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China Macro & Strategy

China's Regulatory Reset

Beijing is shifting its governance priorities to balancing growth and sustainability, tackling social equality and security with a major regulatory reset. It could rebalance the share of economy toward labor, lowering corporate profit share. We see a longer and more profound market impact.

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China's Regulatory Reset

New objective triggering major regulatory reset: We are at a significant moment in the history of China's economy and capital markets: after a decade-long journey to eliminate absolute poverty, Beijing is shifting governance priorities from growth to balancing growth and sustainability: social equality, data security, and self-sufficiency. China's new regulations on fintech, big tech, after-school tutoring, cryptocurrency, and carbon emissions over the past nine months underpin this major regulatory reset.

Economic implications: Under the new governance paradigm, China appears to be attempting to check the rise in corporate power and rebalance the share of the economy in favor of labor, which could result in decline in corporate profit share. We see regulatory headwinds for sectors associated with rising tensions of social inequality, environmental sustainability, and data security risks, while the new framework provides policy support to advanced manufacturing, tech localization, and renewable energy. We remain watchful of the risk of over-regulation, or, in contrast, resumption of offshore (Hong Kong) IPOs for tech companies, clarity over employment benefits and other issues concerning platform companies, progress on audit access dispute resolution, and clearer guidance from top policymakers to curb spillover effects of regulation changes.

Investment implications: We expect a longer and more profound impact from the current regulatory cycle on China's equity market valuations and Equity Risk Premium (ERP) than has occurred in similar past cycles, as it is affecting a more substantial proportion of the market than previously and, in particular, the Internet sector, which accounts for ~40% of MSCI China by index weight. There is a substantial degree of uncertainty over what this means both for future net income margins and revenue growth for the affected sectors and stocks.

Our current base case forward P/E target for MSCI China of 13.0x implies MSCI China would trade on a mid-single-digit percentage valuation discount to MSCI EM ex China for a sustained period of time. Over time we expect the MSCI China universe to gradually have a more balanced sector allocation with a reduced weight for Internet and a higher weight for sectors like Industrials and IT.

Challenges and opportunities by segment/theme: Data-heavy tech and platform companies and property could remain under pressure amid the regulatory reset, while semi localization, cybersecurity, domestic brands catering to the mass market, innovative drugs, biotech, and green economy may enjoy support.

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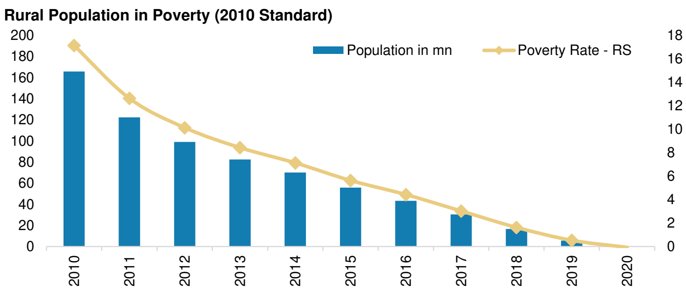
Key Charts at a Glance

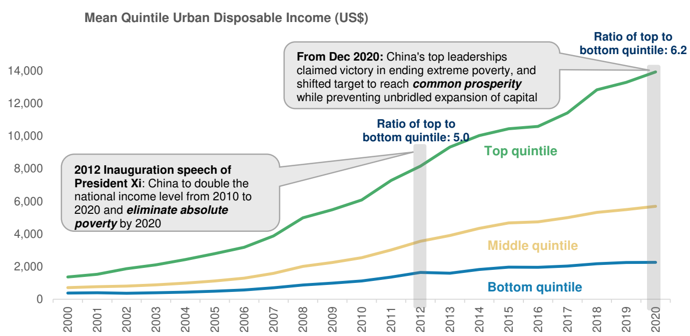
A shift from "growth first" to balancing growth and sustainability...

Exhibit 1: Decade-long journey to eliminate absolute poverty



Source: CEIC, Wind, Morgan Stanley Research

Exhibit 2: New policy priorities: social equality, data security, and self-sufficiency



Source: CEIC, Wind, Morgan Stanley Research

Exhibit 3: Four key areas of policy focus

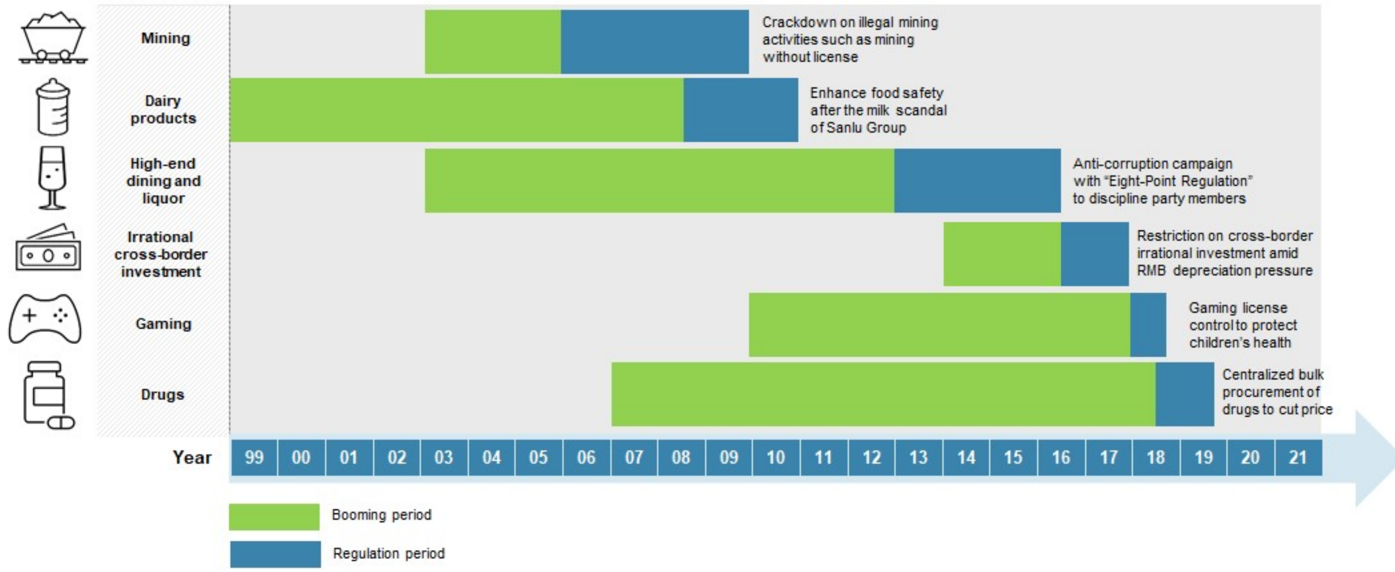
Policy Goal: To Balance Growth and Safety

Social Risks	**Tech giants:** To tackle rising tensions of social inequality	✓ Take up responsibility on welfare of flexible workers ✗ Monopolistic behavior with disregard for social welfare
	Education: To ease parents' burden associated with children's education expenses and time	✓ Increase public school resources, vocational training ✗ Profit-oriented afterschool tutoring
	Housing: To meet living demands of urban dwellers	✓ Property rental market ✗ Housing speculation, over-leveraged developers
	Healthcare: To enhance elderly care and reduce medical costs	✓ Innovative drugs, R&D on medical technology ✗ Generic drugs
	Insurance and Pension: To reduce households' precautionary savings	✓ Commercial insurance (medical + retirement) ✗ Speculative activity, short-term products
National Security Risks	**ADR & overseas listings:** To reduce national security risks, particularly for overseas listing of data-rich tech companies, and enhance monitoring of data flows	✓ Mainland/HK listing; data and algorithms store in China ✗ Overseas listings of data-rich tech firms
	Semiconductors: To enhance self-sufficiency	✓ China-designed chips, next-gen technology such as 5/6G, IoT, quantum networks, and blockchain
	Software: To strengthen cybersecurity	✓ Leading cybersecurity players with big exposure to the public sector
Financial Risks	**Fintech:** To curb regulatory arbitrage and financial stability risks	✓ Entities in line with leverage constraints and capital requirements, proper oversight on data usage ✗ Players with high leverage, low capital, and product/credit concentration risks
	Capital flows: To promote RMB asset internationalization	✓ Orderly increase of two-way flows ✗ Speculative capital flows
Environmental Risks	**Decarbonization:** To reach peak emissions by 2030 and carbon neutrality by 2060	✓ Clean energy, smart grid, electrification, green financing ✗ "Brown assets"

Source: Government announcements, Morgan Stanley Research

…but history rhymes

Exhibit 4: China's volatile regulatory cycle: from relaxed to tight due to lagged regulation in early periods of exponential growth



Source: Morgan Stanley Research

Exhibit 5: Summary of historical equity market impact: relative performance, valuation and total market cap reaction to past episodes of industry level regulatory tightening

Regulatory event	Sector impacted	When	Duration (months)	Relative performance vs. index	Relative valuation change vs. index	Market cap change	Time taken to trough relative to index (months)	Time taken to recover relative to index (months)
Anti-corruption campaign	Consumer Discretionary	Nov 12 - Jun 16	44	-59%	-30%	-52%	30	37
Supply side structural reform*	Old Economy	Dec 15 - 1Q 18	28	41%	23%	49%	n/a	n/a
Education sector reform (phase 1)	Education (K-12 AST)	Feb 18 - Mar 19	14	-28%	-30%	-32%	5	14
Gaming license suspension	Internet / gaming	Mar 18 - Oct 18	8	-13%	6%	-42%	6	3
Drug procurement reform (pilot scheme)	Pharma	Jun 18 - Sep 19	16	-19%	-22%	-42%	8	4
Antitrust / cybersecurity regulation on internet companies	Internet	Since Nov 20 until now	9	-18%	-14%	-24%	n/a	n/a
Education sector reform (phase 2)	Education (K-12 AST)	Since May 21 till now	3	-53%	-58%	-67%	n/a	n/a

Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, Morgan Stanley Research. Relative performance vs. index represents max drawdown or max boost of relative performance for each industry vs. MSCI China, since the start of the tightening campaign. Relative valuation change vs. index represents max de-rate or re-rate of relative forward P/E for each industry vs. MSCI China, since the start of the tightening campaign. Market cap change represents max decline or increase of aggregated market cap for each industry, since the start of the tightening campaign. *Supply side structural reform was beneficial for the old economy sector, hence, the performance, valuation and market cap changes are positive.

Risks and signposts to watch

Exhibit 6: Key policy risks to watch

Source: Morgan Stanley Research

Exhibit 7: Signposts to gauge whether a perceived growth/sustainability balance is attained

- **Chinese firms resume offshore IPOs**, with data-rich tech firms getting listed in HK while firms in less sensitive sectors getting listed in the US
- **Major digital platforms systematically improve social benefit for flexible workers** (riders/drivers)
- **Key fintech companies fully comply with regulatory requirements,** with some greenlighted for IPOs
- **Top leadership clarifies the overarching governance framework** to ease uncertainty

Source: Morgan Stanley Research

Exhibit 8: Morgan Stanley China Equity Strategy framework – Regulatory cycle remains a key component

		2018	2020 Post Covid-19	Q1 2021	2H 2021
1	Economic/ Earnings Estimates	x	✓	✓	Neutral
2	Valuation	x	✓	x	Neutral
3	Policy Cycle	x	✓	x	x
4	Liquidity	x	✓	x	x
5	US/China tension	x	Neutral/ Slightly negative	Neutral/ Slightly negative	Neutral/ Slightly negative
6	USDCNY trend	x	✓	x	Neutral
7	Regulatory	x	Neutral	x	x
		Downgrade to EW	Upgrade to OW	Downgrade to EW	Stay EW

Source: Morgan Stanley Research.

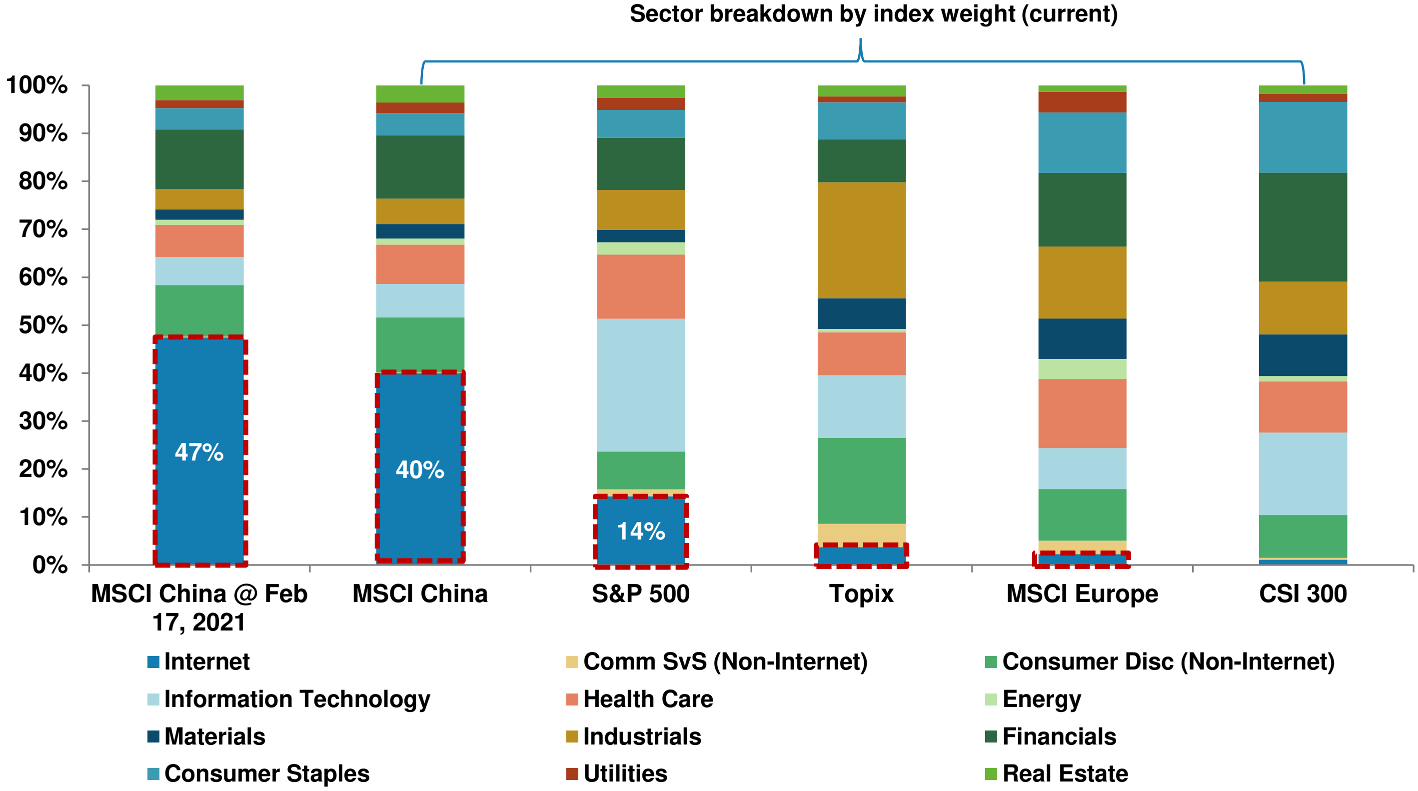
Challenges and opportunities by segment/theme

Exhibit 9: Equity market implications – challenges and opportunities by segment/theme

	Segment	Rationale
Income Inequality/ Social Risks	**Positive:** - Innovative biotech and pharmaceutical companies with well-differentiated drugs. - Medical technology - Mass consumption/domestic brands - Commercial insurance (medical + retirement)	**Healthcare:** As the Chinese population ages and new therapies become more expensive, the government aims to include more new drugs on the public insurance list. However, these drugs must show clear clinical value. Broadening the list will improve patient access, particularly for low-income groups. **Mass consumption/domestic brands:** narrowing income gap will help boost spending power of the masses; domestic brands get increasing prominence **Insurance:** The promotion of medical insurance and pensions helps alleviate funding pressure caused by aging population of government-backed social insurance plans.
Income Inequality/ Social Risks	**Negative:** - Food delivery / ride hailing (social benefit of flexible employment) - Platform companies (antitrust) - Property developers - Property management	**Food delivery / ride hailing:** The announced guidelines around platforms' resonsibility in riders' social insurance present risks to profitability of food delivery business. **Platform companies:** Forced exclusivity will not be allowed, more moderate M&A pipeline, normalized subsidies for transactional business. **Property developers:** The policy stance of "stabilize property price, land price and expectations" implies ongoing price cap for properties in popular cities, which will ultimately weigh on developers' margin. **Property management:** Labor rights protection for dispatched staff is aimed at mitigating the inequality issues, which may be a potential earnings drag in mid-term.
National Security Risks	**Positive:** - Cybersecurity - Semi-localization - Basic software	**Cybersecurity:** Regulatory scope for data security will expand and bring bigger market size for cybersecurity vendors **Semiconductors:** Given US tech export control on semiconductors, national policies should favor semiconductor industry to accelerate semi localization progress. **Basic software:** software localization will be accelerated given existing reliance on foreign vendors
National Security Risks	**Negative:** - Data rich tech companies (particularly with large user base)	**Data rich tech firms:** More hurdles for these companies to seek foreign listing given the concerns over cross-border data security risks, particularly those with large user base
Financial Risks	**Positive:** - Insurance asset management	**Insurance asset mgmt:** As a large investor in the equity and bond markets, a better mangement of financial risks can help promote and sustain longer term value.
Financial Risks	**Negative:** - Property developers	**Property developers:** Given the continuing credit tightening, developers can no longer rapidly grow by adding financial leverage, indicating normalizing sales growth.
Environmental Risks	**Positive:** - Data centre - Steel, Aluminum - Lithium, Cobalt, and Solar Glass - Renewable hydropower/Wind/Solar - City gas	**Data centre:** More stringent environmental standards set higher entry barriers for the sector, which deters new entrants with low capability. This results in more balanced market dynamics. **Steel, Aluminum:** the governemnt implement production/ capacity control for carbon neutrality which support price and margin **Lithium, Cobalt, and Solar Glass:** adoption of renewable energy and EV will be accelerated under carbon neutrality committment, which will drive up the raw materials price for the EV/Solar space **Renewables:** Renewables power will become the primary energy source in China's power system **City gas:** Near-term gas demand growth would be supported by policies to replace coal with natural gas.
Environmental Risks	**Negative:** - Coal power	**Coal:** China is likely to gradually tighten up baselines and small and inefficient coal power units would be pushed to shutdown.

Source: Morgan Stanley Research.

Exhibit 10: Sector mix of major equity indices – we expect a structural shift in sector mix of MSCI China to be less Internet-heavy



Source: Factset, Datastream, Morgan Stanley Research. Data as of July 28, 2021 unless otherwise stated. *Internet includes Media & Entertainment under GICS industry group and Internet & Direct Marketing Retail under GICS industry.

Understanding China's Regulatory Reset

Over the last 9 months, China has imposed new regulations on fintech, big tech, after-school tutoring, cryptocurrency, and carbon emissions. Here is our attempt to de-mystify China's regulatory reset, explore which business models could be affected under the new model, and identify signposts for future regulatory changes.

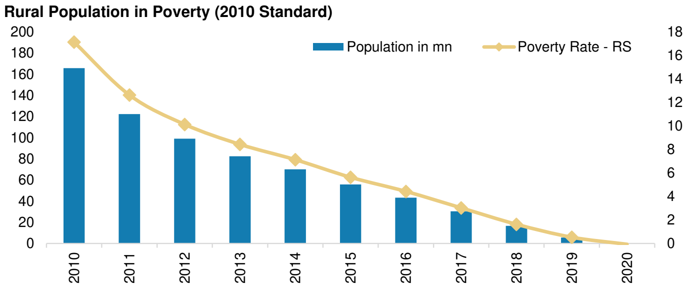
New era, new objective…

We believe the recent regulatory tightening reflects a shift in China's governance priorities from "growth first" to balancing growth and sustainability – i.e., **security, self-sufficiency, and social equality.** In the last decade Beijing said its key goal was to double per capita income and eliminate absolute poverty (President Xi's inaugural speech in Nov. 2012), i.e., giving highest priority to growth. However, this "pro-growth" strategy also led to higher inequality and social problems due to lack of regulations on emerging sectors, pointing to the importance of "pro-poor" measures as a complement (see World Bank (2004): Pro-growth, pro-poor: Is there a tradeoff?). Now, the government is emphasizing "getting rich together" (common prosperity) as the new objective for the next stage of development in the midst of the CCP's 100-year anniversary, and aims to "prevent the unbridled expansion of capital" by introducing a range of KPIs besides economic growth, which covers social equality, supply chain self-sufficiency and data security in the face of rising secular risks – income inequality, US-China tensions, and aging demographics.

Reflecting this reorientation, policymakers have intensified regulations in the past 9 months over fintech, big tech (anti-trust, data regulation and employee protection), after-school tutoring, cryptocurrency, carbon emissions and overseas IPO rules. The anti-trust campaign has mainly targeted the prevention of tech giants from an over-concentration of market power and eroding welfare of smaller businesses and outsourced employees; the fintech regulation serves the purpose of curbing regulatory arbitrage and financial stability risks; and the increased scrutiny over Chinese ADRs and cross-border data flow in July 2021 mainly focuses on reducing risks of security amid lingering geopolitical tensions. Similarly, the recent regulatory changes to after-school tutoring are part of policy efforts to reduce child-raising costs.

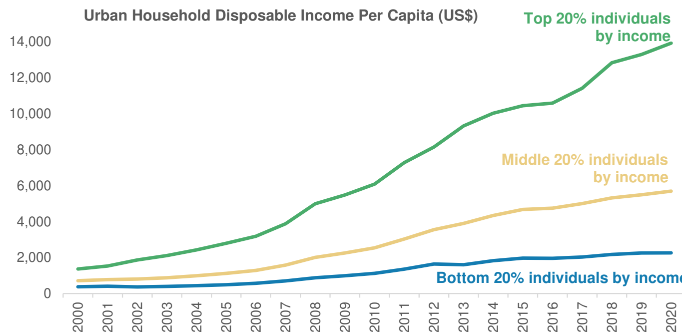
In short, China is trying to rebalance the rise in corporate power and the share of labor compensation, and this may lead to some systematic de-rating in valuations for some sectors. Having said that, policymakers will have to strike a balance, as China's ambition to thrive as an economic super power will require it to ensure continued private sector vitality to spur innovation and further RMB internationalization to attract capital inflows, so as to sustain long-term productivity growth. While the new regulations introduce more requirements on social responsibility and data usage, and might lead to some increase in margin pressures for related enterprises, we think they will not disrupt business models for most sectors (except for after-school tutoring). For instance, the anti-trust law mainly focuses on banning tech-giants from requiring merchants to sign exclusive cooperation pacts, while the government's guidance on enhancing flexible workers' social benefits mainly requires food delivery platforms to pay healthcare and pension coverage for outsourced employees. Online goods sales have also held up quite well recently despite the tech regulation campaign starting from late last year. Meanwhile, some regulatory changes are supportive for advanced manufacturing, hardware localization, and clean energy supply chain.

Exhibit 11: Shift of policy priority from eliminating extreme poverty over the past decade...



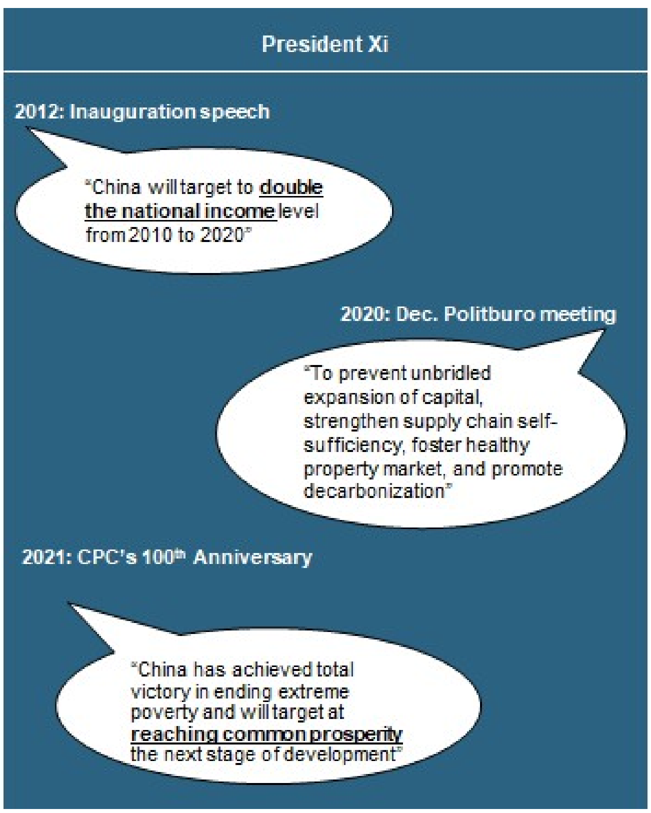
Source: CEIC, Wind, Morgan Stanley Research

Exhibit 12: ... to mitigating income inequality



Source: CEIC, Wind, Morgan Stanley Research

Exhibit 13: Shift of policy focus from pro-growth to pro-poor



Source: Xinhua, Morgan Stanley Research

Exhibit 14: Online goods sales held up well in 1H21 despite tech regulations

Source: CEIC, NBS, Morgan Stanley Research

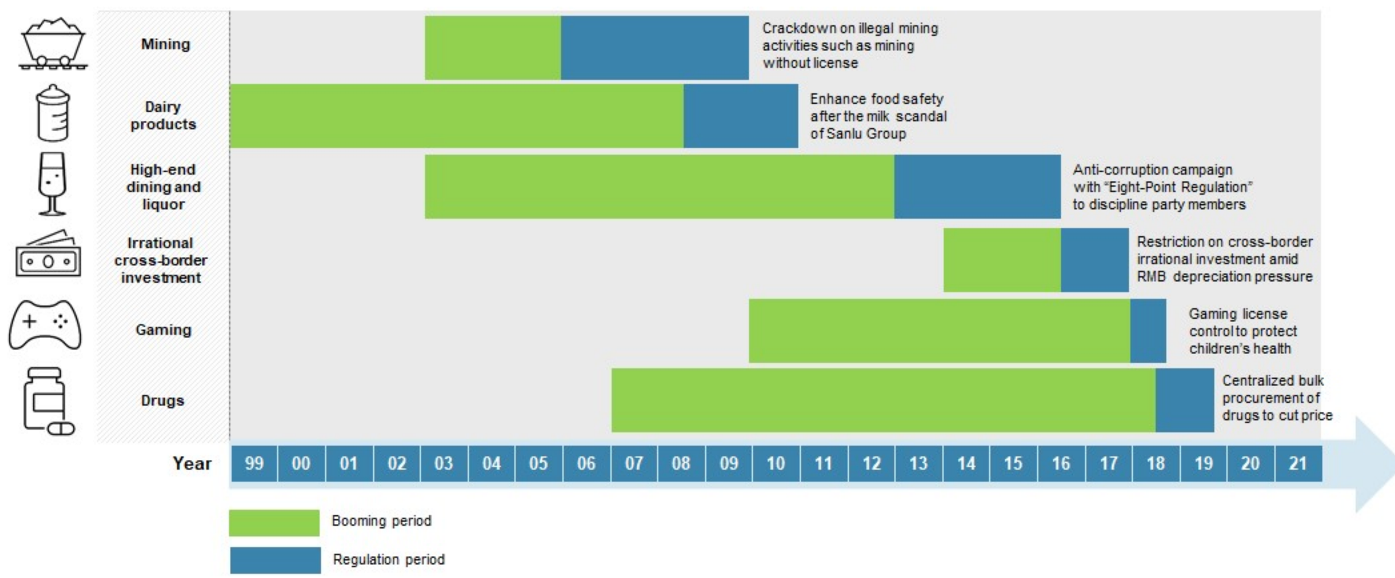
…but history rhymes

While many of the regulations appear long-overdue and make sense (for example on fintech, anti-trust and outsourced labour protection), the pace of changes in last 9 months has caught the market off-guard as a seemingly arbitrary shift in direction.

Why has it occurred in such fashion? We have indeed seen this movie many times: **China's regulatory environments have tended to oscillate between relaxed and tight enforcement, especially in emerging sectors.** But this has tended to result in an **abrupt regulatory reset**. Before the current reversal in regulating big tech, China had a regulation campaign on mining (2006-2009), dairy (2008-2010), high-end dining and liquor (2013-2014), irrational capital outflows (2016-17), gaming (2018), and drugs (2018-2019) – most lasting for one to two years. The sharp shifts in regulatory changes have been largely due to the fact that regulations have tended to lag a period of exponential growth in the sector:

- **Relaxed stage:** Local government support, pro-growth mentality and business interests together contributed to a lag in regulating emerging sectors.
- **Tight regulation stage:** When a problem is looming as evidenced by public opinion and/or financial stability indicators, the top leadership shifts gears, quickly mobilizes all administrative resources to reorientate its policy control and bolster its regulatory capacity.

Exhibit 15: China's volatile regulatory cycle: from relaxed to tight owing to lagged regulation in early periods of exponential growth



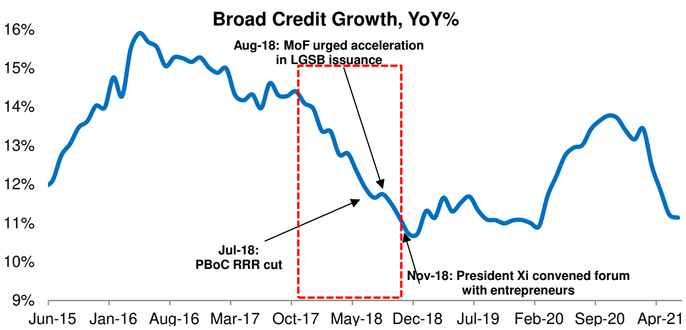
Source: Morgan Stanley Research

However, the abrupt shifts in policy tend to hurt market confidence and would benefit from more clarity: In past regulatory cycles, capital markets usually underperformed at the start, reflecting weaker market sentiment in the face of policy uncertainty, suggesting the need for greater policy communication. Historical patterns suggest that as an initial step to restore private sector confidence, minister-level officials attempt to clarify policy goals publicly. But if this communication is insufficient to temper concern and eventually weakness in private confidence hurts the job market, top-level policymakers tend to step in.

Here we can take 2H18 as an example, when the triple headwinds of deleveraging, regulatory tightening, and US-China trade tensions triggered market concerns about "state advances, private sector retreats". By then, while policymakers already shifted to an easing stance in July 2018 with PBoC's targeted RRR cut, followed by the Ministry of Finance's urge to accelerate local govt. bond issuance in August 2018, it did not stop the deterioration in broad credit growth and private sector confidence. In response, China's President convened a forum with entrepreneurs in November 2018 to send a clear signal on supporting private firms.

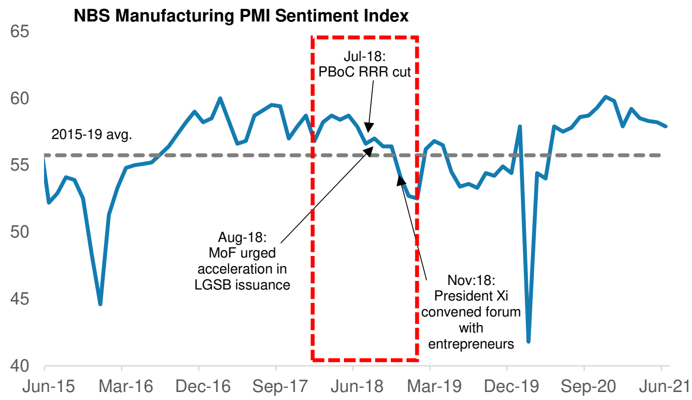
We also see a similar pattern emerging from the government in trying to provide clarity in this cycle. For instance, China's Vice Premier spoke at a business forum on July 27, saying that the nation would "strike a balance between growth and safety, to ensure social fairness and competition, and promote healthy development of the capital market". According to Bloomberg, the China Securities Regulatory Commission (CSRC) also told major investment banks on July 28 that the education policies were targeted and not intended to hurt companies in other industries. Separately, the government of Zhejiang province (one of China's richest provinces) clarified in mid-July that the "common prosperity initiative" does not mean "absolute equal". We will be watchful on the potential impact of intensified regulations on private sector confidence, and see if the existing government clarifications are sufficient to restore market sentiment.

Exhibit 16: President Xi's November forum with entrepreneurs in 2018 helped stabilize broad credit growth...



Source: CEIC, Morgan Stanley Research

Exhibit 17: ...and private sector confidence



Source: CEIC, Morgan Stanley Research

What is next?

The salient shift of governance priorities from "growth first" to balanced growth and sustainability means that sectoral regulations will likely continue to be realigned with the broader goals of social equality and national security. We thus see potential new regulation and/or detailed implementation plans in the coming years for sectors associated with the rising tensions of income and wealth inequality, rapid fertility decline, environment, and national security risks amid post-Covid de-globalization.

That said, as aforementioned, we think these regulations are more about rebalancing the rise in corporate power and the share of labor compensation, and would not necessarily view them through the lens of "state vs. private". Therefore, while we expect regulatory tightening on data-rich tech firms, platform companies, property developers to continue, sectors in-line with China's new economic agenda should continue to get support, such as semiconductor localization, cybersecurity software, innovative biotech and pharmaceutical companies with well-differentiated drugs, mass consumption/ domestic brands, vocational training, and green economy-related investment. For more equity investment analysis, please refer to China Equity Strategy: Implications for Long-Term Valuation and ROE; Opportunities amid Headwinds & Tailwinds . Understanding China's Regulatory Reset

Are there signposts to help us navigate the outlook based on past regulatory changes?

While China's regulatory changes appear less transparent than western counterparts, we do observe similar cycles marked successively by early warning signs, the formal process of drafting and releasing the regulatory documents, and official remarks signaling the end of the campaigns.

1. **Early warning signs:** These include increased social awareness/anxiety, public discussions, and meaningful deterioration in major macro level indicators, usually lasting 1-2 years (or possibly longer). For example, the latest crackdown on after-school tutoring followed top leaders' negative assessment of the sector's impact on children back in Sep-2018, but rapid growth continued, imposing a significant financial burden on middle income households. The antitrust campaign on tech giants was preceded by years of discussion over the controversy from "pick one from two" – a practice that came under the spotlight in 2015, which means platforms force merchants to have exclusive partnerships or distribution channels. Meanwhile, prominent macro-level regulatory campaigns include the financial cleanup since 2017 (following the five-year rapid rise in debt-to-GDP ratios) and capacity cuts in 2016-18 (following multiyear PPI deflation that further deepened in 2015).

Exhibit 18: Four key areas of policy focus

Policy Goal: To Balance Growth and Safety		
Social Risks	**Tech giants:** To tackle rising tensions of social inequality	✓ Take up responsibility on welfare of flexible workers ✗ Monopolistic behavior with disregard for social welfare
	Education: To ease parents' burden associated with children's education expenses and time	✓ Increase public school resources, vocational training ✗ Profit-oriented afterschool tutoring
	Housing: To meet living demands of urban dwellers	✓ Property rental market ✗ Housing speculation, over-leveraged developers
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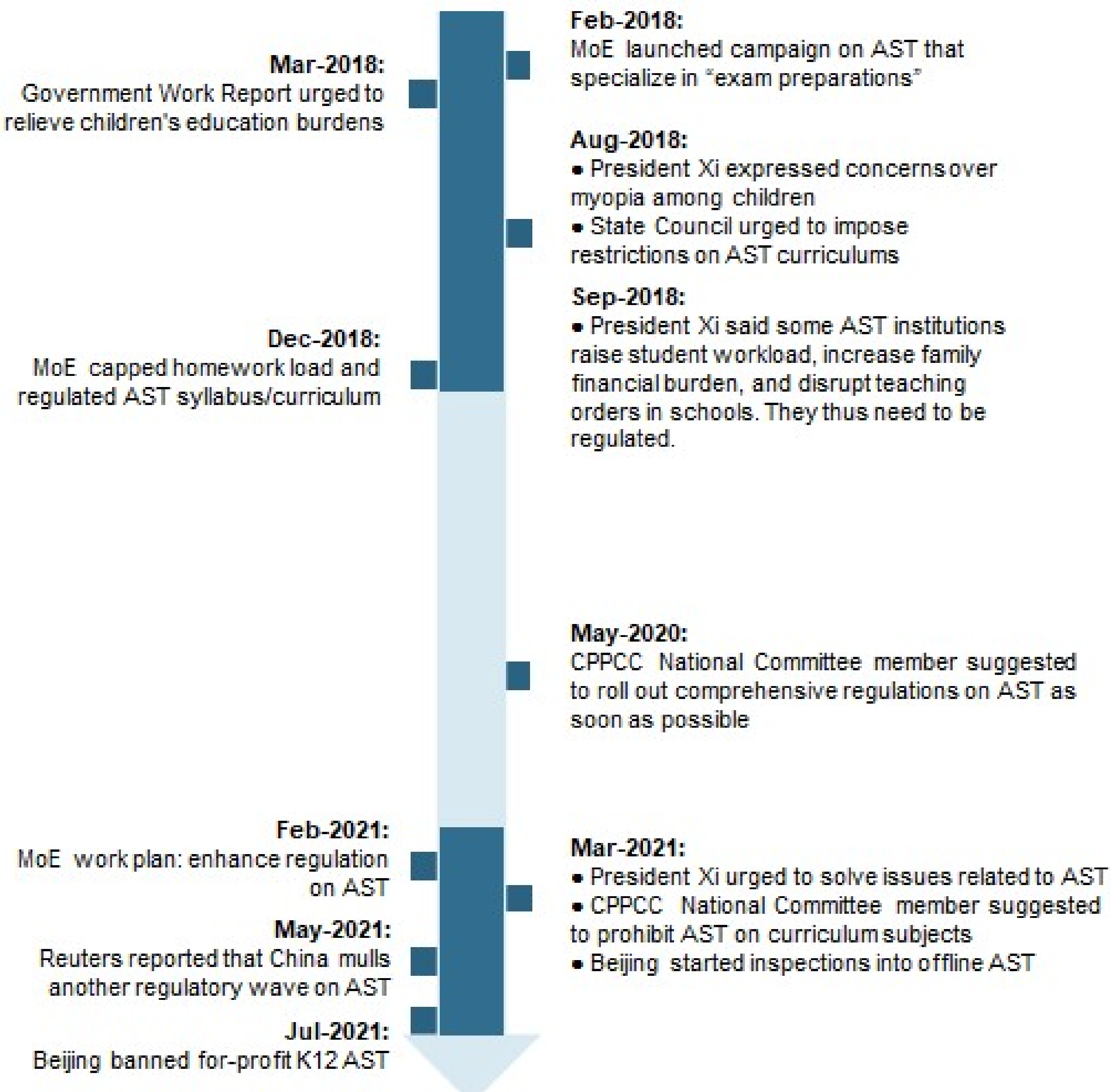
National Security Risks	**ADR & overseas listings:** To reduce national security risks, particularly for overseas listing of data-rich tech companies, and enhance monitoring of data flows	✓ Mainland/HK listing; data and algorithms store in China ✗ Overseas listings of data-rich tech firms
	Semiconductors: To enhance self-sufficiency	✓ China-designed chips, next-gen technology such as 5/6G, IoT, quantum networks, and blockchain
	Software: To strengthen cybersecurity	✓ Leading cybersecurity players with big exposure to the public sector
Financial Risks	**Fintech:** To curb regulatory arbitrage and financial stability risks	✓ Entities in line with leverage constraints and capital requirements, proper oversight on data usage ✗ Players with high leverage, low capital, and product/credit concentration risks
	Capital flows: To promote RMB asset internationalization	✓ Orderly increase of two-way flows ✗ Speculative capital flows
Environmental Risks	**Decarbonization:** To reach peak emissions by 2030 and carbon neutrality by 2060	✓ Clean energy, smart grid, electrification, green financing ✗ "Brown assets"

Source: Government announcements, Morgan Stanley Research

2. **The start of the formal regulatory cycle:** This is usually marked either by approval of draft regulations at high-level government meetings or the release of a publicly accessible version for comment. The final document usually publishes 9-12 months later. For example, the latest regulatory document on capital market irregularities had been drafted and approved last November. In addition, the government will often release detailed plans for implementation, accompanying the original (and usually high-level) guidelines.
3. **Signs of reaching the final stages:** For regulatory campaigns that have progressed relatively more smoothly, policymakers usually declare good results in high-level meetings – such as "decisive progress in the three critical battles against poverty, pollution and financial risk" at the 2021 NPC. On the other hand, for campaigns that brought about meaningful side effects, policymakers tended to soften their stance by, for example, calling for more market- or law-based implementations (e.g., the latter stage of the supply side reforms). In rare cases when private sentiment was severely undermined on a broad scale, China's top leadership has reaffirmed its policy support with measures such as VAT cuts, lower social insurance payment ratio, better funding support, and further reforms and opening up.

Exhibit 19: Case study: origin and development of after-school tutoring (AST) regulation



Source: Morgan Stanley Research

Emergence of new norm following the regulatory shocks: Past experiences suggest that each regulatory wave tends to last for 1-2 years, during the start of which capital markets usually underperformed amid rising risk premiums, but eventually the real economy and capital market adjusted to the new policy framework. As we argued above, most of the ongoing regulation (except for after-school tutoring) mainly focuses on striking a balance between the rise in corporate power and the share of labor compensation rather than aiming to revamp or terminate prevailing business models. In this sense, we believe the key signposts for an end to the current tech regulatory cycle could include:

1. A resumption of offshore IPOs by Chinese firms within less data-sensitive sub-sectors,
2. A systematic improvement in key digital platforms' social benefit packages for flexible workers, and
3. Major fintech companies getting the greenlight for IPOs after fully complying with regulatory requirements.

Key policy risks to watch

We think the key risks lie mainly in China's endogenous growth momentum and external funding. First, while our base case assumes that policymakers can strike a balance between regulation and private sector vitality under the new policy framework, an inherent tendency to over-regulate could stifle private sector confidence and innovation. Second, a lack of sufficient communication and coordination would not only disrupt business operations, but could also discourage foreign investment amid additional informational and cultural barriers. These could slow the pace of capital formation and undermine overall productivity growth in the economy.

Although some short-term pain arising from overdue regulation that follows a prolonged period of unregulated growth is inevitable, we see ways of mitigating the policy overhang.

1. A more anticipatory regulation framework and forward guidance for emerging industries could offer greater visibility and transparency, giving businesses sufficient time to adjust.
2. On policy coordination, regulatory policies would benefit from being pursued in an integrated manner in order to reduce trade-offs and maximize synergies. For example, it might be true that technology in the data era could boost growth, but it could also worsen income inequality, given its effect of favouring capital over labour and favouring skilled over unskilled labour. However, policymakers could narrow income disparities and help to defuse potential negative social impact by accelerating the urbanization 2.0 strategy and increasing fiscal transfers to optimize the social protection network.

Exhibit 20: Signposts to gauge whether a perceived growth/sustainability balance is attained

Source: Morgan Stanley Research

Exhibit 21: Key policy risks to watch

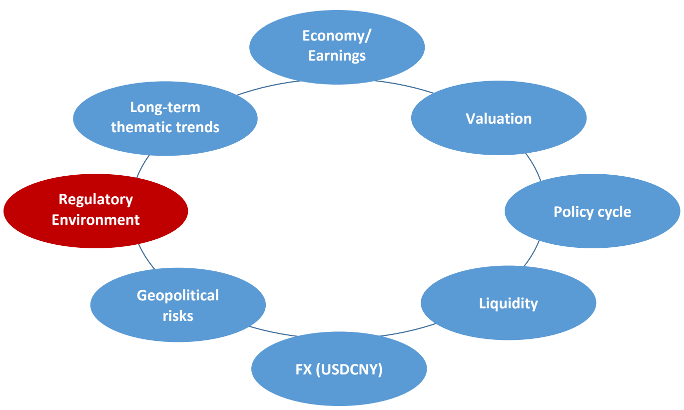
Source: Morgan Stanley Research

China Equity Strategy: Implications for Long-Term Valuation and ROE; Opportunities amid Headwinds & Tailwinds

Executive Summary

Regulatory reforms – an essential factor in our equity market framework. Shifts and changes in the regulatory environment have always been an essential part in our evaluation framework for China's equity market , along with other key factors such as macro business cycles, and their impact on earnings and liquidity cycles, and their impact on valuations (Exhibit 22). **They were a key driver for two of our rating changes for China's equity market since 2018** (June 2018, January 2021, Exhibit 23).

Exhibit 22: Morgan Stanley's evaluation framework for China's equity market – the regulatory environment has always been an essential factor for consideration



Source: Morgan Stanley Research.

Exhibit 23: Morgan Stanley's China Equity Strategy framework

		2018	2020 Post Covid-19	Q1 2021	2H 2021
1	Economic/ Earnings Estimates	x	✓	✓	Neutral
2	Valuation	x	✓	x	Neutral
3	Policy Cycle	x	✓	x	x
4	Liquidity	x	✓	x	x
5	US/China tension	x	Neutral/ Slightly negative	Neutral/ Slightly negative	Neutral/ Slightly negative
6	USDCNY trend	x	✓	x	Neutral
7	Regulatory	x	Neutral	x	x
		Downgrade to EW	Upgrade to OW	Downgrade to EW	Stay EW

Source: Morgan Stanley Research.

We expect a longer and more profound impact from the current regulatory cycle on valuations and Equity Risk Premium (ERP) for China's equity market than has occurred in similar past cycles:

Three key reasons make us convinced that **Chinese equity market valuation will likely fall towards our June 2022 base case P/E target of 13x for MSCI China from current 13.7x level, rather than reversing the recent substantial de-rating from ~18x in mid Feb.**

- The changes are an integral part of long-term national growth plan;
- Regulation is affecting a more substantial proportion of the market than previously and in particular the internet sector (mostly ADRs where foreign ownership is higher vs. HK listed and A-shares), which accounts for ~40% of MSCI China by index weight.
- There is a substantial degree of uncertainty over what this regulatory cycle means both for future net income margins and revenue growth for the affected sectors and stocks.

How to position – avoid ongoing headwinds and align with the tailwinds: Taking into account the framework for ongoing regulation suggested by our economics team, we summarize markets, sectors and segments that could potentially suffer or benefit as a result (Exhibit 24).

Exhibit 24: How to position in the new sustainability driven growth era

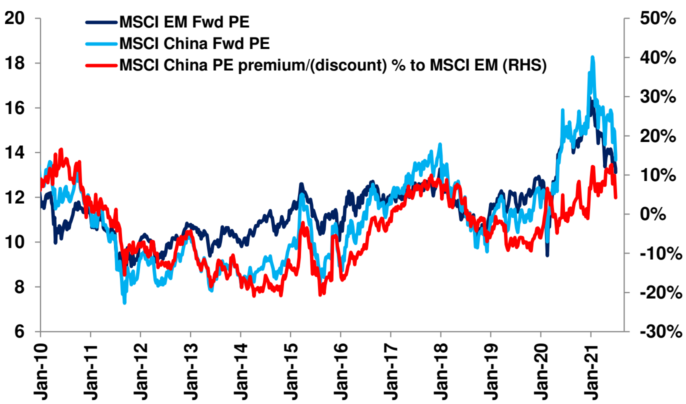
Financial Risks	• **Positive:** Insurance asset management • **Negative:** Property developers
Social Risks	• **Positive: 1)** Innovative biotech and pharmaceutical companies with well-differentiated drugs; **2)** Medical technology; **3)** Mass consumption/domestic brands; **4)** Commercial insurance (medical + retirement) • **Negative: 1)** Food delivery / ride hailing; **2)** Platform companies; **3)** Property developers; **4)** Property management
Environmental Risks	• **Positive: 1)** Data centre; **2)** Steel, Aluminum; **3)** Lithium, Cobalt, and Solar Glass; **4)** Renewable hydropower/Wind/Solar; **5)** City gas • **Negative:** Coal power
National Security risks	• **Positive: 1)** Cybersecurity; **2)** Semi-localization; **3)** Basic software • **Negative:** Data rich tech companies, particularly with large user base

Source: Morgan Stanley Research

If we are right with our current base case forward P/E target for MSCI China of 13.0x, then we think MSCI China would trade on a mid-single-digit percentage valuation discount to MSCI EM ex China for a sustained period of time: China last traded at a sustained discount to EM (Exhibit 25) on forward P/E in the period 2011-2017 when investors concerns were focused on China's high macro leverage and poor ROE trends in the state-owned enterprise sector, with potential knock-on impacts to financial stability and the currency. We argued in our early 2017 Blue Paper that these concerns were overdone and that China's superior ROE and US$ EPS and DPS trends versus other EMs warranted at least valuation parity, if not a premium. By early this year MSCI China had re-rated to an all-time high valuation of close to 18x forward P/E and a 10% premium to EM. Now MSCI China trades at 4% premium vs. MSCI EM, after de-rating recently. We therefore see further room for relative de-rating for China.

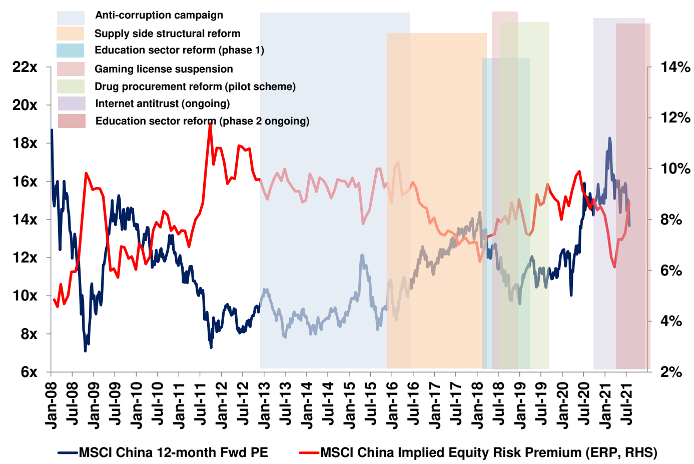
The Implied Equity Risk Premium also still falls short of peak levels during prior episodes of market concern over macro, regulatory changes, and systemic risks (Exhibit 26). We believe the rising ERP trend will sustain in the near term as well.

Exhibit 25: 12-month forward P/E of MSCI China and MSCI EM – we expect MSCI China to trade on a mid-single-digit % valuation discount to MSCI EM ex China for a sustained period of time



Source: Datastream, MSCI, Morgan Stanley Research. Data as of July 30, 2021.

Exhibit 26: MSCI China 12-month forward P/E vs. MSCI China Implied Equity Risk Premium – implied ERP picking up but not yet on par with historical peak range, unlikely to revert soon



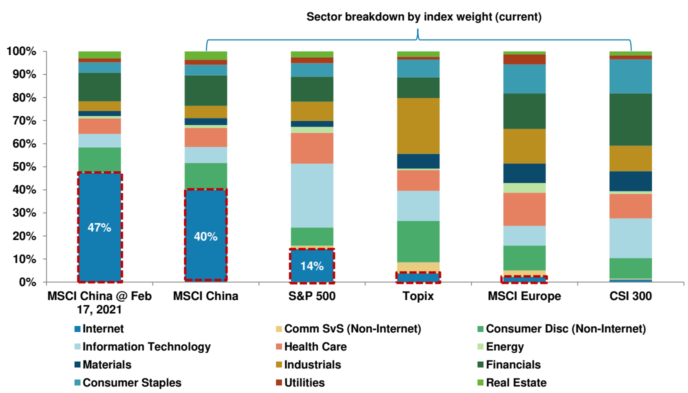
Source: Factset, Bloomberg, IBES, Datastream, MSCI, Morgan Stanley Research. MSCI China forward P/E data as of July 30, 2021 while MSCI China ERP data is monthly data as of each month-end except for as of July 29, 2021 for the latest month.

Structural shift in equity universe composition and ROE distribution highly likely: We expect the internet's sector weight in the China equity space to come down over time, to significantly lower than its current 40%. Instead we expect IT and Industrials' share to rise from a collective 12% to a much higher proportion of the index. We also expect some moderation of ROEs for the large internet companies over time, as more restrictions are applied to the platforms (the big bubbles in Exhibit 29 are moving generally in the lower-left direction). **China's ROE-P/B profile has quickly shifted to below the global trendline now but may continue to move left under ROE pressure** (Exhibit 28).

We argue things are sufficiently uncertain right now such that it is not yet time to turn broadly bullish on Chinese equities. The following concerns by global investors have not been fully addressed:

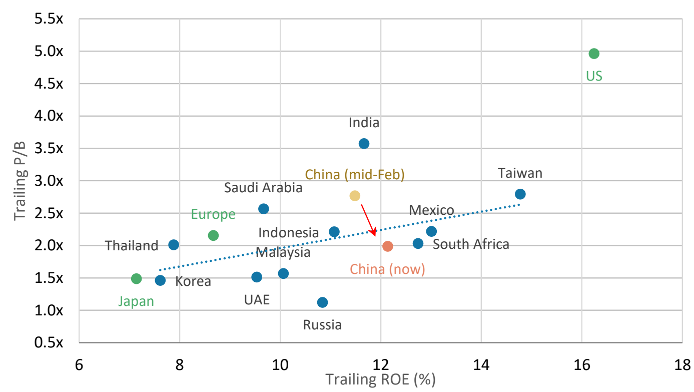
- What is the long-term future for offshore Chinese equities? (ADR delisting risk due to cyber security/access to company audits; will future offshore listings still be possible?)
- Will foreign investors still be able to invest in Chinese companies? (VIE structure concerns, foreign ownership cap in the A-share market.)

Exhibit 27: Sector mix of major equity indices – we expect a structural shift in sector mix of MSCI China to be less Internet-heavy



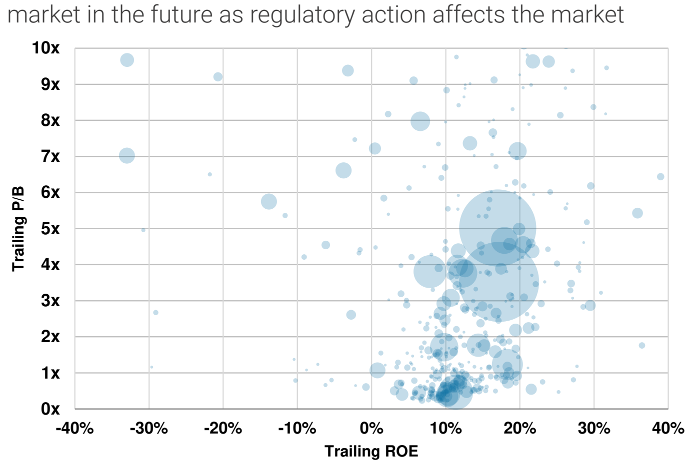
Source: Factset, Datastream, Morgan Stanley Research. Data as of July 28, 2021 unless otherwise stated. *Internet includes Media & Entertainment under GICS industry group and Internet & Direct Marketing Retail under GICS industry.

Exhibit 28: PB vs. ROE for MSCI EM market constituents and developed economies – valuation for MSCI China has de-rated significantly but its ROE profile may deteriorate as a result of China's regulatory reset



Source: RIMES, Morgan Stanley Research. Data as of July 29, 2021. MSCI indices are used to represent each market/economy.

Exhibit 29: P/B vs. ROE for MSCI China constituents – we expect to see a lower dispersion in both ROE and P/B for the MSCI China market in the future as regulatory action affects the market



Source: RIME, Factset, Morgan Stanley Research. Data as of July 28, 2021. Bubble size represents constituents' index weight within MSCI China.

At the sector level, study of past regulatory episodes suggest a negative impact on both valuations and fundamentals in most cases: Our study shows that all previous sector regulatory cycles resulted in various degrees of underperformance and valuation derating vs. MSCI China, except for supply side reform, which had caused designated sectors (old economy) to outperform through reduced debt levels, and improved margins and ROE. The time taken to reach the down-cycle trough has ranged between 5-30 months, while the time taken to recover the underperformance has been between 3-37 months.

We keep in mind that there could be fundamental differences in the current regulatory cycle vs. the previous ones when trying to draw references from the past, as the current cycle is more systematic and likely more persistent given the alignment with China's new era sustainability initiatives. For more details please see Equity market lessons - Near-term market volatility in aspiration for long-term sustainability.

Equity market lessons – near-term market volatility in aspiration for long-term sustainability

We studied seven major episodes of industry specific regulatory reforms since 2012, spanning over six industries (consumer, Internet, healthcare, old economy, etc.) and present the highlights of three – Anti-corruption between Nov. 2012 - June 2016, curbing conglomerates' overseas investments between 2016 - 2017, and Supply Side Reform between Dec. 2015 - 1Q 2018. We chose these three because they provide good examples how regulatory reform impact can vary so differently:

- Anti-corruption in the Chinese liquor space: a serious challenge at the sector level but recovery was realized through company/sector transformation.
- Supply-side reform for old economy sectors: provided an opportunity for ROE and efficiency improvement.
- Conglomerates overseas investment: a serious challenge with failure to recover for certain companies.

For other case studies featured in the table below, please visit Appendix II - Study of Major Episodes of Industry-Specific Regulatory Reforms .

Exhibit 30: Summary of relative performance, valuation and total market cap reaction to past episodes of industry level regulatory tightening

Regulatory event	Sector impacted	When	Duration (months)	Relative performance vs. index	Relative valuation change vs. index	Market cap change	Time taken to trough relative to index (months)	Time taken to recover relative to index (months)
Anti-corruption campaign	Consumer Discretionary	Nov 12 - Jun 16	44	-59%	-30%	-52%	30	37
Supply side structural reform*	Old Economy	Dec 15 - 1Q 18	28	41%	23%	49%	n/a	n/a
Education sector reform (phase 1)	Education (K-12 AST)	Feb 18 - Mar 19	14	-28%	-30%	-32%	5	14
Gaming license suspension	Internet / gaming	Mar 18 - Oct 18	8	-13%	6%	-42%	6	3
Drug procurement reform (pilot scheme)	Pharma	Jun 18 - Sep 19	16	-19%	-22%	-42%	8	4
Antitrust / cybersecurity regulation on internet companies	Internet	Since Nov 20 until now	9	-18%	-14%	-24%	n/a	n/a
Education sector reform (phase 2)	Education (K-12 AST)	Since May 21 till now	3	-53%	-58%	-67%	n/a	n/a

Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, Morgan Stanley Research. Relative performance vs. index represents max drawdown or max boost of relative performance for each industry vs. MSCI China, since the start of the tightening campaign. Relative valuation change vs. index represents max de-rate or re-rate of relative forward P/E for each industry vs. MSCI China, since the start of the tightening campaign. Market cap change represents max decline or increase of aggregated market cap for each industry, since the start of the tightening campaign. *Supply side structural reform was beneficial for the old economy sector, hence, the performance, valuation and market cap changes are positive.

Anti-corruption campaign: November 2012 – June 2016

The anti-corruption campaign was launched at the 18th National Congress of CPC in November 2012. The main efforts were concentrated between 2013-15 with realization of "full coverage" by the Central Commission for Discipline Inspection (CCDI) over key government agencies, party committees, as well as major SOEs and central financial institutions by February 2016. The initiative still continues but in a normalized way, with dedicated special inspection patrols conducted by CCDI on an annual basis.

We closely examine the shift of equity market dynamics between end-2012 and December 2015 to gauge the impact. Key regulatory announcements and measures are represented by:

- Opening of the 18th CPC National Congress on Nov. 8, 2012;
- "An Eight-Point Regulation" in December 2012 issued by the Politburo of the CPC Central Committee. The rules call for close contact with grassroots, more self-discipline among party members, outright rejection of extravagance, and reducing bureaucratic visits, meetings and 'empty talk'.
- A series of anti-corruption measures were subsequently implemented, such as banning luxury foreign vehicle brands from receiving new military license plates, barring government officials from using public funds in organizing extravagant galas, and banning provincial-level officials from taking official cars for general use.
- By 1H2016, eight rounds of inspection patrols by CCDI had been completed, accomplishing "full coverage" by CCDI over key government agencies, party committees, as well as major SOEs and central financial institutions.

Market implications: China White Liquor Index underperformed broad market by 59% in 30 months; Transformation through consumer spending upgrade with discounted ROE

The crackdown on graft had negative equity market implications on discretionary spending sectors, such as liquor, auto, luxury goods, and tobacco. We zoom in on the impact on white liquor names particularly as they suffered from tightening from multiple angles - government procurement, gifting, public funded entertainment, and other activities related to potential corruption.

- Our customized China White Liquor Index (equal-weighted index) underperformed CSI 300 for 30 months between November 2012 to May 2015. We estimate total underperformance of ~59% based on the performances of our customized White Liquor index and CSI 300 during the period (Exhibit 31).
- The index's valuation, measured by 12-month forward PE, had taken 12 months (November 2012 - October 2013) to trough, having derated by 6.6 P/E points from 16x to 9.4x (or a 30% relative change compared with the market valuation). It took another 13 months for the segment's valuation to re-rate to pre-anti-corruption campaign levels (Exhibit 32).
- Aggregate market cap of constituents of China White Liquor index shrunk by 52% between November 2012 and January 2014, when it bottomed. It took another 17 months for the segment's market cap. to recover to pre-anti-corruption regulation levels (Exhibit 33).
- Exhibit 34 shows the ROE trajectory for the white liquor sector. ROE peaked in 2012 at 40% and then deteriorated notably as the anti-corruption campaign progressed. It troughed in 2016 at 20% level and started to gradually recover. It is now stabilized at about 25%, which is significantly lower than its prior peak.

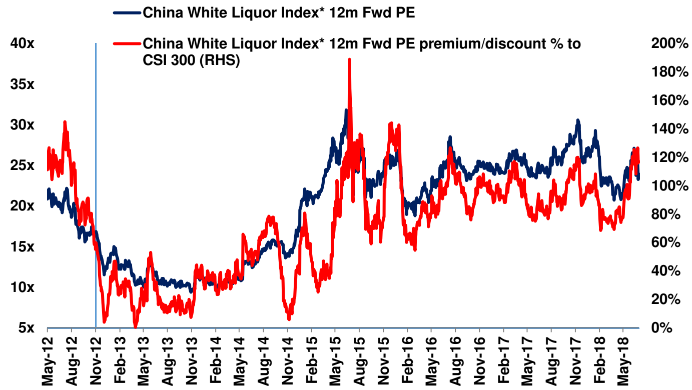
Conclusion: New business model after reform with earnings/profitability fundamentally discounted

White liquor's valuation and market cap. troughed much earlier compared to the segment's underperformance relative to the market. This illustrates how the segment's fundamentals (earnings) suffered from a prolonged negative impact due to restricted spending, much longer than the shock to sentiment and liquidity which happened more during the early stage of the regulatory tightening phase. The sector eventually recovered, not as a result of relaxation on anti-corruption, but more because of the consumer spending upgrade. However, sector ROE has never recovered to pre-regulation levels given lower margins. This provides an example of how a sector that had suffered a seemingly permanent negative impact on profitability could still recover and excel (transforming to cater for a larger market).

Exhibit 31: China White Liquor Index* relative performance vs. CSI 300 - the index underperformed relative to CSI 300 for 30 months with meaningful drawdown of 59% during November 2012 to May 2015

Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, Morgan Stanley Research. Data is from end April 2012 to end June 2018. *The index consists of 17 A-share Chinese white liquor stocks. The index is constructed on an equal-weighted basis with an inception date on end May 2012 and is rebalanced upon IPO day of each new listing during the period. Vertical line represents the start of industry level regulatory tightening.

Exhibit 32: China White Liquor Index* 12m Fwd P/E in absolute and relative terms vs. CSI 300 – its valuation de-rated by 7 P/E points (or 30% bin relative terms) from November 2012 to October 2013, and took another 13 months to recover to pre-tightening levels

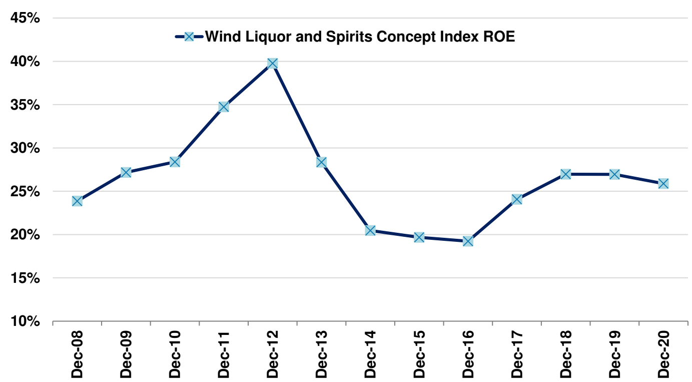


Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, Morgan Stanley Research. Data is from end April 2012 to end June 2018. *The index consists of 17 A-share Chinese white liquor stocks. The index is constructed on an equal-weighted basis with an inception date on end May 2012 and is rebalanced upon IPO day of each new listing during the period. Vertical line represents the start of industry level regulatory tightening.

Exhibit 33: China White Liquor Index* total market cap - aggregate market cap shrank by 52% in from November 2012 to January 2014, before taking another 17 months back to pre-anti-corruption tightening levels

Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, Morgan Stanley Research. Data is from end April 2012 to end December 2016. *The index consists of 17 A-share Chinese white liquor stocks. Total market cap is a simple summation of individual constituents' market cap and only includes stocks listed before tightening start. Vertical line represents the start of industry level regulatory tightening.

Exhibit 34: Trailing ROE trend of Wind Liquor and Spirits Concept Index* – ROE peaked in 2012 and then deteriorated; recovery started in 2016 but yet back to pre-anti corruption campaign level



Source: Wind, Morgan Stanley Research. Data as of each year end from 2008-2020. *Wind Liquor and Spirits Concept Index is an equal-weighted total return index comprised of 18 A-share white liquor companies and was launched by Wind on end October 2017.

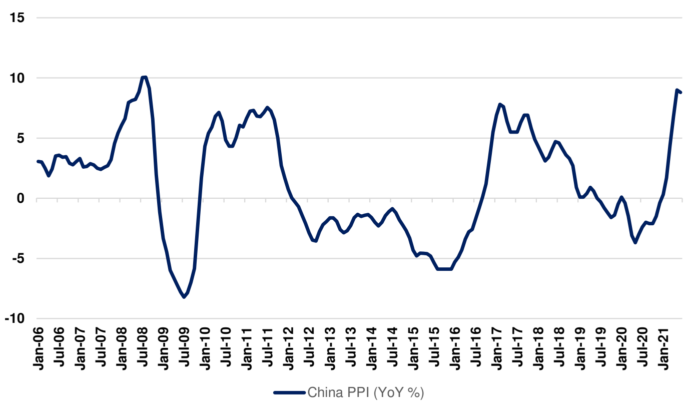
Supply-side structural reforms: December 2015 – 1Q 2018

Supply-side reforms were officially launched at China's Central Economic Work Conference in December 2015. This is an integral part of China's pursuit of high-quality economic growth and higher productivity by eliminating excess capacity, especially low efficiency capacity.

Overcapacity issues had occurred in the aftermath of the 2008-09 Global Financial Crisis' RMB4trn stimulus package, which had resulted in heightened investment in infrastructure and related cyclical industries, as well as a sharp rise in the overall debt-to-GDP ratio at the national level (Exhibit 36). This overcapacity had quickly led to continuous declines in upstream materials prices, as reflected by the sharp drop of PPI from 2011, with an extended period of material price deflation between 2012 to 2015, until supply-side reform finally kicked in (Exhibit 35). Some of the industries (i.e., steel) also suffered from a double whammy of overcapacity and declining demand due to pollution control.

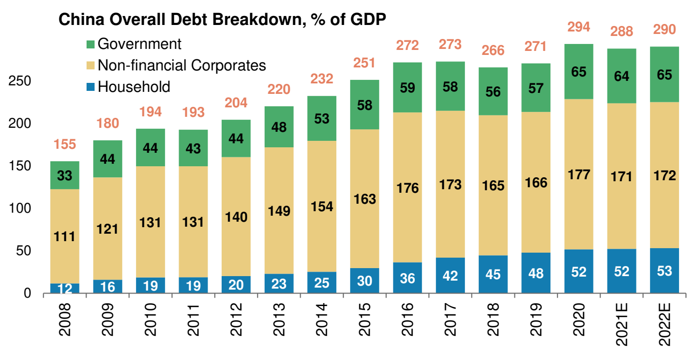
Key industries targeted by supply-side reforms included coal, steel, flat glass, cement, polysilicon, and wind power equipment. The reforms have been ongoing since and rolled out to other sectors.

Exhibit 35: China's PPI trajectory – PPI sharply declined since 2011 and entered deflation territory during 2012-2015, until starting to rebound in 2016 with supply side reforms



Source: CEIC, Morgan Stanley Research. Monthly data as of June 2021.

Exhibit 36: Breakdown of China's debt to GDP % – macro leverage has been on the rise rapidly since the GFC; it is likely to marginally come down and stabilize in 2021-2022



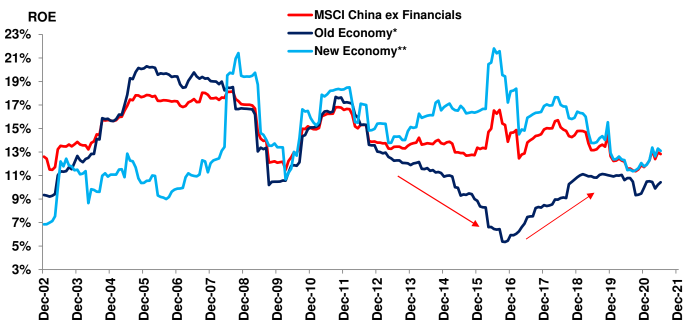
Source: CEIC, Morgan Stanley Research (E) estimates.

Old economy's debt/equity ratio declined ~20% and ROE more than doubled: Supply side reform and the associated over capacity reduction in the old economy (Materials & Industrials & Energy)/ cyclical sectors significantly improved investor returns through optimizing market demand-supply dynamics and deleveraging.

Old economy sectors' aggregate ROE had more than doubled since the launch of supply side reform (Exhibit 37), growing from the trough level at 5% in 2015 to above 10% by 2018 and has largely stabilized since. Overall the net debt to equity ratio has been declining, from the peak at 64% in 2016 to 46% most recently (Exhibit 38).

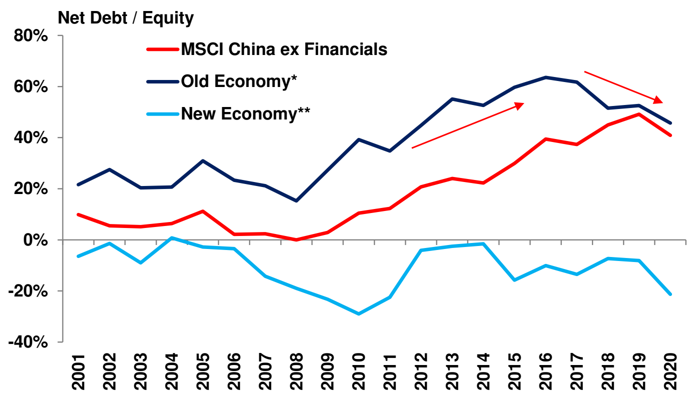
Taking steel as an example, the sector started to cut capacity in 2014 and more materially at the end of 2015. Steel prices troughed in December 2015 and industry leaders started to raise prices in early 2016. Industry utilization and profit margins also bottomed out at end 2015. See here for details. Capacity utilization was as low as 64% in 2015 and has been gradually on the rise as supply side reforms were rolled out and reached 86% in 2018 (Exhibit 39). As a result of declining unused capacity from 2015-2018, gross profit per ton for steel mills also got a notable boost for major steel products (Exhibit 40), which aided the sector's price performance.

Exhibit 37: ROE trend of New and Old Economy - ROE trend in Old Economy sectors bottomed out in October 2016 and showed major improvement since then



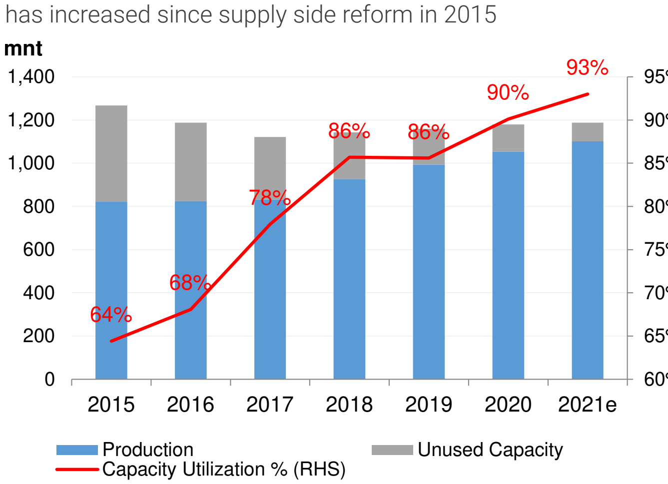
Source: Factset, MSCI, Morgan Stanley Research. Data as of end June, 2021. *Old Economy includes Materials, Industrials and Energy; **New Economy includes Consumer Discretionary, Consumer Staples, Media & Entertainment, IT and Health Care.

Exhibit 38: Old vs. New Economy debt leverage – debt leverage in Old Economy sectors has continued to decline since 2016



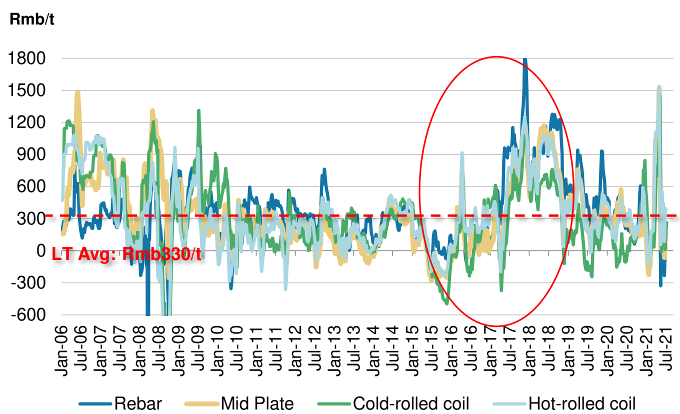
Source: Factset, MSCI, Morgan Stanley Research. Data as of each year end. *Old Economy includes Materials, Industrials and Energy; **New Economy includes Consumer Discretionary, Consumer Staples, Media & Entertainment, IT and Health Care.

Exhibit 39: China's crude steel capacity, production and utilization - unused capacity has been gradually coming down as utilization has increased since supply side reform in 2015



Source: NBS, Mysteel, Morgan Stanley Research estimates.

Exhibit 40: Morgan Stanley estimates of gross profit per ton for mills (spot) - profitability for various steel products saw a major boost in 2016 and 2017

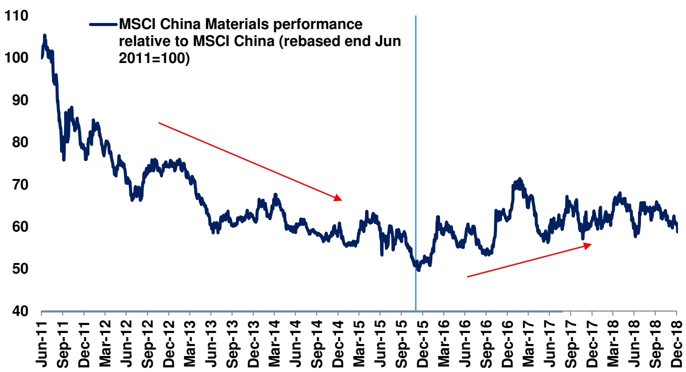


Source: Bloomberg, Mysteel, Morgan Stanley Research estimates.

Market performance and valuation implications (using the Materials sector as a proxy):

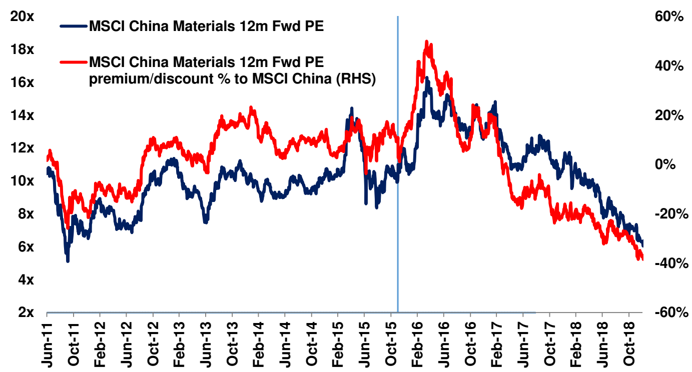
- MSCI China Materials finally started to outperform the broad MSCI China Index from 2016 after an extended period of underperformance since 2012, as the over-capacity and over-leverage issues had emerged (Exhibit 41).
- The outperformance peaked on February 2017, with a max increase of 41% from December 2015 and the index performance remained largely stable until April 2018, affected by macro policy tightening and US/China trade tension. Hence, total outperformance amounted to ~34% and lasted for 28 months.
- On the valuation front, Materials' valuation, measured by 12-month forward PE, re-rated by 4 P/E points from 10x to 14x (or 23% relatively vs. the market) during December 2015 to May 2016, when it peaked. Both absolute and relative valuation for Materials had peaked much earlier than the relative performance did, implying that improvement on the fundamentals side (earnings) lasted for much longer and continued to drive the sector's outperformance (Exhibit 42).

Exhibit 41: MSCI China Materials relative performance vs. MSCI China – Materials had a sustained period of underperformance in 2012-2015; outperformance started since December 2015 thanks to supply-side reform



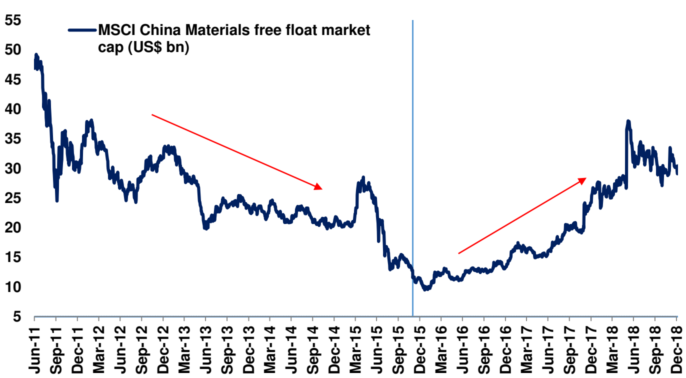
Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, MSCI, Morgan Stanley Research. Data is from end June 2011 to end December 2018. Vertical line represents the start of industry level regulatory tightening.

Exhibit 42: MSCI China Materials 12-month forward P/E in absolute and relative terms vs. MSCI China – both absolute and relative valuation for Materials peaked around six months after supplyside reform kicked in, much earlier than relative outperformance had ended



Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, MSCI, Morgan Stanley Research. Data is from end June 2011 to end December 2018. Vertical line represents the start of industry level regulatory tightening.

Exhibit 43: MSCI China Materials' free float market cap – continued to drop during 2012-2015; the sector started to re-grow after the start of supply side reform, up 49% during Dec 2015 and Feb 2017



Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, MSCI, Morgan Stanley Research. Data is from end June 2011 to end December 2018. Vertical line represents the start of industry level regulatory tightening. Free float market cap is proxied by MSCI index market cap provided by MSCI Index Company.

Regulatory curbs on Chinese conglomerates' overseas investments: 2016 – 2017

In order to prevent systemic risks in the financial system and better control capital outflows, Chinese regulators undertook a series of measures to rein in overseas acquisitions by Chinese companies. Key events included:

- At a press conference at end 2016, NDRC officials indicated that regulatory authorities were closely monitoring irrational overseas acquisitions in leisure and entertainment areas in particular.
- In January 2017, China issued guidance on outbound investments by centrally controlled state firms.
- Guidelines on overseas investment of SOEs were issued by the Ministry of Finance in August 2017 along with guidelines governing private companies' overseas investments in December.
- Chinese conglomerates including HNA Group, Anbang Insurance and Fosun emerged as major offshore assets buyers and were placed under close scrutiny by regulators. The China Banking and Regulatory Commission ordered banks to check their exposures to these four companies in June.

Close regulatory scrutiny not only led to a number of canceled overseas investments but also constrained availability of credit lines from banks to these Chinese conglomerates. In June 2017, China's banking regulator, via window guidance, asked banks to undertake rigourous risk reviews over exposures to these conglomerates. China Economic Weekly reported that banks' financing support for live overseas acquisition deals at the time was partially withdrawn.

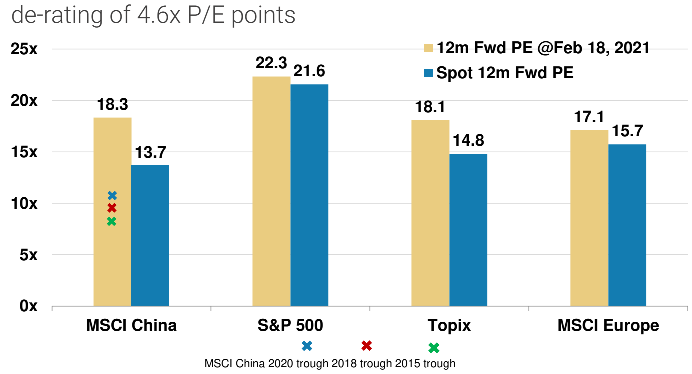
- Only Fosun (0656.HK) was listed at group level out of the four major conglomerates under close regulatory scrutiny. Since the introduction of these regulatory curbs in 2016, Fosun's share price has not recovered back to its pre-2016 peak of ~HKD21/share. It is current share price is around half of its pre-2016 peak levels.
- In June 2017, Chinese authorities asked banks to suspend some business dealings with Anbang Insurance Group (e.g. stop selling Anbang policies at their branch networks), according to Bloomberg reports. In February 2018, the government seized temporary control of Anbang Insurance. A government-appointed takeover team was set in motion to formulate detailed plans for changes in the company's shareholding structure, the sale of assets, any potential division of the company, and whether other insurers would be appointed to manage parts of Anbang's operations. On June 2018, Chinese regulators confirmed the transfer of nearly full ownership of Anbang Insurance to government-controlled China Insurance Security Fund.
- In July 2017, banks started to stop extending new loans to HNA Group. The company started a series of asset disposals. Fast forward to January 2021, HNA Group declared bankruptcy after debt restructuring efforts failed. As part of the restructuring, most of the shares of HNA Group will be transferred to its creditors.

Forward-looking risks and opportunities; investor concerns to address

Our bear case scenario (Exhibit 45) uses a forward P/E at 11.5x, another 2.2 P/E points lower than current consensus level at 13.7x. This scenario compared to our base case would entail additional future rounds of regulatory tightening action and sharper liquidity redemption than we currently expect. Historically MSCI China has tested much lower levels (Exhibit 44) in 2018 and 2015, despite the recent sizeable correction. Some 14% further downside is implied by our bear case price target at 81 for MSCI China. Meanwhile, our bull case at 124, 32% upside from current market levels, looks increasingly unlikely to emerge, but we believe it is still possible under these conditions:

1. Strong signs that the Internet regulation cycle is wrapping up with limited financial impact on companies;
2. Macro policy turning towards the direction of stimulus and easing, particularly on the liquidity side, after nearly three quarters of tightening;
3. Earnings fundamentals keep improving and beating market expectations;
4. Other potentially helpful developments, such as an improving US-China relationship, stronger CNY profile, and stronger domestic consumption recovery momentum.

Exhibit 44: Consensus 12-month forward P/E valuation of major equity indices Feb 18, 2021 vs. latest – MSCI China has shown a de-rating of 4.6x P/E points



Source: Datastream, Morgan Stanley research. Data as of July 30, 2021 unless otherwise stated.

Exhibit 45: Asia/EM Equity Strategy bear, base, and bull case index targets for June 2022 – our bear case target for MSCI China implies another 14% downside from current levels

	Index	Current Price	MS Target Price Jun-22	MS Top-Down EPS YoY %			Consensus EPS Forecast YoY %			MS Target Fwd P/E Jun-22	Consensus 12m Fwd P/E Current	Cons. 12m Fwd P/E 25yr* %'ile
				Dec-21	Dec-22	*Jun-23*	Dec-21	Dec-22	*Jun-23*			
Base Case	**TOPIX**	1,901	**2,050** *8%*	105 *14%*	128 *22%*	133 *14%*	116 *26%*	133 *15%*	*139* *12%*	15.5x	14.8x	45%
	MSCI EM	1,278	**1,330** *4%*	83 *34%*	95 *14%*	100 *12%*	93 *51%*	102 *10%*	*107* *9%*	13.2x	13.1x	78%
	MSCI APxJ	653	**680** *4%*	39 *30%*	44 *13%*	45 *8%*	42 *40%*	47 *11%*	*49* *10%*	15.0x	14.8x	86%
	Hang Seng	25,961	**26,900** *4%*	1,895 *10%*	2,094 *10%*	2,187 *10%*	1,992 *15%*	2,288 *15%*	*2,443* *14%*	12.3x	12.2x	60%
	HSCEI	9,233	**9,500** *3%*	952 *12%*	1,061 *11%*	1,111 *10%*	917 *8%*	1,032 *12%*	*1,091* *12%*	8.5x	8.4x	70%
	MSCI China	94	**100** *6%*	6.4 *19%*	7.3 *14%*	7.7 *12%*	6.3 *17%*	7.5 *18%*	*8.1* *17%*	13.0x	13.7x	86%
	CSI300	4,811	**5,260** *9%*	330 *16%*	368 *12%*	381 *9%*	329 *15%*	373 *13%*	*396* *13%*	13.8x	13.6x	78%
Bull Case	**TOPIX**	1,901	**2,350** *24%*	108 *18%*	133 *23%*	139 *15%*	116 *26%*	133 *15%*	139 *12%*	17.0x	14.8x	45%
	MSCI EM	1,278	**1,560** *22%*	85 *38%*	100 *17%*	106 *14%*	93 *51%*	102 *10%*	107 *9%*	14.8x	13.1x	78%
	MSCI APxJ	653	**810** *24%*	40 *34%*	46 *15%*	47 *10%*	42 *40%*	47 *11%*	49 *10%*	17.0x	14.8x	86%
	Hang Seng	25,961	**32,700** *26%*	1,965 *14%*	2,200 *12%*	2,332 *12%*	1,992 *15%*	2,288 *15%*	2,443 *14%*	14.0x	12.2x	60%
	HSCEI	9,233	**11,800** *28%*	973 *15%*	1,109 *14%*	1,181 *13%*	917 *8%*	1,032 *12%*	1,091 *12%*	10.0x	8.4x	70%
	MSCI China	94	**124** *32%*	6.5 *21%*	7.6 *16%*	8.1 *15%*	6.3 *17%*	7.5 *18%*	8.1 *17%*	15.3x	13.7x	86%
	CSI300	4,811	**6,350** *32%*	337 *18%*	389 *15%*	415 *14%*	329 *15%*	373 *13%*	186 *-47%*	15.3x	13.6x	78%
Bear Case	**TOPIX**	1,901	**1,550** *-18%*	94 *2%*	107 *14%*	111 *11%*	116 *26%*	133 *15%*	139 *12%*	14.0x	14.8x	45%
	MSCI EM	1,278	**1,010** *-21%*	71 *16%*	77 *8%*	81 *9%*	93 *51%*	102 *10%*	107 *9%*	12.5x	13.1x	78%
	MSCI APxJ	653	**530** *-19%*	35 *13%*	39 *10%*	39 *6%*	42 *40%*	47 *11%*	49 *10%*	13.5x	14.8x	86%
	Hang Seng	25,961	**21,500** *-17%*	1,857 *8%*	1,987 *7%*	2,047 *6%*	1,992 *15%*	2,288 *15%*	2,443 *14%*	10.5x	12.2x	60%
	HSCEI	9,233	**7,600** *-18%*	931 *10%*	990 *6%*	1,017 *6%*	917 *8%*	1,032 *12%*	1,091 *12%*	7.5x	8.4x	70%
	MSCI China	94	**81** *-14%*	6.2 *15%*	6.8 *9%*	7.0 *8%*	6.3 *17%*	7.5 *18%*	8.1 *17%*	11.5x	13.7x	86%
	CSI300	4,811	**4,350** *-10%*	321 *12%*	351 *9%*	363 *8%*	329 *15%*	373 *13%*	186 *-47%*	12.0x	13.6x	78%

Source: MSCI, IBES, RIMES, Factset, Bloomberg, Morgan Stanley Research. Data as of July 30, 2021.

Implications at the sector level – beneficiaries and the challenged: Simple sector-level allocation in our view will not be sufficient in the current policy changing environment. We identify the detailed segments under each sustainability growth initiative by potential beneficiaries and those likely to be challenged (Exhibit 46) with detailed rationales in Appendix I – Detailed Rationales for Sector-Level Regulatory Impact . The beneficiary segments are mainly concentrated in the following themes:

- Data & cybersecurity;
- Technology self-sufficiency;
- Green economy & carbon neutralization;
- Mass consumption and domestic brands;
- Innovation and R&D focused.

Exhibit 46: Equity market implications – challenges and opportunities by segment/theme

	Segment	Rationale
Income Inequality/ Social Risks	**Positive:** - Innovative biotech and pharmaceutical companies with well-differentiated drugs. - Medical technology - Mass consumption/domestic brands - Commercial insurance (medical + retirement)	**Healthcare:** As the Chinese population ages and new therapies become more expensive, the government aims to include more new drugs on the public insurance list. However, these drugs must show clear clinical value. Broadening the list will improve patient access, particularly for low-income groups.
		Mass consumption/domestic brands: narrowing income gap will help boost spending power of the masses; domestic brands get increasing prominence
		Insurance: The promotion of medical insurance and pensions helps alleviate funding pressure caused by aging population of government-backed social insurance plans.
	Negative: - Food delivery / ride hailing (social benefit of flexible employment) - Platform companies (antitrust) - Property developers - Property management	**Food delivery / ride hailing:** The announced guidelines around platforms' resonsibility in riders' social insurance present risks to profitability of food delivery business.
		Platform companies: Forced exclusivity will not be allowed, more moderate M&A pipeline, normalized subsidies for transactional business.
		Property developers: The policy stance of "stabilize property price, land price and expectations" implies ongoing price cap for properties in popular cities, which will ultimately weigh on developers' margin.
		Property management: Labor rights protection for dispatched staff is aimed at mitigating the inequality issues, which may be a potential earnings drag in mid-term.
National Security Risks	**Positive:** - Cybersecurity - Semi-localization - Basic software	**Cybersecurity:** Regulatory scope for data security will expand and bring bigger market size for cybersecurity vendors
		Semiconductors: Given US tech export control on semiconductors, national policies should favor semiconductor industry to accelerate semi localization progress.
		Basic software: software localization will be accelerated given existing reliance on foreign vendors
	Negative: - Data rich tech companies (particularly with large user base)	**Data rich tech firms:** More hurdles for these companies to seek foreign listing given the concerns over cross-border data security risks, particularly those with large user base
Financial Risks	**Positive:** - Insurance asset management	**Insurance asset mgmt:** As a large investor in the equity and bond markets, a better mangement of financial risks can help promote and sustain longer term value.
	Negative: - Property developers	**Property developers:** Given the continuing credit tightening, developers can no longer rapidly grow by adding financial leverage, indicating normalizing sales growth.
Environmental Risks	**Positive:** - Data centre - Steel, Aluminum - Lithium, Cobalt, and Solar Glass - Renewable hydropower/Wind/Solar - City gas	**Data centre:** More stringent environmental standards set higher entry barriers for the sector, which deters new entrants with low capability. This results in more balanced market dynamics.
		Steel, Aluminum: the governemnt implement production/ capacity control for carbon neutrality which support price and margin
		Lithium, Cobalt, and Solar Glass: adoption of renewable energy and EV will be accelerated under carbon neutrality committment, which will drive up the raw materials price for the EV/Solar space
		Renewables: Renewables power will become the primary energy source in China's power system
		City gas: Near-term gas demand growth would be supported by policies to replace coal with natural gas.
	Negative: - Coal power	**Coal:** China is likely to gradually tighten up baselines and small and inefficient coal power units would be pushed to shutdown.

Source: Morgan Stanley Research.

Investors looking for key long-term concerns to be addressed: We see concerns from the global investor community over the future investability of Chinese equities, particularly from the two angles below:

- What is the long-term future of offshore Chinese equities? (ADR delisting risk due to cyber security/access to company audits; will future offshore listings still be possible?)
- Will foreign investors still be able to invest in Chinese companies? (VIE structure concerns, foreign ownership cap in the A-share market.) For back ground of these concerns please visit China Equity Strategy: Capital Market Regulation Announcement: Myths, Facts, Implications (8 Jul 2021).

There have been some early signs that the Chinese government is trying to alleviate those concerns, including the following:

- Xinhua, China's official news media platform, published an article on July 28, which stated that China is committed to opening up its capital markets to foreign investors and for the pace of global integration to increase. The report said regulators were supportive of different choices for listing destinations based on companies' own development needs.
- CNBC reported that China will continue to allow Chinese companies to go public in the US as long as they meet listing requirements. The cross-border stock listings can also take place with VIE structure, according to the article.
- China's Vice-Premier Liu He spoke at an SME forum on July 27 and said that China was striking a balance between growth and safety, protecting social fairness, SMEs and consumer benefits. Meanwhile, he said China was still committed to supporting the private sector, property rights and intellectual property rights, as well as internationalization. He said China will not reverse the overall opening up and market reform direction.

That said, initial investor feedback indicates concerns remain, and they are looking for more formal guidance and actions to assuage these potential issues. Also, SEC Chair Gary Gensler's latest request for additional disclosure information from China-based operating companies, and for targeted additional reviews of filings for all companies with significant operations in China, is likely to further weigh on market concerns.

Therefore, we think that while recent newsflow is likely to address some of the market's concerns, it is unlikely to allay all of them. To become more positive, we look for clarifications on the offshore investible opportunity set and foreign participation restrictions, as well as progress along the following: resumption of offshore (Hong Kong) IPOs for tech companies, clarity over employment benefits and other issues concerning platform companies, progress on audit access dispute resolution, and clearer guidance from top policymakers to curb spillover effect of regulation changes. Read more: China Equity Strategy: Our thoughts on latest regulatory newsflow (29 Jul 2021).

Appendix I – Detailed Rationales for Sector-Level Regulatory Impact

Financials

China's financial sector was one of the first that entered a regulatory cleanup cycle around 2016 following several years of innovations and rapid expansions. The series of financial cleanups are designed to:

1. Reduce regulatory arbitrage,
2. Improve financial system transparency,
3. Control the pace of system and household leverage growth,
4. Control the level of capital market leverage,
5. Improve financial system liquidity management and stability, and more recently
6. Improve financial system and household data security and privacy protection.

Specifically, we have seen a series of regulations including:

1. Supply chain reform and NPL digestion of the industrial sector in in 2015-16, when the PBOC and CBRC acted on discounted bills to emphasize scrutiny and promote healthy development of the bill business;
2. Capital market deleveraging aimed at reducing capital market volatility and speculation in 2016-2017, which saw a significant loss reduction;
3. Stricter requirements on interbank business on liquidity management to reduce duration mismatch in 2017-2018, notably the inclusion of WMP into Macro Prudential Assessment to improve transparency of non-standardized credit assets;
4. Local government and infrastructure credit risk containment that reduced implicit guarantees from 2017;
5. Further tightening shadow financing channels to rein in excessive borrowing and financial speculation, notably the cleanup of P2P channels since 2018; and
6. Broad-based tightening on fintech, including loan facilitation, co-lending and credit scoring businesses in 2020 and 2021

We believe we are towards the end of this round of the financial cleanup cycle with the focus gradually transitioning from cleanup to ongoing diligent enforcement of financial rules and regulations, and the continued development of necessary financial market infrastructure.

However, we see three remaining areas of focus in the rest 2021 (all have been announced), including:

1. The deadline for bank wealth management products cleanup by the end of 2021,
2. Cleanup of fintech businesses, particularly for co-lending and loan facilitation businesses, and
3. Capital ratio requirement hike for 10-15 national banks to improve financial system stability.

There are also a few areas of concerns worth watching:

1. Rising level of guidance on interest rates, pace and direction of lending, which could potentially lead to more misallocation of capital.
2. Slowdown in economic activity from broad-based tightening on several sectors, and related NPL and interest rate pressures.

Internet

Antitrust

China's State Administration for Market Regulation ('SAMR') finalized antitrust guidelines on the country's platform economy in February, which signaled stricter antitrust enforcement against monopolistic behaviors by the country's internet platforms. Since then, SAMR has issued fines on various antimonopoly behavior by different companies. In particular, the SAMR conducted investigations into Alibaba and Meituan on suspected monopolistic practices. Alibaba was fined US$2.8bn (4% of 2019 domestic sales) for abusing market power in April and we think the monetary fine removes a major overhang on the stock, as the market was previously concerned about the company having to make significant organizational restructuring and asset divestitures that might jeopardize the company's core competence. For Meituan, we expect a shorter investigation time frame given the precedent set by the Alibaba investigation, and resolution of the investigation would remove a major overhang on the stock. In addition, we see tightened scrutiny of M&A, specifically on historical transactions failing to report business concentration information.

Overall, we see the antimonopoly concern is starting to gradually subside after the imposition of the fine on Alibaba and recent updates on M&A reviews on Tencent, especially with its plan for Sogou privatization being approved. We see the focus for regulators being on anti-competition behavior, such as exclusivity, selling below cost, and market consolidation M&As that prevent competition, rather than targeting all companies having dominant market share in general. We also see a normalized subsidies level in community group buying business as a result, as well as potential for Alibaba and Tencent to open up ecosystems under pressure from tightening anti-trust regulations. We have also seen many internet companies taking steps to commit to reinvestments from profit, providing further merchant support, and donating to social value creation projects to address antimonopoly concerns.

Data privacy and data security

We see regulators' key concerns around data to be in two main areas:

1. Data protection of personal information as regulators seek to prevent breaches of online privacy. Key data collection irregularities include illegal collection, over-collection, and excessive requests for authorization;
2. Increased scrutiny on cross-border data flow and change in the government's stance on overseas listings to reduce external funding risk in the face of US PCAOB rules.

On the data protection front, we saw CAC jointly with MIIT, MPS, and SAMR issue Regulations on the Scope of Necessary Personal Information for Common Types of Mobile Internet Applications, which defined the scope of necessary personal information for 39 common types of mobile phone applications and prohibited the operators of the Apps from collecting "unnecessary" personal information from the users, signaling the intention to stop the illegal collection, over-collection, excessive request for authorization and other violations of personal data protection regulations. As for data security, the recently passed Data Security Law provides more clarity around data collection, usage, and cross-border transmission, particularly for critical infrastructure operators.

In future, we believe companies will apply more stringent control on user data protection in order to be compliant with new regulations on collecting personal information from users and for data-heavy companies that are seeking foreign listings, they will potentially face higher hurdles given the new draft policy document proposed all Internet operators dealing with over 1mn users' personal information to be subject to cybersecurity review when seeking foreign listings.

Social Security for Flexible Workers

We believe the recently announced guidelines for protecting workers' rights under the new labor forms as well as guidelines on protecting food delivery riders' rights and interests represent the government's increased focus on the safety and rights of flexible employees, given that China has previously lacked a clear framework on social security for flexible employment, and a lack of guidance on whether platforms should take corresponding responsibilities. According to the guidelines, platforms will 1) need to work with third-party agencies to participate in social insurance for riders that have an established labor relationship, and 2) support and encourage the exploration of commercial insurance schemes for other riders.

On a positive note, the latest guidelines acknowledge the new format of flexible employment, highlighting regulators' focus in protecting their rights, which should be beneficial for the longer-term healthy development of the industry, such as food delivery and ride hailing. At the company level, we think the announced guidelines present a risk to Meituan's core food delivery business and could weigh on market sentiment. We think the guidelines pose a risk to Meituan's food delivery business unit economics estimates and could potentially delay the progress of profitability for its 1P business, as additional rider costs arise from additional social security responsibilities. However, we think Meituan should be able to pass on relevant costs to consumers.

Healthcare

The Chinese government has stepped up reform of the healthcare industry in recent years. Healthcare policies in China increasingly favor and reward the innovators and dis-incentivize the generic players. These changes have caused short-term ripples and reshuffling in the industry, but favor the true innovators over the long run.

It is our view that the government increasingly favors innovative companies. In our 2H2021 outlook report, we reiterated the following pecking order: Innovation/Biotech > R&D Services > Device > Hospitals > Vaccine & Plasma > Digital Health > Distribution > Generic Pharma > API > TCM. In short, government policies continue to pressure generics and encourage innovation. Since the beginning of this year, we have observed policy changes in line with our expectations, starting with the State Council's published opinions in February on promoting volume-based procurement as a common practice for most generic drugs.

More recently, new CDE guidelines advocated higher standards for running oncology trials by including the best available supportive care as the control arm, implying that the bar for R&D will be raised and Chinese companies will now need to develop drugs that are well differentiated from, or better, than what is on the market. As the new CDE policy measures up to standards in highly regulated markets, like the US and EU, we believe truly innovative companies have the potential to go global, among which we continue to favor Hansoh and Hengrui (both OW) in the large pharma space, and Innovent (OW) and others in the biotech space. It is also a boon for leading CDMOs like WuXi Biologics and WuXi AppTec.

In our view, since 2014 the government has stepped up healthcare reform measures along the value chain. These reforms serve a number of mandates:

1. Regulating sales and marketing practices;
2. Rationalizing drug pricing;
3. Raising drug quality;
4. Controlling healthcare spending and improving the allocation of healthcare spending, particular with respect to innovative therapies; and
5. Spurring innovation.

As China's population ages and the healthcare system is upgraded, with more expensive innovative therapies becoming available, China will need to make more efficient use of its reimbursement dollars, and eventually develop a multi-faceted payment system, including both public and private insurance. We expect the policies to continue at a more intense pace in the coming years, all falling under the broader strategy of "Healthy China" promulgated by the government.

Property Developers

We believe policy makers will be firm in maintaining a "stable property market" and aim to achieve targets including:

1. A healthy property market with limited financial risk;
2. A stable property market to mitigate the inequality issues; and
3. A stable property market to address demographic strategy to encourage birth.

Read more: China Property: Downgrade Industry to In-Line (1 Jul 2021).

We believe two major policy themes will continue to guide the future policy stance:

1. "Houses are for living, not for speculation"; and
2. "Stabilize property prices, stabilize land prices, and stabilize expectations".

From the central government's perspective, we believe key measures will still focus on deleveraging and controlling financial risks on the sector, such as:

1. Continuing strictly controlled various funding channels;
2. “Two red lines” for property-related bank loans; and
3. "Three red lines” for developers (Read more: China Property: Potential new "three red lines and four categories" policy and its impact on developers (2 Sep 2020)).

From a local government perspective, "one city, one policy" guides the local policy based on individual cities' housing market situation. Also, the recent centralized land supply policy will help to maintain a relatively stable land market. We expect some city-level tightening policies such as guided secondary property prices or property tax trials in selected cities will be launched in the future if the land/housing market is still hot in selective cities.

For developers, we believe they can no longer rapidly grow by adding financial leverage. The preferred model will be depending on companies' operation efficiency and companies with diversified land acquisition channels (such as urban redevelopment, mixed-use land acquisition or M&A) and matured diversified business such as property management or commercial properties should outperform. We prefer companies with earnings visibility and strong track records of execution under the current market environment, reflecting tightened policy, gross margin pressures, and normalized sales growth. Our top picks are CR Land and Longfor.

Property Management

We believe the overall policy stance towards the property management sector is still positive in the long term given its position as an affordable social necessity. However, recent policy initiatives of cleaning up irregularities and labor rights protection for dispatched staff, as part of the efforts to alleviate income inequality, may be a potential earnings drag in the mid-term. Read more: China Property Management & Services: Our Read on What New Policies Mean for Property Management (26 Jul 2021).

On the labor rights protection document, we view any near-term risk as manageable. According to the document, the policy is mainly focused on some new jobs based on internet platforms, rather than traditional cleaning and gardening jobs. The social insurance policy was emphasized in 2018, and many listed PMCs have already followed the rule to some extent. According to these companies, they have registered social insurance for all internal employees; however, if the new collection rules are strictly implemented, e.g., requiring full contribution or any additional steps regarding outsourcing of labor, there could be a potential earnings drag for property management companies.

We believe future policy stance will continue to focus on strengthening the complaint handling by property managers (especially the non-listed names) and protecting labor rights, which will benefit the leading property management companies with high service quality.

Basic Materials

We believe the overall stance towards China's basic materials industry is to transform the industry's development (normally considered as high energy consumption and high pollution) to become more environmentally-friendly. Government officials suggest that such industries as steel, building materials, and aluminum will be included into the national carbon emission trading market, following coal and gas fired power plants. Read more: China Materials: Impact of Carbon Trading on Materials (21 Jul 2021). Meanwhile development of renewable energy as well as electric vehicles has become the next focus.

In 2021, energy consumption controls have been implemented in Inner Mongolia, one of the major aluminum producing hubs, which have affected aluminum smelting operations. In addition, China's steel industry is introducing output controls, mainly targeting producers with relatively worse environmental protection standards. Meanwhile, the Ministry of Ecology and Environment (MEE) is currently planning off-peak production plans for industrial producers during winter heating season this year. Differentiated measures will be implemented and a 'one-size-fits-all' measure will be strictly prohibited.

Cybersecurity

We believe the cybersecurity industry in China will benefit from the rising policy focus on national security, specifically data security, recently. After a muted 18 months, we have seen a series of new policies including National Data Security Law, Cybersecurity Review Measures, Network Vulnerability Management Guidance, and 3-year Plan on the Development of China Cybersecurity Market released by MIIT and the Cyberspace Administration over the past few weeks. The government's requirement for public sectors to increase their cybersecurity spending to 10% of total IT spending nearly doubles current market size, indicating strong demand growth. Incremental spending will likely skew to next-general products such as security intelligence and analytics, zero-trust, and cloud security.

Data centers

We believe regulators' rising focus on environmental protection will set higher bars for data center operators. New or small players without operational excellence might not be able to delivery good metrics on environmental protection, so industry leaders should benefit from this. Thus far, we find policy execution to be somewhat inconsistent in different places, and we continue to see whether it can help industry consolidation.

Semiconductors

We believe the overall policy stance towards the semiconductor industry is positive in the long term given the need to localize China's semiconductor supply chain in pursuit of national security.

China has assigned new leadership to spearhead semi industry development: According to Bloomberg news, Mr. Liu He, China's Vice-Premier, has been tapped to spearhead the development of so-called third-generation chip development and capabilities, and is leading the formulation of a series of financial and policy supports for the technology. Since then, A-share semis rose around 13%. Sentiment on 3rd generation semis (e.g., CR-Micro, Starpower, AMEC) is particularly strong.

We maintain our "Selective Control" scenario on the US technology export controls: The US's control on technology exports remains the main challenge for China's semi localization efforts, as we articulated in How China Is Rewiring Global Semis report. However, we see more evidence of "Selective Control". For example, Huawei has been able to launch its new 4G smartphone with Qualcomm's flagship chip, SMIC got partial approval for equipment, while Phytium's 16nm CPU may resume shipments. We see an investment opportunity in China's semi localization theme.

Insurance

We believe that policy risks could be more on the upside for commercial insurance development in the next few years, particularly in the area of medical insurance and retirement pensions, to help build a more comprehensive / multi-pillar system of social security. This could help address funding or efficiency issues of the current government backed social insurance plans, which are facing increasing pressure as a result of the ageing population in China.

Insurance services were once nationalized after the new China was founded. They were liberalized and opened up to private investment and foreign players only from the 1980s.

After 40 years of development, we now have a relatively sizeable commercial insurance market, but penetration is low and product offerings are limited - many essential lines (e.g., long-term care and pension) do not exist in the commercial market and need to reply on government schemes to provide basic coverage. The space is still somewhat under-commercialised in our view vs. many other livelihood related sectors due to onerous regulations. Market entry, operating scope, product pricing and capital management are all subject to tight regulatory oversight and the sector has been operating with a balanced goal of protecting the interests of shareholders, customers and society as a whole. Margins and capital returns have been tracking at decent but non-excessive levels and all major players have been actively working with various levels of governments to manage / underwrite policy backed insurance plans with thin margins. As such, we see little major policy downside to making the sector more "inclusive".

In addition, we see potential policy tailwinds (in the form of subsidiaries or tax incentives) to accelerate the development of commercial, medical or pension insurance. Increasing supply of private schemes could help provide more choices for affluent families who may prefer to use private health care networks or senior care facilities. This could help potentially free-up public resources and alleviate the government burden, which in turn could drive better allocation of public funding / resources towards people who need them the most.

For insurers, we do expect central government-owned SOEs to focus more on mass-market/financial inclusive solutions. This scenario is largely in the price already with 4-6x P/E multiples. Privately run entities such as AIA and Ping An are likely staying in the high-end markets, where margins are generally more lucrative.

Appendix II – Study of Major Episodes of Industry-Specific Regulatory Reforms

Restriction over granting new game licenses – March to October 2018

An eight-month effort to restructure the game approval process, and improving physical and mental health particularly for children

- Gaming license approval was suspended for eight months from March 2018 amid gaming regulator efforts in restructuring and tightening the regulatory review of new game releases, as well as the intention to reduce myopia in children.
- In August 2018, China confirmed that General Administration of Press and Publications was taking over the responsibilities of approving new games. This was announced within a notice by Ministry of Education on its plan to protect kids' and teenagers' eyesight.
- The new games approval process resumed in December 2018. Also at end 2018, China created the Online Games Ethics Committee to evaluate whether content of games abided by China's social values.

Market implications: Investor sentiment hurt as reflected in the valuation decline throughout

The eight-month suspension of new game approvals plus the tightened approval criteria and content control cast significant uncertainty over the internet gaming companies, especially those which relied on new games for revenues and cash flows.

- Our customized China Gaming index (equal-weighted index) underperformed MSCI China for 6 months from March 2018 to August 2018.
- Valuation, measured by 12-month forward PE, de-rated by 3.5 P/E points between March 2018 and October 2018, when its valuation bottomed. However, its relative valuation change during the same period saw a marginal increase of 6.4% due to the valuation for the broad index (MSCI China) derating on a larger scale than our customized index. It took 2 months for gaming companies' valuations to re-rate to pre-suspension of new license levels.
- Aggregate market cap of constituents of China Gaming index shrank 42% in between March 2018 and October 2018, when it bottomed. Market cap recovery back to pre-suspension of new license levels took 19 months.
- The underperformance, in our view, ended effectively around Oct/Nov 2018 as top policy makers sent a clear signal of supporting private businesses through the conference held by President Xi together with entrepreneurs.

Exhibit 47: China Gaming Index* relative performance vs. MSCI China - the index underperformed the market by 13%, in 6 months during March to August 2018

Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, Morgan Stanley Research. Data is from end August 2017 to end December 2019. *The index consists of 19 Chinese gaming stocks listed across A-share, HK and US equity markets. The index is constructed on an equal-weighted basis with inception date on end August 2017 and is rebalanced upon IPO day of each new listing during the period. Vertical line represents the start of industry level regulatory tightening.

Exhibit 48: China Gaming Index* 12m Fwd P/E in absolute and relative terms vs. MSCI China - its valuation de-rated by 3.5 P/E points in 8 months after new game license suspension and recovered in 2 months to pre-suspension levels

Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, Morgan Stanley Research. Data is from end August 2017 to end December 2019. *The index consists of 19 Chinese gaming stocks listed across A-share, HK and US equity markets. The index is constructed on an equal-weighted basis with inception date on end August 2017 and is rebalanced upon IPO day of each new listing during the period. Vertical line represents the start of industry level regulatory tightening.

Exhibit 49: China Gaming Index* total market cap - aggregate market cap shrank by 42% in the eight months since March 2018 when game sector tightening started, and took another 19 months to recover

Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, Morgan Stanley Research. Data is from end August 2017 to end December 2019. *The index consists of 19 Chinese gaming stocks listed across A-share, HK and US equity markets. Total market cap is a simple summation of individual constituents' market cap and only includes stocks listed before tightening start. Vertical line represents the start of industry level regulatory tightening.

Healthcare – Drug procurement reform (national pilot scheme): June 2018 – September 2019

In an effort to improve access and affordability of essential care for the general public, China started national reforms on centralizing drug procurement in mid-2018. This was part of the efforts to implement Opinions of the CPC Central Committee and the State Council on deepening the reform of the medical and healthcare system published in 2009.

- In November 2018, China launched National Pilot Scheme of Centralized Drug Procurement on 31 generics in four municipalities and seven cities.
- The reform has been subsequently expanded nationwide since September 2019 and ongoing. Public hospitals are supplied with drugs purchased by a government-led working group. The working group aggregates national demand for each drug and buys in large quantities through public bidding. The process cuts down costs during the distribution process and, more importantly, leads to a substantial cut in drug prices.

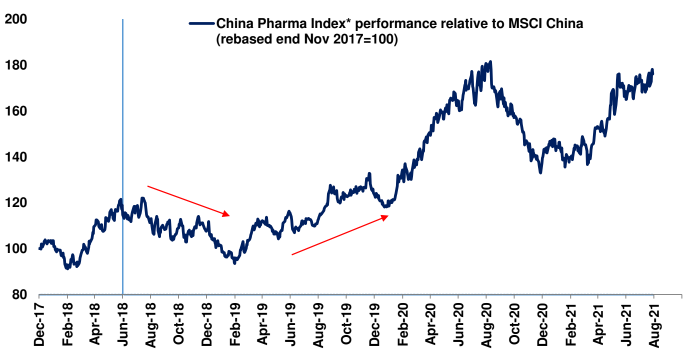
Market implications: Pharma affected more than Biotech given pressure more concentrated on generic drug manufacturers

Drug procurement reforms have led to a fundamental reshuffling, particularly for the generics drug segment, as companies need to make the trade-off between margin and volume increase, should they decide to participate in the bidding process. We checked the Pharma segment's reaction since the kickoff of the reform relative to both the broad market and another segment within Healthcare – Biotech – to gauge whether the impact has been more broad-based or rather focused.

Compared to the broad market:

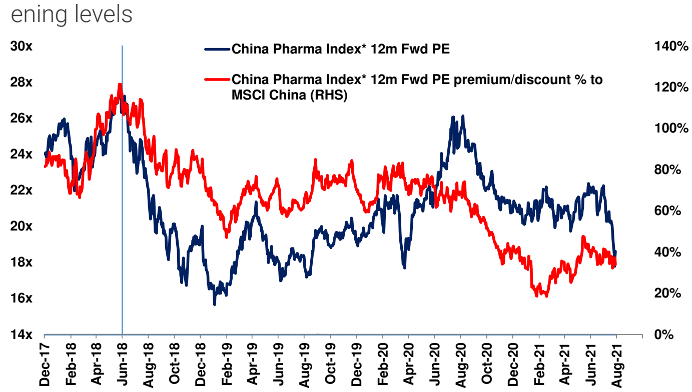
- Our customized China Pharmaceuticals index (equal-weighted index) underperformed MSCI China for 8 months from June 2018 to January 2019, with max drawdown of 19%.
- Valuation, measured by 12-month forward PE, de-rated by 11 P/E points or down 22% if measured in relative terms vs. the market, in between June 2018 and December 2018, when its valuation bottomed. It took 20 months for Pharma stocks' valuation to re-rate to pre-drug procurement reform levels.
- Aggregate market cap of constituents of China Pharmaceuticals index shrank by 42% in between June 2018 and December 2018, when it bottomed. Market cap recovery back to pre-drug procurement program launch levels took 16 months.

Exhibit 50: China Pharma Index* relative performance vs. MSCI China – the index underperformed the market by 19% for 8 months between Jun 2018 and Jan 2019



Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, MSCI, Morgan Stanley Research. Data is from end November 2017 to July 29, 2021. *The index consists of constituents of MSCI China Pharmaceuticals Index as of end May 2021. The index is constructed on an equal-weighted basis with inception date on end November 2017 and is rebalanced upon IPO day of each new listing during the period. Vertical line represents the start of industry level regulatory tightening.

Exhibit 51: China Pharma Index* 12m Fwd P/E in absolute and relative terms vs. MSCI China - its valuation de-rated 11 P/E points (or 22% vs. the market) in the seven months during June-December 2018 and nearly took another 20 months to get back to pre-tightening levels



Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, MSCI, Morgan Stanley Research. Data is from end November 2017 to July 29, 2021. *The index consists of constituents of MSCI China Pharmaceuticals Index as of end May 2021. The index is constructed on an equal-weighted basis with inception date on end November 2017 and is rebalanced upon IPO day of each new listing during the period. Vertical line represents the start of industry level regulatory tightening.

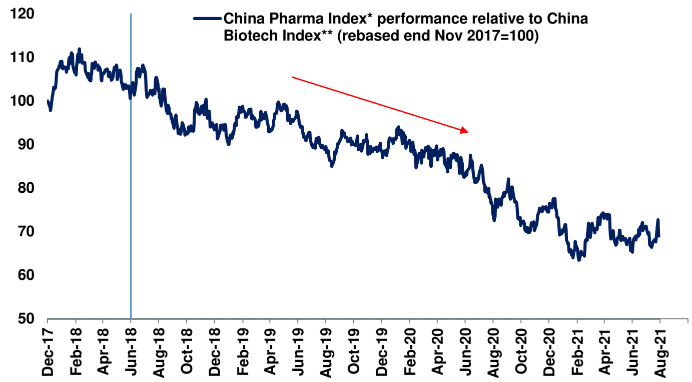
Exhibit 52: China Pharma Index* total market cap - aggregate market cap shrank 42% during June to December 2018, when it bottomed, and took 16 months to return to pre-tightening levels

Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, MSCI, Morgan Stanley Research. Data is from end November 2017 to July 29, 2021. *The index consists of constituents of MSCI China Pharmaceuticals Index as of end May 2021. Total market cap is a simple summation of individual constituents' market cap and only includes stocks listed before tightening start. Vertical line represents the start of industry level regulatory tightening.

Compared to the Biotech segment index:

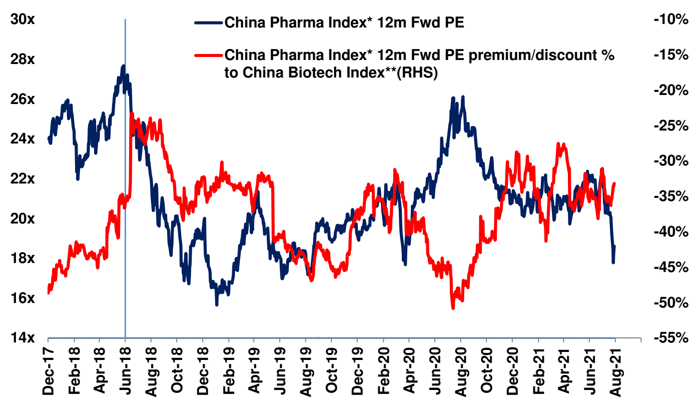
- Our customized China Pharmaceuticals index has consistently unperformed China Biotech Index (equal-weighted index) since the drug procurement reform national pilot officially launched from June 2018, and the underperformance has yet to show signs of bottoming (Exhibit 53).
- In relative valuation (measured by 12-month forward P/E) compared with the Biotech Index, the Pharmaceuticals Index saw a continuous de-rating during the tightening period from June 2018 to August 2019, down 17% compared with the forward P/E of Biotech Index.

Exhibit 53: China Pharma Index* relative performance vs. China Biotech Index** - Pharma index has consistently underperformed the Biotech index since Jun 2018, with underperformance of 36% until now



Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, MSCI, Morgan Stanley Research. Data is from end November 2017 to July 29, 2021. *China Pharma Index consists of constituents of MSCI China Pharmaceuticals Index as of end May 2021. **China Biotech Index consists of constituents of MSCI China Biotech Index as of end May 2021. Both customized indices are constructed on an equal-weighted basis with inception date on end November 2017 and is rebalanced upon IPO day of each new listing during the period. Vertical line represents the start of industry level regulatory tightening.

Exhibit 54: China Pharma Index* 12m Fwd P/E discount vs. China Biotech Index** - its relative valuation saw 17% derate vs. Biotech Index during June 2018 to August 2019



Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, MSCI, Morgan Stanley Research. Data is from end November 2017 till to July 29, 2021. *China Pharma Index consists of constituents of MSCI China Pharmaceuticals Index as of end May 2021. **China Biotech Index consists of constituents of MSCI China Biotech Index as of end May 2021. Both indices are constructed on an equal-weighted basis with inception date on end November 2017 and is rebalanced upon IPO day of each new listing during the period. Vertical line represents the start of industry level regulatory tightening.

Regulatory tightening on the Education sector

- **Phase One: Feb 2018 - Mar 2019**
- **Phase Two: May 2021 - now**

Phase One (2018) centered around standardizing K12 After-School Tutoring (AST) institutions; mainly hurt valuations

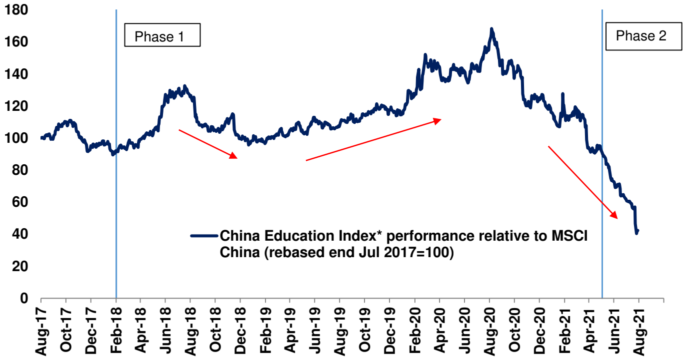
- Phase One started with the tightening of operating standards by K12 AST institutions ... In February 2018, China's Ministry of Education, together with other three ministries, issued policies on AST institution inspections and K12 school admission. See details of policies and implications from our China Education sector team's here.
- General Office of the State Council issued "Opinions on Standardizing the Development of K12 AST Institutions" on Aug 6th 2018;
- For implementation, China's Ministry of Justice released a draft of the Revision of the Promotion of Private Education Law for public opinion on Aug. 10, 2018. The proposals set out tighter regulatory supervision standards on related party transactions among school operators and prohibited private school operators from acquiring/franchising/controlling by agreement not-for-profit schools. The proposal also tightened requirements on K-12 school operations and online education. The revised law was enacted in May 2021, with changes compared with 2018 draft. See our China Education sector team's take here;
- Ministry of Education announced "Notification regarding Thorough Implementation of K-12 AST Dedicated Governance and Rectification Work" on September 3, 2018.

Market implications:

The constant regulatory moves have had a clear impact. The segment largely underperformed the broad market (MSCI China) by 28%, over a period of 5 months (Aug 2018 - Dec 2018) (MS customized equal-weighted China Education sector index). The performance recovery lasted from Jan 2019 to Feb 2020 (in 14 months), when the index rebounded to pre-tightening levels. By contrast, the 12-month forward P/E for the Education Index dropped 14 points in absolute terms or 30% compared with the market, during May 2018 to Dec 2018. The relative valuation, in particular, has never recovered to pre-2018 regulation levels, and has been largely declining till now.

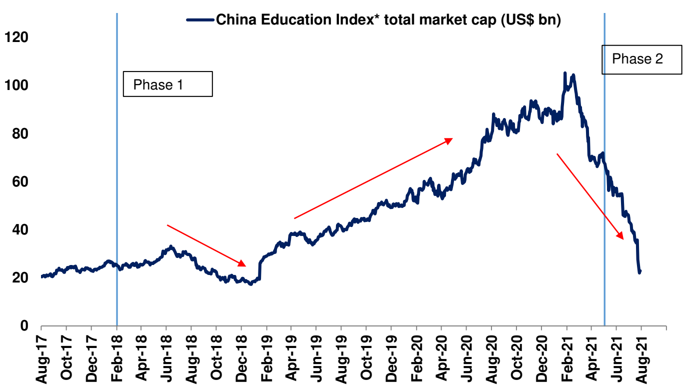
The relatively quick recovery of the sector's relative performance compared to the subdued valuation suggests that the performance recovery was mostly driven by earnings growth, and seems to have not been overly hurt by the 2018 round of regulatory tightening. Morgan Stanley Research's Education team eventually turned more bullish on the sector in Mar 2019, believing the tightened operating environment changes had been largely priced in, and content and technology implementation would drive success.

Exhibit 55: China Education Index* relative performance vs. MSCI China - the index underperformed the market for 5 months from Aug-Dec 2018, down by 28% during the first tightening period



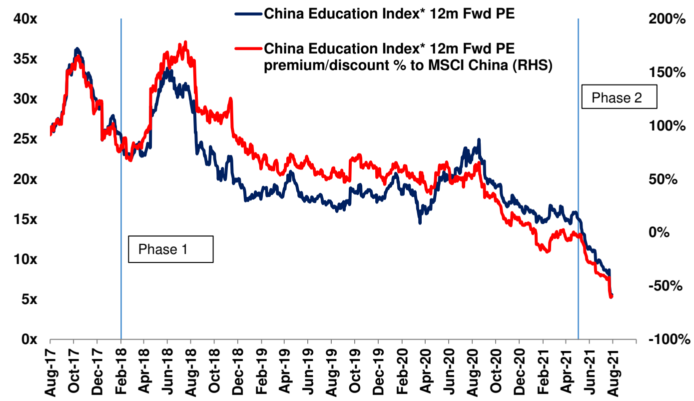
Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, Morgan Stanley Research. Data is from end July 2017 to July 29, 2021. *The index consists of 27 Chinese education stocks listed across A-share, HK and US equity markets. The index is constructed on an equal-weighted basis with inception date on end July 2017 and is rebalanced upon IPO day of each new listing during the period. Vertical line represents the start of industry level regulatory tightening.

Exhibit 57: China Education Index* total market cap – aggregate market cap shrank 32% during February-December 2018, but recovered to pre-regulation levels in only one month and largely remained on a rising trend until the second round of regulation this year



Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, Morgan Stanley Research. Data is from end July 2017 to July 20, 2021. *The index consists of 27 Chinese education stocks listed across A-share, HK and US equity markets. Total market cap is a simple summation of individual constituents' market cap and only includes stocks listed before tightening start. Vertical line represents the start of industry level regulatory tightening.

Exhibit 56: China Education Index* 12m Fwd P/E in absolute and relative terms vs. MSCI China - its valuation de-rated 14 P/E points (or 30% vs. the market) in 8 months to reach a trough, and is still yet to recover, particularly for relative valuation



Source: Datastream, Factset, Refinitiv, Wind, I/B/E/S, Morgan Stanley Research. Data is from end July 2017 to July 29, 2021. *The index consists of 27 Chinese education stocks listed across A-share, HK and US equity markets. The index is constructed on an equal-weighted basis with inception date on end July 2017 and is rebalanced upon IPO day of each new listing during the period. Vertical line represents the start of industry level regulatory tightening.

Phase Two (2Q 2021 - now) embodies much broader restrictions on overall AST, changing the fundamental growth trajectory of the sector

- Market concerns surrounding K12 AST tightening started to spread at the end of March 2021 based on some unsubstantiated documents regarding an upcoming regulatory clamp down. In mid-May, Reuters reported that China was looking to ban on-campus academic tutoring classes, and on and off campus tutoring during weekends. It later reported on a more expanded ban. In June 2021, China's Ministry of Education created a new department dedicated to overseeing the AST market in the country. In the meantime, China's legislature NPC started discussions to revise laws on vocational education by lifting its status to the same level as general education.
- On July 24, 2021, China's top governing body issued guidelines on education sector reforms. Measures include:
  - Regional governments can no longer approve new off-campus tutoring centers providing core/compulsory education. Existing ones must register as non-profit institutions;
  - AST on weekends, public holiday and summer & winter vacation is prohibited;
  - AST institutions teaching core curriculum are banned from corporate financing in the capital markets.

Market implications: Segment market cap down ~70% in the face of a significant headwind against the current business model

- Phase Two of Education sector tightening has had much bigger impact in the equity market with an unprecedented market cap. decline – total market cap of the segment's listed stocks had dropped 78% from over US$100bn at its peak (end Jan 2021) down to US$23bn as of July 29, 2021 (Exhibit 57). In particular, the market size for the industry has seen a more rapid drop since May when news on deepening regulation measures started to spread, down by 67% in the past three months.
- The segment has also recorded the worst relative performance and valuation discount vs. the benchmark index. The segment has underperformed the broad MSCI China Index by 75% if measured from its recent peak (August 2020), and by 53% if measured since May 2021 (Exhibit 55).
- The segment's 12-month forward P/E has already de-rated 19.4 P/E points from its peak at 25x (Aug 2020) to 5.6x as of July 29, 2021, or 76% as measured by relative terms vs. the market, and does not appear to show signs of bottoming yet. It derated by 14.2 P/E points (or 58% by relative change) if we gauge from May 2021. The same observation can be made with its relative valuation vs. MSCI China, with the segment now trading at a 60% discount vs. the broad index, a level not seen previously (Exhibit 56).

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Valuation Methodology and Risks

Longfor Group Holdings Ltd. (0960.HK)
Our HK$60.28/share end-2021 NAV estimate comprises HK$41.27 of development properties (DCF, 10% WACC), HK$31.29 of investment properties (cap rate 3-6%), and HK$12.28 of net debt. To this we apply a 10% discount based on our developers' scorecard, comprising landbank (with a 8/10 score), execution (9), scale (9), growth (9), profitability (8), financing (10), and leverage (9). We use 10-70% discounts in our coverage.

Risks to Upside

Stronger-than-expected contract sales.

Faster-than-expected opening of new shopping malls.

Risks to Downside

Weaker-than-expected contract sales.

Slower-than-expected opening of new shopping malls.

China Resources Land Ltd. (1109.HK)
Our HK$59.75/share end-2021 NAV estimate comprises HK$33.25 of development properties (DCF, 10% WACC), HK$40.95 of investment properties (cap rate 3-6%), and HK$14.46 of net debt. To this we apply a 25% discount based on our developers' scorecard, comprising landbank (with a 8/10 score), execution (8), scale (9), growth (7), profitability (9), financing (10), and leverage (10). We use 10-70% discounts in our coverage.

Risks to Upside

Stronger-than-expected contract sales.

Accelerated opens of new malls.

Risks to Downside

Weaker-than-expected contract sales.

Slower-than-expected opening of new shopping malls.

Innovent Biologics Inc (1801.HK)
We use a discounted cash flow methodology assuming a COE of 8.4%, long-term ROE on new investments of 15%, 25 years to reach steady-state growth, and a terminal growth rate of 6%. We start our DCF timeframe from 2021.

Risks to Upside

Faster than expected pipeline progress

More collaborations with large pharmaceutical companies

Risks to Downside

Failures of clinical trials

Failures or delays in efforts to be included in reimbursement lists, or more competitors being included in reimbursement lists after substantial price cuts

Hansoh Pharmaceutical Group Co Ltd (3692.HK)
We use a discounted cash flow methodology to arrive at our price target. We start the DCF timeframe from 2020 and assume a WACC of 8.5%, a terminal growth rate of 5%, a long-term ROE of 12.5%, 15 years to reach a steady growth rate, and leverage (net debt/equity) of 20%.

Risks to Upside

Earlier-than-expected product launches

Or pace of industry growth picks up

Risks to Downside

Continued industry slowdown and further big price cuts

Unexpected competition in CNS and oncology

Major pipeline failures

Jiangsu Hengrui (600276.SS)
Base case, discounted cash flow methodology. We assume a cost of equity of 8.1%, long-term ROE of 15%, 20 years to reach steady state and a terminal growth rate of 6%.

Risks to Upside

More inclusion of drugs in insurance list

Potential collaborations with global pharmaceutical companies

Risks to Downside

Price cuts on oncology drugs and more injectables entering government's centralized procurement lists

Pollution issues with drug manufacturing processes, or warning letters from US FDA on-site inspections

Significant setbacks in pipeline progress vis-a-vis market expectations

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The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report: Fran Chen, CFA; Jonathan F Garner; Laura Wang.

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(as of July 31, 2021)

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For disclosure purposes only (in accordance with FINRA requirements), we include the category headings of Buy, Hold, and Sell alongside our ratings of Overweight, Equal-weight, Not-Rated and Underweight. Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, Not-Rated and Underweight are not the equivalent of buy, hold, and sell but represent recommended relative weightings (see definitions below). To satisfy regulatory requirements, we correspond Overweight, our most positive stock rating, with a buy recommendation; we correspond Equal-weight and Not-Rated to hold and Underweight to sell recommendations, respectively.

	Coverage Universe		Investment Banking Clients (IBC)			Other Material Investment Services Clients (MISC)	
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
Overweight/Buy	1511	43%	421	48%	28%	676	44%
Equal-weight/Hold	1466	42%	372	42%	25%	654	43%
Not-Rated/Hold	1	0%	0	0%	0%	0	0%
Underweight/Sell	518	15%	84	10%	16%	199	13%
Total	3,496		877			1529	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index or the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index or the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis over the next 12-18 months.

Not-Rated (NR) - Currently the analyst does not have adequate conviction about the stock's total return relative to the relevant country MSCI Index or the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U or Under) - The stock's total return is expected to be below the total return of the relevant country MSCI Index or the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

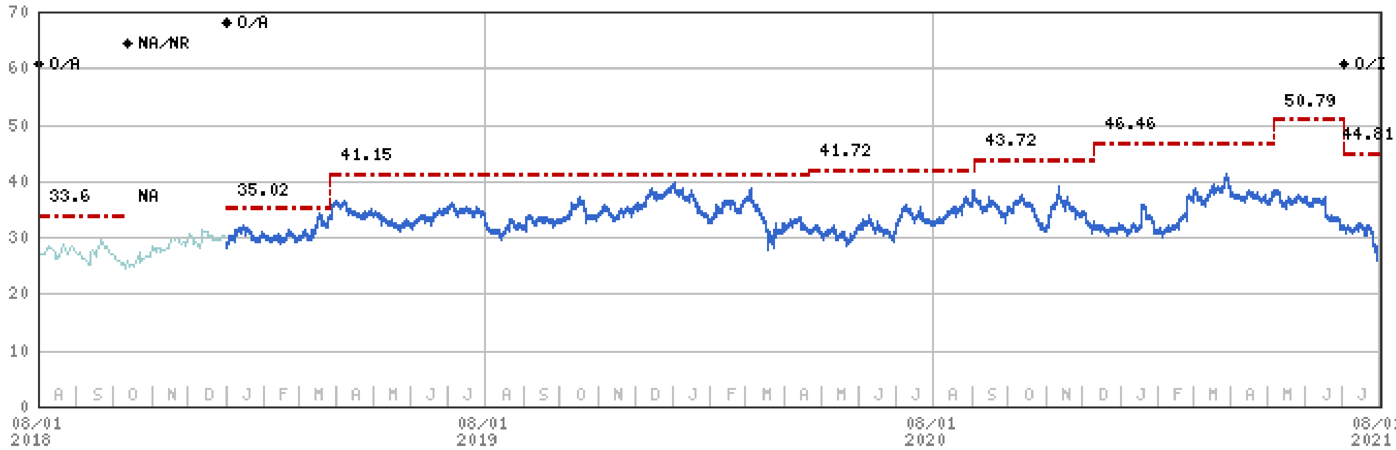
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

Stock Price, Price Target and Rating History (See Rating Definitions)

China Resources Land Ltd. (1109.HK) - As of 7/31/21 in HKD
Industry : China Property



Stock Rating History: 8/1/16 : O/I; 2/7/17 : O/A; 10/13/18 : NA/NR; 1/2/19 : O/A; 7/2/21 : O/I

Price Target History: 7/4/16 : 25.2; 2/7/17 : 27.5; 4/24/18 : 33.6; 10/13/18 : NA; 1/2/19 : 35.02; 3/27/19 : 41.15; 4/21/20 : 41.72; 9/4/20 : 43.72; 12/11/20 : 46.46; 5/6/21 : 50.79; 7/2/21 : 44.81

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) Stock Price (Covered by Current Analyst)
Stock and Industry Ratings (abbreviations below) appear as ◆ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

Effective January 13, 2014, the stocks covered by Morgan Stanley Asia Pacific will be rated relative to the analyst's industry (or industry team's) coverage.

Effective January 13, 2014, the industry view benchmarks for Morgan Stanley Asia Pacific are as follows: relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

Hansoh Pharmaceutical Group Co Ltd (3692.HK) - As of 7/31/21 in HKD
Industry : China Healthcare

Stock Rating History: 8/1/16 : NA/A; 7/16/19 : O/A

Price Target History: 7/16/19 : 29; 1/15/20 : 30.3; 11/2/20 : 34.8; 11/27/20 : 44.2; 1/5/21 : 50; 4/13/21 : 51; 5/7/21 : 45

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) Stock Price (Covered by Current Analyst)
Stock and Industry Ratings (abbreviations below) appear as ◆ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
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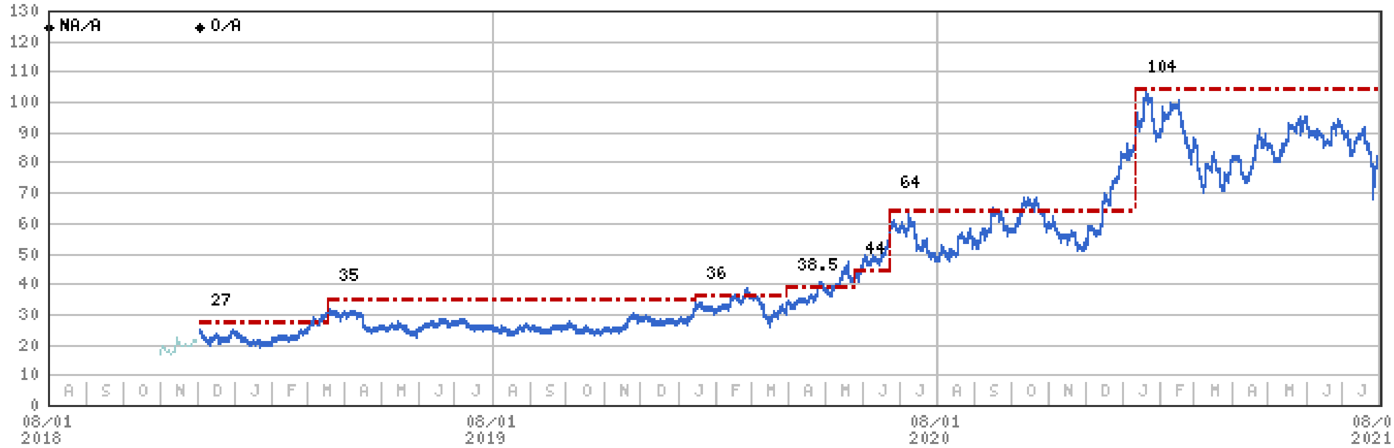
Innovent Biologics Inc (1801.HK) - As of 7/31/21 in HKD
Industry : China Healthcare



Stock Rating History: 8/1/16 : NA/A; 12/3/18 : O/A

Price Target History: 12/3/18 : 27; 3/18/19 : 35; 1/15/20 : 36; 3/31/20 : 38.5; 5/26/20 : 44; 6/23/20 : 64; 1/12/21 : 104

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) Stock Price (Covered by Current Analyst)
Stock and Industry Ratings (abbreviations below) appear as ◆ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
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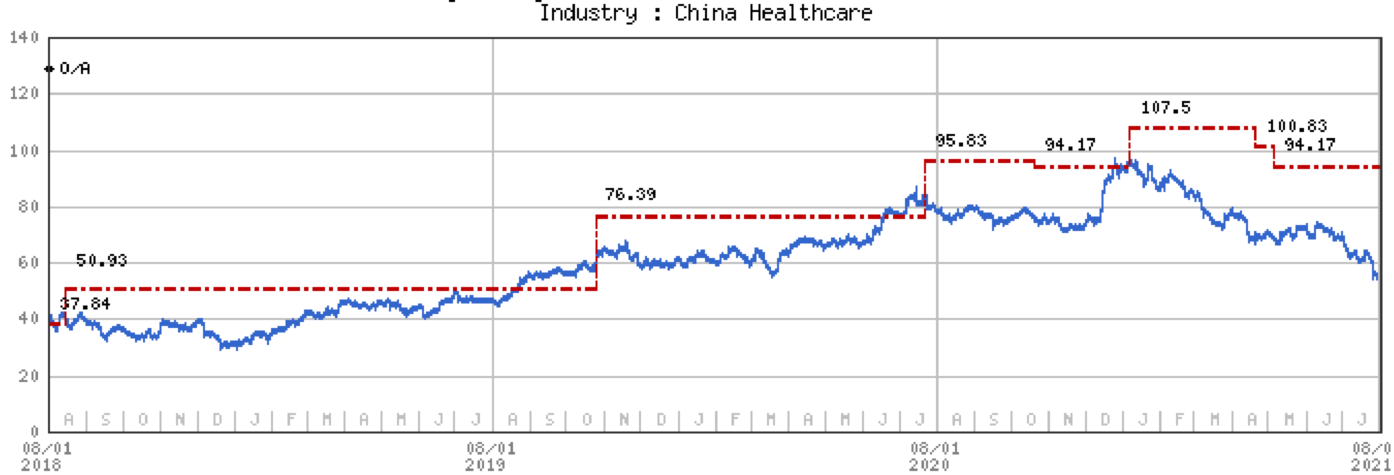
Jiangsu Hengrui (600276.SS) - As of 7/31/21 in CNY
Industry : China Healthcare



Stock Rating History: 8/1/16 : O/A

Price Target History: 11/27/15 : 17.31; 2/1/17 : 20.03; 4/24/17 : 24.48; 7/27/17 : 26.71; 2/9/18 : 37.84; 8/14/18 : 50.93; 10/25/19 : 76.39; 7/22/20 : 95.83; 10/20/20 : 94.17; 1/6/21 : 107.5; 4/20/21 : 100.83; 5/6/21 : 94.17

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) Stock Price (Covered by Current Analyst)
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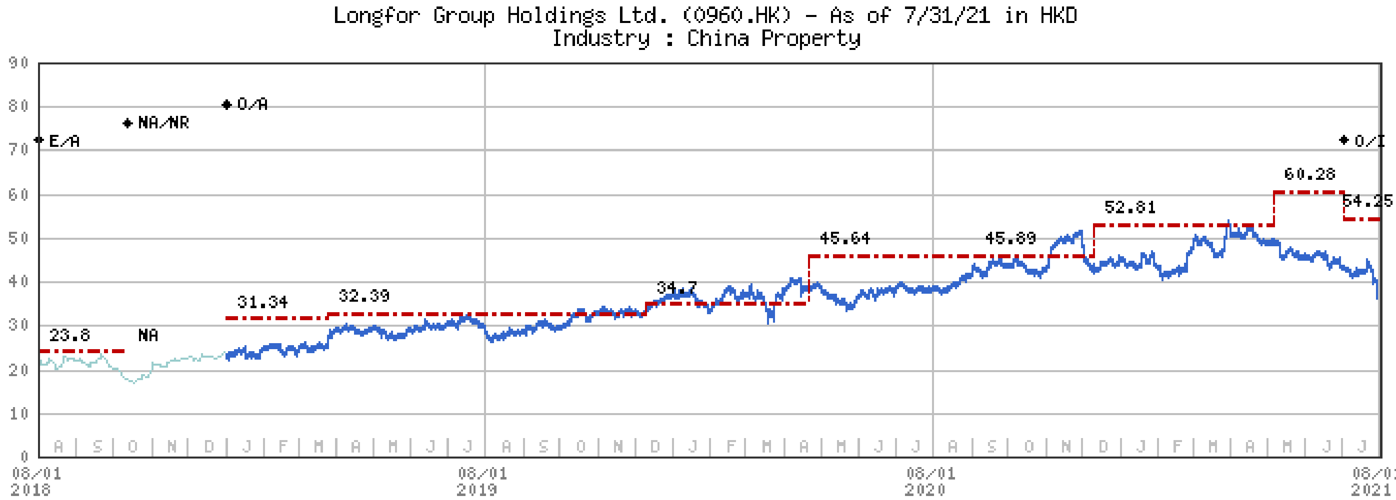

Stock Rating History: 8/1/16 : O/I; 10/31/16 : E/I; 2/7/17 : E/A; 7/5/17 : E/A; 10/13/18 : NA/NR; 1/2/19 : O/A; 7/2/21 : O/I

Price Target History: 7/4/16 : 14; 10/31/16 : 11; 2/7/17 : 12.7; 7/5/17 : 12.7; 11/13/17 : 19.8; 4/24/18 : 23.8; 10/13/18 : NA; 1/2/19 : 31.34; 3/26/19 : 32.39; 12/10/19 : 34.7; 4/21/20 : 45.64; 9/4/20 : 45.89; 12/11/20 : 52.81; 5/6/21 : 60.28; 7/2/21 : 54.25

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) Stock Price (Covered by Current Analyst)
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