VMS鼎珮

Quarterly Market Insight

Q2 2024

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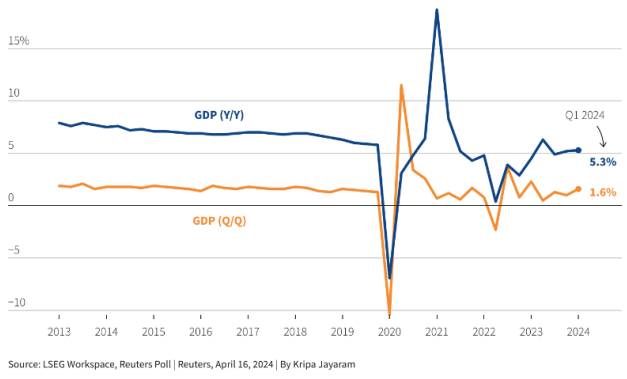
China Macroeconomic Update

During the first quarter of 2024, GDP grew by 5.3%, surpassing market expectations (Chart 1). From January to May 2024, the cumulative growth of industrial added value was 6.2%[1]. While exports and manufacturing investment performed well, total retail sales of consumer goods was average. Real estate investment is still bottoming out, and the disequilibrium between supply and demand has not been significantly alleviated.

Chart 1: China GDP Growth as of Q1 2024

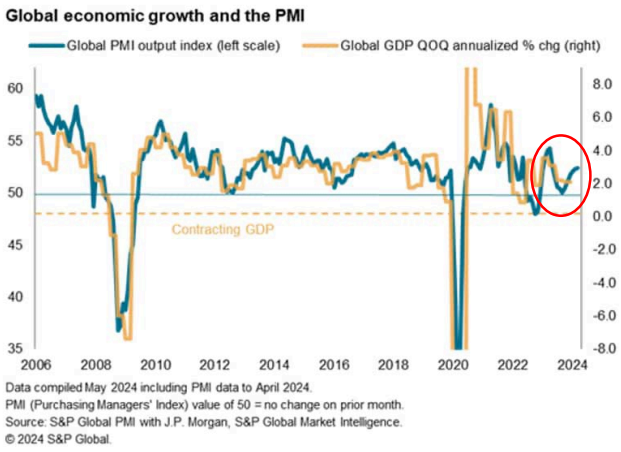


Source: Reuters

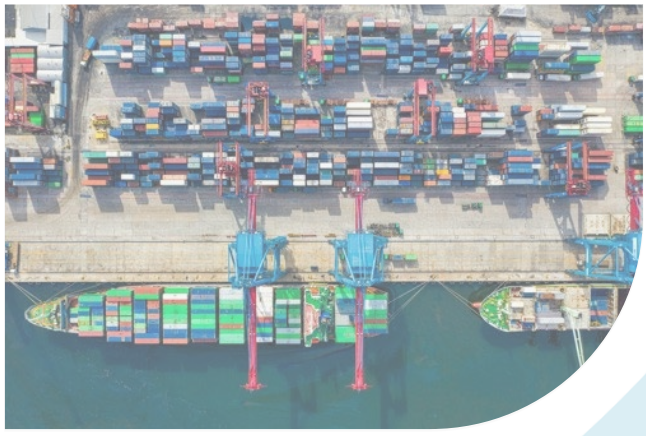
Looking at specific sectors from January to May 2024, the computer, communications, and other electronic equipment industry, the transportation equipment industry including railways, ships, and aerospace, and the automobile manufacturing industry grew by 13.8%, 11.1%, and 10.5% respectively. Non-ferrous metal smelting and chemical industries grew by 11.4% and 10.7% respectively. In terms of products, new energy vehicles, integrated circuits, solar photovoltaic cells, and industrial robots showed the fastest growth, with growth rates of 33.9%, 32.7%, 22.8%, and 8.9% respectively. Traditional industries such as crude steel, cement, and coal experienced negative growth rates[2].

Currently, there is still a need to boost demand and tackle the issue of excess capacity in certain industries. Real estate investment and consumption growth were both lower than market expectations. The Producer Price Index (PPI) remained negative, and inventory recovery lacked momentum. However, there are several positive indications: First, exports are expected to maintain resilience, as global manufacturing Purchasing Managers' Index (PMI) continues to rise (Chart 2) and freight rate indices like China Containerized Freight Index (CCFI) show sustained growth.

Chart 2: Global Economic Growth and PMI



Source: Capital IQ

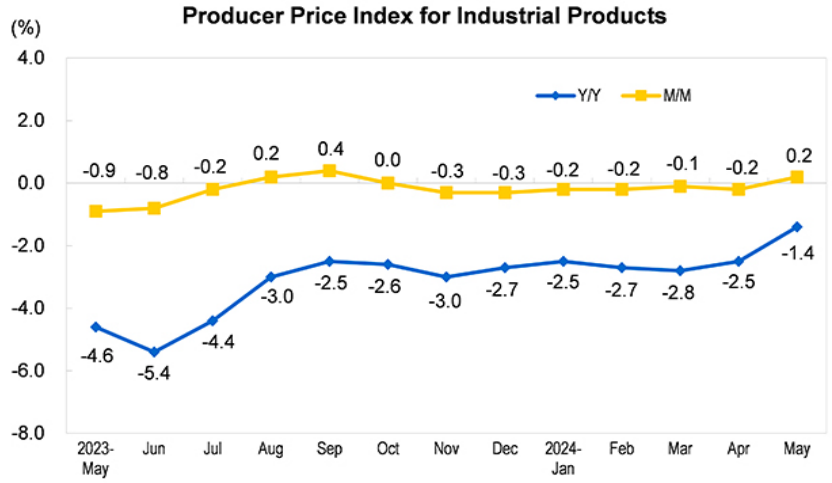


[1] · [2]National Bureau of Statistics

Second, factory prices in May 2024 entered an expansion zone, and the year-on-year decline of PPI significantly narrowed, indicating a potentially weaker drag effect from industrial product prices (Chart 3).

Third, fiscal measures are expected to accelerate infrastructure investment and boost workloads, leading to a slight rebound in production intensity in related industries. Nonetheless, we can still see the pressure on the overall economy and residents' income according to the tax revenue statistics between January to May 2024 in Table 1 below.

Chart 3: China Producer Price Index for Industrial Products



Source: National Bureau of Statistics as of May 2024

Table 1: National Tax Revenue (Jan-May 2024) with Breakdown

Tax Category	Amount (in billion yuan)	Year-on-Year Change
Value-added tax	3,011.9	-6.1%
Domestic consumption tax	760.7	+7.2%
Corporate income tax	2,238.2	-1.7%
Personal income tax	607.2	-6.0%
Import value-added tax	774.1	+1.5%
Customs duties	98.9	-4.4%
Export rebates	970.9	+21.2%
Urban maintenance and construction tax	219.0	-7.4%
Vehicle purchase tax	108.6	-0.1%
Stamp duty	150.5	-18.6%
Securities trading stamp duty	43.9	-50.8%
Resource tax	122.1	-14.0%
Property-related Tax		
Deed tax	232.6	-8.7%
Property tax	208.6	+20.1%
Urban land use tax	112.0	+12.7%
Land value-added tax	244.2	-5.3%
Farmland occupation tax	64.2	+21.4%
Environmental protection tax	11.1	+12.1%
Other taxes	53.2	+3.4%
National Tax Revenue (Jan-May 2024)	**8,046.2**	**-5.1%**

Source: Ministry of Finance

As we conclude our macroeconomic update, we now turn to industry-specific dynamics that are shaping the opportunities within our focused private equity sectors: healthcare, technology, and consumer. In the following sections, our sector teams provide their respective Q2 2024 insights.

Healthcare

Radiopharmaceuticals: The New Frontier of Precision Medicine

Pluvicto: A Game-Changing Radiopharmaceutical in Prostate Cancer Treatment

Pluvicto, a groundbreaking radiopharmaceutical developed by Novartis, soared to near-blockbuster status in 2023, earning USD 980mn in its first full year on the market. Approved by the US FDA in March 2022, Pluvicto targets prostate-specific membrane antigen (PSMA)-positive, previously treated, metastatic castration-resistant prostate cancer (mCRPC) patients. Novartis expects Pluvicto to steadily grow in its current indication with peak sales north of USD 2bn, with a potential upside of gaining additional approvals in the pre-chemo first-line mCRPC setting. The market expects a peak sales at around USD 4bn by 2028[1].

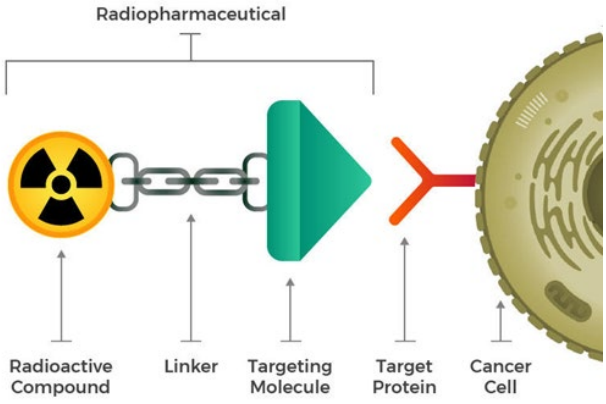
A Wave of Mergers and Acquisitions and Venture Investments into Radiopharmaceuticals

Inspired by Novartis' success, major pharmaceutical companies have been snapping up radiopharmaceutical firms. Eli Lilly acquired Point Bio for USD 1.4bn in October 2023. Bristol Myers Squibb bought RayzeBio for USD 4.1bn in December 2023. AstraZeneca invested up to USD 2.4bn in Fusion Pharmaceuticals in March 2024. Over the past decade, big pharma has spent around USD 15bn on radiopharmaceutical acquisitions, while venture capital firms have invested another USD 1.5bn into this promising field.

What Are Radiopharmaceuticals?

Radiopharmaceuticals act like precision-guided missiles, delivering radiation directly to cancer cells, while minimizing damage to healthy cells (Chart 4). These innovative treatments are part of a concept called theranostics, which refers to the pairing of diagnostic biomarkers with therapeutic agents that share a specific target in diseased cells or tissues, like cancer cells[2].

Chart 4: Application of Radiopharmaceuticals



Source: National Cancer Institute

For example, in prostate cancer treatment, doctors first use a radiopharmaceutical called gallium-68 PSMA (Locametz) to identify cancer cells. This molecule emits a small amount of radiation that can be detected with a PET scan, helping doctors preview where the cancer has spread. Then, they use another radiopharmaceutical called lutetium-177 PSMA (Pluvicto) to deliver a stronger dose of radiation to kill those cancer cells.

[1]Investor's Business Daily: "Why Big Pharma Is Following Novartis' Lead In A USD 25 Billion Market"
[2]Radiological Society of North America: "Theranostics in Nuclear Medicine: Emerging and Reemerging Integrated Imaging and Therapies in the Era of Precision Oncology"

Market Growth and Potential

The global market for radiopharmaceuticals is projected to surpass USD 32bn by 2033. Valued at USD 11bn in 2023, this market is expected to grow at a CAGR of 11.5%. North America has been leading the way, with its market projected to grow to about USD 19bn by 2033[3]. This growth is driven by the increasing incidence of cancer and other diseases, along with technological advancements in medical imaging and treatment.

Development Milestones and Innovations

Along with radiopharmaceutical development, this industry has witnessed the emergence of numerous therapeutics and diagnostic agents for various conditions including thyroid disease, blood disorders, bone metastasis, and malignant tumors, etc.

A pivotal moment came in 2018 when the FDA approved lutetium Lu 177-dotatate (Lutathera) for treating specific neuroendocrine tumors (NETs) affecting the digestive tract. Lutathera demonstrated superior efficacy in slowing NET growth compared to any previous drug[4], and its sales are projected to hit USD 725mn by 2028.

Building on this momentum, the FDA approved Pluvicto in March 2022 to treat adult patients with PSMA-positive mCRPC. On the same day, Locametz was also approved, marking the first radioactive diagnostic agent for patient selection in radioactive therapeutic use.

Medical imaging technology has also made great strides, starting with planar imaging and limited therapeutic procedures in the early days, to the thrilling advancement of cardiac imaging in the early 1980s. This was followed by the introduction of PET radiopharmaceuticals and technology, and the promising development of hybrid technologies such as SPECT/CT (Single-Photon Emission Computed Tomography) and PET/CT (Positron Emission Tomography / Computed Tomography).

Looking Ahead

1. Adapting therapeutics agents from diagnostic imaging compounds

Various researches are involved in the development of radiopharmaceuticals for different types of cancers, including melanoma, lung cancer, colorectal cancer, and leukemia. Any tumor that possesses a targetable molecule on its cell surface with adequate blood supply can potentiate treatments using radiopharmaceuticals. The targeting molecules are repurposed to deliver more potent radioactive compounds to destroy cancer cells instead of solely aiding in the disease imaging. Not surprisingly, many new radiopharmaceutical drugs are adapting drugs modified from existing compounds utilized in nuclear imaging[5].

Picture Source: Advanced Radiology

[3]Biospace: "US Nuclear Medicine Market Size to Hit USD 19bn by 2033", published on May 2024
[4,5]National Cancer Institute: "Radiopharmaceuticals: Radiation therapy enters the molecular age", published on Oct 2020

2. The clinical advancement and application of radiopharmaceuticals drive the demand of nuclear medicine imaging scanning

Diagnostic procedures like PET, SPECT, and scintigraphy utilize radiopharmaceuticals for early disease detection, leading to improved interventions. Beyond diagnostics, radiopharmaceuticals are integral to targeted radionuclide therapy, a precise method of delivering radioactive payloads to diseased tissues. This approach enhances treatment efficacy while minimizing damage to healthy tissues, ultimately improving patient outcomes. The recent technological advancement in digital SPECT/CT imaging systems hold promise in returning higher-quality images and superior diagnosis efficiency over conventional analog system[6]. It is forecasted that each of SPECT and PET/CT market will reach approximately USD 3bn by 2030[7].

Promising Industry Despite Challenges

Radiopharmaceuticals represent an exciting new frontier in precision medicine, offering more effective and targeted treatments for some of the most serious diseases. However, there is a shortage of trained specialists who can administer radiopharmaceutical treatments, and there may also be issues with the supply of radioactive materials. Ensuring a steady supply of these materials is crucial to meet the growing demand.

As technology and research continue to advance, the future nonetheless looks bright for these innovative therapies, promising better patient outcomes and a new era in cancer care.

Technology

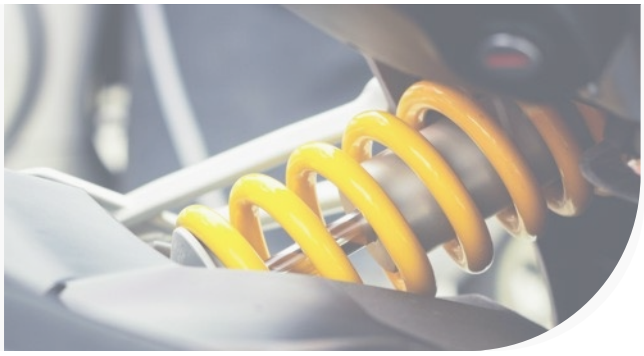
Looking back at the first quarter of 2024, China's primary market experienced an upswing of increased investment activity. In terms of financing data, there were 1,390 investment events during that time period, representing a 10% increase compared to the previous quarter and a 14% increase year-on-year. The total investment amount was approximately RMB 229.17bn, representing an 8% increase both quarter-on-quarter and year-on-year[8]. In terms of specific segments within the technology industry, the most active areas for investment included integrated circuits, new materials, and new energy. Among them, the integrated circuit sector had the highest number of investment events, reaching 153. RMB funds have gradually become the dominant force in the market, with many focusing on the technology sectors closely aligned with national strategies, industrial policies, and technological breakthroughs. Additionally, the AIGC (Artificial Intelligence Generated Content) sector also showed promising activity, with 36 disclosed financing events, representing a 28.6% increase compared to the previous period[9].

[6]GE Healthcare: "Advancing SPECT/CT with CZT digital detectors", published on April 2022; PR Newswire: "Spectrum Dynamics is proud to announce the installation of the VERITON-CT SPECT/CT imaging system at European Leading Cancer Center", published on March 2024
[7]Imaging Technology News, published on Jan 2024; Verified Market Research published on Mar 2024
[8,9]36Kr: "2024 年 Q1 投资报告：VC/PE 们快醒醒，一级市场迎来小阳春"

On the policy front, the second quarter of 2024 saw a clear push in the technology sector. Terms such as "new productive forces", referring to innovation in advanced tech sectors, and "patient capital", referring to long-term investments, began to appear frequently in government documents and were strengthened in practice at the policy level. For example, on 19 June 2024, the General Office of the State Council issued the "Six Measures for Venture Capital," providing comprehensive support and guidance for equity investments in the technology sector as well as actively cultivating "patient capital." The Chairman of the China Securities Regulatory Commission, Wu Qing, recently announced the "Eight Measures for the STAR Market," which deepens reforms for the A-share STAR market and supports the development of technological innovation. More specifically, these measures include:

1) strengthening the positioning of "hard technology" companies on the STAR board
2) conducting pilot programs to deepen the issuance and underwriting system
3) optimizing the financing system for listed companies on the STAR board regarding stocks and bonds
4) providing greater support for mergers and acquisitions
5) improving equity incentive systems
6) enhancing trading mechanisms
7) preventing market risks
8) strengthening supervision of listed companies on the STAR board

Second quarter performance in the technology sector echoed its performance from the previous quarter, with RMB funds dominating the market while USD funds remained in a relatively passive position. Companies with a clear ability to manufacture and implement in the market, such as in advanced manufacturing, semiconductors, and new energy, were the focus of RMB funds' coverage. USD funds and some established dual-currency funds continued to focus on opportunities in the AIGC sector. We have the following observations on various technology sub-sectors:



Automobile Parts

Due to the impact of price wars among major automakers, automotive part suppliers continue to face high survival pressures. However, some seemingly "traditional" tier-1/tier-2 suppliers actually have much room for survival. The fundamental driving force is whether or not these suppliers have established core market barriers and commercial progress. For example, the auxiliary autonomous driving industry, which has higher technological barriers, faces challenges due to the large number of market participants and the self-developed capabilities of leading automakers. This puts pressure on gross profit margins and cash flow for smaller companies in the industry. On the other hand, some seemingly traditional components and solutions, such as molds, component products, and automotive painting/stamping/welding solution providers, have shown positive gross profit margins and healthy cash flow due to years of capital expenditure, cost-effective products, and production experience. Many suppliers are thus looking to expand overseas.

Semiconductors

Driven by demand for domestic substitution, domestic equipment and material companies have entered a stable growth period, also driving continuous growth in the upstream precision component industry. In some equipment (such as etching machines, cleaning equipment) and materials (such as photoresists) sectors, domestic manufacturers have gained considerable market share and continued to expand. Leading precision component manufacturers have sustained growth and maintained a net profit margin of over 20%. We believe that the growth trajectory of equipment, materials, and related precision component manufacturers is quite positive, but in some specific sub-sectors (such as semiconductor materials), it is necessary to pay attention to potential market ceiling issues for single products.

Autonomous Driving

Facing a technological paradigm shift, the performance of end-to-end autonomous driving models has been quite impressive. This type of model has the potential to reshape the current path of autonomous driving technology, which is currently dominated by the "perception-planning-decision" approach. Taking the performance of Tesla's Full Self-Driving version 12 software as an example, these softwares are already achieving the same or even better performance as human drivers in some city scenarios without high-precision maps. Companies that have continuous data sources and technological capabilities are more likely to form a flywheel effect and achieve sustained competitive barriers.

General Advanced Manufacturing

State-owned and government-guided funds have recently put more focus on this sector due to companies' ability to manufacture and quickly implement into the market. However, these companies also need to balance market implementation with financial returns. While more and more companies are directly incorporating the potential value they can bring to the local area in their business plans nowadays, at an operational level, it is still necessary for the investor to consider factors such as valuation and company development. As a result, the investment preferences and interests of financial institutions versus non-financial institutions have gradually become more divergent.

Artificial Intelligence Sub-Sectors

Large Language Models (LLM)

LLM companies have undergone the first round of market elimination, with startup companies and internet giants forming their respective camps and have now entered into a fierce cost-reduction price war. Based on actual performance, China's LLM capabilities are more or less on par with the United States, but due to the impact of chip sanctions on the supply of high-end Nvidia chips, China's LLM companies face high-quality computing power supply bottlenecks. We believe that investment opportunities in the short to medium term lie in the side of computing power, in addition to the application layer. In particular, AI data centers, distributed Ethernet networks, Chiplet and advanced packing technologies are just some of the promising sub-sectors within computing power.

Embodied AI

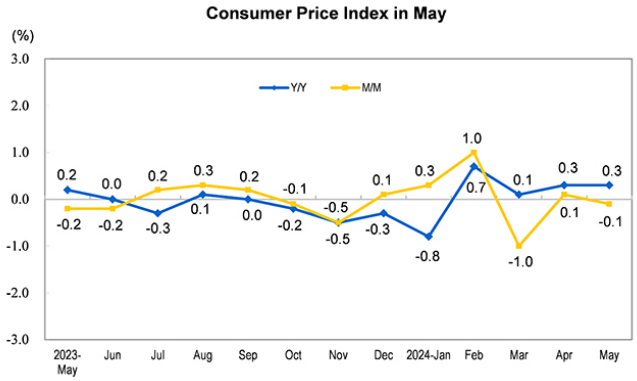
Investment capital has now concentrated on leading embodied AI companies, a trend gradually gaining market consensus. For example, we have been following the development of a company called GalaxyBot, which recently closed its RMB 700mn angel investment round as announced on 21 June 2024. Its prestigious and diversified group of investors include strategic and industrial investment arms of Meituan Dianping, BAIC, SenseTime and iFlyTek, as well as top financial institutions such as Qiming Venture Partners, Lanchi Ventures, Matrix Partners China, Source Code Capital, and IDG Capital.

Picture Source: GalaxyBot's online recruitment info page

Consumer

In terms of the economic fundamentals, consumer demand in China has not seen substantial improvement in the second quarter of 2024. This has been reflected in various economic indicators such as CPI (Chart 5), total retail sales, and new loans and deposits. In order to improve domestic demand and stimulate inflation, the government has implemented numerous policy measures in the first half of 2024, including relaxing restrictions on real estate purchases and increasing public utility charges. However, both actual data and analysis suggests that the effects may be limited and could even have negative consequences on the economy's "soft landing" and domestic demand recovery. In contrast, exports have performed relatively well, mainly due to factors such as the rebound in global manufacturing PMI and the restart of the US real estate cycle. However, there is still a certain degree of a "sacrificing price for volume" approach from exporting companies, so their business sustainability needs further observation.

Chart 5: China CPI as of May 2024



Source: National Bureau of Statistics

Consumer sector investment in China's private equity market remains sluggish, primarily due to the lack of clarity in exit expectations. Although there are still many high-quality consumer companies with scale, growth, and profitability in China, the IPO policies for A-shares have become increasingly stringent after multiple rule adjustments since 2023. Regulators have become more cautious about whether listing applicants display true technological innovation. They have also been cautious about companies operating in certain consumer industries or with certain business models. This trend seems to significantly reduce the feasibility of A-share listings for many consumer companies. Even if they make it past the market's scrutiny, the updated IPO policies impose higher requirements for information disclosure, brokerage verification, and audit responsibility, posing challenges to the companies' intentions for A-share listing. Some consumer companies have turned to listing in Hong Kong, but foreign investment enthusiasm in Chinese companies has not substantially recovered in the secondary market. This puts significant pressure on pre-IPO placements and post-listing stock price trends.

When the long-relied IPO exit path is blocked, many private equity funds have been exploring new investment and exit models in the consumer sector. For example, shifting from minority equity investment to mergers and acquisitions (M&A) operations, or actively seeking options such as mandatory dividends and M&A exits. However, we believe that the M&A operations strategy places higher demands on the GP's fund size, industry resources, and experience, making it a suitable option for only a few institutions. Mandatory dividends also have inherent contradictions, making it more challenging in practice when there is information symmetry between the investee and investor. Although M&A exits are quite common in certain consumer sectors, such as cosmetics, fragrances, clothing, and accessories, the frequency of this form of exit also carries a significant degree of randomness and should not be regarded as a routine exit channel.

Implications on Our Investment Strategy

Against this backdrop, our consumer investment strategy needs to include considerations of both the business and economic fundamentals, as well as the long-term certainty of potential exit channels. In terms of fundamentals, we will continue to explore the following two investment themes:

- First, based on China's long-standing policy focus on the "supply-side" over "demand-side" and the pressures posed by local government debt issues, we believe that policy measures will have limited impact on bringing substantial improvement in domestic consumer demand. Therefore, the phenomenon of weak domestic demand is likely to become the new normal for the next three to five years. As a result, investment focus on rational and "value-for-money" domestic consumption trends will have a longer-term and more certain outlook.

- Secondly, the long-term insufficiency of domestic demand will inevitably lead to companies with excess supply seeking external outlets, providing support for exports. On this basis, Chinese consumer companies' product capabilities and brand strength will continue to upgrade. Coupled with improvements in infrastructure such as logistics and payment systems, Chinese companies can become more competitive in overseas markets. However, this trend of "going global" will become increasingly competitive, and price competition will be an unavoidable challenge. This means that companies with strong product and brand competitiveness will have a higher degree of certainty in maintaining long-term competitiveness.

At the same time, in terms of exit channels, we believe that strong development, both in the sector as a whole and within the company itself, are the best guarantees for determining outlook for exit opportunities. Based on this, we will look for strong indicators in a company's technical attributes, including but not limited to industry leadership, technological innovation, operational compliance, clear capital operation goals, and sufficient safety margins.

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