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October 2023: China Newsletter

Evolution of the Chinese EV landscape

China update

In September, Chinese equities posted modest losses due to higher U.S. Treasury yields and a strong dollar, exerting pressure on emerging market assets. Foreign investors divested from the Chinese market, while domestic investors recorded positive inflows from ETFs purchases. MSCI China and MSCI China A Onshore indices were down 2.7% and 1.8%, respectively. Information Technology and Real Estate sectors declined, while Energy and Financials performed relatively well.

- **China's Q3 GDP grew 4.9% YoY, exceeding expectations, driven by positive trends in consumption and industrial activity.**
- **Beijing increased the budget deficit by issuing 1 trillion yuan in sovereign bonds to address local government debt.**
- **Chinese EV industry faces consolidation due to intense competition; top players will have to excel in robust hardware and software capabilities and integration.**
- **Rox Motor Tech has delivered a total of 3 000 EVs, and the company is valued at an impressive US$2 billion.**

Chinese Equities: The month of September in review

China's economy grew faster than expected at 4.9% year-on-year in the third quarter. September consumption and industrial activity surprised on the upside suggesting that recent stimulus measures are beginning to take effect. Beijing has also stepped-up efforts to address the issue of local government debt, increasing the budget deficit by issuing 1 trillion yuan of sovereign bonds. Additionally, a debt swap program was launched to reduce the interest burden on local governments. Despite a brief uptick in new home sales, housing demand remains weak. The market will look for more clues at the annual Central Economic Work Conference in December, where top officials will decide their economic priorities for 2024. On the geopolitical front, there have been marginal improvements in US-China relations following several rounds of high-level discussions and visits. It is anticipated that Joe Biden and Xi Jinping will meet at the November Asia-Pacific Economic Cooperation (APEC) summit in San Francisco.

Evolution of the EV landscape in China

In a recent Financial Times article, the discussion centred on consolidation in the Chinese EV sector. It highlighted the likelihood of many electric carmakers failing to achieve profitability and eventually being eliminated. This conclusion is not surprising, as it's a common trend in emerging and rapidly growing technologies. Innovations and new ideas often dominate, leaving early entrants and those with limited operations vulnerable to competition, particularly within Chinese borders. One can merely think back to the intense competition among Chinese internet companies during their early growth stage, and the EV sector may experience a similar fate: smaller players lacking management expertise, manufacturing capabilities, and investor support will struggle to remain competitive, and some larger companies could even become obsolete as new ideas emerge, reminiscent of the Betamax versus VHS scenario.

EV production parallels smartphones with components being outsourced for later assembly.

Challenges for smaller players include lack of expertise, manufacturing capabilities, and crucial investor support.

Some Chinese EV brands have emerged as major players on a global scale.

Unlike internal combustion engine vehicles, EV production is more like that of smartphones, where manufacturing of key components can be outsourced and later assembled. This reduces capital requirements significantly and shortens product launch timelines, which in turn encourages new entrants. However, it is important to note that the most challenging aspect of building an EV lies in having robust hardware and software capabilities, as well as successfully integrating the two. This will ultimately distinguish the top players from the rest. For instance, Rox Motor Tech, a Chinese EV brand specializing in sports utility and off-road vehicles, was established just two years ago and has already made 3 000 deliveries, with double that already ordered, far exceeding initial budgets. Backed by prominent investors, such as Tencent for example, the company has successfully secured six rounds of financing and is currently valued at over US$2 billion.

As more new players enter the market, and advancements in AI and autonomous driving technologies continue, the landscape of the EV industry will certainly evolve in coming years. Throughout this transformation, many companies will fail, but those that survive will become stronger and more globally competitive. The 'winner takes all' phenomenon is a result of intense global competition nowadays. Notably, a few Chinese brands have already emerged as major players on a global scale, even without having ventured into the export market yet. Interestingly, RisCura highlighted the appearance of Chinese EV showrooms in Mayfair in a previous newsletter. The report highlighted the ambitions and intentions of Chinese EV manufacturers as they solidify their status as an evident EV global leader.

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