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]

As we conclude our discussion from the last two weeks on venture capital ("VC"), we will review the differences between traditional VC and corporate VC ("CVC").

There are many ways CVC groups can be structured, but the most typical is as a strategic investment department deploying capital directly out of a corporation's balance sheet. Traditional VCs, on the other hand, raise capital through a diversified financial LP base, including funds of funds ("FoF"), university endowments, pensions, corporate investors, family offices, etc. This difference in shareholder base drives the variance between these groups related to compensation policy and investment goals.

Different Compensation Policy

The most important component of traditional VC firms' compensation is carried interest, which is based on fund performance. This drives independent VCs to invest based on projected financial returns, aligning the venture capitalists directly with its LPs. For a CVC, compensation is a big challenge. Most CVCs pay a fixed salary in addition to a bonus which is tied to the parent company's performance. While CVCs might be able to leverage their other business units for proprietary sourcing and due diligence, in many cases the incentive structure may not necessarily encourage this behavior if neither party is appropriately incentivized for the additional effort. This has historically been a significant challenge which has manifested itself in the form of relatively high turnover at CVCs. Morgan Creek has previously been able, in some instances, to facilitate incentive alignment between the various parties and have successfully enabled corporate VC spinouts.

Different Investment Goals

Compared to traditional VCs, which simply pursue financial returns, CVCs may have to consider multiple objectives, including its parent company's strategic goals when making investment decisions. While the goals may appear to be somewhat conflicting, there may not be a distinction between the two goals – the best financial companies would provide for the best strategic returns. Or put another way, if all the companies in a CVC's portfolio have soured and been liquidated, there is no strategic value to be extracted to its parent corporate.

CVC investment considerations - Pros	Accelerate growth quickly: -Talent -Channel -Technology	Compared to VC, CVC not only supports start-ups financially but can also provide value-added services, including marketing, bringing in customers, human resources, operation, etc.
	External Validation	Besides funds and resources, CVCs may be sufficiently experienced in business operations and management, which can be shared with the portfolio companies.
	Branding	A portfolio company could be supported comprehensively on marketing, core business, and suppliers and consumers' resources, making it more likely to be acquired at a higher price or go public, raising its value directly or indirectly.
CVC investment considerations - Cons	Potential conflict of interests	A business unit of the company may also develop similar products as the start-up, which may create a conflict of interest.
	Potential strings attached	CVCs may replace and take over the founding team to lead the business.
	Fear of closing the doors to other competing corporates; especially early in the life cycle of the company	Tech giants often compete with each other, and it could become hard to get capital support from multiple CVCs.

There are of course many other considerations to take into account before accepting any venture capital dollars, but understanding the structure and motives of both CVCs and traditional VCs should be a requirement for all entrepreneurs raising capital.

To see back issues of New China Perspectives, please visit:
https://www.morgancreekcap.com/market-commentary/#investment-process

CHINA NEWS SPOTLIGHT

ECONOMY

High-profile meeting identifies China's next-stage reform priorities: China's top leaders have outlined priorities and tasks for the next-stage reform at a key meeting on Friday, which is expected to play a crucial role in the country's pursuit of a new development paradigm. *Read more .*

China's 'two sessions': leaders must decide whether to scale back economic stimulus as debt risks loom: China is expected to scale back the coronavirus fiscal stimulus measures it enacted last year, as brighter economic prospects and hopes of improved relations with the United States help shift the government's attention to domestic debt risks. *Read more*.

PRIVATE EQUITY & VENTURE CAPITAL

Power Bank Sharing Company Energy Monster Raises $300M and Aims for US IPO: According to the news agency, Energy Monster Charging, a Chinese company that specializes in power-sharing devices, is currently negotiating with investment entities including Citigroup, CICC, China Renaissance and Goldman Sachs, seeking to go public in the first half of this year. The shared power bank provider was established in Shanghai in 2017 and currently has more than 100 million registered users. *Read more.*

Meal replacements taking their place at table: With the influx of significant capital and numerous players vying for a piece of the pie, the meal-replacement market in China is piping hot. Euromonitor International, a market research company, said that China is currently the fastest-growing market for meal replacements, forecasting that it could top 57.2 billion yuan ($8.8 billion) in 2017 and reach 120 billion yuan in 2022. *Read more.*

TECHNOLOGY & CONSUMER

China Invests 260 Billion Yuan in 5G Rollout: China has so far invested more than 260 billion yuan ($40.2 billion) in 5G network construction as the country is committed to promoting the promotion and application of ultrafast wireless technology, the state-owned media China Daily reports on Tuesday, citing the Ministry of Industry and Information Technology. *Read more.*

Huawei Announces New Foldable Mate X2, HarmonyOS to Replace Android on Flagships from April: Chinese smartphone maker Huawei on Monday unveiled its latest foldable flagship, the Mate X2, signaling continued efforts to lead the high-end smartphone space. *Read more.*

HEALTHCARE

Clover Biopharma completes round of Series C financing: Clover Biopharmaceuticals, a Chinese clinical-stage biotechnology company developing transformative biologics for the world's most debilitating diseases, announced the completion of an oversubscribed $230 million round of Series C financing on Tuesday. *Read more.*

A month after multi-billion dollar Novartis deal, BeiGene follows up with 'reverse' deal: Just over a month after striking a deal with Novartis to bring its PD-1 antibody tislelizumab stateside, China-based BeiGene is making a similar play in reverse. *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.