

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@morgancreekc.com.

Best Regards,

Handwritten signature of Mark W. Yusko

Mark W. Yusko
CEO & CIO

NOTES FROM THE BUND¹

The Chinese public markets have been significantly impacted by adverse macro-conditions (Chinese anti-monopoly regulation, US-China tensions and most recently the Shanghai lockdown). U.S. listed Chinese stocks, in particular, have been hit particularly hard, [falling 72% from their peak](#). These same factors have cemented the "winners" of China big tech platforms: Alibaba [BABA/9988.HK], JD[JD], PDD [PDD] in ecommerce, Meituan² [3690.HK] and Didi [DIDI] in services³, Tencent [0700.HK] and Bytedance in gaming and social media. We expect these companies to continue to influence the tech landscape in China, so understanding their strategy going forward will be important. In the next few newsletters, we will analyze Meituan.

In this newsletter, we will:

- Trace Meituan's developmental history
- Discuss its core business model
- Outline reasons for its success

To many Chinese consumers, Meituan is thought of as China's "Amazon" for local services. It is today the largest food delivery app by GMV⁴, the [largest hotel booking platform](#) by number of room nights booked and also, at least for the time being, the largest community group buying company by GMV.

Meituan’s business model briefly is “fast follow” – where it aims to quickly replicate and iterate upon already proven business models. Wang Xing, founder and incumbent CEO of Meituan, has built his career by unabashedly [cloning multiple US tech businesses](#) in China – including Facebook (“Xiaonei”) and Twitter (“Fanfou”) before building Meituan, which itself began as a Groupon copy-cat.

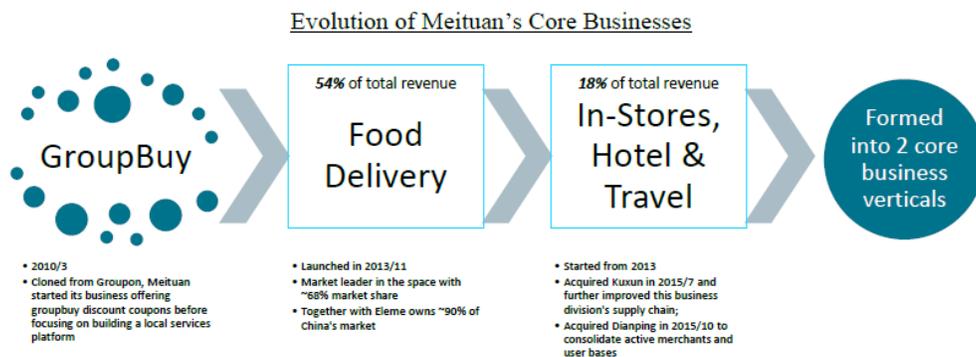
The Chinese have an idiom for this: “青出于蓝而胜于蓝”, which literally translates to “green is born of blue but exceeds blue” (or, the student surpasses the master). There are many examples of companies finding commercial success from imitation and iteration, so this idea in the high tech industry is not new. Google (1998) came after Yahoo (1994), Facebook (2004) after Friendster (2002) and Uber (2009) after Lyft (2007). Going further back, Intel (1968) was the heir to Fairchild Semiconductor (1957) that was formed by the “traitorous eight” ex-employees of Shockley Laboratories (1955), which was credited as the first high tech company to work on silicon-based semiconductor devices in Silicon Valley.

What is interesting with Meituan is that it has developed a playbook to clone different business models on its platform.

It does so by:

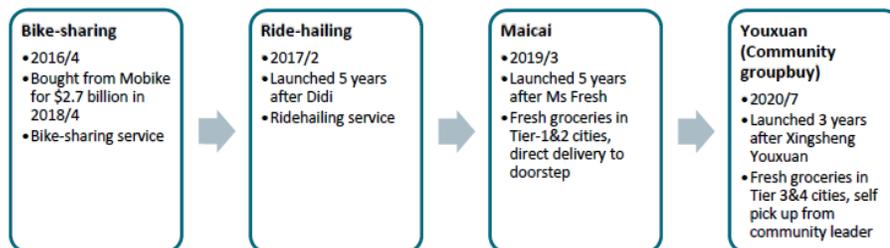
- Identifying and monitoring new startups in the service sector
- Evaluating businesses for strategic fit and cloning feasibility once scale is proven
- Scaling businesses rapidly by injecting cash for user acquisition (in the early days of new business units through subsidies)
- Focusing on operational efficiencies only after desired market share is reached

The charts below show the evolution and current layout of Meituan’s business, which is divided into 3 parts: 1) food delivery, 2) in-store, hotel & travel, and 3) new businesses & others.



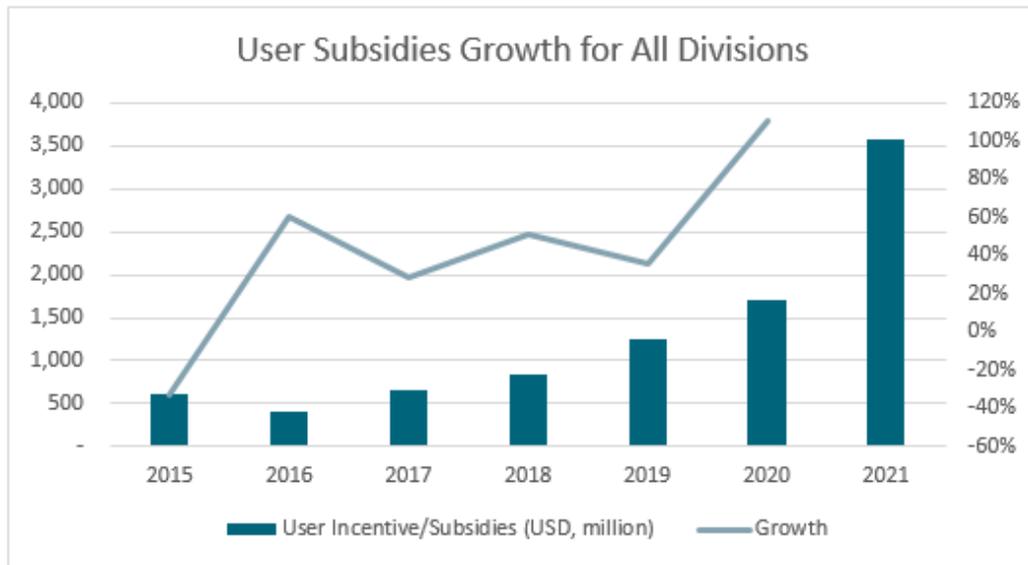
Meituan’s “New Businesses & Others” Initiatives

This division made up 28% of total revenue in 2021.



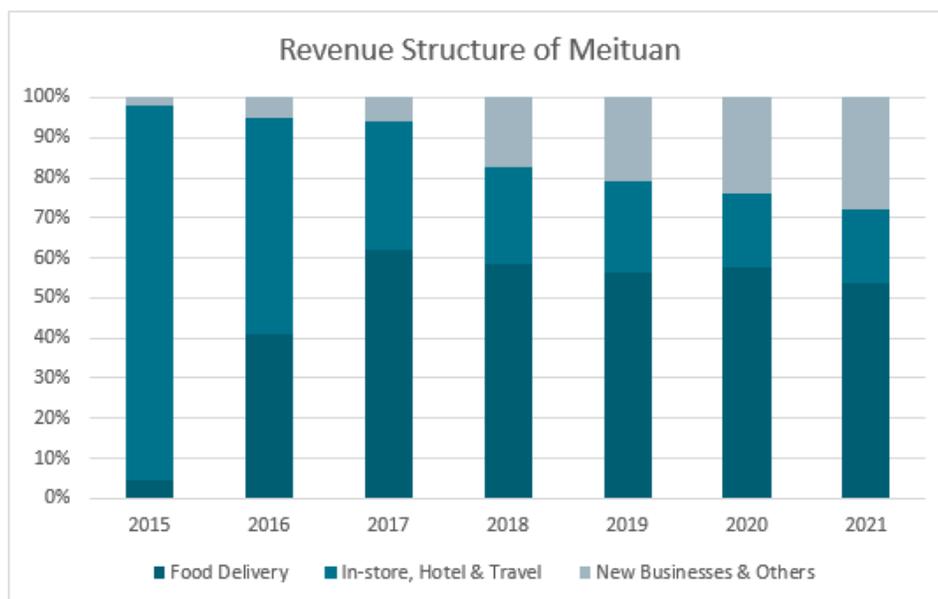
As illustrated in the chart above, Meituan has been successful in systematically pursuing its fast follow strategy across multiple business lines: group buying, food delivery, travel accommodations, and community group buying (“CGB”) of groceries. In all of these areas, Meituan began with heavy subsidies (shown in the chart⁵ below) and most recently spent \$3.6 billion in 2021 to grow its

market share in its latest CGB initiative.



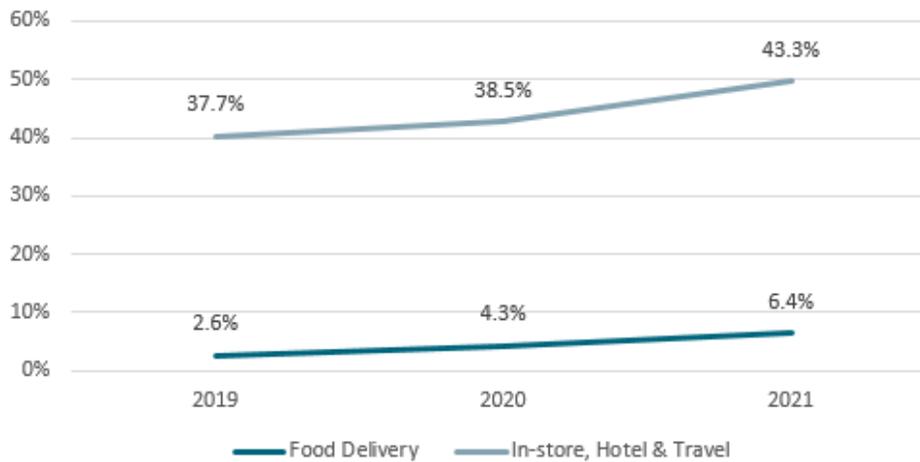
Spending aggressively in these markets made sense for Meituan because consumer internet markets can be winner take all – characterized by many initial entrants but few final survivors. We believe the end game for many of these markets may be 2-3 players dominating the landscape with the leading player ultimately cornering up to 70% of the market, as evidenced with Meituan’s market share in China’s food delivery industry. This is a function of the initial entry barriers for many of these segments, which start low, but then grow exponentially with scale, network effects and consumer mindshare.

This characteristic means a specific investment could have a huge revenue impact on the company. Meituan, now a Super App, offers many services to both consumers and merchants on its platform, but close to 70% of Meituan’s revenue is generated from two main categories: food delivery and travel accommodations.

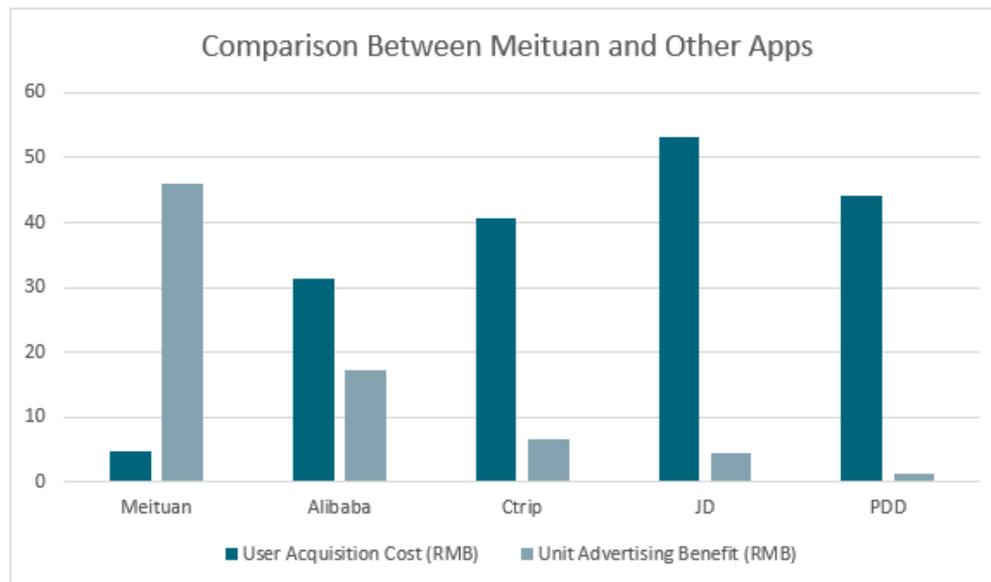


Both of these businesses are now #1 in their respective segments ⁶, and priority has since shifted toward operating efficiencies. Meituan’s success in these two verticals has illustrated the team’s strong executional capability not only in beating out keen competition to emerge to the top, but also to establish a profitable business from there.

Meituan's Operating Margin



Compared to its big tech peers⁷, some of whom may boast larger user bases and/or war chests, Meituan's core competency lies in its strong execution capability geared towards local service providers. The chart below shows Meituan's strong operational metrics compared to some of its peers: illustrating its low user acquisition cost and the higher revenue it generates per advertising spend. This is as Meituan's ability to cross-sell services is very strong.



Since the beginning, when it launched its group buy business, it had to organize a strong business development team to pound the streets visiting a variety of merchants – restaurants, hotels, salons, etc. to persuade them to: 1) list on Meituan's app, and 2) discuss potential promotions. Meituan has had to hire and manage a large personnel base to cover the [high number of hotels](#) and [restaurants](#) in China.

Meituan's local business development team has since established a standard operating process, which it repeatedly refines with every new business vertical (battleground) it enters and wins.

Meituan is today capable of offering its same group of SME⁸ merchants higher value added services. For example, restaurants can utilize Meituan's delivery capability, sign up for SaaS solutions, take loans, and even purchase raw material and ingredients. Over the last 15 years, Meituan has refined a standard operating procedure ("SOP") to engage this vast offline SME merchant base.

[Click here](#) to see back issues of New China Perspectives

Chinese President Xi Jinping Warns against International Decoupling in Russia Speech:

Chinese President Xi Jinping has warned against international decoupling and criticized the imposition of sanctions in a speech to a Russian economic forum. He also expressed "confidence" in the Chinese economy as international investors closely watch what measures it will take to recover from the impact of Covid-19. [Read More.](#)

Hong Kong Sells More U.S. Dollars to Defend Currency Peg: Hong Kong has sold more foreign-exchange reserves to maintain its longstanding peg to the U.S. dollar, taking its total outlay this year to \$7.24 billion. The pressure on Hong Kong's currency is part of turmoil across global foreign-exchange markets. The U.S. dollar has surged as investors adjust to a worsening economic outlook and brace for aggressive action by the U.S. Federal Reserve to bring decades-high inflation back under control. The Fed on Wednesday increased interest rates by the most since 1994. [Read More.](#)

China's Central Bank Accepts Ant's Application for Financial Holding Company: China's central bank has accepted Ant Group's application to set up a financial holding company, three people with knowledge of the matter said, a key step in finishing a year-long revamp of Jack Ma's fintech business and reviving its stock market debut. The People's Bank of China's (PBOC) expected approval of the plan is the latest sign that Ant, a tech giant with financial businesses stretching from payments to wealth management, is poised to emerge from a regulatory crackdown. [Read More.](#)

China's New Oriental Education Giant Finds New Life in English Live Streaming: Shares in China's New Oriental (9901.HK) climbed for a fourth straight day on Wednesday, with analysts saying its new live-streaming sales strategy could help it recover from a regulatory crackdown that decimated its education business. The company was once one of China's largest private tutoring firms but its fortunes changed overnight in July last year when Beijing enforced sweeping new rules on private education that barred tutoring for profit. New Oriental's shares plunged and it dismissed tens of thousands of staff. [Read More.](#)

China's Metaverse Industry Will Evolve Differently: Due to its regulators, the Chinese metaverse industry is shaping up to be different from those in other parts of the world. Tech giants such as Tencent, NetEase, ByteDance, Alibaba, and Baidu will attempt to influence the metaverse industry in China while regulators intend to limit their dominance. Metaverse-related investments will increase over the coming years, but the tech companies must adhere to the government guidelines. [Read More.](#)

Innovent Announces the NMPA Acceptance of the New Drug Application for Tafolecimab Injection (anti-PCSK-9 antibody): Innovent Biologics, Inc. ("Innovent") (HKEX: 01801), a world-class biopharmaceutical company that develops, manufactures and commercializes high-quality medicines for the treatment of oncology, autoimmune, metabolic, ophthalmology and other major diseases, today announced that the China's National Medical Products Administration (NMPA) has formally accepted the New Drug Application (NDA) for tafolecimab injection (anti-PCSK-9 antibody, R&D code: IBI306) for the treatment of primary hypercholesterolemia (including heterozygous familial hypercholesterolemia and non-familial hypercholesterolemia) and mixed dyslipidemia. [Read More.](#)

SinoMab Dosed First Healthy Subject in Phase I Clinical Trial of SM17 in the U.S.: SinoMab BioScience Limited ("SinoMab" or the "Company", together with its subsidiaries, the "Group",

stock code: 3681.HK), a Hong Kong-based biopharmaceutical company dedicated to the research, development, manufacturing and commercialization of therapeutics for the treatment of immunological diseases, today announced that, the first healthy subject has been dosed in the Phase I clinical trial of SM17 in the U.S. SM17 is a First-in-Class (FIC) humanized anti-IL-17RB monoclonal antibody. The subject is currently in a normal condition. [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 Morgan Creek does have a position in Meituan directly and indirectly, however this is not meant to be an investment recommendation.

³ Despite the regulatory issues, the company is currently undergoing and its severe adverse impact on Didi's stock price, the company today remains the largest ride-sharing company in China by a wide margin.

⁴ Gross merchandise value

⁵ Source: Meituan's prospectus and annual reports.

⁶ Food delivery is measured #1 by GMV and the hotel segment by annual number of room nights

⁷ The chart below presented some metrics to show Meituan's operating efficiency, among them:

User acquisition cost (gross) = annual advertising expenses/number of annual active transactional users;

Unit advertising benefit= total revenue/advertising expenses;

Sources: All companies' annual reports, Guosheng Securities Research.

⁸ Small medium enterprise

Important Disclosures

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