



Company Report: Xiao Nan Guo (03666 HK)

公司报告: 小南国 (03666 HK)

Sunny Kwok 郭日升
+852 2509 2642
sunny.kwok@gtjas.com.hk

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SSS Growth Well on Track, Maintain "Buy"

同店销售增长符合预期, 维持“买入”

- **Despite weak results in 2014, SSS growth recovery is on track and 1Q15 SSS growth is expected to exceed 5%.** Xiao Nan Guo's revenue was RMB1,544 million in 2014, up 11.4% YoY and SSS growth was 1.0%. SSS was -4.3% in 1Q14 but improved to 3.9% in 4Q14. SSS growth of "Shanghai Min", "the Dining Room" and "Maison De L'Hui" were 0.4%, 1.4% and 12.7% in 2014, respectively. Net profit in 2014 arrived at RMB0.6 million (2013: RMB1.1 million). The Company operated 103 restaurants by the end of Dec. 2014, up from 83 by the end of Dec. 2013.
- Xiao Nan Guo completed the acquisition of 65% equity interest of "Pokka" in Jan. 2015, with 32 restaurants in operation in 2014. Xiao Nan Guo will continue to open 15 "the Dining Room" restaurants in 2015. SSS growth in 2015-2017 is expected to be 4.8%, 3.8% and 3.3%, respectively. **With SSS growth recovery and new contribution from "Pokka" and "Michelin" franchise business, we expect earnings growth to speed up.** The Company's EPS is expected to be RMB0.045, RMB0.076 and RMB0.095 in 2015-2017, up 115.1x, 69.9% and 25.4% YoY, respectively.
- Valuation is not demanding on expected earnings recovery in 2015 and 2016. **Therefore, we reiterate "Buy" and TP of HK\$1.65 remains unchanged, which represents 29.1x 2015 PER, 17.1x 2016 PER and 13.7x 2017 PER.**
- **虽然 2014 年业绩疲弱, 同店销售增长如预期般改善, 2015 年第 1 季同店销售增长预期将超过 5%。** 小南国 2014 年收入达到人民币 1,544 百万元, 同比增长 11.4%, 而同店销售增长为 1.0%。2014 年第 1 季同店销售增长为-4.3%, 但于 2014 年第 4 季已经转正至 3.9%。「上海小南国」、「南小馆」及「慧公馆」于 2014 年的同店销售增长分别为 0.4%、1.4% 及 12.7%。2014 年净利润为人民币 0.6 百万元 (2013 年: 人民币 1.1 百万元)。公司于 2014 年 12 月底经营 103 家门店, 较 2013 年 12 月底增加 20 家。
- 小南国于 2015 年 1 月完成收购「Pokka」65% 股权, 「Pokka」于 2014 年年底有 32 家餐馆在营运。小南国于 2015 年将会继续新增 15 家「南小馆」。2015-2017 年同店销售预期分别达到 4.8%、3.8% 及 3.3%。**由于同店销售在改善、「Pokka」的新贡献及「米芝莲」许可经营业务, 我们预期公司净利将高速增长。**我们预期公司 2015-2017 年每股净利分别为人民币 0.045 元、人民币 0.076 元及人民币 0.095 元, 同比分别增长 115.1 倍、69.9% 及 25.4%。
- 由于预期 2015 及 2016 年盈利将大幅增长, 现估值仍然吸引。**我们重申小南国的“买入”评级, 目标价 1.65 港元也维持不变, 相当于公司 29.1 倍 2015 年市盈率、17.1 倍 2016 年市盈率及 13.7 倍 2017 年市盈率。**

Rating:

Buy

Maintained

评级:

买入 (维持)

6-18m TP 目标价:

HK\$1.65

Revised from 原目标价:

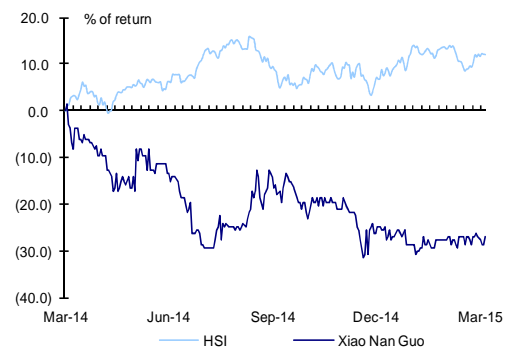
HK\$1.65

Share price 股价:

HK\$0.970

Stock performance

股价表现



Change in Share Price 股价变动	1 M 1 个月	3 M 3 个月	1 Y 1 年
Abs. % 绝对变动 %	2.1	(3.0)	(27.1)
Rel. % to HS index 相对恒指变动 %	3.5	(7.9)	(39.2)
Avg. share price(HK\$) 平均股价 (港元)	1.0	1.0	1.1

Source: Bloomberg, Guotai Junan International.

Year End 年结	Turnover 收入	Net Profit 股东净利	EPS 每股净利	EPS 每股净利变动	PER 市盈率	BPS 每股净资产	PBR 市净率	DPS 每股股息	Yield 股息率	ROE 净资产收益率
12/31	(RMB m)	(RMB m)	(RMB)	(△%)	(x)	(RMB)	(x)	(HK\$)	(%)	(%)
FY13A	1,386	1	0.001	(99.2)	1,027.8	0.527	1.4	0.008	0.8	0.1
FY14A	1,544	1	0.000	(47.6)	2,010.0	0.529	1.5	0.000	0.0	0.1
FY15F	2,267	66	0.045	11,506.3	17.1	0.575	1.3	0.020	2.1	8.1
FY16F	2,777	112	0.076	69.9	10.1	0.627	1.2	0.040	4.1	12.7
FY17F	3,141	141	0.095	25.4	8.0	0.698	1.1	0.050	5.2	14.4

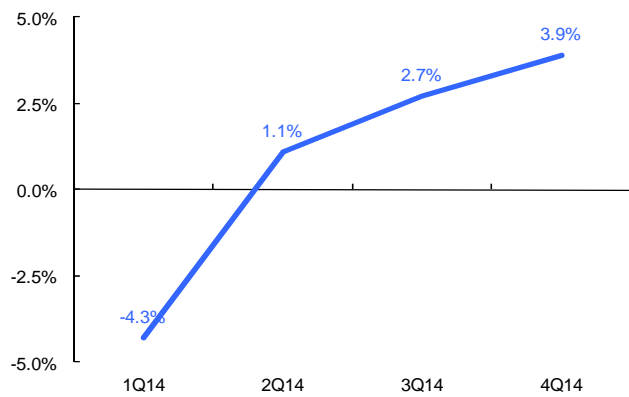
Shares in issue (m) 总股数 (m)	1,475.4	Major shareholder 大股东	Wang Huimin 34.7%
Market cap. (HK\$ m) 市值 (HK\$ m)	1,431.1	Free float (%) 自由流通比率 (%)	53.2
3 month average vol. 3 个月平均成交股数 ('000)	305.2	FY15 Net gearing (%) 15 年净负债/股东资金 (%)	1.3
52 Weeks high/low (HK\$) 52 周高/低	1.290 / 0.910	FY15 Est. NAV (HK\$) 15 年每股估值 (港元)	2.3

Source: the Company, Guotai Junan International.

Key Takeaways from Analyst Meeting:

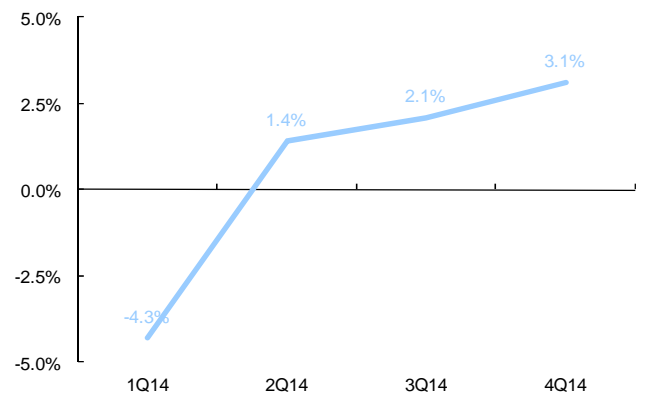
SSS Growth to Exceed 5% in 1Q15 and 4% in 2015. Xiao Nan Guo's SSS growth was roughly -5% in 1Q13 and -10% in 2Q13-4Q13. Since then, the Company's implemented various measures to help SSS to rebound as some pick-ups were achieved in 2014. The Company's consolidated SSS growth rebounded from -4.3% in 1Q14 to 3.9% in 4Q14, of which, Shanghai Min's SSS growth improved to 3.1% in 4Q14 from -4.3% in 1Q14. The Company expects SSS growth to exceed 5% in 1Q15, which was mainly driven by traffic flow improvement and stable per capita spending. In 2015, SSS growth is expected to stay above 4%, which was in line with our previous expectation.

Figure-1: SSS Growth of Xiao Nan Guo in 2014



Source: the Company.

Figure-2: SSS Growth of Shanghai Min in 2014



Source: the Company.

Profitability Improvement in 2015. Despite slight improvement in SSS in 2014, Xiao Nan Guo's earnings remained very weak in 2014. The Company's management expects earnings to significantly improve on SSS growth and stringent cost control measures. SSS growth in 2014 was only 1.0%, which was unable to offset rising costs. In 2015, SSS growth is expected to reach 4.8%, which should be more than enough to offset rising costs and contribute earnings growth to the Company. On the other hand, the Company is reducing headcount per store in order to enhance efficiency of workers as well as saving costs. With SSS improvement, the management hopes Shanghai Min's store operating margin to improve from 8% in 2014 to 15% in 2016.

Multi Brand Strategy to be Implemented in 2015. Xiao Nan Guo only operates "Shanghai Min", "the Dining Room" and "Maison De L'Hui" in 2013. The Company opened 1 "Shanghai Min's Family Restaurant" and managed 32 "Michelin" milk tea stores and 16 "Uncle Tetsu" cheese cake stores in 2014. In addition to the existing store portfolio, Xiao Nan Guo will open/manage new branded restaurants, namely "Pokka", "Oreno", "Beijing Hotpot", "Boat House" and "Wolfgang Puck" in 2015. The Company acquired "Pokka" in Jan. 2015, a café providing western and Japanese cuisines which is mainly based in Hong Kong with 32 restaurants in operation by the end of 2014. Such business generated revenue of HK\$398 million with net profit of HK\$18 million in 2013. "Oreno", a mid-to-high-end restaurant run by Michelin star chef providing premium cuisine of high value for money. "Boat House" and "Wolfgang Puck" will be opened in Shanghai Disney serving the needs of tourists. Although these new cuisines are slightly different from the original business run by the Company, we still believe no major difficulties will be encountered as the Company's management had adequate experience in running chained western cuisines. All these new restaurants target customers aged 20-35, who will be the major diners in the near future.

2014 Annual Results Review:

Strong YoY Improvement in 2H14 but Mild HoH Improvement. Xiao Nan Guo's net loss in 2H14 was reduced by RMB31 million YoY, which was attributable to 1) gross margin improvement; 2) increase in other income; and 3) decrease in other expenses but partially offset by tax expense of RMB6 million vs. RMB4 million tax credit in 2H13. The Company's earnings in 1H14 and 2H14 were basically indifferent.

Table-1: 2014 Annual Results Review

RMB million	Income Statement								
	2013	2014	YoY	1H13	1H14	YoY	2H13	2H14	YoY
Revenue	1,385.9	1,544.2	11.4%	677.6	742.7	9.6%	708.4	801.5	13.1%
COGS	<u>(458.8)</u>	<u>(509.3)</u>	11.0%	<u>(210.8)</u>	<u>(244.4)</u>	15.9%	<u>(247.9)</u>	<u>(264.9)</u>	6.8%
Gross Profit	927.2	1,034.9	11.6%	466.7	498.3	6.8%	460.4	536.6	16.5%
Other income/gains	34.6	44.6	28.9%	21.9	24.0	9.4%	12.7	20.7	62.4%
Distribution costs	(830.0)	(931.9)	12.3%	(396.2)	(452.3)	14.2%	(433.8)	(479.6)	10.6%
Administrative expenses	(113.0)	(127.8)	13.1%	(49.9)	(61.6)	23.5%	(63.1)	(66.2)	4.9%
Other expenses	<u>(10.7)</u>	<u>(7.7)</u>	-27.5%	<u>(0.1)</u>	<u>(5.9)</u>	113.8x	<u>(10.6)</u>	<u>(1.9)</u>	-82.2%
Operating Profit	8.1	12.2	49.9%	42.5	2.6	-94.0%	(34.4)	9.6	n.a.
Finance income, net	<u>(2.3)</u>	<u>(4.0)</u>	75.0%	<u>(1.1)</u>	<u>(1.4)</u>	27.7%	<u>(1.2)</u>	<u>(2.7)</u>	116.2%
Profit before income tax	5.8	8.1	39.9%	41.4	1.2	-97.1%	(35.6)	6.9	n.a.
Income tax	(5.1)	(7.1)	38.1%	(9.6)	(0.9)	-90.5%	4.4	(6.2)	n.a.
Minority interests	<u>0.4</u>	<u>(0.5)</u>	n.a.	<u>0.0</u>	<u>0.3</u>	4014.3%	<u>0.4</u>	<u>(0.8)</u>	n.a.
Net Profit	1.1	0.6	-47.3%	31.8	0.6	-98.2%	(30.8)	(0.0)	-100.0%
Gross Margin	66.9%	67.0%	0.1 ppt	68.9%	67.1%	-1.8 ppt	65.0%	67.0%	2.0 ppt
Operating Margin	0.6%	0.8%	0.2 ppt	6.3%	0.3%	-5.9 ppt	-4.9%	1.2%	6.0 ppt
Net Margin	0.1%	0.0%	0.0 ppt	4.7%	0.1%	-4.6 ppt	-4.3%	0.0%	4.3 ppt

Source: the Company.

Shanghai Min – SSS Growth of 0.4% in 2014. Xiao Nan Guo operated 81 “Shanghai Min” restaurants by the end of 2014, up 12.5% YoY. Total sales from “Shanghai Min” reached RMB1,346 million, up 5.1% YoY. Overall per capita spending in 2014 was RMB189, down 6.0% YoY but remained flat compared to 1H14. The number of comparable stores in 2014 was 46, up from 43 in 2013 but 6 restaurants were closed or suspended operation in 2014. SSS growth in 2014 was 0.4% and was attributable to 6.3% traffic flow growth but offset by 5.6% per capita spending decrease. SSS growth of “Shanghai Min” in China was 1.0% in 2014 but Hong Kong continued to underperform and recorded SSS decrease of 2.4%.

The Dining Room – Sales Growth of 119.4% in 2014. The Company operated 17 “the Dining Room” restaurants by the end of 2014, up from 7 by the end of 2013. Total sales from “the Dining Room” reached RMB129 million, up 119.4% YoY. Overall per capita spending in 2014 was RMB76, down from RMB81 in 1H14. The number of comparable stores in 2014 was only 2 restaurants located in Hong Kong and SSS growth was 1.4%, down from 3.1% in 1H14 as we believe “Occupy Central” posted some negative impacts to SSS growth in 4Q14.

Maison De L'Hui – SSS Growth of 12.7% in 2014. Xiao Nan Guo operated 4 “Maison De L'Hui” restaurants by the end of 2014 (2013: 4). Total sales from “Maison De L'Hui” was RMB50 million, up 5.1% YoY. Overall per capita spending in 2014 was RMB405, down from RMB416 in 1H14. The number of comparable stores in 2014 remained flat at 3 restaurants. SSS growth in 2014 was 12.7% and was attributable to 44.3% traffic flow growth but offset by 21.9% per capita spending decrease.

Table-2: Revenue Breakdown

Detailed Breakdown of Change in Revenue in 2014		
	No. of Restaurants Involved	RMB million
Base in 2013		1,384.6
2014 New Openings of Shanghai Min	11	44.3
2013 New Openings of Shanghai Min	14	168.7
Comparable Results of Shanghai Min (SSS: 0.4%)	46	3.8
2014 New Openings of Shanghai Min's Family Restaurant	1	6.1
Comparable Results of MDL (SSS: 12.7%)	3	5.7
2014 New Openings of the dining room	11	28.9
2013 New Openings of the dining room	4	40.8
Comparable Results of the dining room (SSS: 1.4%)	2	0.5
Stores Closed or Renovated	11	(146.8)
Other Income		<u>7.6</u>
Total Revenue in 2014	103	1,544.2

Source: the Company, Guotai Junan International.

Earnings Forecast Assumptions and Revisions:

Focus on the Dining Room and Pokka. Xiao Nan Guo will continue to open 15 new “the Dining Room” restaurants in 2015. However, no new opening of “Shanghai Min’s Family Dining” is expected in 2015 as we believe the per capita spending between “the Dining Room” and “Shanghai Min’s Family Dining” is immaterial, which affects “the Dining Room” performance if more “Shanghai Min’s Family Dining” restaurant is opened. For Pokka, 32 stores are in operation in 2014 and the Company will only add 3 stores in 2015. We expect such expansion to speed up in 2017 when the management is fully ready to bring such business to China.

Table-3: Store Portfolio – Breakdown by Brand

	2011	2012	2013	2014	2015F	2016F	2017F
Shanghai Min	55	66	72	81	85	88	90
The Dining Room	0	2	7	17	32	45	55
Pokka	0	0	0	0	35	38	45
Maison De L’Hui	3	4	4	4	4	4	4
Shanghai Min’s Family Dining	0	0	0	1	1	1	1
Others	0	0	0	0	9	15	26
Total	58	72	83	103	166	191	221

Source: the Company, Guotai Junan International.

SSS Growth Driven By Traffic Flow. We expect per capita spending of “Shanghai Min” to fall by only 2.5% in 2015 and thus, SSS growth of “Shanghai Min” is expected to improve by 4.8% in 2015, which is primarily driven by traffic flow attributable to attractive pricing and rising dine-out consumption in China. With average high table-turn rate of 4.3x of “the Dining Room” restaurants opened for over 1 year, we do not expect SSS for “the Dining Room” to significantly grow in the future. SSS growth of “Maison De L’Hui” is still expected to outperform other brands on fast traffic flow growth but partially offset by decrease in average per capita spending.

Table-4: SSS Growth – Breakdown by Brand

	2012	2013	2014	2015F	2016F	2017F
Shanghai Min	-7.1%	-10.2%	0.4%	4.8%	4.0%	3.5%
The Dining Room	n.a.	n.a.	1.4%	2.0%	2.0%	2.0%
Maison De L’Hui	40.9%	-8.5%	12.7%	9.2%	5.0%	5.0%
Consolidated	-5.4%	-10.1%	1.0%	4.8%	3.8%	3.3%

Source: the Company, Guotai Junan International.

Revise Up Earnings in 2015 on New Contribution from Pokka. We revise up the Company's earnings in 2015 on 1) higher SSS growth expectation and 2) new contribution from Pokka but partially offset by higher finance cost and minority interests. For 2016, we revise down the Company's earnings due to 1) lower SSS growth expectation; 2) higher operating expenses; and 3) higher finance cost and minority interests. To conclude, we revise up Xiao Nan Guo's EPS in 2015 by 3.0% but revise down the Company's EPS in 2016 by 12.5%. Xiao Nan Guo's EPS to be RMB0.045, RMB0.076 and RMB0.095 in 2015-2017, up 115.1x, 69.9% and 25.4% YoY, respectively.

Table-5: Earnings Estimate Revisions

RMB million	NEW			OLD		CHANGE	
	2015F	2016F	2017F	2015F	2016F	2015F	2016F
SSS Growth	4.8%	3.8%	3.3%	4.3%	4.1%	0.5 ppt	-0.3 ppt
Revenue	2,267	2,777	3,141	1,826	2,143	24.2%	29.6%
Gross Profit	1,515	1,864	2,115	1,240	1,463	22.1%	27.4%
Operating Profit	97	159	195	84	166	15.9%	-4.6%
Net Profit	66	112	141	64	129	2.8%	-12.7%
EPS (RMB)	0.045	0.076	0.095	0.044	0.087	3.0%	-12.5%
Gross Margin	66.8%	67.1%	67.3%	67.9%	68.3%	-1.1 ppt	-1.1 ppt
Operating Margin	4.3%	5.7%	6.2%	4.6%	7.8%	-0.3 ppt	-2.0 ppt
Net Margin	2.9%	4.0%	4.5%	3.5%	6.0%	-0.6 ppt	-2.0 ppt

Source: Guotai Junan International.

Reiterate "Buy" and Maintain TP at HK\$1.65. We believe Xiao Nan Guo is on the right track of earnings recovery as SSS growth rebound proves. Traffic flow improvement and increasing contribution from profitable "the dining room" business hold the key for significant earnings improvement in 2015 and 2016. On the other hand, the management business, though not the Company's principal business, is expected to be profitable. We believe the management has the ability to operate both Chinese and Western cuisines and to help the Company to step out of the darkness. Therefore, we maintain "Buy" on Xiao Nan Guo and TP of HK\$1.65 remains unchanged, which represents 29.1x 2015 PER, 17.1x 2016 PER and 13.7x 2017 PER.

Financial Statements and Ratios

Income Statement					
Year end Dec (RMB m)	FY13A	FY14A	FY15F	FY16F	FY17F
Revenue	1,386	1,544	2,267	2,777	3,141
<i>yoy growth</i>	4.0%	11.4%	46.8%	22.5%	13.1%
Cost of inventories	(459)	(509)	(752)	(913)	(1,026)
Gross Profit	927	1,035	1,515	1,864	2,115
<i>yoy growth</i>	2.1%	11.6%	46.4%	23.0%	13.5%
Other income/gains	35	45	57	65	73
Distribution costs	(830)	(932)	(1,318)	(1,595)	(1,797)
Administrative expenses	(113)	(128)	(152)	(172)	(195)
Other expenses	(11)	(8)	(5)	(3)	(1)
Operating Profit	8	12	97	159	195
<i>yoy growth</i>	-94.7%	49.9%	697.3%	63.8%	22.9%
Finance income, net	(2)	(4)	(5)	(3)	0
Income tax	(5)	(7)	(23)	(39)	(49)
Minority interests	0	(0)	(3)	(4)	(6)
Net Profit	1	1	66	112	141
<i>yoy growth</i>	-99.1%	-47.3%	115.8x	69.9%	25.4%
EPS (RMB)	0.001	0.000	0.045	0.076	0.095
DPS (HK\$)	0.008	0.000	0.020	0.040	0.050

Cash Flow Statement					
Year end Dec (RMB m)	FY13A	FY14F	FY15F	FY16F	FY17F
Profit before tax	6	8	92	155	195
Depr. and Amort.	111	128	166	176	183
Others	16	43	5	3	(0)
Working capital change	21	(79)	(26)	13	19
Tax paid	(42)	(21)	(26)	(42)	(52)
Operating Cash Flow	112	79	211	306	345
CAPEX	(188)	(166)	(250)	(150)	(150)
Others	(15)	2	2	2	2
Investing Cash Flow	(203)	(165)	(248)	(148)	(148)
Issue of shares	0	(3)	0	0	0
Change in borrowings, net	46	33	14	(100)	(150)
Dividends paid	(40)	0	0	(35)	(35)
Others	(2)	(0)	(7)	(6)	(2)
Financing Cash Flow	4	30	7	(141)	(187)
Change in cash	(86)	(56)	(30)	18	10
Foreign exchange effect	(6)	1	0	(1)	(1)
Cash balance at year end	324	269	239	256	265

Source: the Company, Guotai Junan International.

Balance Sheet					
As at Dec 31 (RMB m)	FY13A	FY14A	FY15F	FY16F	FY17F
Property & equipment	686	686	771	747	714
Others	139	163	206	225	247
Non-Current Assets	824	849	978	971	961
Inventories	50	45	58	67	74
Trade receivables	16	18	22	24	28
Other receivables	151	176	178	184	194
Cash	324	269	239	256	265
Current Assets	542	508	497	530	561
Trade payables	85	102	124	150	187
Other payables	224	151	155	168	182
Bank loans	203	236	250	150	0
Others	19	17	18	19	20
Current Liabilities	531	506	548	488	390
Payables	51	62	68	75	82
Deferred tax liabilities	1	1	1	1	1
Non-Current Liabilities	52	63	69	76	83
Minority Interests	5	6	9	13	19
Shareholders' Equity	779	782	848	925	1,030
BPS (RMB)	0.527	0.529	0.575	0.627	0.698

Financial Ratio					
	FY13A	FY14A	FY15F	FY16F	FY17F
Gross Margin (%)	66.9	67.0	66.8	67.1	67.3
EBITDA Margin (%)	8.6	9.1	11.6	12.1	12.1
Operating Margin (%)	0.6	0.8	4.3	5.7	6.2
Net Margin (%)	0.1	0.0	2.9	4.0	4.5
ROA (%)	0.1	0.0	4.7	7.6	9.3
ROE (%)	0.1	0.1	8.1	12.7	14.4
Inventory turnover days	43.2	34.0	25.0	25.0	25.0
Receivable turnover days	5.7	4.1	3.2	3.0	3.0
Payable turnover days	66.5	67.1	55.0	55.0	60.0
Cash conversion cycle	(17.6)	(29.0)	(26.8)	(27.0)	(32.0)
Current Ratio (x)	1.0	1.0	0.9	1.1	1.4
Quick Ratio (x)	0.9	0.9	0.8	1.0	1.2
Net gearing (%)	Net Cash	Net Cash	1.3	Net Cash	Net Cash
Net interest cover (x)	3.5	3.0	19.1	45.7	Net Interest Income
Payout ratio (%)	874.4	0.0	35.3	41.5	41.4

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating	Definition
Buy	Relative Performance >15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	Relative Performance <-15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating	Definition
Outperform	Relative Performance >5%; or the fundamental outlook of the sector is favorable.
Neutral	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	Relative Performance <-5%; or the fundamental outlook of the sector is unfavorable.

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 27/F., Low Block, Grand Millennium Plaza, 181 Queen's Road Central, Hong Kong.
 Tel.: (852) 2509-9118 Fax: (852) 2509-7793
 Website: www.gtja.com.hk