Shenzhen: The “Model City”

What are the stocks that can take advantage of this New Model City?

Shenzhen has this year been promoted as a “model city” by China’s State Council — and this represents a real opportunity for equity investors. A trailblazer since the late 1970s when it pioneered as a Special Economic Zone, Shenzhen has transitioned from being the world’s factory to become a leading hub of innovation. So what are the stocks that can take advantage of this new policy push?

This white paper was developed by the Asia Equity Strategy team led by Raymond Cheng.*

A POLICY OF ENCOURAGEMENT

On August 18, 2019, Shenzhen was advocated as a “leading role model city of socialism with Chinese characteristics,” by China’s State Council. The plan unveiled key areas of focus, including technological innovation, healthcare, finance, smart cities, recycling and environmental sustainability. According to the document, by 2025, Shenzhen will become a global mega city in terms of economic might and development quality, with world-leading research and development (R&D) and industrial innovation capabilities. By 2035, Shenzhen is slated to become a model city in China epitomizing “highly modernized social governance and economy.”

This policy directive is a notable milestone for Shenzhen, which has already been recognized as a leader of China’s reform and opening-up over the past four decades. These policies should spur a further flow of workforce talent, capital and information technology in years to come. It is also safe to assume that further policies will flow on from this announcement, particularly to accelerate the development of innovation and green technology, and in order for Shenzhen to better integrate with Hong Kong, Macao and the Greater Bay Area.

China’s State Council wants to be at the forefront of the latest tech developments, including 5G mobile applications, Artificial Intelligence (AI), cyber tech and life sciences. They are also trying to take global leadership of the looming electric vehicle revolution, plus the push for more energy-efficient home appliances.

BYD is one of China’s leading electric vehicle and battery producers, generating 60% of passenger vehicle and public transportation sales from Shenzhen¹.

01 GREEN TECH PIONEERS

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*There can be no assurance that any or all of these professionals will remain with the firm or that past performance or success of any such professional serves as an indicator of the portfolio's success.
Inside the home, **Midea** is a key beneficiary of China’s recent policy stimulus to speed up the purchase of energy-efficient, smart consumer appliances as the rising middle class incorporates more and more of these applications into their everyday lives. The company has diversified its product portfolio beyond our homes, including factory automation business opportunities in China given that the company’s KUKA AG robotic factory based in Guangdong recently commenced operations.

**02 DEVELOPERS WITH NOTABLE EXPOSURE TO SHENZHEN**

Within the government’s stated emphasis on increasing Shenzhen trade, there is considerable attention paid to the Qianhai Modern Service Industry Cooperation Zone.

As the property arm of China Merchants Group, the state-owned China Merchants Shekou Industrial Zone Holdings occupies 50% of the land bank from Shenzhen\(^2\). It has three key projects\(^3\) based in prime locations across the region, with the Qianhai Shekou free trade zone being one of the most notable.

**03 LEVERAGING INCREASING REGIONAL BUSINESS TRAVEL**

Cutting across all the priority areas of the State Council is the goal of establishing Shenzhen as a comprehensive regional hub attracting a diversity of visitors.

As investment interest and workforce pulls increase, Shenzhen Airport looks set to prosper. Classified as a regional hub, the airport is one of five international airports in the Pearl River Delta region\(^4\). Forecasts suggest that further growth in long-haul route options will occur, particularly given the enhanced government support and a decreasing reliance on Hong Kong International Airport.

**04 ENVIRONMENTAL PIONEERS**

China’s State Council has prioritized the promotion of waste management and sustainable consumption in its planning, within its focus on “green economy”.

This puts **China Everbright International** in a strong position to benefit, as the largest waste-to-energy (WTE) operator in China. The company has three WTE facilities\(^5\) in the Greater Bay Area and trades at 6x price-to-earnings (P/E), despite a 4% dividend yield and mid-teens earnings per share (EPS) at a compound annual growth rate (CAGR)\(^6\).

**05 PRIMARY INFRASTRUCTURE ACTORS**

As one of the largest contractors for commercial property and affordable housing in the Greater Bay Area, **China State Construction** is expected to benefit from policy support, particularly in the facilitation of local government infra bonds to fund public-private partnerships (PPP) in infrastructure. The stock trades at an undemanding valuation of around 6x forward P/E\(^7\).

China State Construction can also benefit from the government’s broader trade push and the drive for new ways of developing cities within the “green economy”.

**06 DRIVERS OF FINANCIAL INNOVATION**

A central pillar of the government’s planning for Shenzhen is a desire to forge closer connections between financial markets in Hong Kong, Macao and further afield. This means deepening foreign exchange management and experimenting with Chinese Yuan (RMB) internationalization. It also involves the mutual recognition of fund products.

An important company providing online financial (and healthcare consulting) services is **Ping An**. Headquartered in Shenzhen, it is one of the world’s leaders in the application of three core technologies to healthcare solutions; namely AI, blockchain and cloud computing. Ping An has a strong track record for incubating fintech and healthtech unicorns, including Lufax, OneConnect, Ping An Good Doctor and Ping An HealthKonnect.

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\(^3\) The projects are the Qianhai project, the Prince Bay project and the Shekou project. Data as of Company Filings. Morgan Stanley. Data as of June 28, 2019.

\(^4\) The five airports are Hong Kong International Airport (HKIA), Guangzhou Baiyun Airport, Macau International Airport, Shenzhen Bao’an Airport and Zhuhai Airport.


China has led the world in the uptake of mobile payment applications and e-commerce — and the government wants to foster further innovation, while increasing privacy protections and network security.

Perhaps the best known Chinese digital pioneer, Tencent, is today a true giant, focusing on communications, online advertising, e-commerce, gaming and cloud services. The company fosters innovation by collaborating with different provincial governments and incubating hundreds of potential next-gen unicorns.

Another notable resident of Shenzhen, Luxshare Precision, is ranked among the top 50 telecommunication and manufacturing enterprises. The company has been an active innovator of the components used in next generation consumer electronics and new energy vehicles, including acoustic components, connectors, 5G-centric optical transceivers and antennas.

**We Can Help**

Speak with your J.P. Morgan representative to see how these ideas and perspectives might bring about investment choices that suit your needs.
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