

Company Report: Dali Foods (03799 HK)

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公司报告: 达利食品 (03799 HK)

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Aggressive Entry into Short Shelf-life Bread Market, Reiterate "Buy"

强势介入短保面包市场，重申“买入”

- Official launch of short shelf-life bread brand.** On October 16, 2018, Dali officially introduced its short shelf-life bread brand - Mei Bei Chen; this includes five product series and 33 SKUs. The Company is implementing a dual brand ambassador strategy by having two stars to appeal to different consumer groups. The Company has also introduced a new cheap soymilk series in order to achieve synergy effects with short shelf-life bread. Dali guided of RMB1.2 billion - RMB1.5 billion for 2019 revenue of Mei Bei Chen, which could achieve profit breakeven once sales reach RMB1 billion.
- Fully prepared to control refund rate after sales begins.** As refund rate fundamentally determines the profitability of short shelf-life bread products, Dali has put things into perspective and made sufficient preparations. Dali will fully leverage its distributors' delivery capability and also provide all-around support to them. New brands, advertisement investment and celebrity endorsement are able to effectively improve refund rate. Dali targets to achieve 20% refund rate at the beginning of Mei Bei Chen operations, then lower to 10% within three months.
- We have lowered TP to HK\$7.20 due to a downtrend in the macroeconomy and sluggish Hong Kong market performance. However, we believe that Dali's current valuation is attractive compared to its peers. The launch event of Mei Bei Chen has achieved great response from distributors and the media. Moreover, the Company has a clear picture of long-term growth and maintains strong execution of its plans. **Therefore, we reiterate the Company's rating at "Buy". New TP represents 22.1x 2018 PER, 19.4x 2019 PER and 16.7x 2020 PER.**
- 正式发布短保面包。** 2018年10月16日，达利正式推出其短保面包品牌-美焙辰，其中包括5个系列和33款不同产品。公司执行双明星代言战略，拥有两位明星吸引不同的消费群体。公司同时推出新的平价豆奶系列，主要为了实现和短保面包的协同效应。达利对于美焙辰2019年收入预测的指引是人民币12亿至15亿，预计销售达到人民币10亿可以盈亏平衡。
- 为销售启动后的退货率管理做好了充分准备。** 因为退货率根本上决定了短保面包的盈利能力，达利已经做好充分预判以及做好了充足准备。达利将充分利用经销商的配送能力并为其提供全方位的支持。新品牌启用，广告投放以及明星代言能够有效地改善退货率。达利美焙辰争取在一开始经营时就实现20%的退货率，随后在三个月内将该数字降低至10%。
- 因为宏观经济下行以及疲弱的港股表现，我们下调目标价至7.20港元。然而，我们认为达利当前估值水平相比同业较为吸引。美焙辰的发布也在经销商和媒体中取得了巨大的反响。而且，公司对于长期增长有着清晰的规划以及维持着强大的执行力。**因此我们重申公司“买入”评级。新的目标价相当于22.1倍，19.4倍和16.7倍2018年，2019年和2020年市盈率。**

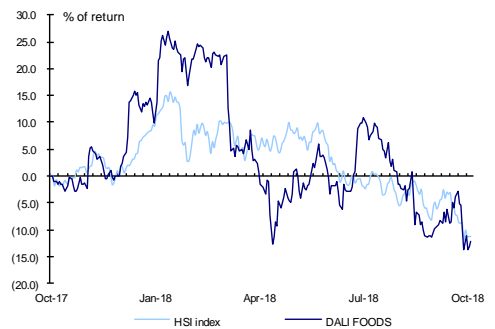
Rating: **Buy**  
Maintained

评级: **买入 (维持)**

6-18m TP 目标价: **HK\$7.20**  
Revised from 原目标价: HK\$7.40

Share price 股价: **HK\$5.400**

Stock performance  
股价表现



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 %	(3.4)	(20.8)	(12.2)
Rel. % to HS Index 相对恒指变动 %	2.1	(11.1)	(0.9)
Avg. Share price(HK\$) 平均股价 (港元)	5.6	5.9	6.4

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	17,842	3,137	0.229	(5.0)	21.1	1.013	4.8	0.160	3.3	24.3
2017A	19,799	3,434	0.251	9.6	17.9	1.007	4.5	0.170	3.8	24.8
2018F	21,749	3,788	0.277	10.4	16.8	1.118	4.2	0.180	3.9	26.0
2019F	24,145	4,323	0.316	14.1	14.7	1.254	3.7	0.189	4.1	26.6
2020F	26,596	5,009	0.366	15.8	12.7	1.431	3.2	0.219	4.7	27.2
Shares in issue (m) 总股数 (m)				13,694.0	Major shareholder 大股东					Family Xu 85.0%
Market cap. (HK\$ m) 市值 (HK\$ m)				73,947.6	Free float (%) 自由流通比率 (%)					15.0
3 month average vol. 3个月平均成交股数 ('000)				6,998.1	FY18 Net gearing (%) FY18 净负债/股东资金 (%)					Net cash
52 Weeks high/low (HK\$) 52周高/低 (HK\$)				7.930 / 5.190	FY18 Est. NAV (HK\$) FY18 每股估值 (港元)					7.6

Source: the Company, Guotai Junan International.

**Official launch of short shelf-life bread brand - Mei Bei Chen (美焙辰).** On October 16, 2018, Dali Foods ("Dali" or the "Company") held a launch event in Quanzhou to officially introduce its short shelf-life bread brand - Mei Bei Chen; this includes five product series and 33 SKUs. Mei Bei Chen is expected to be launched in two stages. In stage one, Dali will initiate its operation in Fujian Province and the northeast region of China in November 2018. In stage two, Dali's 15 branches, mainly located in north and northeast regions, will begin sales in January 2019. The remaining companies will start in February 2019.

**Figure-1: Mei Bei Chen (美焙辰)**



Source: the Company, Guotai Junan International.

**Figure-2: Mei Bei Chen (美焙辰)**



Source: the Company, Guotai Junan International.

**National dual brand ambassador promotion program.** The Company is implementing a dual brand ambassador strategy by having two stars endorse Mei Bei Chen, appealing to family groups and young customers. The endorsement contract period is a half year, then, Dali will review the effectiveness of their endorsement. Dali is going to run their advertisements nationally using a multi-layered strategy, incorporating satellite television to new media. Total advertisement expenses for Mei Bei Chen in 2019 is expected to amount to RMB50 million - RMB100 million.

**Figure-3: Brand Ambassador: Huang Lei (黄磊)**



Source: the Company, Guotai Junan International.

**Figure-4: Brand Ambassador: Yang Zi (杨紫)**



Source: the Company, Guotai Junan International.

**Introducing a new soymilk series to achieve synergy.** While Dali launched Mei Bei Chen, the Company also introduced a new cheap soymilk series - Doubendou Weizhen (豆本豆唯甄), mainly targeting the breakfast channel. Weizhen is low priced and has low protein content. Mei Bei Chen's distributors will take charge of selling Weizhen in order to achieve synergy as bread and soymilk are often consumed at the same time. Classic Doubendou is still distributed by Dali's beverage distributors and is managed by its beverage sales teams. As Doubendou Weizhen and classic Doubendou operate under two different segments, conflicts and competition may initially exist in some retail terminals. But as the two product series have different product positions and channels, negative effects are under control within the big picture.

**Figure-5: DoubenDou Weizhen (豆本豆唯甄系列)**



Source: the Company, Guotai Junan International.

**Figure-6: DoubenDou-Weizhen (豆本豆唯甄系列)**



Source: the Company, Guotai Junan International.

**Fully leveraging distributor delivery capability and also providing all-around support to distributors.** Based on preliminary estimates, there are more than 1,000 distributors supplying Mei Bei Chen, 40% of which are newly recruited but experienced in the short shelf-life bread industry. The company implements a two-level distribution mechanism. Dali is responsible for delivery to distribution centers from factories, with around 5 or 6 distribution centers per city. Dali's distributors are responsible for delivery to the retail terminals from distribution centers. Compared to the factory direct sales model, the Company's distribution model allows flexibility of distributors to carry out their own initiatives. Dali will recruit 1,500-2,000 more sales staff to expand its market along with distributors. Normally, distributors can achieve breakeven once sales value per truck reaches RMB60,000, with profit rising to RMB15,000 with sales value of RMB150,000 per truck. Theoretically, if refund rate is controlled well, distributors of short shelf-life products will be able to earn 2% more profit compared to long shelf-life products due to the save in storage cost and capital cost. In addition, Dali has left room for price hikes for distributors, and Doubendou Weizhen sales can improve in operating efficiency and contribute more profit.

**Figure-7: Delivery System**



Source: the Company, Guotai Junan International.

**How to manage refund rate?** As refund rate fundamentally determines the profitability of short shelf-life bread products, Dali has put things into perspective and made sufficient preparation. Before the final launch of Mei Bei Chen, Dali has run the business of mid shelf-life products since March 2018 in order to accommodate its sales teams and distributors to operations of short shelf-life products. In addition, the Company has recruited many new distributors who have experience in operating other short shelf-life bread brands. Dali will set the target refund rate with each distributor based on performance. Refunds within the target refund rate will be borne entirely by the Company and directly deducted from revenue. Excess refunds will be borne half by the Company and half by the distributor. The Company believes that new brands, advertisement investment and celebrity endorsement can improve refund rate. Dali targets to achieve 20% refund rate at the beginning of its operations, then lower the figure to 10% within three months.

**Guidance on revenue and our earnings forecasts.** Based on target utilization and current capacity, the Company has a guidance of RMB1.2 billion to RMB1.5 billion in revenue for Mei Bei Chen in 2019. The Company also expects that Mei Bei Chen can achieve profit breakeven once sales reaches RMB1 billion. We have calculated Mei Bei Chen's 2019 EBIT based on limited assumptions.

**Table-1: Scenario Analysis of Short Shelf-life Products**

Scenario Analysis									
Sales (RMB million)	1,000	1,000	1,000	1,200	1,200	1,200	1,500	1,500	1,500
Gross Margin (excl refund)*	45.0%	45.0%	45.0%	45.0%	45.0%	45.0%	45.0%	45.0%	45.0%
COGS	550	550	550	660	660	660	825	825	825
Refund Rate	10%	15%	20%	10%	15%	20%	10%	15%	20%
Sales (deduct refund)	900	850	800	1,080	1,020	960	1,350	1,275	1,200
Gross Profit	350	300	250	420	360	300	525	450	375
Gross Margin	39%	35%	31%	39%	35%	31%	39%	35%	31%
Delivery Expense ratio*	5%	5%	5%	4%	4%	4%	3%	3%	3%
Other Expense ratio*	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Promotion Expense*	90	90	90	90	90	90	90	90	90
EBIT	110	60	10	162	102	42	240	165	90
EBIT Margin	11.0%	6.0%	1.0%	13.5%	8.5%	3.5%	16.0%	11.0%	6.0%

Source: Guotai Junan International.

Note: Assumptions may be different from the actual situation.

**New updates on 3Q18 performance.** Hi-tiger solidly increased with market share expansion, but beverage sales somewhat met headwinds, especially herbal tea products. The food segment performed steadily in 3Q18. "Quality Breakfast" series, mainly including long and mid-shelf-life products, will continuously operate, which will be a complement to Mei Bei Chen. The Company is still working on upgrading its existing product series. For instance, Dali recently launched their baby biscuits series and "Hai Bo Lang" (嗨波浪) potato chips.

**Major concerns:** 1) uncontrollable refund rate, 2) higher-than-expected intense competition with Toly, 3) food safety issue.

### Earnings Forecast Assumptions and Revisions

**Lower TP to HK\$7.20 but maintain "Buy".** We have slightly revised down revenue forecasts due to weaker forecasts on beverages, but slightly revised up earnings forecasts due to high-gross-margin Mei Bei Chen contribution. We have lowered TP to HK\$7.20 due to a downtrend in the macro economy and sluggish Hong Kong market performance. However, we believe Dali's current valuation is attractive compared to its peers. The launch event of Mei Bei Chen has achieved great response from distributors and the media. Moreover, the Company has a clear picture of long-term growth and has maintained strong strategy execution. Therefore, we reiterate the Company's rating at "Buy". New TP represents 22.1x 2018 PER, 19.4x 2019 PER and 16.7x 2020 PER.

**Table-2: Earnings Estimates Revisions**

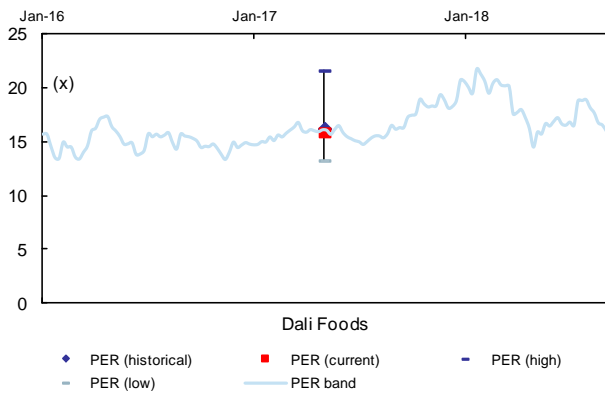
RMB million	NEW			OLD			CHANGE		
	2018F	2019F	2020F	2018F	2019F	2020F	2018F	2019F	2020F
Revenue	21,749	24,145	26,596	21,970	24,149	26,739	-1.0%	0.0%	-0.5%
-Foods	10,496	11,795	13,000	10,667	11,748	13,090	-1.6%	0.4%	-0.7%
-Beverages	10,023	11,182	12,487	10,074	11,233	12,539	-0.5%	-0.5%	-0.4%
Gross profit	8,426	9,549	10,783	8,503	9,413	10,592	-0.9%	1.4%	1.8%
Operating profit	4,857	5,543	6,422	4,894	5,407	6,203	-0.8%	2.5%	3.5%
Shareholder's profit	3,788	4,323	5,009	3,817	4,217	4,838	-0.7%	2.5%	3.5%
EPS (RMB)	0.277	0.316	0.366	0.279	0.308	0.353	-0.8%	2.5%	3.6%
Gross margin	38.7%	39.6%	40.5%	38.7%	39.0%	39.6%	0 ppt	0.6 ppt	0.9 ppt
Operating margin	22.3%	23.0%	24.1%	22.3%	22.4%	23.2%	0 ppt	0.6 ppt	0.9 ppt
Net margin	17.4%	17.9%	18.8%	17.4%	17.5%	18.1%	0 ppt	0.4 ppt	0.7 ppt

Source: Guotai Junan International.

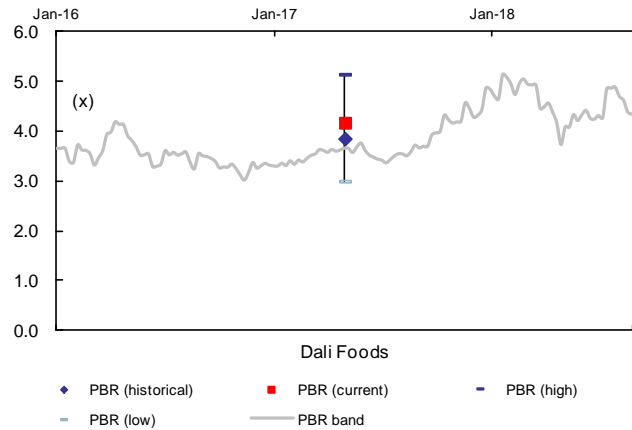
**Table-3: Peers Comparison**

Company	Ticker	\$	Share Price	Market Cap (HK\$ mn)	PER (x)			PBR(x)	ROE(%)	Gross Margin(%)	Operating Margin(%)
					FY18F	FY19F	FY20F	FY18F	FY18F	FY18F	FY18F
China Resources Beer	291 HK	HKD	27.050	87,755	38.3	29.2	23.9	3.9	10.8	35.8	8.8
China Mengniu Dairy	2319 HK	HKD	23.000	90,333	25.8	20.1	16.4	3.1	12.8	38.0	5.6
Dali Foods	3799 HK	HKD	5.400	73,948	17.0	14.8	13.0	4.3	26.7	38.9	21.1
Tinavi	322 HK	HKD	12.320	69,211	24.6	20.9	18.3	3.0	12.7	31.3	6.8
Want Want China	151 HK	HKD	5.750	71,583	19.5	18.3	16.9	4.0	21.8	43.1	20.2
Tsingtao Brewery	168 HK	HKD	32.700	45,508	24.8	21.0	18.3	2.1	8.9	40.3	6.1
Uni-President China	220 HK	HKD	7.800	33,691	25.7	22.5	20.2	2.2	8.8	34.3	6.7
Vitasoy	345 HK	HKD	25.450	27,005	45.9	39.2	33.6	9.3	21.8	52.9	12.6
China Foods	506 HK	HKD	3.600	10,070	21.7	17.9	15.1	2.1	9.5	35.5	5.2
<b>Simple Average</b>					<b>27.0</b>	<b>22.7</b>	<b>19.5</b>	<b>3.8</b>	<b>14.9</b>	<b>38.9</b>	<b>10.3</b>
<b>Weighted Average</b>					<b>26.5</b>	<b>22.0</b>	<b>18.8</b>	<b>3.7</b>	<b>15.5</b>	<b>38.2</b>	<b>11.1</b>

Source: Bloomberg.

**Figure-8: PER Band of Dali**


Source: Bloomberg, Guotai Junan International.

**Figure-9: PBR Band of Dali**


Source: Bloomberg, Guotai Junan International.

**Financial Statements and Ratios**

Income Statement						Balance Sheet					
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F	Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F
Total Revenue	17,842	19,799	21,749	24,145	26,596	Property, plant and equipment	3,896	4,273	4,430	4,232	3,994
Cost of sales	(11,001)	(12,341)	(13,322)	(14,595)	(15,814)	Prepaid lease payments	591	577	564	551	539
Gross profit	6,840	7,458	8,426	9,549	10,783	Others	248	205	165	120	123
Other income and gains	360	666	628	682	778	Total Non-current Assets	4,735	5,055	5,159	4,902	4,656
Distribution costs	(2,788)	(3,248)	(3,632)	(4,056)	(4,495)	Cash & Cash Equivalents	7,986	6,764	9,112	10,758	13,962
Administrative expenses	(431)	(524)	(565)	(633)	(644)	Inventories	1,109	1,333	1,169	1,609	1,452
Operating Profit	3,982	4,352	4,857	5,543	6,422	Bills receivable	284	1,085	703	885	864
Finance costs	(5)	0	0	0	0	Others	2,366	2,089	2,120	2,175	2,231
Profit Before Tax	3,977	4,352	4,857	5,543	6,422	Total Current Assets	11,746	11,271	13,104	15,426	18,508
Income Tax	(840)	(918)	(1,069)	(1,219)	(1,413)	Total Assets	16,480	16,326	18,263	20,328	23,164
Profit after Tax	3,137	3,434	3,788	4,323	5,009	Short-term debts	0	0	0	0	0
Non-controlling Interest	0	0	0	0	0	Bills payable	1,027	889	1,017	1,099	1,232
Shareholders' Profit / Loss	3,137	3,434	3,788	4,323	5,009	Accrued expenses and other payables	1,092	1,143	1,359	1,419	1,641
Basic EPS	0.229	0.251	0.277	0.316	0.366	Others	177	183	215	239	263
						Total Current Liabilities	2,296	2,216	2,592	2,757	3,137
						Net current asset	9,450	9,055	10,512	12,669	15,371
						Total assets less current liabilities	14,184	14,110	15,671	17,571	20,027
						Deferred revenue	319	324	356	395	435
						Total Non-current Liabilities	319	324	356	395	435
						Total Liabilities	2,615	2,540	2,948	3,153	3,573
						Share capital	113	113	113	113	113
						Reserves	13,753	13,673	15,202	17,063	19,479
						Total Shareholders' Equity	13,866	13,786	15,315	17,176	19,591
						Minority Interest	0	0	0	0	0
						Total Equity	13,866	13,786	15,315	17,176	19,591
Cash Flow Statement						Financial Ratios					
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2019F		2016A	2017A	2018F	2019F	2019F
PBT	3,977	4,352	4,857	5,543	6,422	Revenue growth (%)	5.8	11.0	9.8	11.0	10.2
DD&A	531	555	643	699	738	Gross profit growth (%)	17.6	9.0	13.0	13.3	12.9
Change in working capital	(213)	(1,472)	969	(522)	492	Operating profit growth (%)	7.4	9.3	11.6	14.1	15.9
Others	(73)	(94)	(6)	(6)	(6)	Net profit growth (%)	7.7	9.5	10.3	14.1	15.9
Cash generated from operations	4,222	3,341	6,463	5,714	7,645	Gross margin (%)	38.3	37.7	38.7	39.6	40.5
Income and interest tax paid	(811)	(937)	(1,019)	(1,199)	(1,392)	-Foods	34.2	35.2	35.3	35.9	36.6
Cash from Operating Activities	3,412	2,404	5,443	4,515	6,253	-Beverages	45.6	45.5	47.1	47.5	48.2
Investing activities						PAT margin (%)	17.6	17.3	17.4	17.9	18.8
Capital expenditure	(452)	(807)	(778)	(452)	(500)	Net margin (%)	17.6	17.3	17.4	17.9	18.8
Available-for-sale investments	644	13	(13)	(13)	(14)	ROE (%)	24.3	24.8	26.0	26.6	27.2
Increase in bank deposits	(1,874)	542	(97)	0	0	ROA (%)	19.4	20.9	21.9	22.4	23.0
Others	(6)	139	51	58	59	Inventory turnover days	20.9	22.5	21.0	21.0	21.0
Cash from Investing Activities	(1,688)	(113)	(836)	(407)	(455)	Account receivable days	4.4	12.6	15.0	12.0	12.0
Financing activities						Account payable days	20.4	17.7	16.0	16.0	16.0
Loans changes	0	0	0	0	0	Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Share placing	0	0	0	0	0	Payout ratio (%)	69.9	65.8	65.0	60.0	60.0
Dividend paid	(1,460)	(3,305)	(2,259)	(2,462)	(2,594)						
Others	(1,507)	0	0	0	0						
Cash from Financing Activities	(2,966)	(3,305)	(2,259)	(2,462)	(2,594)						
Net Changes in Cash	(1,242)	(1,014)	2,348	1,646	3,204						
Foreign exchange effect	293	(209)	0	0	0						
Cash at Beg of Year	8,935	7,986	6,764	9,112	10,758						
Cash at End of Year	7,986	6,764	9,112	10,758	13,962						

Source: the Company, Guotai Junan International.

### 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.

### DISCLOSURE OF INTERESTS

- (1) The Analysts and their associates do not serve as an officer of the issuer mentioned in this Research Report.
- (2) The Analysts and their associates do not have any financial interests in relation to the issuer mentioned in this Research Report.
- (3) Except for KAISA GROUP (01638 HK), GUOTAI JUNAN I (01788 HK), BINHAI INVESTMENT (02886 HK), VALUE A SHARE (03095 HK), CAM SCSMALLCAP (03157 HK), MR CSI300 ETF-R (CNY) (83127 HK), Guotai Junan and its group companies do not hold equal to or more than 1% of the market capitalization of the issuer mentioned in this Research Report.
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