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@morgancreekcap.com.

Best Regards,

Mark W. Yusko

Mark W. Yusko
CEO & CIO

NOTES FROM THE BUND[1]

This is the first installment of a three-week discussion on the China SaaS industry. We will begin with the history of the development of the sector in this issue, and then focus on the challenges and our philosophy of identifying good players in the next two newsletters.

Software as a service ("SaaS") refers to a business model where software is licensed on a subscription basis and delivered via the internet. In the US, driven by the expansion of the internet and the popularization of personal computers ("PCs"), the industry took off in the early 2000s with Microsoft's Web Services and IBM's Automatic Computing Manifesto.[2] Soon after, other software vendors followed suit and began offering their IT service products over the internet. Today, the SaaS model in the US is a 152-billion-dollar industry[3] and has permeated almost every sector of the economy.

In China, the industry began to see significant activity in 2015 with nearly half of the domestic SaaS companies founded between 2014-2016. By 2016, the capital markets also reached their peak in SaaS investments with 372 such companies funded in a single year.

Figure 1: No. of private SaaS companies founded[4]

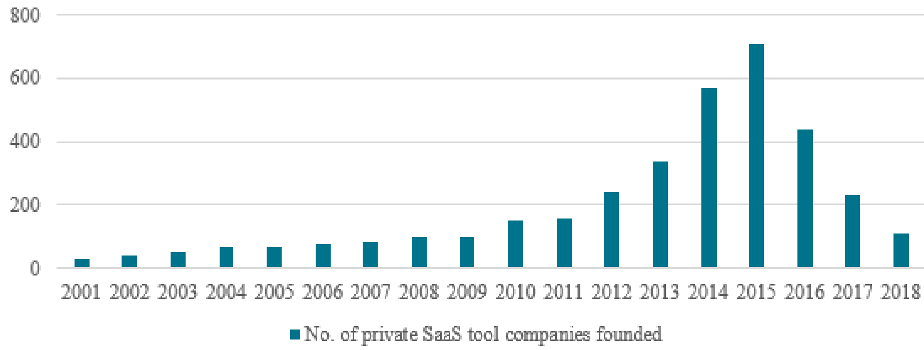
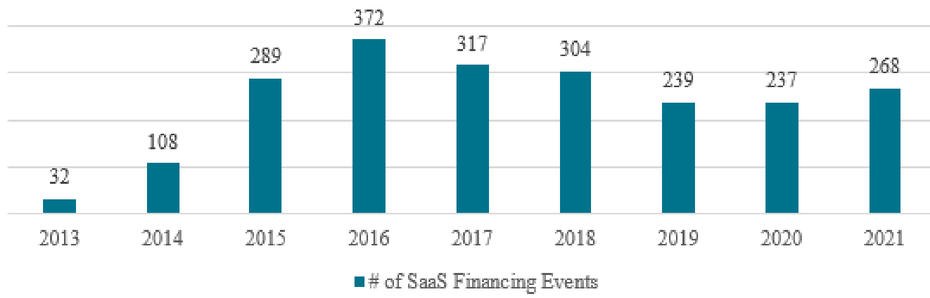


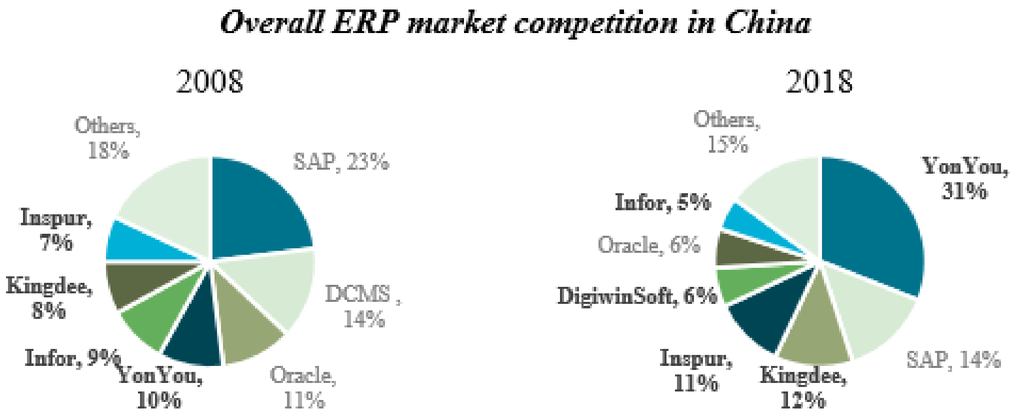
Figure 2: No. of private SaaS companies financing events[5]



The rationale for investors' excitement around the SaaS business model over the past decade is as follows:

a. Tense US-China geopolitics. There is a real concern among Chinese businesses around technological decoupling with the West. The Chinese authorities are preparing for this by encouraging the development of its domestic technology sector. Specifically, China's 14th Five-Year (2021-2025) Plan aims to raise the proportion of its digital economy to 10% from 7.8% in 2020. The plan calls for investments to optimize and upgrade digital infrastructure, to accelerate the digital transformation of enterprises, and to expand international cooperation. The strong regulatory support for domestic technology companies underlies opportunities for developing enterprise services.

Figure 3: Increasing local market share of domestic SaaS companies[6]



b. Saturation of consumer internet markets. China has experienced a golden decade for consumer internet since 2012. By 2020, China's mobile monthly average users ("MAU") reached 1.2 billion, the largest in the world, with its MoM growth now only at 1.7%.[7] The large internet giants, having consolidated their users, are now shifting their focus away from growth towards efficiency by investing in enterprise services. As an example, all three internet giants – Baidu, Alibaba and Tencent have cloud infrastructure divisions. This shift in investment priority has encouraged many entrepreneurs to collaborate with and/or build new software on top of that technology stack. In the meantime, thanks to constant encouragement from the regulation on cloudification, IaaS, the infrastructure of SaaS tools, has been the fastest-growing vertical in China's cloud computing market. The once competitive IaaS landscape has begun consolidation with a concentration ratio of 76.3% into the top five industry leading companies during 2020.[8] Hence, the underlying technology layer is now mature for SaaS to grow.

Figure 4: Timeline of released regulation on cloud computing

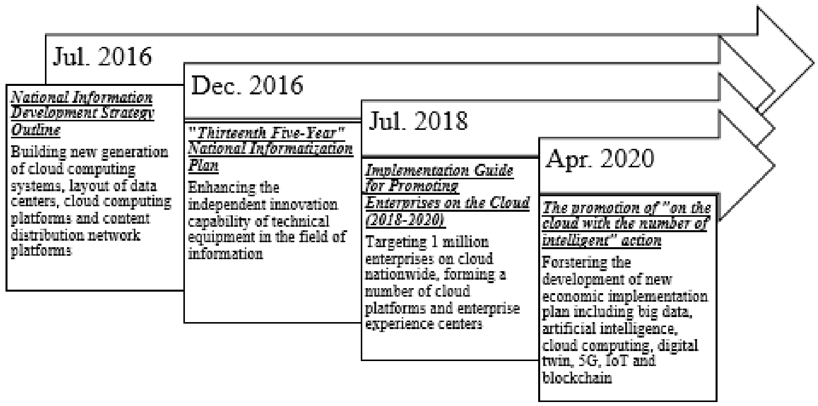
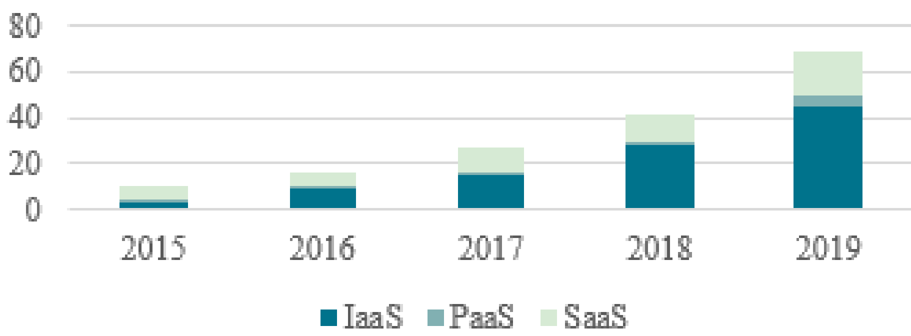
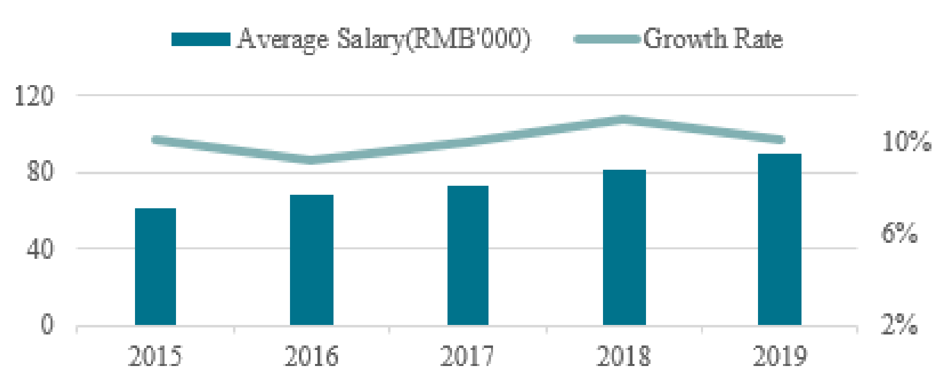


Figure 5: China cloud computing market (RMB billion)[9]



c. Shrinking labor pool. China's workforce has fallen by 40 million in the past decade since 2010 and is expected to drop by another 35 million over the next five years.[10] This has led to increasing labor costs (see Figure 6). Enterprises will need to find solutions to substitute and/or supplement labor to maintain margins over the long run.

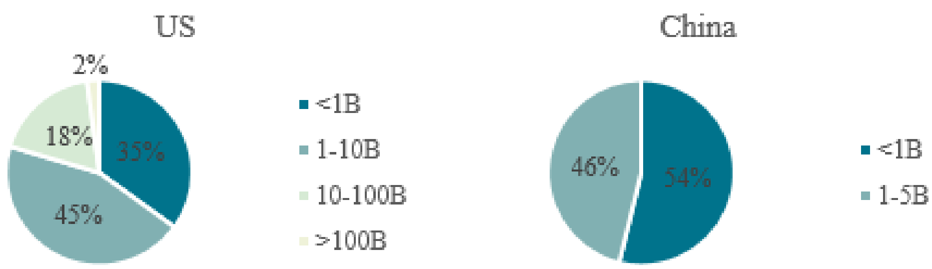
Figure 6: Average salary in China[11]



d. Low technology penetration compared to the US. As illustrated in the chart below, China's publicly listed SaaS companies are very much smaller than their peers in the US.

Additionally, with over 13 times the valuation gap between US and China SaaS tool companies, investors have high expectations that this technology gap will eventually close.

Figure 7: No. of public SaaS by valuation[12]



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CHINA NEWS SPOTLIGHT

China to encourage qualified digital culture companies go public: China will encourage qualified digital cultural companies to go public in a bit to promote the digitalization in the culture sector. *Read More.*

China to launch ETF connect with Hong Kong: China's securities regulator said on Friday it has agreed to include exchange-traded funds (ETFs) in stock connect schemes with Hong Kong. The formal launch date will be announced later as the process will take about two months to prepare, the China Securities Regulatory Commission said in a statement. *Read More.*

Shanghai edges towards COVID reopening as Beijing plans to ease curbs: The Chinese metropolis of Shanghai inched further towards a gradual reopening from two months of grinding COVID-19 lockdown, while officials in Beijing prepared to ease curbs in parts of the capital, saying on Saturday its outbreak was under control. *Read More.*

Huawei's quick-delivery data center cuts construction time by half: Huawei Technologies unveiled a new data center design Thursday that the Chinese group says can be deployed in about half the time previously required, aiming for government contracts in its home market. *Read More.*

ECARX to Go Public in $3.82 Billion Merger with COVA Acquisition Corp., Accelerating Development of Next-Generation Automotive Intelligence: ECARX Holdings, Inc. ("ECARX"), a global mobility tech company, has entered into a merger agreement with COVA Acquisition Corp. ("COVA") and upon completion of the transaction expects to be listed on Nasdaq under ticker symbol "ECX". The closing of the transaction is expected to occur in the fourth quarter of 2022. *Read More.*

Didi Is Said to Draw China FAW's Interest in Buying Stake: State-owned automaker China FAW Group Co. is considering acquiring a significant stake in the troubled ride-hailing giant Didi Global Inc., according to people familiar with the matter. The Chinese carmaker has reached out to Didi's top executives and expressed its interest in becoming a major shareholder in the firm, said the people, who asked not to be identified as the information is private. FAW pledged to help Didi resolve issues related to data security, paving the way for a Hong Kong listing, the people said.

Read More.

GSK's 2-dose HPV vaccine Cervarix wins approval in China to prevent cervical cancer in girls 9 to 14: China's National Medical Products Administration (NMPA) approved GSK's (NYSE:GSK) two-dose schedule of HPV vaccine Cervarix for girls aged nine to 14 years to prevent cervical cancer. The vaccine's use also includes preventing cervical intraepithelial neoplasia and adenocarcinoma in situ causally related to oncogenic Human Papillomavirus (HPV) types 16 and 18. Read More.

VV116 Versus PAXLOVID Phase III Registration Trial for Early Treatment of Mild to Moderate COVID-19 in High Risk Patients Reaches Primary Endpoint: Shanghai Junshi Biosciences Co., Ltd ("Junshi Biosciences," HKEX: 1877; SSE: 688180), a leading innovation-driven biopharmaceutical company dedicated to the discovery, development, and commercialization of novel therapies, announced today that the Phase III clinical study (NCT05341609) comparing the efficacy and safety of VV116 (JT001) and nirmatrelvir/ritonavir ("PAXLOVID") in the treatment of patients with mild to moderate COVID-19 who are at high risk for progression to severe COVID-19 including death, has reached its pre-specified primary endpoint and secondary efficacy endpoint. 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] Notes: In October 2001, IBM released a manifesto that pointed out the need to integrate several heterogeneous environments into corporate-wide computing systems, and to extend that beyond company boundaries into the Internet, introducing new levels of complexity.

[3] Source: Statista

[4] Source: Forward-The Economist

[5] Source: iResearch Inc.

[6] Source: SPDB International

[7] Source: Quest Mobile

[8] Source: Forward-The Economist

[9] Source: CAICT

[10] Source: SCMP

[11] Source: National Bureau of Statistics of China

[12] Source: Wind