CHINA

002292 CH	Outperform
Price (at 13:59, 15 Feb 2018 GMT)	Rmb10.87

Valuation	**Rmb**	**13.00-14.00**
- PER		
12-month target	**Rmb**	**13.58**
Upside/Downside	**%**	**+24.9**
12-month TSR	**%**	**+24.9**
GICS sector		
Consumer Durables & Apparel		
Market cap	**Rmbm**	**14,752**
Market cap	**US$m**	**2,325**
Free float	**%**	**63**
30-day avg turnover	**US$m**	**19.4**
Number shares on issue	**m**	**1,357**

Investment fundamentals

Year end 31 Dec		2016A	2017E	2018E	2019E
Revenue	m	3,360.7	3,641.5	3,992.4	4,733.9
EBIT	m	446.1	257.1	498.7	633.2
EBIT growth	%	-0.2	-42.4	94.0	27.0
Reported profit	m	498.4	82.4	472.6	670.6
EPS rep	Rmb	0.38	0.06	0.35	0.49
EPS rep growth	%	-1.5	-83.5	452.8	41.9
PER rep	x	28.5	172.5	31.2	22.0
Total DPS	Rmb	0.00	0.00	0.00	0.00
Total div yield	%	0.0	0.0	0.0	0.0
ROA	%	6.8	3.1	5.9	7.0
ROE	%	12.7	1.7	9.3	11.9
EV/EBITDA	x	29.7	41.2	25.2	20.5
Net debt/equity	%	14.7	13.8	6.3	-1.4
P/BV	x	3.0	2.9	2.8	2.5

Source: FactSet, Macquarie Research, February 2018
(all figures in Rmb unless noted, TP in CNY)

Analyst(s)
Marcus Yang
+86 21 2412 9087 marcus.yang@macquarie.com
Wendy Huang, CFA
+852 3922 3378 wendy.huang@macquarie.com
Ivy Luo, CFA
+852 3922 1507 ivy.luo@macquarie.com
Frank Chen
+852 3922 1433 frank.chen@macquarie.com

21 February 2018
Macquarie Capital Limited

Alpha Group (A-Share)

The power of IP

We initiate coverage of Alpha Group, the leading kids and comics IP company in China, with an Outperform rating and TP of RMB13.58. We like the company's rich IP resources and its strategy to transform into an IP licensing company from a toy manufacturer. The over-diversification in 2015-2016 has eroded its earnings in 2016-17 and sent its valuation to a trough of 31.2x18E PER (vs historical average of 42x). We think that suggests a decent buying signal in light of the inflection point where Alpha sits, thanks to strategy realignment. Our TP of RMB13.58 is based on a 39x 18E PE, or 25% upside.

From toy manufacturing to entertainment & licensing

The company is at its initial stage to transform itself into an IP licensing company from a toy manufacturer. Its key IP, Pleasant Goat and Big Big Wolf (喜羊羊与灰太狼), is one of the best-known Chinese cartoon series and its newly launched K12 IPs Super Wings (超级飞侠) also has gained wide popularity among Chinese kids. In 2017, Alpha had a mere 2.9% of revenue from IP licensing, which is compared to international companies such as Hasbro's 10% and eOne's 51%. We expect that figure to expand to 4.4% in 2020 and help improve the gross margin of Alpha by ~1ppt a year. The licensing is not just among K12 products, but also mass market products, e.g. FMCG, F&B, hotels, given the fame of the IPs.

Comic IPs geared to rising demand from OTT platforms

Alpha owns U17, the second largest online comic platform in China. That is geared to the rising original IP demand from iQiyi/Youku/Tencent Video, which are keen to increase original TV drama series to attract subscribers and lower costs. We see comic IP-based TV dramas in China jumping to 13 series in 2017 from 1-2 series in 2015-16. Along with regulators' encouragement in content based on original IPs, we see growing value to quality IP libraries such as U17.

K12 IPs benefit from lift of one-child policy

New births in China should finally see a 3% CAGR from 2015-25E, estimated by NBS, after a chronic 1.5% decline since 1990, thanks to the lift of the one-child policy. Alpha Group, which has around 60% sales exposure in K12 and 30% in juvenile products, will benefit directly. Based on the company's plan, there will be more K12 educational products based on its key IPs to come. They also aim to prudently expand the IP-based indoor kids' playground business at a low cost by partnering with mall developers. Its home-grown IPs fit well with the government's attempt to cultivate domestic brands in culture fields.

Strategy realigned to focus on core IPs; initiate with OP

The company realigned its strategy to focus on core IPs from 2018, after suffering from over-diversification in 2015-17, which has sent its valuation to a trough of 31x 18E PER (vs historical average of 42x). Our TP is based on a 39x PER to factor in the execution risk of its new strategy. We expect the earnings to return to a growth trajectory in 2018 with a 185% CAGR in 2017-19E, after a 42% decline in 2014-17E. Initiate on the company with an Outperform rating.

Risks: execution risk, competition from foreign brands, over-diversification

Inside

IPs hub for kids and teens

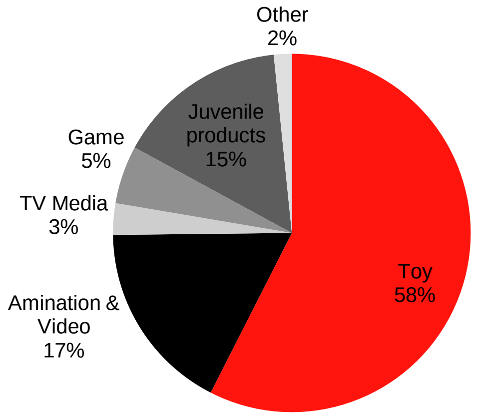
Company profile

Alpha group is a leading animation culture group headquartered in Guangzhou, China.

In 2016, about 58% of its sales were generated from sales of toys, 15% from Juvenile products (mainly baby carriers and car seats), 17% from the amination & video business, and 10% from others including movie and game businesses.

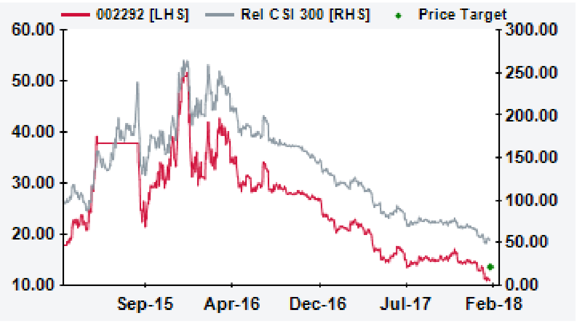
The company was founded in 1993 under the name of GuangDong Audi Toy Industry Co., Ltd (广东奥迪玩具实业有限公司). It was then renamed Alpha Group Co., Ltd. in 2016.

Fig 1 Alpha Group sales split, 2016



Source: Company data, Macquarie Research, February 2018

Fig 2 002292 CH rel CSI 300 performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, February 2018 (all figures in Rmb unless noted, TP in CNY)

The power of IP

Initiate with Outperform and TP of Rmb13.58

- We initiate on Alpha Group, the leading kids and comics IP company in China, with an Outperform rating and TP of RMB13.58. We like the company's rich IP resources and its strategy to transform into an IP licensing company from a toy manufacturer.
- The over-diversification in 2015-2016 has eroded its earnings in 2016-17. The company reported its 2017 preliminary results on 13 February, with a 4Q17 net loss of RMB233m, primarily due to the one-off write-offs on movies and online game businesses (totalled around RMB300m). The full year earnings thus came in 82% below consensus. That has sent its valuation to the lower band of a 31x 18E PER (vs its historical average of 42x, or 23x-77x). We think that suggests a buying signal thanks to the company's strategy realignment to focus on the core IPs' cultivation and monetization in 2018.
- Our 2018-19E earnings forecasts are 22% and 10% below Wind consensus, primarily because consensus hasn't been updated since Alpha's release of preliminary 4Q17 results on 13 February.
- Alpha Group's 31x18E PER and 10% 18E ROE is compared to the average 58x for Chinese IP companies (which is mainly being boosted by the lofty valuation of China Literature) and 7% ROE.
- Our TP of RMB13.58 is based on a 39x 18E PER, or 25% upside. This is compared to its 5-year average PER of 42x. We expect Alpha Group's earnings to grow by a 185% CAGR in 2017-19E off the trough in 2017, compared to a -42% CAGR in 2014-17E.

Risks to our view

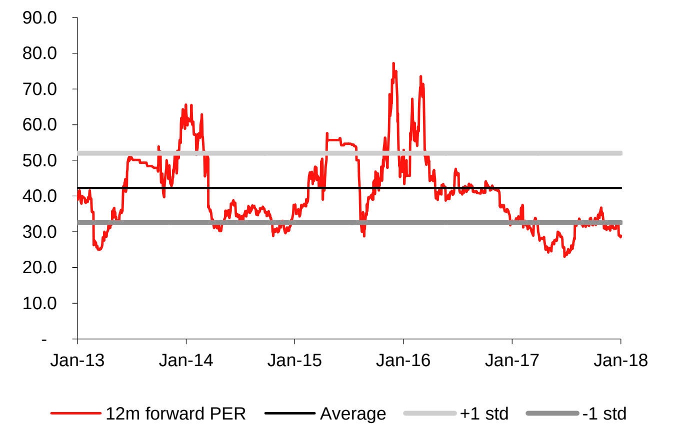
- **Execution risk.** Although Alpha Group has a good track record to cultivate new IPs, e.g. Super Swings since 2015, the company hasn't proven its ability to resume the popularity of its existing IPs, e.g. 'The Pleasant Goat and Big Big Wolf'. It is the company's strategy to focus on these major IPs from 2018, and we believe the execution will be the key risk for the group.
- **Competition from foreign brands.** The rise in the middle class not only benefits local brands but also foreign ones. Peppa Pig, one of the leading pre-school brands in key territories such as the US and the UK, has gained significant traction in China recently. It has surpassed 24bn views across iQiyi, Youku, Tencent and LeEco since launch in 2016. Our current view is that the fast-growing China market and the support from the Chinese authorities on local brands will allow both foreign and domestic IPs to grow in tandem, while any significant cannibalization from foreign brands will be a risk to our view.
- **Over-diversification.** The excessive acquisitions on new IPs and diversification into non-core businesses such as movies and online games has eroded the company's profits in 2017. We see milder risk on this front going forward after the company's new strategy to divest the non-core business and to focus on core IPs. However, there are still some new initiatives such as the kids' playground business despite Alpha Group's prudent stance. The company will partner with mall developers to enjoy low rent costs in exchange for traffic contributions, and will expand slowly initially to test market feedback.

Fig 3 A-share upstream media comp sheet

Company Name	Bloomberg Code	Price (Local $)	Macq Rating	TP (Local $)	Market Cap (US$mn)	PE (x) 2018	PE (x) 2019	EV/EBITDA (x) 2018	EV/EBITDA (x) 2019	ROE (%) 2018	ROE (%) 2019
Alpha Group	002292 CH	10.87	Outperform	13.58	2,326	31.2	22.0	24.7	19.5	9.3	11.9
IP											
iReader	603533 CH	32.31	NR	NR	2,043	62.7	44.7	52.5	37.9	17.9	19.5
ChineseAll Digital Publishing	300364 CH	9.93	NR	NR	1,114	29.8	nmf	19.6	nmf	7.3	nmf
China Literature	772 HK	76.05	NR	NR	8,812	63.1	40.5	47.9	30.6	6.4	9.4
Subtotal Average						**51.9**	**42.6**	**40.0**	**34.2**	**10.5**	**14.5**
Film production											
Enlight Media	300251 CH	12.07	NR	NR	5,584	32.8	26.7	32.3	25.6	12.8	13.8
Ciwen Media	002343 CH	32.49	NR	NR	1,738	19.8	16.0	14.0	11.0	25.2	24.3
Talent	300426 CH	17.72	NR	NR	1,118	14.6	11.2	11.9	9.1	27.7	27.0
Huace	300133 CH	11.80	Outperform	17.30	3,293	26.2	20.5	21.0	16.8	10.9	12.6
Perfect World	002624 CH	29.25	Outperform	43.10	6,064	24.7	22.8	23.1	19.4	19.4	17.6
Huayi Brothers	300027 CH	9.20	NR	NR	3,789	23.5	19.0	16.4	14.0	10.4	11.4
Subtotal Average						**23.6**	**19.4**	**19.8**	**16.0**	**17.7**	**17.8**

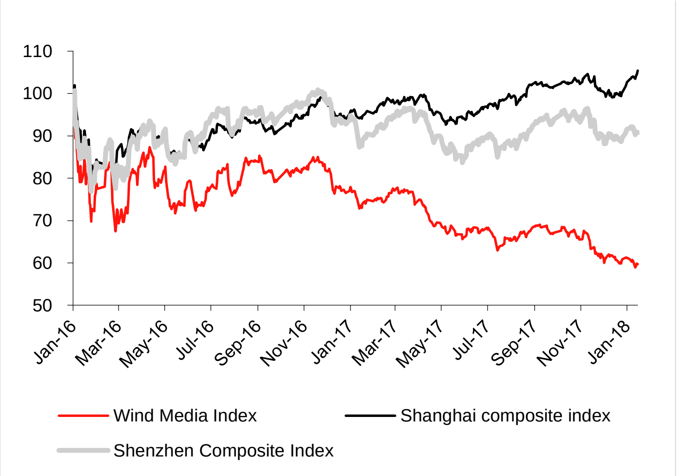
Source: Wind, Bloomberg, Macquarie Research, shares priced at 20 Feb, 2018; estimates for not rated companies are based on consensus

Fig 4 1-year forward PER - Alpha



Source: Wind, Macquarie Research, February 2018

Fig 5 China media sector underperforms Index for two years in a row



Source: Wind, Macquarie Research, February 2018

From toy manufacturing to entertainment & licensing

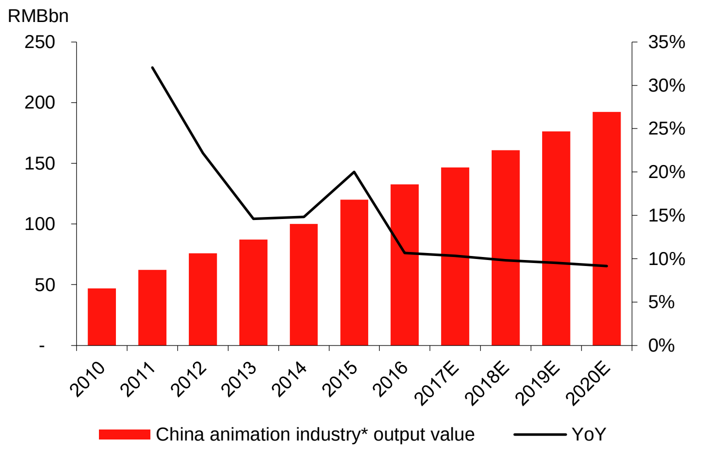
Alpha is transforming itself from a toy manufacturer to an entertainment IP licenser. We believe this is strategically right considering the company's long-term growth, the business opportunity based on the company's major IPs and the more matured environment for IP licensing in China. We expect the sales contribution from IP licensing to increase to 4.4% in 2020 from 2.9% in 2017.

Eyeing the bigger peripheral businesses

Although the Chinese animation industry began relatively late compared to countries like the U.S. and Japan, the industry has seen steady growth and is expected to reach more than RMB192bn (or US$29.5bn; including peripheral businesses) by 2020, up from RMB133bn (US$20.4bn) in 2016 (9% of global market share), or a 10% CAGR in 2016-20E, according to Abaogao, a domestic think tank. And split by each segment, animation series and comics (including mobile comics, online comics and comic publishing) accounted for only 14% and 12% of the industry's total 2016 output value, respectively, while the peripherals including licensing, theme parks and other derivatives, such as toys, made up the bulk of output value.

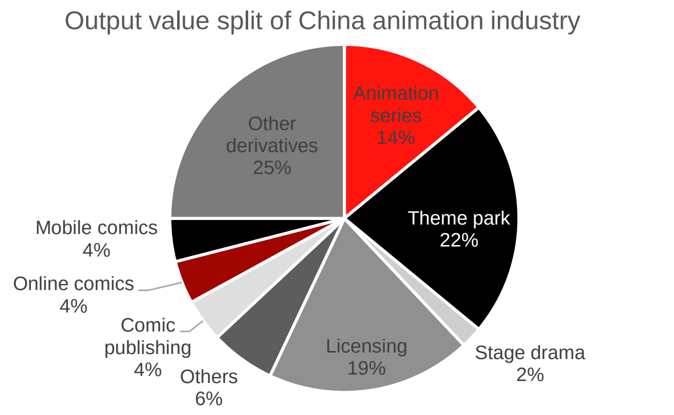
Alpha Group is the largest toy manufacture in China with a roughly 7% of market share, while we see its potential more from animation and licensing businesses going forward. Its market share in animation series is around 2%. That also implies a highly fragmented market in China, as foreign brands take a significant share of the market and given different IPs for different age group among kids. Overall, we see a highly fragmented market, especially in teenager IPs given the fast-changing taste and substantial productivity in comics. Comparatively, young children show higher loyalty and that is reflected in several long-lasting IPs.

Fig 6 China animation industry output value*



*Including peripheral businesses; Source: abaogao, February 2018

Fig 7 …peripheral business is much bigger than animation series and comics, 2016

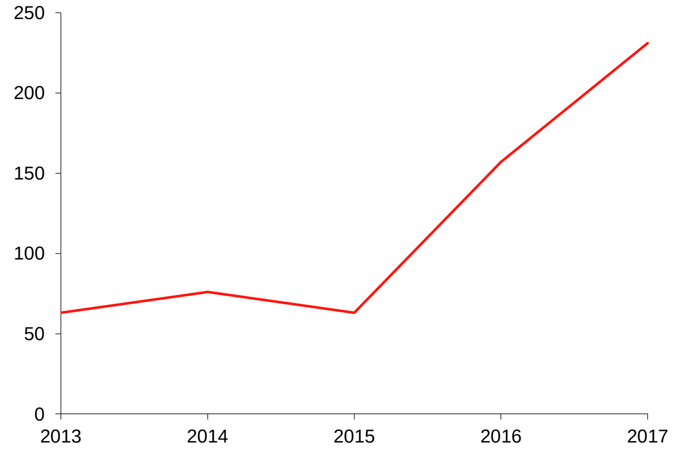


Source: abaogao, Macquarie Research, February 2018

Licensing business on the rise

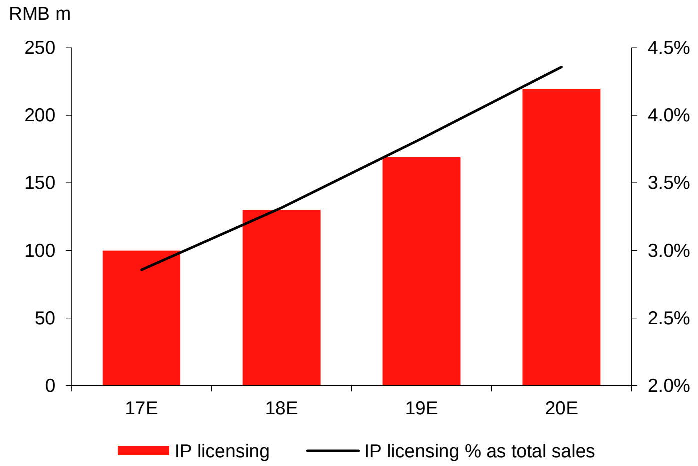
The company is at its initial stage to transform itself into an IP licensing company from a toy manufacturer. Its key IP, ‘Pleasant Goat and Big Big Wolf (喜羊羊与灰太狼)’ is one of the best-known Chinese cartoon series and its newly launched K12 IPs Super Wings (超级飞侠) also has gained wide popularity among Chinese kids. In 2017, Alpha had a mere 2.9% of revenue from IP licensing, which is compared to international companies such as Hasbro's 10% and eOne's 51%. We expect that figure to expand to 4.4% in 2020 and help improve the gross margin of Alpha by ~1ppt a year. The licensing is not just among K12 products, but also mass market products e.g. FMCG, F&B, hotels given the fame of the IP. Its licensing clients include but are not limited to: Heinz (亨氏), China Post (中國郵政), Home Inn (如家酒店) and P&G, KFC, Chow Tai Fook (周大福), Better Lift (步步高), Yili (伊利), and Mengniu Dairy (蒙牛).

Fig 8 Licensing partners - increasing



Source: Company data, February 2018

Fig 9 Licensing revenue and sales contribution to increase



Source: Macquarie Research, February 2018

Fig 10 Licensing partners of Alpha Group (examples)…

Source: Alpha Group, February 2018

Leading local IPs for K12 in China

In K12 (Kindergarten through grade 12, or ~aged 5-18, Alpha has renowned local IPs. "Pleasant Goat and Big Big Wolf (喜羊羊与灰太狼)" is the top ranked domestic animation in China, and was the only anime series with viewership of >2% in the latest ranking for 2016. The cartoon became enormously popular with Chinese schoolchildren after its debut in 2005. Cashing in on the cartoon's success, the producer made an animated feature in 2009 and generated a box office of RMB130m (US$20m) during CNY that year. It is aired on over 40 local TV stations and in 2010, Disney gained the licence to broadcast the popular children's show on their Disney Channels.

Super Wings '超级飞侠' is another major K12 IP of Alpha Group, launched in 2015. It tells the story of a group of jets flying around the world to deliver packages to kids to help solve their problems. The IP is the first trial of Alpha to gain an overseas presence. It was launched in 60 countries and had good market feedback. It received viewership of 13bn in 2 years, and won the Golden Dragon Award for Original Animation & Comic Competition (中国动漫金龙奖最佳动漫品牌奖) in Sep 2017.

Fig 11 Pleasant Goat and Big Big Wolf '喜羊羊与灰太狼'

Source: Company data, February 2018

Fig 12 Super Swings '超级飞侠'

Source: Company data, February 2018

萌鸡小队 (TBD Monji Team), the new K12 IP that Alpha Group launched in November 2017, swiftly won >1bn in viewership, on online video platforms, within two months, and has become one of the top-viewed K12 cartoons nationwide.

Besides K12 IPs, Alpha Group also acquired Baby Trend Inc., a leading worldwide manufacturer of juvenile products, for US$94 million, back in May 2016. The acquisition marks Alpha's entry into the infant category in North America, catalysing the global development plan for Alpha's juvenile business. So far, Baby Trend contributes around RMB600-700m a year and still has around 90% of sales exposure in North America. The plan is to gradually introduce this brand to the China market by leveraging Alpha Group's existing entrenched local networks.

For teenagers, the company strengthened its performance after the acquisition of the leading online comic platform "*U17*, (有妖器)" (www.u17.com). The platform enables individual content providers to create original comics and stories on the platform and share revenue from that. It monetizes subscription fees and IP licensing. The platform has already cultivated several renowned comics such as *Rakshasa Street 镇魂街* (3.1bn views) and *One hundred thousand bad jokes '十万个冷笑话*. *Rakshasa Street* was adapted into an online drama and *One hundred thousand bad jokes* was for movies.

After the massive IP acquisitions since 2013, the company said they will slow down its M&A pace and focus on the development and monetization of existing IPs from a longer term perspective.

Fig 13 Anime / TV dramas based on U17 IPs aired on Youku

Title		Views (bn)	Launch	Douban score
镇魂街2017 第一季	Rakshasa Street 2017 Season1	3,068	2/08/2017	7.6
镇魂街2016	Rakshasa Street 2016	472	28/04/2016	9.8
雏蜂 第一季	School Shock 2015	7	23/07/2015	8.4
十万个冷笑话 第三季	One Hundred Thousand Bad Jokes Season3	212	31/12/2015	8.2

Source: Youku, Macquarie Research, February 2018

Ample room to grow from global peers' experience

Compared to developed countries like the US and Europe, the IP entertainment market is relatively fragmented in China. Despite already being the leading player (only next to Disney in the China market in terms of licensing revenue in China, according to Alpha), the market share of Alpha is merely 8% in China, which is compared to a market share of ~30% for Hasbro in the North America, according to Alpha Group. That also reflects the smaller scale of Alpha Group compared to its global peers (Fig. 11).

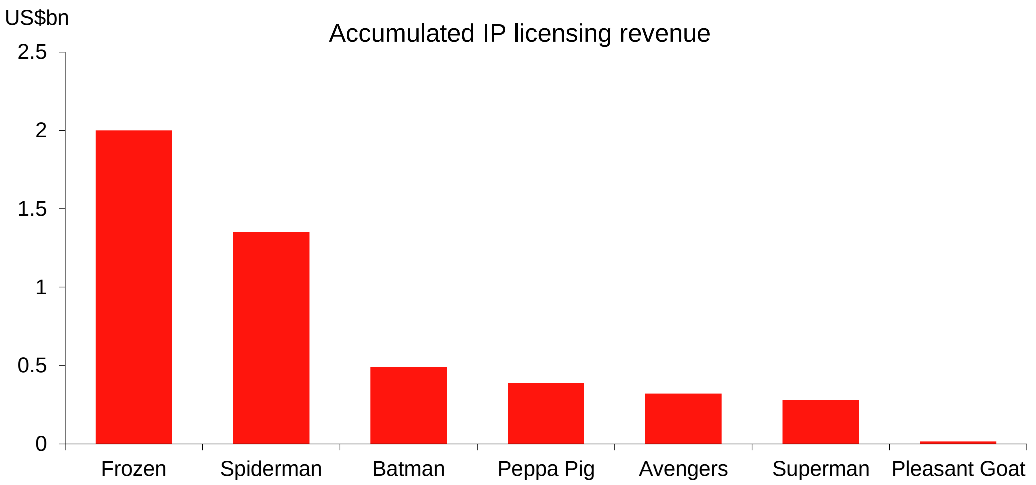
Also among peers, Alpha demonstrated low revenue contribution from licensing (refers to licensing to merchandise or hotels etc, not including IP licensing to TV series). In 2017, Alpha Group had a mere 3% of revenue from licensing its IP. Hasbro outperformed at around 10% and Entertainment One, the IP owner of Peppa Pig, had 51% of its family business sales from IP licensing (Year ended March'17). For an absolute amount, Alpha Group's RMB100m (US$15m) licensing revenue in 2017 is also compared to licensing revenue of US$59m for Peppa Pig (FY17 ended March 2017).

Fig 14 Comps with international peers

Company	Ticker	Market cap (US$bn)	2016 Sales* (US$m)	Major IPs	IP licensing revenue**	IP licensing % as of sales
Hasbro	HAS US	11.9	5,020	Nerf, My Little Pony, Transformers	US$502m	10%
Benesse	9783 JP	3.95	3,978	Shima Shima Tora no Shimajirō	NA	NA
eOne	ETO LN	1.89	1,415	Peppa Pig	US$59m	51% (for family business only)
Alpha Group	002292 CH	2.92	645	Pleasant Goat and Big Big Wolf, Super Wings	around US$15m (RMB100m)	3% (2017)

*Year ended March 2017 for Benesse and eOne; **Revenue from IP licensing represents the contracted value of licence fees, which is recognised when the licence terms have commenced and collection of the fee is reasonably assured. Source: Company data, Macquarie Research, February 2018

Fig 15 IP licensing revenue comps – Pleasant Goat far below (accumulated)



Source: Hollywood Report, Alpha Group, February 2018

The low licensing revenue also reflects the total retail sales of Alpha Group's major IPs. Total retail sales with Pleasant Goat and Big Big Wolf was RMB4.05bn (US$620m) in 2017 reportedly, and that is compared to US$1.2bn of total retail sales by Peppa Pig (FY17 ended March 2017).

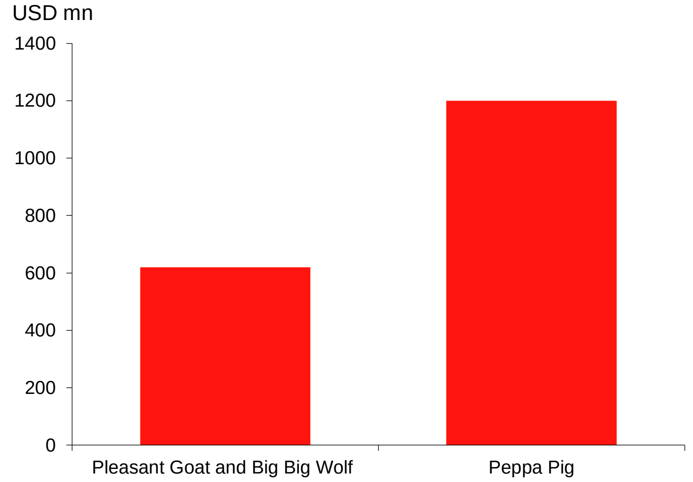
One thing in common among the global players is the positive prospect held for the China market. And we do see their increasing presence, especially in top tiered cities. However, Alpha Group stress their network advantage, especially for tier 3-4 cities, which they have a dense selling channel through long-time partnered dealers. That is compared to international brands' presence only in top-notch hypermarkets such as Walmart and Target etc. On the other hand, Alpha Group in recent years is also enhancing its selling channels to Walmart etc.

According to the Alpha, the newly added licensed partners include Heinz (亨氏), China Post (中國郵政), Home Inn (如家酒店), P&G, KFC, Chow Tai Fook (周大福), Better Lift (步步高), Yili (伊利), and Mengniu Dairy (蒙牛) in 2017.

If purely looking at the size of market and the prospect of the K12 education business of each market, there is ample room for Pleasant Goat and Big Big Wolf to grow. New births of China are set to grow at a 3% CAGR from 2015-25E, according to NBS, with increasing spending per kid. That is compared to stagnant growth in North America and Japan, where Peppa Pig and Shima Shima Tora no Shimajirō are located.

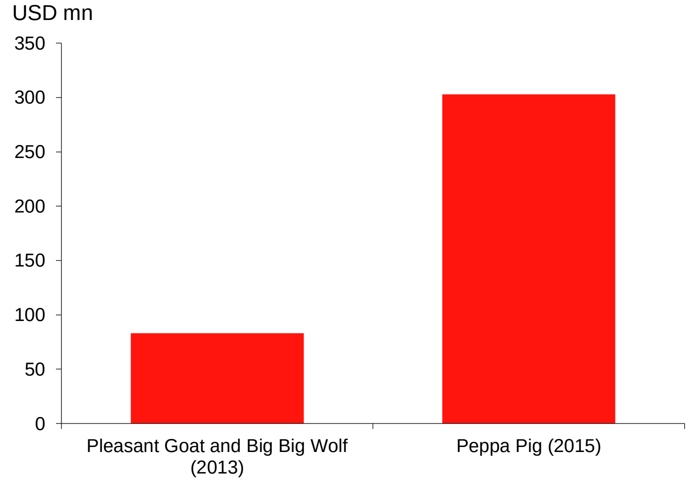
Also an interesting angle to look at the value of IPs is through the deal transactions. In 2013, Alpha Group purchased 100% of the equity of Creative Power Entertaining Limited with RMB540m (US$83m) to acquire the trademarks and copyrights related to cartoon images of the Pleasant Goat. And that is compared to the US$302m implied value of Astley Baker Davies—producers of the animated children's series Peppa Pig, back in 2015. Entertainment One paid £140 million (US$212m) for a 70% stake in this British animation studio in 2015.

Fig 16 Total retail sales generated from the 'Goat' and the 'Pig', FY2017



Source: Company data, February 2018

Fig 17 Implied IP value from acquisition



Source: Company data, news, February 2018

Piracy issues being gradually sorted

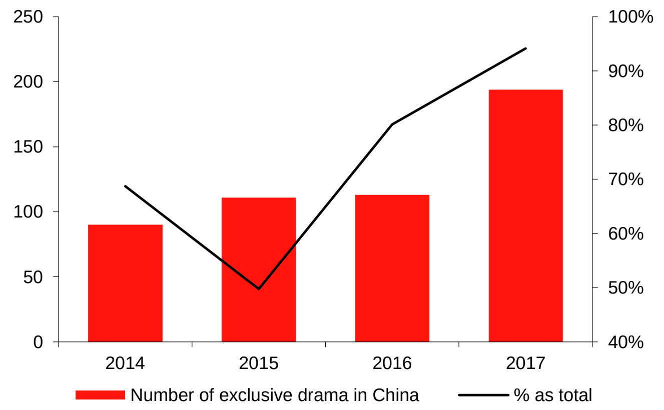
Piracy has been an issue for the toy merchandise licensing business, and thus for Alpha Group. People who are unwilling to pay can easily find other counterfeits online. However, we see measures from both the government and enterprises to crack down on fake products. The crackdown from Alibaba Group is aggressive. In the 2017 Annual Report on Intellectual Property Protection released by Alibaba on 10 January 2018, the fake rate on their site is declining. Out of every 10,000 trades, merely 1.49 were suspected as counterfeits in 2017, down from 2.1 in 2016.

Comic IPs geared to rising IP demand from OTTs

U17 – the leading comic platform could benefit

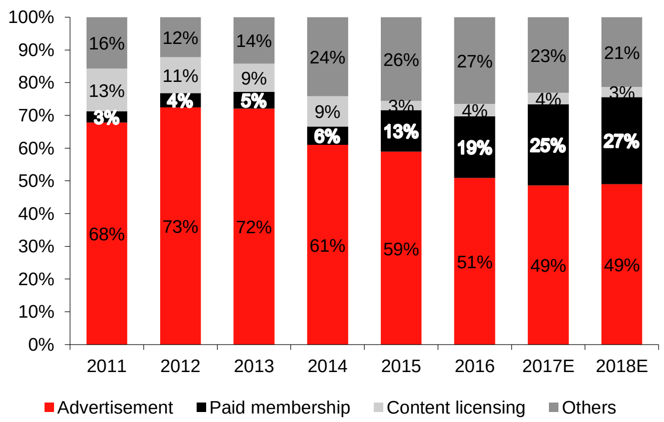
iQiyi/Youku/Tencent Video are poised to increase original and exclusive content to push subscriptions and to better control the rising cost. This is indeed the case globally, i.e. Netflix plans to spend US$8bn to make its library 50% original by 2018. In China, the leading trios set a clear strategy to enhance the original content. Tencent's management mentioned that they have established production teams internally and also have partnered or invested in over 10 leading studios in different genres. iQiyi and Youku also set a clear strategy to expand exclusive content on the platforms to attract more paid subscribers.

Fig 18 Number of exclusive drama increases in the China online video market



*For pure online drama only; not including TV dramas being aired online;
Source: SAPPRFT, Macquarie Research, February 2018

Fig 19 …exclusivity helps paid subscriptions, which are emerging to be the next driver for online video platforms in China



Source: Analysys, Macquarie Research, February 2018

From that perspective, U17, the second largest online comics platform in China (next to Tencent AC), is becoming more valuable, in our view. And in fact, the number of TV dramas based on domestic animation IPs jumped to 13 series in 2017, from merely 2 in 2016. U17 already have several successful corporations with the leading trios. Its IP licensing for "Rakshasa Street (镇魂街)" to Youku reached viewership of 3.1bn in 2017 Season1 (镇魂 2017 第一季)". It also partnered with Tencent Video on strange tales of Kaifeng (開封奇譚) and sold the IP of Die Now (端腦) to SOHU in 2H17.

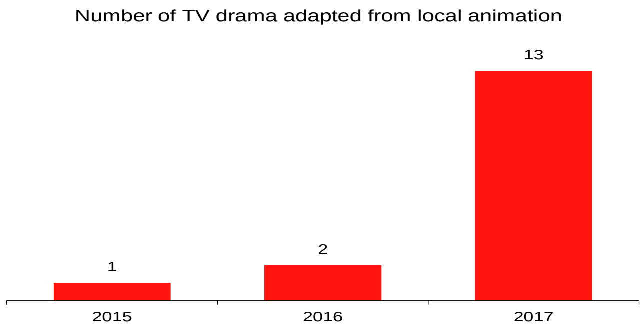
Overall, the business model is for Alpha to sell the IPs to those OTT platforms, at 10-15% of the estimated production budget, and Alpha Group itself may or may not serve as a co-investor of the film production. For instance, in the partnership with SOHU on Die Now (端腦), Alpha Group works as a pure IP seller and that price is basically negotiated between two parties, and SOHU, for example, can have two years of tenure to complete the film-making of this IP. In the case Alpha is a part of investors, the company can then also share the advertising revenue from the films.

Fig 20 TV drama based on U17 comic aired on each OTT platform

Chinese title	English title	Views (bn)	Launch	Douban score	Partnered platform
学院传说之三生三世桃花缘	TaoHuaYuan	0.28	26/01/2017	4.0	LeTV
镇魂街 2017	Rakshasa Street	3.08	2/08/2017	6.0	Youku
开封奇谈	Kaifeng	0.31	30/10/2017	6.4	Tencent Video
端脑	Die Now	0.43	6/12/2017	7.6	Sohu Video

Source: Company data, Macquarie Research, February 2018

Fig 21 TV dramas based on domestic animation IP – on the rise



Source: EntGroup, Macquarie Research, February 2018

Fig 22 Partners of U17, China's 2nd largest online comics platform (owned by Alpha Group)

Source: Alpha Group, February 2018

Animation - the wanted content of video platforms

Animation features high user stickiness compared to other genres of film. Kids can always watch the same cartoon for many times for instance. Thanks to that feature and relatively rare IPs in the animation space, iQiyi/Youku/Tencent Video, the video platforms under BAT, are keen to have animation content with quality IPs on their platform. For example, a recent deal between Alibaba and Disney will allow more than 1,000 series of Disney anime on Youku.

The animated series of Alpha Group has become a must-have on each OTT platform in China. And the price of IPs has trended upward for Alpha Group over recent years, according to the company, given the growing demand of IP content and also the improving content quality of Alpha themselves. Alpha's animations are aired on all video platforms in China.

In the animation business, Alpha sold broadcast rights to iQiyi, Youku, Tencent Video etc by the length of animation such as RMB50k-80k per minute. The price is largely determined by market mechanisms.

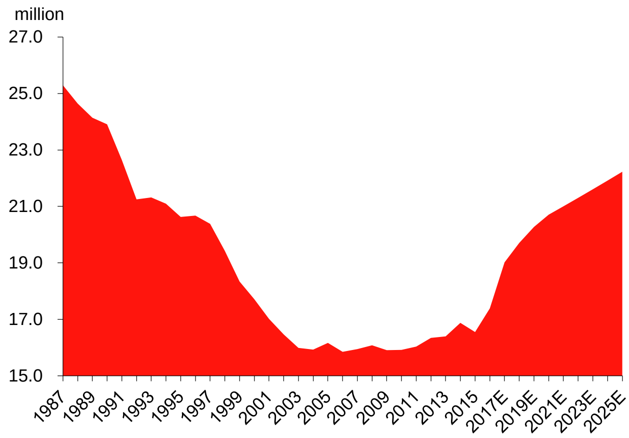
K12 IPs benefit from lift of one-child policy

We believe Alpha Group, as the owner of key K12 IPs in China, will benefit upfront from the release of the two-child policy in China. According to the company, it has around 60% sales exposure in K12 and 30% in juvenile products, and thus is set to benefit the most from the sharp increase of new births in China.

New births in China to 22m by 2025E

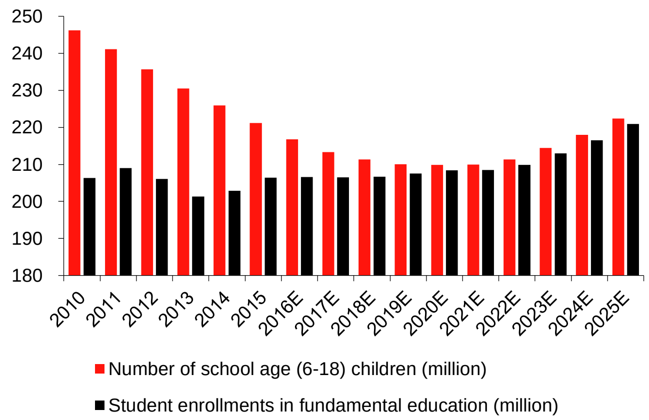
New births in China will increase by a 3% CAGR in 2015-2025 to 22.2m, according to NBS. This is after a 1.5% decline p.a. on average since 1990. On the other hand, the number of K12 students will grow at a 0.2% CAGR over 2015-2020E to 208 million by 2020E and increase at a 1.2% CAGR over 2020-2025E to 221 million by 2025E, according to NBS. This is after stagnant growth during 2010-2015 due to decades of the one-child policy.

Fig 23 Number of new births in China



Source: NBS, Macquarie Research, June 2017

Fig 24 School age children and student enrolments



Source: NBS, Frost & Sullivan, Macquarie Research, June 2017

Alpha well positioned to the tide

60% exposed to K12; 30% sales exposure to new births

Alpha Group is well positioned to the tide of increasing numbers of kids in China. It has full product lines covering kids from newborns to teenagers. It currently has 30% sales exposure to juvenile products, with two brands Baby Trend and Auby, and 60% in K12 children from toys to animation etc, with the leading IPs in the China market.

The expansion in education business

Alpha Group is planning to launch more educational products. They plan to launch a video series for kids learning English based on the IP of Super Wings and to partner with video platforms. And they aim to direct viewers who are interested to dig further into their membership pages to enjoy a systematic program with learning materials. Alpha may then charge an amount for an annual membership fee. The reason to leverage Super Wings IPs is due to its targeted age group of 2-8 and given Super Wings' English version.

In addition, they will also continue to launch Funny goat school (智趣羊學堂) and some encyclopedia animation based on the IP of The Pleasant Goat and Big Big Wolf.

Fig 25 English learning material based on 'Super Wings' IP

Source: Wind, Macquarie Research, February 2018

Expanding kids' playground business

The combination of higher spending on children, urbanization and environmental issues (like air pollution) leads to growing demand of indoor playgrounds in China. With most valuable kids IP in China, Alpha Group entered its first kids' playground in Guangdong in late 2017 and plans to add another 6-7 in 2018. While this is a way of monetization for its IPs, we hold a relatively cautious view on the playground business given there are rare successful cases in theme park-related businesses nationwide, given expensive fixed costs from rent etc and large execution risk. However, the company claims they enjoy discounts in rent, which is basically waived in the first year of operation and also fairly substantial discounts in the second year as they can help bring traffic to malls. They remained prudent in their expansion pace to avoid being over-budget in 2015-17. From the perspective of an increasing number of children, this will be another business that could benefit from the trend. But again, execution is the key risk at top of our minds.

Strategy realigned to focus on core IPs

We agree with Alpha's change in strategy from 2017 to focus on the core IP development and divest the non-core businesses such as movies and gaming. The new strategy to adopt an asset light strategy on the peripheral businesses is also right in the long term, in our view. In the near term, we expect to see cost/expense cut, thanks to the change to an asset-light strategy and also some cost cut initiatives.

Earnings erosion during 2015-2017 on over-diversification…

Alpha Group had its earnings decline by a 59% CAGR in 2015-17, largely due to the large-scaled expansion in the non-core business.

Movie businesses. The company made more than RMB100m in losses (or c. one-third of its 2017E earnings) in 2017 from its investment in movie production. We view this unfavourably considering they were investing in movies irrelevant of their IPs. Coupled with the downturn in the movie industry over the past two years, the substantial losses seemed to be inevitable.

Gaming business. Alpha diversified to the gaming business by fully acquiring two gaming developing companies. However, after being aware that they are relatively unfamiliar with this business and the fact that the shares were gradually taken by Tencent and NetEase, they chose to stand on the sidelines, spinning off the two gaming companies with stakes lowering to 49%. They still keep this business as they believe this remains a market full of opportunity for IP companies like them. However they are just no longer willing to afford a continuous fixed cost amount just to wait for the tipping point.

…but lesson learned

The company largely changed its strategy in 2017 to focus more on the core IP development. The peripheral business since then is also surrounded by its core IPs.

Asset light strategy in peripheral business. The company is now adopting an asset-light strategy for its peripheral business to lower the risk and raise the return. In movies/videos, they co-invest with other counterparts and also tend to reduce their investments, especially in the movie industry, which requires hefty capital with limited visibility. For the playground business, by partnering with mall developers, they will adopt a revenue-sharing model with limited initial cost burden from leasing etc, to keep it as light as possible. Developers will basically take care of the rent for the first year and around 50% of the rent in the second year as an exchange of incremental traffic brought up by Alpha's IPs.

No more pure movie investments. In addition to cutting the numbers of films every year, the management also mentioned that they will no longer invest in movies that are NOT based on their own IPs. Namely, all the movie investments going forward will be related to their own IPs, either from K12 IPs or from U17. And they will only adopt a co-investment strategy, and cap the investment % at 30% for the fields that they are less familiar with, e.g. TV drama. This makes more sense in our view instead of jumping on a movie fad band wagon with no links to the core businesses.

Cost reduction initiatives

The company's reform is also seen with its spending allocation.

Among the 3k+ staff in 2017 (excluding those in manufacturing), the company plans to reduce the sales people in the toys and gaming divisions in 2018, and increase staff in design and IP development. They also have a new team of 200-300 in North America to help with the IP development. There is a focus on the virtual IP cycle based on quality IPs instead of on sales and marketing.

In addition, after the completion of the rights issue in Jan 2018, the company will pay back the bank borrowing, and they aim to reduce the hefty interest expense by 40%-50% in 2018.

Financial forecast

Earnings to return to a growth trajectory with 185% CAGR in 2017-19E

Sales to grow by a 14% CAGR in 2017-19E

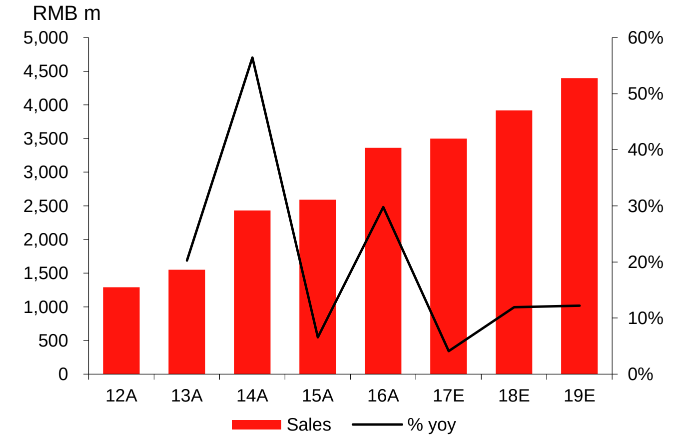
We expect Alpha Group's top-line to grow by a 14% CAGR in 2017-19E, primarily driven by the core toy and juvenile businesses, which account for 55%/28% of its 2017E sales per our estimate.

We expect 10%/18% sales growth in 2018/19E for the toy business. Toy sales dropped by 3% in 9M17 after a 17% CAGR in 2012-16. This is because of the strategy change to focus less on those en vogue but non-IP categories, e.g. yoyo or gyro. The company has decided to focus more on the toys IPs category in early 2017, which we believe is also more sensible from a long-term perspective. We believe toy sales growth in 2018 will be in part driven by the new IP 'Monji Team' launched in November 2017.

For the juvenile business, which contains brands of Baby Trend and Auby, we forecast 15%/25% growth in 2018/19E. We believe growth will be fuelled by the China domestic market, thanks to Alpha Group's push and integration into the local channels. This is to offset the relatively stagnant growth in North America, which still contributed around 90% of sales of Baby Trend in 2017. Baby Trend makes up around 60-70% of 2017 sales in the juvenile business.

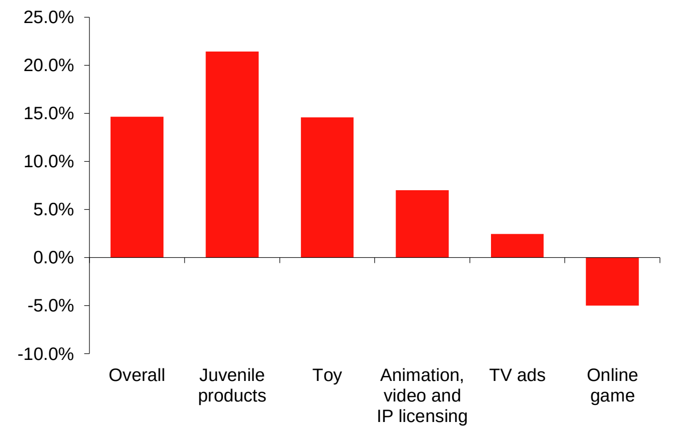
We expect sales from movies to decline in 2018-19 and that will offset the incremental sales in the IP licensing business. Net net, we expect sales of other businesses to be relatively flattish.

Fig 26 Sales & sales growth YoY, 2012-19E



Source: Wind, Macquarie Research, February 2018

Fig 27 2017-19E sales CAGR by category



Source: Wind, Macquarie Research, February 2018

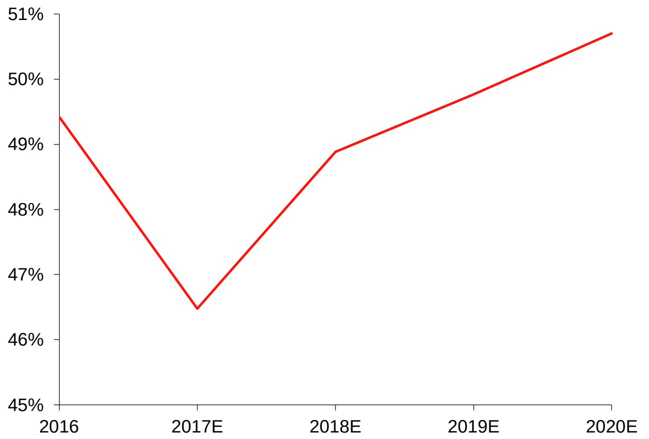
OPM to expand on lower opex %

On the margin front, we expect the gross margin to gradually improve to 49%/50% in 2018/19E, from 46% in 2017E when the company recognized an impairment loss from the movie business. This is thanks to the rapid growth in higher-margin businesses, i.e. toys (GM of 56% in 2017E) and IP licensing (GM of 90%+), though the sales contribution from the juvenile business (GM of 37% in 2017E) should also increase. For the toy business, there is also margin upside from Alpha Group's channel restructuring, as they aim to gradually lower the % sold through dealers from currently 70% to 50%, while increasing the % sold through EC and hypermarket (more direct sales). In addition, the toy category with IPs also yields better margins.

We expect SG&A % to decline from a peak of 38% in 2017 to 35% in 2018 and 2019, thanks to the company's cost initiatives, i.e. optimizing human resources from a long-term strategic perspective as well as better control of the budget in peripheral businesses.

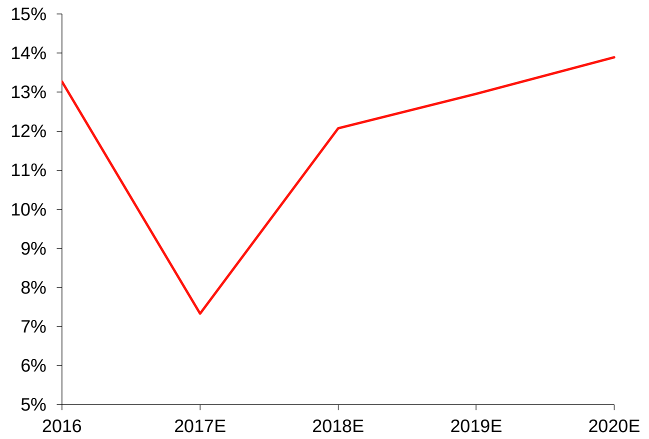
Also the interest expense is set to decline from the peak of RMB100m in 2017 after paying the bank barrowing back (after the company raised ~RMB700m from a rights issue in January 2018). All in all, we expect earnings to grow at a 185% CAGR in 2017-19E off a low base in 2017.

Fig 28 Gross margin, 2016-20E



Source: Wind, Macquarie Research, February 2018

Fig 29 EBIT margin, 2016-20E



Source: Wind, Macquarie Research, February 2018

Fig 30 Key Financial summary

YE 31 December	FY2014A	FY2015A	FY2016A	FY2017F	FY2018F	FY2019F	17E-18E	18E-19E	17-20E
Consolidated income statement (RMB mn)									
Revenue	2,430	2,589	3,361	3,641	3,992	4,734	10%	19%	14%
Cost of revenue	(1,219)	(1,207)	(1,700)	(1,959)	(2,045)	(2,383)	4%	17%	11%
Gross Profit	1,211	1,382	1,661	1,682	1,948	2,351	16%	21%	18%
GPM	50%	53%	49%	46%	49%	50%	260 bps	89 bps	443 bps
SG&A	(732)	(908)	(1,184)	(1,395)	(1,417)	(1,680)	2%	19%	11%
EBIT	456	447	446	257	499	633	94%	27%	44%
EBIT Margin	19%	17%	13%	7%	12%	13%	543 bps	89 bps	726 bps
Operating Profit (reported)	434	405	379	124	386	547	212%	42%	76%
OPM	18%	16%	11%	3%	10%	12%	627 bps	189 bps	910 bps
PBT	442	550	563	97	586	831	501%	42%	117%
Income Taxes (Credit)	(30)	(69)	(86)	(11)	(88)	(125)	719%	42%	141%
Net Income to parent	428	489	498	82	473	671	474%	42%	114%
NPM	18%	19%	15%	2%	12%	14%	958 bps	233 bps	1267 bps
EBITDA	507	497	502	362	612	754	69%	23%	36%
EBITDA Margin	21%	19%	15%	10%	15%	16%	539 bps	60 bps	673 bps
Consolidated balance sheet (RMB mn)									
Total current assets	2,198	2,100	3,192	2,697	3,146	3,882	17%	23%	21%
Cash & cash equivalents	914	411	788	396	740	1,169	87%	58%	64%
Investments - current	0	10	5	-	-	-	nm	nm	nm
Accounts receivable	343	733	645	599	656	778	10%	19%	14%
Inventories & WIP	412	434	1,195	1,074	1,120	1,305	4%	17%	11%
Other current assets	528	511	559	629	629	629	0%	0%	0%
Total non-current assets	1,912	2,709	5,174	5,446	5,503	5,552	1%	1%	1%
Net tangible fixed assets	267	256	332	388	436	478	13%	10%	10%
Associates & affiliates	161	330	542	484	484	484	0%	0%	0%
Long term financial assets	55	379	856	977	977	977	0%	0%	0%
Net goodwill	1,166	1,191	2,600	2,757	2,757	2,757	0%	0%	0%
Net intangibles	210	189	514	524	532	539	2%	1%	1%
Other non-current assets	53	364	330	317	317	317	0%	0%	0%
Total assets	**4,110**	**4,809**	**8,366**	**8,143**	**8,649**	**9,434**	**6%**	**9%**	**8%**
Total current liabilities	814	1,149	2,630	2,938	2,980	3,145	1%	6%	4%
Short term borrowings	283	652	1,056	1,048	1,048	1,048	0%	0%	0%
Accounts payable	245	184	491	566	591	689	4%	17%	11%
Other payables	25	45	235	273	282	331			
Long term debt due in 1 yr	76	53	258	-	-	-			
Other short term non-financing liabilities	147	164	509	964	964	964	0%	0%	0%
Total non-current liabilities	659	573	846	226	226	226	0%	0%	0%
Long term financing liabilities (inc. pref capital treated as debt)	548	549	451	37	37	37	0%	0%	0%
Post-employment obligations							nm	nm	nm
Long-term Account Payable	86	19	387	187	187	187	0%	0%	0%
Other long-term liabilities	25	6	8	2	2	2	0%	0%	0%
Total liabilities	**1,473**	**1,722**	**3,476**	**3,164**	**3,206**	**3,370**	**1%**	**5%**	**4%**
Stated equity capital (inc MI)	2,637	3,087	4,890	4,979	5,443	6,064	9%	11%	11%
Common shares	632	1,265	1,308	1,358	1,358	1,358			
Capital reserves	858	243	1,464	1,464	1,464	1,464			
Other comprehensive incomes	(19)	15	71	71	71	71			
Surplus	96	123	155	163	211	278	29%	32%	30%
Retained earnings	972	1,384	1,797	1,819	2,236	2,790	23%	25%	24%
Minorities	98	57	95	104	104	104	0%	0%	0%
Total liabilities & shareholders' funds	**4,110**	**4,809**	**8,366**	**8,143**	**8,649**	**9,434**	**6%**	**9%**	**8%**
Consolidated cash flow (RMB mn)									
Reported net profit (as per P&L)	428	489	498	82	473	671	474%	42%	114%
Depreciation/Amortization	51	50	56	105	113	121	8%	7%	7%
Change in working capitals	95	(423)	200	742	(63)	(143)			
(inc)/dec in receivable	(19)	(390)	89	46	(58)	(122)			
(inc)/dec in inventory	31	(22)	(761)	122	(47)	(185)	-138%	297%	-209%
(inc)/dec in other current assets	-	-	-	-	-	-	nm	nm	nm
inc/(dec) in payables	27	(41)	497	113	33	147	-71%	340%	4%
inc/(dec) in other current liabilities	56	30	375	461	8	18	-98%	111%	-67%
Others	(71)	(603)	(480)	(251)	-	-	-100%	nm	-100%
Operating cash flow	**523**	**(97)**	**186**	**678**	**523**	**649**	**-23%**	**24%**	**6%**
Capital expenditure,(tangible+intangible)	(57)	(55)	(318)	(170)	(170)	(170)	0%	0%	0%
Others	(766)	(645)	(1,122)	(221)	-	-	-100%	nm	-100%
Cashflow from investing activities	**(823)**	**(700)**	**(1,440)**	**(391)**	**(170)**	**(170)**	**-56%**	**0%**	**-24%**
Dividends paid	(101)	(95)	(117)	(52)	(9)	(50)	-83%	474%	10%
Share capital issuance / (buy-back)	501	18	1,264	50	-	-	-100%	nm	-100%
Debt issuance / (repayment)	(193)	366	508	(674)	-	-	-100%	nm	-100%
Other financing inflows / (outflows)	221	16	(55)	9	-	-	-100%	nm	-100%
Cashflow from financing activities	**429**	**305**	**1,601**	**(668)**	**(9)**	**(50)**	**-99%**	**474%**	**-53%**
Effects of exchange rate changes	(3)	4	20	(6)	-	-	-100%	nm	-100%
Cash inflow / (outflow)	125	(488)	366	(386)	344	429	-189%	25%	-214%

*Headline numbers of 2017 full year results were released on 13 Feb, 2018; Source: Company data, Macquarie Research, February 2018

Fig 31 Key ratios

YE 31 December		FY2014A	FY2015A	FY2016A	FY2017F	FY2018F	FY2019F	FY2020F	17E-18E	18E-19E	17-20E	18-21E
EPS (diluted)	RMB	0.68	0.39	0.39	0.06	0.35	0.49	0.60	453%	42%	111%	24%
DPS	RMB	0.08	0.04	0.04	0.01	0.04	0.05	0.06	453%	42%	111%	24%
BVPS	RMB	4.02	2.40	3.67	3.73	3.93	4.39	4.94	5%	12%	10%	12%
Cash per share	RMB	-0.01	0.66	0.74	0.53	0.25	-0.06	-0.48	-52%	-125%	-197%	-256%
Diluted share - year end	RMB	632	1,265	1,308	1,307	1,357	1,357	1,357	4%	0%	1%	0%
Per Share												
EPS (diluted)	RMB	0.68	0.39	0.39	0.06	0.35	0.49	0.60	453%	42%	111%	24%
DPS	RMB	0.08	0.04	0.04	0.01	0.04	0.05	0.06	453%	42%	111%	24%
BVPS	RMB	4.02	2.40	3.67	3.73	3.93	4.39	4.94	5%	12%	10%	12%
Net debt/cash per share	RMB	-0.01	0.66	0.74	0.53	0.25	-0.06	-0.48	-52%	-125%	-197%	-256%
Value												
EV/Revenue	X	5.3x	5.0x	3.8x	3.7x	3.4x	2.9x	2.5x	--	--	--	--
EV/EBITDA	X	25.4x	25.9x	25.6x	37.7x	22.3x	18.1x	15.1x	--	--	--	--
EV/FCF	X	25.0x	-349.6x	40.7x	15.0x	44.7x	39.3x	27.9x	--	--	--	--
P/E	X	16.9x	29.5x	29.5x	172.5x	31.2x	22.0x	18.3x	--	--	--	--
P/E, ex cash	X	16.9x	27.8x	27.6x	164.1x	30.5x	22.1x	19.1x	--	--	--	--
Price/ Sales	X	6.2x	5.8x	4.5x	3.9x	3.6x	3.0x	2.6x	--	--	--	--
Price/ Book	X	2.9x	4.8x	3.1x	2.9x	2.8x	2.5x	2.2x	--	--	--	--
Key forecasts												
Revenue	RMB Mn	2,430	2,589	3,361	3,641	3,992	4,734	5,412	10%	19%	14%	15%
EBITDA	RMB Mn	507	497	502	362	612	754	902	69%	23%	36%	17%
EBIT	RMB Mn	456	447	446	257	499	633	775	94%	27%	44%	20%
Net Income	RMB Mn	428	489	498	82	473	671	808	474%	42%	114%	24%
Profitability												
EBITDA Margin	%	21%	19%	15%	10%	15%	16%	17%	539 bps	60 bps	673 bps	111 bps
EBIT Margin	%	19%	17%	13%	7%	12%	13%	14%	543 bps	89 bps	726 bps	174 bps
Net Margin	%	18%	19%	15%	2%	12%	14%	15%	958 bps	233 bps	1267 bps	301 bps
Cash Flow												
Operating Cash Flow	RMB Mn	523	-97	186	678	523	649	808	-23%	24%	6%	20%
Free Cash Flow :	RMB Mn	514	-37	317	905	304	346	489	-66%	14%	-19%	23%
+EBIT*(1-t)	RMB Mn	425	391	378	229	424	538	659	85%	27%	42%	20%
+D&A	RMB Mn	51	50	56	105	113	121	127	8%	7%	7%	5%
-Capex & Investments	RMB Mn	-57	-55	-318	-170	-170	-170	-170	0%	0%	0%	0%
+Change in NWC	RMB Mn	95	-423	200	742	-63	-143	-127	-108%	128%	-156%	25%
Yield												
Dividend Yield	%	1%	0%	0%	0%	0%	0%	1%	28 bps	14 bps	51 bps	30 bps
FCF Yield	%	7%	0%	2%	6%	2%	2%	3%	(431 bps)	28 bps	(306 bps)	179 bps
Earnings Yield	%	6%	3%	3%	1%	3%	5%	5%	262 bps	134 bps	490 bps	285 bps
Balance Sheet												
Net debt (cash)	RMB Mn	-7	832	971	688	344	-85	-653	-50%	-125%	-198%	-256%
Net debt/ equity	RMB Mn	cash	27%	20%	14%	6%	cash	cash	N/M	N/M	N/M	N/M
Shareholders Equity	RMB Mn	2,539	3,030	4,795	4,875	5,339	5,960	6,698	10%	12%	11%	12%
Efficiency												
ROE (average)	%	19%	17%	12%	2%	9%	12%	13%	740 bps	259 bps	1089 bps	333 bps
ROA (average)	%	12%	11%	8%	1%	6%	7%	8%	463 bps	179 bps	718 bps	265 bps
ROIC (average)	%	16%	13%	9%	5%	9%	11%	12%	447 bps	142 bps	694 bps	234 bps

Source: Company data, Macquarie Research, February 2018

Appendices

History

- The company was founded in 1993, engaged in the toy manufacturing business, with no self-owned IPs.
- In 2006, the company kicked off the strategy to cultivate its own IPs. It launched the first original animation, “Blazing teens“(火力少年王), started the new business model as “Animation + Toys”, and cultivated its own IP library. In the same year, Alpha Animation used ads to sell "yo-yo" ball and Blazing Teens (Chinese:火力少年王).
- In 2012, Alpha partnered with Hasbro to co-develop brands for China and other global markets. One of the brands selected was Alpha's Blazing Teens series, alongside an unnamed Hasbro property. The first results from this collaboration include Blazing Team and a Kre-O line of toys based on Alpha's Armor Hero franchise, both of which launched in late 2015.
- In 2013, Alpha Group purchased 100% of the equity in Creative Power Entertaining Limited with RMB540m to acquire the trademarks and copyrights related to cartoon images of the Pleasant Goat.
- In 2014, the company established Alpha Pictures, and developed a strategy in cooperation with New Regency Productions, a top entertainment company in Hollywood, by investing no more than US$60nm in 3 films produced by New Regency Productions.
- In 2015, the company acquired U17 (有妖气), a leading online comics platform in China, by purchasing 100% of the shares of Beijing April Star Network Technology (北京四月星空网络技术有限公司) at price of RMB904nm.
- In 2016, the company was renamed “Alpha Group” (奥飞娱乐).
- In 2009, the company was listed on the SME board of the Shenzhen Stock Exchange.
- Shareholder structure
  - ⇒ Major Top 10 shareholders control 64.13% of stake, according to Wind.
  - ⇒ As of 31 Dec 2017, institutional investors held 0.65%, according to Wind.

Management and Directors’ backgrounds

- Mr Cai Dongqing, chairs Alpha Group. Before founding GuangDong Audi Toy Industry Co., Ltd (广东奥迪玩具实业有限公司), the predecessor of Alpha Group in 1993, Mr Cai ran a manufacturing business for entry-level toys. He introduced and developed toys like mini racing cars to China after founding Audi Toy Industry, which accumulated capital swiftly for the company. That serves as a good capital base for the company to develop its strategy in the animation business etc. Mr Cai holds an EMBA degree from Zhongshan University.
- Mr Cai Xiaodong, brother of Mr Cai Dongqing, is the Vice-Chairman of Alpha Group. He also serves as vice president of China Toy and Juvenile products Association (中国玩具和婴童用品协会). Mr Cai Xiaodong holds an EMBA degree from Cheung Kong Graduate School of Business (CKGSB).

Covered companies mentioned:

China Mengniu Dairy Company (2319 HK, HK$24.85, Neutral, TP: HK$18.20, Linda Huang)

Chow Tai Fook (1929 HK, HK$8.41, Outperform, TP: HK$10.40, Linda Huang)

Perfect World (A-Share) (002624 CH, Rmb29.25, Outperform, TP: Rmb43.10, Marcus Yang)

Procter & Gamble (PG US, US$82.60, Outperform, TP: US$96.00, Caroline Levy)

Tencent (700 HK, HK$445.80, Outperform, TP: HK$450.00, Wendy Huang)

Walmart (WMT US, US$104.78, Neutral, TP: US$85.00, Bob Summers)

Yili (A-Share) (600887 CH, Rmb32.25, Outperform, TP: Rmb36.00, Linda Huang)

Zhejiang Huace Film & TV (A-Share) (300133 CH, Rmb11.80, Outperform, TP: Rmb17.30, Marcus Yang)

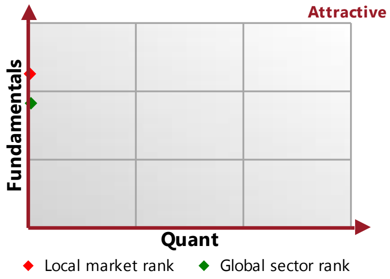
Macquarie Quant View

The quant model currently holds a strong negative view on Alpha Group (A-Share). The strongest style exposure is Earnings Momentum, indicating this stock has received earnings upgrades and is well liked by sell side analysts. The weakest style exposure is Valuations, indicating this stock is over-priced in the market relative to its peers.

652/656

Global rank in
Consumer Durables & Apparel

% of BUY recommendations	50% (3/6)
Number of Price Target downgrades	0
Number of Price Target upgrades	1

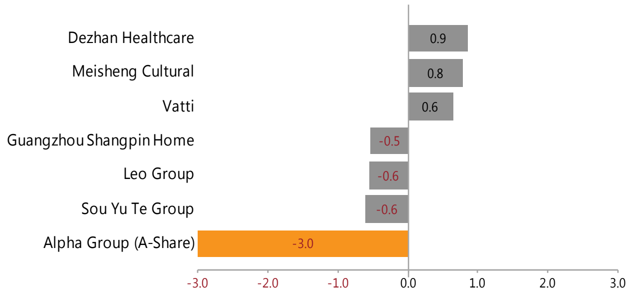


Displays where the company's ranked based on the fundamental consensus Price Target and Macquarie's Quantitative Alpha model.

Two rankings: Local market (China A) and Global sector (Consumer Durables & Apparel)

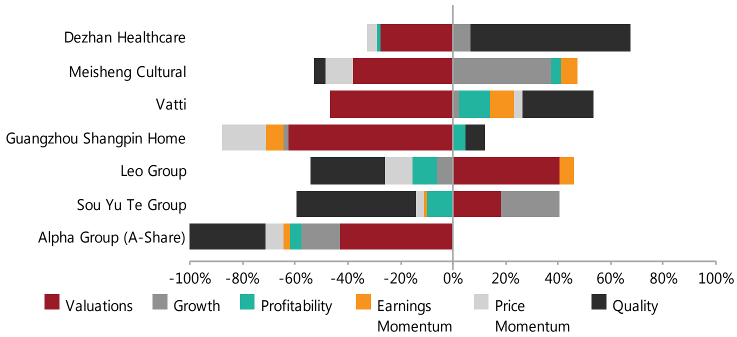
Macquarie Alpha Model ranking

A list of comparable companies and their Macquarie Alpha model score (higher is better).



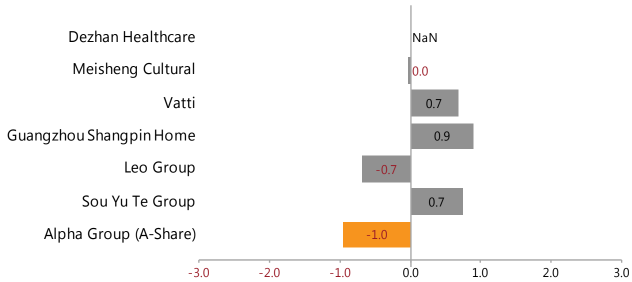
Factors driving the Alpha Model

For the comparable firms this chart shows the key underlying styles and their contribution to the current overall Alpha score.



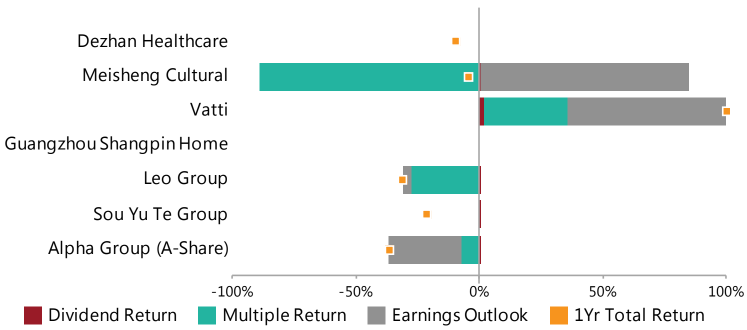
Macquarie Earnings Sentiment Indicator

The Macquarie Sentiment Indicator is an enhanced earnings revisions signal that favours analysts who have more timely and higher conviction revisions. Current score shown below.



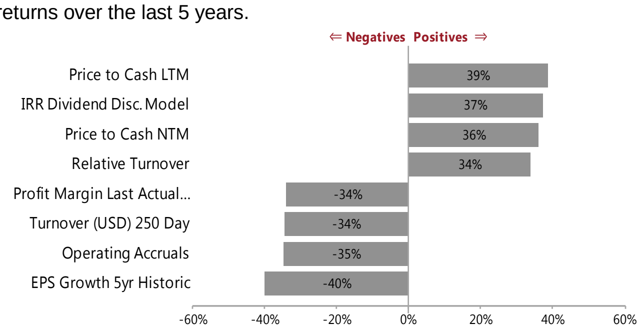
Drivers of Stock Return

Breakdown of 1 year total return (local currency) into returns from dividends, changes in forward earnings estimates and the resulting change in earnings multiple.



What drove this Company in the last 5 years

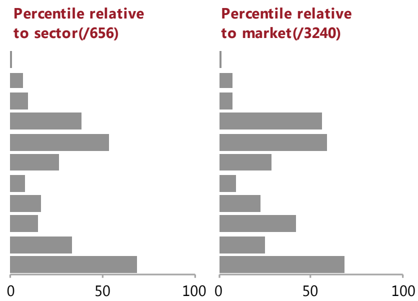
Which factor score has had the greatest correlation with the company's returns over the last 5 years.



How it looks on the Alpha model

A more granular view of the underlying style scores that drive the alpha (higher is better) and the percentile rank relative to the sector and market.

	Normalized Score
Alpha Model Score	-3.03
Valuation	-0.87
Growth	-0.57
Profitability	-0.51
Earnings Momentum	-0.17
Price Momentum	-0.44
Quality	-0.72
Capital & Funding	-0.47
Liquidity	-2.61
Risk	-0.19
Technicals & Trading	0.86



Source (all charts): FactSet, Thomson Reuters, and Macquarie Research. For more details on the Macquarie Alpha model or for more customised analysis and screens, please contact the Macquarie Global Quantitative/Custom Products Group (cpg@macquarie.com)

Alpha Group (A-Share) (002292 CH, Outperform, Target Price: Rmb13.58)

Quarterly Results		3Q/17A	4Q/17E	1Q/18E	2Q/18E
Revenue	**m**	**867**	**996**	**943**	**981**
Gross Profit	**m**	**418**	**379**	**458**	**478**
Cost of Goods Sold	m	449	617	485	502
EBITDA	**m**	**97**	**18**	**139**	**146**
Depreciation	m	26	26	28	28
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**71**	**-8**	**111**	**117**
Net Interest Income	m	-25	-30	-19	-20
Associates	m	0	0	0	0
Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	148	-221	39	41
Pre-Tax Profit	**m**	**193**	**-259**	**132**	**139**
Tax Expense	m	-9	39	-20	-21
Net Profit	**m**	**184**	**-220**	**112**	**118**
Minority Interests	m	-3	-13	-6	-6
Reported Earnings	**m**	**180**	**-233**	**106**	**112**
Adjusted Earnings	**m**	**180**	**-233**	**106**	**112**
EPS (rep)		0.14	-0.18	0.08	0.08
EPS (adj)		0.14	-0.18	0.08	0.08
EPS Growth yoy (adj)	%	24.1	nmf	124.0	20.7
EBITDA Margin	%	11.2	1.8	14.8	14.9
EBIT Margin	%	8.1	-0.8	11.8	12.0
Earnings Split	%	219.0	-283.0	22.5	23.7
Revenue Growth	%	-11.9	16.0	6.7	9.5
EBIT Growth	%	-60.2	nmf	30.9	6.9

Profit and Loss Ratios		2016A	2017E	2018E	2019E
Revenue Growth	%	29.8	8.4	9.6	18.6
EBITDA Growth	%	1.0	-28.0	69.2	23.2
EBIT Growth	%	-0.2	-42.4	94.0	27.0
Gross Profit Margin	%	49.4	46.2	48.8	49.7
EBITDA Margin	%	14.9	9.9	15.3	15.9
EBIT Margin	%	13.3	7.1	12.5	13.4
Net Profit Margin	%	14.8	2.3	11.8	14.2
Payout Ratio	%	0.0	0.0	0.0	0.0
EV/EBITDA	x	29.7	41.2	25.2	20.5
EV/EBIT	x	33.4	57.9	31.0	24.4
Balance Sheet Ratios					
ROE	%	12.7	1.7	9.3	11.9
ROA	%	6.8	3.1	5.9	7.0
ROIC	%	9.8	4.1	7.5	9.3
Net Debt/Equity	%	14.7	13.8	6.3	-1.4
Interest Cover	x	8.4	2.5	6.2	13.4
Price/Book	x	3.0	2.9	2.8	2.5
Book Value per Share		3.7	3.7	3.9	4.4

Profit & Loss		2016A	2017E	2018E	2019E
Revenue	**m**	**3,361**	**3,641**	**3,992**	**4,734**
Gross Profit	**m**	**1,661**	**1,682**	**1,948**	**2,351**
Cost of Goods Sold	m	1,700	1,959	2,045	2,383
EBITDA	**m**	**502**	**362**	**612**	**754**
Depreciation	m	56	105	113	121
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**446**	**257**	**499**	**633**
Net Interest Income	m	-53	-104	-80	-47
Associates	m	0	0	0	0
Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	170	-56	167	245
Pre-Tax Profit	**m**	**563**	**97**	**586**	**831**
Tax Expense	m	-86	-11	-88	-125
Net Profit	**m**	**477**	**87**	**498**	**706**
Minority Interests	m	21	-4	-25	-36
Reported Earnings	**m**	**498**	**82**	**473**	**671**
Adjusted Earnings	**m**	**498**	**82**	**473**	**671**
EPS (rep)		0.38	0.06	0.35	0.49
EPS (adj)		0.38	0.06	0.35	0.49
EPS Growth (adj)	%	-1.5	-83.5	453.2	41.9
PE (rep)	x	28.5	172.5	31.2	22.0
PE (adj)	x	28.5	172.7	31.2	22.0
Total DPS		0.00	0.00	0.00	0.00
Total Div Yield	%	0.0	0.0	0.0	0.0
Basic Shares Outstanding	m	1,308	1,307	1,357	1,357
Diluted Shares Outstanding	m	1,308	1,307	1,357	1,357

Cashflow Analysis		2016A	2017E	2018E	2019E
EBITDA	**m**	**502**	**362**	**612**	**754**
Tax Paid	m	0	0	0	0
Chgs in Working Cap	m	0	0	0	0
Net Interest Paid	m	0	0	0	0
Other	m	-316	317	-89	-105
Operating Cashflow	**m**	**186**	**678**	**523**	**649**
Acquisitions	m	0	0	0	0
Capex	m	-318	-170	-170	-170
Asset Sales	m	0	0	0	0
Other	m	-1,122	-221	0	0
Investing Cashflow	**m**	**-1,440**	**-391**	**-170**	**-170**
Dividend (Ordinary)	m	-117	-52	-9	-50
Equity Raised	m	0	0	0	0
Debt Movements	m	508	-674	0	0
Other	m	1,209	59	0	0
Financing Cashflow	**m**	**1,601**	**-668**	**-9**	**-50**
Net Chg in Cash/Debt	**m**	**366**	**-386**	**344**	**429**
Free Cashflow	**m**	**-132**	**508**	**353**	**479**

Balance Sheet		2016A	2017E	2018E	2019E
Cash	m	788	396	740	1,169
Receivables	m	645	599	656	778
Inventories	m	1,195	1,074	1,120	1,305
Investments	m	5	0	0	0
Fixed Assets	m	332	388	436	478
Intangibles	m	2,600	2,757	2,757	2,757
Other Assets	m	2,801	2,930	2,939	2,946
Total Assets	**m**	**8,366**	**8,143**	**8,649**	**9,434**
Payables	m	491	566	591	689
Short Term Debt	m	1,056	1,048	1,048	1,048
Long Term Debt	m	451	37	37	37
Provisions	m	0	0	0	0
Other Liabilities	m	1,478	1,514	1,531	1,598
Total Liabilities	**m**	**3,476**	**3,164**	**3,206**	**3,370**
Shareholders' Funds	m	4,570	4,641	5,058	5,612
Minority Interests	m	95	104	104	104
Other	m	226	234	281	348
Total S/H Equity	**m**	**4,890**	**4,979**	**5,443**	**6,064**
Total Liab & S/H Funds	**m**	**8,366**	**8,143**	**8,649**	**9,434**

All figures in Rmb unless noted.
Source: Company data, Macquarie Research, February 2018

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand
Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie – South Africa
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA
Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell)– return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to Asia/Australian/NZ/Canada stocks only

Recommendations – 12 months
Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:
Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*
ROA = adjusted ebit / average total assets
ROA Banks/Insurance = adjusted net profit /average total assets
ROE = adjusted net profit / average shareholders funds
Gross cashflow = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 December 2017

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	51.82%	55.57%	44.05%	45.06%	60.00%	42.51%	(for global coverage by Macquarie, 4.36% of stocks followed are investment banking clients)
Neutral	35.40%	28.60%	36.90%	47.59%	28.67%	40.42%	(for global coverage by Macquarie, 2.58% of stocks followed are investment banking clients)
Underperform	12.77%	15.83%	19.05%	7.34%	11.33%	17.07%	(for global coverage by Macquarie, 0.69% of stocks followed are investment banking clients)

Company-specific disclosures:

Important disclosure information regarding the subject companies covered in this report is available at www.macquarie.com/research/disclosures.

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MACQUARIE

Asia Research

Head of Equity Research

Jake Lynch (Asia – Head)	(852) 3922 3583
David Gibson (Japan – Head)	(813) 3512 7880
Conrad Werner (ASEAN – Head)	(65) 6601 0182

Automobiles, Auto Parts

Janet Lewis (China, Japan)	(813) 3512 7856
Allen Yuan (China)	(8621) 2412 9009
James Hong (Korea)	(822) 3705 8661
Amit Mishra (India)	(9122) 6720 4084

Banks and Financials

Scott Russell (Asia)	(852) 3922 3567
Dexter Hsu (China, Taiwan)	(8862) 2734 7530
Keisuke Moriyama (Japan)	(813) 3512 7476
Chan Hwang (Korea)	(822) 3705 8643
Suresh Ganapathy (India)	(9122) 6720 4078
Jayden Vantarakis (Indonesia)	(6221) 2598 8310
Anand Pathmakanthan (Malaysia)	(603) 2059 8833
Gilbert Lopez (Philippines)	(632) 857 0892
Ken Ang (Singapore)	(65) 6601 0836
Passakorn Linmaneechote (Thailand)	(662) 694 7728

Commodities and Basic Materials

Tom Price (Global – Head of Commodities Research)	(44 20) 3037 2849
Jim Lennon (Global)	(44 20) 3037 4271
Polina Diyachkina (Asia, Japan)	(813) 3512 7886
Matthew Turner (Global)	(44 20) 3037 4340
Vivienne Lloyd (Global)	(44 20) 3037 4530
Serafino Capoferri (Global)	(44 20) 3037 2517
Lynn Zhao (Global)	(86 21) 2412 9035
Yasuhiro Nakada (Japan)	(813) 3512 7862
Anna Park (Korea)	(822) 3705 8669
Sumangal Nevatia (India)	(9122) 6720 4093
Jayden Vantarakis (Indonesia)	(6221) 2598 8310

Conglomerates

David Ng (China, Hong Kong)	(852) 3922 1291
Conrad Werner (Singapore)	(65) 6601 0182
Gilbert Lopez (Philippines)	(632) 857 0892

Consumer, Gaming

Linda Huang (Asia)	(852) 3922 4068
Zibo Chen (China, Hong Kong)	(852) 3922 1130
Terence Chang (China, Hong Kong)	(852) 3922 3581
Sunny Chow (China, Hong Kong)	(852) 3922 3768
Stella Li (China, Taiwan)	(8862) 2734 7514
Kwang Cho (Korea)	(822) 3705 4953
KJ Lee (Korea)	(822) 3705 9935
Amit Sinha (India)	(9122) 6720 4085
Karisa Magpayo (Philippines)	(632) 857 0899
Chalinee Congmuang (Thailand)	(662) 694 7993
Robert Pranata (Indonesia)	(6221) 2598 8366
Richardo Walujo (Indonesia)	(6221) 259 88 369

Emerging Leaders

Jake Lynch (Asia)	(852) 3922 3583
Kwang Cho (Korea)	(822) 3705 4953
Corinne Jian (Greater China)	(8862) 2734 7522
Conrad Werner (ASEAN)	(65) 6601 0182
Bo Denworalak (Thailand)	(662) 694 7774

Industrials, Transport and Infrastructure

Patrick Dai (China)	(8621) 2412 9082
Eric Zong (China, Hong Kong)	(852) 3922 4749
Kunio Sakaida (Japan)	(813) 3512 7873
James Hong (Korea)	(822) 3705 8661
Corinne Jian (Taiwan)	(8862) 2734 7522
Inderjeetsingh Bhatia (India)	(9122) 6720 4087
Azita Nazrene (ASEAN)	(65) 6601 0560

Internet, Media and Software

Wendy Huang (Asia)	(852) 3922 3378
Ivy Luo (Greater China)	(852) 3922 1507
Marcus Yang (Greater China)	(8862) 2734 7532
David Gibson (Japan)	(813) 3512 7880
Soyun Shin (Korea)	(822) 3705 8659
Alankar Garude (India)	(9122) 6720 4134

Oil, Gas and Petrochemicals

Aditya Suresh (Asia)	(852) 3922 1265
Polina Diyachkina (Asia, Japan)	(813) 3512 7886
Yasuhiro Nakada (Japan)	(813) 3512 7862
Anna Park (Korea)	(822) 3705 8669
Corinne Jian (Taiwan)	(8862) 2734 7522
Yupapan Polpornprasert (Thailand)	(662) 694 7729

Pharmaceuticals and Healthcare

Alankar Garude (India)	(9122) 6720 4134
Patti Tomaitrichitr (Thailand)	(662) 694 7727
Richardo Walujo (Indonesia)	(6221) 259 88 369

Property, REIT

Tuck Yin Soong (Asia, Singapore)	(65) 6601 0838
David Ng (China, Hong Kong)	(852) 3922 1291
Keisuke Moriyama (Japan)	(813) 3512 7476
Corinne Jian (Taiwan)	(8862) 2734 7522
Abhishek Bhandari (India)	(9122) 6720 4088
Aiman Mohamad (Malaysia)	(603) 2059 8986
Kervin Sisayan (Philippines)	(632) 857 0893
Patti Tomaitrichitr (Thailand)	(662) 694 7727

Technology

Damian Thong (Asia, Japan)	(813) 3512 7877
Allen Chang (Greater China)	(852) 3922 1136
Jeffrey Ohlweiler (Greater China)	(8862) 2734 7512
Chris Yu (Greater China)	(8621) 2412 9024
Kaylin Tsai (Greater China)	(8862) 2734 7523
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Patrick Liao (Greater China)	(8862) 2734 7515
Verena Jeng (Greater China)	(852) 3922 3766
Daniel Kim (Korea)	(822) 3705 8641
Abhishek Bhandari (India)	(9122) 6720 4088

Telecoms

Allen Chang (Greater China)	(852) 3922 1136
Soyun Shin (Korea)	(822) 3705 8659
Prem Jearajasingam (ASEAN)	(603) 2059 8989
Kervin Sisayan (Philippines)	(632) 857 0893
Nathania Nurhalim (Indonesia)	(6221) 2598 8365

Utilities, Renewables

Hiroyuki Sakaida (Japan)	(813) 3512 6695
Patrick Dai (China)	(8621) 2412 9082
Inderjeetsingh Bhatia (India)	(9122) 6720 4087
Karisa Magpayo (Philippines)	(632) 857 0899

Economics and Macro

Ric Deverell (Chief Economist & Head of Macro Research)	(612) 8232 4307
Larry Hu (China, Hong Kong)	(852) 3922 3778
Upasana Chachra (India)	(9122) 6720 4355

Quantitative, CPG

Gurvinder Brar (Global)	(44 20) 3037 4036
Alvin Chao (Asia)	(852) 3922 1108
Tracy Chow (Asia)	(852) 3922 4285
YingYing Hou (Asia)	(852) 3922 5422

Strategy, Country

Viktor Shvets (Asia, Global)	(852) 3922 3883
David Ng (China, Hong Kong)	(852) 3922 1291
Chan Hwang (Korea)	(822) 3705 8643
Jeffrey Ohlweiler (Taiwan)	(8862) 2734 7512
Inderjeetsingh Bhatia (India)	(9122) 6720 4087
Jayden Vantarakis (Indonesia)	(6221) 2598 8310
Anand Pathmakanthan (Malaysia)	(603) 2059 8833
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Conrad Werner (ASEAN, Singapore)	(65) 6601 0182
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Sales Trading

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Stanley Dunda (Indonesia)	(6221) 515 1555

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Michael Santos (Philippines)	(632) 857 0813
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Marc Rosa (New York)	(1 212) 231 2555
Justin Morrison (Singapore)	(65) 6601 0288
Daniel Clarke (Taiwan)	(8862) 2734 7580
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Mike Keen (UK/Europe)	(44 20) 3037 4905

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