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	USD2.2 billion
Benchmark	8% Hurdle Rate
Number of holdings	32
Active share	84.5%
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 30 APRIL 2018

	1M	1Q	YTD	Since Incept.
CASF (U) Net Returns	-4.46	4.41	-0.26	15.57
CASF (U) Gross Returns	-4.97	5.40	0.16	19.74
CSI 300	-4.33	-0.01	-4.34	9.48
Difference (CSI 300)	-0.64	5.41	4.50	10.27
MSCI China A	-5.27	-2.14	-7.29	1.32

Performance of the Fund is represented by the asset weighted performance of the Class A 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 APS China A Share Fund (UCITS) fell 4.97% gross in April 2018 underperforming the CSI 300 by 0.64 percentage points.

China’s A-share market lost ground in April as Sino-US trade friction showed no signs of easing. Healthcare was the only sector that advanced during the period on expectations of accelerated China Food and Drug Administration approvals for innovative medicine. This is aimed at narrowing the gap in quality between medicine from domestic pharmaceutical companies and those from global peers. Electronics, media, and auto names led the decline on concerns of potential escalation in the trade spat.

A-share companies on the whole showed continued recovery in profitability for 2017 as well as 1Q18. Aggregate profits grew 18.4% YoY in 2017 for all listed companies and advanced 14.3% YoY in 1Q18. The recovery of ROE further extended a run that dates back to 3Q16, with trailing 12-month ROE reaching 9.1% in 1Q18 if the banking and oil&gas sectors are excluded, helped mainly by improving profit margins. It’s also the highest ROE print since 2Q12, ex-banking and ex-oil&gas.

The US embargo of Integrated Circuit chip sales to ZTE, one of China’s leading communications equipment makers, created more than just resentment in China. The move exposed China’s longstanding neglect of research in fundamental technologies and the cultivation of human capital in these essential research areas. It’s a reminder that after decades of focus on the innovative application of technologies, it is time China invests in upstream technologies that underpin the innovations. During the working group meeting on National Cyber-security and IT held during 20th~21st April, President Xi Jinping stressed the importance of mastering core technologies. It is no surprise that the fields of semiconductors, operating systems, cloud computing, and artificial intelligence will see enhanced investments from the state.

In April, there had been some important though subtle macro policy developments in China. The People’s Bank of China reduced the Reserve Requirement Ratio by one percentage point for major state and commercial banks. It also announced the postponement of the deadline for compliance with new regulations on asset management products to the end of 2020, instead of the initial mid-2019 target. The new regulations mean the end of banks offering implicit capital guarantees for wealth management products. This delay in implementation is to pave the way for a smoother drawdown of existing financial products, and an orderly transition to a more transparent and efficient capital market.

The long awaited MSCI inclusion of China A shares will soon come to fruition, with a 2.5% inclusion on 1st June and a further 2.5% on 3rd September to bring it to 5%. The list of stocks for inclusion will be announced in May. This will be yet another milestone in the A-share market’s steady progress toward a deep, credible, and internationalised financial market.

Sichuan Kelun Pharmaceutical’s stock price was up 4% in April, outperforming both the healthcare sector index and market index. It announced in March that its antibiotic API production base in Xinjiang Province has finally passed the Ministry of Environment Protection’s site inspection and has received approval to ramp up to its full capacity. This is the turning point for its API business, which has been loss making for three years after its CNY6 bn capital investment. Its core earnings hit a low in FY2017, due to the loss of the API business, a continuous increase in R&D expense, an 89% jump in financing costs, and a one-off asset write-off of one small API project. In 1Q2018, the company reported a 78% YoY growth in recurring profit, boosted by the API production base in Xinjiang contributing CNY100 mn of net profits and strong sales of flu-related infusion products. In addition, the company in April announced a second restricted stock incentive scheme comprising 2.16 mn shares, which accounts for 0.15% of outstanding shares. They are to be granted to 312 employees that include senior management, mid-level management, and core technicians. The vesting of the shares will be subject to earnings growth of at least 60% YoY in 2018 and 30% in 2019. At 41.8x FY2018E P/E and 31.7x FY2019 P/E, our view is that it is fairly valued and has priced in earnings recovery over the next 2 years. We decided to exit and take profit.

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SECTOR ALLOCATION (%)

	FUND	INDEX	DIFFERENCE
Information Technology	31.6	9.0	22.5
Consumer Staples	21.8	7.8	14.0
Consumer Discretionary	14.6	11.3	3.4
Health Care	7.4	6.7	0.7
Materials	6.1	6.9	-0.8
Real Estate	3.2	5.1	-1.9
Industrials	1.7	13.5	-11.8
Financials	0.6	33.8	-33.2
Telecommunication Services	-	0.7	-0.7
Energy	-	2.5	-2.5
Utilities	-	2.7	-2.7

MARKET CAP DISTRIBUTION (%)

	FUND	INDEX	DIFFERENCE
> 5 Bn	50.9	89.9	-39.0
2 Bn – 5 Bn	35.0	10.1	24.9
1 Bn – 2 Bn	1.1	-	1.1
< 1 Bn	-	0.0	0.0

TOP 5 HOLDINGS	SECTOR	% OF NAV
Venustech Group	Information Technology	9.1
Beijing Orient National	Information Technology	9.1
Kweichow Moutai	Consumer Staples	7.8
Gree Electric Appliances	Consumer Discretionary	7.4
Yonghui Superstores	Consumer Staples	5.1

Index: CSI 300
Sources: APS, Bloomberg and Wilshire

Venustech Group's stock was a contributor in April, shrugging off news that the founder and her spouse sold shares in February 2018 without making a public announcement 6 months ahead of time as required by regulators. We remain constructive on Venustech, which is well positioned to benefit from growing demand from government agencies, the military, and SOEs. This is part of the trend of increasing emphasis on cyber security, as well as recovering demand after the completion of a major leadership reshuffle in China. Its order book is expected to grow at 30% p.a. in the next 2 years, partly underpinned by product localization. It has been reinforcing its competitive moat by building an internet security operations center and providing security software services for the different levels of local governments.

Tasly Pharmaceutical was a contributor for the month of April. The company reported 15.4% YoY revenue growth and 13.9% YoY recurring profit growth in FY2017, in line with our estimate. The growth momentum continued in 1Q2018, with 18.1% YoY revenue growth and 15.2% YoY net profit growth. We expect growth to accelerate in 2018 and 2019. The key growth driver comes from its innovative thrombolytic drug which was included in the new national drug reimbursement list (FY2017) for the treatment of cardiac infarction. The drug is also undergoing a Phase II clinical trial for treating cerebral stroke, which is expected to be approved by FY2019/2020. Its peak sales potential, according to our research, is likely to be CNY1-1.5bn, contributing CNY350-530 mn to the bottom line, which is up to a third of its estimated total profits in 2018. Shanghai Tasly Pharmaceutical, the company's wholly owned biological drug subsidiary, is planning to list in Hong Kong in FY2018. This listing will result in more information about its technology and product platform entering the public domain, which would be positive for the valuation of the parent company. The stock is traded at 32x FY2018E P/E and 27x FY2019 P/E, with estimated EPS growth of 16% and 19% for these two years.

Gree Electric Appliances' share price slipped 6% in April after the company skipped a dividend payout for 2017, its first time in the past decade which surprised investors expecting a 70% payout ratio. Its 2017 earnings were as anticipated and were largely discounted by the market. The company's balance sheet and cash flow remains healthy, with ROE at 34% on a 15% net margin in 2017.

The company intends to fund capital expenditure for both capacity expansion and business diversification using the retained earnings. Investors are concerned that its profitability can be diluted by such investments, and would like to see further details of those plans.

We expect Gree, the undisputed leader in China's air-conditioner market, will continue to do well in a duopoly with second-placed Midea. The duo account for almost two thirds of the market, which allows for price hikes and market-share gains. We think the stock price pullback has largely priced in the negative factors, and the current valuation of 11x 2018E P/E carries limited downside risk in our view.

RF components manufacturer **Shenzhen Sunway Communication's** share price tumbled -16.56% in April as the US froze the supply of critical components to ZTE, possibly upsetting the global supply chain for 5G equipment and delaying China's 5G network roll-out.

Despite a 4Q2017 earnings miss and market talk of order losses, we remain positive about Sunway's FY2018 earnings outlook. We expect revenues to double in 2018 to CNY7 billion. We expect wireless charging, antenna, and connectors/structured parts to be the three primary earnings drivers for Sunway. Other high value-add products such as LCP antenna, front end RF solutions, and acoustics components for Android devices could bring in new growth opportunities in 2019 and beyond.

Goertek's share price underperformed the CSI300 by 12 percentage points in April, as persistent market talk of 2Q2018 IPhone order weakness weighed on share performance. On top of that, the US freezing the supply of critical components to ZTE led to the sell-down of both 5G equipment and mobile phone value chain supply names.

Our view is that most short-term negatives have been discounted in the price, and we expect earnings to recover in 3Q2018 on the new iPhone product cycle and Virtual Reality products. We continue to hold Goertek at an undemanding 17x FY2018E P/E.

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RECENT NEW POSITIONS

We initiated a position in **Lens Technology** as it will be a key beneficiary of smartphone form-factor changes ahead of the upcoming 5G product cycle, which will drive a multi-year upgrade trend that will also see price increases as well as growing handset penetration. Although Apple Inc went back to glass back panels for its iPhone 8 and iPhone X handsets, the majority of Android-based smartphones today continue to use aluminum and plastic back panels. We expect growing adoption of glass or ceramic for smartphone back covers, to allow wireless charging via magnetic fields and also because these new materials have far less interference with 5G's high-frequency radio waves.

Lens Technology is a world leader in cover glass for mid to high-end mobile devices, with a 25%-30% market share. It counts Apple, Samsung, Huawei, Xiaomi, and other major smartphone makers as its key clients. Privately owned Biel Crystal and BYD Electronics are its main competitors. Compared with metal casings, glass covers pose much higher entry barriers in terms of significant capital expenditure, know-how in multi-step material processing, need for a high degree of quality consistency, and a typically low yield.

We expect the continued use of dual-glass panel designs in Apple's new iPhones, and the adoption of 3D curved glass designs by Android-based brands to drive strong earnings growth between through to FY2019. Curved glass covers enjoy a strong premium over 2D flat glass panels due to complexities in glass folding and coloring, which results in tight supply. We expect earnings to grow 33% p.a. over the next 3 years. At 17x FY2018E P/E, we believe it is undervalued considering its dominant position, technological leadership, and the promising outlook for 3D curved glass.

RECENT EXITS

There were no stocks deleted from the portfolio in April.

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SUBSCRIPTION

	Class A	Class B	Class C	Class D	Class E
NAV Prices as at 30th April 2018	USD115.60	N.A.	N.A.	N.A.	USD115.56
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	20% with High Water Mark	0%	0%	20% with High Water Mark
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 Luxembourg Management Company SA				

Registration No: 1980-00835-G

Unless otherwise stated, all information is as of 30th April 2018 and sourced internally from APS

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