China Strategy

Implications of the 20th CPC Congress Meeting

- **Macro:** The policy framework should remain stable as China continues to focus on high-quality development in future. Investors should pay attention to several key themes: manufacturing upgrading, technology innovation, digital economy, security, green development and common prosperity.
- **Strategy**: The lack of surprises in key policies such as zero-COVID and housing market means there are no catalysts for re-rating in China/HK stock markets yet. Over the longer term, growth stocks could lead a re-rating as early as end-2022, while low-end industries might underperform.
- **Banking & Insurance:** We expect to see a fast expansion of the pilot projects of individual pension account, along with policy incentives on other protection insurance products, i.e., long-term care insurance etc., in the coming years. Banks and insurers will benefit from an expansion of customer base and cross-selling of other financial products, in our view.
- **Property:** The overall tone remains unchanged compared to 19th CPC with "housing is for living, not for speculation". We think this would imply no big policy breakthrough to overcome the current market downturn so the property sales recovery would be lengthy and bumpy.
- **Technology:** The 20th CPC work report stressed on modernizing China's national security system and safeguarding national security. Compared to 19th CPC, this work report highlighted the importance of security and reliability of food, energy, and supply chains. Considering ongoing China-US tensions and national security concerns, we believe this will further boost the strategic importance of supply chain self-sufficiency in semiconductor industry.
- **Software & IT services**: National security including supply chain security was being emphasized in the 20th CPC. Amid escalating US-China tech war, we believe China will continue to implement the technology localization initiatives, benefiting software companies under 1) Xinchuang supply chain, 2) public security and 3) network security. In the short term, we prefer Hikvision (002415 CH, BUY) on its technology leadership and strong cash position.
- **Internet I:** Digital economy is an integral part of national economy, and the right policy guidance can enhance quality economic growth. The leading tech companies have been providing infrastructure to facilitate enterprise digitization, empowering various industries to improve efficiency and global competitiveness. We expect regulations for the consumer internet industry and large-scale platforms will remain consistent. While the support on guiding companies to invest in frontier technologies will increase, we expect the leading companies, such as Alibaba, Tencent, Baidu and JD's enterprise related income will surpass its consumer internet income over the long run.
- **Internet II:** Internet-related tone is largely in line, with more focus on "tech innovation" and "security". Fundamental improvement and potential lockdown relaxation would be the key to trigger a turnaround. The internet sector might still consolidate for one or two quarters, but would gradually bottom out on 12-month horizon.
- **Capital goods:** The President's report emphasized the industrial supply chain security and the acceleratoin of building a country with strong manufacturing

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capability. The report also highlighted the target of achieving carbon neutrality through a gradual process and the importance of energy security. All these are basically in line with the existing policy direction. By segment, we believe the advanced manufacturing, solar power and energy equipment sector will be beneficiaries over the coming five years. We have identified nine names in this report.

- **Energy-Gas:** The 20th National Congress of the CPC proposed to speed up the green transformation, ensure energy security and make a steady progress in realizing the "carbon peaking" and "carbon neutrality" targets. We believe the gas demand will rise in the mid to long term, given China will strengthen the exploration of gas resources to further ensure energy security. Otherwise, gas can also be a low-polluting energy to help China reach the "carbon peaking" and "carbon neutrality" goals. Thus, gas producers like "Three barrels of oil" and gas distributors like CRG (1193 HK), ENN (2688 HK) will benefit from it.
- **Healthcare:** China aims to promote the development of strategic industries, while biotechnology is one of the seven key industries mentioned. We think the government is going to further encourage the innovation of drugs and medical devices, which will benefit innovative biotech and innovative medical device sectors. China aims to introduce supportive policies to lift birth rate, which will boost the penetration of ART in China. China will enhance the medical system's capabilities of emergency care in order to effectively contain the risks of infectious disease outbreak. We think local medical equipment manufacturers will benefit.
- **F&B/ Cosmetics/ DFS:** We are not changing our views that the promotion of employment stability and hence the "common prosperity" will ensure a steadfast consumption upgrade not only for daily necessities but also for affordable travel and luxuries. CRB, Proya and CTGDF are top beneficiaries.
- **Consumer discretionary:** The commitment on zero-Covid policy would continue to weigh on consumer industries especially the catering and tourism in the short run. In the long run, key themes are consumption upgrades amid the rise of middle class, the rise of domestic brands, the development of lower-tier cities and more balanced income distributions and recovery of HK retail.

Macro Economy

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According to President Xi's report at the opening session of the 20th CPC congress meeting, China will focus on high-quality development in next five years. Investors should pay attention to several key themes in President Xi's report, which reflects the policy-making philosophy in the future.

I. Manufacturing upgrade, technology innovation & digital economy development

1) China will facilitate manufacturing upgrade towards the highend, the intelligent and the green. Amid higher labor costs, stricter environmental protection and more trade tensions, the competitiveness of Chinese manufacturers declines in labor-intensive industries. Some Chinese and foreign companies are relocating their factories for labor-intensive products or for the assembling from China to Southeast Asia. This conforms to the natural law that industrial structure upgrade with economic development. To maintain growth and competitiveness, China has to accelerate its manufacturing upgrade towards the high-end, the intelligent and the green. Leading companies in China's manufacturing industries should take the lead in the upgrading and transition.

2) China will support new generation IT, artificial intelligence, biotechnology, new energy, new material, high-end equipment and green technology to become new growth engines for China's economy. These industries are of great importance for China's high quality development as well as competition in the global market. The policymakers will launch more policies including tax credit, special lending and talent support to accelerate the development of these new strategic industries. China has huge domestic market and comprehensive supply chain system, which could attract capital & talents and support industrial applications of high technologies.

3) China will accelerate the development of IoT industry and digital economy. According to the Ministry of Industry and Information Technology, the value of China's IoT industry reached over RMB2.4trn in 2020. The IoT is widely used in smart equipment, facilities and vehicles. Leading companies in key components like intelligent controllers will have growth opportunities in future. According to China's Academy of Information and Communications Technology, the country's digital economy reached over RMB45.5trn in 2021 with the average growth for 2012-2021 at 15.9%. China will continue to improve and upgrade digital infrastructure (e.g., 5G network), fully utilize data as a core factor of production and implement digital transformation across all industries.

II. Food & energy supply security, technology independence and cyber security

1) China will continue to enhance national food and energy security by increasing domestic supply and diversifying source of imports. To increase domestic food supply, China will increase fixed investment in agriculture and water conservancy and support the development of agricultural technology (e.g. seed technology). These policies should benefit leading agricultural companies in China. To ensure energy security, China will increase capex in both traditional energy and new energy. Meanwhile, China will enhance trade & investment ties with more countries to diversify the energy import source.

2) China will support technology independence and enhance cyber security. In face of the Sino-US decoupling risk in the technology sector, China has launched the "indigenous innovation"(自主创新) strategy with the target of independence in core technologies. The US has launched new export controls of chip technologies to Chinese tech companies. The ban will slow China's progress in downstream tech sectors, but may enhance China's determination in technology independence. China will also enhance cyber security for national security. China's cyber security policies should benefit domestic software and service suppliers as they are negative for foreign companies.

III. Green development

1) China will steadily push forward energy structural transition with lower coal & petroleum consumption and higher gas & new energy consumption. China will facilitate its energy transition while ensuring energy security. It will accelerate the development of PV and wind power, steadily develop hydropower & nuclear power and build more coal-fired plants as a reserve for use when renewable energies are in short supply. China will continue to encourage the substitution of coal with gas in heating sector in the north region.

2) China will continue to support the development of new energy vehicles. New energy vehicles have become a new engine for China's economic growth as well as its green development. China has taken the lead in the supply chain of new energy vehicles, supporting the strong growth of China's exports of autos and components this year. The increase of new energy vehicles should help China to slow the growth of its crude oil imports and improve the energy security.

IV. Common prosperity & consumption upgrading

1) China targets higher shares of household income in national income and labor compensation in primary income. This should point to higher labor costs, which is positive for consumer staples and negative for labor-intensive sectors with low labor productivity. It is also positive for robot industry as business will use more robots to replace simple labors in future. China may also increase fiscal transfer incomes or benefits to households.

2) China will increase incomes of the poor and expand the middle class by boosting employment, enhancing social safety net and increasing transfer incomes. China will also enhance labor protection in flexible employment. These policies are positive for consumer staples and durables.

3) China will encourage the development of life and health insurance products. Insurance products can help consumers to hedge against their life and health risks, which is in line with the common prosperity spirit. China will proactively promote the development of commercial insurance products in future.

4) China will maintain the policy stance that housing is for living not for speculation. This indicates China will not aggressively stimulate housing market in future. In face of the housing market collapse this year, the policymakers may ease mortgage and credit policy in the property sector in a gradual manner. In the medium term, China will maintain prudent credit policy towards the property sector. Meanwhile, China will build more subsidized rental housing to the youth in tier-one and tier-two cities. Amid demographic changes and prudent policy stance, property development investment as % of China's GDP may continue to decline in future, which is positive for China's transition towards the consumption and technology driven economy.

5) China will reduce birth costs and childcare & education burden for young couples and regulate the development of private hospitals. Birth costs and childcare & education burden are the key factors behind the decline of birth rates. China's target to control education burden points to policy uncertainty for the tutoring sector. Meanwhile, China positions state-owned hospitals as public welfare institutions and vows to regulate the development of private hospitals. This indicates private hospitals cannot have high profitability, which may lower capital inflows into the sector. China will continue to support the development of Chinese medicines in future.

Figure 1: Number of Occurrences for Key Words in President Xi's 20th CPC Congress Report

20th CPC congress		19th CPC Congress		18th CPC Congress	
Key words	**Number of occurrences**	**Key words**	**Number of occurrences**	**Key words**	**Number of occurrences**
Development "发展"	238	Development "发展"	232	Development "发展"	301
Politics "政治"	63	Politics "政治"	93	Economy "经济"	104
Economy "经济"	59	Economy "经济"	70	Reform "改革"	86
Innovation "创新"	55	Reform "改革"	69	Innovation "创新"	58
Reform "改革"	51	Innovation "创新"	59	Politics "政治"	52
Education "教育"	49	Education "教育"	43	Education "教育"	49
Science & tech "科技"	44	Opening up"开放"	27	Opening up "开放"	38
National security "国家安全"	29	Struggle "斗争"	23	Market "市场"	24
Opening up "开放"	29	Revolution "革命"	20	Employment "就业"	20
Struggle "斗争"	22	Market "市场"	19	Healthcare "医疗或卫生"	19
Quality "质量"	20	Livehoods "民生"	18	Livehoods "民生"	18
Employment "就业"	18	National security "国家安全"	18	Science & tech "科技"	16
Market "市场"	18	Science & tech "科技"	17	Revolution "革命"	9
Healthcare "医疗或卫生"	17	Quality "质量"	16	Quality "质量"	9
Livehoods "民生"	15	Employment "就业"	14	Finance "金融"	9
Revolution "革命"	12	Healthcare "医疗或卫生"	13	Anti-curruption "反腐"	8
Anti-curruption "反腐"	10	Ideology "意识形态"	8	Urbanization "城镇化"	7
Ideology "意识形态"	10	Anti-curruption "反腐"	8	Struggle "斗争"	5
Finance "金融"	9	Finance "金融"	7	Common prosperity "共同富裕"	4
Common prosperity "共同富裕	8	Common prosperity "共同富裕"	6	National security "国家安全"	4
Social stability "社会稳定"	4	Social stability "社会稳定"	2	Ideology "意识形态"	1
Urbanization "城镇化"	4	Urbanization "城镇化"	2	Social stability "社会稳定"	1
Total number of words for the report	31551	**Total number of words for the report**	32329	**Total number of words for the report**	28997

Source: Xinhua News Agency, CMBIGM

HK Market Strategy

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Short-term outlook

- **Lack of catalysts to drive a re-rating in the broad market…**

In President Xi's 20th CPC National Congress Report, there are no material changes to policy direction in key areas, including zero-COVID, housing market and common prosperity.

While the lack of changes in these policies for now have largely been expected by the market, it is safe to say **there are no major positive surprises to drive a re-rating in China/HK stock markets, and in particular Consumer Discretionary, Property and Internet sectors**, which have been affected by zero-COVID, housing market and common prosperity policies respectively.

On the plus side, the Report mentioned that "development is the top priority for the Party to govern and rejuvenate the country" ("发展是党执政兴国的第一要务"). This may help alleviate some investors' worries (non-consensus though) that China might sacrifice economic growth to achieve certain ideologies.

- **…or in high-end development and green industries, despite policy support**

The Report emphasised the importance of high-quality growth by accelerating manufacturing upgrade towards the high-end, the intelligent and the green. **While this blueprint bodes well for the long-term development of these industries, we do not expect relevant stocks to react strongly in the short term,** because 1) support for these industries is not entirely new or surprising; 2) these are long-term blueprint, with specific policies / targets yet to be announced, possibly in the Central Economic Work Conference in Dec 2022 or the Government Work Report in Mar 2023; 3) some of the high-end, strategic industries such as semi-conductor, artificial intelligence and biotechnology are vulnerable to China-US tension, and investors may wait and see ahead of the US midterm election on 8 Nov 2022.

Medium-to-long-term outlook

- **Growth stocks to lead re-rating as early as end-2022**

When the uncertainties in US rate hikes, China-US tension and China's reopening policy dissipate (possibly towards the end of 2022), China/HK stock markets may start to have more re-rating potential and upward momentum.

By then, we expect growth stocks to have more upside than value stocks, because:

1) Growth stocks typically have a higher beta;
2) Growth stocks' valuations are more sensitive to interest rates, and thus had significant de-rating in the past 12 months when US bond yields surged, but should enjoy re-rating when US yields peak out;
3) After the US mid-term election on 8 Nov 2022, the US policy moves targeting China's strategic sectors such as semi-conductors, AI, technology, military and biotech might become less frequent for some time, and thus these sectors could stage a rebound, especially in case of a divided US government which makes it more difficult to pass bills (polls show the Republicans are favoured to win the House). Over the long term, however, China-US tension is likely to linger and cause volatilities in these sectors from time to time.

- **Low-end industries to underperform**

The stress on high-quality growth, in our view, implies that the old model of massive stimulus in infrastructure, property market and low-end manufacturing is behind us. Compared to high-end and innovative industries, real estate, banking, infrastructure and building materials are likely to underperform over the long run.

In the medium-term though, when China's housing market has stabilised, some real estate (survivors) and banking stocks could outperform due to their currently distressed valuations.

Banking & Insurance

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The 20th CPC Congress emphasizes the concept of "Common Prosperity", highlighting the necessity to further enhance the social welfare system. The development of the 3rd pillar of pension system, the serious disease insurance scheme, long-term care insurance policies and commercial health insurance products are on financial institutions' priority list of the next five years. We expect to see a fast expansion of the pilot projects of individual pension account in the coming years, along with policy incentives on protection insurance products.

Currently, the scale of the 3rd pillar pension funds are only less than 0.1% of China's annual GDP. As of end-2020, the AUM pension mutual funds and tax-deferred pension insurance amounted to RMB59bn and RMB0.4bn respectively, much smaller compared to the RMB8.3 trn scale of the 1st pillar of pension system and the RMB3.5 trn AUM of the 2nd pillar. Although the profitability of social-welfare products could be thin, we still believe financial companies, i.e. banks and insurers etc., will benefit from the development of individual pension account system, as the improvement of individual pension penetration will lead to an expansion of customer base and cross-selling of other profitable financial products.

Property

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The overall tone remains unchanged compared to 19th CPC with "housing is for living, not for speculation". We think this would imply no big policy breakthrough to overcome the current market downturn so the property sales recovery would be lengthy. Especially in the near term, property sales will remain lackluster as 1) policy support is only 60% of that in 2015; 2) Oct sales may weaken again as forecasted by our leading indicator; and 3) 4Q property loans may still decline by 25% YoY and most of them may go to SOEs rather than POEs. Therefore, we prefer names from long-term perspective with little to none default probability, outperforming sales and land acquisitions: A-share developers (Binjiang A, Huafa A), and H-share ones (Yuexiu, COLI, Longfor).

Policy: Current policy support is only 60% of that in 2015 but property market is much worse: We did a comparative study between now and 2015 when government was trying to stabilize the market in both years. The conclusion is the current sales recovery will be much bumpy and lengthy than 2015 as 1) the policy support was much stronger in 2015 in terms of policy relaxation (almost no home purchasing restrictions for most cities in 2015), downpayment ratio (20% for most cities) and tolerance for speculation/home price increase. 2) The property market is much worse now in terms of sales, property investment and home prices. Therefore, with policy relaxation in baby steps plus pandemic here and there, we expect the sales recovery to be bumpy.

Sales: Our leading indicator Gain suggested a weakening Oct after being corrected again in Sep: The preliminary Sep sales beat market expectation (at 0% MoM) with 10% MoM by major developers and 6% MoM in 30 cities. We think this is mainly attributed to more supplies and contained pandemic in 2nd half of Sep. At the company level, SOE names Yuexiu, CM Shekou, COLI&CRL were outperforming with sales up 18-183% YoY while POE names CIFI/Country Garden were still seeing -31/38% decline. Looking into Oct, our Gain indicator, which has been corrected for each month since its launch in May, suggested the sales to weaken slightly YoY, in line with our forecast for a bumpy recovery. In a longer term, we expect overall sales to stabilize in 2023E (stay flat afterwards) after 25% YoY decline in 2022E (Chart 5).

Financing- underpin only instead of spurring: BBG reported on 30 Sep that PBOC demanded banks to net increase property loans by at least RMB600bn in Sep-Dec 2022. To us, this is merely to support the market from further deteriorating, rather than boosting as 1) Compared to RMB800bn net increase in property loans in 4Q21, this rumored RMB600bn is still 25% below the same period. 2) If there is no change on individual banks' KPI assessment, these SOE banks are likely to lend most of money to SOEs so POEs which need money most are still hard to get real liquidity.

Technology

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The 20th CPC work report stressed modernizing China's national security system and safeguarding national security and social stability. In particular, compared to 19th CPC, this work report highlighted the importance of security and reliability of food, energy, and supply chains. Considering ongoing China-US tensions and national security concerns, we believe this will further boost the strategic importance of supply chain self-sufficiency, especially semiconductor industry.

Ongoing China-US tensions to accelerate semiconductor localization. In the past 20 years, China has built a well-developed technology supply chain as a major global brand and manufacturer of key electronics products (e.g. PC, smartphone, communications) as well as leading suppliers of various electronics components. Since the trade war with US in 2018, China semiconductor localization accelerated to further secure processing, communications and memory supply chain. In addition, to reduce supply chain risk amid geopolitical tensions, more Chinese customers are supportive and willing to adopt new domestic semiconductor suppliers. In the past five years, we see emerging home-grown leaders in EDA/IP, materials, equipment, fabless, foundry, OSAT and memory subsectors. With the 70% localization target by 2025 as announced (vs 35% in 2019), we believe domestic substitution will continue to benefit domestic semiconductor players.

Expect more favorable policy support amid US recent restrictions. Since trade war in 2018, the Chinese government announced a series of industry supporting policies, such as "Measures to further boost IC and software industry" in July 2020, which aims to support local semiconductor industry through tax relief, government R&D grants and National IC fund. In addition, in the 14th Five-Year Plan for 2021-25, more policy emphasis was placed on innovation and self-development for localization. On the other hand, the US government started to tighten export restrictions of semiconductor technology/products to China in 2022, such as 1) "CHIP Acts" in July 2022, 2) new export license on advanced GPU to China in Aug 2022, and 3) additional export controls on advanced chips in Oct 2022, including 16nm/14nm or below logic, 18nm DRAM chips, and 128L NAND chips. Overall, we believe these restrictions will accelerate localization of Chinese semiconductor industry given the current external environment, and domestic semiconductors leaders will benefit from these trends, including fabless (Willsemi, Maxcend, SG Micro, 3Peak), IDM/foundry (SMIC, Huahong Semi, Wingtech), equipment players (Naura, ASM Pacific).

Software & IT Services

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Xi Jinping stresses safeguarding national security and social stability in the 20th CPC. President Xi called for "strenthening the ability to maintain national security, ensuring food and energy supplies, security supply chains, improving the ability to deal with disasters and protecting personal information". In particular, compared to the 19th CPC, Supply Chain security is being mentioned for the first time.

Amid rising US-China tension in technology, we believe China will continue to implement the technology localization initiatives. Software companies under three themes including 1) Xinchuang supply chain, 2) Public security and 3) Network security should benefit in the medium to long term. In the short term with macro fluctuations and uncertainties, we prefer safer name like Hikvision (002415 CH, BUY) on its technology/ market leadership as well as strong cash flow.

Figure 2: Key software companies that would benefit

Theme	Key software companies	
Xinchuang supply chain	Enterprise software	• Kingsoft office (688111 CH) • Kingdee (268 HK) • Yonyou (600588 CH)
	Industrial software	• ZWSoft (688083 CH) • Empyrean (301269 CH) • Supcon (688777 CH) • Baosight (600845 CH)
Public security	AI/ Surveillance camera	• Hikvision (002415 CH) • SenseTime (20 HK) • Dahua (002236 CH)
Network security	Network security software	• Venustech (002439 CH) • Qianxin (688561 CH) • Sangfor (300454 CH)

Source: CMBIGM

Internet I

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China will continue to accelerate the development of digital economy and leverage digital capabilities to empower the real economy. Since the last five-year plan, the leading internet technology companies are preparing for infrastructural technologies that can empower enterprise digitization, with investments into cloud computing, AI, SaaS, fintech, blockchain and other frontier technologies. While we expect regulations on consumer internet, data related arena, large-scale platform, will remain consistent. But policies will support the tech companies to continue investing in areas that can facilitate the digital economy for better development. State Council released the 14th Five-Year Plan of Digital Economy in January 2022, which articulates the roadmap for development of the China's digital economy: by 2025, value added by the digital economy will contribute 10% of China's GDP (2020: 7.8%).

Figure 3: State Council: major target of the 14th Five-Year Plan of digital economy

	2020	2025E target	2020-2025E CAGR
Valued added by digital economy as % of GDP (%)	7.8	10	na
Number of IPv6 active users (mn)	460	800	11.7%
Number of users using Gigaband (mn)	6.4	60	56.5%
Size of software and IT service market (RMBtn)	8.16	14	11.4%
Penetration rate of industrial internet application (%)	14.7	45	na
Total online retail sales (RMBtn)	11.76	17	7.7%
E-commerce GMV (RMBtn)	37.21	46	4.3%
Number of users of online public services (mn)	400	800	14.9%

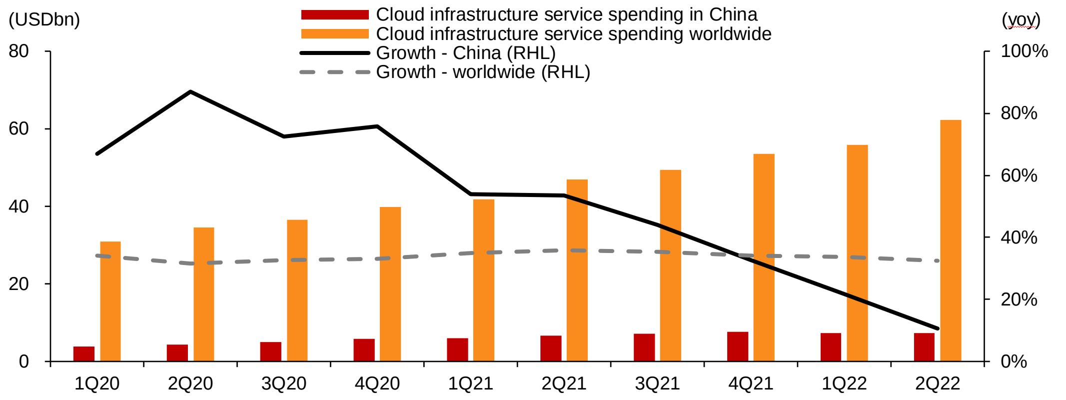
Source: Gov.com, CMBIGM

Back in March 2021, the tax rate adjustment for the national key software enterprises already provided guidance on frontier technology directions. Companies with operations in these seven categories can still enjoy key software enterprise beneficiary tax rate: Application software (includes operating system, databank and middleware, etc.), R&D industrial software (such as CAD, CAE, CAM, CAPP, BIM, PDM, etc.), production industrial software (such as MES, MOM, ORION, APC and PLC, etc.), frontier software technology (such as distributed computing, data mining and visualization, etc.), information security software, software applied in key industries, management industrial software (such as ERP, SCM, CRM and PLM, etc.), public cloud services, and embedded software.

For instance, Alibaba/Tencent/Baidu, which ranked the 1st/3rd/4th in terms of 2Q22 total cloud infrastructure spend in China (per Canalys). Alibaba Cloud takes the lead in Chinese cloud infrastructure market with 34% of the market share in 2Q22. Although revenue growth of Alibaba Cloud slowed in the near term due to soft macro and weak performance of customers in internet industry, we think the gradual recovery in macro, as well as the increase in demand generated from emerging industries such as smart manufacturing and new energy could support a recovery in revenue growth for Alibaba Cloud. Tencent has taken enterprise services as its strategic investment area in 2021, with its R&D expenses up by 33% to RMB51.9bn in 2021. Its cloud solutions help accelerate digitalisation of enterprises and government. Among all internet giants, Baidu's cloud business revenue growth of 30.5% YoY was the highest, which we attributed to Baidu's strong AI capability, as it helped Baidu established comparative advantage in industries such as smart transportation, manufacturing, energy & utilities and public services. We expect Baidu Cloud to sustain higher than industry average cloud revenue growth in 2H22.

Over the long run, with the trend of deepening of digitalization across all industries, we believe Chinese enterprises' demand for cost optimization and efficiency enhancement should remain steady.

Figure 4: Cloud infrastructure service spending in China and in worldwide



Source: Company data, CMBIGM

Fintech services will also help fulfil the goal of common prosperity in the long term. Tencent and other leading fintech platforms focus on offering inclusive financial services to improve convenience of all people and reducing financing costs of SMEs. The leading tech companies offer comprehensive user cases in both online and offline environment, Tencent's Weixin Pay average commercial transactions per day has surpassed 1bn since 4Q19. WeBank, an affiliated internet bank of Tencent, has offered over RMB1tn loan in total to over c.880k SME as of the end of 2021.

Regulations in the fintech industry will enable healthy long-term growth in our view. We believe the goal of the regulations is to ensure large scale digital economy applications while keeping national financial system robust. Fintech can help the banking sector to adjust its loan book exposure according to structural shift in China's economic growth drivers. With the appropriate regulations in place, fintech companies can better facilitate consumer credit, wealth and insurance coverage demand of mass population. Population of all income brackets will have access to appropriate consumer credit and financial services, putting technology into the right use to facilitate the country's goal of common prosperity development. The regulations and risks management requirements will reduce fintech industry's profits compared to previous levels, but it will also provide the industry with clear development directions, in our view.

Internet II

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The 20th CPC reiterated "Development First" as priority, followed by emphasis on "high-quality growth" and "security". Compared to 19th CPC, internet-related tone in 20th CPC is largely in line, except for more focus on "innovation" and "security". We view it as neutral or slightly positive to internet sector, given: 1) supportive tone from tech innovation, with moderate interpretation on common prosperity; and 2) no additional regulations comments on platform companies, suggesting sectoral regulation to normalize.

- **"Technological innovation" as the key.** CPC emphasized on indigenous hard technology development, to strengthen economic power and tackle tech exports restrictions. We expect this tone to guide internet giants more commitment on tech investment, including big data, AI, chips, etc. In addition, CPC maintained the supportive tone on "digital economy" (despite with less content), relatively positive to sector LT development. Despite short-term margin dilution from tech investment, it would create secular and sustainable driver and meanwhile enhance industrial efficiency. *Key beneficiaries: Tencent, Alibaba, Baidu,* which engaged deeply on tech & infrastructure establishment and digital economy (e.g. Alicloud, Tencent "smart city" project, Baidu's Apollo Go).
- **"Common prosperity" & "rural revitalization" with moderate tone.** CPC mentioned "common prosperity" to promote balanced development, and reaffirmed the importance of "rural revitalization". We view this tone as moderate to internet names, guiding companies to focus more on social responsibility. Rural revitalization policy should be positive to ecommerce companies with high exposure in lower-tier cities, such as *Pinduoduo, Huitongda*.
- **More focus on "Security".** 20th CPC upgraded "Security" to a focus, including enhancing national security system, across data privacy, network, culture, content security (Internet-related). As such, we expect PIPA and content regulations to continue (affecting ads and entertainment companies), but financial impact should be manageable. Network security names would benefit, such as *Kingsoft Office, Baidu*.
- **Covid-zero policy color:** little clue in 20th CPC, but supportive tone from official media before CPC. Although we do not expect lockdowns relaxation immediately, we think further policy would balance "development" demand. Internet sector might still consolidate for one or two quarters, but would bottom out for fundamental recovery and potential reopening on 12-month horizon, especially for ecommerce/lifestyle subsectors. Suggest to eye on more signals from NPC meeting in Mar 2023.
- **Sectoral regulation trend on platform companies:** focus on security and common prosperity, but well priced in. As CPC did not comment on additional regulations on platform companies, we expect regulation to normalize ahead. More detailed regulatory measures would be ongoing, but major change in framework seems unlikely, in our view.

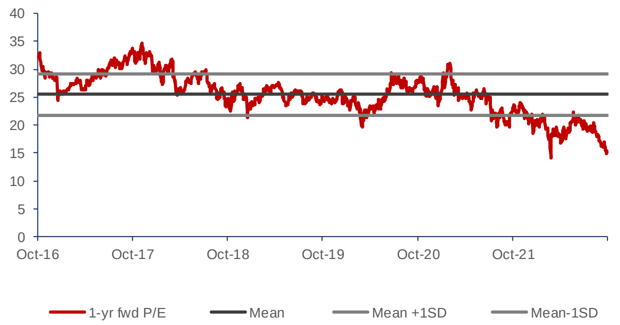
Internet sector pulled back sharply last week on epidemic resurgence, geopolitical tension and Covid-zero tone, with valuation at 5-year historical trough (12x FY23E P/E). As policy tone barely changed in 20th CPC, we believe fundamental improvement and potential lockdown relaxation would be the key to trigger a turnaround. Sector stock price might see volatility in 4Q22E & 1Q23E, but would gradually bottom out on resilient growth and macro recovery. By segment, we prefer **consumer internet > short/middle video > games > ads**, while cautious on traditional livestreaming and long-form video. Risk reward is favorable currently, given limited valuation& earnings downside. We recommend quality growth plays, with 1) resilient fundamental, 2) relatively high defense on macro, epidemic and geopolitical tension; and 3) attractive valuation. **Our pecking order: Meituan > PDD > Kuaishou.**

Figure 5: Internet-related highlights in 20th CPC

Highlights	20th CPC	19th CPC	Sector impact	Related tickers
Technological innovation	Emphasized more on indigenous hard technology development, to strengthen economic power and tackle tech exports restrictions. Supportive tone on digital economy unchanged, but with less content.	Focus more on digital economy, digital industrialization, IoT, and synergy between real economy & Internet.	More supportive policies on hard tech to come. Guiding internet giants more commitment on tech investment, including big data, AI, chips, etc.	Alibaba, Tencent, Baidu
Common prosperity	"common prosperity" to promote balanced development, with equal opportunites. No additional comment on platform companies in this issue.	Largely in line with 20th CPC.	Moderate tone to internet names; Guiding internet giants to focus more on social responsibility.	
Rural revitalization	Comprehensively promoting "rural revitalization", with higher priority on food supply.	To implement "rural revitalization" strategy and enhance "rural modernization".	Positive to ecommerce plays with high exposure in lower-tier and rural cities.	Pinduoduo, Huitongda
Security	Upgraded "Security" to a focus, but still behind "development". Emphasized on enhancing national security system, across areas of data privacy, network, culture, content, energy, food, supply chain, finance and infrastructure.	Shorter chapters on "Security", with relatively lower emphasis on security of "data privacy, network".	PIPA and content regulations to continue (affecting ads and entertainment companies), but financial impact should be manageable. Network security names would benefit.	Kingsoft Office, Baidu

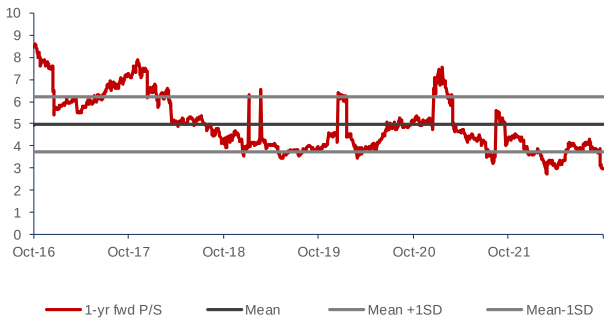
Source: 20th CPC speech, CMBIGM

Figure 6: Core Internet P/E band



Source: Bloomberg

Figure 7: Core Internet P/S band



Source: Bloomberg

Capital goods

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Message from the President's report

The report emphasized the industrial supply chain security and the acceleratoin of building a country with strong manufacturing capability. The report also highlighted the target of achieving carbon neutrality gradually and the importance of energy security. All these are basically in line with the existing policy direction.

Our view

Against the backdrop of Covid-related global supply chain disruption over the past two years as well as the most recent mounting geopolitical tension, the manufacturing industry will play a more important role in the China economic development through moving towards a more high-end and intelligent transformation.

To recap, a series of policies that facilitate the supply chain upgrade has been issued. For instance, the Outline of the 14th FYP Development Plan set plans to improve modernization level of supply chain and promote manufacturing industry upgrades, with a focus on the development of intelligent manufacturing and robotics technology. On the other hand, the 14th FYP for Intelligent Manufacturing targets that >70% of large-scale manufacturing enterprises will basically achieve digitalization and more than 500 demonstration manufacturing facilities will be built nationwide by 2025. It also proposes to strengthen independent supply and focus on core technology breakthroughs of core components and intelligent manufacturing equipment, with market satisfaction rate of >70%. For industrial robotics, according to the 14th FYP for robotics industry, China targets to become a key hub for global robotics industry.

On the energy side, coal mining machinery and gas storage equipment will continue to gain traction given the emphasis on energy security.

Investment ideas

By segment, we believe **advanced manufacturing**, **solar power** and **energy equipment sector** will be beneficiaries over the coming five years.

Manufacturing upgrade & industrial automation:

- **Inovance (300124 CH, NR) –** We believe Inovance is well positioned to achieve further market share gain from foreign players, driven by 1) leading market positions (1st in servo / 3rd in LV AC drives/ 4th in PLC market in 1H22), 2) breakthroughs in industrial solutions for lithium battery industry, and 3) strong order intakes of EV solutions segment.

- **Estun (002747 CH, NR) –** We view Estun, the largest Chinese robot maker, as one of the key beneficiaries, on the back of 1) leaderships in multiple fast growing sub-markets such as solar PV and lithium battery, 2) potential penetration to high-end market (e.g. auto OEM market) due to the recent Covid-related supply chain disruption and short supply of overseas players.

Energy security:

- **SANY Internatoinal (631 HK, BUY)** - We expect SANY Internatoinal to benefit from the decent growth of coal mining capex (28% in 8M22) and the transformation to electric and intelligent mining equipment.
- **CIMC Enric (3899 HK, NR)** will be a key beneficiary of capex growth of gas storage equipment and vessels.

Carbon neutrality:

- The long-term goal to achieve carbon neutrality will continue to provide solar equipment manufacturers with huge market of capacity growth and upgrade. We continue to like **S.C. New Energy (300724 CH, BUY), Zhejiang Jingsheng (300316 CH, BUY)** and **Suzhou Maxwell (300751 CH, NR)** for their cuting edge technologies.

Import substitution:

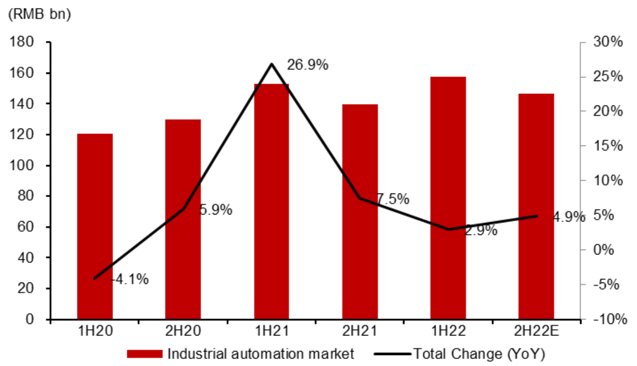
- We expect **Jiangsu Hengli (601100 CH, HOLD)** and **Weichai Power (2338 HK, BUY / 000338 CH, HOLD)** to benefit from market share on key components such as hydraulic pump and valve (for Hengli), as well as engines with high thermal efficiency and CVT power system (for Weichai).

Figure 8: Key supporting policies for manufacturing upgrades and industrial automation industry in China

Date	Authority	Policy	Summary
State level			
Mar-21	State Council	The Outline of the 14th Five-Year Plan for the National Economic and Social Development and Long-Range Objectives Through the Year 2035 《中华人民共和国国民经济和社会发展第十四个五年规划和2035年远景目标纲要》	· **Improve modernization level of supply chain and industrial chain, promote manfacturing industry upgrades and optimizations and promote high-end, intelligenet and green manufacturing.** · Focus on the deveopment of intelligent manufacturing and robotic technology, which includes the development of industrial control equipment and key robotic technologies such as decentralized control system, advanced controller, high-precision servo drive systems and reduction drives. · Support the development of new specialized service providers, which includes intelligent manufacturing system solution providers.
Nov-21	Ministry of Industry and Information Technology	The 14th Five-Year Development Plan for In-depth Integration of Informatization and Industrialization 《"十四五"信息化和工业化深度融合发展规划》	· By 2025, the CNC ratio of key process will reach 68%. · Develop new intelligent products such as industrial-grade intelligent hardware, intelligent robots and intelligent connected vehicle, etc.
Nov-21	MIIT, Standardization Administration	Guidelines on Establishment of National Standards Systems for Intelligent Manufacturing (2021) 《国家智能制造标准体系建设指南（2021版》	· By 2023, accelerate the standards for collaboration system, process equiipment and other intelligent equipment; By 2025, gradually build a standard system of intelligent manufacturing that adapts to technological trends, meets industrial development needs and lives up to the international advanced levels.
Dec-21	Ministry of Industry and Information Technology	The 14th Five-Year Development Plan for Intelligent Manufacturing 《"十四五"智能制造发展规划》	· By 2025: manufacturing enterprises above designated size will be basically digitalized and key enterprises in key industries will initially achieve intelligent transformation. Specific targets: 1) **over 70% of manufacturing enterprises above designated size will achieve digitalization**. Build more than 500 industry-leading benchmark intelligent manufacturing factories. 2) **domestic market satisfaction rate of intelligent manufacturing equipment and industrial software will exceed 70% and 50% respectively**, as well as cultivating over 150 system solution suppliers. 3) build over 120 industrial internet plaforms with industry and regional influences. · By 2035: **manufacturing enterprises above designated size will be comprehensively digitalized.** · Focus on key core technology breakthroughs and accelerate technical breaktrhoughs in system integration.
Dec-21	MIIT, NDRC, MOST, Ministry of Public Security, Ministry of Civil Affairs and other 10 departments	The 14th Five-Year Development Plan for Robotics Industry 《"十四五"机器人产业发展规划》	· **By 2025: China become a key source of global robotics innovation, a cluster of high-end manufacturing and a new highland of integrated application.** · **By 2025: the average annual growth rate of the robotic indsutry's operating income exceeds 20% & manufacturing robot density doubles** · 5 clear development directions: 1) Improve innovation capabilities, especially core technology; 2) Build a solid foundation for industrial development; 3) Increase the supply of high-end products focused on specific industry sectors; 4) Expand the depth and breadth of application; 5) Optimize the overall structure of the robotics industry.
Provincial level			
Jul-21	People's Government of Zhejiang Province	The 14th Five-Year Plan for the Construction of Global Advanced Manufacturing Base in Zhejiang Province 《浙江省全球先进制造业基地建设"十四五"规划》	· Accelerate the construction of "Factory of the Future" and intelligent factories (digital workstations). · Build IIoT platforms and support manufacturing enterprises to build factories with full 5G network coverage.
Jul-21	People's Government of Guangdong Province	Implementation Plan for Digital Transformation of Manufacturing Industry in Guangdong Province (2021-2025) 《广东省制造业数字化转型实施方案（2021-2025年）》	· By 2023: over 30k industrial enterprises above designated size will achieve digital transformation and over 80k enterprises to use cloud platform, 500 manufacturiing digital transformation service providers will be introduced, 5 national-level cross-industry and cross-field IIoT platforms and 20 profession-specialized IIoT platforms will be built. · By 2025: over 50k industrial enterprises above designated size will achieve digital transformation and 100k enterprises to use cloud platform.
Jul-21	People's Government of Shanghai Province	The 14th Five-Year Plan for the Development of Advanced Manufacturing Industry in Shanghai 《上海市先进制造业发展"十四五"规划》	· By 2025: the industrial robot intensity will be increased by 100 units/10k workers, the transformation ratio of industrial enterprises above designated size will achieve 80%, the total number of benchmark intelligent factories and iconic digital application scenarios will be over 200 and 1,000 respectively. · By 2025: Shanghai will be the new national echnology base of intelligent manufacturing, with an expected industry scale of RMB180bn.
Sep-21	Industry and Information Technology Bureau of Jiangsu Province	The 14th Five-Year Plan for the High-Quality Development of Manufacturing Industry in Jiangsu Province 《江苏省"十四五"制造业高质量发展规划》	· By 2025, the provincial level of integration of information technology and industrialization will achieve above 70, the CNC ratio of key process of industrial enterprises above designated size will achieve 65%. · Focus on intellignet manufacturing, foster the implementation of intellegent manufacturing projects and accelerate the tranformation of manufacturing mode and corporate organization.

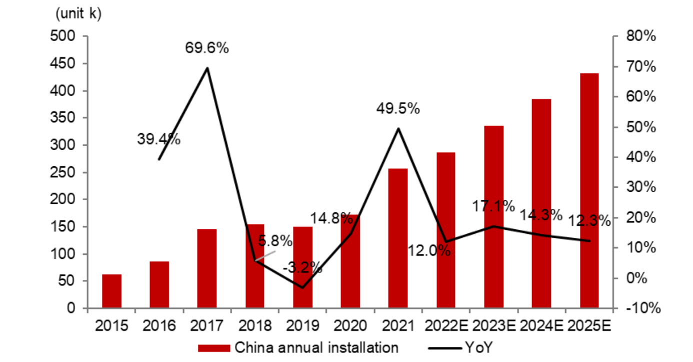
Source: State Council, MIIT, CMBIGM

Figure 9: China industrial automation market size



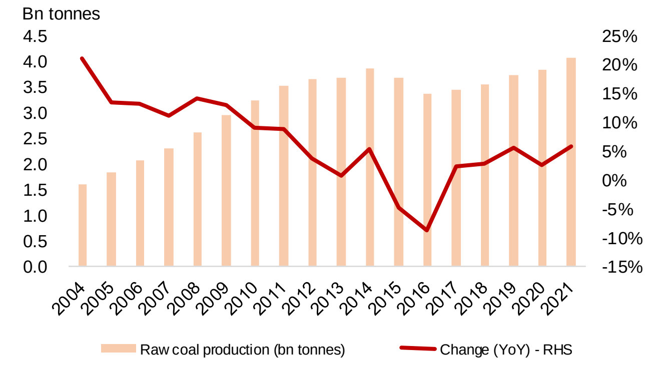
Source: MIR Databank, CMBIGM

Figure 1: China's annual installation of industrial robots



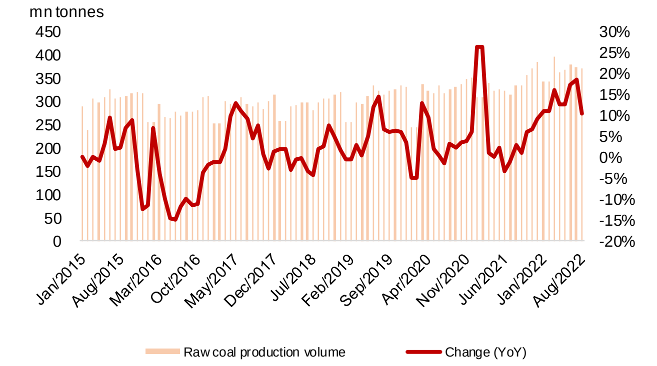
Source: MIR Databank, CMBIGM

Figure 11: China raw coal production (annual)



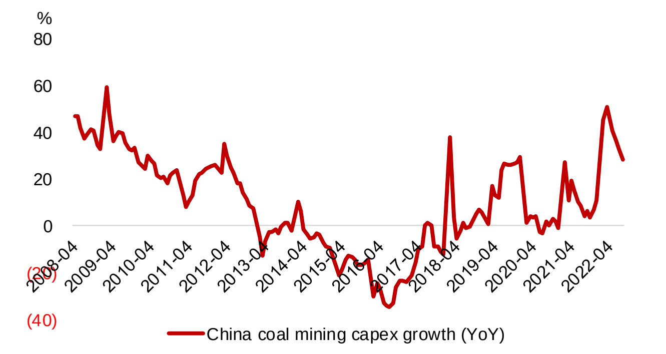
Source: Wind, CCTDCOAL, CMBIGM

Figure 12: China raw coal production (monthly)



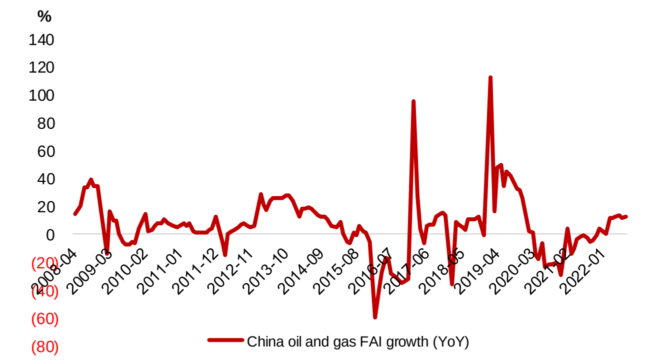
Source: Wind, CCTDCOAL, CMBIGM

Figure 13: China coal mining FAI



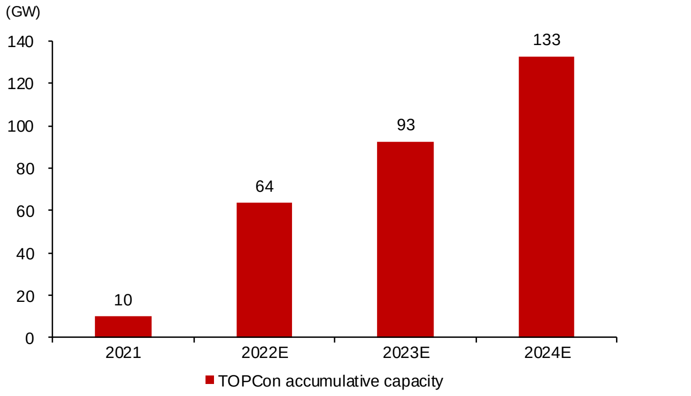
Source: Wind, CMBIGM

Figure 14: China oil and gas FAI



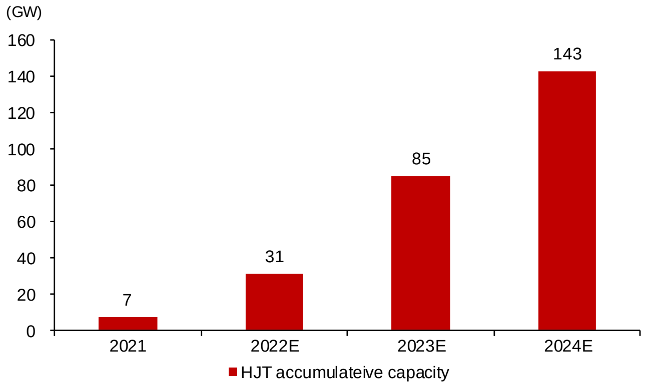
Source: Wind, CMBIGM

Figure 15: Projected market size of solar TOPCon capacity



Source: Data based on 15 companies that announced expansion plan, CMBIGM

Figure 16: Projected market size of solar HJT capacity



Source: Data based on 34 companies that announced expansion plan, CMBIGM

Energy-Gas

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Green transformation

The 20th CPC Congress proposes to speed up the green transformation. China aims to promote industrial optimization, energy structure improvement, and transportation mix adjustment. Moreover, China looks forward to fully implementing energy savings and accelerating the construction of a waste recycling system to strengthen green technology innovation. On the environmental side, China is dedicated to developing a green, low-carbon economy.

Steady progress was made in realizing the 'carbon peaking' and 'carbon neutrality' targets

During the 20th CPC Congress, China mentions that it will continue to realize the targets of 'carbon peaking' and 'carbon neutrality' step by step as follows: 1) China improves the regulation of total energy consumption and intensity, strictly controls fossil energy consumption; 2) Deepening energy system reform, China steps up efforts to ensure the cleaner and more efficient use of coal, strengthen the exploration and development of oil and gas resources to ensure energy security; 3) China advocates for further energy reserves and involves in the construction of a new energy system. 4) China devotes to build a clean energy supply system, ensuring the proportion of non-fossil energy consumption can reach 20% in year 2025 and 25% in 2030.

Energy security

Stressing China's role as a major energy consumer and producer, China will make more efforts to safeguard the country's energy security. In particular, China will give full play to coal as the ballast stone in the energy mix and enhance oil and gas exploration and production. China also aims to improve the early warning capacity for energy security and strengthen energy supply to key regions. Besides, the Chinese Government attaches great importance to safeguarding the legitimate rights and interests of its oversea citizens and strengthens the construction of the overseas energy supply chain.

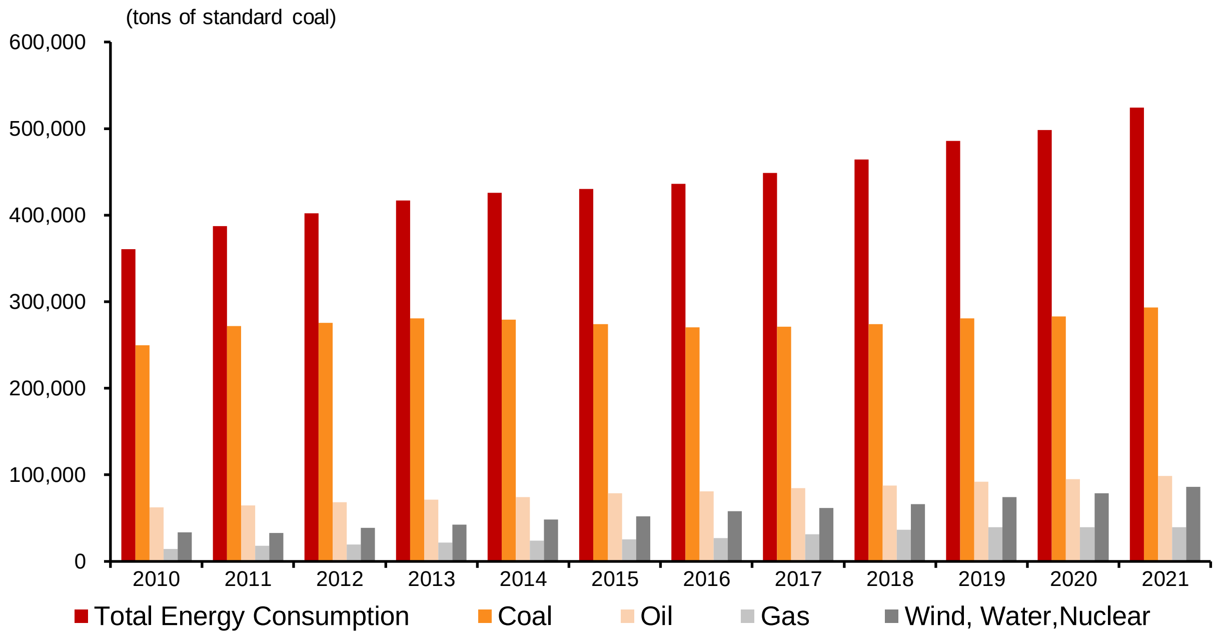
Perfect the carbon emissions accounting methods and carbon market trading systems

To better involve in global climate governance, China also proposes to improve national carbon emissions accounting methods and the carbon market trading system.

Implications

The related energy implications of the 20th CPC Congress deliver positive signs on gas and clean energy. We believe the gas demand will rise in the mid-long term, as gas is vital energy to help China to reach the 'carbon peaking' and 'carbon neutrality' goals. In addition, China also strengthens the gas resources exploration to ensure energy security. Thus, it will benefit gas producers like 'Three barrels of oil' and gas distributors like CRG (1193 HK), ENN (2688 HK), etc.

Figure 17: China energy consumption



Source: Bloomberg, CMBIGM estimates

Healthcare

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China aims to promote the development of strategic industries, while biotechnology is one of the seven key industries mentioned. We think the government is going to further encourage the innovation of drugs and medical devices, which will benefit innovative biotech and innovative medical device sectors.

China is going to widen the coverage of social security funds and promote the development of commercial health insurance. We believe the enhanced medical insurance coverage will accelerate the penetration of innovative drugs and medical devices, as well as innovative medical technologies. Furthermore, the expanding coverage of commercial health insurance will accelerate the penetration of internet healthcare services and high-end medical services, in our view.

China aims to introduce supportive policies to lift birth rate. We think medical costs related to assisted reproductive technology (ART) may be covered by basic medical insurance, in the long term, which will boost the penetration of ART in China.

China will enhance the medical system's capabilities of emergency care in order to effectively contain the risks of infectious disease outbreak. We think local medical equipment manufacturers will benefit.

Overall, we expect healthcare sector to re-rate from the current very cheap valuation level in the next 6-12 months thanks to 1) solid earnings of CXO companies, 2) encouraging R&D progress of biotech companies, 3) consistent regulatory policies of China healthcare industry. Our top picks include WuXi Bio (2269 HK), Joinn Lab (6127 HK, 603127 CH), Innovent (1801 HK), BeiGene (BGNE US, 6160 HK, 688235 CH) and AK Medical (1789 HK).

F&B/ Cosmetics/ DFS

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The promotion of employment stability and urbanization should accelerate income equality, and bode well for food consumption upgrade and benefit domestic leaders such as **CR Beer (291HK, Buy),** and **Mengniu (2319HK, Buy)**. On the other hand, the pursuit of "Common prosperity" should expand the audience of travel retail and consumption of affordable luxuries, in which we regard **Proya (603605CH, Buy)** and **CTGDF (601888CH, Buy)** as the major beneficiaries.

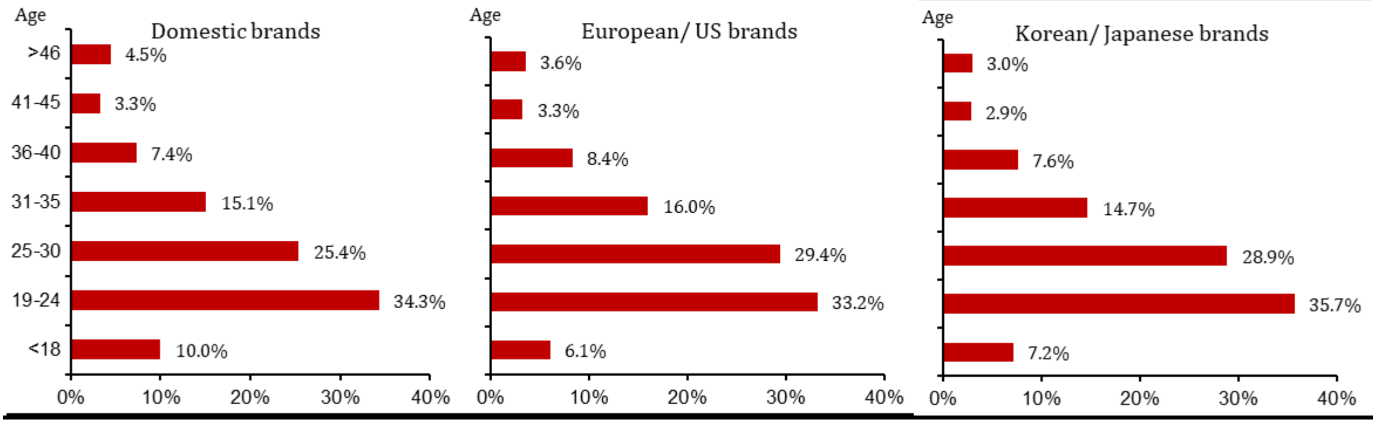
"Common prosperity" extends "consumption upgrade" to a larger audience group
We envisage that a growing number of middle class and a raising disposable income to rural cities will be the major driving force to facilitate the next consumption trade-up. On the supply side, we see good examples from dairy players to exhibit product innovation while beer brewers are role models in consumer trade-ups execution.

- **Beer** – CR Beer's brand pillars cover a wide pricing range, from local mid/ mass market to imported luxury brand such as Heineken. Each sub-segment offers a differentiated taste, packaging presentation and hence well-defined customer group. The launch of SKUs under the Heineken brand umbrella, such as Heineken, Sol Tiger and Desperados last year acted as a game changer for local beer drinkers in terms of the way of consumption, taste re-vamp and brand perception.

- **Dairy -** We see frequent and continuous new SKU introduction in liquid milk categories that are aiding the expansion of the customer base for dairy consumption. For instance, Mengniu executed different strategies across its star brands Milk Deluxe, Fruit Milk Drink and Just Yoghurt. Milk Deluxe's "Dream Cap" series is designed to penetrate the luxury segment, while Just Yoghurt and Fruit Milk Drink is set up to pinpoint Gen-Z/ health-conscious consumer demand.

Employment stability ensures steady release of Gen-Z's spending power
Generation Z (a.k.a Gen Z) refers to those who were born in 1995-2009 and currently aged 12-28. China's Gen Z grew up in a much more affluent macroeconomic environment, with notably improved life quality, compared to their parents. Speaking of cosmetics spending, Gen-Z are mainly young women who are less savings-cautious, internet savvy, ingredient-obsessive and domestic-brand-oriented. We are positive that a stable employment environment would nurture an ongoing Gen-Z spending and facilitate the development of domestic cosmetic brands.

Figure 18: Cosmetics buyers breakdown by age group



Source: Company data, Bloomberg, CMBIGM estimates

Regarding the 20th CPC congress, we believe it is the key event to crystalize the authority of the government as well as their corresponding polices.

Consumer Discretionary

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Regarding the 20th CPC congress, we believe it is the key event to crystalize the authority of the government as well as their corresponding polices.

In the short run, we believe the **commitment on Zero-COVID strategy** was being reiterated, and would be **continue to weigh on the economic growth** and various consumer sub-industries (esp. the catering and domestic tourism).

While **in the long run**, out of the many sessions highlighted, we believe there are 5 areas that could impact the consumer sector meaningfully, namely: **1) Chinese style modernization**/ 中國式現代化 (including the common prosperity/ 共同富裕), **2) High-quality economic development**/ 高質量發展 (e.g. balance development of different industries, regions or income groups), **3) Development of Chinese cultural self-confidence/** 推進文化自信自強, **4) Enhancement of living standard** and quality of the population/ 提高人民生活品質 and **5) Effective execution of the "One Country Two System"/** 堅持和完善「一國兩制」**.**

To be more specific, the key themes and implications behind these areas mentioned above, in our view, are:

1) consumption upgrades and the rises of middle classes, which shall benefit the premium brands like FILA, Descente, Arc'teryx, JNBY, Bosideng, Haidilao, Casarte , Joyoung etc. under companies like Anta (2020 HK), Bosideng (3998 HK), JNBY (3306 HK), Haidilao (6862 HK), Haier (6690 HK) and Joyoung (002242 CH) or JS Global (1691 HK),

2) rise of domestic brands and fashions (to overtake more market shares from the oversea brands), which should be positive for Anta (2020 HK), Li Ning (2331 HK), Xtep (1368 HK), Bosideng (3998 HK), JNBY (3306 HK), Haidilao (6862 HK), XBXB (520 HK),

3) development of lower-tier cities and more balanced income distributions, which should aid the brands that have greater exposure on lower tier cities like YUMC (9987 HK), Xtep (1368 HK), China Lilang (1234 HK) and Miniso (9896 HK),

4) recovery of HK retail, as Hong Kong's economic continue to recover and be more connected with the mainland, hence names like CDC (341 HK) may experience better growth in both HK and in the Greater Bay Area. Also positive to Wharf REIC (1997 HK) and SaSa (178 HK).

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