

MORGAN CREEK

CAPITAL MANAGEMENT

ALTERNATIVE THINKING ABOUT INVESTMENTS

New China Perspectives



Welcome to the latest issue of Morgan Creek's **New China Perspectives**. This issue 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. 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

It has been two years since China implemented its "double reduction" education policies, which included a series of strict review and approval regimes for all new off-campus and after-school training institutions, including:

- Banning private tutoring over weekends and holidays for Chinese students below 16
- No new issuances of licenses for new academic tuition centers
- Registering existing centers as non-profit institutions
- Schools reducing students' daily homework

The policies were aimed at easing pressure on families in China's highly stressful educational system, which is blamed as a key reason behind the falling birth rate in the country. It is estimated that between a quarter and a third of household income is spent on supplemental education. LEK consulting projects that parents could spend up to \$600,000 USD over the life of a child on education.²

The goal of the policy was well-intentioned: to relieve the financial burden on the student's family, improve education equity across the country and standardize off-campus training to improve education outcomes.

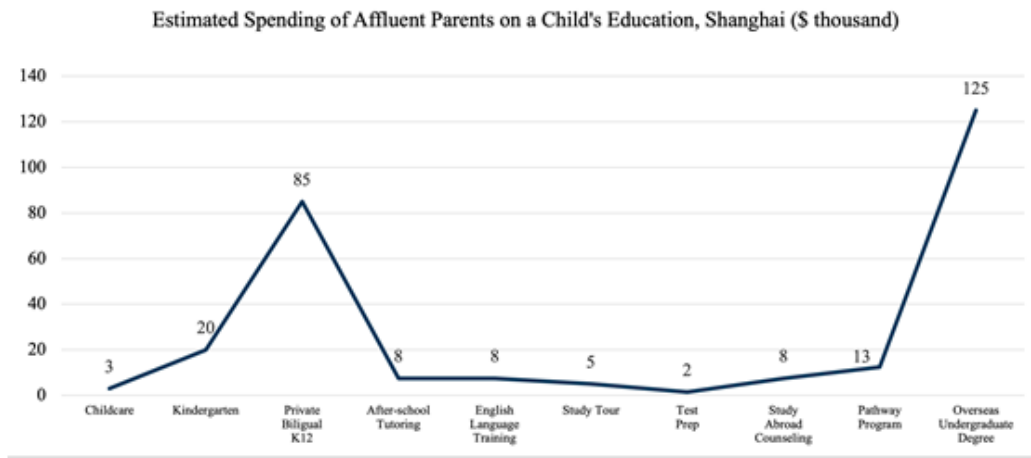


Figure 1: Education has financially burdened upper-middle class family in China³

Prior to curbs, capital flows into China's education sector was excessive

To give an idea of the disproportionate investments into the Chinese education sector, the chart below illustrates overall VC funding in US and China. In 2020, the US received 1.5x more funding than China. However when one drills down by sector, educational technology (edtech) in China received more than 4x the funding in the US. To put that in perspective: an aggregate of \$15 billion was deployed into China edtech in 2020 – equivalent to almost 40% of the *entire market size* of the Chinese online education sector.

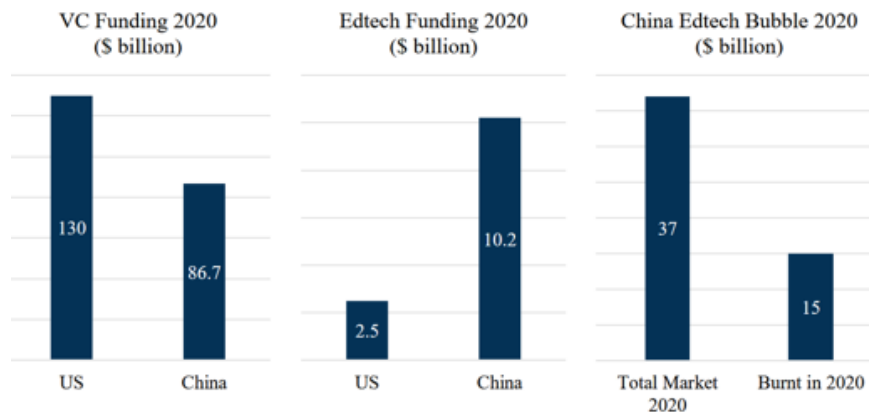


Figure 2: Capital burnt in the edtech sector was disproportionately high before the crackdown

Most of that capital was going disproportionately into the market leaders – publicly traded New Oriental, TAL, Gaotu; and private unicorns ZYB, VIPKid, Yuanfudao, etc. Similar to other internet business models of the time, the strategy of these businesses were simple: raise and burn money through subsidies to the consumer, gain monopoly share of the markets and then begin to monetize once most of the competitors have ceased to exist.

A typical advertisement of that period preys on the fear of parents, compelling them to sign their children up for tuition lest they get left behind. One academic tuition center ran an ad that stated: “Let us train your children, or we’ll train their competitors.”



Figure 3: “Let us train your children, or we’ll train their competitors.”

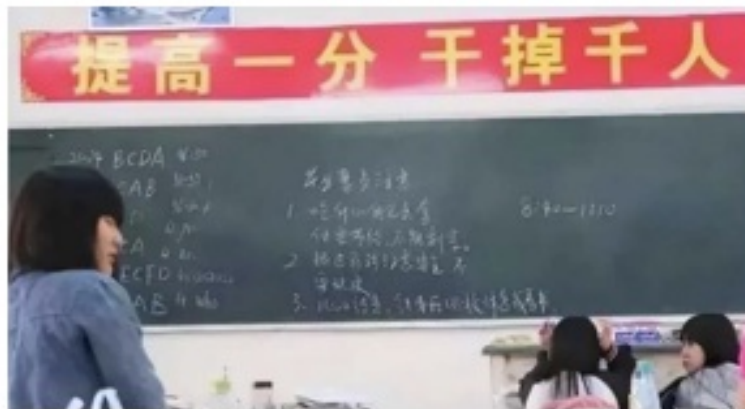


Figure 4: “Increase your test score by one point and eliminate a thousand peers”

In an attempt to capture the wall of money gushing into this sector, private tutoring companies enticed teachers from renowned public schools with high salaries, approaching thousands of RMB per hour, to attract students from “lower quality” schools. Such activities disrupted the public education system as some teachers began to “save the best material for their after school tutoring students”, exacerbating education inequity. Even for those who could afford off-campus education, the test-oriented repetitive training did not facilitate or enhance the long term development of a child by way of learning critical skillsets and problem solving skills.

Ultimately, the authorities decided to implement a ban to stem the wave of disruptive capital into the sector.

The subsequent impact to society

The shockwaves from the ban were widely felt across the industry, with the closure of more than 25 online tutoring centers in 2021 alone⁴, and more than a million people impacted including over 200,000 being laid off.⁵ Some of these teachers have begun to operate underground.⁶

For the parents who choose to continue to send their children for after school tutoring, the cost of doing so has gone up significantly. Indeed, some news articles⁷ report that one on one tuition in first tier cities can cost as much as 3,000 rmb per hour, multiples what it used to be before the crackdown.

However, this increase was likely where the industry was headed even absent the restrictions. The charts below show the huge investments the large public education companies had to make to fend

off their competitors – companies that were profitable for over a decade suddenly began losing money. The cash burn of private online education companies like Yuanfudao are even more devastating – with many spending 1.5x their revenues on acquiring customers and subsidizing classes.⁸ In order to survive, these companies may have to raise their prices significantly to recoup their massive losses.

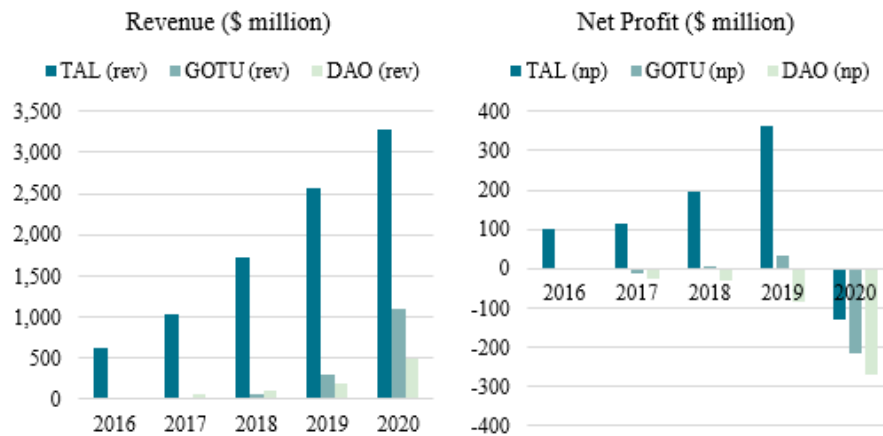


Figure 5: Major education companies suffered net loss even with record high revenue in 2020

Surviving education companies have had to embrace new business models

These curbs had a significant adverse impact on the valuation of companies in the edtech sector, with over \$100 billion in equity wiped out and the market value of major listed edtech companies’ shrinking by 90% in 2021. Combined with the impact of the regulatory crackdown on companies such as Alibaba and DiDi this resulted in adverse media reporting in the West with certain firms and pundits raising concerns about investing in China.

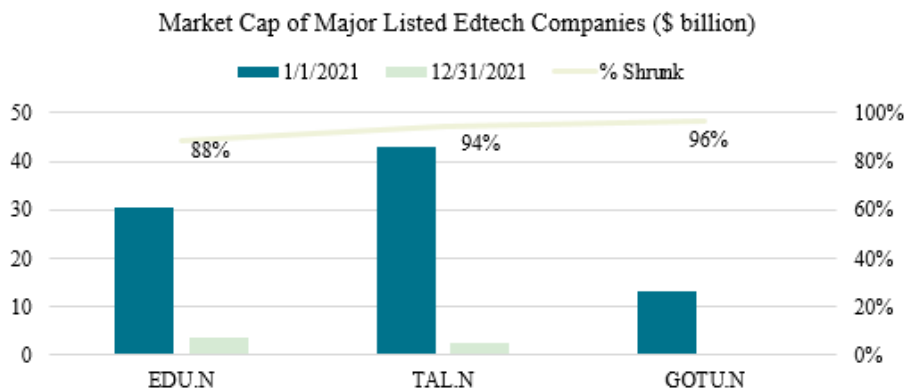


Figure 6: Chinese edtech giants suffered devastating loss in 2021⁹

Many of the edtech companies themselves had to find a new direction with certain of them being very successful.

- Zuoyebang which began as an online K-12 education platform has transitioned to selling edtech hardware products, including smart pens, desks and portable printers becoming #1 in sales during Taobao’s double eleven shopping festival in 2022. The company has recovered to its 2020 sales levels and is now profitable for the first time in its history.
- In February 2023, New Oriental’s online business subsidiary Koolearn announced the change of its subsidiary company name to East Buy. This name change completed its successful transition from an online tuition platform into livestreaming ecommerce platform. At the end of 2021 when the company stopped all tutoring services up to K-9¹⁰, 20 teachers were selected out of its 500 staff to be livestreamers and sell books, daily necessities and

agricultural products. This branch has now grown into a business generating \$293.5 million¹¹ in the six months ended last November. This summer, New Oriental has officially launched its tourism business, re-positioning its teachers and developed cultural tourism products.

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CHINA NEWS SPOTLIGHT

China's Central Bank Trims 1-year Rate, but Unexpectedly Leaves 5-year Rate Unchanged:

China's central bank cut its one-year loan prime rate Monday, while leaving its five-year rate unchanged. These decisions are weaker than expectations for more muscular policy intervention following a raft of data that pointed to faltering growth momentum in the world's second-largest economy. The People's Bank of China trimmed its one-year loan prime rate — the peg for most household and corporate loans in China — by 10 basis points from 3.55% to 3.45%, just shy of the 15 basis points that a majority of economists expected in a Reuters poll. This was the second time China has cut this rate in three months. [Read More.](#)

China Bolsters Efforts to Retain Foreign Investment Magnetism: In a recent development, China has intensified its policy support aimed at attracting foreign investment and catering to the needs of international firms. These robust efforts send clear and resounding signals of the country's commitment to further open up, thereby solidifying its position as one of the world's most appealing consumer and manufacturing markets. [Read More.](#)

Honor Confirms India Comeback, Teases New Smartphones Launch Soon : Honor has officially announced its comeback to the Indian market with the impending launch of new smartphone models. After a three-year partnership with Noida's PSAV Global for its smartphone distribution in India, Honor is gearing up to release models introduced earlier this year in China, including the notable Honor 90. The brand has recently started dropping hints about its return through its Honor Tech India profiles on X (previously known as Twitter) and Instagram. [Read More.](#)

China Introduces Largest Quantum Cloud Computing Platform, Moves Industry to Practical Stage: China Mobile on Saturday launched the largest quantum cloud computing platform in China along with China Electronics Technology Group Corp (CETGC), vowing to take quantum computing to a new level of practical use. As the country's most recent computing platform, it achieved hybrid computing of both quantum and general computing power for the first time in the industry, China Mobile said in a statement. [Read More.](#)

China's NMPA Accepts and Grants Priority Review Designation to the New Drug Application for Luye Pharma's Rotigotine Extended-Release Microspheres: Luye Pharma Group today announced that the New Drug Application (NDA) of its weekly-dosed Rotigotine Extended-Release Microspheres for Injection (LY03003) for the treatment of Parkinson's disease (PD) has been accepted and granted priority review by the Center for Drug Evaluation (CDE) of China's National Medical Products Administration (NMPA). Developed on the company's industry-leading microsphere platform, LY03003 is the world's first long-acting extended-release microsphere formulation for the treatment of PD. This drug is also being developed in the U.S. and Japan. [Read More.](#)

BYD, KG Mobility in Talks to Build EV Battery Plant in Korea: BYD, the world's No. 3 electric vehicle battery producer, and KG Mobility Corp., formerly Ssangyong Motor Co., are in talks to build a joint cell factory in South Korea where smaller carmakers are scrambling to secure the key component to power the motors of the eco-friendly automobiles. The Chinese cell manufacturer and the South Korean automaker specializing in sport utility vehicles aim to start mass production of the battery pack plant in January 2025, according to industry sources in Seoul on Sunday. [Read More.](#)

China Wants to Regulate its Artificial Intelligence Sector Without Crushing it: Beijing is poised to implement sweeping new regulations for artificial intelligence services this week, trying to balance state control of the technology with enough support that its companies can become viable global competitors. The government issued 24 guidelines that require platform providers to

register their services and conduct a security review before they're brought to market. [Read More.](#)

HUTCHMED Announces that the Sovleplenib Phase III ESLIM-01 Study Met Its Primary Endpoint in Primary Immune Thrombocytopenia in China: HUTCHMED (China) Limited (“HUTCHMED”) (Nasdaq/AIM:HCM; HKEX:13) today announces that the pivotal Phase III trial ESLIM-01 evaluating the investigational use of sovleplenib met its primary endpoint of durable response rate and all secondary endpoints in adult patients with primary immune thrombocytopenia (“ITP”) in China. HUTCHMED plans to submit the New Drug Application (“NDA”) around the end of 2023. The National Medical Products Administration of China (“NMPA”) granted Breakthrough Therapy designation (“BTD”) to sovleplenib for the indication studied in ESLIM-01 in January 2022. [Read More.](#)

China Specifies Targets of Sweeping Anti-Graft Probe Into Medical, Drug Sectors: Authorities have specified the direction of a recently launched year-long anti-graft probe into China’s medical and pharmaceutical sectors, with rent-seeking, kickbacks and other forms of bribery, as well as misuse of health insurance funds particular areas of focus. The crackdown is targeting six areas, the National Health Commission (NHC) said in a statement Tuesday. They include rent-seeking by health administrators; bribery in service providers run by health administrators; illegal drug trading by pharmaceutical companies; kickbacks in medical institutions and the sale of drugs, medical devices and consumables; misuse of health insurance funds; and integrity breaches by medical personnel. [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.

²[China's private education market set to reach \\$330 billion by 2020 \(consultancy.asia\)](#)

³Data represents the average cost

⁴[China tech crackdown: at least 25 large online tutoring firms closed up shop in 2021 | South China Morning Post \(scmp.com\)](#)

⁵[200K Layoffs, \\$100B Lost: The Tsunami of China's Regulation on Education — Class Central](#)

⁶[China's Tutoring Crackdown Sends Kids to Underground Test Prep - Bloomberg](#)

⁷[To reduce academic stress, China banned private tuition. Has the policy backfired? - CNA \(channelnewsasia.com\)](#)

⁸[In Depth: Online Learning Specialists Burning Cash as Fast as They Can Raise It \(caixinglobal.com\)](#)

⁹Source: Wind.

¹⁰[New Oriental's Koolearn Tech to stop tutoring services up to K-9 · TechNode](#)

¹¹[New Oriental's Koolearn sees 590% increase in revenue · TechNode](#)

Important Disclosures

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

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

[Constant Contact Data Notice](#)

Sent by myusko@morgancreecap.com