



## Company Report: Lenovo Group (00992 HK)

公司报告: 联想集团 (00992 HK)

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10 December 2018

# Robust PC Business and Fast-growing Data Center Business, "Accumulate"

稳健的PC业务和快速发展的数据中心业务, "收集"

- **1HFY19 results of Lenovo Group beat expectations, shareholders' net profit increased sharply by 267.7% yoy to USD 245 million**, mainly due to increase in personal computer business, significant reduction in loss in mobile business, as well as strong growth of data center business.
- **Revenue of PC and smart device business ("PCSD") has achieved strong double-digit growth for three consecutive quarters.** Revenue of PCSD increased in 1HFY19 by 17.9% yoy to USD 18,873 million, mainly due to the increase in proportion of high-end PCs and rising PC shipments. Besides, loss in mobile business continued to decrease, thanks to the strategy to simplifying product portfolio and focus on core profitable market.
- **Revenue of data center business in 1HFY19 grew substantially by 63.0% yoy to USD 3,173 million**, mainly driven by **Hyperscale, Software Defined Infrastructure ("SDI") and Flash Arrays**. The partnership with NetApp will enable Lenovo to expand market share in the storage market. With penetration into tier-2 and tier-3 customer markets, data center business is expected to maintain rapid revenue growth as well as improved margin.
- **We set the Company's investment rating as "Accumulate" and set the TP at HK\$6.30.** We set FY19-FY21 EPS at USD cent 3.925/ 5.004/ 5.710, respectively. The TP represents 20.5x, 16.1x and 14.1x FY19, FY20 and FY21 PER.
- **联想集团 2019 财年上半年业绩好于预期, 股东净利同比激增 267.7%至美元 2.45 亿**, 主要是由于个人电脑业务的增长, 移动业务亏损的大幅减少, 以及数据中心业务的强势增长。
- **个人电脑和智能设备集团收入连续三个季度实现两位数的强势增长。**个人电脑和智能设备业务 2019 财年上半年收入同比上升 17.9%至 188.73 亿美元, 主要是由于高端 PC 占比的提升以及 PC 出货量的上升。此外, 由于产品组合简化和核心市场聚焦策略, 移动业务的亏损持续减少。
- **数据中心集团 2019 财年上半年收入同比大幅上升 63.0%至 31.73 亿美元, 主要受超大规模数据中心, 软件定义基础设施业务和快闪储存阵列的推动。**与 NetApp 的合作将扩大联想在存储市场的份额。随着对二线和三线客户的渗透, 预计数据中心业务将保持快速的收入增长以及利润率的提高。
- **我们设定公司的投资评级为“收集”, 目标为 6.30 港元。**我们预测 2019-2021 财年的每股盈利为 3.925/ 5.004/ 5.710 美分。目标价相当于 20.5 倍、16.1 倍和 14.1 倍 2019 - 2021 财年市盈率。

Rating:

**Accumulate**

评级:

收集

6-18m TP 目标价:

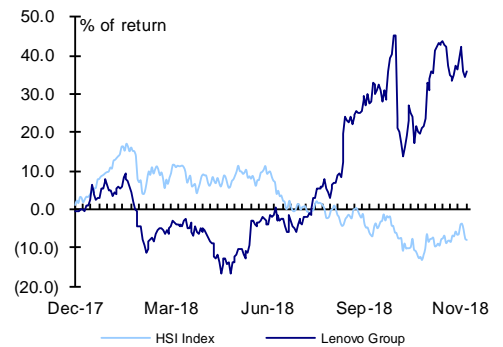
**HK\$6.30**

Share price 股价:

HK\$5.510

### 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 %	-7.76	2.49	24.42
Rel. % to HS Index 相对恒指变动 %	-7.82	6.23	34.97
Avg. Share price(HK\$) 平均股价 (港元)	5.63	5.33	4.37

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
03/31	(US\$ m)	(US\$ m)	(US\$ Cent)	(Δ %)	(x)	(US\$)	(x)	(US\$)	(%)	(%)
2017A	43,035	535	4.860	n.a.	14.6	0.293	2.4	0.034	4.8	17.2
2018A	45,350	(189)	(1.674)	(134.4)	(42.1)	0.311	2.3	0.033	4.7	(5.6)
2019F	51,080	472	3.925	n.a.	17.9	0.299	2.4	0.034	4.9	13.3
2020F	54,400	601	5.004	27.5	14.1	0.314	2.2	0.035	5.0	16.3
2021F	57,218	686	5.710	14.1	12.3	0.336	2.1	0.036	5.2	17.6

Shares in issue (m) 总股数 (m)	12,014.8	Major shareholder 大股东	Legend Holdings Limited 29.1%
Market cap. (HK\$ m) 市值 (HK\$ m)	66,201.5	Free float (%) 自由流通比率 (%)	70.9
3 month average vol. 3 个月平均成交股数 ('000)	63,855.1	FY19 Net gearing (%) FY19 净负债/股东资金 (%)	37.0
52 Weeks high/low (HK\$) 52 周高/低 (HK\$)	6,000 / 3,530	FY19 Est. NAV (HK\$) FY19 每股估值 (港元)	6.8

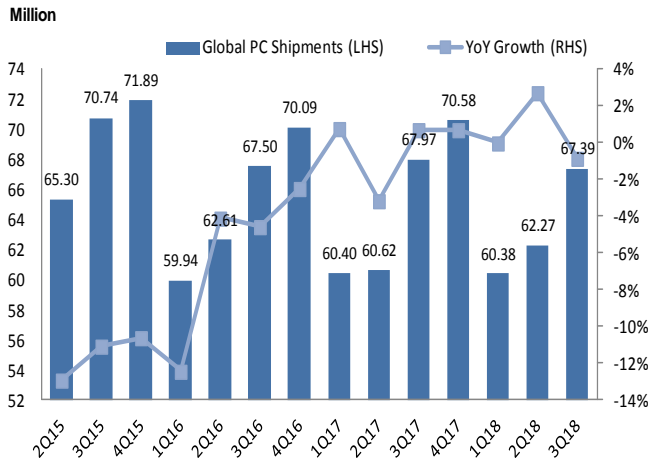
Source: the Company, Guotai Junan International.

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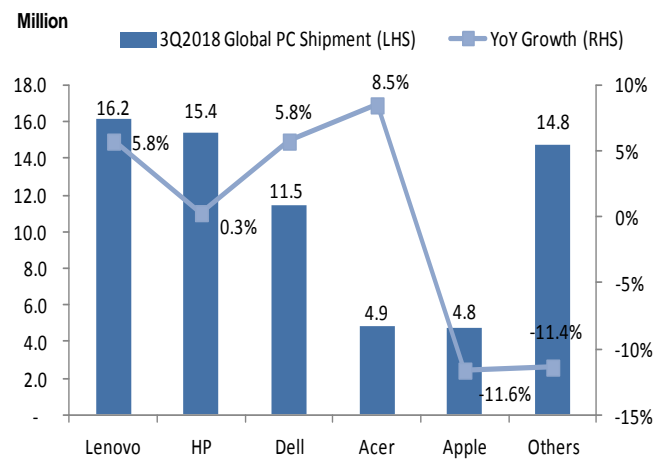
In 3Q2018, global PC shipments reached nearly 67.4 million, a decrease of 0.9% yoy. Lenovo (the "Company") reclaimed the number one spot in terms of PC shipments. Shipments for the global top 5 brands increased by 2.6% while market share increased by 2.6 ppt. The PC market trended towards stabilization and high concentration. The U.S. PC market had strong growth with a total of 17.2 million units shipped in 3Q2018, mainly due to growing demand for notebook PCs in the enterprise segment and rising popularity of gaming computers. The CPU shortage of Intel may affect global PC shipments, but we believe that leading enterprises like Lenovo are less likely to be affected, and AMD supply could help with processor demand to some extent.

**Figure-1: Global PC Shipments**



Source: IDC, Guotai Junan International.

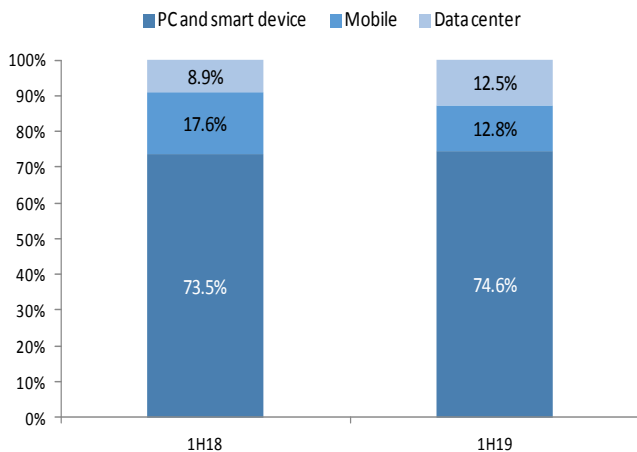
**Figure-2: Global PC Shipments by the Company**



Source: IDC, Guotai Junan International.

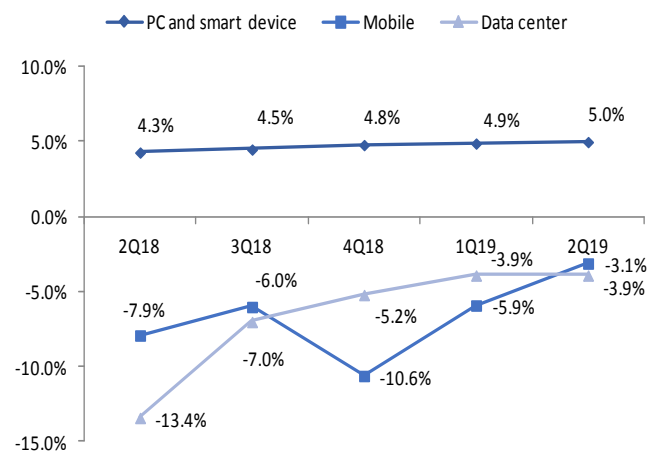
1HFY19 results of Lenovo Group beat expectations, shareholders' net profit increased sharply by 267.7% yoy to USD 245 million, mainly due to an increase in personal computer business, significant reduction in loss in mobile business, as well as strong growth of data center business. Revenue in 1HFY19 increased by 16.2% yoy to USD 25,293 million, mainly due to rapid growth of PC and data center business. Revenue in 2QFY19 increased by 13.8% yoy to USD 13,380 million, while profit before tax in 2QFY19 increased sharply by 503.4% to USD 213 million. Shareholders' net profit increased by 21.1% yoy to USD 168 million in 2QFY19.

**Figure-3: Lenovo's Revenue Breakdown**



Source: the Company, Guotai Junan International.

**Figure-4: Lenovo's Pre-tax Margin by Business Segment**



Source: the Company, Guotai Junan International.

**Table-1: Lenovo's Financial Results Analysis**

USD (Million)	1HFY19	1HFY18	YoY	Comments
Total revenue	25,293	21,773	16.2%	
-PC & Smart Devices (PCSD)	18,873	16,004	17.9%	Driven by ASP improvement and PC shipments increase
-Mobile Business Group (MBG)	3,247	3,823	(15.1%)	Simplify product portfolio and focus on North American and Latin American markets
-Data Center Business Group (DCG)	3,173	1,947	63.0%	Driven by Hyperscale, Software Defined Infrastructure and Flash Arrays
Cost of sales	(21,867)	(18,796)	16.3%	
Gross profit	3,426	2,977	15.1%	
S&D expenses	(1,309)	(1,461)	(10.4%)	
Admin costs	(1,000)	(848)	18.0%	
R&D costs	(622)	(602)	3.3%	
Operating profit	470	82	476.1%	
Finance income	11	18	(-35.0%)	
Finance costs	(154)	(132)	16.7%	
Profit from associates & JV	(2)	(2)	9.6%	
Shareholders' profit	245	67	267.7%	
EPS (USD cents)	2.064	0.608	239.6%	
Gross profit margin	13.5%	13.7%	(0.1 ppt)	
Operating profit margin	1.9%	0.4%	1.5 ppt	
Net profit margin	1.0%	0.3%	0.7 ppt.	

Source: the Company, Guotai Junan International.

### Revenue of PC and smart device business ("PCSD") achieved strong double-digit growth for three consecutive quarters.

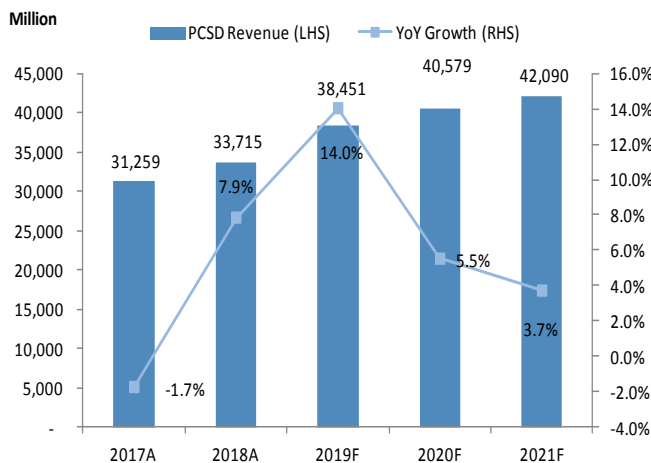
Revenue of PCSD increased in 1HFY19 by 17.9% yoy to USD 18,873 million, mainly due to increase in proportion of high-end PCs as well as rising PC shipments; Pre-tax income margin increased by 0.8 ppt yoy to 5.0%, driven by product mix improvement and improved service attach rate. During 2QFY19, workstations achieved year-on-year growth of 27%, while gaming computers and thin & light PCs (such as Yoga, Thinkpad, Ideapad) all achieved double-digit growth. The rapid development of high-end PCs will support sustainability of the Company's earnings growth. In addition, revenue and shipments of the Company's commercial PCs continued to grow. The Company's commercial PCs accounted for 63% of total shipments in 2QFY19, which is higher than the industry average of 55%. Rapid development of commercial PCs will also promote the development of the Company's PC business. In addition to the PC market and smart devices market will also bring many opportunities to the Company, such as smart earphones, unmanned stores, smart locks, etc.

**Loss in mobile business continued to decrease.** Pre-tax loss of mobile business in 1HFY19 decreased significantly by 56.7% to 146 million, mainly due to the Company's strategy to simplify product portfolio and focus on core profitable markets, i.e. North America and Latin America markets. The Company's mobile shipments increased sharply by 65% yoy in North America; revenue in Latin America continued to grow, and maintained the number two position in the market (After Samsung); the Company's loss in China was also reduced. In 2QFY19, the Company's mobile business outside of China and Motorola globally achieved operational breakeven. In addition, Lenovo launched the Moto z3, the world's first smartphone which can be upgraded to 5G with 5G moto mod™. The Company's strategy to focus on key portfolios and core profitable markets will reduce operating expenses and increase the profitability of the Company.

Revenue of data center business grew substantially by 63.0% yoy to USD 3,173 million in 1HFY19, mainly driven by Hyperscale, Software Defined Infrastructure ("SDI") and Flash Arrays. Hyperscale reported triple-digit year-on-year growth for the third consecutive quarter, and SDI continued triple-digit year-on-year growth for the seventh consecutive quarter. Due to the effective implementation of transformation strategy, data center business loss narrowed sharply by 55.2% yoy. According to IDC, Lenovo has become the third largest server provider in the world, as well as the fourth cloud infrastructure vendor (also fastest growing among major vendors). The Company announced in September to strategically partner with NetApp, which enables Lenovo to expand its addressable market coverage for storage and data management from 15% to over 90%. Through the partnership, Lenovo could utilize its world-class supply chain and NetApp's core software technology to expand market share in storage, which could be a growth driver in the future. With penetration of the Company's Hyperscale business into tier-2 and tier-3 markets, Hyperscale is expected to keep growing, and margin is expected to increase, given that Lenovo has more bargaining power for small and medium-sized customers. We expect data center business to maintain rapid growth and be one of the major growth engines for Lenovo due to rapid development of the cloud industry, Hyperscale, as well as Software Defined Infrastructure.

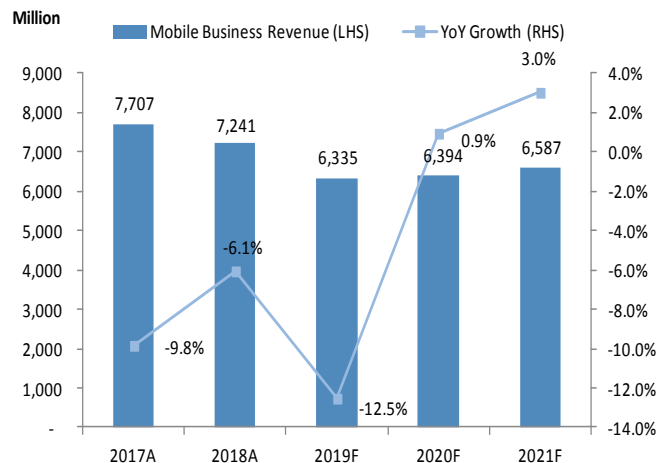
Lenovo continues to promote intelligent transformation strategy from three dimensions (smart IoT, smart infrastructure and smart vertical solutions). Big data and AI smart vertical solutions revenue was up 44.2% yoy in 2QFY19; service and software revenue reached 688 million in 2QFY19. Industrial intelligence is the inevitable future trend of the industry, therefore, Lenovo's intelligent transformation combing data program, computing power and algorithms will bring huge opportunities to the Company, especially in fields like smart manufacturing where Lenovo possesses a lot of experience.

**Figure-5: Lenovo's PCSD Revenue and YoY Growth**



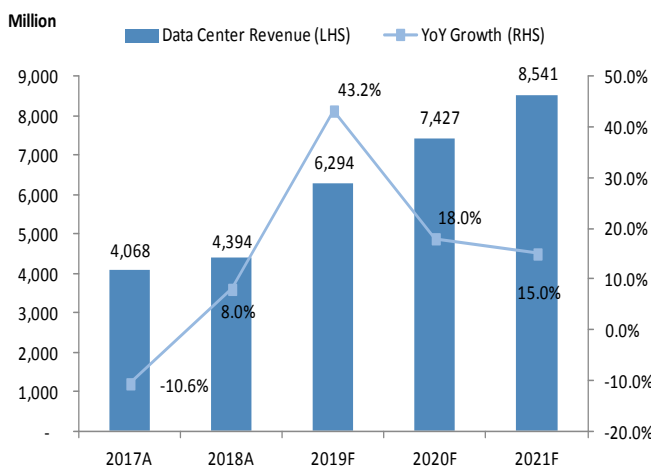
Source: the Company, Guotai Junan International.

**Figure-6: Lenovo's Mobile Revenue and YoY Growth**



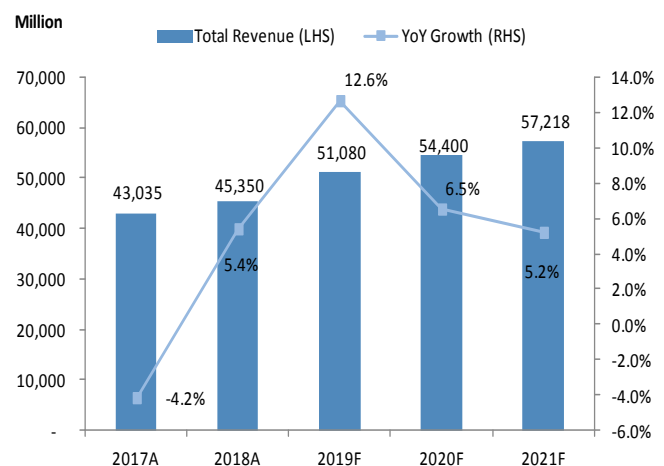
Source: the Company, Guotai Junan International.

**Figure-7: Lenovo's Data Center Revenue and YoY Growth**



Source: the Company, Guotai Junan International.

**Figure-8: Lenovo's Total Revenue and YoY Growth**



Source: the Company, Guotai Junan International.

## Profit Estimates

**FY19-21 EPS is expected to increase to be US cent 3.925/ 5.004/ 5.710, respectively.** We forecast FY19-21 revenue to increase by 12.6%/ 6.5%/ 5.2%, respectively, due rapid growth of PCSD and data center business. We forecast FY19-21 EPS to be USD cent 3.925/ 5.004/ 5.710, respectively, due the strong revenue growth and rising profit margin.

## Risk Factors

**We believe the key risks for Lenovo are:** 1) escalation of trade friction between the US and China, 2) more intense competition in PC and smartphone market, 3) decline in PC demand due to longer replacement cycle, and 4) weak smartphone market.

## Valuation

**We set the investment rating as "Accumulate" with the TP of HK\$6.30.** Lenovo is expected to benefit from growing demand of high-end PCs, fast growing data center business, as well as the development of industrial intelligence. The strategy to focus on core profitable markets and simplify product portfolios for mobile business is expected to improve the profitability of the Company. The TP represents 20.5x FY19 PER, 16.1x FY20 PER and 14.1x FY21 PER.

**Table-2: Peers Comparison**

Company	Ticker	Currency	Price	Market Cap (HKD Mil)	PER			PBR			ROE (%)	D/Y (%)	EV/EBITDA
					18F	19F	20F	18F	19F	20F	18F	18F	18F
<b>HK Listed Companies</b>													
Lenovo Group Ltd	992 HK	HKD	5.510	64,279	14.0	10.5	8.7	2.4	2.0	1.8	(5.6)	6.6	7.7
Xiaomi Corp-Class B	1810 HK	HKD	13.640	298,025	26.3	20.5	14.0	3.8	3.3	2.7	(13.1)	0.0	51.3
Zte Corp-H	763 HK	HKD	15.600	90,108	n.a.	14.0	10.2	1.8	1.6	1.5	(18.7)	0.0	41.8
Coolpad Group Ltd	2369 HK	HKD	0.720	3,624	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.0	n.a.	n.a.
Simple Average					20.2	15.0	11.0	2.7	2.3	2.0	(8.1)	2.2	33.6
Weighted Average					24.1	17.8	12.5	3.2	2.8	2.3	(13.0)	0.9	43.2
<b>PRC Listed Companies</b>													
Inspur Electronic Informat-A	000977 CH	CNY	17.700	25,442	35.4	24.5	16.6	2.9	2.6	2.2	8.3	0.3	16.7
Dawning Information Indust-A	603019 CH	CNY	39.450	28,275	57.3	39.3	28.9	7.2	6.2	5.3	12.7	0.3	35.1
Tsinghua Tongfang Co Ltd-A	600100 CH	CNY	10.210	34,239	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
China Greatwall Technology-A	000066 CH	CNY	5.410	17,792	14.7	12.9	10.0	2.1	1.8	1.5	14.5	n.a.	n.a.
Simple Average					35.8	25.5	18.5	4.1	3.5	3.0	11.8	0.3	25.9
Weighted Average					38.9	27.4	19.8	4.4	3.8	3.2	11.6	0.3	26.4
<b>Japan Listed Companies</b>													
Toshiba Corp	6502 JP	JPY	3,540.000	159,926	2.2	2.1	14.5	2.9	1.3	1.2	n.a.	0.0	13.3
Panasonic Corp	6752 JP	JPY	1,108.000	185,006	10.9	10.3	9.4	1.5	1.4	1.3	14.4	2.0	5.9
Sharp Corp	6753 JP	JPY	1,435.000	50,859	13.5	10.8	10.4	4.0	2.0	1.8	47.5	0.3	12.2
Sony Corp	6758 JP	JPY	5,886.000	503,948	15.2	11.2	12.7	2.5	2.1	1.8	18.0	0.5	5.3
Nec Corp	6701 JP	JPY	3,575.000	64,606	20.3	25.9	14.8	1.1	1.0	1.0	5.3	2.0	7.0
Fujitsu Ltd	6702 JP	JPY	6,981.000	98,827	8.5	11.4	11.2	1.3	1.2	1.1	17.2	1.7	4.0
Simple Average					11.8	11.9	12.2	2.2	1.5	1.4	20.5	1.1	7.9
Weighted Average					12.1	10.6	12.3	2.3	1.7	1.5	17.9	0.9	6.9
<b>Taiwan Listed Companies</b>													
Asustek Computer Inc	2357 TT	TWD	214.000	40,237	14.0	11.3	10.8	0.9	0.9	0.9	6.4	6.8	6.4
Acer Inc	2353 TT	TWD	19.300	14,595	16.9	15.1	14.8	1.0	1.0	0.9	5.6	3.5	6.0
Simple Average					15.5	13.2	12.8	1.0	0.9	0.9	6.0	5.2	6.2
Weighted Average					14.8	12.3	11.9	0.9	0.9	0.9	6.2	5.9	6.3
<b>US Listed Companies</b>													
Apple Inc	AAPL US	USD	168.490	6,247,620	14.0	12.6	11.4	7.5	7.6	7.0	49.4	1.2	11.6
Hp Inc	HPQ US	USD	22.930	283,524	6.9	10.4	9.9	(56.8)	263.6	30.6	(141.5)	2.3	8.5
Dell Technologies Inc-CI V	DVMT US	USD	104.000	162,005	19.0	15.8	14.9	3.7	n.a.	n.a.	25.3	n.a.	4.7
Simple Average					13.3	12.9	12.1	(15.2)	135.6	18.8	(22.3)	1.8	8.3
Weighted Average					13.9	12.6	11.4	4.7	18.7	8.0	40.7	1.3	11.3
Overall Average					19.3	15.7	13.3	(1.1)	28.8	5.2	1.6	2.1	16.4
Overall Weighted Average					20.8	16.1	13.6	3.1	5.6	3.2	12.7	1.9	18.8

**Financial Statements and Ratios**

Income Statement					
Year end 31 March (USD m)	2017A	2018A	2019F	2020F	2021F
PC & smart device business	31,259	33,715	38,451	40,579	42,090
Mobile business	7,707	7,241	6,335	6,394	6,587
Data center business	4,068	4,394	6,294	7,427	8,541
Total Revenue	43,035	45,350	51,080	54,400	57,218
Cost of revenues	(36,929)	(39,078)	(44,133)	(46,892)	(49,207)
Gross profit	6,106	6,272	6,947	7,507	8,010
Sell & Distribution costs	(2,681)	(2,833)	(2,656)	(2,720)	(2,804)
Admin costs	(1,852)	(1,757)	(2,043)	(2,176)	(2,289)
R&D costs	(1,362)	(1,274)	(1,277)	(1,414)	(1,545)
Others	461	(21)	(15)	(12)	(10)
Operating Profit	672	387	956	1,185	1,364
Finance Income	28	32	21	28	31
Finance costs	(232)	(263)	(296)	(306)	(319)
Profit from associates & JCE	21	(3)	(3)	(3)	(3)
Profit Before Tax	490	153	678	904	1,073
Income Tax	41	(280)	(163)	(240)	(312)
profit After Tax	530	(127)	515	664	760
Non-controlling Interest	5	(63)	(43)	(63)	(74)
Shareholders' Profit / Loss	535	(189)	472	601	686
Basic EPS (USD Cent)	4.860	(1.674)	3.925	5.004	5.710

Cash Flow Statement					
Year end 31 March (USD m)	2017A	2018A	2019F	2020F	2021F
Profit before tax	490	153	678	904	1,073
D&A	742	739	759	690	684
Finance cost, net	204	231	275	278	288
Other non-cash items	(356)	(94)	567	(65)	(52)
Change in working capital	1,617	(1,090)	62	118	85
Interest paid	(174)	(244)	(266)	(275)	(287)
Tax paid	(404)	(451)	(451)	(390)	(455)
Cash from Operating Activities	2,120	(756)	1,624	1,260	1,336
CAPEX	(803)	(671)	(599)	(608)	(619)
Change in bank deposits	(44)	112	4	4	4
Others	(550)	(555)	124	73	78
Cash from Investing Activities	(1,398)	(1,113)	(471)	(531)	(537)
Dividends paid	(377)	(381)	(402)	(414)	(426)
Bank borrowings change	(682)	701	169	(13)	206
Others	1,204	554	(71)	3	(24)
Cash from Financing Activities	145	874	(304)	(424)	(245)
Net Changes in Cash	867	(995)	850	305	554
Cash at Beg of Year	1,927	2,755	1,848	2,575	2,881
FX change	(40)	89	(122)	0	0
Cash at End of Year	2,755	1,848	2,575	2,881	3,435

Source: the Company, Guotai Junan International.

Balance Sheet					
Year end 31 March (USD m)	2017A	2018A	2019F	2020F	2021F
PP&E	1,236	1,305	1,287	1,273	1,258
Prepaid land lease payment	473	508	482	518	557
Intangible assets	8,349	8,515	8,401	8,341	8,281
Deferred income tax assets	1,435	1,531	1,756	1,967	2,167
Other non-current assets	824	973	994	1,027	1,068
Total Non-current Assets	12,318	12,831	12,921	13,126	13,331
Inventory	2,794	3,792	4,271	4,548	4,784
Trade & notes receivable	4,537	4,984	5,614	5,977	6,284
Deposits, prepayments & other receivables	4,333	4,703	5,108	5,440	5,722
Cash & Cash Equivalents	2,755	1,848	2,575	2,881	3,435
Other current assets	450	336	391	382	376
Total Current Assets	14,868	15,663	17,959	19,227	20,601
Total Assets	27,186	28,494	30,880	32,353	33,932
Trade & notes payable	6,486	7,253	7,679	8,159	8,562
Other payables, accruals & Provisions	10,878	10,076	11,226	11,836	12,343
Bank borrowings	70	1,167	2,043	1,904	2,003
Other current liabilities	900	964	1,069	1,147	1,217
Total Current Liabilities	18,334	19,460	22,017	23,046	24,125
Warranty provision	280	279	315	335	353
Deferred revenue	537	583	657	700	736
Retirement benefit obligations	370	413	426	439	452
Bank borrowings	2,967	2,649	1,941	2,067	2,174
Other non-current liabilities	602	564	997	979	965
Total Non-current Liabilities	4,757	4,488	4,336	4,520	4,680
Total Liabilities	23,091	23,948	26,353	27,566	28,805
Share capital	2,690	3,186	3,186	3,186	3,186
Reserves	534	333	402	590	849
Total Shareholders' Equity	3,224	3,519	3,588	3,776	4,035
Minority Interest	872	1,027	939	1,011	1,091
Total Equity	4,095	4,546	4,527	4,787	5,126

Financial Ratios					
Year end 31 March (USD m)	2017A	2018A	2019F	2020F	2021F
Gross margin (%)	14.2	13.8	13.6	13.8	14.0
Operating margin (%)	1.6	0.9	1.9	2.2	2.4
Net margin (%)	1.2	-0.4	0.9	1.1	1.2
ROA (%)	2.1	-0.7	1.6	1.9	2.1
ROE (%)	17.2	-5.6	13.3	16.3	17.6
Current ratio (x)	0.8	0.8	0.8	0.8	0.9
Quick ratio (x)	0.7	0.6	0.6	0.6	0.7
Debt to equity ratio (x)	0.9	1.1	1.1	1.1	1.0
Net gearing (%)	2.6	53.5	37.0	26.9	16.6

### 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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