

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

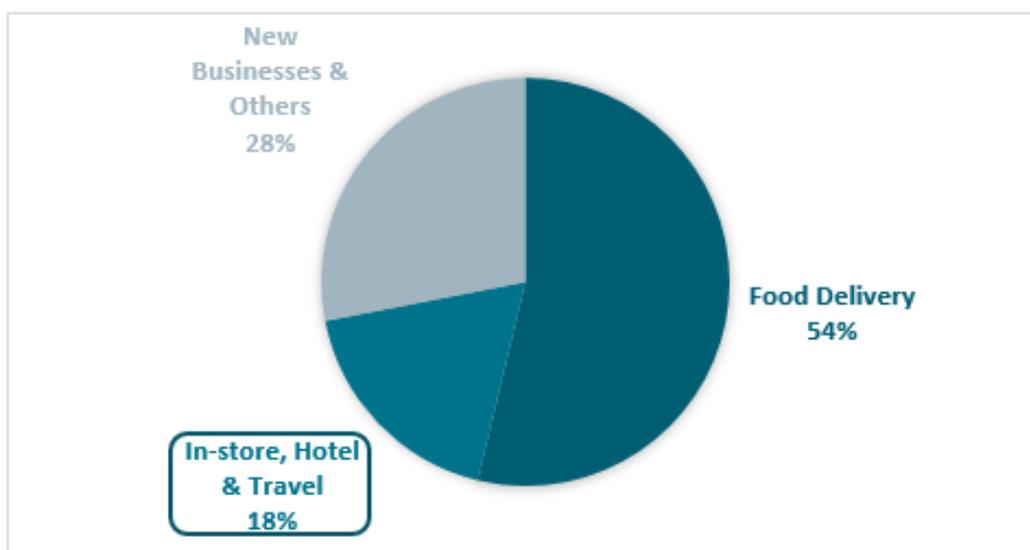
We will continue our deep dive into Meituan's core business verticals in this newsletter, focusing on its hotel accommodations business. The chart below shows the breakdown of Meituan's revenue: its hotels business is included in the "In store, hotel and travel vertical" and is Meituan's cash cow, posting operating margins of 43.3% in 2021.

In this newsletter, questions we will explore include:

- The size and potential growth of China's online travel agency ("OTA") market
- How Meituan gained an advantage from competition
- Meituan's next move

Meituan's Revenue Breakout (2021)

Source: Meituan Research and Leadleo Research Institute



China's online travel agency market

Many industry participants would have assumed that the consolidation of the online travel sector would have been complete after the merger of Ctrip and Qunar in 2015. Ctrip, the leading company in China providing online travel services, has progressed by acquiring and merging with strong competitors in the Online Travel Agency ("OTA") sector, including:

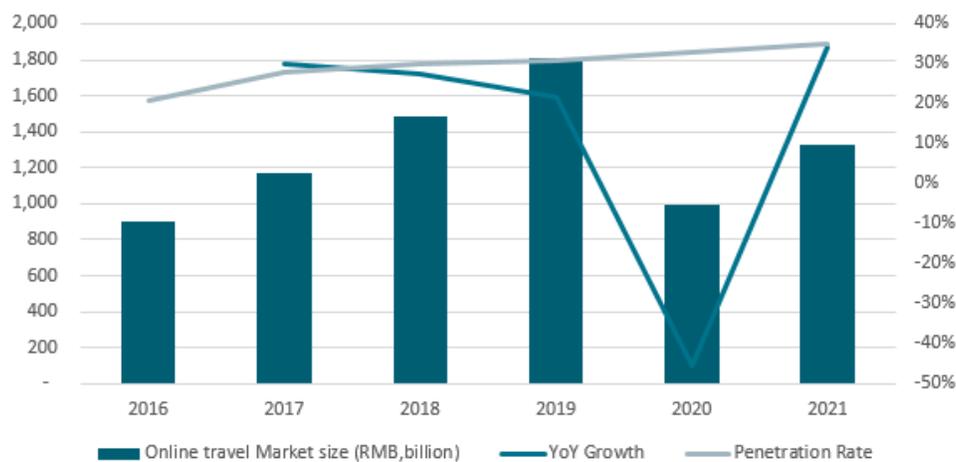
- Acquisition of UK based global travel information search company Skyscanner (2015)
- Merger of the leading and largest Chinese online travel search engine Qunar (2016)
- Investments in eHi Car Services (car rental), Tujia (China's Airbnb), Seven-day Hotel Chain, Shanghai Metropolis travel agency, Tuniu (organizer of package tours²), Elong (an online travel booking website), etc.

By the end of 2017, Ctrip emerged as the dominant player (with 62%³ market share) in China's OTA industry, which was valued at \$22.6 billion.⁴ However not too long after we witnessed the rapid rise of other platforms, which have since started eating into Ctrip's market share. There are a few reasons why it has proven difficult for Ctrip to sustain its dominance in the market, despite its many acquisitions and tie-ups with many companies in the industry:

- China's travel market is still at its early stages of development and travel penetration remains low.⁵ Outbound travel, for instance, reached a peak of 169 million trips in 2019, translating to only 12% of China's population.⁶

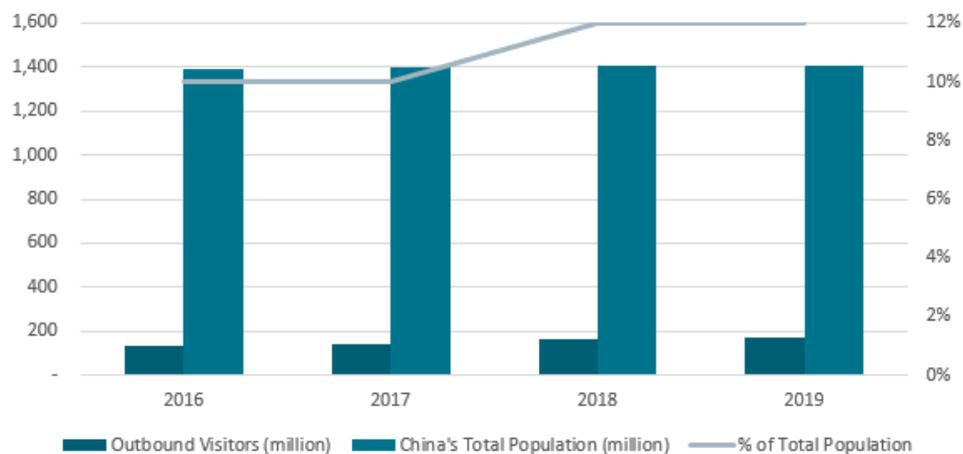
Online Travel Market Size & Penetration Rate

Source: iResearch

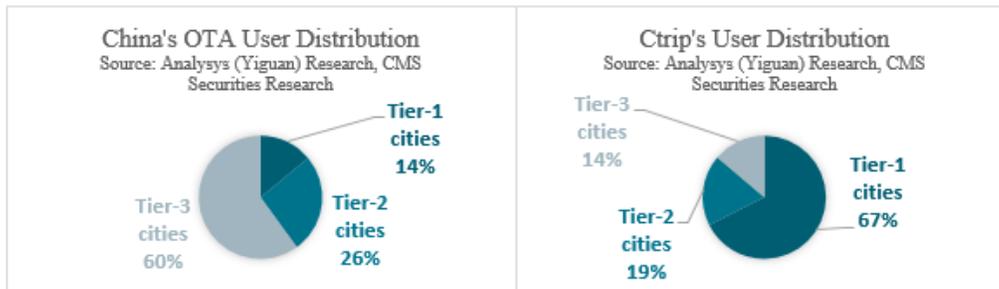
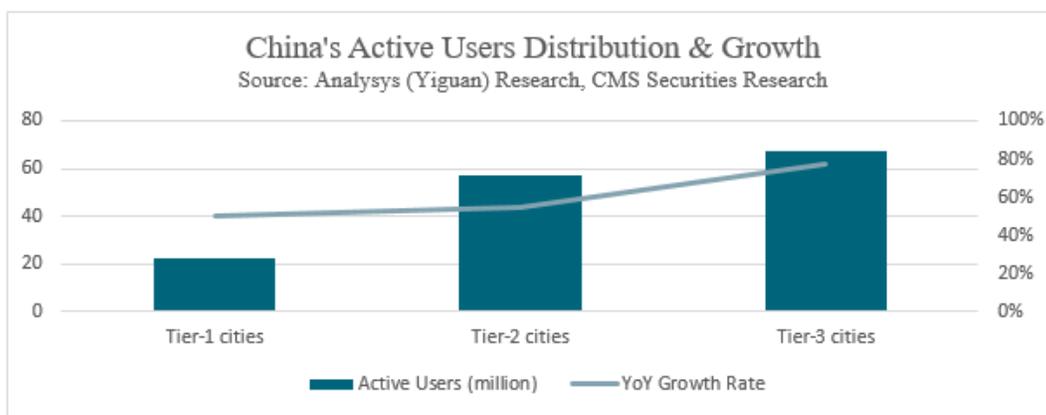


Total Population vs. Outbound Visitors

Source: National Bureau of Statistics



- New customer growth is occurring at lower segments of the market, which Ctrip does not currently cover well. In the first half of 2019, the number of monthly active users in OTA industry in Tier-3 and below cities grew 77%⁷, significantly faster than Tier-1 and Tier-2 cities. Ctrip's historical focus on higher end customers⁸ left a blank space for new players including Meituan, Tongcheng Elong and Fliggy to enter. Due to the vastly different user price points and needs, there are limited synergies for Ctrip to exploit with its current business model.



- Fragmentation of entry traffic to online travel portals – the chart below shows there are many channels connecting Chinese travellers to tourism operators besides the online and offline travel agencies, with travel review companies like Qiongyou and Lvmama, lifestyle apps like Meituan and Tencent, and even social media/live-streaming apps like douyin and Xiaohongshu. The proliferation of so many different gateways make it difficult for any one travel portal to monopolize the sector.

China's fragmented travel channels⁹



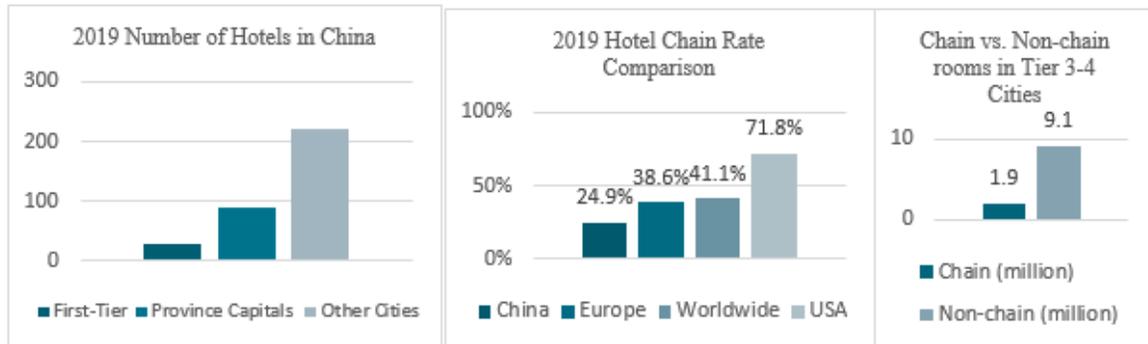
- Furthermore, vacation travel is a low frequency demand, as compared to dining (grocery, F&B, etc), retail (ecommerce) or transportation (ride hailing) which translates to lower touchpoints and consumer mindshare. This has allowed platforms like Alibaba and Meituan to leverage and cross sell travel services to their large and higher frequency user base built from other verticals.

Indeed, Meituan took advantage of both of these incumbent deficiencies - unmet customer needs and low purchase frequency - to rapidly scale its hotel accommodations business by cross selling its users. In fact, ~80% of the users¹⁰ on its hotel app have bought other services from Meituan.

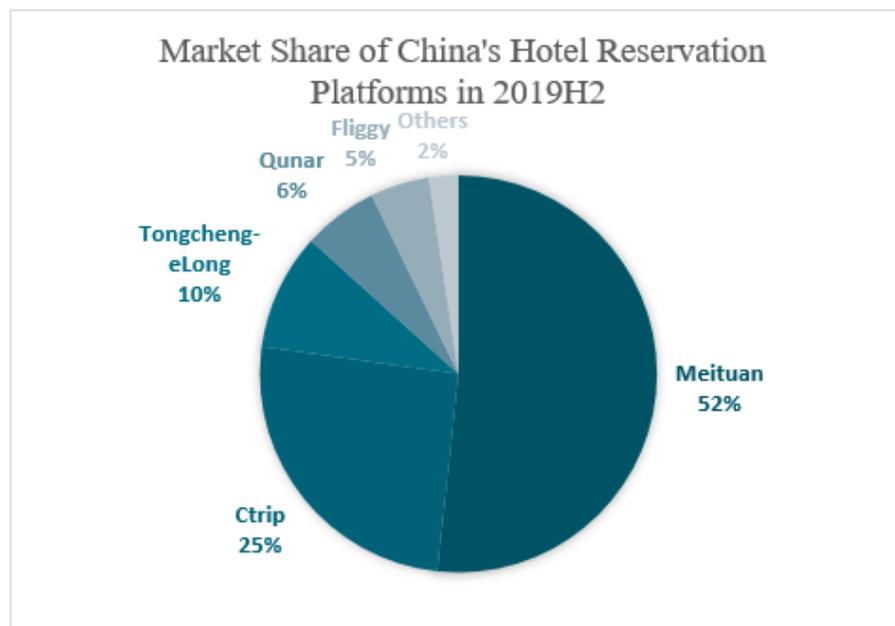
How did Meituan accomplish this? Meituan's initial target customer was the small to medium enterprise ("SME") hotel owner in a lower tier city. The charts below show the attractive industry dynamics for Meituan to consolidate: most of the hotels in China are found in lower tier cities where there is low penetration by hotel chains. As such, these operators are mom and pops and suffer from lack of customer visibility and scale. Because of the difficulty of aggregating these merchants onto platforms and the low average room rate ("ARR"), Meituan's hotel room rate is RMB 140 vs 480 for Ctrip, this segment of the market was almost completely ignored. Meituan leveraged its strong existing local business development team (more than 20,000 people covering 2,700 cities/towns across China) to sign up hotel merchants and integrate offline resources needed by users, such as takeout, group purchasing, catering, hotels and scenic spot tickets.

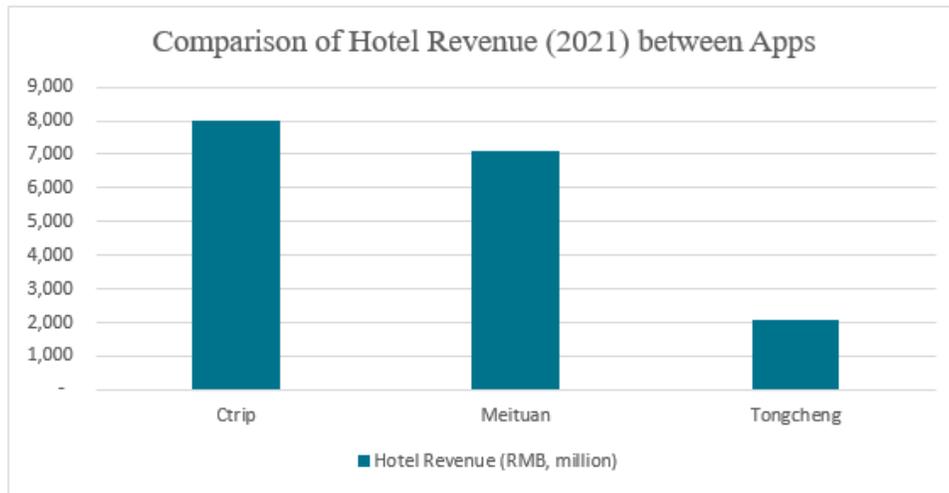
China's fragmented hotel market¹¹

Source: Daxue Consulting



By 2019, six years after its initial launch, Meituan's hotel accommodation business reached the #1 spot in China, measured by number of room nights sold.





Currently, Meituan’s revenues from hotel accommodation accounts for ~20% of the “in store, hotel & travel” division, and only 4% of firm-wide revenue. However, with its success in this category, Meituan has not only proven its strong execution in overtaking industry stalwarts rapidly, but also showcased its ability to create new sub segments like the hotel + X category mentioned above. Going forward, Meituan is now looking to replicate its success in serving new, equally fragmented sub segments including offline local pet stores, leisure, sports and entertainment venues, medical care, etc.

Overall, this business division has historically grown at almost 100% compound annual growth rate ("CAGR") from 2016-2021, and expectations are that it can keep growing at similar rates for the near future given the size of the markets and its robust historical track record.

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CHINA NEWS SPOTLIGHT

China Clears its Backlog of Stranded Australian Coal — but don’t Expect Beijing to Buy More Soon: China has finished clearing a backlog of stranded Australian coal amounting to over \$1 billion, China customs data shows. But analysts say it’s not likely that Chinese coal buyers will start purchasing new supplies of Australian coal anytime soon. That is because coal inventories have been building up, local production is higher, and there are now higher supplies from exporters such as Russia purchased at a discount. [Read More.](#)

China Cuts Travel Quarantine in Biggest Covid Zero Shift Yet: China reduced quarantine times for inbound travelers by half, the biggest shift yet in a Covid-19 policy that has left the world’s second-largest economy isolated as it continues to try to eliminate the virus. Travelers will now only need to spend seven days in a quarantine facility, and then monitor their health at home for a further three days, according to a revised government protocol released Tuesday by China’s National Health Commission. That is down from 14 days hotel quarantine in many parts of China currently, and as many as 21 days of isolation in the past. [Read More.](#)

China's June Factory Activity Expands at Fastest Pace in 13 Months:

China's manufacturing activity expanded at its fastest in 13 months in June, buoyed by a strong rebound in output, as the lifting of COVID lockdowns sent factories racing to meet recovering demand, a private sector poll showed on Friday. [Read More.](#)

CATL Details Next-gen Cell-to-pack Battery Tech with “Disruptive” Water-cooling Design:

CATL last week disclosed more details regarding its third-generation tech, which is also referred to as Qilin, or CTP 3.0. CATL revealed Qilin earlier this spring with the claim that it could produce more power than the latest battery tech from Tesla. It says that the cell-to-pack system can deliver

13% more power by volume than Tesla's 4680 battery, with an energy density of 255 Wh/kg with current-tech lithium-ion cells and 160 Wh/kg for LFP cells—delivering more than a 1,000-km range (621 miles) “in a breeze,” claimed the company. [Read More.](#)

China AI Giant SenseTime Dives as Much as 51% as Lockup Expires: Chinese artificial intelligence software maker SenseTime Group Inc. slumped as much as 51% in Hong Kong on Thursday, after a lock-up of its shares expired following its December initial public offering. The shares ended the day down 47% at HK\$3.13, their lowest ever, and below their IPO price of HK\$3.85. A lock-up on a portion of the stock owned by cornerstone investors and shareholders -- amounting to 23.4 billion of shares -- expired on Wednesday. [Read More.](#)

Zai Lab Announces Primary Listing on the Main Board of The Stock Exchange of Hong Kong Limited: Zai Lab Limited (NASDAQ: ZLAB; HKEX: 9688), a patient-focused, innovative, commercial-stage, global biopharmaceutical company, today announced that it has completed its voluntary conversion of its secondary listing status to a primary listing on the Main Board of The Stock Exchange of Hong Kong Limited (the “Hong Kong Stock Exchange”). Zai Lab is now a dual-primary listed company on both Nasdaq and the Hong Kong Stock Exchange. [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 Package tour is a vacation organized by a travel agent, with arrangements for transportation, accommodations, etc., made at an inclusive price.

³ Source: Analysys (Yiguan) Research, CMS Securities Research.

⁴ Source: The market capitalization of Ctrip [TCOM] as of December 31st, 2017, according to Wind database.

⁵ Source: iResearch.

⁶ Source: National Bureau of Statistics.

⁷ Source: Analysys (Yiguan) Research, CMS Securities Research.

⁸ Source: Analysys (Yiguan) Research, CMS Securities Research.

⁹ [China: online travel booking penetration rate 2021 | Statista](#)

¹⁰ [Fitch Assigns Meituan First-Time 'BBB' Rating, Rates Proposed USD Notes 'BBB' \(fitchratings.com\)](#)

¹¹ [China's hotel market sees fast recovery from the epidemic and positive outlook for future development - Daxue Consulting - Market Research China](#)

Important Disclosures

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