

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 in black ink.

Mark W. Yusko
CEO & CIO

NOTES FROM THE BUND¹

This is the second installment discussing current IPO markets, focusing in particular on a year-to-date status update of the Chinese capital markets. Following record numbers of global IPOs in 2021, IPO markets year to date are contracting due to many factors, including the Ukraine war, spiraling inflation, monetary tightening, and new COVID variant outbreaks, etc. The reversal of decades of loose monetary policy in an attempt to control global inflation has cooled risk appetite and influenced fundraising activities across the board.

Despite the bleak macro backdrop and the disruption caused by the three-month lockdowns in Shanghai, IPO markets in China continued to grow by 7% from the prior year. Global IPO proceeds, over the same period, fell 80%. Specifically, China markets raised almost \$40 billion (including Hong Kong); more than double the amount of the US, which is currently in second place.

China takes the lead in global IPOs Funds raised by the new listings in 2022 (\$bn)

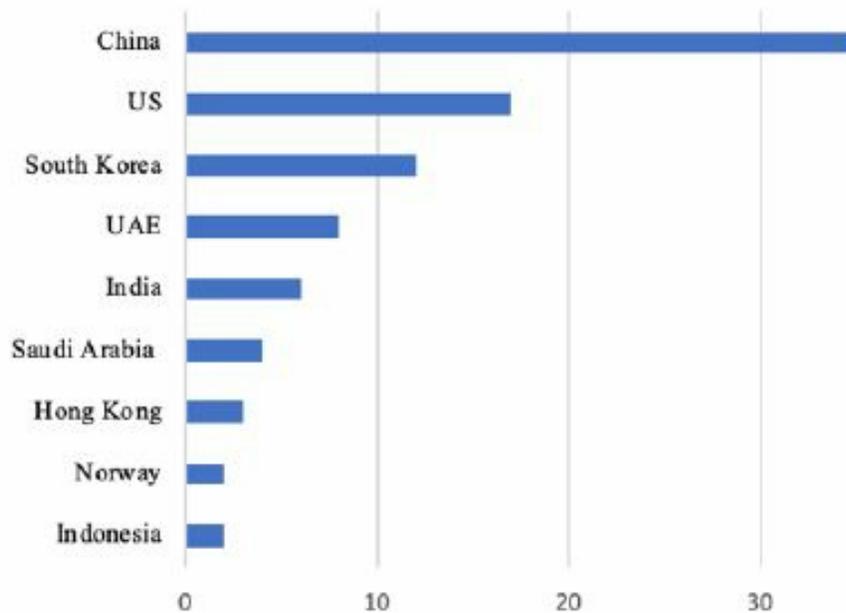


Figure 1: China's current lead in Global IPO markets (Source: Dealogic, Financial Times)

To date, this steady pace of one IPO per day in China is driven by the overarching goal of achieving technological self-reliance given the geopolitical tensions of late. The favorable government policies supporting strategic sectors earmarked for vital economic growth include renewables, high-end manufacturing, life sciences and semiconductors (see chart below). Just the semiconductor sector, for instance, [contributed \\$6.6 billion in fundraising activities](#).

Funds flow to strategic sectors: Onshore equity fundraising by strategic emerging industries (Rmb bn)

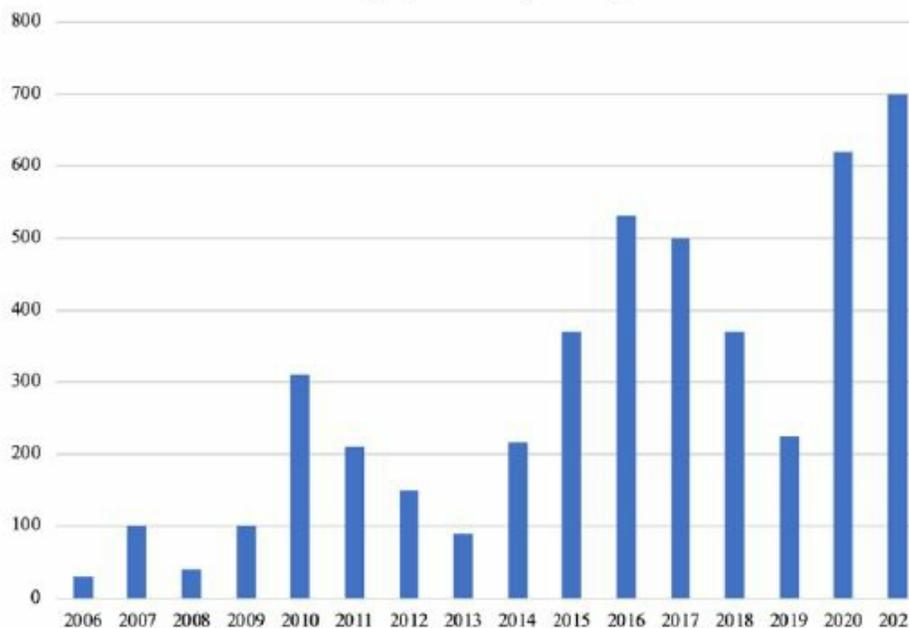


Figure 2: Increased investment in Chinese strategic sectors
(Source: Gavekal-Dragonomics Research, Financial Times)

A little over a year ago, the Chinese authorities began to enforce the concept of [common prosperity](#), orchestrating a large regulatory crackdown on consumer internet companies, to tame

“disorderly” capitalism. In addition, the Chinese authorities wanted to clamp down on the strategy many foreign venture capital (VC) funds employed: raising lots of capital, which was spent on uneconomic subsidizing of products or services to gain users quickly in an attempt to consolidate the market and squeeze out competitors. Once sufficient market share was obtained, certain of these companies would then hike up prices for profitability and potentially engage in other monopolistic behavior. Examples included compelling their suppliers not to work with any of their competitors. Some notable examples of companies that pursued parts of this strategy in their early days included the likes of Luckin Coffee and Meituan. The authorities frowned upon “business model” innovation partly due to its predatory nature towards mom-and-pop businesses. Under the concept of common prosperity, they claim that these businesses were disrupted by the internet platforms and believed that the capital that went into this effort was a “waste” – that no long-term technological competitive advantage for China was being created by these categories of investments. As such, the government enacted policies to burst this bubble and channel the capital instead towards what they deemed as technologically productive sectors.

To lead the way for private investors, the authorities have introduced Government Guided Funds (GGFs), or government-backed funds created to implement Beijing’s policies. To date, there are [approximately eighteen hundred such funds with over RMB 6 trillion \(approximately \\$900 billion\) in assets under management](#) directed to invest in sectors favored by Beijing. GGFs are today [responsible for 40%](#) of fundraising activities in these strategic sectors.

The figure below shows the breakdown of funds by Venture Capital funds in China after the ANT crackdown. As can be seen by the data points, it is evident that there has been a shift in the allocation of funds from consumer tech to hard tech and biotech.



Figure 3: [Breakdown by sector of money raised by Venture Capital Funds in China in 2021 \(in RMB\)](#) (Source: Statista)

Due also to the geopolitical tensions and poor overseas investor sentiment on Chinese American Depository Receipts (ADRs), there has been a resulting decline in Chinese companies seeking offshore listings, as illustrated in the chart below. China companies had historically been [very profitable customers](#) for Wall Street banks, accounting for almost \$6.5 billion in fees since 2014. The impact of this dramatic reshaping and reversal of the Chinese capital markets can be seen with Goldman Sachs, for example, which recently announced a [41% investment banking revenue decline](#) in Q2’22. Many analysts expect the foreign investment banks to make announcements of layoffs later in the year if the situation does not improve.

Overseas listings evaporate: Share of China IPO fundraising on major exchanges (%)



Figure 4: [Falling overseas listings in China](#) (Source: Dealogic, Financial Times)

While there was undoubtedly significant pain and confusion over the recent government policy pivot towards strategic sectors, it appears that the authorities' initial steps towards aligning capital with its goals of technological self-sufficiency had been achieved.

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CHINA NEWS SPOTLIGHT

China Surprises with Key Rate Cuts to Boost Struggling Economy : China on Monday announced surprise interest rate cuts in a bid to boost its struggling economy as industrial production and retail sales weakened while youth unemployment hit a record high. The world's No. 2 economy has yet to gain a solid footing and narrowly avoided a second-quarter contraction, as repeated lockdowns under China's strict zero-COVID policy weigh on activity with factory output and consumer spending struggling to mount a strong recovery. [Read More.](#)

China's Imports of US Oil have Hit an 18-month High as it Pivots Away from Russian Crude: China's imports of US oil rose to their highest level in 18 months in July as the country turned away from Russian crude, according to Vortexa. The commodities data company said ships in the US had loaded around 330,000 barrels a day of oil bound for China in July, compared with just 60,000 barrels a day in the previous two months. The cargoes were destined for refineries owned by state oil giant Sinopec, which is stocking up on crude oil in the expectations that demand will increase in the fall. [Read More.](#)

Toyota, CATL Shut Plants in Sichuan as Power Crisis Worsens : Toyota Motor Corp. and Contemporary Amperex Technology Co., the world's top battery maker, are closing plants in China's Sichuan province as a drought-induced power crisis worsens. The Japanese automaker shut a factory in the provincial capital of Chengdu and will keep operations suspended until Aug. 20, a company spokesperson said. Contemporary Amperex halted activity at its major lithium battery base in Yibin through the same date, a local business publication reported. [Read More.](#)

As Gaming Sales Slump, China's Tencent Signals a Hot Ad Trend it is Betting on: Tencent said advertising in its nascent short video platform could become a "substantial" revenue source in the future, even as other areas of its business — such as gaming — face pressure. The focus on this advertising product from one of China's biggest technology giant puts it in direct competition with the country's two leading short video players: ByteDance's Douyin, the Chinese cousin of TikTok as well as Kuaishou. [Read More.](#)

Xiaomi to use BYD & CATL Batteries for First BEV: Chinese smartphone manufacturer Xiaomi has reportedly chosen CATL and BYD as battery suppliers for its first electric car. According to the report, Xiaomi is planning two variants with 400 and 800 volts battery voltage for its first electric vehicle model. The 400 V version is to use Blade batteries from BYD with LFP cells, while the 800 V model is to receive the latest Qilin battery from CATL with NCM cells. At least this is

reported by the Chinese portal 36kr, which is well connected to the Chinese battery industry. [Read More.](#)

China's Jemincare Nabs \$650M Biobucks Pact with Roche's Genentech for Prostate Cancer Hopeful: After penning a deal with Orion back in May, Jemincare is back at the licensing deal table, inking a development and sales deal with Roche's Genentech unit that is on the lookout for a new prostate cancer drug after the recent flop of its phase 3 asset ipatasertib. The pact, worth \$60 million with an additional \$590 million in biobucks also thrown into the mix, sees Genentech buy Jemincare's androgen receptor degrader JMKX002992. The Swiss major grabs all global rights for the therapy, which is being developed for prostate cancer, and will now head up trial work. [Read More.](#)

China's NMPA Approves InnoCare's Orelabrutinib to Treat Marginal Zone Lymphoma : China's National Medical Products Administration (NMPA) Centre for Drug Evaluation (CDE) has accepted InnoCare Pharma's supplemental New Drug Application (sNDA) for orelabrutinib to treat relapsed or refractory Marginal Zone Lymphoma (R/R MZL). Orally available bruton's tyrosine kinase (BTK) inhibitor, orelabrutinib irreversibly binds to BTK for inducing downstream kinase inactivation and cell death. It has been designed with a single ring at the scaffold centre and is believed to have higher selectivity that results in less off-target side effects which may lead to discontinuation of treatment. [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.

Important Disclosures

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Morgan Creek Capital Management | 301 W. Barbee Chapel Road, Suite 200, Chapel Hill, NC
27517

[Unsubscribe ljacob@morgancreekcap.com](mailto:ljacob@morgancreekcap.com)

[Constant Contact Data Notice](#)

Sent bymyusko@morgancreekcap.com