



Company Report: China Unicom (00762 HK)

公司报告: 中国联通 (00762 HK)

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1Q18 Results Beat with Better Margin, "Accumulate"

2018年1季度业绩因利润率的改善好于预期, “收集”

- **China Unicom's 1Q18 results were slightly better than expectations, with 248.6% growth in net profit.** EBITDA margin improved by 1.8 ppt yoy to 35.9% due to lower finance costs, reductions in handset subsidies and larger 4G user base.
- **China Unicom is shifting its 2G resources for 4G network usage, which can improve its 4G network quality.** 1Q18 mobile ARPU was RMB47.9, up 2.6% yoy. We slightly revise up FY18-FY20 mobile ARPU by 1.1%/ 1.5%/ 1.7% to RMB49.3/ RMB51.3/ RMB53.4, respectively, to reflect better 4G user penetration rate and improvement in network coverage.
- **FY18-FY20 EBITDA margin is expected to improve by 1.2 ppt/ 0.5 ppt/ 0.7 ppt to 34.1%/ 34.7%/ 35.4%, respectively, thanks to lower finance costs, and handset subsidies and better service revenue growth.** China Unicom is expected to further lower its handset subsidies and finance costs from better cash flow and operating model.
- **Maintain the investment rating of "Accumulate" but revise up the TP from HK\$11.00 to HK\$12.20.** We revise up FY18-FY20 EPS by 3.0%/ 3.8%/ 4.6%, respectively. The new TP represents 30.8x FY18 PER, 21.9x FY19 PER, 16.7x FY20 PER and 1.0x FY18 PBR.
- **中国联通 2018 年 1 季度业绩略好于预期, 净利润同比增长 248.6%。** 由于财务成本降低、手机补贴缩减以及更大的 4G 用户基数, EBITDA 利润率同比提升 1.8 个百分点至 35.9%。
- **中国联通正在将其 2G 资源向 4G 网络的使用进行迁移, 将可改善其 4G 网络质量。** 2018 年 1 季度移动 ARPU 为 47.9 元人民币, 同比上升 2.6%。我们分别将 2018 财年至 2020 财年的移动 ARPU 轻微上调 1.1%/1.5%/1.7%至人民币 49.3 元/51.3 元/53.4 元, 以反映 4G 用户渗透率的提升以及网络覆盖的改善。
- **得益于财务成本降低, 手机补贴缩减以及服务收入增长加快, 预计 2018 财年至 2020 财年的 EBITDA 利润率将分别提升 1.2 个百分点/0.5 个百分点/0.7 个百分点至 34.1%/34.7%/35.4%。** 预计中国联通将进一步下调其手机补贴并凭借更佳的现金流和经营模式降低财务成本。
- **维持公司的投资评级为“收集”及目标价从 11.00 港元上调至 12.20 港元。** 我们分别上调 2018 财年至 2020 财年的每股盈利 3.0%/3.8%/4.6%。新的目标价相当于 30.8 倍的 2018 财年年市盈率、21.9 倍 2019 财年年市盈率、16.7 倍 2020 财年年市盈率以及 1.0 倍的 2018 财年年市净率。

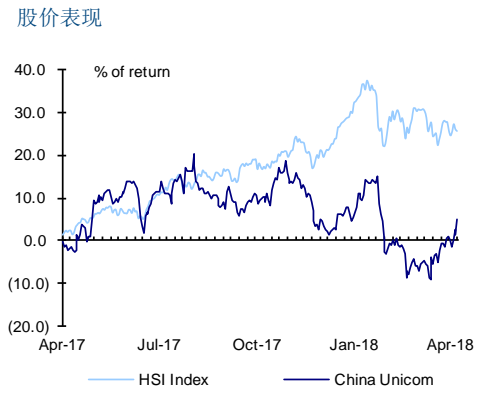
Rating: Accumulate
Maintained

评级: 收集 (维持)

6-18m TP 目标价: HK\$12.20
Revised from 原目标价: HK\$11.00

Share price 股价: HK\$10.760

Stock performance



Change in Share Price	1 M	3 M	1 Y
股价变动	1 个月	3 个月	1 年
Abs. % 绝对变动 %	0.0	(8.0)	26.1
Rel. % to HS Index 相对恒指变动 %	15.0	3.9	(20.4)
Avg. Share price(HK\$) 平均股价 (港元)	10.0	10.4	11.0

Source: Bloomberg, Guotai Junan International.

Year End	Turnover	Net Profit	EPS	EPS	PER	BPS	PBR	DPS	Yield	ROE
年结	收入	股东净利	每股净利	每股净利变动	市盈率	每股净资产	市净率	每股股息	股息率	净资产收益率
12/31	(RMB m)	(RMB m)	(RMB)	(Δ %)	(x)	(RMB)	(x)	(RMB)	(%)	(%)
2016A	274,197	625	0.026	(94.1)	370.6	9.508	1.0	0.000	0.0	0.3
2017A	274,829	1,828	0.074	184.6	117.8	12.388	0.7	0.050	0.6	0.7
2018F	284,081	10,296	0.337	355.4	25.9	12.985	0.7	0.270	3.1	3.4
2019F	292,871	14,476	0.473	40.4	18.4	14.262	0.6	0.400	4.6	4.5
2020F	301,035	18,985	0.621	31.3	14.0	15.014	0.6	0.530	6.1	5.5
Shares in issue (m) 总股数 (m)				30,598.1	Major shareholder 大股东				China Unicom Group	54.7%
Market cap. (HK\$ m) 市值 (HK\$ m)				329,235.6	Free float (%) 自由流通比率 (%)					25.6
3 month average vol. 3 个月平均成交股数 ('000)				43,689.0	FY18 Net gearing (%) FY18 净负债/股东资金 (%)					1.9
52 Weeks high/low (HK\$) 52 周高/低 (HK\$)				13.240 / 9.290	FY18 Est. NAV (HK\$) FY18 每股估值 (港元)					13.5

Source: the Company, Guotai Junan International.

1Q18 Results Review

China Unicom's 1Q18 results were slightly better than expected, with 248.6% yoy growth in net profit, due to lower finance costs, reductions in handset subsidies and larger 4G user base. EBITDA margin improved 1.8 ppt yoy to 35.9% in 1Q18. Mobile service revenue grew 11.6% yoy in 1Q18, driven by higher 4G user penetration rate. Fixed-line service revenue grew 3.4% yoy in 1Q18, driven by moderate growth in fixed-line user growth. China Unicom added 2.8 million fixed-line broadband users in 1Q18, up 101.5% yoy. Thanks to the launch of mixed ownership reform, China Unicom managed to boost industrial internet business revenue by 36.0% yoy. Finance costs decreased by 56% yoy in 1Q18 thanks to lower debt ratio from capital injection from the launch of mixed reform ownership. China Unicom was able to make significant improvement for 4G users due to the launch of data traffic SIM cards with internet companies. Mobile ARPU was RMB47.9 in 1Q18, up 2.6% yoy. China Unicom may re-allocate its 2G frequency spectrum for 4G network usage, which can improve the Company's network coverage and quality. China Unicom is expected to cancel data roaming fees in July 2018 and lower 30% of handset data tariffs in 2018 to support the launch of the speed upgrade and tariff reduction strategy. China Mobile obtained the FDD-LTE 4G operating license from MIIT in 1Q18 which may intensify market competition. We expect that the speed upgrade and tariff reduction strategy effects will impact the company's earnings more significantly in 2Q18.

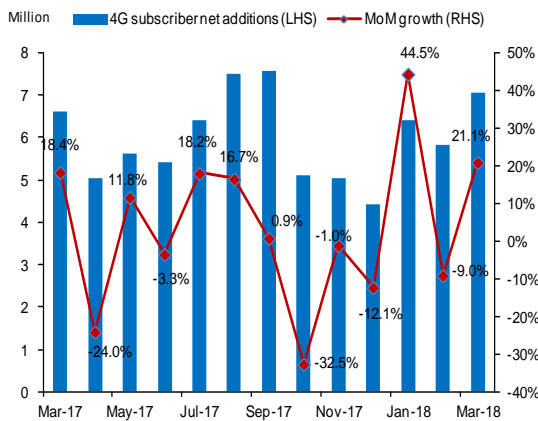
Table-1: China Unicom's Income Statement

RMB (Billion)	1Q18	1Q17	YoY	Comments
Total revenue	74,935	69,005	8.6%	
Service revenue	66,609	61,426	8.4%	Contributed by larger 4G user base
Sales of products & others	8,326	7,579	9.9%	
Interconnection charges	(2,960)	(3,102)	(4.6%)	
D&A	(20,017)	(19,024)	5.2%	
Networks, operations & support expenses	(13,318)	(13,205)	0.9%	Due to tower leasing expense increase
Employee benefit expenses	(11,920)	(9,832)	21.2%	
Cost of products sold	(8,340)	(7,900)	5.6%	
Other operating expenses	(14,488)	(13,991)	3.6%	
Finance costs	(674)	(1,537)	(56.1%)	Due to lower debt ratio with capital injection from mixed ownership reform
Interest income	455	286	59.1%	
Share of net profit of associates	132	234	(43.6%)	
Share of net profit of JV	102	79	29.1%	
Others	124	163	(23.9%)	
Profit attributable to shareholders	3,005	862	248.6%	
EPS (RMB)	0.098	0.036	172.9%	
EBITDA	23,909	20,973	14.0%	
Net profit margin	4.0%	1.2%	2.8ppt	
EBITDA / service revenue	35.9%	34.1%	1.8ppt	

Source: the Company, Guotai Junan International.

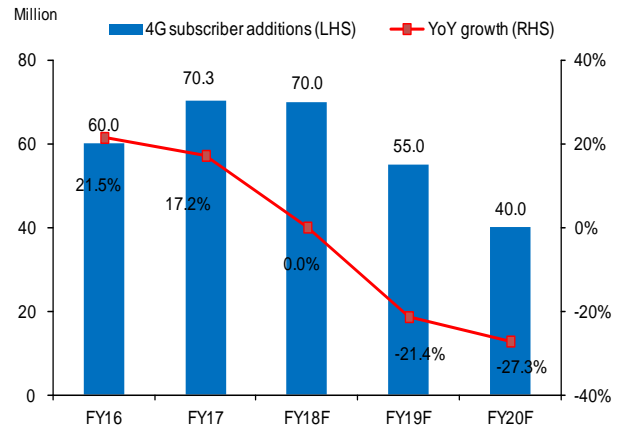
Higher 4G user penetration rate drives mobile ARPU amid lower data service tariffs. Mobile service revenue grew 11.6% yoy to RMB41.5 billion in 1Q18, which was 3% better than expected. 1Q18 mobile ARPU reached RMB47.9, up 2.6% yoy, better than expected. China Unicom is expected to cancel data roaming fees in July 2018 and lower handset data service tariffs by more than 30% in 2018 to follow the speed upgrade and tariff reduction policy. Average data usage per user reached over 4GB/ month, up 360% yoy, due to lower data service tariffs. China Unicom is shifting its 2G resources for 4G network usage, which can improve its 4G network capacity and quality. We slightly revise up FY18-FY20 mobile ARPU by 1.1%/ 1.5%/ 1.7% to RMB49.3/ RMB51.3/ RMB53.4, respectively, to reflect better 4G user penetration rate and improvement in network coverage in rural regions. We expect that China Unicom will launch more data SIM cards in 2018 with cooperation with internet companies. China Unicom added 19.3 million new 4G users in 1Q18, up 6.3% yoy. The proportion of 4G users over total number of mobile users reached 66.1% in Mar 2018, up 20.0 ppt yoy. Higher 4G user penetration rate helped China Unicom to develop data service revenue. We forecast China Unicom to add 70 million/ 55 million/ 40 million new 4G users in FY18-FY20, respectively.

Figure-1: China Unicom's Monthly 4G Subscriber Net Additions and MoM Growth



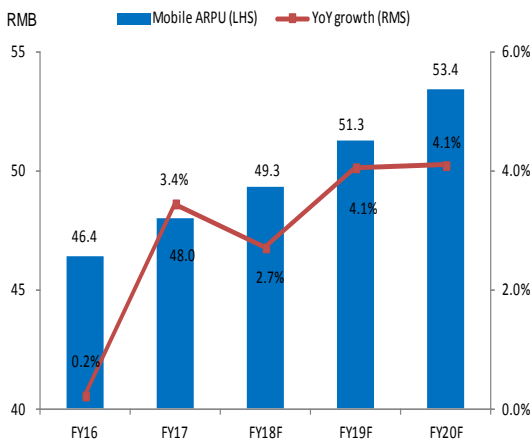
Source: the Company.

Figure-2: China Unicom's 4G Subscriber Net Additions and YoY Growth



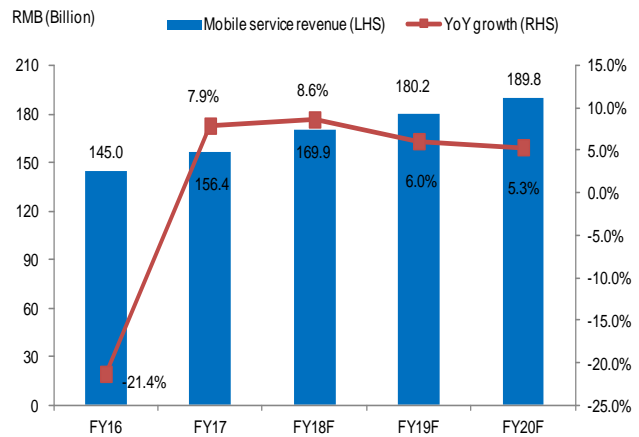
Source: the Company, Guotai Junan International.

Figure-3: China Unicom's Blended Mobile ARPU Forecast and YoY Growth



Source: the Company, Guotai Junan International.

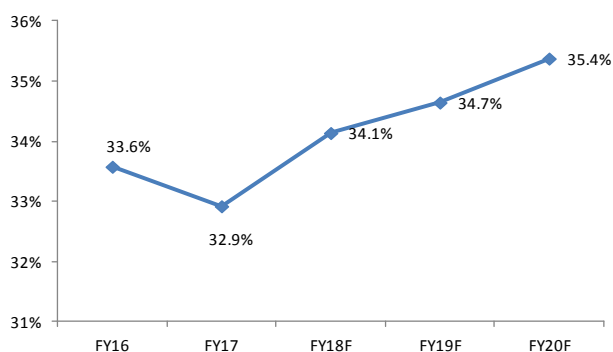
Figure-4: China Unicom's Mobile Service Revenue and YoY Growth



Source: the Company, Guotai Junan International.

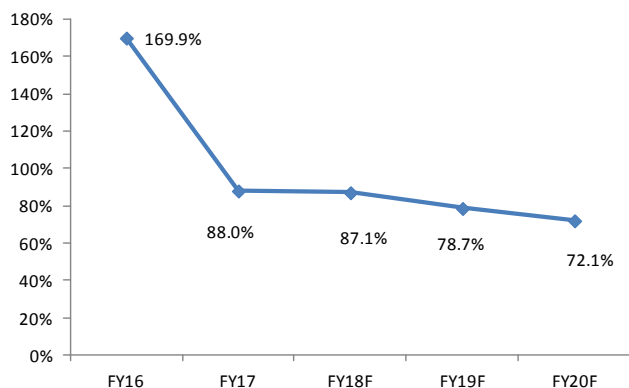
Lower handset subsidies and operating costs support profit margin to grow. EBITDA margin improved 1.8 ppt yoy to 35.9% in 1Q18, thanks to lower finance costs and service revenue growth improvement. Finance costs lowered by 56% yoy in 1Q18, thanks to lower debt ratio with capital injection resulting from mixed ownership reform. We expect FY18-FY20 gearing ratio to lower by 0.9ppt/ 8.4 ppt/ 6.6 ppt to 87.1%/ 78.7%/ 72.1%, respectively. Handset subsidies decreased by 67% yoy to RMB190 million. China Unicom is changing its strategy from handset subsidizing to lower service tariffs to boost user growth. FY18-FY20 EBITDA margin is expected to improve by 1.2 ppt/ 0.6 ppt/ 0.7 ppt to 34.1%/ 34.7%/ 35.4%, respectively.

Figure-5: China Unicom's EBITDA Margin



Source: the Company, Guotai Junan International.

Figure-6: China Unicom's Debt/ Equity Ratio



Source: the Company, Guotai Junan International.

Profit Revisions

We lift FY18-FY20 EPS by 3.0%/ 3.8%/ 4.6%, respectively. We revise up FY18-FY20 mobile service revenue forecasts by 2.1%/ 2.9%/ 3.1%, respectively, due to larger 4G user base with the shift in 2G network resources to the 4G platform.

Table-2: Financial Estimation Revisions

RMB (Million)	OLD			NEW			CHANGE		
	2018F	2019F	2020F	2018F	2019F	2020F	2018F	2019F	2020F
Total operating revenue	279,883	286,567	293,121	284,081	292,871	301,035	1.5%	2.2%	2.7%
Mobile revenue	166,413	175,108	184,098	169,908	180,186	189,805	2.1%	2.9%	3.1%
Fixed-line revenue	90,412	90,864	91,591	90,412	90,864	91,591	0.0%	0.0%	0.0%
Sales of products	23,057	20,595	17,432	23,762	21,821	19,639	3.1%	6.0%	12.7%
Net profit	9,996	13,946	18,150	10,296	14,476	18,985	3.0%	3.8%	4.6%
EPS (RMB)	0.327	0.456	0.594	0.337	0.473	0.621	3.0%	3.8%	4.6%

Source: Guotai Junan International.

Maintain the Company's investment rating of "Accumulate" but revise up the TP from HK\$11.00 to HK\$12.20. China Unicom is expected to improve its 4G network coverage with the shift in 2G telecom network. Thanks to mixed ownership reform, China Unicom managed to improve debt ratio, which lowered its finance costs. We expect the Company's profit margin to improve with better revenue growth and lower operating costs. The new TP represents 30.8x FY18 PER, 21.9x FY19 PER, 16.7x FY20 PER and 1.0x FY18 PBR.

Table-3: Peers Comparison

Company	Ticker	Currency	Price	PER			PBR			ROE(%)	D/Y (%)	EV/EBITDA	ROA(%)
				18F	19F	20F	18F	19F	20F	18F	18F	18F	18F
HK Listed Companies													
China Unicom Hong Kong Ltd	762 HK	HKD	10.760	29.9	18.6	13.6	0.8	0.8	0.8	2.8	1.4	3.1	1.5
China Mobile Ltd	941 HK	HKD	74.000	10.4	10.2	9.7	1.2	1.1	1.0	11.7	4.8	2.7	7.1
China Telecom Corp Ltd-H	728 HK	HKD	3.670	11.7	10.5	9.3	0.7	0.7	0.6	6.1	3.5	2.9	3.2
Pccw Ltd	8 HK	HKD	4.800	21.5	18.6	15.5	2.0	2.0	1.9	8.9	5.8	5.7	1.9
HKT	6823HK	HKD	10.380	15.2	14.9	14.3	2.0	2.0	2.0	13.0	6.3	8.6	5.5
Smartone Telecom	315 HK	HKD	8.310	14.9	15.4	15.5	2.0	1.9	1.9	13.1	5.4	4.9	7.9
Hutchison Telecomm Hong Kong	215 HK	HKD	2.830	35.8	35.8	37.2	0.8	0.9	0.9	2.5	2.0	5.0	1.4
Simple Average				19.9	17.7	16.4	1.4	1.3	1.3	8.3	4.2	4.7	4.0
Weighted Average				13.9	11.9	10.6	1.1	1.0	1.0	9.6	4.2	3.1	5.6
US Listed Companies													
AT&T Inc	T US	USD	34.890	10.1	9.9	10.0	1.5	1.4	1.3	15.0	5.8	6.1	4.6
Verizon Communications Inc	VZ US	USD	48.660	10.8	10.5	10.3	3.8	3.2	2.8	38.9	4.9	6.6	7.5
Centurylink Inc	CTL US	USD	17.730	18.7	13.9	14.2	0.8	0.9	1.0	3.0	12.2	6.5	0.6
Simple Average				13.2	11.4	11.5	2.0	1.9	1.7	19.0	7.6	6.4	4.2
Weighted Average				10.8	10.4	10.3	2.5	2.2	2.0	25.5	5.6	6.3	5.8
JP Listed Companies													
Nippon Telegraph & Telephone	9432 JP	JPY	5,165.000	11.7	11.3	10.7	1.1	1.0	0.9	9.2	2.9	5.2	4.7
Kddi Corp	9433 JP	JPY	2,871.000	12.2	11.5	11.0	1.8	1.7	1.6	15.6	3.2	5.5	9.1
Ntt Docomo Inc	9437 JP	JPY	2,758.000	14.1	14.1	13.6	1.7	1.6	1.5	12.6	3.6	6.6	9.6
Softbank Corp	9984 JP	JPY	8,208.000	8.7	12.4	5.8	1.8	1.5	1.2	21.0	0.5	8.0	3.8
Simple Average				11.7	12.3	10.3	1.6	1.5	1.3	14.6	2.6	6.3	6.8
Weighted Average				11.7	12.4	10.4	1.6	1.4	1.3	14.2	2.6	6.3	6.7
EU Listed Companies													
Vodafone Group Plc	VOD LN	GBP	212.300	22.8	22.1	19.1	0.9	1.0	1.0	3.7	6.2	6.6	2.1
Deutsche Telekom Ag-Reg	DTE GR	EUR	14.210	14.8	13.0	11.8	2.0	2.0	2.0	12.3	5.0	5.8	2.7
Telenor Asa	TEL NO	NOK	174.050	17.4	16.2	15.3	4.5	4.4	4.2	25.6	4.9	6.6	8.7
Telecom Italia Spa	TIT IM	EUR	0.869	11.4	10.6	10.0	0.8	0.8	0.7	7.3	0.6	5.3	3.5
Simple Average				16.6	15.5	14.0	2.1	2.0	2.0	12.2	4.2	6.1	4.2
Weighted Average				17.8	16.6	14.8	1.9	1.9	1.8	10.7	5.0	6.2	3.5
Other Developed Market													
Telstra Corp Ltd	TLS AU	AUD	3.100	10.4	9.7	11.2	2.4	2.3	2.2	23.9	7.1	5.2	9.7
Singapore Telecom Ltd	ST SP	SGD	3.430	14.4	14.1	13.0	1.9	1.8	1.8	14.8	5.9	12.8	9.0
Simple Average				12.4	11.9	12.1	2.2	2.0	2.0	19.4	6.5	9.0	9.3
Weighted Average				12.8	12.3	12.3	2.1	2.0	1.9	18.4	6.4	9.7	9.3
Overall Average				14.7	13.8	12.9	1.8	1.7	1.7	14.7	5.0	6.5	5.7
Overall Weighted Average				15.4	13.0	12.4	2.0	1.9	1.9	16.4	4.8	6.3	6.2

Source: Bloomberg.

Financial Statements and Ratios

Income Statement					
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F
Mobile service revenue	145,018	156,441	169,908	180,186	189,805
Fixed line service revenue	91,710	90,866	90,412	90,864	91,591
Sales of telecom products & others	37,469	27,522	23,762	21,821	19,639
Total Revenue	274,197	274,829	284,081	292,871	301,035
Interconnection charges	(12,739)	(12,617)	(12,365)	(12,117)	(11,875)
Depreciation & amortization	(76,805)	(77,492)	(78,267)	(79,050)	(79,840)
Networks, operations & support expenses	(51,167)	(54,507)	(58,278)	(61,804)	(64,913)
Employee benefit expenses	(36,907)	(42,471)	(43,464)	(45,395)	(46,660)
Costs of telecommunications products sold	(39,301)	(26,643)	(23,068)	(21,031)	(18,831)
Other operating expenses	(54,585)	(57,166)	(58,023)	(58,604)	(59,190)
Total operating expenses	(271,504)	(270,896)	(273,466)	(278,000)	(281,310)
Operating Profit	2,693	3,933	10,615	14,871	19,725
Finance costs	(5,017)	(5,734)	(2,010)	(1,201)	(722)
Interest income	1,160	1,647	1,918	1,852	2,186
Share of loss of JV & associate	357	1,467	1,907	2,384	2,622
Other income - net	1,591	1,280	1,408	1,549	1,704
Profit Before Tax	784	2,593	13,838	19,455	25,515
Income Tax	(154)	(743)	(3,460)	(4,864)	(6,379)
Profit After Tax	630	1,850	10,379	14,591	19,136
Non-controlling Interest	(5)	(22)	(82)	(116)	(152)
Shareholders' Profit / Loss	625	1,828	10,296	14,476	18,985
Basic EPS	0.026	0.074	0.337	0.473	0.621

Cash Flow Statement					
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F
Profit before income tax	784	2,593	13,838	19,455	25,515
Net interest expenses (income)	(1,160)	(1,647)	(1,918)	(1,852)	(2,186)
Depreciation & amortization	76,805	77,492	78,267	79,050	79,840
Other non-cash items	8,637	11,115	4,327	3,552	3,107
Working capital change	(3,898)	1,966	4,833	6,350	6,211
Interest received	335	807	1,918	1,852	2,186
Interest paid	(4,938)	(6,293)	(2,010)	(1,201)	(722)
Income tax paid	(1,972)	(979)	(3,460)	(4,864)	(6,379)
Cash from Operating Activities	74,593	85,054	95,796	102,342	107,573
CAPEX	(98,293)	(61,489)	(64,563)	(70,374)	(76,004)
Others	2,544	14,153	19,172	20,151	21,224
Cash from Investing Activities	(95,749)	(47,336)	(45,392)	(50,223)	(54,780)
Bank loan change	(3,635)	(52,945)	(25,195)	(28,589)	(25,015)
Dividend paid	(4,071)	0	(1,591)	(8,926)	(12,549)
Others	30,583	24,531	(24,894)	(7,937)	(6,715)
Cash from Financing Activities	22,877	(28,414)	(51,680)	(45,452)	(44,278)
Net Changes in Cash	1,721	9,304	(1,276)	6,668	8,515
Cash at Beg of Year	21,755	23,633	32,836	31,469	38,055
FX change	157	(101)	(91)	(82)	(74)
Cash at End of Year	23,633	32,836	31,469	38,055	46,497

Source: the Company, Guotai Junan International.

Balance Sheet					
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F
PP&E	451,115	416,596	434,035	439,684	454,121
Lease prepayments	9,436	9,313	9,872	10,365	10,884
Goodwill	2,771	2,771	2,771	2,771	2,771
Other non-current assets	68,614	66,581	63,106	59,930	57,026
Total Non-current Assets	531,936	495,261	509,784	512,751	524,801
Inventories & consumables	2,431	2,239	2,335	3,210	4,124
Account Receivables	13,622	13,964	16,344	17,653	18,969
Prepayments & other current assets	14,023	13,801	13,111	12,455	11,833
Cash & Cash Equivalents	23,633	32,836	31,469	38,055	46,497
Other current assets	28,509	13,882	13,404	13,177	12,969
Total Current Assets	82,218	76,722	76,664	84,549	94,392
Total Assets	614,154	571,983	586,448	597,300	619,193
Accounts payable & accrued liabilities	143,224	125,260	156,587	159,945	162,620
Amounts due to related parties	8,700	8,126	8,532	8,959	9,407
Commercial papers	35,958	8,991	7,193	4,316	2,589
Short-term bank loans	76,994	22,500	18,000	10,800	6,480
Current portion of other obligations	3,141	2,987	3,368	3,786	4,247
Advances from customers	47,028	49,283	50,590	52,958	55,258
Others	27,610	25,475	7,791	8,299	8,848
Total Current Liabilities	342,655	242,622	252,061	249,063	249,451
Long-term bank debt	4,495	3,473	2,778	1,389	695
Deferred revenue	2,998	3,020	3,122	3,218	3,308
Others	36,324	18,521	14,853	9,113	5,676
Total Non-current Liabilities	43,817	25,014	20,753	13,721	9,678
Total Liabilities	386,472	267,636	272,814	262,784	259,129
Share capital	179,102	254,056	254,056	254,056	254,056
Reserves	48,305	49,994	59,189	79,987	105,569
Total Shareholders' Equity	227,407	304,050	313,245	334,112	359,625
Minority Interest	275	297	388	404	439
Total Equity	227,682	304,347	313,634	334,516	360,064

Financial Ratios					
	2016A	2017A	2018F	2019F	2020F
Operating margin (%)	1.0	1.4	3.7	5.1	6.6
Net profit margin (%)	0.2	0.7	3.7	5.0	6.4
ROA (%)	0.1	0.3	1.8	2.5	3.1
ROE (%)	0.3	0.7	3.4	4.5	5.5
Net gearing (%)	65.0	12.4	1.9	Net cash	Net cash

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance > 15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	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	跑赢大市	Relative Performance > 5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance < -5%; Or the fundamental outlook of the sector is unfavorable.

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