

Idea Brunch with Xin Wu of Banyan Partners

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Welcome to [Sunday's Idea Brunch](#), your interview series with great off-the-beaten-path investors. We are very excited to interview Xin Wu!

Xin is the CEO of Banyan Partners, which he founded in 2010. Out of Shanghai they invest in public Chinese companies with a Value Investing philosophy and a long/short strategy. Xin's 30+ years career in finance started with investment banking in Silicon Valley and evolved into principal investing that covered all the stages of a company's development including venture capital, private equity, leveraged buyout, and now hedge fund investing.

Xin, thanks for doing Sunday's Idea Brunch! Can you please tell readers a little more about your background and why you decided to launch Banyan Partners?

Thanks for having me, Edwin! I was born in Shanghai and moved to New York at the age of 12 in the early eighties. After graduating from Stanford in 1994 with a master's degree in engineering, I spent three years as an investment banker at the Silicon Valley investment bank Robertson, Stephens & Company. During this period, just before the DotCom bubble, many investment banks in Silicon Valley were seeking professionals who could comprehend the technology behind the ventures they were raising money for.

While those years were insightful, I wanted to transition from being an intermediary to becoming a principal investor with real skin in the game. Therefore, I switched to private equity and joined Chase Capital Partners. Based in Singapore and Hong Kong, our LBO/MBO fund managed over US\$1 billion, focusing on controlling stake deals across all of Asia.

After another three years, I had the opportunity to return to my hometown and join one of the earliest and most active VC funds in China. During this period, the idea of transitioning from private to public markets began to take shape. Venture deals in the early 2000s in China began to include essential terms for investor protection, such as liquidation preference and anti-dilution protection. However, in practice, minority shareholders were at the mercy of the majority founder management when disputes arose. Additionally, venture investors were stuck holding their minority shares with poor prospects of resolution or exit. In contrast, public investments offer the flexibility to sell shares at any time for whatever reason, thus achieving optimal risk management.

I also observed many ventures going public prematurely, meaning there were still many weaknesses and uncertainties in their business models. Often, their stock prices faced significant declines after a single disappointing quarter. Theoretically, I could have achieved venture-type multiples of returns in a shorter amount of time than typical venture deal holding periods by applying value investing and taking advantage of the market's wild swings. This realization hit me hard: it is possible to achieve VC-type high returns in the public market while exercising proper risk control at all times of holding.

After this eye-opening realization, I teamed up with a partner experienced in public investing to found my first hedge fund. We combined a private equity philosophy with public market tools, applying a long/short strategy within the China-centric equities universe. We had a good run in the years leading up to the 2008/2009 Global Financial Crisis caused by the Subprime Meltdown in the US. As a consequence, we faced significant challenges with investor funding. My partner shifted his career, but I founded a new company, Banyan Partners, to pursue the same goal, maintaining the same investment philosophy and strategy. My persistence and hard work paid off soon after, with fresh capital and new partners.

For an investor looking to add China exposure, why is investing in Banyan better than buying a China index?

As in any market, if you are seeking average returns, picking an index in China can be a sound strategy and allow you to enjoy the peace of mind of being passive. However, a recent report by UBS stated that the dispersion of returns in China is higher than in the US and Europe. This means individual stock returns deviate more from the average, allowing for greater potential outperformance in both long and short positions

compared to other countries. In other words, market conditions in Chinese equities offer skilled fund managers opportunities to deliver better risk-adjusted returns.

We at Banyan have been very successful in utilizing this market condition by consistently identifying the winners and losers. Over the last eight years, we have outperformed the CSI 300 every year, returning over 8% annually to our investors, while the CSI 300 has delivered less than 0.5%. Because we short single stocks instead of an index, our shorts are also a separate profit center while at the same time protecting us against systematic risks.

We are convinced that we will continue to outperform with our strategy due to the following three strengths. First, our unique quantitative and qualitative capabilities stem from my education as an engineer and a business owner mindset due to my background in private markets. This blend permeates the entire culture at Banyan and has led to the development of proprietary databases, models, and algorithms that drive efficiency in our data-driven fundamental investment process.

Secondly, the whole team has a unique understanding of the Chinese market. Our extensive global network, built upon the diverse backgrounds of our team members, provides unparalleled access to key figures within global business circles and especially within China. Having the right connections with experts is invaluable for navigating the complexities of this vast and regionally diverse country, coupled with numerous regulations and policies where information is often untransparent and cryptic.

Thirdly, we are long-term oriented and have aligned interests with our investors. Our core team has worked together for over 14 years, with an average of more than 25 years of experience in finance. Both the core team and all employees have a significant portion of their own money invested in the fund, ensuring aligned interests between our investors and the investment team. We treat our investors' money as our own, succeeding only when investors succeed. We are prudent stewards of our investors' capital, which is especially important in a country like China, where from the outside looking in, it is very hard to get a grip.

How does being located in China help you in your investment process?

Being located in China helps immensely. China is vast and highly diverse. Unlike the United States, which is relatively uniform with one official language and similarly developed cities and states, China is more akin to Europe. While people can generally understand each other, the existence of different spoken and written languages and vastly different business practices in different regions means that effective communication can be challenging. The contrast between Tier 1 cities like Shanghai and Beijing and the over 700 Tier 2 to Tier 5 cities is significant in terms of culture and development. Judging China from the US or even from Hong Kong is very difficult, if not impossible. It is one thing to read about hypercompetitiveness in China's EV market, but another to witness 100 different EV brands driving by on a street corner.

You are not going to understand the real China by sitting in an office in Shanghai or Beijing, let alone New York or Hong Kong. To truly understand and take the pulse of what's happening in real China, we need our network to extend far and wide. While we may not have employees in every corner, we have friends, associates, and a robust professional network. Without being part of this ecosystem for many years, it is impossible to gain real insights and make judgments on which companies truly have sustainable competitive advantages.

What are some of the ways the Chinese equity market differs from the U.S. equity market? Do you feel U.S. investors have any misconceptions about the Chinese markets?

The biggest difference lies in the market participants. In the Chinese A-shares market, 80% of the volume is contributed by retail investors, whereas in the US, it is less than 10%. To illustrate this, we can say that Mr. Market in the US is lazy, while Mr. Market in China is crazy. In the US, you might find small stocks that neither institutions nor retail investors look at, allowing you to find potential value. However, in China, this is not the case. Even the small caps are under constant surveillance. This can be further illustrated by a slang used by local investors: “炒新, 炒小, 炒差” which translates to "speculate on new, small, and bad companies." This leads to a very interesting valuation structure. While everyone thinks Chinese stocks are cheap currently, this is only true for the top companies such as the constituents in the CSI 300, the largest 300 companies valued at an average P/E of around 12. The next 500 companies have a P/E of 23, the next 1000 have a P/E of 37, and the last 2000 have a P/E of 59! This creates a very interesting hunting ground for rational investors with a long-term fundamental strategy to take

advantage of the low valuation of the biggest and best companies and short the bad small companies once their business models deteriorate and even the speculators lose hope. That being said, we want to highlight that the current market characteristics will not remain constant.

We believe there are many misconceptions about Chinese markets, the biggest might be that every Chinese company is engaged in fraud and that their numbers cannot be trusted. While it is true that there have been fraudulent companies in China, this issue is not unique to China; it also occurs in the US and Europe. However, we believe that the instances of fraud in China are often magnified more than any positive news, leading to a biased perception against Chinese companies. Fraud is a cat-and-mouse game worldwide, but from our analysis, regulatory oversight is much stricter in China. Reporting standards have been continually improving, and the rules are more standardized than elsewhere, significantly limiting “creative accounting.”

Another commendable tool to protect investors is the Inquiry System introduced by the local stock exchanges. Professional teams from the stock exchanges are dedicated to spotting irregularities in financial statements and other deal-related public disclosures and issuing public formal inquiries that the recipient companies must reply to within a limited number of days. Especially during earnings season, these inquiries pose confrontational questions when irregularities are detected in newly reported statements. We have seen previous inquiries asking questions as direct as whether a company's cash is real, requiring supporting bank documents and verification by auditors. Over the past eight years since the start of this Inquiry System, the volume of inquiries has steadily increased. This method, coupled with very harsh jail sentences for fraud and the general improvement in disclosure, means we do not blanketly write off the quality of the financial statements from Chinese companies. We believe the quality of the disclosures for a securities analyst to do research is on par with Western markets.

What are some interesting ideas on your radar now?

We have just recently published our three highest conviction ideas in your friend Richard Howe's [Stock Spinoff Investing](#) newsletter. Our ideas are [linked here](#) and reproduced for reader convenience below:

1/ Andon Health (SHE: 002432 — 19.7 billion yuan)

As described by Rich and supported by public opinion, China is cheap. So much so that in over 15 years of investing in stocks in China, this is the first time we have found sound companies trading below their cash value.

Andon Health, in one sentence, is a fair company at a great price. The company has a stable, cash-generating B2C medical supply business while currently trading at cash, with two major catalysts to unlock value: new contracts and continued buybacks.

The company sells its medical B2C products overseas under the “iHealth” brand, available on [its own website](#), [Amazon](#), and Walgreens. The products include blood pressure monitors, thermometers, glucometers, wireless scales, and test kits. The “Jiuan” brand mainly sells domestically, offering products such as nebulizers, nasal irrigators, and blood pressure monitors. The industry is highly competitive, and before the start of COVID-19, Andon was losing money. However, in November 2021, their COVID-19 antigen test was approved by the FDA for over-the-counter sales. There were only eight other approved tests at that time, so the US government and retail outlets purchased directly from Andon in Q1 2022. This resulted in revenues of 26.3 billion RMB in 2022, compared to 0.7 billion RMB in 2019, 2.0 billion RMB in 2020, and 2.3 billion RMB in 2021. The huge jump in revenues led our automatic financial analysis tool to detect the company. However, we were not the only ones, and the market price increased tenfold in two months. At this point, we did not invest because we were wary of a common occurrence with family-owned Chinese businesses: they often jump on the latest fad and waste money on unrelated ventures. We decided to wait and see.

The management of Andon did not engage in self-destructive actions and instead prudently invested in US Treasuries with different maturities. When we add the cash together with these risk-free treasuries and deduct the debt, we arrive at 19.4 billion RMB. We bought when the market cap was slightly below that. The current market cap is around 20 billion RMB.

There is no reason to believe the rest of the business should be worth only one billion RMB. In 2023, Andon generated 3.2 billion RMB in revenue with a net income margin of around 15%. Excluding government orders and pandemic-related test kit demand, normal revenue is estimated from Q2 2023 and Q3 2023 levels (0.8 billion RMB and 0.4 billion RMB,

respectively), averaging 0.6 billion RMB per quarter or 2.4 billion RMB annually, indicating growth compared to pre-pandemic levels.

The market is overlooking this opportunity because Andon is small, with a market cap of 20 billion RMB (2.8 billion USD) versus around 3 billion RMB (0.4 billion USD) before the pandemic. Consequently, there is zero sell-side coverage. Additionally, all the ratios are skewed because of the COVID-19 outlier. The cash is also not visible without going through the annual report.

Catalysts to unlock the value include continued buybacks, which have already amounted to 5.5% of shares outstanding YTD as of May, revenue collection from the new US government order at the beginning of the year, and new government contracts for the newly approved combined COVID-19 and flu test.

2/ Goneo Group (SHA: 603195 — 95.2 billion yuan)

Goneo, in one sentence, is a great company at a fair price. The company is a category-killing civil electrical engineering firm with 10-15% revenue growth, a stable 20% net income margin, no debt, an industry-leading 27% ROE, majority family ownership, and continued growth potential in EV and overseas expansion. Additionally, Goneo profits when Chinese real estate recovers. The valuation is relatively high at an EV/EBITDA of 19.2 and a PE of 27, on a LTM basis, but fair given its proven ability to enter and excel in new business areas and to compound for many years.

Goneo was founded in 1995 and started with electrical connection products like extension cords, power strips, USB sockets, and travel converters. In this category, where most sales go through mom-and-pop shops, Goneo dominates with an estimated 80% market share in China. For online sales in 2023, Goneo holds a 56% market share, with the second-largest company at 6%. Goneo stands out with its brand recognition as durable and safe, which makes customers willing to pay a premium. This recognition stems from being the first producer in 1995 to deliver a high-quality and safe product at a 50-60% premium to its peers, being the first mover in many rural areas in China and providing free store signs with its logo to mom-and-pop stores across the country. With its achieved scale and vertical integration over the years, it is now also the low-cost producer. This segment provides 48% of Goneo's revenue, has stable 5% growth, and gross profit margins of 41%.

The second category was launched in 2007 with intelligent electrical lighting products, such as wall switches and LED lighting. Competing with global giants like Siemens and Schneider, which have 8% and 7% market shares respectively in 2023, Goneo holds 34% online market share. This segment represents 50% of the revenues with a gross profit margin of 46%. Even though China is going through a real estate crisis, this segment grew 15% year-over-year, demonstrating its resilience. Whether for new buildings or renovations, new electrical items must be purchased. Additionally, it is a small-ticket item, with an average of less than 5% of the budget spent on electronic items yet a source of serious security concern for electrical failures that could cause fires. We see an upturn in real estate as a catalyst for even more growth and profits.

The management has done an impressive job in these two segments, achieving a roughly 10 percentage points higher ROE than competitors. In 2022, they started a new EV charging venture and delivered 149% year-over-year growth, with a gross profit margin of 34% and a market share of 11%, placing it in third place. With the massive EV boom in China, there is a long runway. The same goes for its international expansion, which started in H2 2023 and will target Southeast Asia and Europe. Our core thesis is that if you are a category killer in the homeland of competitiveness for cheap electronic goods, you can be successful worldwide.

85% of the shares are family and management-owned, showing strong alignment with shareholders. The low float is of no concern due to the generally high liquidity in Chinese A-shares. The 1 billion RMB in debt is also of no concern with 14 billion RMB in cash. This company is a candidate to hold for the long term if they can keep up the excellent execution.

3/ Yuyue Medical (SHE: 002223 — 38.1 billion yuan)

Yuyue, in one sentence, is a great company at a fair price. The company is the leader in household medical devices in China, boasting a 50% gross margin, a 20% net income margin, and a 30% return on capital, while having quadrupled its revenues over the past ten years. The founders hold 43% of the company. Yuyue benefits from several trends in China, such as an aging population and increased spending on healthcare. The valuation, at 16.7 EV/EBITDA and 27.1 P/E, on a LTM basis, is fair given its strong industry position and significant tailwinds.

Founded in 1998, Yuyue develops, manufactures, and sells household medical devices and clinical products. It focuses on five primary segments: respiratory oxygen generation, diabetes management, infection control, household electronic testing, and in vitro diagnostics. Additionally, it has incubated high-potential businesses such as life support information (first aid), ophthalmology, and intelligent rehabilitation. The company offers over 600 product categories with nearly 10,000 specifications. Historically, many products in China were imported due to better quality, e.g. Japan's OMRON, but Chinese companies have caught up and even lead in R&D efforts while producing more cost-effectively. Familiarity with local sales channels also contributes to their success. These factors, together with management's excellent execution, have made Yuyue the number one household medical device seller on JD.com and Tmall for China's Singles' Day shopping festival for eight consecutive years, demonstrating strong consumer trust that is hard for competitors to replicate across so many products.

Confluence of the following three key trends in China support continued growth: an aging population with more chronic diseases, increased disposable income used for healthcare, and a specific focus on home care. In China, hospitals serve as the primary point of care for patients. Unlike in Europe and the US, where primary care is typically provided by family doctors or general practitioners in small clinics, in China, patients go directly to hospitals for both general health issues and specialized treatments. This centralization means that hospitals handle a larger volume of primary care cases, often resulting in extremely short consultations and long queues. Therefore, especially for chronic diseases, patients prefer to avoid hospitals and buy home care products. While healthcare provided at hospitals is subsidized by the government where drugs and equipment are bought through centralized procurements which put a lot of pressure on pricing, B2C medical devices do not undergo this process and enjoy market pricing.

The founder and his son, who is also the CEO, own 43% of the company, aligning management with shareholder interests. Since going public in 2008, Yuyue has increased over 2000% in value but is still only worth about 40 billion RMB (5.5 billion USD), while being very conservatively financed with only 1 billion RMB in debt and 9 billion RMB in cash. The industry is poised for growth, and Yuyue is well positioned to continue to grow revenues 10-15% annually with margins at around 20%. This is a company to hold for the long term.

Richard connected us with you, Edwin, so thanks a lot to both of you!

What are some of the first things you do when researching a potential investment? What does that first hour of research look like for you? Do you do anything that few others do?

The first thing we do is decide whether a company is worth spending time on, as opportunity cost is paramount. As discussed, financial statements from Chinese listed companies are fairly uniform, so we developed an automatic financial analysis tool that analyzes all 5,000+ A-shares for us, generating new ideas four times a year. We prioritize growth, margins, valuation, and risk metrics. Additionally, we can immediately generate comparison tables among competitors to determine the company's competitive advantage reflected in the numbers. If it appears to be an attractive opportunity based on the numbers, we quickly try to understand the business and start reading annual reports. Within the first hour, we formulate a hypothesis about why the investment could be a good one, which we then substantiate during our research process.

I wouldn't say we do something that few others do. It's important not to fall into the trap of thinking we possess some secret advantage or are inherently better. We work hard, efficiently, and methodically, avoiding mistakes to allow more room for our good decisions to work their magic. We believe our strength lies in being extremely efficient, thanks to our vast and broad experience while also utilizing many technical tools. As the saying goes, we are a lean, mean fighting machine.

What would you like Banyan Partners to look like 10 years from now?

All together, our team has over 100 years of experience in finance. We believe we have the formula down for executing value investing in China. We want to continue making all our stakeholders happy and are optimistic that China will recover, leading to even better results. With our growing AUM, we will leverage our position as significant shareholders to engage in more positive activism, enhancing our portfolio companies. In China, we are not aware of any competitor with the same private equity background investing in public equities. This gives us a unique advantage and credibility in helping the managers of our invested companies realize their intrinsic value. We believe this is the true essence of being a business owner.

Xin, thank you for the great interview! What is the best way for readers to follow or connect with you?

The best way to connect with me is through my [LinkedIn profile](#) or via email at xin@banyanpartners.cn. Additionally, we will soon be launching our YouTube channel where we hope to cover more topics regarding investing in China!

Thank you for reading! Sunday's Idea Brunch is entirely reader-supported and we are grateful for your support. If you liked this interview, please consider hitting the heart button, tweeting it out, or forwarding it to a friend and encouraging them to [subscribe](#).

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