

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@morgancreekcip.com.

Best Regards,

Handwritten signature of Mark W. Yusko

Mark W. Yusko
CEO & CIO

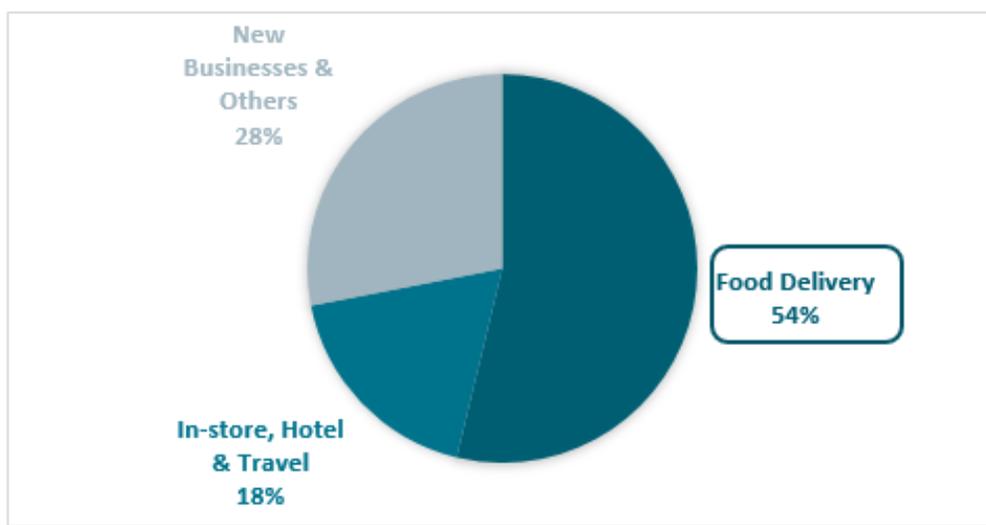
NOTES FROM THE BUND¹

In the prior newsletter, we discussed Meituan's "fast follow" model and highlighted reasons behind its success so far. In the next few newsletters, we will dig deeper into each of its core business verticals: food delivery and hotel accommodations. We will also explore a new vertical Meituan is looking to enter – grocery community group buy.

The chart below shows the breakdown of Meituan's revenues. We will begin our analysis with its largest business division – food delivery.

Meituan's Revenue Breakout (2021)

Source: Meituan Research and Leadleo Research Institute

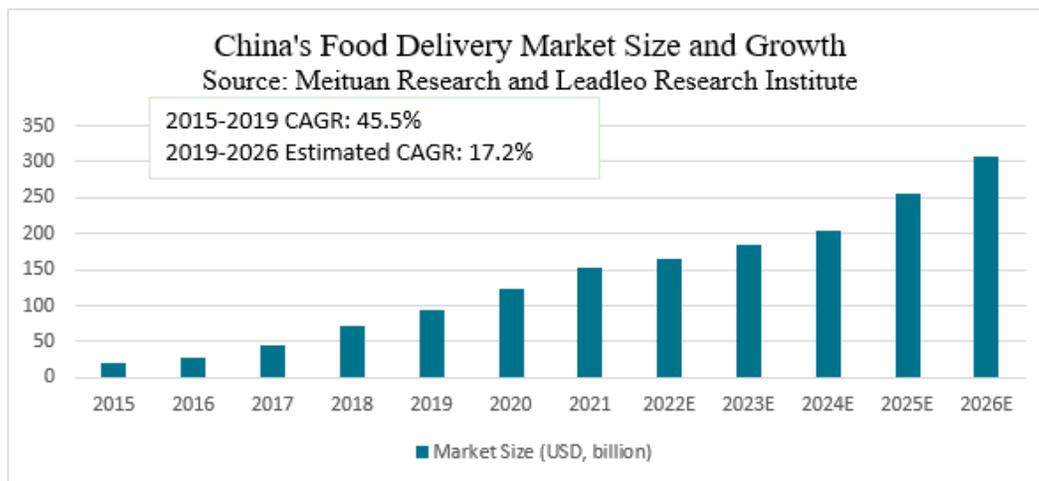


Questions we aim to address in this newsletter include:

- Size, future growth, and structure of the food delivery industry
- Meituan’s market positioning and competitive advantage vs. its largest competitor Eleme

Overview of China’s food delivery market and impact of the pandemic

The food delivery industry in China has witnessed significant development over the past decade. The chart below displays that from 2015 to 2019, the number of consumers increased from 210 million to 410 million, and the market size grew from \$134.8 billion to \$603.5 billion.² The compound annual growth rate ("CAGR") for 2015 to 2019 is 45.5%. Further, for the period from 2019 to 2026 the CAGR is still expected to be approximately 17.2% even as penetration rates increase.



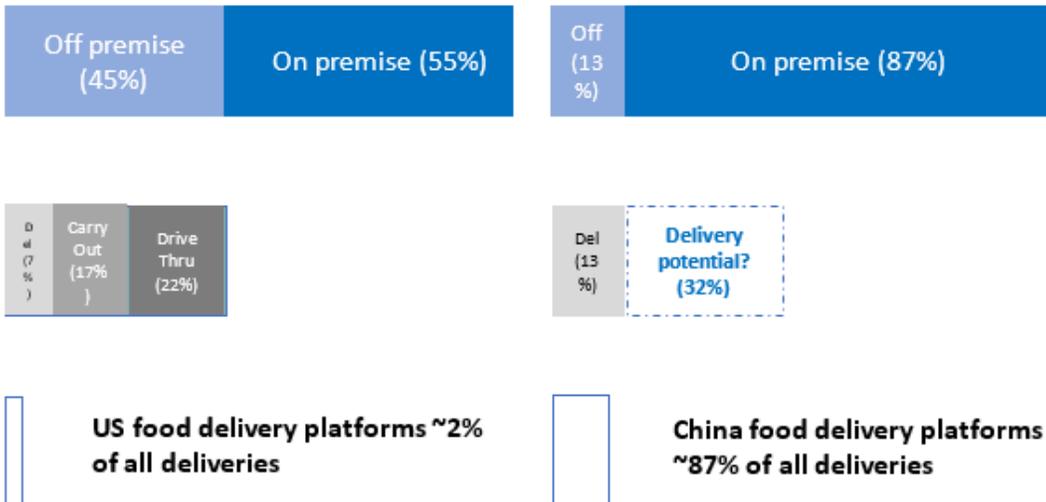
However, there still exist huge gaps between China and developed markets in terms of dining habits, which provides a strong tailwind for China’s food delivery market to continue its robust growth.

US vs China Dining Habits³

Source: GlobeNewswire, RecordTrend, Chris Huskey

US Restaurant GTV (2018)
\$555B
Growth: 4% CAGR 20-26⁽¹⁾

China Restaurant GTV (2018)
\$660B⁽³⁾
Growth: ~10% CAGR 20-24⁽²⁾

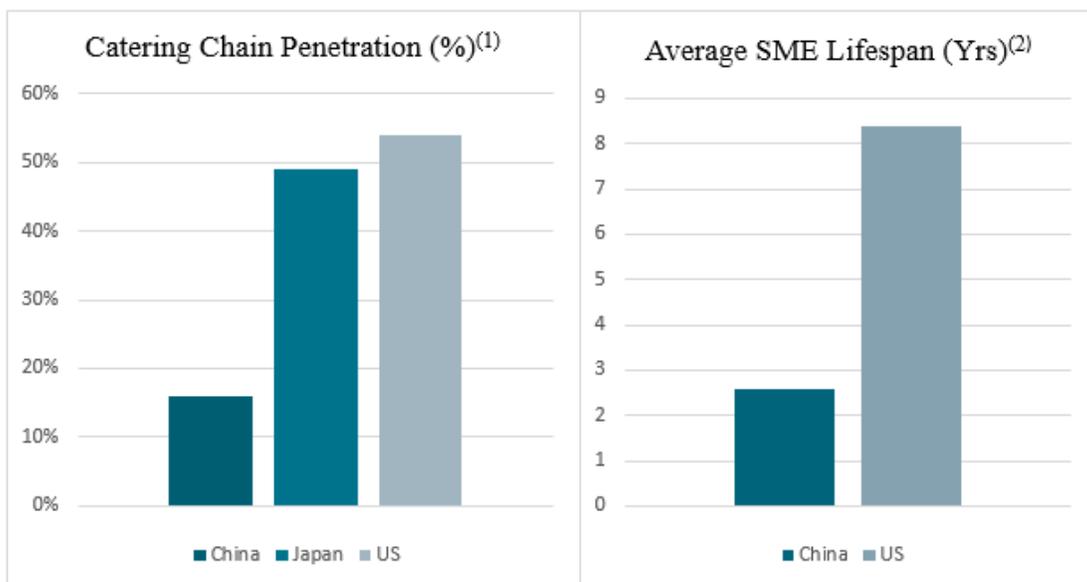


Shown in the chart above, the potential market for third party food delivery services in China (like Meituan) is very attractive and larger than that of a developed market like the US.

- *Overall pie is bigger and growing more rapidly* – China restaurant gross transaction value ("GTV") is 1.2x larger and growing ~2x faster.
- *Overall penetration remains low* – China's off premise (to go) consumption remains a fraction (~30%) that of the US.
- *Lack of substitutes for food delivery* – China's lower wage levels which makes third party delivery affordable and the low concentration of restaurant chains (see chart below) means most restaurants lack delivery capabilities and have no drive thru options. This is a big contrast with the US, where consumers tend to pick up their own meals.

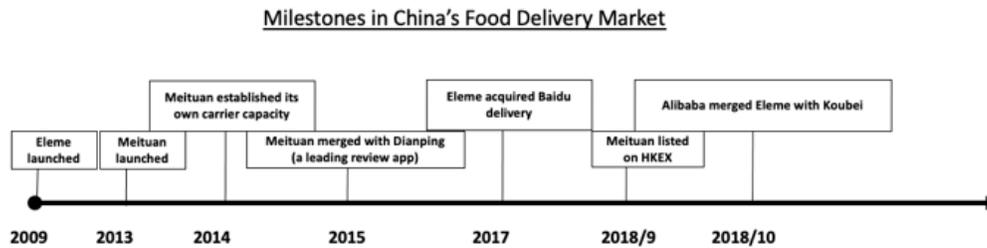
Furthermore, China's restaurant industry is largely made up of small and medium enterprises ("SMEs") that turnover almost every 2 years, creating high customer discovery costs. There is thus a ripe environment for a platform like Meituan to aggregate these mom and pop shops and provide them with services including customer discovery and delivery.

China Restaurant Industry: Highly Fragmented with High Degree of Churn⁴



Lastly, the recent COVID-19 lockdowns across China have also worked to expedite the adoption of food delivery, with on premise dining restrictions.

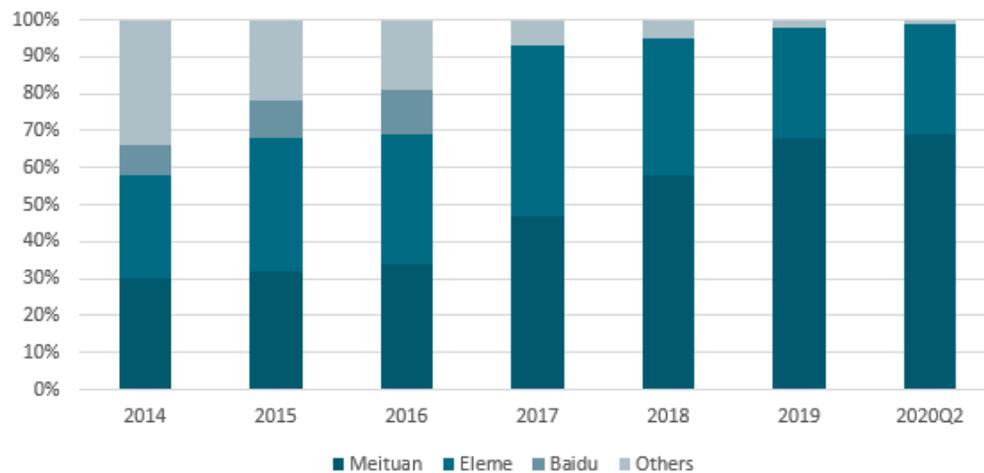
Competition between Meituan and Eleme



Meituan and Eleme currently dominate the food delivery market in China. Eleme was actually the first Chinese food delivery company, established in 2009 to serve college students. Due to the immature market and lack of financing available to the company, growth was slow for many years. By 2013, Meituan sensed this opportunity and entered as a competitor. Baidu, a distant third player, eventually merged into Eleme in 2017. In 2018, Eleme sold itself to Alibaba. A little under a year later, Meituan had emerged as the dominant player in this space, with close to 70% market share.⁵

Meituan vs. Eleme Market Share (%)

Source: Medium



Analysts attribute the following reasons to Meituan's ultimate success over its rival:

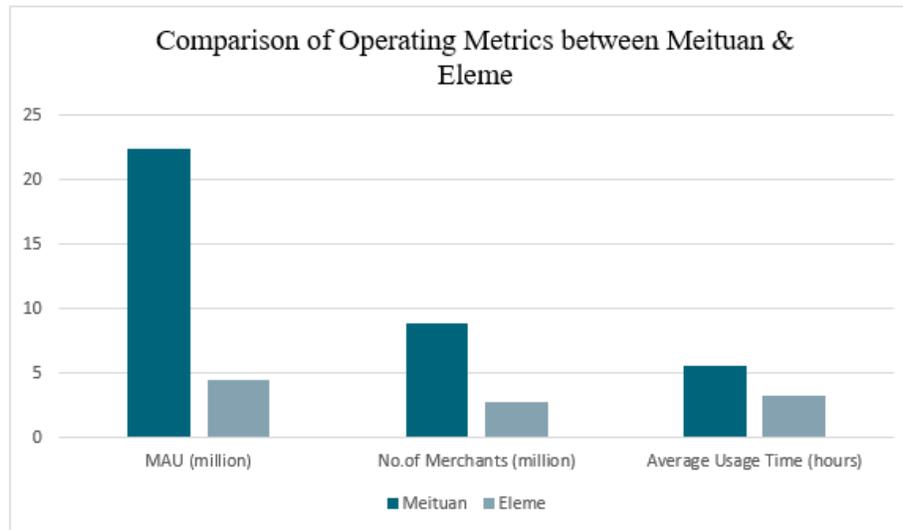
- Synergies – Meituan picked the right battleground where there was significant synergies with its existing core group of users and SME merchants.
- Superior team execution – Meituan was led by a veteran team who was one of two (the other being Dianping) to survive a prior “group buy” battleground which [featured over 5,000 competitors](#) at its peak.
- Smart strategy of Dianping merger – Dianping was, among other things, the Yelp of China and the gateway for local services in China, offering customer reviews for restaurants, salons, hotels, etc. Prior to the merger with Meituan, it was also a competitor and an investor (and source of customer traffic) for Eleme. Post-merger, in one fell swoop, Meituan removed a potential competitor in the group buy arena, freeing up cash to be burnt in the food delivery space, and removed a customer resource for Eleme, which led Eleme to scramble looking for strategic deals with Baidu and Alibaba, to little avail.

While Meituan can take much credit for its success in the food delivery space, Alibaba's own missteps post acquisition have also helped its rival gain market share. Alibaba's core expertise and competitive advantage lies in its China ecommerce business (~70% of its revenue). Through the years, Alibaba has trained and developed a very strong team. Due to this deep talent pool, Alibaba tends to make acquisitions and in many cases will replace management, which may require a transition period especially when the company expands outside its circle of competence. In the Eleme acquisitions case, the company's market share continued to decline post acquisition. [Alibaba](#)

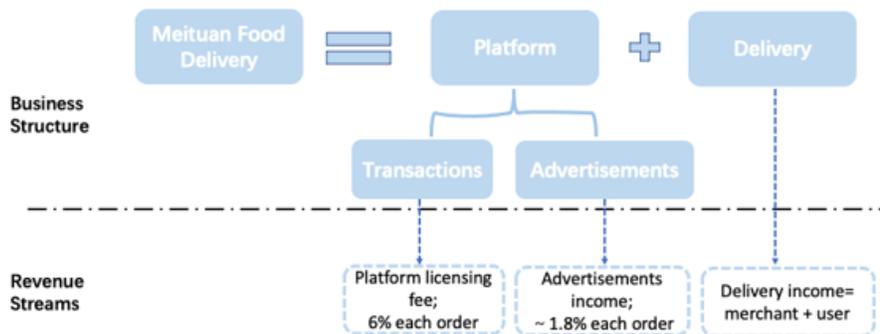
has undergone restructuring as well to create a new “lifestyle services” division, under which Eleme falls under in an effort to improve synergies.

Meituan’s operating margins on its food delivery vertical has grown 2.5x from 2019 to 6.4 % in 2021. It continues to invest in drone delivery and other autonomous solutions to maximize efficiencies. Conversely, the outlook on profitability for Eleme is more challenging given its smaller scale. Alibaba’s cash reserves (10x that of Meituan) at this time are not a direct competitive advantage, as the current regulatory environment prohibits burning cash to grow users.

All of these factors result in the higher operating efficiency for Meituan’s food delivery business and a higher market share, which could transform the growth of this division in the future.



Business model & Valuation



China’s density and population advantage compared to its global peers is stark as viewed in the number of orders and GTV. As such, Meituan is currently the only food delivery company globally that is profitable. However, due to lower relative income levels and tighter government regulation, Meituan has a more modest take rate, 7.8% in the food delivery division and all together about 14%. The current global average price to sale ("P/S") would imply that this one division is worth 40%⁶ of Meituan’s market capitalization today.

Valuation comparison with global peers

USDm/m	Users (m)	Merchants	Orders	GTV	Revenue	Take Rate	Operating Margin	Revenue Growth	Market Cap	P/S
Justeat	99	0.63	1086	29600	5760	19%	-20.9%	33%	7700	1.3x
Doordash		0.55	1390	41944	4888	12%	-9.2%	69%	38600	7.9x
Delivery Hero			2960	38450	7170	19%	-27.2%	89%	11700	1.6x
										3.6x
Meituan (food delivery only)	691	8.3	14368	109696	15049	14%	6.4%	45%		

CHINA NEWS SPOTLIGHT

China's New Live-streaming Guidelines Set to Change the Influencer Business Known for its 'Low Threshold, High Income': China's new live-streaming guidelines have raised the bar for an industry once known for its "low threshold and high income", requiring platforms to vet influencers in certain fields. Short video app Kuaishou is asking its influencers to upload relevant records to prove their identity and credentials. Although it is not mandatory at this stage, those who complete the process receive a "verified" icon. [Read More.](#)

CIPS Payment Lens Service was Launched, and The Convenience of RMB Cross-border Payment was Further Improved: The convenience of RMB cross-border payment is expected to open a Xintiandi. On June 26, based on CIPS standard transceiver, the cross-border clearing company launched CIPS payment lens service, a value-added function, to support enterprises, banks and other cross-border payment market entities to check their payment status, and further improve the efficiency and transparency of RMB cross-border payment. It is reported that some enterprises and banks have tried it out. In terms of specific purposes, CIPS payment lens service integrates financial technologies such as big data and artificial intelligence to provide global RMB users with real-time, complete, full link coverage, one-stop payment status penetration display services, which can meet the needs of enterprises, banks and other cross-border payment entities for round the clock query of cross-border payment status. [Read More.](#)

China Proposes Rules to Regulate Private Pension Investment via Mutual Funds: China's securities regulator proposed rules to regulate private pension investment via mutual funds, setting the criteria for qualified products and sales agents under a scheme that will channel fresh savings into the country's capital markets. The draft rules, published by the China Securities Regulatory Commission (CSRC) late on Friday, came after Beijing in April launched a milestone private pension scheme to tackle challenges of aging population. [Read More.](#)

Polestar becomes Latest Electric Vehicle Maker to go Public via SPAC Merger: Shares of Polestar made their public-market debut under the ticker "PSNY" on Friday, making it the latest electric vehicle maker to go public via a merger with a special purpose acquisition company, or SPAC. Polestar's stock began trading on the NASDAQ exchange one day after it completed its merger with the SPAC Gores Guggenheim. The EV maker's shares ended the day at \$13.00, up 15.8% from the SPAC's final closing price on Thursday. [Read More.](#)

GogoX Slumps in Trading Debut as Hong Kong's First Unicorn Marks the Return of IPO Ceremonial Gong since Pandemic: Shares of GogoX Holdings slumped in their Hong Kong trading debut as the city's very first unicorn kicked off the return of the ceremonial gong after a two-year absence to mark a new initial public offering. The logistics group fetched HK\$21.60 in the first transaction, compared with its initial public offering (IPO) price of HK\$21.50. The stock slid 22 per cent to HK\$16.72 at the close of Friday trading, giving it a HK\$10.4 billion (US\$1.32 billion) market value. [Read More.](#)

China's CATL Announces 1,000-Km / 620-Mile CTP 3.0 EV Battery: China's Contemporary Amperex Technology Company Limited (or CATL for short), the world's biggest EV battery manufacturer, has just announced a technology breakthrough that bumps up the energy density of the cells it produces. They call this new battery Qilin, the name of a creature straight out of the Chinese legend books, and it's not only more energy dense, but it also charges quicker and they say it's also safer and longer lasting. [Read More.](#)

Innovent: China Approves TYVYT Combination As Treatment For Esophageal Squamous Cell Carcinoma: Innovent Biologics Inc. and Eli Lilly and Co. (LLY) said that the Center for Drug Evaluation of China's National Medical Products Administration or NMPA has approved the supplemental New Drug Application or sNDA for TYVYT (sintilimab injection) in combination with cisplatin plus paclitaxel or cisplatin plus 5-fluorouracil chemotherapy for the first-line treatment of unresectable, locally advanced, recurrent or metastatic esophageal squamous cell carcinoma or ESCC. [Read More.](#)

Ocumension OT-401 (Product name: YUTIO), a Treatment for Chronic Non-infectious Uveitis Officially Approved for marketing by the National Medical Products Administration: Ocumension Therapeutics (1477.HK) announced that the New Drug Application (NDA) for the core product in its pipeline, OT-401 (Sterile non-bioerodible intravitreal implant, Product name: YUTIO), was officially approved by the National Pharmaceutical Administration (NMPA) for the treatment of chronic non-infectious uveitis involving the posterior segment of the eye (chronic NIU-PS). This is the first new drug in Ocumension's pipeline to be approved for marketing and is currently the potential best-in-class therapy for the treatment of this indication in China. [Read More.](#)

invoX Pharma to Acquire F-star Therapeutics, Inc. a Pioneering Next Generation Bispecific Discovery Platform and Clinical Programs: invoX Pharma (“invoX”), a wholly owned subsidiary of Sino Biopharmaceutical Limited (“Sino Biopharm”) (HKEX 1177 HK), focused on research and development (R&D) and business development activities outside of China, and F-star Therapeutics, Inc. (“F-star”) (NASDAQ:FSTX), a clinical-stage biopharmaceutical company pioneering bispecifics in immunotherapy so more people with cancer can live longer and improved lives, today announced that the companies have entered into a definitive agreement whereby invoX will acquire all of the issued and outstanding shares of F-star common stock for \$7.12 per share. The proposed acquisition values F-star at approximately \$161 million. The transaction has been unanimously approved by the invoX and F-star Boards of Directors and is expected to close in the second half of 2022. [Read More.](#)

¹The 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.

²Source: This data is based on the revenue and orders of the biggest competitors in China’s food delivery industry, questionnaire survey results from Meituan Research, and a projection by Leadleo Research Institute.

³Sources: (1)[Outlook on the Foodservice US Market to 2026 - Key Drivers \(globenewswire.com\)](#) (2) [Report on China’s chain catering industry in 2021 – Fresh Research reports and Daily Fintech briefings \(recordtrend.com\)](#); (3) [US and China Food Delivery Analysis \(Meituan 美团, GrubHub\) | by Chris Huskey | Medium](#)

⁴Sources: (1)[Outlook on the Foodservice US Market to 2026 - Key Drivers \(globenewswire.com\)](#) (2) [Small Business Statistics | Nav](#)

⁵Source: [Ele.me is losing the "food delivery wars" | Medium](#)

⁶Meituan’s food delivery division valuation, based on a P/S of 3.6x and 2021 revenue of \$15 billion, is \$54 billion, or ~40% of Meituan’s 31/5/2022 market cap.

Important Disclosures

The above information reflects opinions of Morgan Creek Capital Management, LLC (“Morgan Creek”) as of the date it is written and, as such, all such opinions are subject to change. No representation or warranty, express or implied, is given by Morgan Creek as to the accuracy of such opinions and no liability is accepted by such persons for the accuracy or completeness of any such opinions. Further, Morgan Creek does not warrant the accuracy, adequacy, completeness, timeliness or availability of any information provided by non-Morgan Creek sources.

