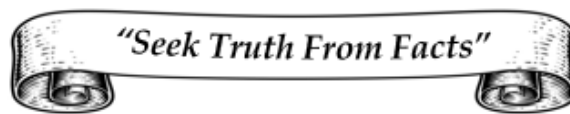


The China Rambler

An Occasional Letter On Topics Of Interest To China Investors

Issue #23



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In this edition: Japan's mathematically-assured (almost) future crisis. A trip to Yunnan's capital reminds what's great about China, and what's not. Shenzhou (#02313), long-time growth story faces tougher times ahead. How the clock's run out on this being China's year; the problem and the fix. Finally, a must-see if you ever find yourself in Kunming.

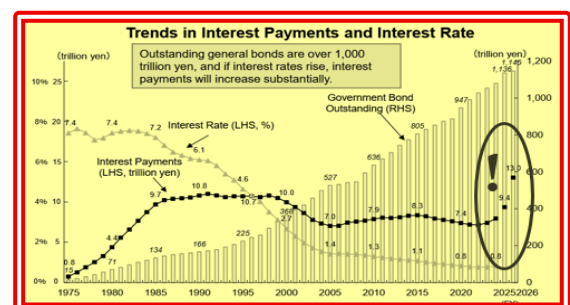
Japan's Mathematically-Assured (Almost) Future Crisis

Most know the first chart. Japan's debt to GDP is the highest in the developed world; but so? It's not and hasn't been a problem since, forever. Two factors have arrested concern.

The first is the majority of this debt is owned by the Japanese themselves. The [Asian Financial Crisis](#) was rooted in the problem governments at that time had with foreign creditors as their currencies wilted. Japan, it's been argued, can be relaxed about its weak currency because debts don't have to be repaid in this softer unit. OK, so far.



The second reason for ongoing calm is falling rates for the last 30-years held the cost-of-service low as debt issuance swelled; but see over on the right what's happening now. The debt service cost just went to an all-time high and is going higher. [I'm aware, this is a slightly lopsided argument. Charts BTW are from a deck from Japan's Ministry of Finance sent out earlier this year, [here](#).]



Rates now need to rise quickly and significantly to attract capital, but the government is resisting hence the weaker yen. Politicians' preferred solution is to stimulate the economy, tinker with the forex and take rates up, a bit; I'm no expert, but I don't think that'll work.

Therefore: a) rates go up too little and too slow, bond buyers strike, a funding crisis ensues, recession follows or, b) rates are suppressed, the currency continues to weaken, still no bond buyers, funding crisis and recession again or, c) growth resumes, debt as a percentage of GDP shrinks. The government seem to be betting on c), but that seems like wishful thinking. I believe it's wiser to assess risk informed by numbers, not the bromides of career politicians.

Kunming Fling

August was my birthday month, and I'd been angling for a trip to Kunming, the capital of [Yunnan Province](#). I decided therefore timing was ripe to put in a request and the trip-fairy delivered. I've been ticking off second-tier locales of late, viz. Tianjin, Harbin, Yiwu and Chongqing, but Kunming was a harder sell to my regular traveling companion on account of it having little obvious 'Wow!'-factor(s). As one of the main reasons for this second-tier rummaging is to look for new ideas and stop by on-the-ground operations of investee companies it's not always a fun prospect for my regular plus-one. The histories of Kunming and Yunnan however are fascinating and for those with more than a passing interest there's reason enough to spend a few days there. For the not-so-curios it's a jumping off point for the very Wow!-factor destinations of [Dali](#), [Lijiang](#), and [Shangri-La](#) further north.

Competition, Capacity and Consumption-Constraints

To business. Here I'm outside investee Lilang (#01234), a mid-range men's outfitter. Reminded once again that competition is brutal and relentless in all businesses in China. As soon as one disruptor folds another springs up to take their place. This is a market where no companies, especially those in the retail sector, have durable moats, brand equity or can count on customer loyalty. If this shot were widened you'd see to both right and left dozens of similar businesses along the high-street with barely distinguishable products. Investors have gotten China wrong time and time again by not understanding this brutal dynamic or failing to appreciate, in nearly all businesses, capacity exceeds demand and demand is finite. China's a big place, but there are just so many autos, washing machines and shirts it can absorb.



Oh Lordy! Not Again?!



To some of the points above. Remember a few years ago the rental-bike 'thing'? Massive supply, bikes piling up in cities in all the wrong places, losses for all? Bicycles appear extinct in Kunming, but their place has been taken by e-bikes and scooters, and the rental game seems again afoot. Here you see a Meituan scooter-wrangler with their haul off to somewhere there might be customers; and how do we think this sequel to a movie so recently played-out is likely to end? [Some useful context, [here](#)]

Overall

A refreshing dip into a charming city and a timely reminder China, even on the periphery, continues to barrel relentlessly forward, profits be darned!

Stockwatch: #02313 Shenzhou International

Summary of a recent closer look

Basically: Market cap.: c. U\$7.0bn, PE 8.5x, Yield 7.0%*, PB 1.3x. Avg. daily TO (3m) U\$33m. Business: the company is China's largest listed contract garment maker. [*P/E and Yield numbers are historic. Earnings and dividend could be down 40% this year]

The company doubled its capacity in the last ten years from annual production of just over 300m-garments to around 600m now. This impressive growth made it an investor-darling.

A look at this chart **1**, shows by how much the company has increased its intrinsic value, impressive. At the same time, you see margin and ROE trends, both disappointing.

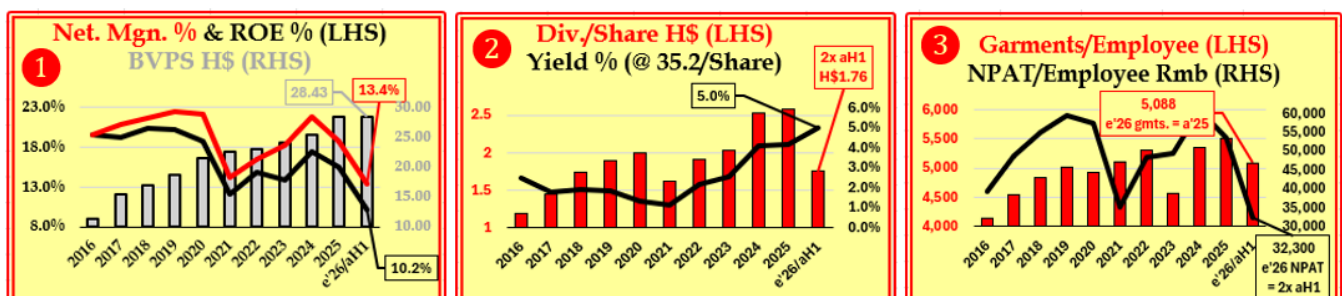
Consistent with its 'growth' stock status the yield in the past has only been modest **2**. The dividend has been on a steadily rising trajectory, but that's almost certainly about to change.

This chart **3** shows how scale is eating into operating KPIs. New factories in Indonesia and Vietnam together with a sales slow-down account for this. This won't/can't change soon.

Not to like: They've issued CBs in the past, for me at least, always a corporate governance red-flag. There've also been hard to fathom placements which may occur again. I think they may also be involved in deposit 'round-tripping', starting in 2020. Legacy holders may take a long time to adjust positions resulting in a 'tap' and stock price pressure for some time.

To like: It's a beast, I visited one of their workshops in Ningbo a while back and one could almost see the curvature of the earth looking across it. Scale, plus a healthy cash balance, assures survival. This space is likely to be a killing-ground for smaller China based peers for years to come. They'll have a tough time too but will surely survive.

Would I buy them? No. Not at any price. H1 2026 results spelled out the problems they're up against, none of which they can do anything about: 1) A strong Rmb hurts a company reporting in Rmb but billing in U\$, we can't know how this may change, 2) China operations are under the constant pressure of higher wages, overseas facilities will mitigate this but only to an extent, 3) industry overcapacity is their problem whether they like it or not, there's no elegant pivot away from their scale, 4) some customers, Nike (NKE) especially, are not having an easy time of it, 5) new facilities have yet to be fully ramped-up, other's experience of this hasn't been plain-sailing. In conclusion, they'll be around in 10-years' time, but the decade ahead won't be as kind to them as the one just past.



How's My Investing?

Performance summary, review of recent trading etcetera

August — YTD, Performance:	-6.6% — -1.1%
Performance Since Inception (Nov. '24):	+23.5%
Cash Percentage of Portfolio:	22%

2026 Is Not Going To Be China's (Or My!) Year

I had a great time out and about last month, but in the market not so much. In fact, I'd go so far as to say there, I had a rotten one. Not only did many investee companies come up short on H1 earning (some reducing or even omitting dividends in the process) but also the stocks of the few that pleasantly-surprised received little love thereafter.

Behind gleeful headlines about record stock issuance in Hong Kong and moonshot dancing-robot-company IPOs in Shanghai the underlying reality of China's economy in H1, as revealed by company reporting in August, was that things in general are slow. Moreover, guidance from nearly all companies I reviewed suggested no sign of a pickup in H2.

Misery Doesn't Always Love Company, But It's Often Grateful

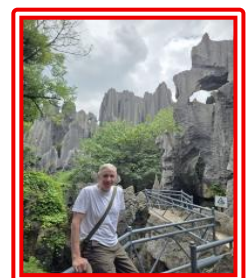
I've achieved a total return from China investing of -1.1% so far this year (inc. divis., reference to index returns that follow don't include these). With the exception of Shanghai's Star Market investors in the more accessible China markets at the end of August will have found themselves either side of unchanged, or worse (e.g. HSI TECH c. -17%). What's the problem, how much longer will it persist and what, if anything can be done about it?

It Remains The Property Market, Stupid!

China consumers' animal spirits have been crushed by the ongoing collapse of asset prices that affect nearly 90% of urban households i.e. their homes. I believed at the beginning of this year prices would soon bottom and the economy would pick up as a consequence; it's clear now, I was wrong. There's only one fix from here, some stability at least in that market. Until then consumer sentiment and stock prices, joined at the hip, will remain depressed.

Kunming Adjacent Wow!

80-km from Kunming is the 'Stone Forest', a UNESCO World Heritage Site, seriously Wow! and you should visit if in the locale. If not, I'm reminded of Dr. Samuel Johnson's summary of 'The Giant's Causeway' in Ireland. His friend Boswell inquired "Is not the Giant's-Causeway worth seeing?" Johnson, "Worth seeing, yes; but not worth going to see." Uncommonly severe methinks Sam. You get the point though.



Datawatch

Key Releases In The Last Month

Two 😞 Three 😞 Three 😊

Trade 😊 : July exports +23.9% (June +27.0%), imports +27.5% (June +36%). Big numbers continue; why remains the bigger question?

Prices 😊 : July CPI 0.9% (June +1.0%), PPI +3.5% (June +4.1%). The PPI was an unexpected and good-news-for-margins drop.

Credit 😞 : July M2 +7.7% (June +8.0%), Outstanding Loan Growth +5.1% (June +5.3%). Related aggregate numbers were also depressing.

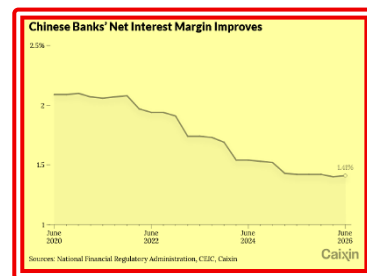
Consumption 😞 : July retail sales +0.6% (June +1.0%). A disappointment versus forecasts. A poor 2026 now seems locked in.

Industrial Activity 😞 : July +4.5% (June +5.3%). This series was picking up steam last month; but that seems to have been a false dawn.

New Home Prices 😞 : July -3.2% (June -3.3%). A good-ish number, but still a yuk! picture overall. Check out the series in more detail [here](#).

Business Confidence 😞 : Aug. PMIs. Mfg. 49.8 up from 49.2. Svcs. 49.9 unchanged. Comp. 49.5 up from 49.3. Thin cheer, but we'll take it.

Banks' Net Interest Margins (NIMS) 😊 : For the first time since late 2021 NIMS at Chinese commercial banks widened in Q2. It was by the tiniest of fractions but if the blip becomes a trend investors in the asset class will need to hold onto hats. The sector re-rating could go much further.



That wraps it up for August. What's here isn't advice or recommendation, it's what I've been up to, how I'm looking at the world and a small piece of the market puzzle which, combined with yours, I hope may be of some use.

"He who receives an idea from me, receives instruction himself without lessening mine; as he who lights his taper at mine, receives light without darkening me". Thomas Jefferson.

Good Luck with *your* investing. Feedback please to me at nial@nialgooding.com