

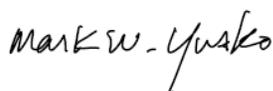
New China Perspectives



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,



Mark W. Yusko
CEO & CIO

NOTES FROM THE BUND¹

According to the World Bank, global government and private debt levels have risen to their highest level, and at the fastest single-year pace, in five decades. In 2020, global government debt increased by 13% of Gross Domestic Product to reach a record 97% of Gross Domestic Product, driven by large fiscal packages to support economies in the wake of Covid-19. There is also much concern about the levels of debt in China and, given the recent property clampdown if China might come across a "Lehman" moment. Over the next few newsletters, we will explore how the debt structure varies significantly across countries and how the authorities have utilized debt to invest in the future by financing infrastructure and home-growing new industries.

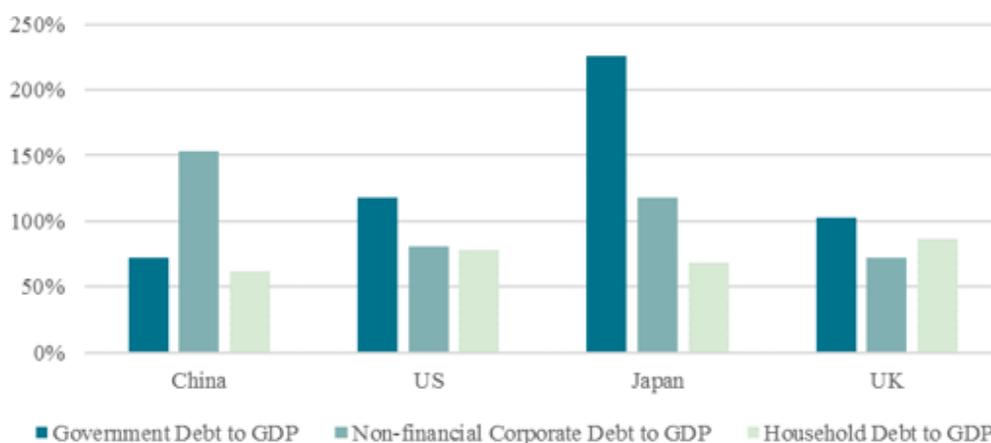
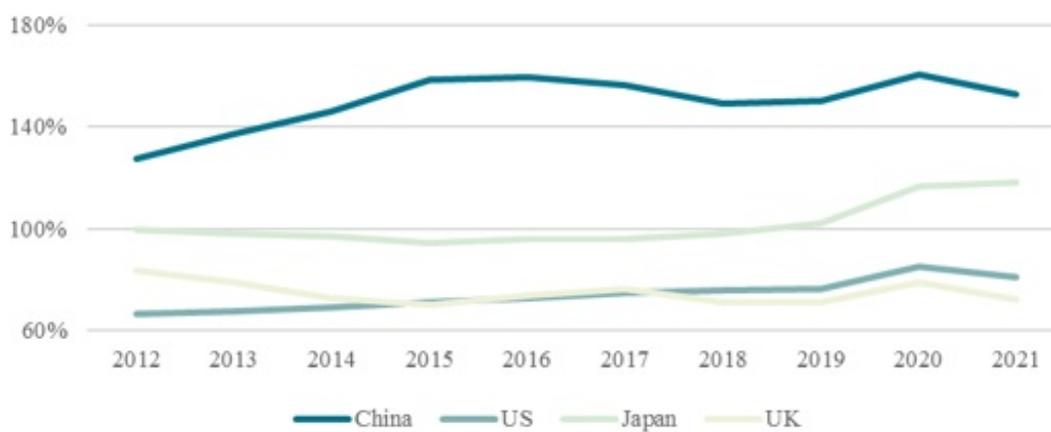


Figure 1: 2021 Debt composition across countries²

Debt structure varies across countries

In most countries, government debt comprises the main component of a country's total debt. This is the case in the US, UK, and Japan, with government debt accounting for over 100% of those countries' nominal GDP in 2021, which has grown alongside the economy as a result of increased government responsibilities and in response to economic developments, such as national defense, and resident's welfare. China remains an outlier among this peer set, with the majority of its debt comprised of corporate debt, which rose over the past decade because of credit being fed to state-owned enterprises post the global financial crisis. China's corporate debt stands at 157% of GDP, with approximately 70% from state-owned enterprises ("SOEs").



*Figure 2: Corporate debt to GDP across countries*³

| Countries | National Government (government responsibilities and economic development) | Local Government (infrastructure construction and industry development) |
|-----------|---|--|
| US | Government Debt | Equity Funds ⁴ |
| China | Fiscal Revenue | Corporate Debt |

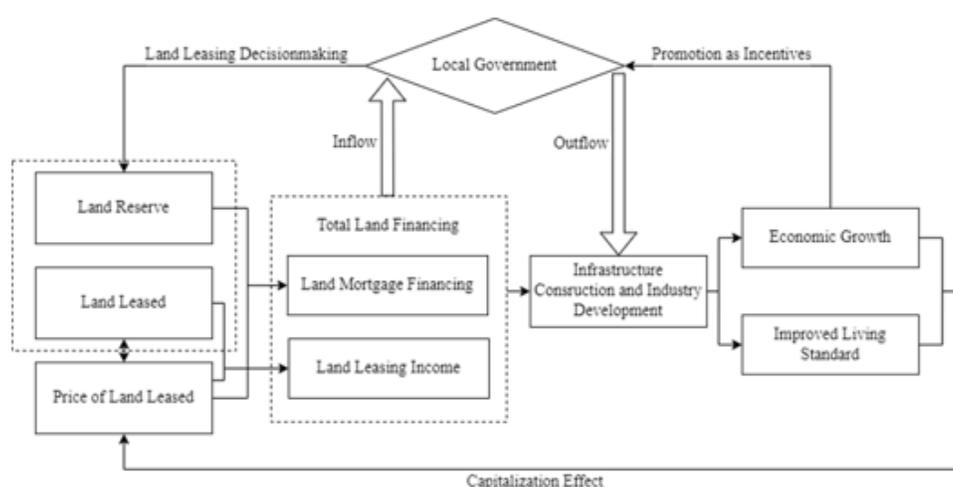
Table 1: Key financial instruments for spending (US vs China)

Why China's headline government debt is low

Over half of China is uninhabitable due to difficult terrain and/or inhospitable climate. Approximately 94% of the population lives on the east side of the country that is more suitable for cultivation and trade advantage. Thus, the west side of the country only has 6% of the population.⁵ China's unequal resource allocation, coupled with historical economic policies, which allocated scarce resources to develop certain regions at the expense of others⁶, resulted in significant income disparity. For example, Beijing's GDP per capita is 4.5 times higher than that of Gansu province.⁷ As such China has historically tended towards and prospered when it featured a strong, centralized government capable of aggregating and dispersing resources to far-flung regions that require them. Today, the central government collects about 60% of the tax revenues from local governments, which is a much higher proportion compared to most developed countries.⁸ Table 1 illustrates how China uses a different financial instrument to fund programs compared to the US. As China's central government is cash rich, they do not have to take on the national debt; but its local government is less liquid.

Financing strategy of local governments

Given their inability to keep and mobilize a large portion of their tax revenues, local governments have had to find alternative means to raise funds for infrastructure construction and industrial investment. While local governments have sole discretion in determining land acquisitions and depositions, they have developed a land-driven financialization strategy. Table 2 illustrates how local governments generate funds from land development via various financing vehicles typically structured as SOEs. Local governments have increasingly utilized land rights to attract high-tech companies, aiming to create an industrial ecosystem to grow their local economy and tax base.



*Table 2: Chinese financing and investment for urban development*⁹

To do this, local governments form dedicated Urban Investment and Development Corporations

("UIDC"s) with land use rights owned by the authorities. Implicit government guarantees from the central government allow UIDCs to borrow heavy amounts of debt and issue bonds from the China Development Bank (CDB), a state-funded finance institution financing long-term economic development strategies, national saving banks, and urban development banks. Table 3 illustrates Shanghai UIDCs formed with specific government mandates.

| Group Name | Registered Capital | Debt | Total Assets | Affiliated Enterprises | Main business |
|-------------------|--------------------|-------|--------------|------------------------|---|
| Jiushi Group | 60 bn | 176bn | 468 bn | 70+ | Urban transportation and joint technology-transfer ventures with foreign companies |
| Shanghai Chengtou | 50 bn | 297bn | 547 bn | 13 | Infrastructure construction including roads, bridges, water utilization and etc |
| Shanghai Lujiazui | 24 bn | 104bn | 140 bn | 72 | Real estate management and supporting industries including trade and finance zone development, high-tech industry parks |
| Shenhong | 50 bn | 44bn | 70 bn | 10 | National strategic project including business district and transportation hub |

*Table 2: Illustration of four Shanghai UIDC groups with specific mandates.*¹⁰

Some worry that UIDCs are piling up large amounts of hidden debts in raising funds for various projects, but neglect their important role in China's urban development. UIDCs, besides being responsible for developing and managing core public infrastructure projects, such as power plants and metro systems, also play a critical role in supporting entrepreneurial activity. As mentioned above, to attract high-tech companies, local governments grant benefits such as:

- Free land and equipment use rights for the first 3-5 years
- Low-interest rate loans from banks
- Subsidies

In return, the entrepreneur has to sign an agreement to:

- Invest a minimum amount within the province via capital expenditures and leasing fees
- Generate a minimum amount of annual taxes
- Pay back the loan within a period of time, or convert it into equity

UIDCs are a type of SOE that does not belong to the central state but have specific government missions. State-owned enterprises sit on the commanding heights of the Chinese economy, which ensure state control of key sectors, especially in solving energy shortages and bottleneck technology. In our following newsletters, we will use the photovoltaic industry to illustrate how we believe that government incentives are the driving force behind industrial development.

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CHINA NEWS SPOTLIGHT

China Ready to Restart Economic, Trade Exchange Mechanism with Australia: China is ready to restart the economic and trade exchanges mechanism with Australia, Commerce Minister Wang Wentao said Monday. During his talks via video link with Australian Trade Minister Don Farrell, Wang said China is also willing to expand cooperation in emerging areas, such as climate change and new energy, and promote high-quality development of bilateral economic and trade relations. [Read More.](#)

China Eases Housing Curbs in Wuhan, Paving Way for Other Cities to Follow: A major city in China has eased a key restriction on housing purchases, paving the way for more cities to follow suit and prop up demand as the property slump in the world's second-biggest economy drags on. Wuhan, China's eighth-most populous city, will allow local families to buy an additional home in areas with purchasing caps, according to a local government statement. The city in central China where Covid-19 cases first emerged more than three years ago, supports "reasonable" home purchases, according to the statement. [Read More.](#)

China Reforms IPO Rules – Registration-Based Mechanism to Facilitate Public Listings: China's top securities regulator, the China Securities Regulatory Commission (CSRC), released a raft of draft measures and regulations for the implementation of a registration-based initial public offering (IPO) system for public comment until February 16, 2023. Key among them is the Measures for the Administration of Initial Public Offering Stock Registration (hereinafter the "draft measures"), which outlines the basic requirements for the public listing of companies on the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE). [Read More.](#)

Baidu to Finish Testing ChatGPT-style Project 'Ernie Bot' in March; Shares Rally: China's Baidu Inc (9888.HK) said on Tuesday it would complete internal testing of a ChatGPT-style project called "Ernie Bot" in March, as interest in generative artificial intelligence (AI) gathers steam. The search engine giant's Hong Kong-listed shares closed up 15.3% on Tuesday, while its U.S shares climbed 11.2% in morning trade. [Read More.](#)

Chinese Lidar Maker Hesai to Raise up to \$171 Million in U.S. IPO: China's Hesai Group on

Friday announced plans to raise as much as \$171 million in an initial public offering in the United States, according to a term sheet. The Shanghai-based LIDAR maker will offer up to 9 million American depositary shares (ADS) at between \$17 and \$19 apiece. Laser-based LIDAR sensors help self-driving cars detect objects ahead and around the vehicle and are the key components of autonomous driving systems. [Read More.](#)

Structure Therapeutics Announces Pricing of Upsized Initial Public Offering: Structure Therapeutics Inc. (NASDAQ: GPCR), a clinical-stage global biopharmaceutical company developing novel oral small molecule therapeutics for metabolic and pulmonary diseases, today announced the pricing of its upsized initial public offering of 10,740,000 American depositary shares (ADSs), each representing three ordinary shares, at a public offering price of \$15.00 per ADS. The aggregate gross proceeds to Structure Therapeutics from the offering are expected to be \$161.1 million before deducting underwriting discounts and commissions and offering expenses. In addition, Structure Therapeutics has granted the underwriters a 30-day option to purchase up to an additional 1,611,000 ADSs at the initial public offering price, less underwriting discounts and commissions. All of the ADSs are being offered by Structure Therapeutics. The shares are expected to begin trading on the Nasdaq Global Market on February 3, 2023 under the ticker symbol “GPCR.” The offering is expected to close on February 7, 2023, subject to the satisfaction of customary closing conditions. [Read More.](#)

Harbour Biomed's HBM-1022 Targeting CCR8 Cleared to Enter Clinic for Solid Tumors: Harbour Biomed Ltd. has received IND clearance by the FDA to initiate clinical trials in the U.S. with HBM-1022, a monoclonal antibody generated from Harbour's integrated G protein-coupled receptor (GPCR) platform. The antibody can enhance antitumor immunity by depleting CCR8 positive regulatory T cells, activating effector T cells. [Read More.](#)

China's Energy Storage Sector set for Strong Growth in 2023 as Electric Cars, Clean Energy Projects Boost Demand: China's energy storage industry will go from strength to strength in 2023, say analysts, after its leading companies forecast strong earnings amid surging demand from the electric vehicle (EV) sector and as the country rolls out more renewable power projects. It is estimated that China's demand for advanced energy storage could surge by roughly 50 per cent to 30 gigawatt-hours (GWh) in 2023, driving global demand to 100GWh. [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 Source: Bank for International Settlements (BIS), Wind

³ Source: Bank for International Settlements (BIS), Wind.

⁴ Note: Equity funds indicate equity investors which include endowments, pension funds and etc, which is much bigger and mature compared with China.

⁵ Sources: China Population Density Maps; www.china-mike.com; 2020

⁶ Deng Xiaoping's maxim to “let some get rich first”

⁷ Sources: Chinese Local Governments Fight for Their Share of Tax Revenue; Sources www.jonesday.com; Mar, 2008

⁸ Sources: Per capita gross domestic product (GDP) in China in 2021, by province or region www.statista.com; 2021

⁹ Source: Infrastructure Investment, Land leasing and Real Estate Price: A Unique Financing and Investment Channel for Urban Development in Chinese Cities; Zheng Siqi, Su Weizeng; Tsinghua University; 2015

¹⁰ Note: Figures are as of 2017, which has been rounded up recently. Source: Who Builds Cities in China? How Urban Investment and Development Companies Have Transformed Shanghai; www.onlinelibrary.wiley.com; Jun, 2020

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 by myusko@morgancreekcap.com