



Company Report: Tingyi (00322 HK)

公司报告: 康师傅 (00322 HK)

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A Rough Road Back to Glory, Upgrade to "Accumulate"

重回荣耀之路必将充满艰辛，上调至“收集”

- **Sluggish sales but earnings beat expectations.** Tingyi's 3Q18 revenue was down 4.2% YoY to RMB18,863 million due to sluggish beverage sales which decreased 6.5% YoY, while Noodles sales slightly increased 0.7% YoY. Thanks to price hikes and product mix upgrades, the Company's 3Q18 gross margin was up 0.9 ppt YoY to 33.4%. Attributable to lower SG&A expense to sales ratio, Tingyi's EBIT increased 4.3% YoY to RMB2,623 million. As its shareholding of beverage business rose, the Company's 3Q18 shareholders' profit was up 25.5% YoY.
- **Due to intense competition, Tingyi will implement volume-first strategy in 2019.** Affected by slower economic growth, China's instant noodles and beverage sales growth both decelerated in 3Q18 but competition has become even more intense as local players have aggressively expanded. Tingyi will implement volume-first strategy in 2019, hoping to regain more market share. Tingyi will start to double its advertising expense from 4Q18 and strengthen its coverage in new channels.
- Based on lower earnings forecasts, we lower TP to HK\$12.50. We think the market may overestimate the negative effect of its volume-first strategy on profitability. Backed by big data technology, precision marketing will empower the Company to efficiently allocate advertisement resources. Volume-first strategy will also improve its product mix. Moreover, implementation of asset-light and activation on asset will further improve its productivity. We think Tingyi's current valuation is attractive. **Therefore, we upgrade to "Accumulate". The new TP represents 23.2x 2018 PER, 22.6x 2019 PER, and 20.6x 2020 PER.**
- **疲弱销售但盈利超出预期。**康师傅 2018 年第 3 季度收入同比下降 4.2% 至人民币 188.63 亿，主要因疲弱的饮料销售，其同比下降 6.5%。同时方便面销售同比小幅上升 0.7%。因价格上調和产品组合改善，公司 2018 年第 3 季度毛利率同比上升 0.9 个百分点至 33.4%。归因于更低的三费占比，康师傅息税前利润同比上升 4.3% 至人民币 26.23 亿。因其饮料业务股权占比提升，公司 2018 年第 3 季度股东溢利同比上涨 25.5%。
- **因为激烈的竞争，康师傅将在 2019 年执行销量优先战略。**受到更慢的经济增长影响，中国方便面 and 饮料销售增长都在第 3 季度减速，但因为本土厂商的积极扩张竞争反而变得更加激烈。康师傅将会在 2019 年执行销量优先战略，以期夺回更多的市场份额。康师傅将在今年第 4 季度起翻倍增加广告投入并将强化其在新渠道的覆盖。
- 基于更低的盈利预测，我们下调目标价至 12.50 港元。我们认为市场可能高估了销量优先战略对于盈利能力的负面影响。在大数据技术的支撑下，精准营销将赋予公司更有效投放广告的能力。销量优先战略也将改善其产品结构。而且，轻资产及资产活化的执行将进一步提高其生产效率。我们认为康师傅当前估值吸引。**因此上调投资评级至“收集”。新的目标价相当于 2018 年 23.2 倍，2019 年 22.6 倍和 2020 年 20.6 倍市盈率。**

Rating:

Accumulate

Upgraded

评级:

收集 (上调)

6-18m TP 目标价:

HK\$12.50

Revised from 原目标价:

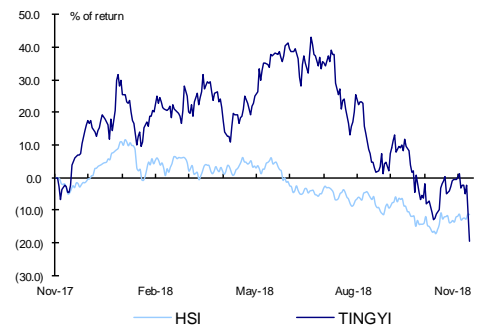
HK\$15.00

Share price 股价:

HK\$10.480

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 %	(10.0)	(34.6)	(20.6)
Rel. % to HS Index 相对恒指变动 %	(16.5)	(27.7)	(9.3)
Avg. Share price(HK\$) 平均股价 (港元)	12.5	13.1	15.3

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	55,579	1,162	0.207	(30.3)	45.3	3.140	3.0	0.103	1.1	6.3
2017A	58,954	1,819	0.325	57.0	26.8	3.171	2.8	0.165	1.9	10.0
2018F	61,373	2,449	0.436	34.2	21.2	3.551	2.6	0.218	2.4	12.8
2019F	64,210	2,516	0.448	2.8	20.6	3.781	2.4	0.224	2.4	12.2
2020F	67,263	2,755	0.490	9.4	18.8	4.048	2.3	0.245	2.7	12.5
Shares in issue (m) 总股数 (m)				5,617.8	Major shareholder 大股东					Ting Hsin 33.8%
Market cap. (HK\$ m) 市值 (HK\$ m)				58,874.5	Free float (%) 自由流通比率 (%)					32.3
3 month average vol. 3 个月平均成交股数 ('000)				8,112.6	FY18 Net gearing (%) FY18 净负债/股东资金 (%)					3.7
52 Weeks high/low (HK\$) 52 周高/低 (HK\$)				19.500 / 10.340	FY18 Est. NAV (HK\$) FY18 每股估值 (港元)					17.2

Source: the Company, Guotai Junan International.

Tingyi's 3Q18 Quarterly Results Review

Sluggish sales performance in 3Q18. In 3Q18, the Company's revenue was down 4.2% YoY to RMB18,863 million, lower than expected, hurt by weak beverage sales. Due to the Company's weakening competitiveness of bottled water, contraction in market size of diluted juice, as well as unfavorable weather condition, Tingyi's 3Q18 beverage sales decreased 6.5% YoY to RMB11,748 million, much lower than 9.2% YoY growth in 1H18. Among the beverage segment, the Company's sales in RTD tea, juice and bottled water slumped 5.9% YoY, 17.5% YoY and 36.0% YoY, respectively, affected by sales contraction resulted from price hike and intense competition. On the other hand, in 3Q18, Tingyi's instant noodles sales slightly increased, up 0.7% YoY to RMB6,752 million, driven by the growth of high-end instant noodles sales, but sales growth was much lower than 1H18 (8.4% YoY).

Tingyi's 3Q18 earnings beat expectations. Thanks to price hikes, product mix upgrade and declining raw material costs, the Company's 3Q18 gross margin was up 0.9 ppt YoY and 0.7 ppt QoQ to 33.4%. Attributable to lower SG&A expense to sales ratio, which was down 0.7 ppt YoY, Tingyi's EBIT increased 4.3% YoY to RMB2,623 million. Due to the increase in shareholding of beverage business, Tingyi's shareholders' profit from beverages increased 28.5% YoY to RMB889 million, driving the Company's 3Q18 shareholders' profit, up 25.5% YoY to RMB1,554 million, better than expectations. Based on strong 3Q18 performance, the management guided up 2018 earnings (excluding impairment loss & disposal gains) growth forecast to 35% YoY.

Table-1: Tingyi's 3Q18 Quarterly Results Review

Income Statement						
RMB million	3Q17	3Q18	YoY	1-3Q17	1-3Q18	YoY
Turnover	19,687	18,863	-4.2%	48,254	49,859	3.3%
Cost of sales	(13,289)	(12,568)	-5.4%	-33,544	-33,884	1.0%
Gross Profit	<u>6,397</u>	<u>6,294</u>	-1.6%	<u>14,711</u>	<u>15,975</u>	8.6%
Other net income	230	134	-41.6%	641	932	45.3%
Distribution costs	(3,230)	(3,036)	-6.0%	-8,888	-9,203	3.5%
Administrative expenses	(644)	(544)	-15.6%	-1,706	-1,783	4.5%
Other operating expenses	(217)	(198)	-8.8%	-702	-1,146	63.4%
Operating Profit	<u>2,536</u>	<u>2,651</u>	4.6%	<u>4,056</u>	<u>4,775</u>	17.7%
Finance costs, net	(90)	(106)	17.1%	-361	-328	-9.0%
Share of results of associates	52	62	17.6%	147	157	6.9%
Profit before tax	<u>2,498</u>	<u>2,607</u>	4.4%	<u>3,843</u>	<u>4,604</u>	19.8%
Taxation	(615)	(702)	14.2%	-1,079	-1,210	12.1%
Profit after tax	<u>1,883</u>	<u>1,906</u>	1.2%	<u>2,763</u>	<u>3,394</u>	22.8%
Minority interests	(645)	352	-154.5%	-825	170	-120.6%
Shareholder's Profit	<u>1,238</u>	<u>1,554</u>	25.5%	<u>1,938</u>	<u>2,861</u>	47.6%
Gross Margin	32.5%	33.4%	0.9 ppt	30.5%	32.0%	1.6 ppt
Operating Margin	12.9%	14.1%	1.2 ppt	8.4%	9.6%	1.2 ppt
PAT Margin	9.6%	10.1%	0.5 ppt	5.7%	6.8%	1.1 ppt
Net Margin	6.3%	8.2%	1.9 ppt	4.0%	5.7%	1.7 ppt

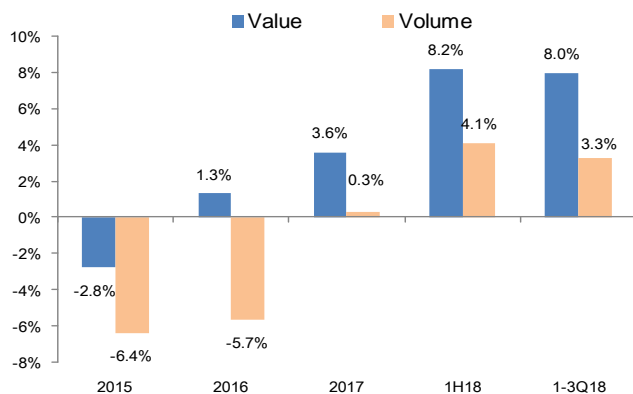
Source: the Company, Guotai Junan International.

Table-2: Tingyi's Segment Results Breakdown

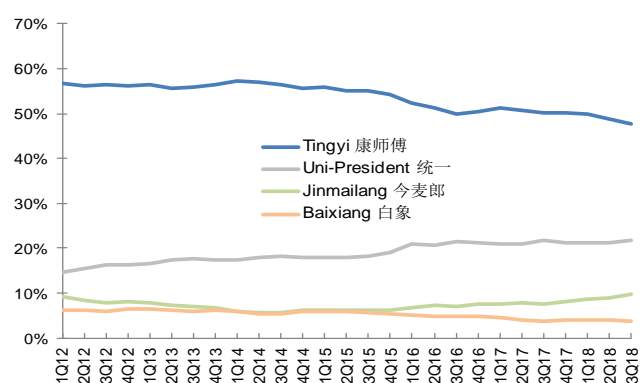
Segment Revenue						
RMB million	3Q17	3Q18	YoY	1-3Q17	1-3Q18	YoY
Segment revenue						
Instant Noodle	6,707	6,752	0.7%	16,979	17,886	5.3%
Beverage	12,568	11,748	-6.5%	30,104	30,895	2.6%
Instant Food & Others	411	363	-11.8%	1,172	1,078	-8.0%
<u>Total</u>	<u>19,687</u>	<u>18,863</u>	-4.2%	<u>48,254</u>	<u>49,859</u>	3.3%
Gross profit						
Instant Noodle	2,075	2,164	4.3%	4,902	5,485	11.9%
Beverage	4,204	4,010	-4.6%	9,474	10,162	7.3%
Instant Food & Others	118	121	2.4%	335	328	-2.1%
<u>Total</u>	<u>6,397</u>	<u>6,294</u>	-1.6%	<u>14,711</u>	<u>15,975</u>	8.6%
EBIT						
Instant Noodle	842	1,000	18.8%	181	181	0.0%
Beverage	1,692	1,580	-6.6%	296	296	0.0%
Instant Food & Others	(17)	43	-352.3%	18	18	0.0%
<u>Total</u>	<u>2,517</u>	<u>2,623</u>	4.2%	<u>495</u>	<u>495</u>	0.0%
Profit after tax						
Instant Noodle	626	715	14.2%	1,158	1,382	19.3%
Beverage	1,331	1,236	-7.1%	1,670	1,775	6.3%
Instant Food & Others	(74)	(45)	-38.7%	(65)	238	-468.1%
<u>Total</u>	<u>1,883</u>	<u>1,906</u>	1.2%	<u>2,763</u>	<u>3,394</u>	22.8%
Gross margin						
Instant Noodle	30.9%	32.1%	1.1 ppt	28.9%	30.7%	1.8 ppt
Beverage	33.5%	34.1%	0.7 ppt	31.5%	32.9%	1.4 ppt
EBIT margin						
Instant Noodle	12.5%	14.8%	2.3 ppt	1.1%	1.0%	-0.1 ppt
Beverage	13.5%	13.5%	0 ppt	1.0%	1.0%	0 ppt
Net margin						
Instant Noodle	9.3%	10.6%	1.3 ppt	6.8%	7.7%	0.9 ppt
Beverage	10.6%	10.5%	-0.1 ppt	5.5%	5.7%	0.2 ppt

Source: the Company, Guotai Junan International.

Instant noodles market growth slowed down and competition intensified. According to Nielsen, in 3Q18, China's instant noodles sales volume recorded 3.0% YoY growth, lower than 4.1% in 1H18, dragged by sluggish macro economy and competition from O2O food delivery. In spite of weaker market growth, market competition has become intense as local players who are seeking public listing aggressively grasp market share in lower-tier cities. For example, Jinmailang launched "One and Half Bowl (一桶半)" and "One and Half Package (一袋半)" which have the same price as Tingyi's classic product, but provide 50% more food. Jinmailang's strategy has effectively worked out in low-tier cities, where there is higher demand for large volume noodles. Tingyi's market share went down 1.2 ppt QoQ to 47.6% in 3Q18. In order to defend its core market, Tingyi is solidifying its market position in its high-end market by introducing several new products, and it has also tapped into the ultra premium market with the launch of Express series. The management expects that instant noodles will record high single-digit percentage growth in 4Q18.

Figure-1: China's Instant Noodles Retail Sales Growth


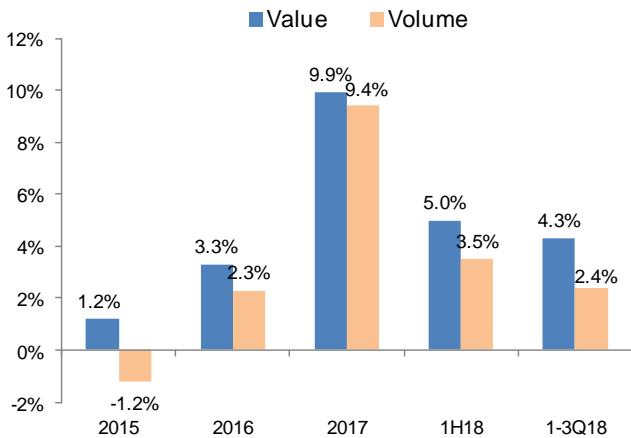
Source: Nielsen, the Company, Guotai Junan International.

Figure-2: Instant Noodles Market Share – by Value


Source: Nielsen, the Company, Guotai Junan International.

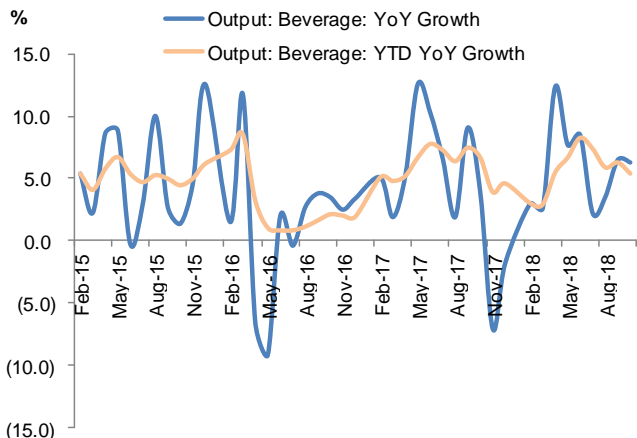
Beverage sales performance is relatively more vulnerable to macroeconomic changes. Affected by the sluggish macroeconomy environment and retail sales, as well as unfavorable weather, beverage sales growth in China witnessed notable deceleration in 3Q18 compared to 1H18. According to Nielsen, in 3Q18, China's RTD tea sales growth only recorded 1.2% YoY (16.7% in 3Q17), while bottled water sales growth declined to 6.9% YoY (12.4% in 3Q17). Consumption diversification has been the major trend in the beverage industry as high-end and low-end products both experienced ups and downs. In the dynamically changing market, beverage companies may pay high trial-and-error costs to launch new products, indicating more uncertainty.

Figure-3: China's Beverage Retail Sales Growth



Source: Nielsen, the Company, Guotai Junan International.

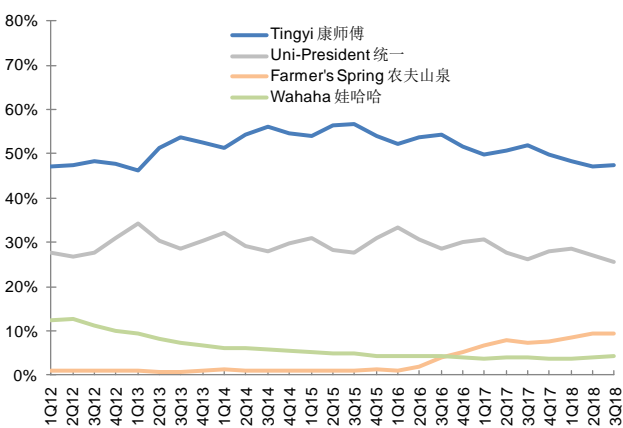
Figure-4: China's Beverage Output



Source: National Bureau of Statistics of China, Guotai Junan International.

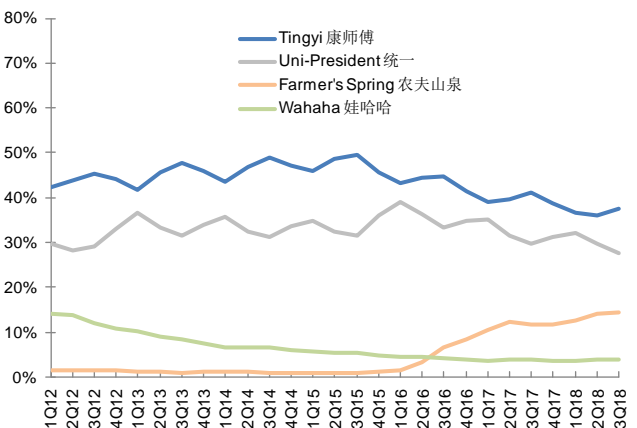
Bottled water in its darkest hour in 3Q18. Due to the increase in shareholding of beverage business, Tingyi's shareholders' profit from beverages increased 28.5% YoY in 3Q18. Likewise, the Company's shareholders' profit from beverages is expected to record higher loss in 4Q18, which is the off-season for beverages. As channels have not fully absorbed the impact of the Company's price lift of bottled water as well as that Tingyi's major competitor in the RMB1 bottled beverage market has not lifted price, performance of Tingyi's bottled water was still sluggish in which market share fell to 8.6% and market share rank came down to No.5. However, the Company maintained its market position in RTD tea, as less competitive products were launched into the market. The Company's coffee sales achieved satisfactory performance due to a sophisticated lineup, which is expected to contribute more profit to Tingyi.

Figure-5: RTD Tea (including milk tea) Market Share – by Volume



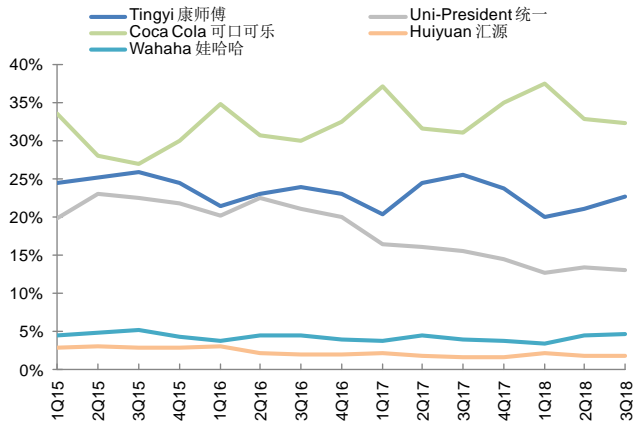
Source: Nielsen, the Company, Guotai Junan International.

Figure-6: RTD Tea (including milk tea) Market Share – by Value



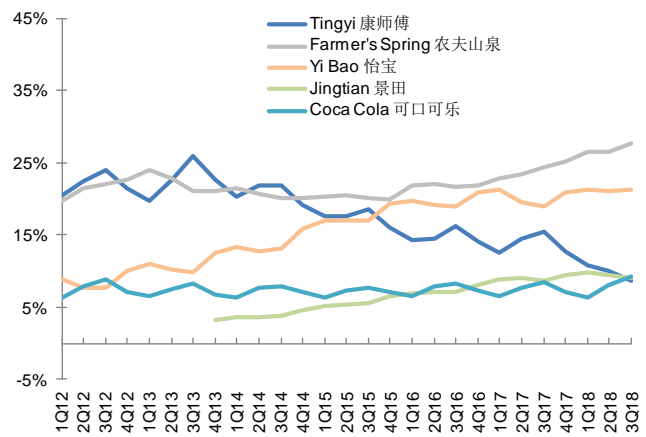
Source: Nielsen, the Company, Guotai Junan International.

Figure-7: Diluted Juice Market Share – by Volume



Source: Nielsen, the Company, Guotai Junan International.

Figure-8: Bottled Water Market Share – by Volume

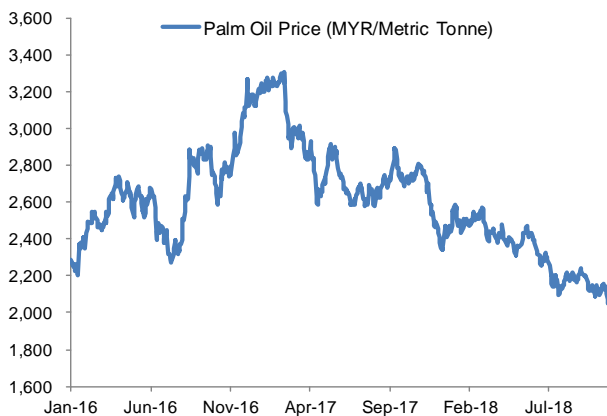


Source: Nielsen, the Company, Guotai Junan International.

Volume-first strategy will be implemented in 2019. In the face of competition from ambitious local players who are seeking IPO, such as Jinmailang, Jingtian and Nongfu Spring, the Company will implement volume-first strategy in 2019, hoping to regain market share as much as possible. Tingyi will start to double its advertising expense since 4Q18 and strengthen its coverage in new channels, in order to attract more consumers. The Company will continuously focus on bottled water by improving packaging quality and strengthening IP cooperation. Tingyi's volume-first strategy may affect its profitability improvement.

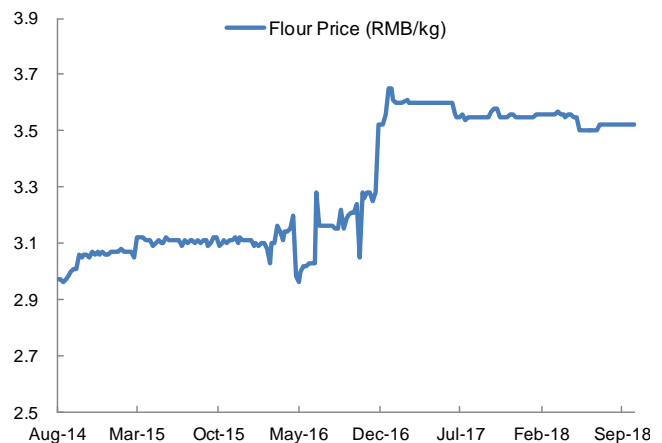
Raw material prices have become favorable to the Company as packaging prices have begun to decline. As at November 27, 2018, YTD price of flour, palm oil and sugar dropped 1.3% YoY, 18.2% YoY and 12.8% YoY, respectively. The burden on raw material costs was primarily derived from packaging price. As at November 27, 2018, the YTD price of PET increased 16.5% YoY. However it has turned to decline since September, down 27% from the highest point. Moreover, cardboard paper price has started to fall month over month, down 19% from the highest point. Overall, as the price of most raw materials has declined, they may be favorable for the Company in 2019.

Figure-9: Palm Oil price



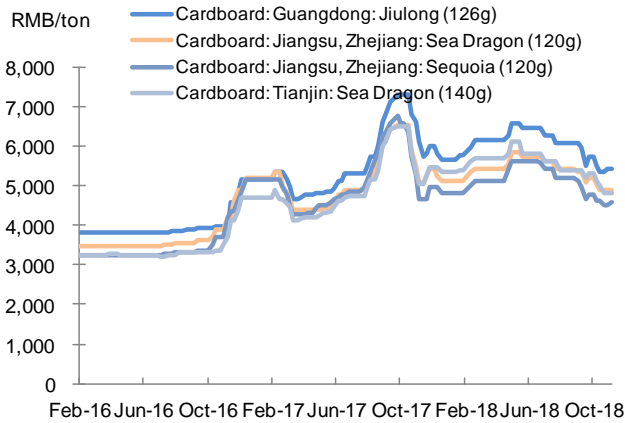
Source: MDEX.

Figure-10: Flour price



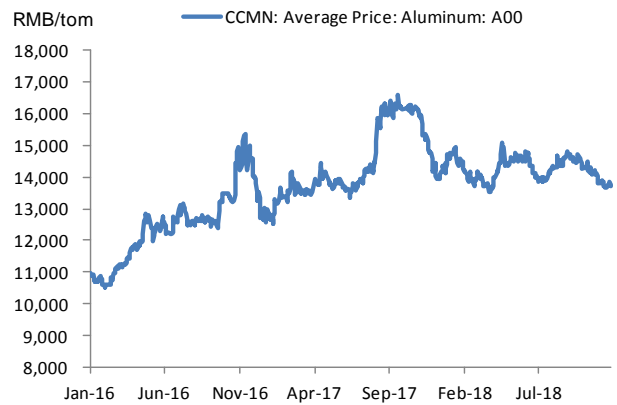
Source: the Ministry of Agriculture of China.

Figure-11: Cardboard Price



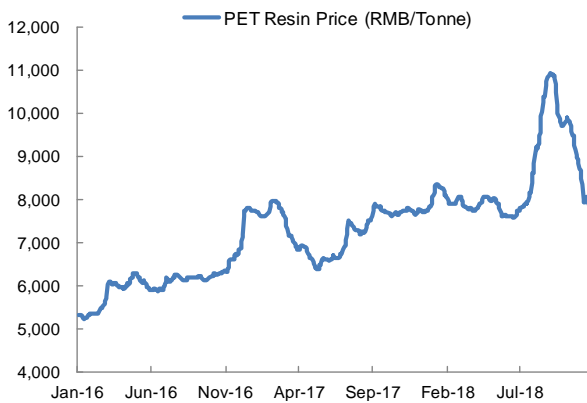
Source: WIND.

Figure-12: Aluminum



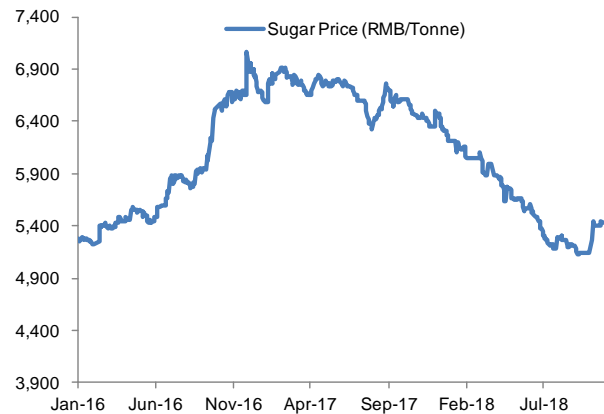
Source: WIND.

Figure-13: PET price



Source: www.tbs-china.com, WIND.

Figure-14: Domestic Sugar price



Source: Bloomberg.

Earnings Forecasts Assumptions and Revisions

Due to weaker industry growth forecasts and lack of further price hike momentum, we have trimmed down revenue forecasts in 2018, 2019 and 2020 by 1.9%, 2.6% and 2.9%, respectively. Due to lower-than-expected SG&A expenses in 3Q18, we have raised earnings in 2018 by 5.2%, in line with the management's guidance. As higher advertisement expense is expected to be incurred in 2019 and 2020, and with promotion expenses unavoidably increasing to support the Company's volume-first strategy, we have revised down earning forecasts in 2019 and 2020 by 4.5% and 5.3%.

Table-3: Earnings Estimates Revisions

RMB million	NEW			OLD			CHANGE		
	2018F	2019F	2020F	2018F	2019F	2020F	2018F	2019F	2020F
Revenue	61,373	64,210	67,263	62,548	65,900	69,288	-1.9%	-2.6%	-2.9%
Gross profit	19,196	20,175	21,068	19,687	20,844	21,858	-2.5%	-3.2%	-3.6%
Operating profit	4,363	4,484	4,860	4,132	4,671	5,096	5.6%	-4.0%	-4.6%
Profit after tax	2,776	2,827	3,093	2,619	2,944	3,240	6.0%	-4.0%	-4.5%
Shareholders' profit	2,449	2,516	2,755	2,327	2,635	2,909	5.2%	-4.5%	-5.3%
EPS (RMB)	0.436	0.448	0.490	0.414	0.469	0.518	5.3%	-4.5%	-5.3%
Gross margin	31.3%	31.4%	31.3%	31.50%	31.60%	31.50%	-0.2 ppt	-0.2 ppt	-0.2 ppt
Operating margin	7.1%	7.0%	7.2%	6.60%	7.10%	7.40%	0.5 ppt	-0.1 ppt	-0.2 ppt
PAT margin	4.5%	4.4%	4.6%	4.20%	4.50%	4.70%	0.3 ppt	-0.1 ppt	-0.1 ppt
Net margin	4.0%	3.9%	4.1%	3.70%	4.00%	4.20%	0.3 ppt	-0.1 ppt	-0.1 ppt

Source: Guotai Junan International.

Lower TP to HK\$12.50 but upgrade to "Accumulate". Based on lower earnings forecasts, we lower TP to HK\$12.50. Tingyi's share price has fallen 17.4% after the analyst meeting as the market is concerned that Tingyi's volume-first strategy may hurt profitability in 2019 and 2020 and impact the Company's plan to return to its historical peak level of profit in 2020. However, we think that the market may overestimate the negative effect of its volume-first strategy on profitability. We expect that profitability in 2019 and 2020 may not be lower than 2018 as volume-first strategy will also improve product mix. In addition, backed by big data technology, precision marketing will empower the Company to efficiently allocate advertisement resources. Moreover, the Company plans to reduce production base of instant noodles and beverages by 15% and 45% by 2020, which will further improve its productivity. We think Tingyi's current valuation is attractive, lower than the industry average and its historical mean. Therefore, we lower TP to HK\$12.50 but upgrade rating to "Accumulate". The new TP represents 23.2x 2018 PER, 22.6x 2019 PER, and 20.6x 2020 PER.

Table-4: 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	26.850	87,106	38.1	29.2	24.0	3.9	10.8	36.1	8.5
China Mengniu Dairy	2319 HK	HKD	23.950	94,064	27.0	21.0	17.3	3.3	12.8	38.1	5.6
Tingyi	322 HK	HKD	10.480	58,874	21.1	18.7	16.6	2.6	12.7	31.4	6.7
Dali Foods	3799 HK	HKD	5.670	77,646	17.8	15.6	13.6	4.5	26.7	38.9	21.1
Want Want China	151 HK	HKD	5.810	72,330	19.7	18.6	17.4	4.0	21.8	43.1	20.2
Tsingtao Brewery	168 HK	HKD	30.750	43,805	23.3	19.9	17.4	2.0	8.9	37.3	5.8
Uni-President China	220 HK	HKD	7.000	30,235	24.1	21.0	18.8	2.0	8.6	34.7	6.5
Vitasoy Ltd	345 HK	HKD	30.700	32,576	55.3	44.5	38.5	11.2	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
Simple Average					27.6	22.9	19.8	4.0	14.8	38.7	10.2
Weighted Average					27.0	22.3	19.2	3.9	15.8	38.4	11.2

Source: Bloomberg.

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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