MORGAN CREEK
CAPITAL MANAGEMENT

ALTERNATIVE THINKING ABOUT INVESTMENTS

New China Perspectives

Welcome to the weekly issue of Morgan Creek's ***New China Perspectives****. It is comprised of research from Morgan Creek's China-based investment team together with curated articles of interest. In addition to timely political and economic news covering greater China, Morgan Creek's China team seeks to provide in-depth perspectives on investing in the technology, consumer and healthcare sectors in the region. Our research leverages the "on the ground" insights of our team together with Morgan Creek's decades-long experience in covering the region. Our team are focused, thematic investors primarily covering the technology, consumer, and healthcare sectors and investing in private companies and early-stage managers with deep local expertise. To learn more about our team and investment offerings, please email chinateam@morgancreekcap.com.*

Best Regards,

Mark W. Yusko

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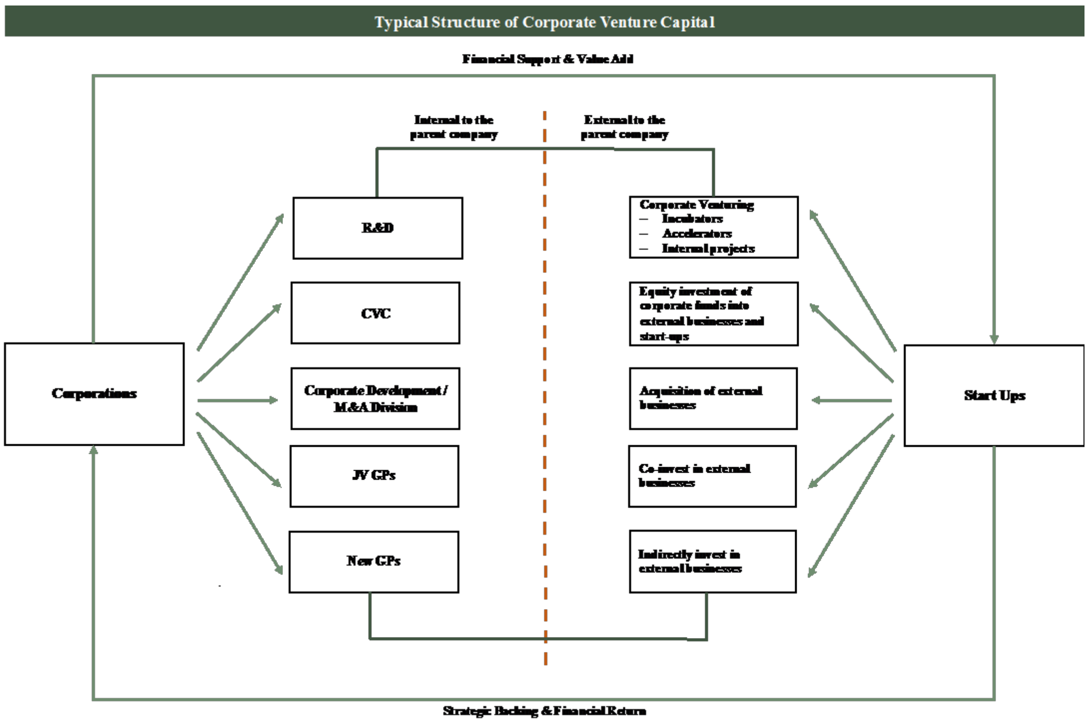
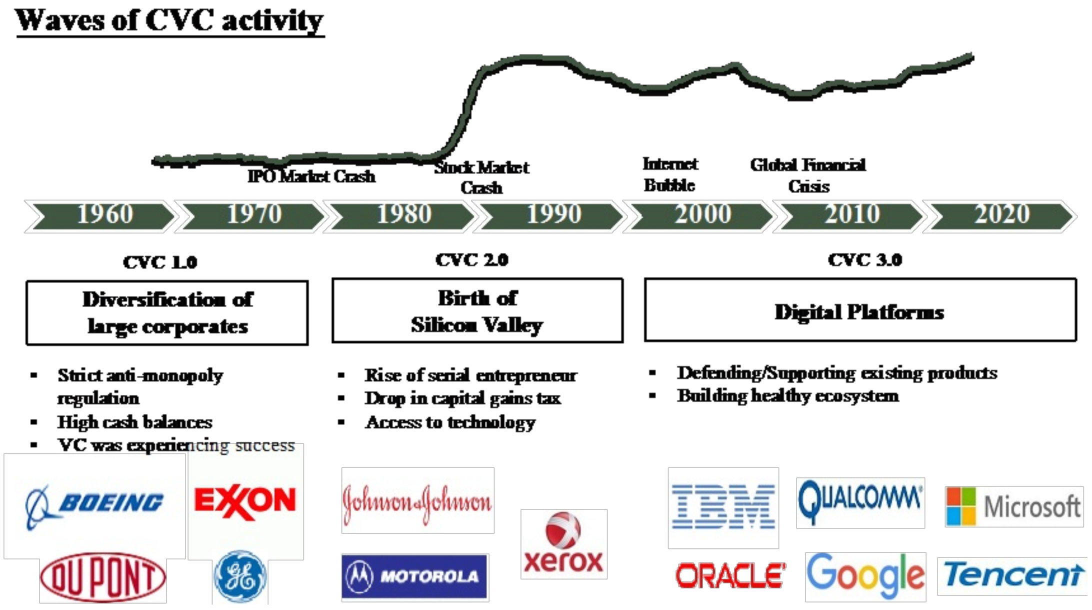
CEO & CIO

NOTES FROM THE BUND[1]

Many internet conglomerates in China are active in venture investing. They do this to keep abreast of new developments in the highly competitive technology sector and also to dip their toes into new sectors in which they may eventually decide to extend business lines. We appreciate the investment talent corporate venture capital ("CVC"s)[2] can cultivate because of: (i) their unique vantage point within the industry and appreciation of how incumbents view themselves and competition and (ii) their ability to truly add operational value to their portfolio companies. Indeed, an important pillar of our China investment strategy is to identify such talent to back, which we will discuss in future newsletters. In this issue, we will start from the beginning, and explore the development of the CVC in the US.



The first available report of CVC occurred in 1914 when DuPont invested in a still young General Motors ("GM") and made a 7x return, introducing this corporate venturing model to its peers.[3]



The first era: Diversification of Large Corporates (1960 - 1980)

After the Great Depression and the strict anti-monopoly laws that were swiftly enacted, large American corporations were forced to find new opportunities in new sectors in their quest for profits. This environment kick-started the modern CVC era in North America. Since the model was still relatively new at the time, many were still searching for a coherent strategy and suffered from long-term commitment issues. Ultimately, many corporations' enthusiasm for the strategy dimmed with the stagflation of the late 70's and the economic recession that followed. An example of a corporate VC representative of that period is discussed below.[4]

<u>Case Study - Exxon Enterprises</u>

- Founded in 1964 initially to exploit underutilized tech from Exxon's labs
- Became largest investor of 1970s
- In 1976, President of Exxon's goal: "to [invest] in new tech and business opportunities that could have some significance in the 1980s and beyond."
- Invested in businesses as diverse as test scoring machine, printing, air pollution mitigation tech, text editing, surgery equipment, graphite composite golf clubs, computers. More than half of the investments had nothing to do with Exxon's core business
- Exxon got impatient, tried to merge and consolidate the ventures under corporate structure, entrepreneurs left
- Shut down in 1984

The second wave: Birth of Silicon Valley (1980 - 1994)

In the late 1970s, the prosperity of the economy and the reduction of capital gains tax gave enterprises more cash to invest in technologies. The birth of computers accelerated the rise of serial entrepreneurs who became the investment targets of the second wave of CVC. However, due to the lack of market level compensation for CVC teams, especially with the rise of the financial VC firms, CVC activity continued to struggle within most corporations. From 1988 to 1996, the average lifetime of CVC was only 2.5 years, one-third of their typical VC peers.[5] An example of a CVC representative of this time period is discussed below.[6]

<u>Case Study - Xerox Technology Ventures</u>

- Founded in 1988
- To exploit and monetize technology from its research labs
- Goal: "to hedge against repeated missteps of the past". (ie. Apple monetizing its technology)
- Initially modeled like independent VC firms (quasi independent); compensation in line with market, 56% IRR from 1988 to 1996
- Victim of success, created internal strife at Xerox because of compensation, replaced with Xerox New Enterprises which became a business unit

The third wave: Digital Platforms (1995 onwards)

The primary objective of the prior waves of CVC activity was to acquire new technologies, occupy new markets, and expand product lines. From the late 90's, with the advent of the digital platform businesses built on top of the spread of PCs, laptops, and eventually smartphones, the intention from the resulting tech giants extended to utilizing corporate investing to defend existing product lines by either establishing an ecosystem and/or outright acquiring competition.
Modern examples of this include tech giants such as Google and Microsoft, both of which launched their CVC initiatives post 2014.[7]

Case Study - Microsoft Ventures (M12)

- Rejuvenated in 2016 through Nagraj Kashyap, formerly head of Qualcomm Ventures
- Focused on financial returns, "The best financial companies make for the best strategic returns."
- 90% of investments focused on enterprise startups providing B2B services
- Value-add offered:
  - — Technical integration with Microsoft's products
  - — (Azure or Office 365)
  - — Go-to-market help leveraging on Microsoft sales team
  - — Promotional services at Microsoft conference
- Relationship handled by internal BD team, staffed by Microsoft employees
- Investment team staffed by professionals from independent VCs and other CVCs like Intel

CHINA NEWS SPOTLIGHT

ECONOMY

China approves merging Shenzhen bourse's main, SME boards: China's securities regulator on Friday approved merging the Shenzhen Stock Exchange's main board with the SME (small and medium-sized enterprises) board. The merger will follow the general principles of unifying business rules and unifying operation supervision modes, with issuance and listing conditions, investor thresholds, trading mechanisms, and stock codes and abbreviations remaining unchanged, said Pi Liuyi, an official with the China Securities Regulatory Commission. *Read more.*

China says to retain benchmark deposit rate system for long term: China's central bank said Thursday that the benchmark deposit interest rates, the "ballast stone" of the entire interest rates system, will be retained for the long term. In a statement released after a teleconference on deposit management, the People's Bank of China (PBOC) stressed the externalities of deposit rate pricing, noting that the competition order in the deposit market is closely related to the vital interests of the people. *Read more*.

PRIVATE EQUITY & VENTURE CAPITAL

Kuaishou Shares Jump 194% in Hong Kong Trading Debut: Shares of Chinese short video app company Kuaishou jumped 194% at the open on its Hong Kong debut on Friday. Kuaishou priced its shares at HK$115 apiece, at the top of its range. *Read more.*

Didi is Looking to Raise $4 Billion for Its Group Buying Business: Chengxin Youxuan, the community group buying business of Chinese ride-hailing giant Didi Chuxing, is considering raising $4 billion to boost its growth, Bloomberg reported, citing people familiar with the matter. *Read more.*

TECHNOLOGY & CONSUMER

ByteDance Sues Tencent for Monopolistic Behavior: Tiktok owner Bytedance sued Tencent Holdings on Tuesday, filing a lawsuit against Tencent for monopolistic behavior and the company is seeking CNY 90 million in compensation. *Read more.*

Luckin Coffee Files Bankruptcy Protection in New York: The Chinese coffee chain Luckin Coffee has filed for bankruptcy protection in the U.S, ten months after it announced hundreds of millions of dollar of sales had been fabricated. *Read more.*

HEALTHCARE

The packed PD-(L)1 game just got another player — a low-profile biosimilars company looking to branch out with a $150M cash pact: After the majors lined up their PD-(L)1s, a low-profile biosimilars company has stepped up with the latest partnership as the next wave of checkpoints is about to hit a crowded shore. *Read more.*

Neurophth Closes RMB 400 Million Series B Financing: Neurophth Biotechnology Ltd., a fully-integrated genetic medicines company developing AAV-delivered gene therapies for the treatment of ocular diseases, today announced the closing of a RMB 400 million ($61.9 million USD) Series-B financing with a premier syndicate of investors, co-led by Guofang Capital and InnoVision Capital. Additional new investors include funds and accounts managed by Oriza Holdings, Harvest Capital and Grand Mount Capital with participating from existing investors Sequoia Capital China and Northern Light Venture Capital. *Read more.*

[1] The Bund is a historic waterfront area in central Shanghai, where Morgan Creek's office is located. From the 1860s to the 1930s, it was the rich and powerful center of the foreign establishment in Shanghai, operating as a legally protected treaty port. The picture above is part of the historical waterfront.

[2] Corporate venture capital (“CVC”) is the investment of corporate funds into external startup companies through a strategic investment department or through wholly owned subsidiaries.

[3]Morgan Creek Research.

[4] Morgan Creek Research.

[5] Morgan Creek Research.

[6] Morgan Creek Research.

[7] Morgan Creek Research.

Important Disclosures