

Anta Sports Products [2020.HK]

Industry Leader Offering Multi-year Growth Story. Initiate with BUY

Anta Sports has been the no.1 domestic sportswear company in China. The driver comes from Anta Sports is the no.1 domestic sportswear company in China, driven by its core ANTA brand and acquired FILA brand. We expect the ANTA brand will continue to capture growing demand in the sportswear market, while the high-end FILA sports fashion brand should benefit from the increasing wealth in Tier 1 & 2 cities. In general, we expect Anta's unrivalled scale to create a virtuous cycle, offering a multi-year growth story. In 2018E/2019E, we expect Anta Sports to maintain a ~20% YoY net profit growth rate. Initiate with BUY. Our target price of HK\$49.16 is based on 24.0x 2019E PER. We believe the Company will continue to trade at a premium because of its industry-leading status, as well as its consistent track record of paying steady dividends. We believe the recent correction caused by some accusations offer a good entry point.

Investment Highlights

- ANTA – The King of Domestic Sportswear.** We believe Anta Sports will be a multi-year growth story. One of the early entrants in the industry, Anta Sports has been a leading domestic sportswear company for years. The core ANTA brand, which we estimate accounted for ~75% of revenue in 2017, has maintained steady growth amid intensified competition. We believe ANTA is likely to maintain its growth momentum. The Company is the largest domestic sportswear company in terms of revenue, and therefore, its spending on advertising and marketing is also the largest. We believe this will create a virtuous cycle for ANTA, allowing it to capture more market share from smaller players.
- FILA & Foreign Brands – Engine of High Growth.** Another growth engine for Anta Sports is the significant contribution from the FILA brand, which we estimate accounted for ~25% of revenue in 2017. As a high-end sports fashion brand, it complements the ANTA brand, and has helped the Company increase its share of the overall sportswear market. We expect the FILA brand to continue to be a key driver for the Company. It is likely to maintain strong growth (top line: >30% YoY) in the future. The GPM of FILA, which we estimate to be 60%-70%, is also notably higher than that of ANTA so it raises the overall GPM.
- Consistent Track Record.** Thanks to steady growth from the ANTA and FILA brands, as well as well-controlled operating costs, we expect in annual net profit in 2018E and 2019E to achieve ~20% YoY growth. We acknowledge that Anta Sports has been a uniquely successful sporting goods company in China and has delivered superior returns compared to its peers. However, its EBIT margin is still lower than that of the China operations of Nike and Adidas, so the criticism of abnormally high margins is unfounded, in our view.
- Initiate with BUY.** Our EPS forecast for 2018E/2019E is RMB1.40/1.68 respectively, implying 19.6%/20.2% growth. This earnings growth is in line with the previous growth rate. The Company is the industry leader and is likely to enjoy a virtuous cycle in terms of earnings growth. Therefore, we believe a longer horizon should be considered. Initiate with BUY. Our TP of HK\$49.16 is based on 24x 2019E PER. Our target multiple of 24x takes into consideration earnings growth (19.1% CAGR for EPS between 2017 to 2020E) and a premium for its status as the industry leader. Also, the Company has a good track record of paying dividends at a 70% payout ratio, which warrants a premium.

Key Financials (RMB m)	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Revenue	13,346	16,692	20,613	24,615	28,610
YoY Change	20.0%	25.1%	23.5%	19.4%	16.2%
Net Profit After Tax	2,386	3,088	3,695	4,444	5,204
YoY Change	16.9%	29.4%	19.6%	20.3%	17.1%
EPS (RMB)	0.95	1.17	1.40	1.68	1.97
YoY Change	16.8%	22.8%	19.6%	20.3%	17.1%
ROE	25.0%	32.3%	27.0%	30.0%	31.7%
P/E	34.3x	28.0x	23.4x	19.4x	16.6x
Dividend Yield	2.0%	2.5%	3.0%	3.6%	4.2%

Sources: Company, CGIS Research

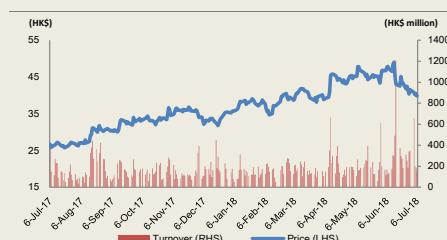
China Consumer Sector Sporting Goods

BUY

Close: HK\$39.85 (July 6, 2018)

Target Price: HK\$49.16 (+23.4%)

Price Performance



Source: Bloomberg

Market Cap	US\$13,633m
Shares Outstanding	2,684.8m
Auditor	KPMG
Free Float	48.4%
52W range	HK\$24.72-49.30
3M average daily T/O	US\$32.1m
Major Shareholding	Chairman Ding Shizhong (61.81%)

Sources: Company, Bloomberg

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Key financials

Income Statement (RMB m)						Balance Sheet (RMB m)					
	FY2016	FY2017	FY2018E	FY2019E	FY2020E		FY2016	FY2017	FY2018E	FY2019E	FY2020E
Revenue	13,346	16,692	20,613	24,615	28,610	Bank Balances and Cash	5,830	6,968	8,444	9,746	11,700
COGS	(6,887)	(8,451)	(9,964)	(11,648)	(13,367)	Restricted Bank Deposits	1,687	2,586	2,586	2,586	2,586
Gross Profit	6,459	8,241	10,649	12,967	15,243	Trade Receivables	2,641	3,733	3,800	5,195	5,260
SG&A	(3,515)	(4,710)	(6,234)	(7,657)	(9,019)	Inventories	1,295	2,155	1,368	2,539	1,945
Other Operating Items	260	458	515	615	715	Other Current Assets	-	-	-	0	-
Operating Profit	3,203	3,989	4,930	5,925	6,940	Total Current Assets	11,453	15,442	16,198	20,066	21,492
Finance Income, Net	108	322	186	214	239	PP&E	1,170	1,203	1,690	1,534	1,427
Other Items	-	-	-	-	-	Goodwill & Intangible Assets	478	705	705	705	705
Net Profit Before Tax	3,311	4,311	5,116	6,139	7,179	Other Non Current Assets	1,123	1,724	1,065	1,134	1,203
Income Tax	(866)	(1,152)	(1,345)	(1,614)	(1,887)	Total Non Current Assets	2,770	3,632	3,461	3,373	3,336
Net Profit After Tax	2,386	3,088	3,695	4,444	5,204	Total Assets	14,224	19,074	19,659	23,440	24,828
Minority Interest (After Tax)	59	71	77	82	88	Trade Payables	3,060	3,978	3,261	5,201	4,509
EPS (RMB)	0.95	1.17	1.40	1.68	1.97	Short-term Borrowings	938	148	174	204	234
DPS (RMB)	0.65	0.83	0.98	1.18	1.38	Other Current Liabilities	275	373	413	495	579
EBITDA	3,472	4,545	5,425	6,413	7,426	Total Current Liabilities	4,273	4,498	3,848	5,900	5,322
EBIT	3,246	4,295	5,111	6,134	7,172	Long-term Borrowings	-	-	-	-	-
Revenue Growth	20.0%	25.1%	23.5%	19.4%	16.2%	Other Non-current Liabilities	14,224	19,074	19,659	23,440	24,828
Operating Profit Growth	18.8%	24.5%	23.6%	20.2%	17.1%	Total Non-current Liabilities	14,224	19,074	19,659	23,440	24,828
Net Profit Growth	16.9%	29.4%	19.6%	20.3%	17.1%	Total Liabilities	18,496	23,573	23,507	29,340	30,150
EPS Growth	16.8%	22.8%	19.6%	20.3%	17.1%	Total Common Equity	9,549	13,706	14,829	16,425	18,252
Gross Margin	48.4%	49.4%	51.7%	52.7%	53.3%	Minority Interest	348	654	731	813	901
Operating Margin	24.0%	23.9%	23.9%	24.1%	24.3%	Total Equity	9,896	14,361	15,560	17,237	19,153
Net Profit Margin	17.9%	18.5%	17.9%	18.1%	18.2%	Total Equity & Liabilities	28,392	37,933	39,067	46,577	49,303
Cash Flow Statement (RMB m)						Ratios					
	FY2016	FY2017	FY2018E	FY2019E	FY2020E		FY2016	FY2017	FY2018E	FY2019E	FY2020E
Net Profit After Tax	2,386	3,088	3,695	4,444	5,204	ROE	25.0%	32.3%	27.0%	30.0%	31.7%
D&A Add-back	226	250	314	279	254	ROA	16.8%	10.9%	9.7%	11.4%	11.2%
Net Change in Working Capital	(216)	(381)	23	(569)	(106)	Net Debt / Equity	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Other Operating Items	72	224	77	82	88	EBITDA Interest Coverage	54x	293x	1134x	1137x	1127x
CFO	2,468	3,181	4,108	4,235	5,440	Rec. Turnover Days	66	70	67	67	67
CAPEX	(626)	(589)	(87)	(114)	(139)	Inventory Turnover Days	61	75	65	61	61
Other Investing Items	111	(990)	-	-	-	Payables Turnover Days	134	152	133	133	133
CFI	(515)	(1,579)	(87)	(114)	(139)	Other Payables Turnover Days	48	51	50	50	50
Dividends Paid	(1,541)	(1,937)	(2,572)	(2,848)	(3,377)	Current Ratio	2.68x	3.43x	4.21x	3.40x	4.04x
Net Change in Debt	(392)	(827)	26	29	30	Quick Ratio	2.38x	2.95x	3.85x	2.97x	3.67x
Issue of Shares	15	3,435	-	-	-	Valuation					
Other Financing Items	535	2,762	0	0	0		FY2016	FY2017	FY2018E	FY2019E	FY2020E
CFF	(1,398)	(2)	(2,545)	(2,819)	(3,347)	P/E	34.3x	28.0x	23.4x	19.4x	16.6x
Total Cash Flow	555	1,601	1,476	1,302	1,955	P/B	8.6x	6.3x	5.8x	5.3x	4.7x
Free Cash Flow	1,819	2,502	4,083	4,196	5,388	Dividend Yield	2.0%	2.5%	3.0%	3.6%	4.2%

Sources: Company, Capital IQ, CGIS Research estimates

Investment Thesis

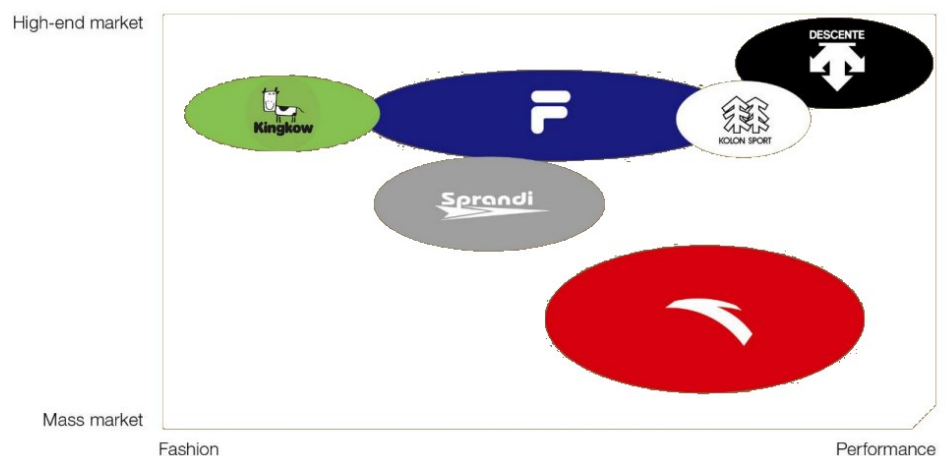
(1) ANTA – The King of Domestic Sportswear

We believe Anta Sports will be a multi-year growth story. One of the early entrants of the industry, Anta Sports has been a leading domestic sportswear company for years. With careful execution of its expansion strategy, the Company overtook Li Ning Company as the largest domestic sportswear company after the industry downturn in the early 2010s.

The core ANTA brand captures mass market demand

Although Anta Sports has acquired different brands, the core brand ANTA is still what makes Anta Sports successful, and it will continue to be one of the key pillars of the Company. As the Company's brand mix indicates, ANTA is a brand tilted towards the mass market, offering mainly functional sporting good products related to running, basketball and cross-training. In other words, value-for-money is the main competitive feature of the brand, and customers in Tier 2 cities and below are the key customer group.

Figure 1: Brand Portfolio of Anta Sports



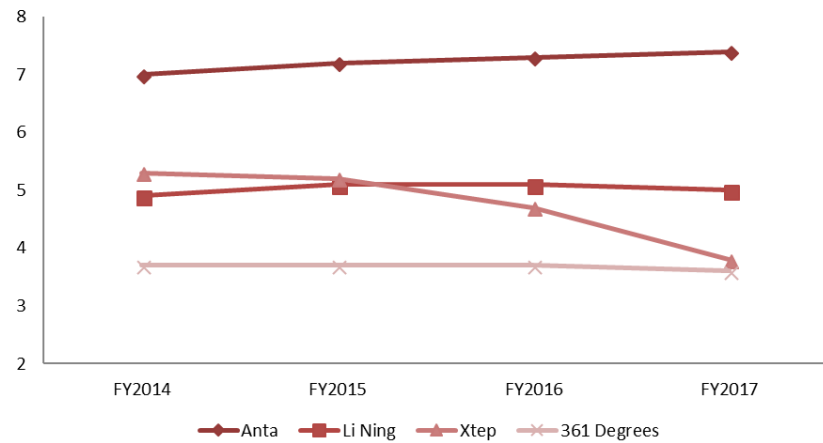
Sources: Company

ANTA : Performance and mass market driven

ANTA still managed to keep market share expanding

ANTA has maintained steady growth amid intensified competition with international brands (such as Nike and Adidas). It is a unique case among major domestic brands, as the market share of its competitors has been mostly flat, or declining. ANTA's success is the result of accumulated efforts in advertising, marketing, product positioning and channel management. Its well-established system will continue to keep the brand successful and will be a good reference for other brands it acquires, in our view.

Figure 2: Market Share of Major Domestic Brands (i.e. Excluding FILA, etc)



Sources: Company, Euromonitor, CGIS Research estimates

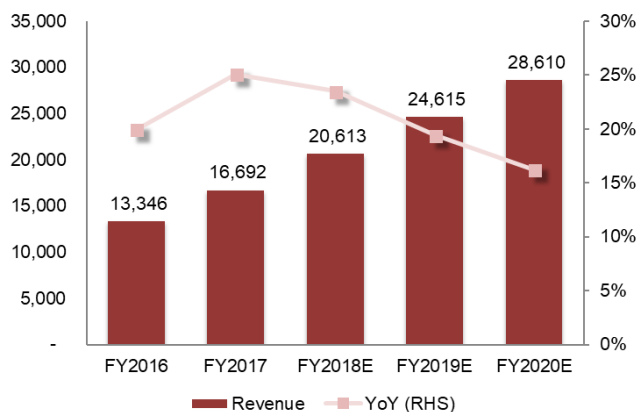
The ANTA Brand Continues to Be the Main Pillar of Growth

A&P ratio expected to remain at 10%

The ANTA brand has been the Company's largest revenue contributor, and we believe this will continue thanks to increasing sports participation among urban residents. Supplemented by e-commerce, we expect ANTA's expansion to come from both same store sales growth (SSSG) and its well-managed store expansion plan.

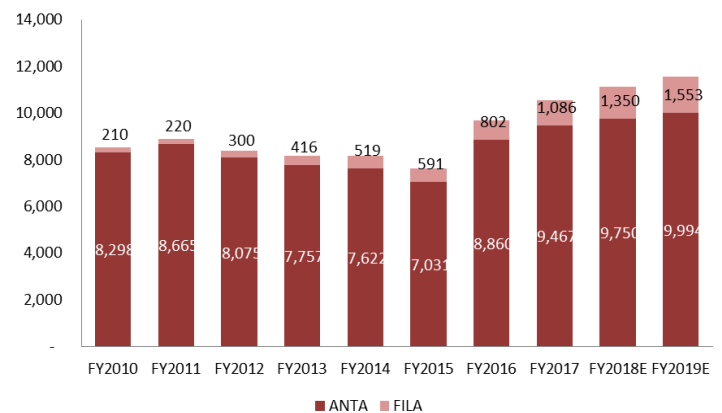
In 2017, we estimate more than 60% of the Company's revenue was from the core ANTA brand. However, for the ANTA brand, the Company adopts the wholesale-only model, while it operates other brands in the retail model. That means the revenue from the ANTA brand is mostly in ex-factory prices, which is lower than retail prices.

Figure 3: Revenue of Anta Sports (All Brands Combined)



Sources: Company, CGIS Research estimates

Figure 4: Number of Stores – ANTA and FILA

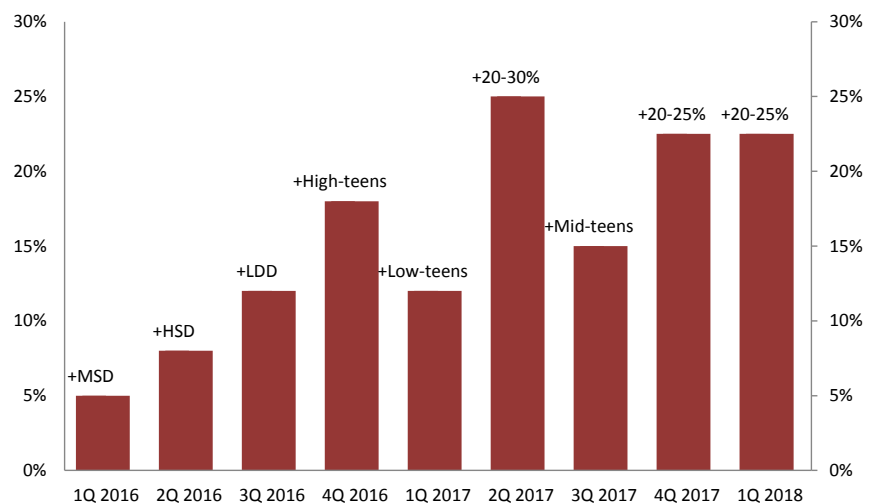


Sources: Company, CGIS Research estimates

RSV Accelerated in 2017

By retail sales value (RSV), sales of ANTA brand products accelerated in 2017. While RSV growth in 2016 ranged from mid-single digits to high teens, in Q2 and Q4 in 2017, it exceeded 20%. Going forward, we believe ANTA is likely to maintain its growth momentum. The Company is the largest domestic company in the sector in terms of revenue, and therefore its spending on advertising and marketing is also the largest. We believe this will create a virtuous cycle for ANTA, allowing it to take more market share from smaller players.

Figure 5: ANTA Brand RSV YoY Growth



Sources: Company, CGIS Research

An obvious example is its vast investment in basketball-related campaigns. Due to the popularity of basketball in China, the Company has a long history of engaging in NBA-related promotions. Its increasing budget for marketing allows the Company to engage in more extensive campaigns than its competitors. In 2014, Anta Sports officially became a strategic partner of the NBA and is authorized to sell NBA merchandise in China. Following that, the Company also signed an endorsement contract with NBA superstar Klay Thompson. This allows ANTA to offer brand-name products in both China and the international market, increasing its brand recognition among consumers.

Figure 6: ANTA's Strategic Partnership with the NBA



Sources: Company, Media

Figure 7: ANTA Collaborates with Klay Thompson (One of the Top Players on the Golden State Warriors)



Sources: Company

Investment Thesis (Continue)

(2) FILA & Foreign Brands – Engine of High Growth

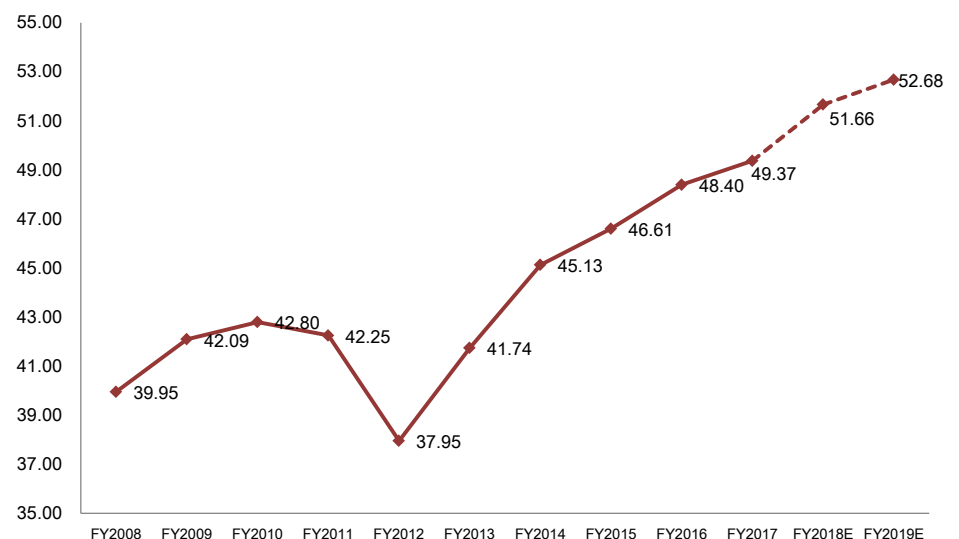
Another growth engine for Anta Sports is the significant contribution from FILA, an Italian brand owned by a South Korean company. In 2009, Anta acquired the rights to the brand in the Greater China region, and since then, it has become an increasing contributor to the Company's overall revenue. FILA is a high-end sports fashion brand, which complements the ANTA brand and has helped the Company increase its overall share of the sportswear market.

FILA – A Margin Driver

We estimate FILA accounted for ~25% of total revenue in 2017

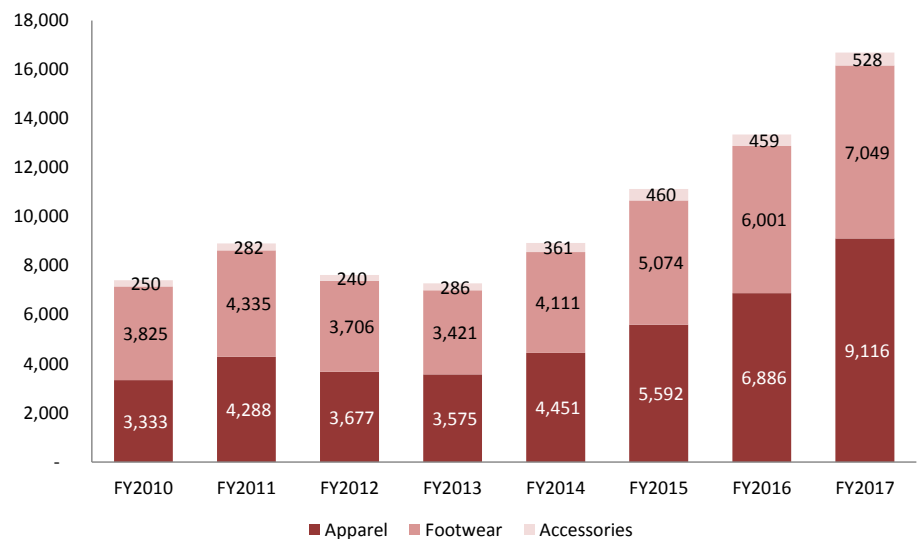
According to our estimate, FILA accounted for ~25% of Anta's total revenue in 2017, or more than RMB4bn. Anta uses a self-operated model for FILA, which means the Company is responsible for the operating cost of retail shops, but can earn higher margins. While the core brand ANTA may earn a GPM of 40%+, we estimate that the GPM for FILA ranges from 60% to 70%. Because of the increasing contribution from FILA, overall sales and GPM could improve over time. And from the product breakdown angle, the main FILA product is apparel, which has higher margins.

Figure 8: Anta Sports—Gross Profit Margin



Sources: Company, CGIS Research estimates

Figure 9: Anta Sports Revenue Breakdown by Product – Apparel Is Driven by FILA (Unit: RMB m)



Sources: Company, CGIS Research

High Growth Continues

We expect FILA to continue to be a key driver for the Company, maintaining strong growth in the coming periods. We expect a key driver for the strong growth to be store expansion. The number of FILA stores was still around 200 at the beginning of 2010s. As the brand recognition grew, the Company added stores, notably since 2016. The store count exceeded 1,000 in 2017, and we expect the store expansion to continue from 2018E on. The pace may be slower due to the higher base, but we believe a net addition of 200-300 stores in 2018E/2019E is still plausible.

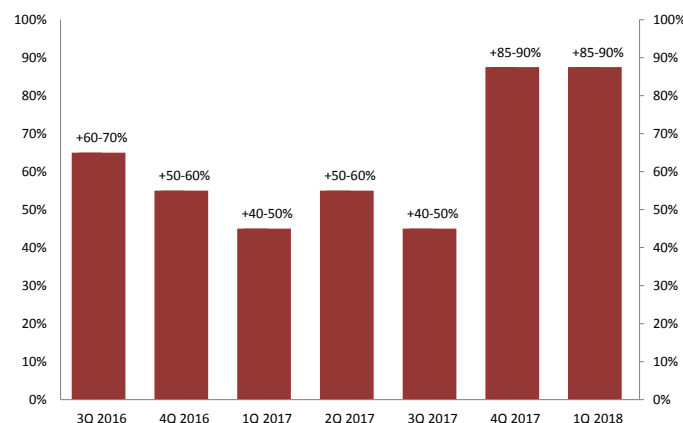
We expect store expansion to continue in 2018E

And SSSG to remain strong

We also expect SSSG for the Fila brand to remain positive. Based on industry data and our estimates, SSSG for the FILA brand has been strong, particularly in 2017, thanks to increasing demand from the “post-80s” generation, i.e. those in their 30s. Their increasing spending power, coupled with the increasing preference for elegant, comfortable clothing with a strong brand name, has driven average store sales for the FILA brand.

Therefore, we expect the momentum to be sustained. In recent quarters, we have seen the RSV of Anta Sports’ other brands (including FILA and other foreign brands it acquired) maintain strong double-digit growth.

Figure 10: Other Brands RSV YoY Growth (FILA and other brands acquired)



Sources: Company, CGIS Research

Multi-brand Strategy: Let's See Who Will Win

The successful Filia story has turned Anta Sports into the unrivalled domestic leader. As the sporting goods market in China continues to grow, consumers are demanding more differentiated and professional products. There is still room for another brand to emerge. As there are still many sporting goods brands that have not yet tapped into the China market, domestic companies could have the opportunity to introduce these brands in China through acquisition or cooperation.

Figure 11: Recent Notable M&A / Co-operation for Anta Sports

Date	Acquirer	Brand	Origin	Area	Type of Transaction	Est. Consideration
Dec-15	Anta	Sprandi	Russia	Leisure footwear	M&A	Tens of Million US\$
Feb-16	Anta	Descente	Japan	Skiing, cross-training and running	JV	RMB150m Invested in JV
Feb-17	Anta	Kolon Sport	South Korea	Outdoor sportswear products & winter sports products	JV	< RMB500m
Oct-17	Anta	Kingkow	Hong Kong	Kid's fashion products	M&A	~HK\$60m

Sources: Company, media reports, CGIS Research estimates

New brands are targeting new segments, such as winter sports

Anta Sports has been trying to replicate its FILA story in recent years. Since 2015, it has introduced different brands in its business portfolio: Sprandi, Descente, Kolon Sport and Kingkow. They target different segments, with most targeting emerging sports in China, such as the winter sports products. The 2022 Winter Olympics, hosted by China, may present a business opportunity in this area, and the strategy for the Company is to ride on the rising popularity of winter sports and supporting government policies.

At this stage, the number of stores for each new brand is still small, with none of them exceeding 100 in 2017. Based on our estimate, these stores are unlikely to produce meaningful operating profit in the near term, but we believe this is a meaningful investment in the longer term. Therefore, we do not expect a substantial impact on the overall financials to come from these brands. Even though some brands may occur losses in the early stages, the scale of the Company allows it to afford it without trimming group level margins.

Investment Thesis (continued)

(3) Consistent Track Record

The dual engine of growth, ANTA and FILA, has pushed the Company into a top-tier company, moving it closer and closer to international giants such as Nike and Adidas in China. As a result, the Company's net profit between 2013 to 2017 achieved a CAGR of 23.8%.

NP growth expected to remain ~20% YoY in 2018E and 2019E

We expect net profit in 2018E and 2019E to also achieve ~20% YoY growth, thanks to the steady growth of the ANTA and FILA brands and well-controlled operating expenses.

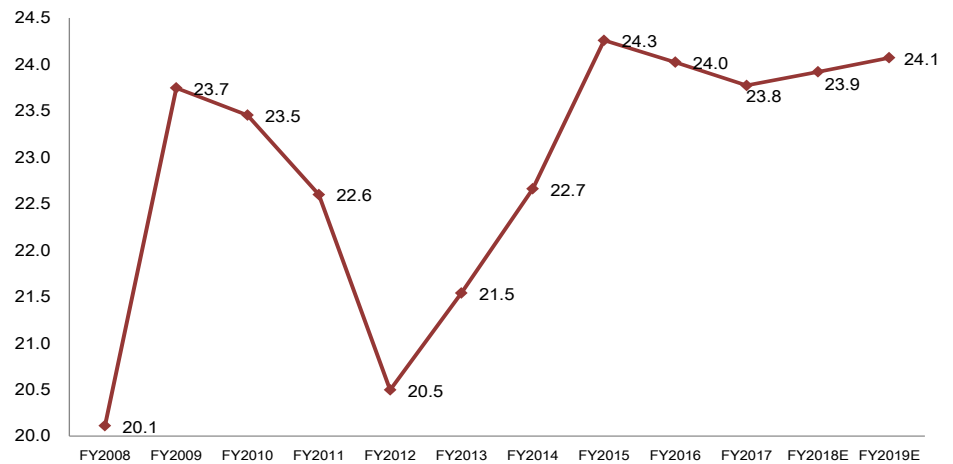
Revenue driven by both ANTA (~low teens) and FILA (>30%)

We expect the Company to achieve 23.5%/19.4% YoY revenue growth in 2018E/2019E, to RMB20.6B/24.6B, respectively. For ANTA, we expect overall sales (both offline and online) to continue to expand at close to low-double-digit levels, somewhat in-line with the overall sportswear market because of the Company's large scale. But we expect FILA revenue to grow at >30% per year thanks to the continuous increase in same-store sales and new store additions.

We expect flat OPM

For operating profit, we expect the operating margin to remain at a similar level. Although the gross margin should continue to expand thanks to the increasing contribution from FILA products, the operating costs for the FILA brand are higher than for ANTA's traditional wholesale model. As a result, we expect rental expenses and employee expenses to go up proportionally.

Figure 12: Operating Margin of Anta Sports

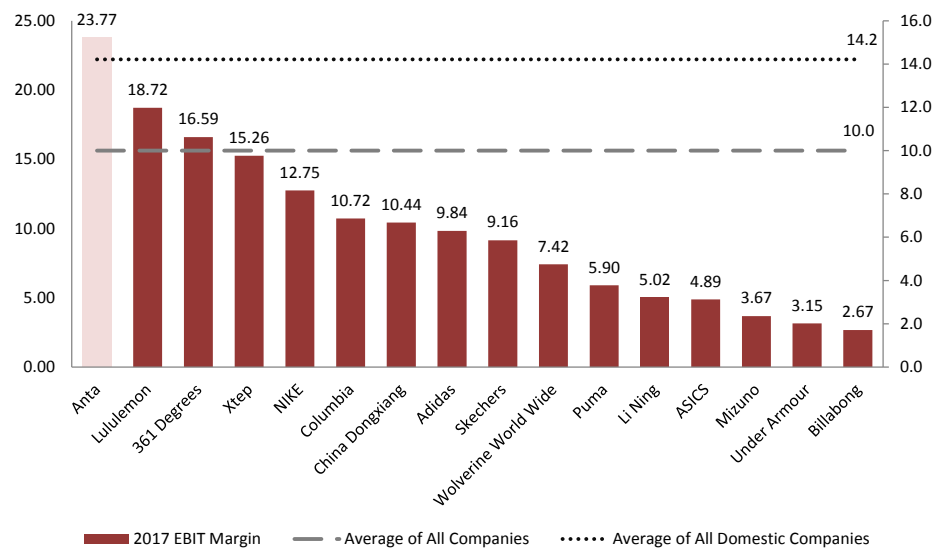


Sources: Company, CGIS Research

Is Anta Sports An Abnormality? We Don't Think So

Anta Sports has been a uniquely successful sporting goods company in China and has delivered superior returns compared to its peers. On a global peer comparison basis, Anta is the most profitable sporting goods company, taking operating margin into consideration. This may lead some investors to question how the Company can deliver such a superior return.

Figure 13: Operating Margin of Global Major Sportswear Companies – Anta is the most profitable

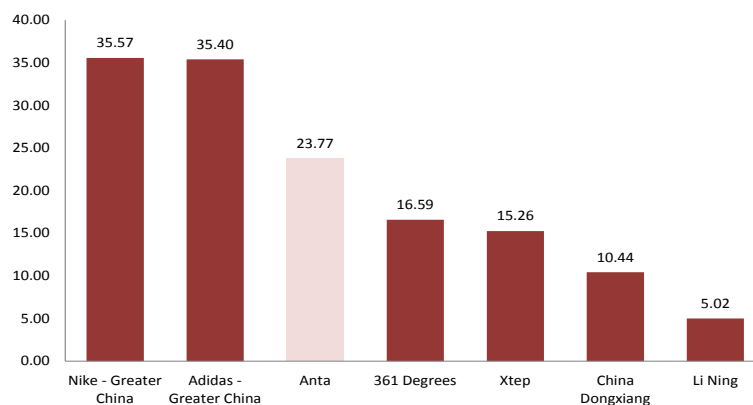


Sources: Company, Capital IQ, CGIS Research

The business environment in China offers higher margins for leading consumer product companies

In 2017, Anta achieved a 23.77% EBIT margin, which is much higher than the global average, as well as the average in China. It was even higher than that of Lululemon, which is a US-based premium yoga sporting goods brand, and global giants such as Nike and Adidas. However, if the margin in China is considered, Nike and Adidas actually earned an EBIT margin of >35% in 2017, much higher than that of Anta and its domestic peers. We believe this is the result of (1) economies of scale in China. This can be seen in various areas, such as higher profit per store and the number of customers per store, which is higher in China than in many developed countries; (2) lower operating costs in China, especially regarding salaries, and (3) shared resources from global headquarters, such as sponsoring international athletes outside China, which also benefits the China market.

Figure 14: Operating Margin of Sportswear Company in China – Anta Still Have Room to Catch Up



Sources: Company, Capital IQ, CGIS Research

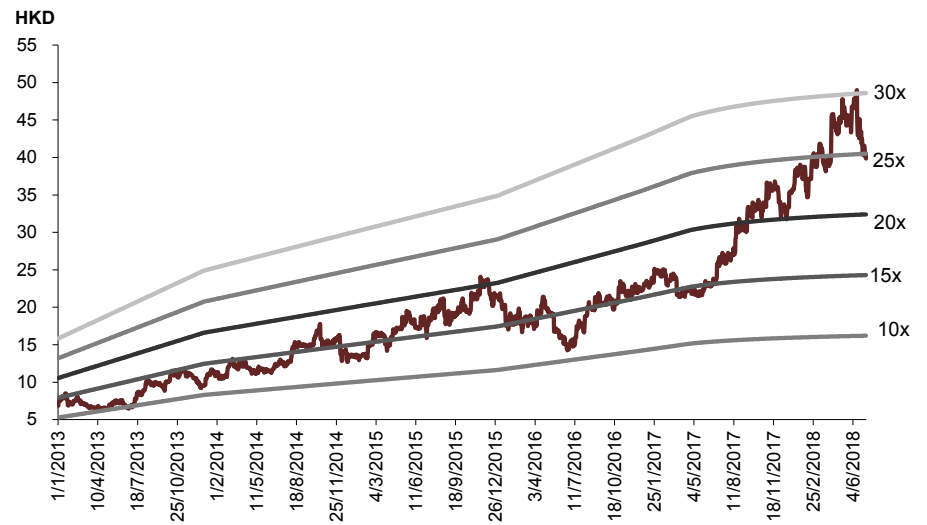
Initiate with BUY

We like the company for its consistent earnings growth and steady dividend payout

Our EPS forecast for 2018E/2019E is RMB1.40/1.68, respectively, implying 19.6%/20.2% growth. The earnings growth is in line with the previous growth rate. The Company is the industry leader and is likely to enjoy a virtuous cycle in terms of earnings growth. Therefore, we believe a longer horizon should be considered. Initiate with BUY. Our TP of HK\$49.16 is based on 24x 2019E PER. Our target multiple of 24x has considered earnings growth (19.1% CAGR for EPS between 2017 to 2020E) and the premium for its status as an industry leader. Also, the Company has a good track record of paying out dividends at a 70% payout ratio, which warrants a premium as well.

The Company has been able to maintain a clean balance sheet and strong operating cash flow for years. In 2017, it had net cash of close to RMB10 billion, which is expected to be used for M&A. We note that some investors may be concerned about the rising number of inventory turnover days in 2017 (75 days). Apart from increasing the inventory value of FILA products (which have a higher ASP), the main reason for the increase was seasonal factors. In 2018, Chinese New Year was earlier than usual, so the Company had to keep more inventory for distribution. Excluding this, we expect the number of inventory turnover days to be similar to that of previous years, that is 60-something days.

Figure 15: Forward PER Band of Anta Sports



Sources: Bloomberg, CGS Research

Risks

1. Slowdown in Revenue Growth Momentum

Our forecast is based on the assumption that Anta's SSSG will continue to remain at a positive level, especially for the FILA brand, as it is expected to be a fast-growing brand. If FILA sales slow down to the low-teen level or below, it would hurt overall revenue and could impact the overall operating margin considerably due to operating leverage.

A slowdown in revenue growth can be caused by factors such as unsatisfactory product launches, unfavourable reaction to marketing campaigns, or intensified competition from other brands. We note that Anta relies on the Klay Thompson name for certain products and its marketing campaign. Any negative news related to the NBA player may jeopardize sales, in our view.

2. Risk of Unsuccessful Expansion of New Brands

Although the Company has enjoyed huge success with the FILA brand, there is no guarantee that the FILA model can be replicated for other brands. Recently, the Company introduced foreign brands such as Kolon Sport and Sprandi to China, but these brands do not share the long history or brand recognition of FILA, which was founded in 1911. These brands are also targeting new segments, such as winter sports, but it may take years for demand to kick in, say 2022, when China will host the Winter Olympics. Before that, the Company may have to endure low return on its investment.

In case of unsuccessful expansion, these new brands may drag down the overall operating margins of Anta Sports. In the most extreme case, there would be write-off in these investments, resulting in a spike in SG&A in a particular financial year.

3. Worse-than-expected SG&A Control

Our estimate of Anta's continuous profit growth rests on the assumption that the Company is able to control its costs well. Rising competition from both domestic and foreign brands may pressure Anta to increase its marketing budget, for example. Meanwhile, the Company is now shifting part of its focus to the retail model. Anta is responsible for rent and employee expenses for brands such as FILA. Sharp increases in rent or salaries for front-line staff would impact the operating margins of the Company.

Company Description

Anta Sports Products Limited is a leading sportswear company in China. Its history goes back to 1991, when the ANTA brand was established. The Company was listed in Hong Kong in 2007 and is engaged principally in the design, development, manufacturing and marketing of the ANTA sportswear series, which supplies the mass market in China with professional sporting products, including footwear, apparel and accessories. Its current brand portfolio consists of ANTA, ANTA KIDS, FILA, FILA KIDS, DESCENTE, SPRANDI, KINGKOW, KOLON SPORT and NBA. Ding Shizhong is the largest shareholder, with a 61.81% stake.

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- SELL : share price will decrease by >20% within 12 months in absolute terms
- HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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