

AAC Technologies Holdings Inc (2018 HK)

Weak product demand in 2020; initiate with HOLD

- We forecast AAC Tech's ("the Company" or "AAC") net profit to drop by 6.9% YoY in 2020E
- Gross profit margin in 2020E is expected to be affected by COVID-19, fierce market competition, and weak product demand. We project AAC's gross margin to drop by 1.6ppt YoY to 27.0% in 2020E.
- Net profit is estimated to grow at a CAGR of 10.8% in 2019-22E.
- Initiate with HOLD and TP of HK\$41.0. The TP implies 21.6x/17.3x FY20E/21E P/E

Company Report Initiation

June 5, 2020
Rating: HOLD

TP: HK\$41.0

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Share price (HK\$)	41.75
Est. share price return	(1.8%)
Est. dividend yield	1.8%
Est. total return	0.0%

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L(HK\$)	72.90/32.85
Issued shares (mn)	1,208.5
Market cap (HK\$ mn)	50,455
Avg daily turnover (HK\$ mn)	13.0
Major shareholder(s)	
WU Ingrid Chun Yuan	40.7%
JP Morgan	12.9%
GIC Private Ltd.	6.0%

Source(s): Bloomberg

Share Performance (%)

	Absolute	Relative*
1-mth	(8.5)	(9.9)
3-mth	(35.3)	(26.3)
6-mth	(27.3)	(16.6)

*Relative to HSI

Source(s): Bloomberg

A producer of electronic components since 1993. AAC primarily engages in producing electronic components for various electronic devices, including smartphones, tablets, wearables, PCs, and notebooks, and provides related application solutions, including dynamic components, haptics, RF/antenna, MEMS components and others.

2020 business affected by COVID-19. The Company's production facilities and supply chains were severely affected in 1Q20 by the outbreak of COVID-19 with shutdowns and disruptions. Due to COVID-19, AAC recorded 87.8% YoY decline in net profit in 1Q20.

We estimate AAC's revenue to grow at a CAGR of 7.4% in 2019-22E. The global smartphone shipments are expected to be weak with unfavorable economy environment, fierce market competition and weak product demand.

Net profit is estimated to grow at a CAGR of 10.8% in 2019-22E. AAC will face margin pressure, market competition, and unfavorable market atmosphere. We estimate net profit to drop 6.9% YoY in 2020E.

Valuation. We initiate with **HOLD** and TP of HK\$41.0. The TP represents 21.6x/17.3x FY20E/ FY21E P/E.

Risks: (1) Fierce competition in the electronic component sector; (2) Business may be affected by Sino-US trade tensions; (3) Global smartphone shipments affected by COVID-19.

Results and Valuation

FY ended Dec 31	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	18,131	17,884	19,065	20,759	22,172
Chg (% YoY)	(14.1%)	(1.4%)	6.6%	8.9%	6.8%
Net profit (RMB mn)	3,796	2,222	2,070	2,574	3,021
Chg (% YoY)	(28.7%)	(41.5%)	(6.9%)	24.4%	17.4%
EPS (RMB)	3.106	1.836	1.713	2.130	2.500
Chg (% YoY)	(28.5%)	(40.9%)	(6.7%)	24.4%	17.4%
BPS (RMB)	15.49	16.00	17.05	18.33	19.82
Chg (% YoY)	(28.5%)	(40.9%)	(6.7%)	24.4%	17.4%
P/E (x)	11.8	20.23	21.94	17.64	15.03
P/B (x)	2.37	2.32	2.20	2.05	1.90
ROAE (%)	20.8%	11.6%	10.4%	12.0%	13.1%
ROAA (%)	12.5%	6.9%	6.0%	7.4%	8.5%
DPS (RMB)	1.2	0.4	0.7	0.9	1.0
Dividend Yield (%)	3.4%	1.0%	1.8%	2.3%	2.7%

*Exchange rate assumption for FY20E-22E: HKD 1 = RMB 0.90

Source(s): Bloomberg, ABCI Securities estimates



農銀國際

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

AAC Technologies Holdings Inc. (2018 HK, HOLD)

China Telecom Sector

June 5, 2020

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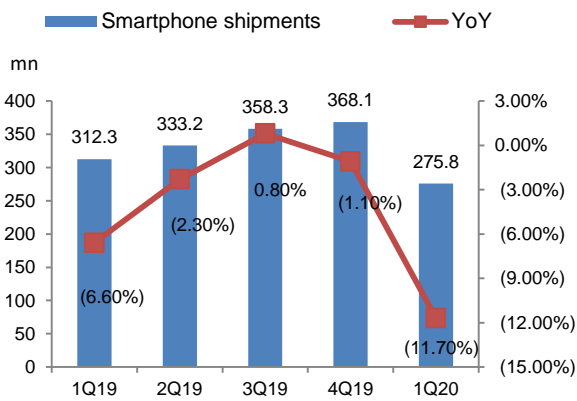


Industry analysis

The smartphone shipments dropped by 11.7% YoY in 1Q20

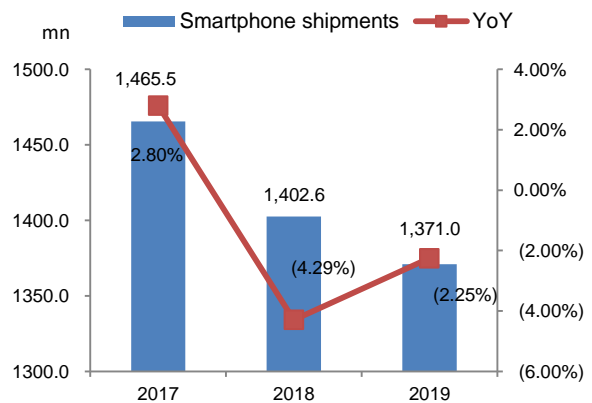
According to IDC preliminary data, global smartphone shipments lowered by 11.7% YoY in 1Q20 to 275.8mn. The smartphone shipments were affected by COVID-19 with the shutdown of production facilities, supply chain disruptions, and consumption decline. Many countries were under lockdown which disabled business activities and purchases. The business environment is recovering in 2Q20 in China. The 5G smartphone shipments reached 24.1mn in 1Q20, which surpassed the overall 5G shipments in 2019 at 18.7mn.

Exhibit 1: Quarter smartphone shipments



Source(s): IDC

Exhibit 2: Yearly smartphone shipments



Source(s): IDC

Exhibit 3: Smartphone shipments in 1Q20

mn	Shipments	YoY growth	Market share
Samsung (5930 KS)	58.3	(18.9%)	21.1%
Huawei	49.0	(17.1%)	17.8%
Apple (AAPL US)	36.7	(0.4%)	13.3%
Xiaomi (1810 HK)	29.5	6.1%	10.7%
Vivo	24.8	7.0%	9.0%
Others	77.5	(17.2%)	28.1%

Remarks: Data are preliminary and subject to change

Source(s): IDC (Quarterly mobile phone tracker, April 29, 2020)



Peer Comparison

AAC's comparative peers in the market include Goertek (002241 CH) and Luxshare (002475 CH). AAC is more dependent on Apple compared to its peers – revenue of Goertek and Luxshare are more dependent on Android smartphone makers. Compared with other competitors, AAC recorded the weakest growth in revenue (-1.4%) and net profit growth (-41.5%) in 2019.

The Company's ROAE was lower than Luxshare but higher than Goertek in 2019. In 2020, AAC is undergoing a transition period marked by (1) a shift to high- end components, especially those for the 5G, (2) and increasing revenue contribution from Android smartphone makers.

Exhibit 4: Financial comparison table of AAC, Goertek and Luxshare in 2019

	AAC	Goertek	Luxshare
Revenue (YoY growth)	(1.4%)	48.0%	74.4%
Net profit (YoY growth)	(41.5%)	47.6%	73.1%
Net profit margin	12.4%	3.6%	7.5%
ROAA	6.9%	4.0%	11.0%
ROAE	11.6%	8.2%	26.3%

Source(s): Companies



Company Overview

Company introduction

AAC Technologies (the “Company” or “AAC”) was founded in 1993. Listed on HKEx in 2005, AAC primarily engages in producing electronic components for various electronic devices, including smartphones, tablets, wearables, PCs, and notebooks, and provides related application solutions.

Exhibit 5: AAC’s milestones

Date	Events
1993	Founded in China
1998	Mass production of transducers
2005	Listed on Hong Kong Stock Exchange with code (2018 HK)
2009	Acquired ISQR (a Japanese lens designer)
2010	Invested in Kaleido
2011	Invested in MEMS Tech (a Singapore MEMS Die design)
2011	Commenced comprehensive RF business
2015	Acquired Wispry to enhance RF antenna and solution capability
2015	Commenced 3D glass business
2016	Being selected as a constituent of the Hang Seng Index

Source(s): the Company

Diversified electronic components

AAC produces diversified electronic components, and has outstanding researching ability and solid connections with major customers. AAC’s products can be classified into two major groups: acoustic and non-acoustic.

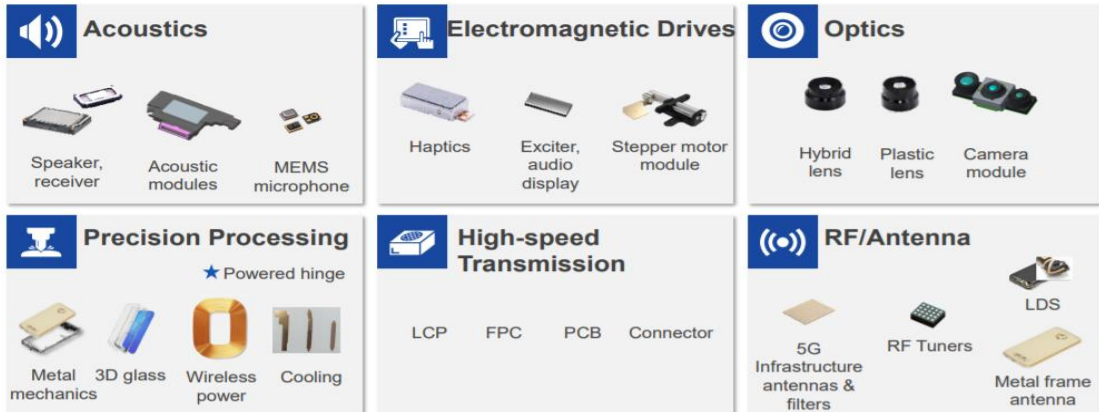
The acoustic products include speakers, receivers, and microphones, while the non-acoustic products include haptics vibrators, RF/antennas, and optical lenses. AAC offers three-tier solutions to customers. AAC’s headquarters is located in Nanshan, Shenzhen, China; it has 15 R&D centers in China, USA, Finland, Denmark, South Korea, Japan and Singapore. The Company has strong R&D capability with over 4,800 patents. The Company is included in most of the tracking indices, which include the Hang Seng Mainland 100 Index, Hang Seng Composite Large Cap Index, Hang Seng Composite Industry Index (Information Technology), Hang Seng IT Hardware Index, MSCI China Index, and FTSE Hong Kong Index. ACC’s customers include many well-known smartphone producers.



Developed networks and productivity

Many smartphone makers are adding new functions and features to attract customers' attention, which in turn will boost the demand for dynamic components, haptics, and acoustic products. AAC offers tailor-made products and provides application solutions to suit customers' need in different electronic products.

Exhibit 6: AAC's products



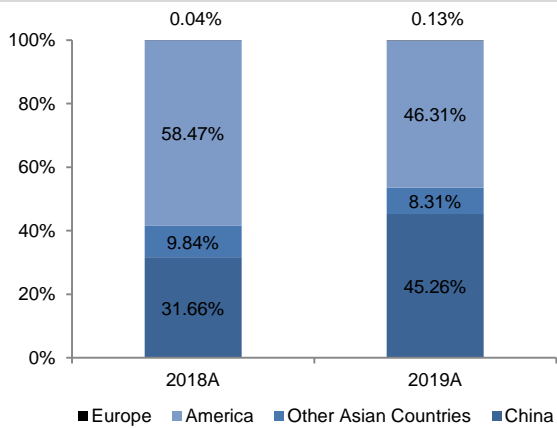
Source(s): the Company

The Americas contributed to over 46.3% of the Company's revenue in 2019

In 2019, the Americas accounted for 46.3% of total revenue, compared to 45.3% from China, 8.3% from other Asian countries and 0.1% from Europe. Since Apple (AAPL US) is AAC's major customers, shipment of iPhone will affect the Company's financial performance. Revenue contribution from the Chinese market increased from 31.7% in FY18 to 45.3% in FY19 due to rising demand from the Chinese smartphone makers. In the coming future, AAC is expanding its customer range to include more Android smartphone makers, which will raise the revenue income from the Chinese market. The Chinese branded smartphone makers are growing their market shares in recent quarters and this would help AAC grow revenue from China. The dynamic components business generated the most revenue for the Company. AAC is also developing other new businesses, such as optics and antenna, which will reduce the dependency and reliance on dynamic component business.

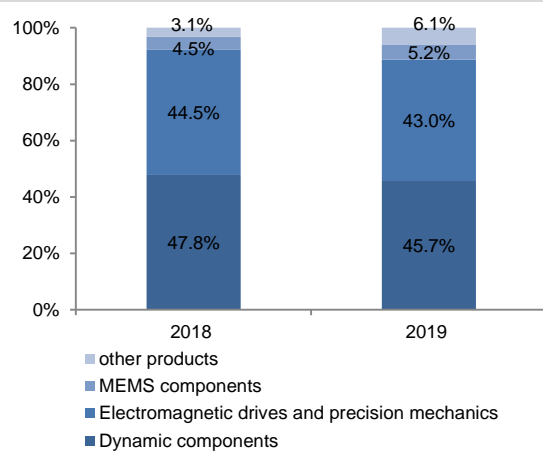


Exhibit 7: AAC's revenue breakdown by region



Source(s): the Company

Exhibit 8: AAC's revenue breakdown by product



Source(s): the Company



Business Overview

Product and Services

AAC's businesses can be divided into several segments including (1) Dynamic components; (2) Electromagnetic drives and precision mechanics; (3) Micro Electro-Mechanical Systems (MEMS) components; and (4) Other products.

(1) Dynamic components

AAC's dynamic components business mainly produce components related to acoustic that are being used as speakers in electronic devices, such as smartphones, tablets, wearable devices, etc.

In 2018, AAC has achieved a major breakthrough in acoustic technology with the launch of Super Linear Structure SLS speakers. The SLS speakers compromise high sound quality with miniaturized design. The smartphones makers are seeking thinner and smaller electronic speakers to improve user experiences and design aesthetic. Users are also looking for smartphones with better speaker quality and stereo systems that are water-/dust-proof.

Affected by reduced global smartphone shipments and extended cycles for specification innovations and upgrades in 2019, both ASP and volume of the Company's acoustic business were under pressure. AAC's FY19 revenue from dynamic components dropped 5.8% YoY. We forecast the segment's revenue to edge up by 2.5%/ 5.0%/ 4.5% in 2020-22E.

(2) Electromagnetic drives and precision mechanics

In this business segment, AAC produces haptics products such as linear motors and ceramic motors to perform vibrating functions for various electronic products. Haptics have become the necessities for smartphones nowadays in order to provide feedback and response to users. There are many smartphone applications supporting 3D Touch functions which included online games, office documentation and sports-related functionalities to improve user experiences and refresh application features. There is a wide range of applications that use these tiny vibration motors to offer vibration alert notifications and haptic feedback.

In 2019, the Company's electromagnetic drives and precision mechanics components revenue was affected by decline in ASP and shipment volume due to market competition and trade dispute. The Company is expanding its customer base with an increasing proportion of Android smartphone makers. Many latest smartphones are equipped with high-end components to improve user experience. We forecast AAC's electromagnetic drives and precision mechanics revenue to grow by 8.0%/ 11.0%/ 8.0% in 2020-22E.

(3) MEMS components

The Company's MEMS components are mainly related to microphones that are being used in smartphones and other electronic devices. AAC has both in-house and outsourced MEMS components. The Company is shifting its production towards in-house in a bid to boost gross margin. Recently, the Company's MEMS components are being used in smart home. MEMS components revenue grew 14% YoY in FY19. AAC is developing more Android smartphone maker customers to diversify revenue sources. We expect MEMS components revenue to grow by 9.5%/10.0%/9.0% in 2020-22E.

(4) Other products

The others business segment include electronic components related to optics, traditional microphones and headsets. AAC has started its optics business in 2018 in light of the growing demand of optical lens from smartphones. The Company has acquired equity interests in Kaleido Technology to improve its manufacturing capacity and capability in producing optical lens. Kaleido Technology is a Danish company and an industry leader in wafer-level glass molding technology. Kaleido designs and manufactures ultra-precise micro-optics products of display and imaging lenses with its proprietary precision micro-milling, and wafer-glass molding technologies. AAC is able to manufacture plastic lens, glass lens, and hybrid lens. Nowadays, smartphones are equipped with multi-camera and better resolution.

The Company has also planned for the production of high-end hybrid designs WLG lens in 2020 with an expanded production capacity to boost shipments. With demand for high-end smartphones being affected by COVID-19 pandemic, we project AAC's revenue in this segment to grow by 25.0%/19.0%/11.0% in 2020-22E.

Exhibit 9: Revenue analysis

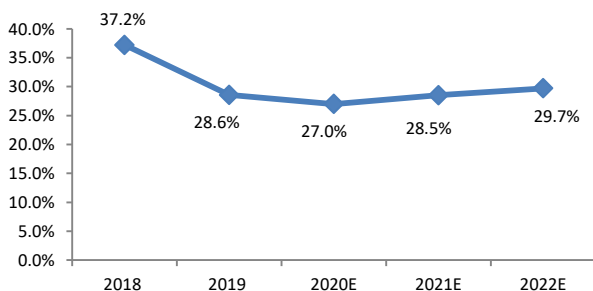
RMB mn	2018	2019	2020E	2021E	2022E
Dynamic components	8,674.642	8,167.276	8,371.458	8,790.031	9,185.582
YoY growth	(9.4%)	(5.8%)	2.5%	5.0%	4.5%
Electromagnetic drives and precision mechanics	8,073.135	7,694.198	8,309.734	9,223.805	9,961.709
YoY growth	(23.1%)	(4.7%)	8.0%	11.0%	8.0%
MEMS components	814.438	928.524	1,016.734	1,118.407	1,219.064
YoY growth	(3.9%)	14.0%	9.5%	10.0%	9.0%
other products	568.938	1,093.759	1,367.199	1,626.967	1,805.933
YoY growth	190.6%	92.2%	25.0%	19.0%	11.0%
Total Revenue	18,131.153	17,883.757	19,065.124	20,759.209	22,172.288
YoY growth	(14.1%)	(1.4%)	6.6%	8.9%	6.8%

Source(s): the Company, ABCI Securities estimates

Gross profit margin is expected to lower by 1.6ppt in 2020E

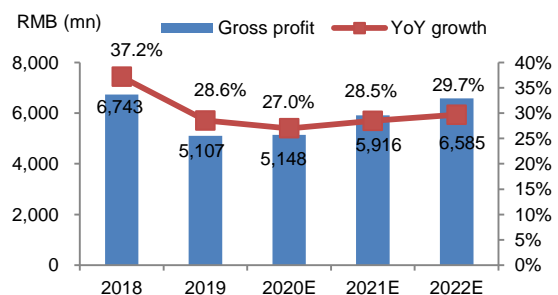
Affected by market competition and slower components demand in 2019, AAC's gross profit margin was 28.6% in FY19, down 8.6 ppt YoY, due to market competition and weaker-than-expected smartphone shipments growth. Affected by COVID-19, fierce market competition and uncertain global economy, we forecast the Company's gross margin to lower by 1.6ppt YoY to 27.0% in 2020E.

Exhibit 10: AAC's gross profit margin



Source(s): the Company, ABCI Securities estimates

Exhibit 11: AAC's gross profit and growth



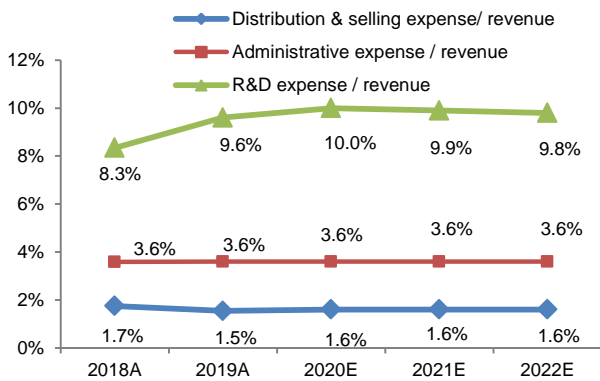
Source(s): the Company, ABCI Securities estimates

R&D expense (RMB1.7 bn), as a percentage of revenue in FY19, was 9.6%, up 1.3 ppt YoY, due to higher expenses for 5G technology development and innovations. We estimate AAC will further increase its research expenses to launch the 5G antenna and other components in 2020 to gain market share. We forecast R&D expense, as a percentage of revenue, to be 10.0%/9.9%/9.8% in 2020-22E.

Net profit to grow at a CAGR of 10.8% in 2019-22E

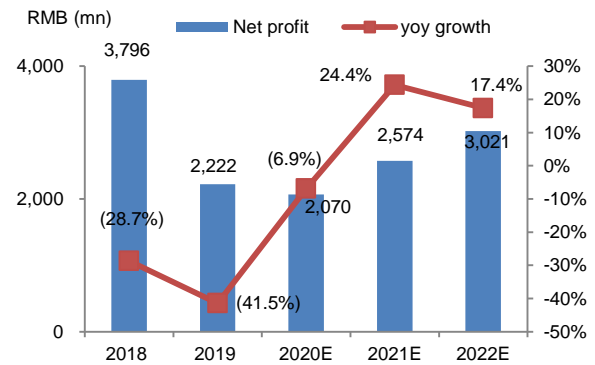
AAC's net profit dropped by 41.5% YoY in 2019 with sluggish smartphone shipments, fierce market competition, and the delay in purchase for the 5G products in 2020. Due to the pandemic and a weak global economy, we expect net profit to drop 6.9% YoY in 2020E. Higher R&D expenses and weak revenue growth are expected to affect profit growth in 2020. We forecast net profit margin to lower by 1.5ppt YoY to 10.9% in 2020E.

Exhibit 12: AAC's operating costs as a percentage of revenue



Source(s): the Company, ABCI Securities estimates

Exhibit 13: AAC's net profit and YoY growth



Source(s): the Company, ABCI Securities estimates



Valuations

Recommend HOLD with TP at HK\$41.0

We derive the Company's TP at HK\$ 41.0 based on DCF model analysis (WACC: 11.9%; perpetuity growth rate: 3%). The TP represents 21.6x/ 17.3x FY20E/ FY21E P/E. We initiate AAC with **HOLD**. The H-shr peers are trading at 13.9x20E P/E while the A-shr peers are trading at 31.2x 20E P/E.

Exhibit 14: Peer Comparison Table

Ticker	Price*	P/E				P/B				ROE	ROA	EV/EBITDA	
		19A	20E	21E	22E	19A	20E	21E	22E	20E	20E	20E	
HK Listed													
FIH Mobile Ltd	2038 HK	0.96	n.a.	8.1	6.5	n.a.	0.4	0.5	0.4	n.a.	4.9	1.1	0.3
AA Technologies	2018 HK	41.75	17.5	16.7	12.7	11.1	2.0	1.9	1.7	1.6	11.6	6.7	8.8
Comba Telecom	2342 HK	3.14	50.3	22.9	16.0	16.8	2.2	1.9	1.8	1.7	6.1	2.1	n.a.
Q Technology	1478 HK	10.26	18.1	14.5	11.7	10.5	3.5	3.0	2.4	2.1	22.0	6.0	9.2
Cowell E Holdings	1415 HK	1.56	8.0	7.6	5.8	5.5	0.7	0.7	0.7	0.7	10.6	5.9	1.7
Average			19.8	13.9	10.6	11.0	1.5	1.6	1.4	1.5	11.0	4.4	5.0
A-shr													
Goertek Inc	002241	23.35	48.4	32.4	24.5	20.3	3.8	3.5	3.1	2.7	10.9	5.3	16.6
Lens Technology	300433	19.42	29.3	22.6	18.1	14.0	3.5	3.2	2.7	2.2	15.7	7.9	10.7
Luxshare Precision	002475	50.20	53.8	38.6	28.8	23.0	12.5	9.4	7.2	5.6	25.8	11.5	26.0
Average			43.8	31.2	23.8	19.1	6.6	5.4	4.4	3.5	17.5	8.2	17.8

*Based on closing price on June 4, 2020

Source(s): Bloomberg



Risk factors

Fierce competition in the electronic component sector

The electronic component sector in China is highly competitive with numerous companies (such as Goertek and Luxshare). AAC may face pressure in product shipments and ASP if competition intensifies.

Smartphone shipments slows down may affect the Company's revenue growth

As the Company's revenue is highly related to the smartphone shipments, any downward pressure to smartphone shipments may affect electronic components demand. The global smartphone recorded a YoY decline in 1Q20.

Business may be affected by trade tensions

If there is any international trade tensions or disputes, the Company's product shipments may be affected.

COVID-19 affected smartphone shipments

The COVID-19 pandemic, is still rampant in non-China regions, which may further affect global economic activities and smartphone demand. If the pandemic further damages the global economy, it may severely hamper smartphone shipments in 2020.

Our forecasts may deviate from actual results

We make our forecasts relies on a number of assumptions, such as shipment and ASP and estimates. The actual results may deviate from our estimates.

Generated over 46.3% revenue income from America in 2019

AAC generated most of its revenue from the Americas. Reduced revenue from the Americas will affect the Company's financial earnings.



Financial Statements

Consolidated income statement (2018A-2022E)

FY Ended Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
Total revenue	18,131	17,884	19,065	20,759	22,172
Cost of goods sold	(11,388)	(12,777)	(13,918)	(14,843)	(15,587)
Gross profit	6,743	5,107	5,148	5,916	6,585
Other income	237	247	254	262	270
R&D costs	(1,512)	(1,717)	(1,907)	(2,055)	(2,173)
Distribution and selling expenses	(317)	(275)	(305)	(332)	(355)
Administrative expenses	(650)	(643)	(685)	(746)	(797)
Others	29	19	21	22	23
Exchange (loss) gain	(2)	63	44	40	36
Finance cost	(218)	(248)	(193)	(150)	(119)
Profit before tax	4,310	2,552	2,377	2,956	3,470
Tax	(514)	(330)	(307)	(382)	(449)
Net profit	3,796	2,222	2,070	2,574	3,021
EPS (RMB)	3.106	1.836	1.713	2.130	2.500

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2018A-2022E)

As of Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
PPE	15,440	16,911	11,235	12,111	13,030
Others	2,444	2,489	9,656	9,538	9,424
Total non-current assets	17,884	19,400	20,891	21,648	22,455
Cash & cash equivalents	4,126	5,512	4,874	5,513	6,598
Inventories	3,319	3,664	3,481	3,307	3,141
Others	4,539	5,631	5,076	4,577	4,129
Total current assets	11,985	14,808	13,431	13,397	13,868
Total assets	29,869	34,207	34,322	35,046	36,323
Bank borrowings	3,493	1,876	1,688	1,520	1,368
Trade and note payable	4,548	5,474	5,748	6,035	6,337
Others	276	361	457	463	475
Total current liabilities	8,317	7,711	7,894	8,018	8,179
Bank borrowings	2,428	3,850	2,695	1,886	1,320
Others	190	3,286	3,130	2,992	2,871
Total non-current liabilities	2,618	7,136	5,825	4,879	4,192
Total liabilities	10,935	14,846	13,719	12,897	12,371
Shareholders' equity	18,934	19,351	20,593	22,137	23,939
Minority interests	0	10	10	11	12
Total equity	18,934	19,361	20,603	22,148	23,951

Source(s): Company, ABCI Securities estimates



Consolidated Cash Flow Statement (2018A-2022E)

As of Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
Operating profit before change in working capital	4,310	2,552	2,377	2,956	3,470
Change in working capital	1,149	(728)	1,007	956	912
Others	1,330	2,019	372	275	198
Operating cash flow	6,789	3,843	3,755	4,187	4,581
CAPEX	(1,086)	(1,268)	(1,332)	(1,398)	(1,468)
Others	(2,513)	(2,126)	(65)	(58)	(51)
Investing cash flow	(3,599)	(3,395)	(1,396)	(1,457)	(1,519)
Bank Loan	(555)	(263)	(1,342)	(977)	(718)
Others	(2,692)	518	(1,010)	(1,168)	(1,315)
Financing cash flow	(3,247)	255	(2,353)	(2,146)	(2,033)
Net increase in cash & cash equivalents	(57)	704	6	585	1,029
Cash & cash equivalents at beginning of year	4,034	4,059	4,814	4,874	5,513
Effect of changes in foreign exchange rate	81	51	53	55	56
Cash & cash equivalents at end of year	4,059	4,814	4,874	5,513	6,598

Source(s): Company, ABCI Securities estimates

Financial ratios (2018A-2022E)

As of Dec 31	2018A	2019A	2020E	2021E	2022E
Gross profit margin	37.2%	28.6%	27.0%	28.5%	29.7%
Net profit margin	20.9%	12.4%	10.9%	12.4%	13.6%
ROAA	12.5%	6.9%	6.0%	7.4%	8.5%
ROAE	20.8%	11.6%	10.4%	12.0%	13.1%
Costs ratio					
% to revenue					
R&D costs/ revenue	8.3%	9.6%	10.0%	9.9%	9.8%
Distribution and selling expenses/ revenue	1.7%	1.5%	1.6%	1.6%	1.6%
Administrative expenses/ revenue	3.6%	3.6%	3.6%	3.6%	3.6%
YoY growth					
Revenue	(14.1%)	(1.4%)	6.6%	8.9%	6.8%
Gross profit	(4.1%)	(8.6%)	(1.6%)	1.5%	1.2%
Net profit	(28.7%)	(41.5%)	(6.9%)	24.4%	17.4%

Source(s): Company, ABCI Securities estimates



Disclosures

Analyst Certification

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Definition of equity rating

Rating	Definition
Buy	Stock return rate \geq Market return rate (10%)
Hold	- Market return rate (-10%) \leq Stock return rate < Market return rate (+10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2008 (HSI total return index 2008-19 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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