanghai Giga Factory (2019-2020)



Source: Tesla Website

In 2019, China's NEV sales reached 1.2 million units, and five years later, in 2023, they increased to 9.8 million units, accounting for 46% of the global market. Over the past five years, China's NEV industry has grown rapidly, reflecting the strength of Chinese manufacturing.

Bin Yuan is confident in the market share expansion of Chinese automotive players, driven by technological advancements and improved manufacturing capabilities. The Chinese automotive industry is experiencing a systemic upgrade, with the value chain of vehicles extending both upstream and downstream, demonstrating significant vitality. Bin Yuan's Investment Process looks for companies with high entry barriers, global competitiveness, and ESG compliance, focusing on exploring long-term growth potential and investment value that aligns with the increasing demand for improved living standards.

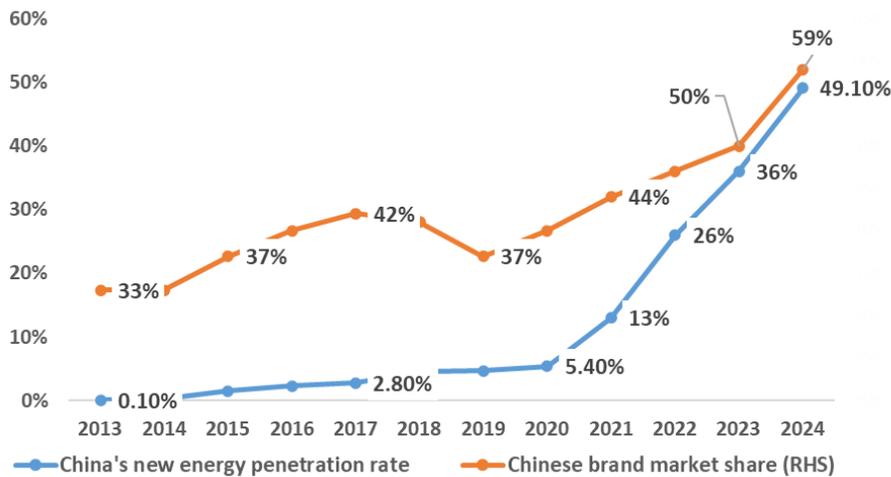
## The Rise of China's Automotive Supply Chain

**Chinese car brands have led the development of the NEV production, boosting the international competitiveness of component suppliers.** In recent years, emerging forces represented by Chinese car brands have successfully promoted the comprehensive transformation of the Chinese automotive industry towards new energy vehicles, reshuffling the automotive industry landscape and giving rise to a group of local component suppliers.

According to the latest data, as of July 2024, the penetration rate of NEVs in the Chinese passenger car sales market has exceeded 50%. This milestone achievement was reached 11 years ahead of the national planning target.

As the main force of electrification, Chinese brands have shown strong growth. Emerging forces like NIO, Li Auto, and XPeng are leading the market, while traditional brands like BYD, Geely, and Changan are actively transitioning. Leveraging market insights and technological innovation, Chinese brands have quickly seized the high ground in the new energy market, with a market share of close to 60% in the overall automotive market (Chart 1). They have comprehensively improved in terms of quality, service, and brand image.

Chart 1. Trends in NEV Penetration Rate & Market Share of Chinese Brands in China



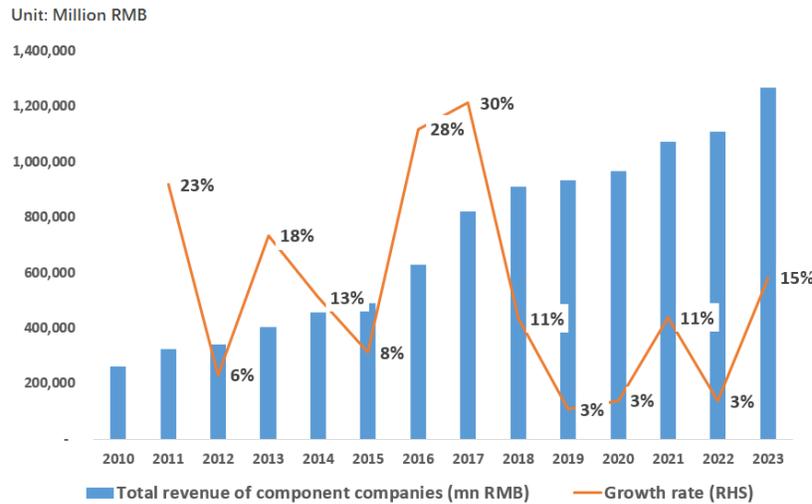
Source: China Passenger Car Association, Bin Yuan Capital

**As domestic car brands increasingly prefer domestic supply chains, they are driving the growth of local component suppliers.** These local companies have built technical expertise in high-end manufacturing, energy-saving technologies, and intelligent systems, thereby gaining influence within the global supply chain and steadily enhancing their competitiveness.

In recent years, China's automotive component industry has achieved significant rapid growth, with the localization rate steadily increasing. From 2010 to 2022, the total revenue of listed companies in this sector increased from RMB 0.26 trillion to RMB 1.26 trillion, achieving a fourfold growth in sales (Chart 2).



Chart 2. Market Size and Growth Rate of China's Automotive Component Market, 2010-2023

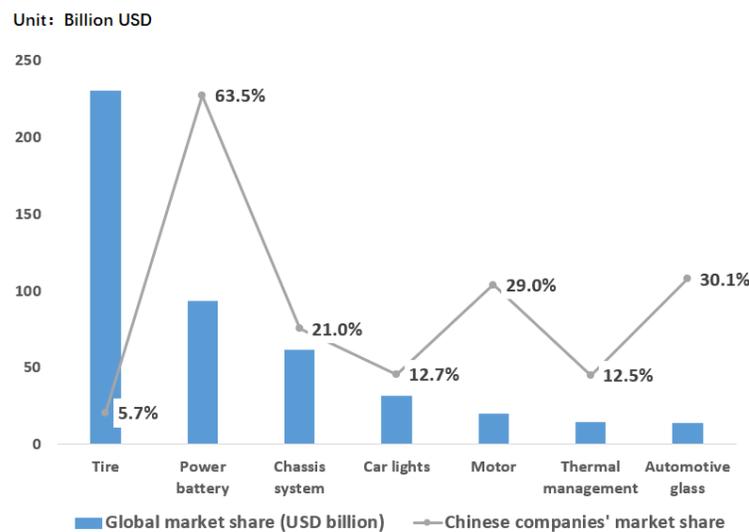


Source: iFIND, Bin Yuan Capital

The tire segment shows great potential in the component supply chain.

In the upstream sectors, Chinese companies have made significant breakthroughs in some key component fields, with a notable increase in global market share, especially in the NEV supply chain. For example, Chinese companies lead with battery systems (64%), motors (29%), and thermal management systems (15%). At the same time, in areas relatively dependent on economies of scale and technological accumulation, such as automotive glass (30%), chassis (21%), and lightweight casting products (20%), Chinese companies have also shown strong competitiveness (Chart 3).

Chart 3. Market Space and Global Market Share in Various Links of the Automotive Industry Chain



Source: Bin Yuan Capital

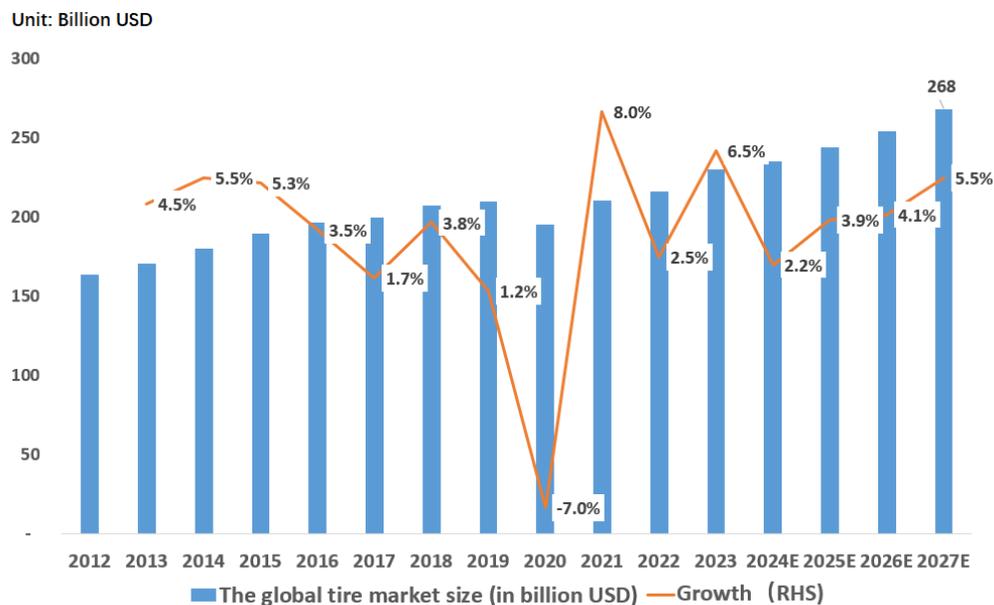
In contrast, the tire industry, as one of the largest segments in the automotive supply chain, has a global market share of only 5.7% for Chinese brands, indicating vast growth potential. In recent years, rising Chinese car brands are increasingly willing to use domestic brand tires on high-end models, bringing opportunities to the domestic tire industry to showcase its products and brands.

Chinese tire brands have taken advantage of the industrial dividend of NEV, increased investment in technology R&D, expanded global manufacturing and sales networks, and accelerated the expansion of market share worldwide, aiming to transform from "followers" to "leaders".

### The Leap of Chinese Tire Companies: A Breakthrough in Global Market Share

**The global tire market continues to expand, and Chinese brands are seeing an explosion of opportunities.** The global tire market is huge, expected to reach \$230 billion in 2024, with a year-on-year growth rate of 6.5% (Chart 4).

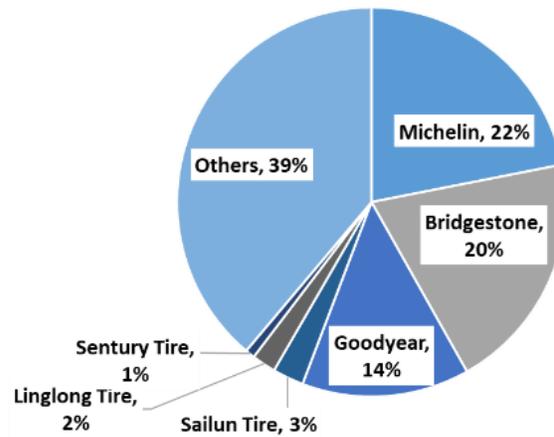
Chart 4. Global Tire Market Size and Growth Rate, 2012-2027E



Source: iFind, Bin Yuan Capital

Asia is the largest tire market in the world, accounting for nearly half of global sales. However, foreign brands still dominate, and the market is led by large international companies, providing substantial growth potential for the rise of Chinese brands (Chart 5).

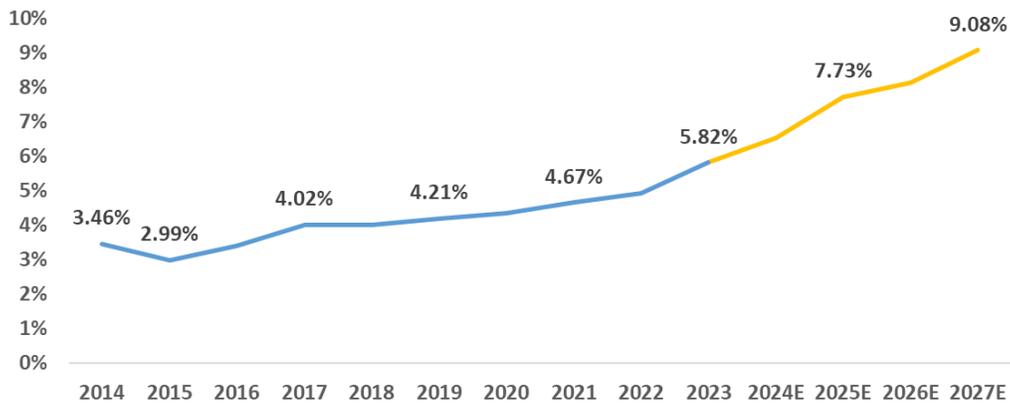
Chart 5. Distribution of the Automotive Tire Industry Landscape



Source: Listed Company Annual Reports, Bin Yuan Capital

**The position of Chinese tire brands in the global market is rapidly improving.** Through continuous investment in R&D, Chinese tire companies' product performance has become comparable to that of internationally renowned brands, and their global market share has been expanding continuously, with the potential for sustained rapid growth in the future (Chart 6).

Chart 6. Forecasted Trends in Global Market Share of Chinese Tire Brands

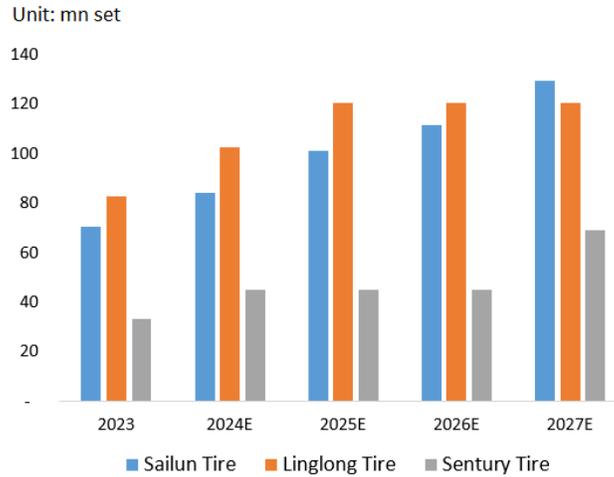


Source: Listed Company Annual Reports, Bin Yuan Capital



**Global capacity layout lays a solid foundation for future growth.** Chinese brands are accelerating the internationalization process by establishing factories overseas to set up near raw material production sources and end-sales markets. Between 2023 and 2027, the production capacities of Sailun Tire, Linglong Tire, and Sentury Tire are expected to increase by 83.5%, 45.6%, and 108.8%, respectively, mainly distributed in Southeast Asia, North America, Europe, and North Africa. With the further expansion of capacity, the global market share of Chinese tire companies is expected to accelerate (Chart 7).

Chart 7. Capacity Planning of Leading Chinese Tire Companies

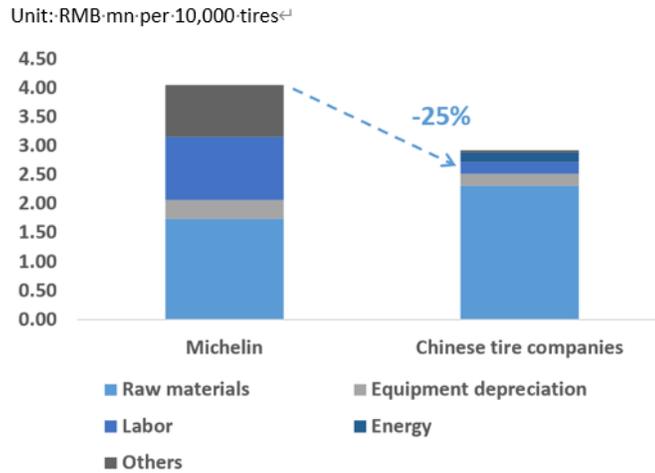


Source: Listed Company Annual Reports, Bin Yuan Capital

### Three Advantages of Chinese Tire Companies in International Competition

**Efficiency Advantage** - In the standardized, capital-intensive tire industry, Chinese companies have adopted advanced industrial robots and automated equipment, effectively reducing human error and significantly lowering labor costs. According to our estimates, the production cost of leading Chinese tire companies is about 25% lower than that of Michelin. Labor costs represent about 25% of Michelin's total expenses, whereas for Chinese companies, they have dropped to below 10% (Chart 8). This is mainly due to the fact that new production capacity has adopted advanced industrial robots.

Chart 8. Comparison of Tire Production Costs



Source: Listed Company Annual Reports, Bin Yuan Capital

During our field research, we found that Chinese tire companies have realized digital and intelligent management of production and supply chains. They can monitor production and sales conditions, dealer inventory, and track the location of transportation vehicles and ships globally in real-time, efficiently solving various issues in the production, transportation, and sales processes (Picture 2).

Picture 2. Sailun Operation System

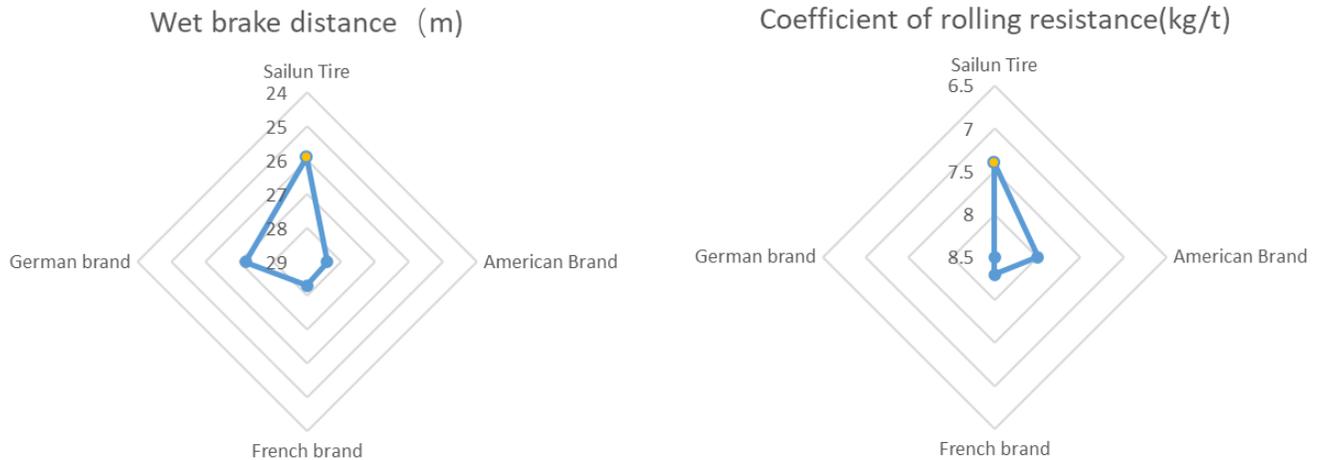


Source: Bin Yuan Capital

**Product Advantage** - Chinese tire companies have also made substantial advancements in product quality. For example, Sailun Tire developed the "liquid gold" technology, positioning itself as one of the most profitable companies in the Chinese tire industry.

Tires incorporating liquid gold technology exhibit significant improvement in key metrics such as braking distance, rolling resistance, and wear resistance, surpassing American, German, and French tires of the same class (Chart 9).

Chart 9. Product Performance Comparison of Liquid Gold Technology



Source: Sailun Liquid Gold Product Information, Bin Yuan Capital

\* Lower rolling resistance means greater energy efficiency. Compared to traditional tires, liquid gold tires save 644 liters of fuel over 100,000 kilometers for fuel-powered vehicles, reducing carbon emissions by 1,480 kg and saving RMB 5,800 in fuel costs. For new energy vehicles, the cruising range increases from 500 km to 540 km. "Tire Technology International" has recognized this innovation as a catalyst for leapfrog development in the Chinese tire industry.

**Supply Chain Support Advantage** --- The competitiveness of the Chinese tire supply chain is further enhanced by improvements in supporting infrastructure, including technological advancements in tire equipment and molds. For instance, Himile Technology, a leading tire mold manufacturer, has mastered several key technologies—such as electric discharge machining, low-pressure casting, and engraving—using advanced CNC and precision processing equipment to ensure high accuracy and durability of its molds. In recent years, Himile Technology has expanded globally by establishing subsidiaries in North America, Latin America, and Southeast Asia, creating a comprehensive international production and service network.

With technological innovation, scale advantages, and a well-supported supply chain, Chinese tire companies show significant growth potential in the global market, with promising prospects for sustained and substantial growth in the long term.

## Investment Opportunities

### **Investment Opportunities in the Tire Sector: The Growth Potential of Sailun Tire**

Sailun Tire is one of the fastest-growing Chinese tire manufacturers globally, ranking 12th in the "Tire Business" 2023 global top 75 tire rankings, demonstrating strong market potential and competitiveness. The company has the following outstanding advantages in technological innovation and global layout:

- **Technological Innovation:** Sailun Tire has successfully solved the "devil's triangle" challenge—balancing wear resistance, fuel efficiency, and rolling resistance—in the tire industry with its "liquid gold" technology, earning double-A certification in the European market. Its liquid gold tires have become a key component for BYD, replacing Michelin on BYD's mid-to-high-end new energy platforms.
- **Global Layout:** Sailun has significantly expanded in Southeast Asia and North America, strategically positioning itself near raw material production areas and key markets. This expansion has enabled localized production and more efficient supply chain management.
- **New Product Line Expansion:** Sailun operates across full steel, semi-steel, and off-road tires, with its off-road tire products now part of the supply chain for global machinery giants like Caterpillar. Off-road tires have high technical barriers and a gross profit margin exceeding 40%.

**Valuation:** Sailun Tire's revenue is expected to reach RMB 54.6 billion, with net income projected at RMB 8.2 billion by 2027. In 2023, the revenue was RMB 26 billion, and the net profit was RMB 3.1 billion. The 2024-2027 Net Income CAGR forecast is 17.5%. If the PE is 15x, yield is 3.1%, there is potentially 152.5% upside by 2027.

### **Investment Opportunities in Supply Chain: Himile Technology's Leading Position in Tire Molds**

Himile Technology is the clear leader in China's tire mold industry, renowned for its excellent business model and advanced technical expertise. The following drivers position Himile Technology to benefit from industry trends and achieve rapid growth:

- **Customer Stickiness and Accelerated Updates:** Tire molds have a service life of about three years and are consumables. Himile's customized molds increase customers' costs of switching suppliers, creating strong customer stickiness. Himile has won widespread recognition with its high-precision and long-life molds. Its Computer Numerical Control (CNC) machine tool core components are also adopted by leading global manufacturers.
- **Scale and Quality Advantages:** Himile holds over 50% of China's tire mold market share, far ahead of its competitors, with significant scale advantages. In addition, molds account for a minimal portion of tire production costs (about 1%), and customers are focusing more on stable mold quality and delivery capability.



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- **Global Layout:** Himile Technology has established production bases in Mexico, Thailand, and Vietnam, promoting a global strategy to provide large-scale production and maintenance services, significantly improving service capability and response speed for global customers.

**Valuation:** Himile Technology expects its revenue will reach RMB 14.2 billion on its intrinsic growth, and net income will be RMB 3.3 billion in 2027. In 2023, revenue was RMB 7.1 billion, and net profit was RMB 1.6 billion. The 2024-2027 NI CAGR forecast is 18%. According to the reasonable valuation for the high-end equipment industry, if the PE is 20x, yield is 2.8%, there is an 78.4% upside by 2027.

The rise of Chinese car brands is upgrading the domestic auto component value chain, creating growth opportunities for the tire industry. With improved technology, localization, and efficient supply chains, Chinese tire manufacturers are catching up with global competitors. Their focus on innovation and the new energy vehicle transition positions them for strong global market growth. We believe Chinese brands can fully capitalize on this trend, offering investors the chance for significant returns.

Sincerely,



Ping and the Team

October 8, 2024



## Bin Yuan on the Road

September 29, 2024



**We visited Luckin Coffee and talked with the management to get an update on the freshly-made coffee drinks industry and learn about changes in consumer behavior in the current macro environment.**

According to the management, the price war started by key rivals has come to an end as the emergence of new brands and their store openings slowed down. But the penetration of coffee continues to increase, repeat purchases of current consumers are still rising. The demand for coffee remains resilient with strong stickiness, although consumers became more cautious of spending. As the competitive landscape improves, Luckin, as the top coffee brand in China, with a much greater scale advantage, is expected to benefit from the growth of the industry, which is the largest segment in the beverage industry, with better profitability.

*"The possibility of new round of price wars is low as the current price for freshly-made coffee has come to a level that is very close to the break-even point for some brands."* – IR of Luckin

September 25, 2024



**We made some field trips to lower-tier cities this month to learn about household consumption and the effect of the policy stimulus.**

We visited hotel managers, home appliance distributors, super market/shopping mall operators, canteen owners, and others. The average daily rate (ADR) for hotels has been facing downward pressure due to increased supply after the pandemic, but leading players like Huazhu are outperforming on better service and more effective operations. Households in lower-tier areas experience less pressure to downgrade their consumption due to a lower property burden. Sales of home appliances saw improvement from the stimulus of the trade-in programmes. Policy stimulus is still effective at boosting demand and restoring confidence.

*"Customer visits and orders kept coming in and posted 20-30+ growth since the trade-in programme started."* – Home appliance distributor in Baoji city of Shan'anxi province in northeast of China

September 24, 2024



**We visited one of Sinofuse's distributors in Shenzhen and spoke with the owner of the distributor to cross-check the fuse industry..**

Sinofuse is an integrated solution supplier of energy protection systems, including traditional and intelligent fuses. The owner of the distributor mentioned that demand from the automotive industry in 3rd quarter is still very strong, especially from commercial vehicles (heavy-duty trucks, mining trucks, etc.). According to his data, Sinofuse has even higher yoy growth rate this quarter than in the 2nd quarter. He also said that their intelligent fuse (Pyrofuse) has remarkable safety advantages, highlighting that since the use of their intelligent fuse, Tesla's accident rate has dropped significantly.

*"With the construction of overseas production capacity, Sinofuse is expected to take market share because of its strong product competitiveness."* - Owner of Sinofuse's distributor, Mr. Liu

## Bin Yuan Environment Tracking

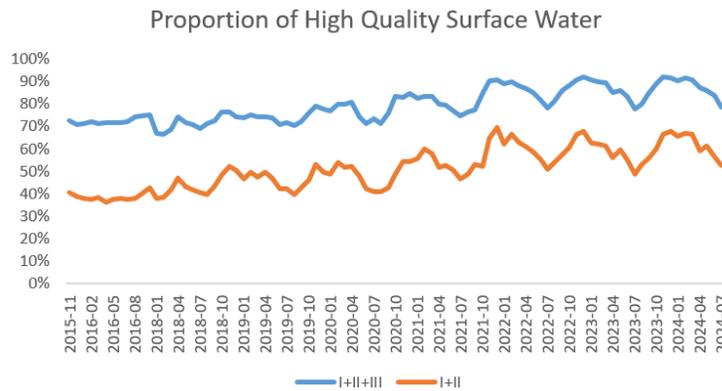
This tracking includes monthly air and water quality data, both showed steady improving trend in the last 5 years. Air pollution concentration dropped due to reduced coal combustion, increased proportion of new energy vehicles, and tightened emission control measures. Water quality improved mainly from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

### China air pollutant concentration data June 2016-2024



\*PM<sub>2.5</sub>, PM<sub>10</sub> and SO<sub>2</sub> are mainly from fossil fuel combustion, and NO<sub>2</sub> is mainly from vehicle emissions.

### The proportion of high-quality water in China data June 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.



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