APS CHINA A SHARE FUND (UCITS)

FUND DETAILS

Structure	Open ended Sub-Fund (SICAV)
Domicile	Luxembourg
Inception date	3 July 2017
Base currency	USD
Fund size	USD27 million
Strategy size	USD2.4 billion
Benchmark	8% Hurdle Rate
Number of holdings	32
Active share	86.1%
Portfolio managers	Wong Kok Hoi Stella Zhang

STRATEGY DESCRIPTION

The APS China A Share Fund (UCITS) invests in companies that are listed on the A-share markets of the Shanghai Stock Exchange and/or Shenzhen Stock Exchange. We seek to invest in companies with strong management teams and durable growth prospects at attractive valuations. We conduct primary research on company fundamentals, which includes members of the management teams, and adopt a strong investigative slant. Site visits and meetings with management form an important part of our research work. This portfolio is benchmark agnostic, and we seek to achieve absolute returns for our investors over a market cycle.

PERFORMANCE AS 31 MARCH 2019

				Annualized Returns (%)	
	1M	1Q	YTD	1Y	Since Incept.
CASF (U) Net Returns	6.32	26.75	26.75	-11.80	3.78
CASF (U) Gross Returns	6.40	27.04	27.04	-11.46	6.45
MSCI China A	6.13	32.99	32.99	-10.58	-2.52
Difference	0.27	-5.95	-5.95	-0.88	8.97

Performance of the Fund is represented by the asset weighted performance of the Class A, Class C and Class E share classes. The Fund is not managed against a benchmark, and the Indices are only shown as an illustration. All performance quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the return figures quoted.

Sources: APS, Bloomberg and Wilshire

COMMENTARY

The Fund rose 27.04% (gross) in 1Q19, underperforming the index by 5.95 percentage points.

China A shares rebounded strongly in 1Q19 after five consecutive quarters of losses. The MSCI China A-share index soared 30.2% in the quarter, led by technologies, food & beverages, and non-bank financials. Lagging the overall market were banks, utilities, and automobile names.

Overall economic activities staged a gradual recovery in the quarter, with Manufacturing PMI coming in at 50.5 in March, up from 49.2 in February. PMI for the non-manufacturing sector also edged up to 54.8, the highest since last October.

In the quarter, sentiments were also buoyed by improved prospects for at least a partial agreement between Beijing and Washington on contentious trade issues. A series of developments pointed to a gradual loosening of requirements on foreign direct investment in China, and also for technology transfers by foreign corporates. Several foreign firms obtained approval for 100%-owned subsidiaries in diverse industries from chemicals to autos, since Sino-U.S. trade tensions heightened in 2H2018.

Apart from tackling external uncertainties, the Chinese government also accelerated measures to re-vitalize the private sector and stabilize domestic consumption. The income-tax cut introduced in October 2018 is expected to reduce the number of individual income tax payers from 145 mn to 65 mn. SMEs (mall and micro enterprises) will also enjoy VAT exemption if they register monthly revenue under CNY100,000, more than a three-fold increase from the previous threshold of CNY30,000. According to government estimates, the series of measures are expected to save SMEs around CNY200 bn a year.

The ramp up of the Science and Technology Innovation Board (Sci-Tech Board) also gathered pace in the quarter. So far, the Shanghai Exchange has received IPO application materials from 13 companies for the Sci-Tech Board. The Sci-Tech Board, with its focus on innovative companies that fail to meet the profitability requirements of the main board, represents China’s latest efforts to both promote an innovation-driven economy, and improve the depth of the A-Share market.

Venustech Group was a top contributor during the first quarter, driven by upbeat prospects for their urban security operations business and substantial fund flows into the tech sector. The market size for the urban security operations business is around CNY20 bn, and Venustech’s goal is to take 30% market share, making it one of the company’s largest growth drivers over the next several years. New orders in 2019 will likely reach around CNY450 mn versus CNY150 mn in 2018. On the other hand, investor sentiment towards the sector recovered, prompting ample liquidity inflows to the tech sector. The stock traded at 44x 2019E P/E. This is reasonable considering the 30% earnings growth p.a. over the next three years, the cyber security industry’s large growth potential, and recurring earnings from its urban security operations business.

Kweichow Moutai was a top contributor in 1Q19, as demand during the Lunar New Year (LNY) holiday period turned out to be stronger than expected despite macro weakness. Consumers don’t seem to be price sensitive during important festivals, and Moutai is still their top choice to share with family members and friends. Wholesale prices for Moutai stayed high, exceeding CNY1,750 in most regions during LNY.

In addition, Moutai reported 2018 full-year financial results at the end of March. Total revenue in 2018 was +26.5% YoY and net profit was +30.0% YoY to CNY35.2 bn, 3.5% higher than market expectations of CNY34 bn. Revenue in 4Q18 was +34.1% YoY, beating market expectations of 20%-25% YoY. The better-than-expected 4Q18 result erased investors’ concern over the soft economy, and also supported company management’s confident guidance for growth in 2019.

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SECTOR ALLOCATION (%)

	FUND	INDEX	DIFFERENCE
Consumer Staples	24.2	10.3	14.0
Information Technology	24.2	10.4	13.8
Consumer Discretionary	19.2	9.6	9.6
Health Care	8.1	6.6	1.5
Real Estate	4.8	5.7	-0.9
Materials	2.0	8.5	-6.5
Financials	1.2	29.9	-28.7
Industrials	0.3	13.2	-12.9
Communication Services	-	1.5	-1.5
Energy	-	2.0	-2.0
Utilities	-	2.4	-2.4

MARKET CAP DISTRIBUTION (%)

	FUND	INDEX	DIFFERENCE
> 5 Bn	50.3	73.8	-23.5
2 Bn – 5 Bn	33.6	23.1	10.5
1 Bn – 2 Bn	-	3.1	-3.1
< 1 Bn	-	-	-

TOP 5 HOLDINGS	SECTOR	% OF NAV
Kweichow Moutai	Consumer Staples	9.2
Beijing Orient National	Information Technology	8.3
Venustech Group	Information Technology	8.2
Gree Electric Appliances	Consumer Discretionary	7.4
Tasly Pharmaceutical	Health Care	5.1

Index: MSCI China A
Sources: APS, Bloomberg and Wilshire

Moutai is a structural alpha stock for APS, and first entered our portfolio in 2004. We believe the company will benefit from the long-term trend of consumption upgrades in China, as well as industry consolidation. We estimate that earnings will increase at 15%-20% CAGR for the next 3 years. The stock trades at 25.4x 2019 P/E, which we do not think is over-stretched, given its strong franchise, high earnings quality, and deep moat that helps it maintain a high profit margin.

Beijing Orient National was a key contributor in 1Q19, underpinned by healthy 2018 financial results and strong growth potential in the industrial internet business. In addition, investor sentiment towards the tech sector also recovered. The company's 2018 results showed earnings growing 30%, and the company is targeting 20%-25% growth in 2019, which exceeds market expectations. Meanwhile, its digital twin technology underpins its core competency in the industrial internet field, which is expected to contribute more as a growth driver for the company. The stock traded at 26.7x 2019E P/E, which is still reasonable given that the adoption of big data software in China's industrial sector is still in its early stages.

Zhejiang Huace Film & TV was a detractor in 1Q19. The company announced preliminary 2018 results at the end of January, and its net profit estimate of between CNY200 mn and CNY300 mn was far below investors' expectations. The major reason for the likely miss was the decline of drama prices in 4Q18, due to downstream clients' weak financial condition as well as the sharp decline of star actors/actresses' compensation. Meanwhile, stricter tax policies created additional tax expense of around CNY200 mn in 2018.

Looking ahead, we expect results in 1H19 to continue to be under pressure. Both drama prices and sales volume are likely to decline further YoY. Revenue growth and profitability are expected to recover in 2H19 as sales volume accelerate and production costs come down.

Although Huace's short-term performance was negatively impacted by a weak macro picture and strengthened government regulation on TV dramas, we believe structurally, demand for high-quality TV dramas will rise as consumers become more affluent. As long as Huace can produce high quality blockbuster dramas, its competitiveness and bargaining power will remain strong, and earnings will eventually recover.

We trimmed our position in **Kangde Xin Composite Materials** on heightened debt default risks stemming from corporate governance issues. Its ambitious founder and major shareholder, Zhong Yu, personally invested more than USD1 bn in a carbon fiber factory and a composite materials company using bank loans secured by 93% of the listed company's shares. The listed company also has a 14% stake in the composite materials asset. Since last summer, many company founders risk losing control of their firms via margin calls as their stocks come crashing down during the bear market, having pledged vast chunks of their shares to secure bank loans for further investments. The government had since instructed the banks to halt forced selling of collateral to meet margin calls, especially in the cases of entrepreneurs who risked losing controlling stakes in the companies they had built up. Unfortunately, this order came a little too late for Kangde Xin, as its unutilized credit lines were withdrawn by the banks. This resulted in the company being unable to redeem CNY1.5 bn of bonds which matured on January 15th and 21st, leading to a crisis of confidence. As we had previously suspected, the founder and company now admit to misuse of the company's cash. We believe the funds were used to meet margin calls and to support the stock price in the market.

We believe the stock price collapse – which made the stock a detractor for 1Q19 - was mainly due to a total loss of confidence in company management, rather than a sudden deterioration of the company's business. As the CSRC is now involved in the investigations and the founder has promised to repay the outstanding bonds by the end of March, we believe a comprehensive plan will be worked out to address the liquidity problems, which is a big positive for minority shareholders. This underpinned a stock price rebound of around 50% from the bottom, and we trimmed our position in case the plan doesn't go smoothly.

Gosuncn Technology Group's stock price lost ground in 1Q as investors locked in some gains after a strong rally in China's 5G segment. The company's fundamentals remain sound and its 2018 results met consensus, with net profit climbing 32% YoY to CNY540 mn. We expect the company will again post YoY net profit growth exceeding 20% in 2019, which will likely be mainly driven by the IoT business. This includes China NB-IoT terminals, China public security terminals, and overseas sales of automobile IoT modules.

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RECENT NEW POSITIONS

We established new positions on **Poly Real Estate** as an opportunistic alpha. We will re-evaluate our investment thesis as local governments gradually unwind cooling measures over the next 3-6 months. Both the central and local governments have put into place a series of tightening policies for close to 3 years. Looking forward, it's possible that the governments would start to relax the stance on the property sector, in view of poor sales figures and weak property investment growth. However, we believe the easing process would be mild and gradual, without any appreciable rise in housing prices, unlike the last round of increases during 2014-2015.

Poly is among the top 4 largest property developers in China. Like Vanke and China Merchant Shekou (CMSK), Poly is focused on big cities, with more than 60% of landbank located among tier-1/2 cities. Poly's net gearing ratios are higher than Vanke and CMSK, and it will benefit more from lower funding costs. The current valuation of Poly-A is roughly a 40% discount to the 2018E NAV per share.

We added **Gosuncn Technology Group** as a structural alpha stock. We believe the company will benefit from the accelerating application of IoT/V2X technologies as the transition to 5G communications gathers pace, and also from the rapid growth of the company' electronic vehicle identification (EVI) business.

Gosuncn is a leading IoT/V2X company in China focusing on RFID and IoT modules. In recent years, Gosuncn has won the majority of contracts in the US and Europe for vehicle IoT modules. In the fast approaching 5G era, IoT will be a very big market, especially for vehicular applications. We believe Gosuncn will continuously benefit from this trend. The firm's EVI system has been piloted in Tianjin and Chongqing, and this will likely be extended to other regions, continuing the growth in penetration. At 25x 2019E P/E, valuation is reasonable given our expected 20% annual earnings growth over the next two years.

RECENT EXITS

Lianhe Chemical Technology is China's leading pesticide and drug API producer, specializing in chemical process development of pesticides under patent protection. The company will likely continue to grab global market share of API production, capitalizing on its R&D pipeline and capital expenditure over the last 4 years. However, we expect a muted recovery in 2019 after its production halt in 2018 and a more meaningful pick up later in 2020, contingent on the success of its consolidation of a UK acquisition. We decided to exit the position at 1.5x P/B with 6% 2019E ROE.

We exited **Changyuan Group**, which was also a detractor for 1Q19, due to the weaker-than-expected performance of its battery separator as well as textile automation equipment businesses. The company spent around CNY3.5 bn to acquire these two assets, of which the separator business swung to a loss of CNY100 mn and the textile automation business declined around 60% in 2018. Looking forward, we think its separator business cannot compete against the market leaders due to the gap in technology and lack of scale economies. We think the company's textile equipment business is overvalued and the earnings quality is low, and therefore the stock valuation needs to digest these negatives over the next several years. Additionally, a huge amount of goodwill will likely be written off in the next two years due to earnings that are likely to be poor. These failed acquisitions led us to doubt the capability of the management team, and we chose to exit the position.

We exited our position in **Lens Technology**, which was established in the portfolio as a dynamic alpha play on expectations the company will benefit from increasing penetration in smartphone glass covers. While that was indeed the case, lower-than-expected iPhone sales and the resultant aggressive price cuts weighed on the stock. Looking ahead, we expect iPhones sales to remain weak and competition will become more intense. We exited the position for these reasons.

Source: APS

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SUBSCRIPTION

	Class A	Class B	Class C	Class D	Class E
NAV Prices as at 31st March 2019	USD106.97	N.A.	USD103.53	N.A.	USD106.88
Bloomberg	APSCAAA LX	APSCABH LX	APSCACA LX	APSCADH LX	APSCAEA LX
Initial investment	USD100,000	EUR100,000	USD100,000	EUR100,000	USD100,000
Management fee	1.00%	1.00%	1.75%	1.75%	1.00%
Performance fee	20% with High-water Mark + 8% hurdle rate	20% with High-water Mark + 8% hurdle rate	0%	0%	20% with High-water Mark + 8% hurdle rate
Liquidity	Weekly				
Dealing deadline	5:00 pm CET 4 Business Days prior to the relevant Dealing Day				
Redemption fee	Up to 5%				
Subscription fee	Up to 5%				
Legal advisers	Arendt & Medemach SA				
Auditor	Pricewaterhouse Coopers				
Administrator	Northern Trust Global Services SE				

Unless otherwise stated, all information is as of 31st March 2019 and sourced internally from APS

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