

The sleeping dragon awakens: China's economic prowess unleashed

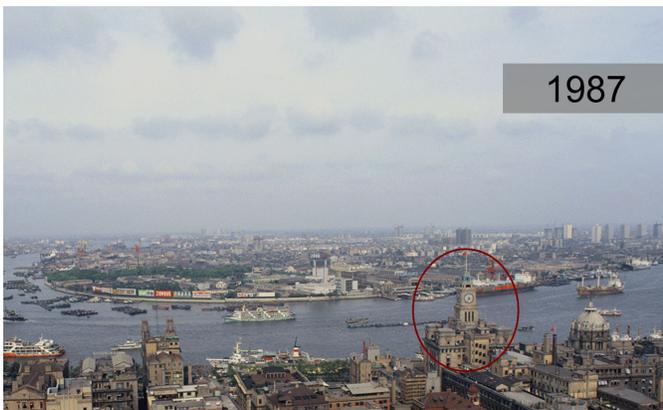
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In 1987 in Shenzhen, a former People's Liberation Army engineer founded a small telecoms equipment trading company by the name of Huawei. By the end of 2017, it was the world's largest telecommunications equipment firm and number two globally in smartphone sales, trailing only Korean giant Samsung. It has made no bones about its desire to challenge Apple in the fiercely competitive premium end of the smartphone market. Its rise is a phenomenal story and provides an allegory of China's own emergence on the world stage over the past 30 years.

The juxtaposition of the two pictures below taken from the exact same framing and perspective 26 years apart shows how far China has come over the past three decades. This is Pudong, home to Shanghai's financial district. The half-complete building in the second picture is Shanghai Tower, which was completed last year and is currently the world's second-tallest building.

Exhibit I: Shanghai Pudong in 26 years

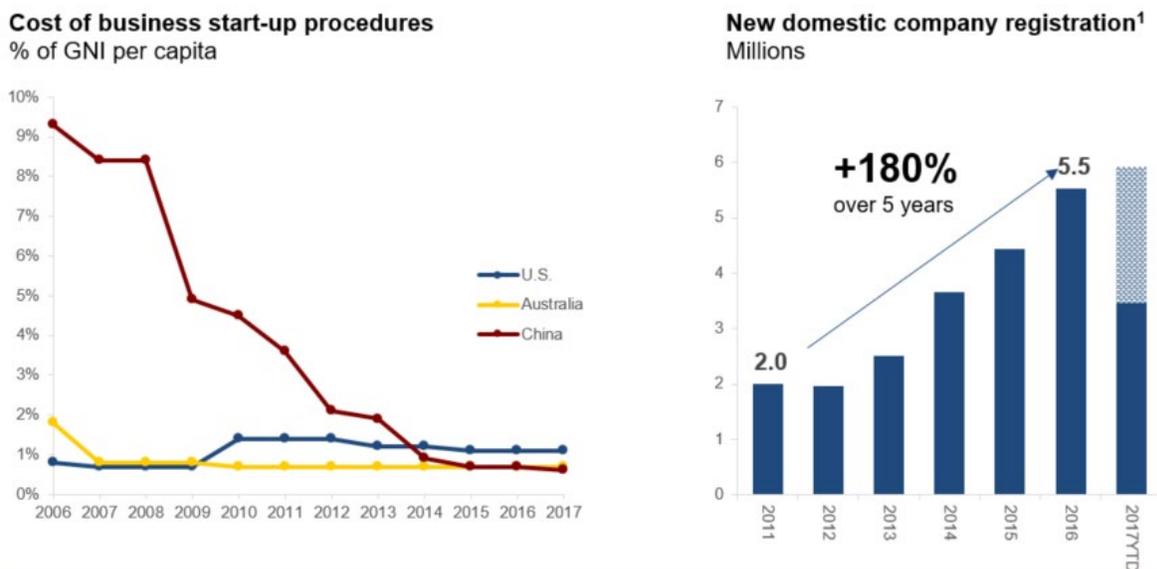


Source: Google images.

That private enterprise has been the engine of China’s extraordinary growth is no secret. According to the UBS/PwC 2017 Billionaires Report, Asian billionaires have now outnumbered their U.S. counterparts for the first time. In fact, Asia generates one new billionaire every other day, with two new billionaires created every week in China. Indeed, entrepreneurship has been a key driver of China’s wealth creation as virtually all new entrants to the list were self-made rather than a recipient of inherited wealth.

A confluence of other factors has also contributed to this rise, including the rapid emergence of first-class logistics systems and infrastructure in China. Another boost has been the government’s determination to reform processes and create an environment in which businesses can thrive. As shown in the chart below, the cost of starting up a business in China has dropped dramatically in the past decade and now resembles a business backdrop that one would normally associate with more developed economies. New company registrations in China from 2011 to 2016 nearly tripled – further proof that Chinese entrepreneurship is alive and well.

Chart I: Wealth creation has been driven by entrepreneurship



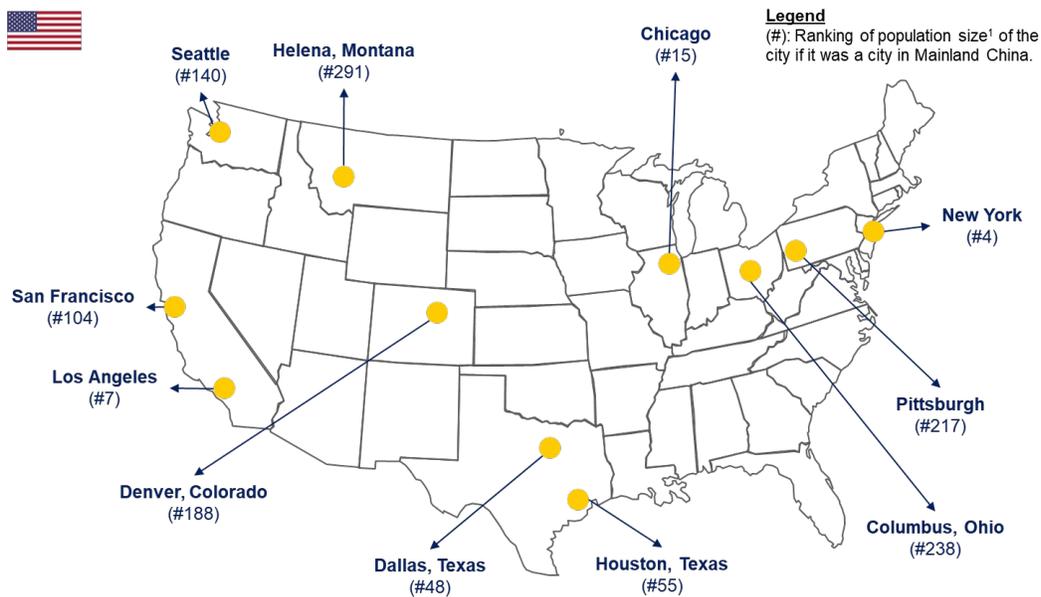
Today’s entrepreneurs drive tomorrow’s growth and job creation.

¹ 2017YTD is up to July 2017. Shaded section of bar is the full-year extrapolation assuming linear registration rate.
Source: World Bank, “World Development Indicators” (Dec 14, 2017); CEIC.

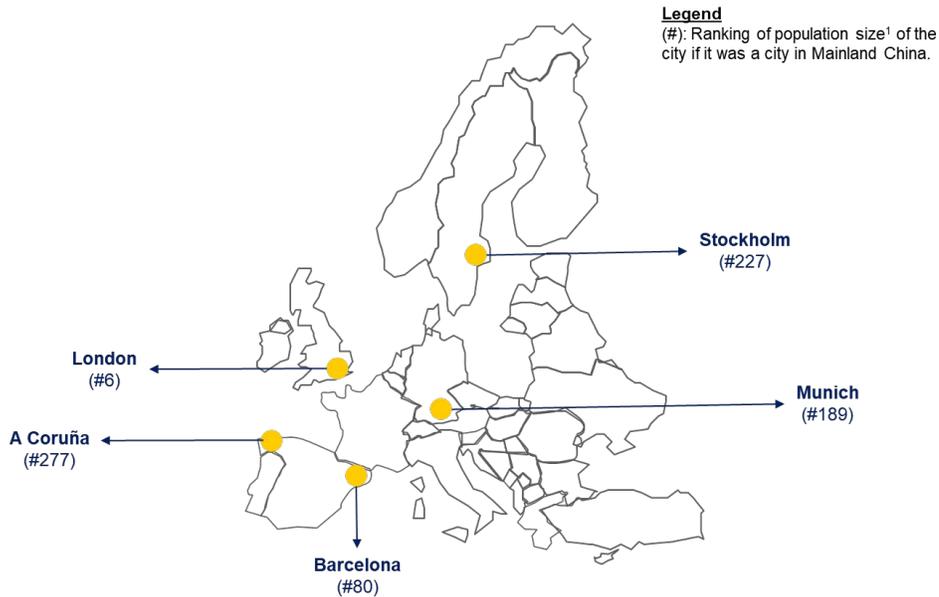
Although China is commonly known as the “world’s factory”, the country’s increasing reliance on consumption for growth is transforming the economy in profound ways. While it no doubt still possesses this manufacturing prowess (China makes 80% of the world’s air conditioners and 60% of its shoes¹), the country’s mammoth population is powering a consumption revolution.

The numbers speak for themselves. In China, there are over 279 cities with populations of over one million people. Yet the 20 largest cities in China contribute to only around 30% of China’s GDP, highlighting the as-yet-untapped potential that the country’s interior cities have to offer. To put this into context, the city of San Francisco would be ranked 104th in terms of population size if it were considered a city in Mainland China.

Chart II: Where do U.S. and European cities rank in China in terms of population?



¹ “Made in China?”, *The Economist*, 12 March 2015.



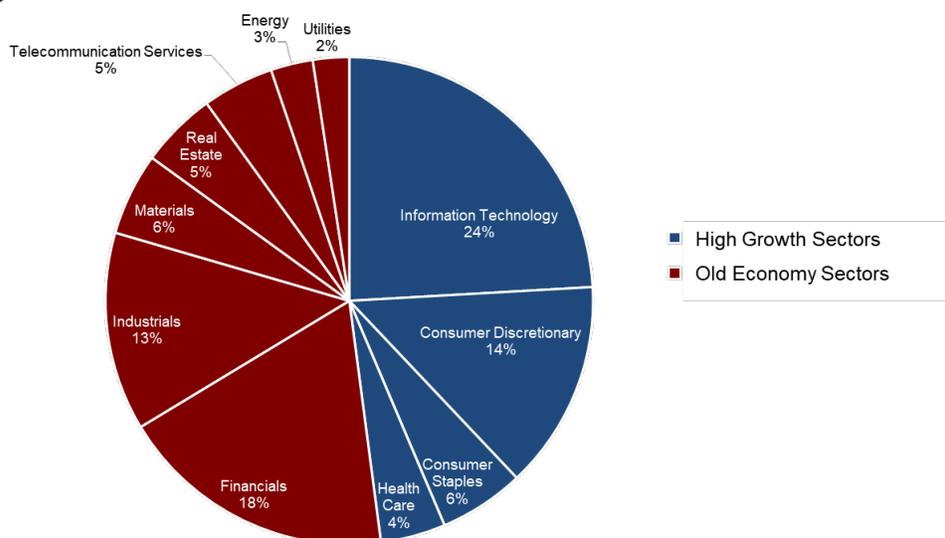
¹ Refers to the population size of the Metropolitan Statistical Area of the said city as of 2015 with the exception of Helena, Montana, which refers to the population size of the Micropolitan Statistical Area as of 2015.
Source: United States Census Bureau; Eurostat; China City Statistical Yearbook 2016.

Needless to say, China’s growing affluence and the rise of e-commerce are demographic and technological forces that are redefining the landscape of its consumer market. This phenomenon is driving the ever-growing demand for goods and services that young, entrepreneurial companies— backed by VC and PE firms — are catering to.

Private equity in Asia often focuses on private enterprises in the “new economy” where innovation, entrepreneurship and growth are to be found. This is markedly different from public markets in the region that are concentrated in “old economy” sectors. Key benchmarks (such as the MSCI Asia below) are significantly weighted towards sectors such as Finance, Industrials and Construction, which tend to be dominated by State-Owned Enterprises and government-linked companies.

Chart III: Asian PE has a different return profile from public markets

MSCI AC Asia¹ Index Sector Weights
US\$



¹ The MSCI AC Asia Index captures large and mid-cap representation across Developed Markets countries and Emerging Markets countries in Asia. With 954 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Developed Markets countries in the index include: Hong Kong, Japan and Singapore. Emerging Markets countries include China, India, Indonesia, Korea, Malaysia, Pakistan, the Philippines, Taiwan and Thailand.
Source: MSCI AC Asia Index. Data as of Oct 31, 2017.

PE-backed companies are directly benefiting from the consumption upgrade, such that the growth rates of these companies can be higher than that of their public market peers. Net private equity returns in Asia have historically produced consistent outperformance against the gross returns from the public markets over a 3, 5, 10, 15 and 20-year basis. As seen in Chart IV, the outperformance can be as large as an IRR of 7.5% over 10 years. Allocating to private equity in Asia continues to be accretive for a patient global investor.

Table 1: Asia Emerging Markets PE&VC Index vs. Public Market Indices

Index ¹	3-Year	5-Year	10-Year	15-Year	20-Year
Asia/Pacific Emerging Markets Private Equity & Venture Capital Index	13.41	14.62	12.08	13.01	11.43
MSCI Emerging Markets Index (gross)	1.44	4.33	2.25	10.95	5.76
MSCI Emerging Markets Asia Index (gross)	5.37	8.11	4.18	10.77	4.40

¹ Private indices are pooled horizon internal rate of return (IRR) calculations, net of fees, expenses, and carried interest. The timing and magnitude of fund cash flows are integral to the IRR performance calculation. Public indices are average annual compounded returns (AACR) calculations which are time-weighted measures over the specified time horizon, and are shown for reference and directional purposes only.
Source: Cambridge Associates LLC, “Private Equity & Venture Capital and Benchmark Statistics” (data as of Jun 30, 2017).

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