



Rating  
**Buy**

Asia  
China

Industrials

Company  
**SEG**

Reuters  
2386.HK

Bloomberg  
2386 HK

Exchange  
HSI

Ticker  
2386

Date

12 December 2017

## Company Update

Price at 11 Dec 2017 (HKD)	6.19
Price target - 12mth (HKD)	9.40
52-week range (HKD)	8.32 - 6.03
HANG SENG INDEX	28,640

# SASAC approved SEG's incentive scheme; reiterate Buy

## SASAC approved management incentive scheme, next EGM on 20 Dec

SEG announced SASAC has approved the Proposed H-Share Appreciation Rights Scheme (the scheme), the next would be shareholders' approval which the EGM is scheduled to be held on December 20. We believe the scheme is positive for both shareholders and the company by aligning investors' interests with management performance. After the scheme, the focus will return to SEG's outlook on new order contracts growth, and backlog improvements. Reiterate Buy with target price of HK\$9.4 with 54% upside potentials.

## Strong order pipelines in China

China's upcoming refining and chemicals projects for tender are significant. To our understanding, there are a RMB471bn worth of total investment in projects in China for potential tender offer in 2018E, including RMB149bn of refining and chemical projects (excluding Sinopec-KPC [RMB57bn], Zhejiang Petrochem [RMB90bn], and Hengli Dalian Petrochem [RMB80bn] projects which EPC tender is expected to completed in 2H17) and a potential RMB322bn of coal-to-chemical projects. If we assume EPC contracts worth 50% of total investment, with success rate of 100% / 50% / 20% for Sinopec / non-Sinopec R&C / CTO projects, respectively, the potential new orders could be RMB81bn, equal to 86% of current backlog.

## Valuation & Risks

We derive our price target based on 4.8x 2018E EV/EBITDA by applying a Gordon Growth Model. Our target multiple is in line with SEG's historical mean. Currently, share price trades at 3.1x EV/EBITDA, and below -1 SD of historical mean. We expect a strong EPS recovery (at a 26% CAGR 2016-19E) with strong ROE improvement (ROE of 11.3% in 2019E vs 6.7% in 2016) to trigger a re-rating. Key risks: 1) volatility in oil prices; 2) project delays; 3) FX risk; 4) cost inflation; and 5) CTO project cancellation.

## Valuation & Risks

Vitus Leung

Research Analyst

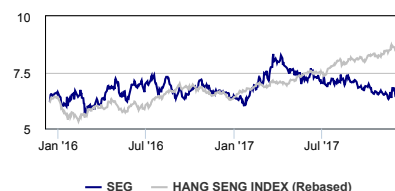
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## Price/price relative



Performance (%)	1m	3m	12m
Absolute	-6.2	-12.4	-6.4
HANG SENG INDEX	-0.5	3.6	27.3

Source: Deutsche Bank

## Key indicators (FY1)

ROE (%)	7.7
Net debt/equity (%)	-40.6
Book value/share (CNY)	5.96
Price/book (x)	0.9
Net interest cover (x)	-
Operating profit margin (%)	5.1

Source: Deutsche Bank

Deutsche Bank AG/Hong Kong

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**Forecasts and ratios**

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
EBITDA (CNYm)	4,464.5	2,657.5	2,621.4	4,309.1	4,377.7
Reported NPAT (CNYm)	3,317.7	1,662.9	1,978.0	3,274.8	3,319.9
DB EPS FD(CNY)	0.75	0.38	0.45	0.74	0.75
DB EPS growth (%)	–	-49.9	19.0	65.6	1.4
PER (x)	7.3	15.1	11.7	7.1	7.0
EV/EBITDA (x)	2.8	4.9	4.7	2.0	1.4

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*Source: Deutsche Bank estimates, company data*



Figure 1: H-Share Appreciation Rights Scheme

H Share Appreciation Rights Scheme	<p>To establish and cultivate a performance-oriented culture that creates values to the shareholders, to establish an interests sharing and restraining mechanism between shareholders and management team, to effectively mobilize the enthusiasm of management and core team;</p> <p>The Board approved the Scheme, subject to the approval of the SASAC and shareholders at the General Meeting and the satisfaction of initial conditions of grant, and the date of grant is determined by the Board.</p>
Incentive Instrument	<p>The H share appreciation rights refer to the entitlements of the qualified incentive recipients to gain from the increase in the price of the company's H shares within a specified time period and subject to certain conditions. The Incentive Recipients do not actually hold the shares;</p> <p>The H share appreciation rights are to be settled by way of cash, it does not affect the total number of H Shares in issue and will not result in any dilution effect on the shares of the Company.</p>
Proposed Recipients	<p>The 84 incentive recipients are limited to the Company's directors, senior management members and core technical employees, key management officers and highly skilled talents who have direct influence over the Group's overall performance and sustainable development;</p> <p>Proposes to grant 12,523,000 units of H share appreciation rights, corresponding number of H Shares is 12,523,000, approximately 0.28% of the total issued shares of the Company.</p>
Initial Grant Conditions	<p>First Effective Phase : the ROE of the financial year immediately before the year of the effective date shall not be lower than 10.0% ; the growth rate of revenue of the financial year immediately before the grant date shall not be lower than 14.2% ; the EVA of the financial year immediately before the year of the effective date shall not be less than RMB2.099 billion;</p> <p>Second Effective Phase : the ROE of the financial year immediately before the year of the effective date shall not be lower than 10.0%; the growth rate of revenue of the financial year immediately before the grant date shall not be lower than 21.6% ; the EVA of the financial year immediately before the year of the effective date shall not be less than RMB2.233 billion;</p> <p>Third Effective Phase : the ROE of the financial year immediately before the year of the effective date shall not be lower than 10.0%; the growth rate of revenue of the financial year immediately before the grant date shall not be lower than 29.3% ; the EVA of the financial year immediately before the year of the effective date shall not be less than RMB2.373 billion.</p>
Exercise Price	<p>On the grant date, the exercise price shall be the highest of the followings: (i) the closing price as stated the daily quotation sheet of the HKEX; (ii) prior to the average closing price of the Company's H Shares stated in the daily quotation sheets of the Stock Exchange for the five consecutive trading days; or (iii) the nominal value of the Company's H Shares.</p>

Source: Company data, Deutsche Bank

Figure 2: SEG currently tracking projects pipelines in 4Q17/2018

Province	Location	Refinery / Chemical capacity	Project owner	Est. total project investment (RMB bn)
Tinjian	Tinjian	Polycarbonate projects	Sinopec-Sabic	11
Fujian	Gulei	Gulei Integrated Refinery	Sinopec-Fujian-TW	35
Jiangsu	Lianyungang, Nanjing	Integration and optimization	Rongsheng	78
Hebei	Tangshan Caifeidian	Sinochem-Xuyang	Sinochem, Xuyang	26
<b>Total</b>				<b>149</b>
Province	Location	Coal-to-Chemical capacity	Project owner	Est. total project investment (RMB bn)
Xinjiang	Tacheng	Suxin Energy Hefeng Coal-to-Natural Gas	Suxin Energy	41
Inner Mongolia	Erdos	Beijing Enterprise Inner Mongolia Coal-to-Natural Gas	Beijing Enterprise	28
Xinjiang	Yili	Yitai Yili Coal-to-Oil	Yitai Energy	19
Guizhou	Bijie	Guizhou Yufu Bijie (Ph 1) Coal-to-Oil	Guizhou Yufu Energy	34
Ningxia	Ningdong	Shenhua Ningxia Coal-Sabic Coal-to-Alkene	Shenhua Ningxia Coal, Sabic	200
<b>Total</b>				<b>322</b>

Source: Company data, Deutsche Bank



Figure 3: Major refinery & chemical projects in 2018-20

Province	Location	Refinery / Chemical capacity	Project owner	Est. total project investment (RMB bn)
Fujian	Quanzhou	Sinochem Quanzhou Capacity Expansion: CDU +3mmtpa, Ethylene +1mmtpa	Sinochem	43.3
Liaoning	Xizhong Island, Dalian	Hengli Dalian Integrated Refinery & Chemical Project	Hengli Petrochem	74
Zhejiang	Zhoushan	Rongsheng Zhoushan Refinery: CDU 40mmtpa, Ethylene 2.8mmtpa, Aromatics 10.4mmtpa	Rongsheng, Tongkun, Juhua	160
Guangdong	Zhanjiang	Sino-Kuwait Guangdong Integrated Refinery & Chemical Project	Sinopec, KPC	57
Guangdong	Maoming-Zhanjiang	Zhenhai, Shanghai, Maoming-Zhanjiang and Nanjing Refining & Chemicals Centers - Existing capacity integration and optimization	Sinopec	TBC
Shanghai	Caojing, Shanghai		Sinopec	
Jiangsu	Lianyungang, Nanjing		Sinopec	
Zhejiang	Zhenhai, Ningbo		Sinopec	
Jiangsu	Lianyungang, Nanjing	Shenghong Petrochem	Shenghong Petrochem	
<b>Total new refining capacity</b>				405

Source: Company data, Deutsche Bank

Figure 4: Major refinery & chemical projects beyond 2020

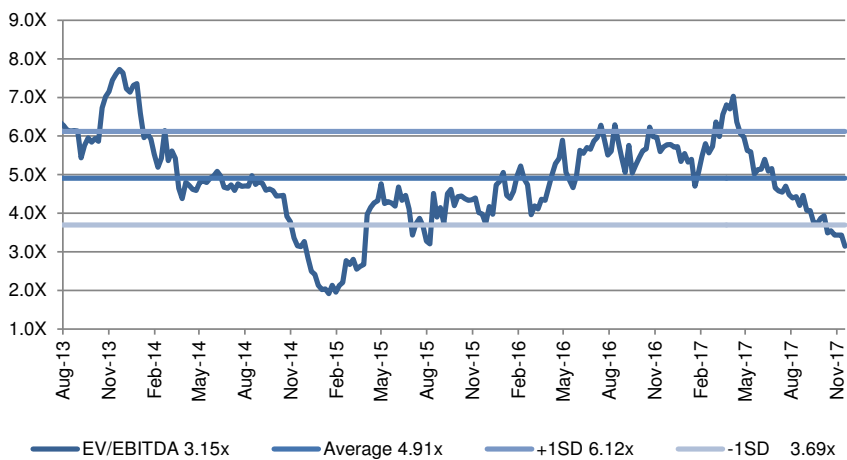
Province	Location	Refinery / Chemical capacity	Project owner	Est. total project investment (RMB bn)
Guangdong	Jieyang	Jieyang Petrochem	Petrochem, Venezuela	TBC
Liaoning	Panjin	Huajin Petrochem	China North Industries	TBC

Source: Company data, Deutsche Bank



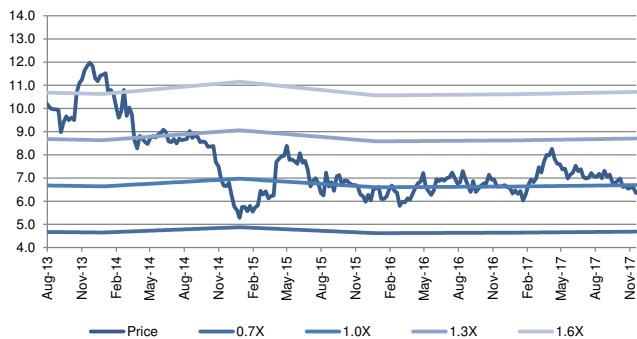
## Valuation charts

Figure 5: 12-month forward EV/EBITDA



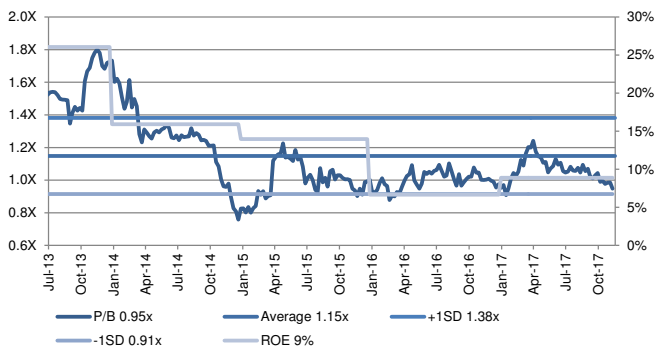
Source: Deutsche Bank estimates, Bloomberg Finance LP

Figure 6: 12-month forward P/E



Source: Deutsche Bank estimates, Bloomberg Finance LP

Figure 7: 12-month forward P/B



Source: Deutsche Bank estimates, Bloomberg Finance LP



Figure 8: Comp sheet

Name	Reuters Ticker	DB Rating	Trading Curr	11-Dec Price	Mkt Cap (USD mn)	P/E (x)		P/B (x)		ROE (%)		Dvd yield (%)		EV/EBITDA (x)	
						FY17E	FY18E	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
<b>China Oil &amp; Gas Engineering</b>															
SEG	2386.HK	Buy	HKD	6.19	3,856	12.9	7.8	1.0	0.9	7.7	12.0	3.1	5.1	5.6	2.5
COOEC	600583.SS	Hold	CNY	6.03	4,032	22.9	13.3	1.1	1.1	5.0	8.5	3.7	6.3	9.7	6.4
<b>EPC - Offshore Engineering</b>															
KBR	KBR.N	Buy	USD	19.20	2,671	13.5	15.2	2.9	2.5	23.3	17.7	1.7	1.7	7.8	7.2
SBM OFFSHORE NV	SBMO.AS	NR	EUR	14.61	3,536	70.5	17.8	1.3	1.3	3.2	13.8	1.3	1.4	12.7	11.2
Saipem	SPMI.MI	NR	EUR	3.43	4,083	27.9	23.0	0.7	0.7	1.7	3.0	0.0	0.3	5.0	5.6
Petrofac	PFC.L	NR	GBP	435.00	1,941	5.4	6.5	1.6	1.5	31.2	23.7	11.5	11.5	3.3	3.4
<b>Weighted average</b>						<b>33.5</b>	<b>17.2</b>	<b>1.5</b>	<b>1.4</b>	<b>11.6</b>	<b>12.6</b>	<b>3.9</b>	<b>2.7</b>	<b>7.6</b>	<b>7.2</b>
<b>EPC - Refining &amp; Chemical</b>															
Daelim Industrial Co Ltd.	000210.KS	NR	KRW	81,400.00	2,591	4.9	5.3	0.6	0.5	12.7	10.5	0.4	0.4	6.4	6.1
Petrofac	PFC.L	NR	GBP	435.00	1,941	5.4	6.5	1.6	1.5	31.2	23.7	11.5	11.5	3.3	3.4
GS Engineering & Construction Corp	006360.KS	NR	KRW	26,750.00	2,099	9.1	NA	0.6	NA	6.9	NA	1.2	NA	7.0	NA
SNC-Lavalin Group Inc.	SNC.TO	NR	CAD	56.58	7,730	23.3	17.8	1.8	1.8	9.6	11.4	1.9	2.0	16.1	11.0
KBR	KBR.N	Buy	USD	19.20	2,671	13.5	15.2	2.9	2.5	23.3	17.7	1.7	1.7	7.8	7.2
Fluor	FLR.N	Hold	USD	50.13	6,526	30.0	21.2	2.0	1.9	6.8	9.0	1.8	1.8	9.5	7.5
CTCI CORP	9933.TW	NR	TWD	44.80	1,139	12.3	13.1	1.9	1.9	15.4	14.7	6.8	7.5	7.9	6.9
Chiyoda	6366.T	NR	JPY	743.00	1,719	NA	37.5	1.2	1.2	-19.8	2.1	0.8	0.8	4.6	NA
China National Chemical Engineering	601117.SS	NR	CNY	6.29	4,820	14.8	12.0	1.1	1.0	7.8	9.1	1.7	2.1	5.4	4.6
<b>Weighted average</b>						<b>18.3</b>	<b>16.5</b>	<b>1.6</b>	<b>1.6</b>	<b>9.9</b>	<b>11.4</b>	<b>2.4</b>	<b>2.6</b>	<b>9.2</b>	<b>7.5</b>
<b>EPC Consulting</b>															
Amec Foster Wheeler Plc	AMFW.L	Hold	GBP	NA	2,731	21.7	19.7	2.1	2.0	9.5	10.3	3.0	3.2	11.1	10.5
KBR	KBR.N	Buy	USD	19.20	2,671	13.5	15.2	2.9	2.5	23.3	17.7	1.7	1.7	7.8	7.2
Petrofac	PFC.L	NR	GBP	435.00	1,941	5.4	6.5	1.6	1.5	31.2	23.7	11.5	11.5	3.3	3.4
Wilson Engineering Services Co Ltd	2236.HK	NR	HKD	1.69	880	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Jacob Engineering services	JEC.N	Hold	USD	68.38	6,592	22.8	18.9	1.6	1.7	6.9	9.2	0.0	0.0	13.1	10.6
<b>Weighted average</b>						<b>18.4</b>	<b>16.6</b>	<b>2.0</b>	<b>1.9</b>	<b>13.9</b>	<b>13.1</b>	<b>4.8</b>	<b>4.9</b>	<b>10.3</b>	<b>8.9</b>
<b>General Construction Co - A shares</b>															
<b>A- Shares</b>															
China Zhonghua Geotechnical Engg.	002542.SZ	NR	CNY	7.74	2,103	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
China railway construction group	601186.SS	Sell	CNY	11.84	24,278	10.3	10.0	1.1	1.0	11.6	10.9	1.5	1.5	5.5	5.3
China railway group	601390.SS	Sell	CNY	8.69	30,063	15.1	13.9	1.3	1.2	9.0	9.1	1.0	1.1	7.5	7.3
China communications construction	601800.SS	NR	CNY	14.01	29,476	11.7	10.4	1.4	1.2	11.9	12.1	1.6	1.8	10.4	9.5
Beijing Airport High Tech Park-A	600463.SS	NR	CNY	11.13	529	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Shenzhen Grandland Group - A	002482.SZ	NR	CNY	7.97	1,918	24.3	19.8	1.9	1.7	8.0	9.0	1.1	1.4	16.3	12.2
<b>Weighted average</b>						<b>12.8</b>	<b>11.7</b>	<b>1.3</b>	<b>1.2</b>	<b>10.7</b>	<b>10.6</b>	<b>1.4</b>	<b>1.5</b>	<b>8.1</b>	<b>7.6</b>
<b>H- shares</b>															
China State Construction Int'l holdings	3311.HK	Buy	HKD	10.26	5,986	8.6	6.9	1.6	1.4	20.0	21.4	3.5	4.3	7.3	6.0
China railway group	390.HK	NR	CNY	8.68	27,326	13.4	12.1	1.4	1.2	10.2	10.5	1.2	1.4	9.7	8.9
China railway construction group	1186.HK	Hold	HKD	9.12	15,835	6.7	6.5	0.7	0.7	11.6	10.9	2.3	2.4	4.0	3.9
China communications construction	1800.HK	Buy	HKD	8.67	18,220	6.2	5.5	0.7	0.6	11.6	11.8	3.4	3.8	6.5	6.2
<b>Weighted average</b>						<b>9.5</b>	<b>8.5</b>	<b>1.0</b>	<b>0.9</b>	<b>11.8</b>	<b>11.9</b>	<b>2.3</b>	<b>2.5</b>	<b>7.3</b>	<b>6.7</b>
<b>Chinese average</b>						<b>11.1</b>	<b>10.1</b>	<b>1.2</b>	<b>1.0</b>	<b>10.9</b>	<b>10.9</b>	<b>1.7</b>	<b>1.9</b>	<b>7.5</b>	<b>7.0</b>
<b>Global peers</b>															
NCC AB-B SHS	NCCb.ST	NR	SEK	174.90	2,230	14.4	12.9	3.2	2.9	23.9	24.1	5.2	5.6	7.5	7.0
GS Engineering & Construction Corp.	006360.KS	NR	KRW	26,750.00	2,099	9.1	NA	0.6	NA	6.9	NA	1.2	NA	7.0	NA
Daelim Industrial Co Ltd.	000210.KS	NR	KRW	81,400.00	2,591	4.9	5.3	0.6	0.5	12.7	10.5	0.4	0.4	6.4	6.1
CTCI Corp	9933.TW	NR	TWD	44.80	1,139	12.3	13.1	1.9	1.9	15.4	14.7	6.8	7.5	7.9	6.9
<b>Weighted average</b>						<b>9.6</b>	<b>9.6</b>	<b>1.5</b>	<b>1.7</b>	<b>14.6</b>	<b>16.4</b>	<b>2.8</b>	<b>3.7</b>	<b>7.1</b>	<b>6.6</b>

Source: Deutsche Bank estimates; Bloomberg Finance LP estimates are used for Non-Rated (NR) companies.



Model updated: 26 November 2017

## Running the numbers

Asia

China

Industrials

## SEG

Reuters: 2386.HK

Bloomberg: 2386 HK

## Buy

Price (11 Dec 17) HKD 6.19

Target Price HKD 9.40

52 Week range HKD 6.03 - 8.32

Market cap (m) HKDm 27,409  
USDm 3,511.2

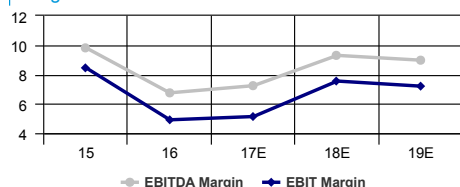
## Company Profile

SEG is one of the leading chemical engineering companies in China. It engages in four main services, namely: 1) licensing engineering and consulting; 2) EPC contracting; 3) construction and 4) equipment manufacturing. SEG is one of the top 10 global contractors based on revenue from services provided to chemical and oil refining industries in 2011.

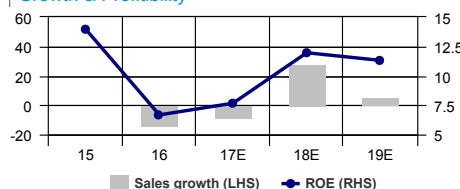
## Price Performance



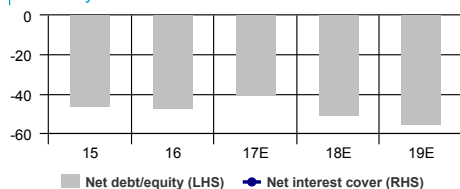
## Margin Trends



## Growth &amp; Profitability



## Solvency



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Fiscal year end 31-Dec

## Financial Summary

	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	0.75	0.38	0.45	0.74	0.75
Reported EPS (CNY)	0.75	0.38	0.45	0.74	0.75
DPS (CNY)	0.30	0.15	0.18	0.30	0.30
BVPS (CNY)	5.6	5.7	6.0	6.4	6.9
Weighted average shares (m)	4,428	4,428	4,428	4,428	4,428
Average market cap (CNYm)	24,100	25,087	23,234	23,234	23,234
Enterprise value (CNYm)	12,570	13,088	12,380	8,709	6,270

## Valuation Metrics

P/E (DB) (x)	7.3	15.1	11.7	7.1	7.0
P/E (Reported) (x)	7.3	15.1	11.7	7.1	7.0
P/BV (x)	0.96	0.97	0.88	0.82	0.77
FCF Yield (%)	22.9	16.5	5.3	22.0	16.8
Dividend Yield (%)	5.5	2.6	3.4	5.6	5.7
EV/Sales (x)	0.3	0.3	0.3	0.2	0.1
EV/EBITDA (x)	2.8	4.9	4.7	2.0	1.4
EV/EBIT (x)	3.3	6.8	6.7	2.5	1.8

## Income Statement (CNYm)

Sales revenue	45,498	39,375	36,212	46,327	48,787
Gross profit	6,699	4,943	5,542	7,309	7,679
EBITDA	4,464	2,658	2,621	4,309	4,378
Depreciation	619	723	761	811	863
Amortisation	0	0	0	0	0
EBIT	3,845	1,935	1,860	3,498	3,515
Net interest income/(expense)	375	419	657	681	723
Associates/affiliates	20	16	19	19	19
Exceptionals/extraordinary	0	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0
Profit before tax	4,240	2,369	2,536	4,199	4,257
Income tax expense	922	706	558	924	936
Minorities	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0
Net profit	3,318	1,663	1,978	3,275	3,320
DB adjustments (including dilution)	0	0	0	0	0
DB Net profit	3,318	1,663	1,978	3,275	3,320

## Cash Flow (CNYm)

Cash flow from operations	5,793	4,522	1,771	5,805	4,627
Net Capex	-273	-395	-533	-682	-718
Free cash flow	5,521	4,128	1,238	5,123	3,909
Equity raised/(bought back)	0	0	0	0	0
Dividends paid	-1,333	-1,129	-791	-1,310	-1,328
Net inc/(dec) in borrowings	0	0	0	0	0
Other investing/financing cash flows	-1,964	-2,542	-1,603	-154	-153
Net cash flow	2,224	456	-1,157	3,659	2,427
Change in working capital	2,132	2,377	-972	1,715	440

## Balance Sheet (CNYm)

Cash and other liquid assets	11,406	11,862	10,705	14,365	16,792
Tangible fixed assets	4,014	3,975	3,867	3,854	3,825
Goodwill/intangible assets	327	272	212	155	97
Associates/investments	128	141	153	165	177
Other assets	42,530	42,570	42,716	47,175	48,340
Total assets	58,404	58,818	57,654	65,713	69,230
Interest bearing debt	0	0	0	0	0
Other liabilities	33,766	33,616	31,265	37,359	38,884
Total liabilities	33,766	33,616	31,265	37,359	38,884
Shareholders' equity	24,639	25,198	26,389	28,354	30,346
Minorities	4	4	4	4	5
Total shareholders' equity	24,639	25,202	26,389	28,354	30,346
Net debt	-11,406	-11,862	-10,705	-14,365	-16,792

## Key Company Metrics

Sales growth (%)	nm	-13.5	-8.0	27.9	5.3
DB EPS growth (%)	na	-49.9	19.0	65.6	1.4
EBITDA Margin (%)	9.8	6.7	7.2	9.3	9.0
EBIT Margin (%)	8.5	4.9	5.1	7.6	7.2
Payout ratio (%)	39.6	39.9	40.0	40.0	40.0
ROE (%)	14.0	6.7	7.7	12.0	11.3
Capex/sales (%)	0.6	1.0	1.5	1.5	1.5
Capex/depreciation (x)	0.5	0.6	0.7	0.8	0.8
Net debt/equity (%)	-46.3	-47.1	-40.6	-50.7	-55.3
Net interest cover (x)	nm	nm	nm	nm	nm

Source: Company data, Deutsche Securities estimates



# Appendix 1

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\*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
SEG	2386.HK	6.10 (HKD) 12 Dec 2017	6, 9, 13

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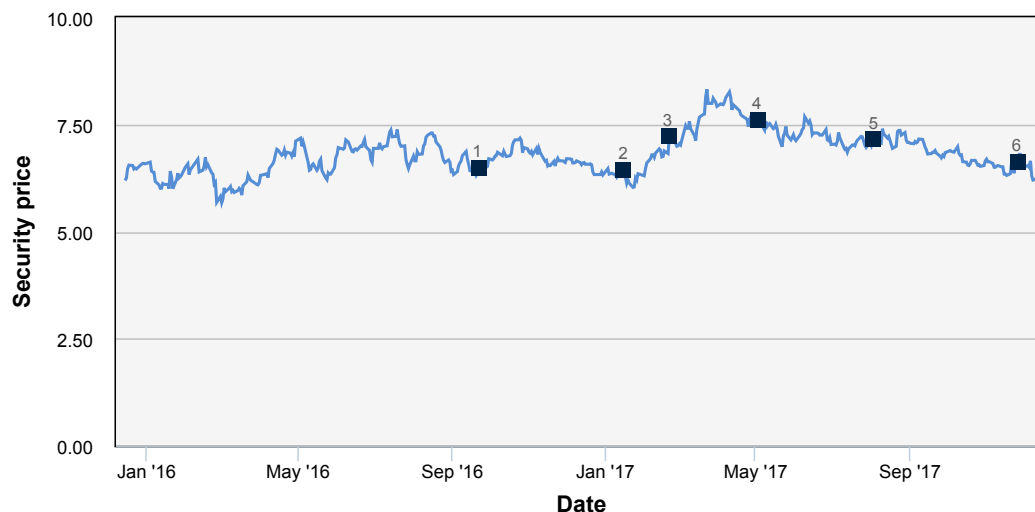
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## Historical recommendations and target price. SEG (2386.HK)

(as of 12/12/2017)



### Current Recommendations

Buy  
Hold  
Sell  
Not Rated  
Suspended Rating

\*\* Analyst is no longer at Deutsche Bank

1.	09/22/2016	Buy, Target Price Change HKD 7,60 Vitus Leung	4.	05/03/2017	Buy, Target Price Change HKD 9,20 Johnson Wan
2.	01/16/2017	Buy, Target Price Change HKD 7,40 Vitus Leung	5.	08/04/2017	Buy, Target Price Change HKD 9,00 Johnson Wan
3.	02/21/2017	Buy, Target Price Change HKD 8,60 Vitus Leung	6.	11/26/2017	Buy, Target Price Change HKD 9,40 Vitus Leung

## Equity Rating Key

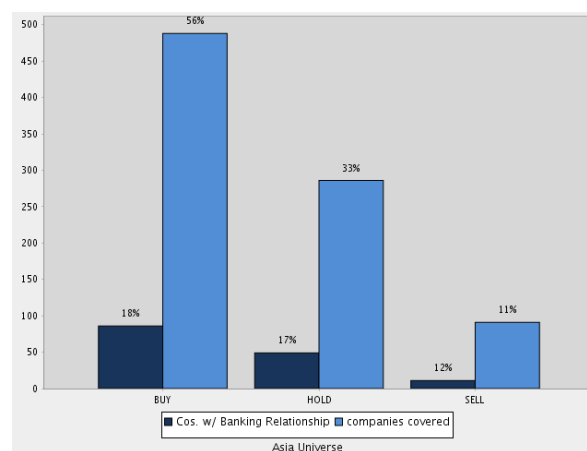
**Buy:** Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield ) , we recommend that investors buy the stock.

**Sell:** Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

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