

Optics continue to drag on earnings

Rating	Neutral	Maintain
Target Price	HK\$ 14.75	From \$30.17
Current price	HK\$ 14.06	Upside: +4.9%

2Q22 net profit slight beat despite another GM miss

AAC's 2Q22 revenue was largely in-line with Bloomberg consensus, but net profit beat Bloomberg consensus (~RMB 121mn) by ~20%. Both revenue and net profit attributable to shareholders down 7.8%/29.2% QoQ to RMB4,516mn/RMB145mn. We attribute the net profit beat to **i) increase in haptics shipment (+49% Yoy) to Android customers' models including OPPO, vivo and Redmi models; ii) revenue contribution from Toyo Precision (acquired in Oct 2021) drove precision mechanics segment sales and GM (+1.6 ppts Yoy) and ii) lower R&D %**. However, 2Q22 blended GM stood <20% for the 2nd consecutive quarter at 18.3% (-6.7ppts Yoy), mainly due to **i) intense competition in optics' segment (lens + CCM) as AAC strived to increase market share under current weak smartphone demand, in particular lens GM fell into negative territory on inventory write-off and ii) 2.6 ppts Yoy drop in MEMS GM. AAC do not declare any interim dividends for the first time since listed in Aug 2005.**

AAC's share price rose as much as 5.5% on Aug 24 afternoon session on better than expected bottom line. Nevertheless, each business segment was largely in-line with our expectation, with optics' margin pressure persists in 2H22. Though AAC provided an update on its AR/VR, automotive related business exposure for its acoustics (software+hardware solutions in smart cockpit for OEMs, including leading Chinese EV) and optics segment (automotive lens and CCM), it still takes time to materialize.

Acoustics' GM for Android customers gradually improve (+1.1 ppts QoQ to 27.7%), thanks to increasing adoption of SLS speaker module (both mid-high end customers + target mid-low end customers). For precision mechanics, after having acquired Toyo Precision, operational efficiency increased as revenue grew 40% Yoy and accompanied by improved utilization rate and 5.0 ppts Yoy increment in GM. AAC obtained new non-smartphone projects and would be delivered in 1H23.

Optics share gain at the expense of sacrificing margin persists

AAC's optics' revenue was flattish QoQ at RMB 929mn and took up ~20.6% of 2Q22 revenue (vs. 9.2%/10.6%/18.9% in 3Q21-1Q22). Management stated that plastic lens and CCM shipment each grew 15% QoQ/117% Yoy in 2Q22. Blended GM fell to negative territory (vs. ~20% in 2Q22) on the back of lens inventory write-off (RMB70mn impact) and intense market competition.

Though AAC is still optimistic towards WLJ prospect, with another WLJ project (Redmi K50 Pro with 100mn pixel 1G5P) has undergone mass production and shipment, the WLJ impact on optics' GM remains yet to be seen. We still remain cautious on vast adoption of WLJ hybrid lens sets by Android customers, unless AAC delivers an increasing pace of volume shipment and sustainable GM improvement in upcoming quarters.

CCM shipment rose 117% Yoy, however GM further deteriorated and slipped to <1% (vs. 3-4% in 1Q22), margin level was much lower than Q Tech (1478.HK), Sunny Optical (2382.HK) and Truly (732.HK) (based on our 1Q22 data for Truly). AAC aims at 6P+ lens shipment would be ~10% total shipment in FY22E and targets inventory level to lower to ~3 months (vs. 3-4 months currently) by end-2022. Our take remains unchanged that CCM business is challenging while AAC is still on its learning curve, we expect GM still stays low in 2H22 and early 2023.

Result Takeaways

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Trading data

52-Week Range (HK\$)	48.25/13.42
3 Mth Avg Daily Vol (m)	78
No of Shares (m)	1,208.5
Market Cap (HK\$m)	16,991.5
Major Shareholders (%)	Benjamin Pan (43%)
Auditors	Deloitte
Result Due	3Q22E: Nov 2022

Company description

Founded in 1993, AAC Technologies is the leading miniature acoustic component supplier for handheld devices with 30% global market share. Currently Apple and Nokia are its key customers. About 60% sales are generated by smartphone and tablet related business

Price chart



Sources: Bloomberg, CIRC

■ **Further earnings cut on lower GM assumption; Unappealing valuation justified as earnings visibility still unclear, Maintain Neutral**

AAC still faces following challenges on near term profitability/ margin: **i) optics business continue to strive for share gain at the expense of margins, ii) legacy products' (e.g. MEMS) margin pressure due to dampened smartphone demand and iii) slow product upgrade as a result of semi cost hike.**

We slashed AAC FY22E-23E EPS by 56.7%/53.9% respectively to factor in lower sales and blended GM assumption due to optics and MEMS segment, which set off the gradual margin recovery on acoustics, haptics and precision mechanics segments. We also introduce FY24E forecasts, we expect AAC EPS to grow at 5.0% CAGR in FY21-FY24E EPS, driven by ~11% sales CAGR, while GM still drags on earnings recovery. AAC is trading at 13.8x FY23E PE (> 1.s.d. below AAC's 5-year average), as near-term margin overhang remains, optics profitability remains yet to be seen which would hinder overall earnings visibility. We deem AAC's current valuation unattractive and maintain AAC's rating at NEUTRAL with new TP at HK\$14.75, which translates to 14.5x FY23E PE (24% discount to AAC's 5-year average P/E). We continue to advise investors to stay on the sideline before meaningful turnaround opportunities appear.

Exhibit 1: AAC's quarterly financials

	3Q20A	4Q20A	1Q21A	2Q21A	3Q21A	4Q21A	1Q22A	2Q22A
Income statement (RMB mn)								
Revenue	4,520	4,783	4,292	4,317	4,246	4,812	4,896	4,516
Cost of goods sold	-3,442	-3,441	-2,961	-3,218	-3,297	-3,826	-3,926	-3,750
Gross profit	1,078	1,342	1,331	1,099	949	986	970	765
SG&A	-239	-240	-244	-295	-290	-326	-331	-329
R&D	-452	-485	-453	-441	-434	-398	-387	-341
Operating profits	399	995	713	464	309	342	364	312
Interest expenses	-77	-107	-98	-113	-116	-89	-102	-101
Share of associates earnings	0	0	0	0	0	0	0	0
Pre-tax profit	322	888	621	360	193	253	248	177
Tax	-69	39	-86	32	-13	-54	-54	-89
Minority interest	-5	11	4	4	-13	29	-11	-57
Net profit	248	938	532	389	167	228	205	145
As % of sales								
Gross profit	23.8%	28.1%	31.0%	25.4%	22.4%	20.5%	19.8%	17.0%
SG&A	-5.3%	-5.0%	-5.7%	-6.8%	-6.8%	-6.8%	-6.8%	-7.3%
R&D	-10.0%	-10.1%	-10.6%	-10.2%	-10.2%	-8.3%	-7.9%	-7.5%
Operating profits	8.8%	20.8%	16.6%	10.8%	7.3%	7.1%	7.4%	6.9%
Net profit	5.5%	19.6%	12.4%	9.0%	3.9%	4.7%	4.2%	3.2%
Growth QoQ								
Revenue	5.7%	5.8%	-10.3%	0.6%	-1.6%	13.3%	1.8%	-7.8%
Gross profit	9.5%	24.6%	-0.8%	-17.5%	-13.6%	3.8%	-1.5%	-21.1%
Operating profits	1.5%	149.1%	-28.3%	-35.0%	-33.4%	10.7%	6.5%	-14.3%
Net profit	-7.1%	277.6%	-43.3%	-26.9%	-57.0%	36.1%	-9.9%	-29.5%

Source: Company data, CIRC

Exhibit 2: We cut AAC FY22E-24E earnings forecasts and introduce FY24E estimates

	FY22E (new)	FY22E(old)	Diff	FY23E (new)	FY23E(old)	Diff	FY24E	Yoy
Revenue	19,489	19,414	0.4%	21,706	21,763	-0.3%	24,443	12.6%
Operating Profit	1,471	2,593	-43.3%	1,718	3,078	-44.2%	2,182	27.0%
Net Profit	851	1,973	-56.8%	1,101	2,388	-53.9%	1,528	38.8%
EPS (RMB)	0.68	1.58	-56.7%	0.88	1.92	-53.9%	1.23	38.8%

Source: CIRL estimates

Exhibit 3: AAC provides 'hardware+software solutions for partners (OPPO Reno 8)


Source: Company data

Exhibit 4: Financial statement

Income statement						Cash flow					
Year to Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E	Year to Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	17,140	17,667	19,489	21,706	24,443	Pre-tax profit	1,648	1,413	1,082	1,349	1,840
Gross profit (reported)	4,227	4,365	3,866	4,451	5,259	Taxes paid	(174)	(130)	(165)	(162)	(202)
EBITDA	4,478	4,531	4,388	4,488	4,836	Depreciation	2,478	2,702	2,917	2,770	2,654
Depreciation	(2,478)	(2,702)	(2,917)	(2,770)	(2,654)	Associates	0	0	0	0	0
EBIT	2,000	1,828	1,471	1,718	2,182	CFO bef. WC change	3,951	3,985	3,833	3,957	4,291
Net interest income (exp.)	(353)	(415)	(390)	(369)	(342)	Change in working cap	275	(1,948)	(677)	(1,599)	(1,627)
Associates	0	0	0	0	0	Cashflow from operation	4,226	2,038	3,157	2,358	2,664
Exceptionals/others	0	0	0	0	0	CAPEX	(4,159)	(4,098)	(1,949)	(1,954)	(2,200)
Profit before tax	1,648	1,413	1,082	1,349	1,840	Free cash flow	67	(2,060)	1,208	404	464
Tax expenses	(147)	(120)	(162)	(202)	(276)	Dividends	(305)	(201)	(130)	(168)	(234)
Minority interest	(6)	(23)	(68)	(46)	(36)	Balance sheet adj.	(980)	(610)	0	0	0
Net profit	1,507	1,316	851	1,101	1,528	Share issued	1,252	(457)	71	(38)	(65)
Dividends	-305	-201	-130	-168	-234	Others	0	0	0	0	0
Balance sheet						Net cash flow	34	(3,329)	1,149	198	165
Year to Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E	Net cash (debt) start	(3,423)	(3,378)	(6,660)	(5,512)	(5,314)
Cash & equiv	7,632	6,054	7,202	7,400	7,565	Net cash (debt) at year-end	-3,390	-6,707	-5,512	-5,314	-5,149
Trade receivables	5,176	6,013	6,259	7,179	7,968	Ratios					
Other receivables	0	0	0	0	0	Year to Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Inventories	3,995	5,695	6,283	6,997	7,880	Growth rate (%)					
Other current assets	46	193	193	193	193	Revenue	(4.2)	3.1	10.3	11.4	12.6
Fixed assets	18,592	19,987	19,020	18,203	17,750	EBITDA	(7.1)	1.2	(3.1)	2.3	7.7
Intangible assets	164	220	220	220	220	EBIT	(28.6)	(8.6)	(19.5)	16.8	27.0
Investment, associates etc	3,305	3,860	3,860	3,860	3,860	Net profit	(32.2)	(12.6)	(35.3)	29.4	38.8
Total assets	38,911	42,022	43,037	44,053	45,435	Fully diluted EPS	(32.2)	(12.6)	(35.3)	29.4	38.8
Account payables	108	155	312	347	391	Margins (%)					
Other payables	0	0	0	0	0	Gross margin	24.7	24.7	19.8	20.5	21.5
Short-term debt	3,349	2,902	2,902	2,902	2,902	EBITDA	26.1	25.6	22.5	20.7	19.8
Other current liabs	5,923	6,610	6,608	6,648	6,721	EBIT	11.7	10.3	7.6	7.9	8.9
Long-term debts	7,662	9,812	9,812	9,812	9,812	Net margin	8.8	7.5	4.4	5.1	6.3
Deferred tax and others	49	41	41	41	41	Other ratios					
Other long-term liabs	0	0	0	0	0	ROE (%)	6.9	5.8	3.6	4.5	6.0
Total liabilities	17,090	19,520	19,674	19,750	19,867	ROA (%)	3.9	3.1	2.0	2.5	3.4
Share capital	98	98	98	98	98	Net gearing (%)	15.5	29.8	23.6	21.9	20.1
Reserves	21,061	21,713	22,505	23,399	24,629	Interest coverage (x)	5.7	4.4	3.8	4.7	6.4
Shareholders' equity	21,159	21,811	22,603	23,498	24,727	Receivables days	114.5	115.6	114.9	113.0	113.1
Minorities	662	691	759	805	841	Payables days	15.6	3.6	5.5	7.0	7.0
Total equity	21,821	22,502	23,362	24,303	25,568	Inventory days	108.2	132.9	139.9	140.5	141.5
Net cash (debt)	-3,378	-6,660	-5,512	-5,314	-5,149	Effective tax rate (%)	8.9	8.5	15.0	15.0	15.0

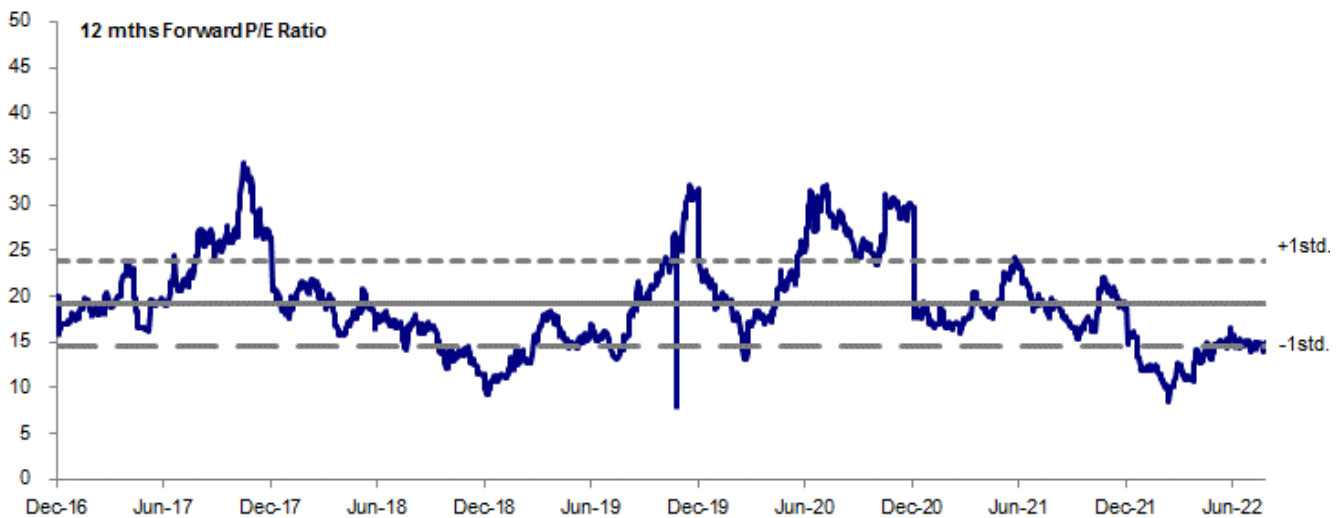
Source: Company data, CIRL estimates

Exhibit 6: Peers comparison

	bloomberg code	Mkt Cap (HKD mn)	Price (HKD)	Share Price Movement (%)			PER (x)						P/B (x)						Yield (%)					
				1M	3M	YTD	FY19	FY20	FY21	FY22E	FY23E	FY24E	FY19	FY20	FY21	FY22E	FY23E	FY24E	FY19	FY20	FY21	FY22E	FY23E	FY24E
HK Listed Peers																								
SUNNY OPTICAL	2382 HK	120,215	109.60	2.0	(1.8)	(55.6)	26.5	21.8	19.9	30.5	21.2	17.7	8.6	6.1	4.8	4.6	3.9	3.4	0.8%	0.9%	1.0%	0.8%	0.9%	1.1%
LENOVO GROUP	992 HK	82,229	6.78	(9.7)	(5.7)	(24.3)	17.3	15.5	9.2	5.5	5.4	5.3	3.1	3.3	2.9	2.1	1.5	1.3	4.1%	4.1%	4.5%	6.7%	6.1%	7.4%
BYD ELECTRONIC	285 HK	46,416	20.60	2.5	34.1	(27.8)	25.6	7.6	16.6	17.9	12.1	9.5	2.4	1.8	1.6	1.5	1.4	1.2	0.4%	1.3%	0.6%	0.6%	0.8%	1.1%
COWELL	1415 HK	14,042	16.80	27.1	146.0	27.9	61.3	42.5	36.0	24.1	15.3	10.7	5.3	7.2	5.8	4.2	-	2.7	11.3%	43.0%	0.0%	1.3%	2.0%	2.9%
FIT HON TENG LTD	6088 HK	8,575	1.18	(9.9)	11.3	(21.9)	4.2	23.8	7.4	7.7	7.1	6.2	0.5	0.5	0.5	0.4	0.4	0.4	0.0%	0.0%	0.0%	0.8%	1.4%	1.5%
FIH MOBILE LTD	2038 HK	8,121	1.02	(2.9)	3.0	(25.0)	-86.8	-6.2	18.7	-127.5	21.7	13.1	0.5	0.5	0.5	0.6	0.6	0.5	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
TRULY INTL HLDGS	732 HK	5,474	1.67	(7.2)	(23.7)	(47.6)	9.8	10.9	4.0	4.2	3.4	-	0.7	0.6	0.5	0.5	0.4	-	0.0%	0.0%	6.0%	5.8%	7.8%	0.0%
Q TECHNOLOGY GRO	1478 HK	5,212	4.40	(3.1)	(14.1)	(56.3)	8.1	5.4	5.0	11.7	6.8	4.9	1.6	1.1	0.9	0.9	0.8	0.7	2.3%	1.1%	0.0%	1.1%	1.1%	1.8%
SAS DRAGON HLDG	1184 HK	2,316	3.70	6.0	(11.9)	(28.8)	9.8	8.8	3.2	-	-	-	1.4	1.2	1.0	-	-	-	1.1%	5.8%	8.5%	0.0%	0.0%	0.0%
JU TENG INTL HDG	3336 HK	1,788	1.49	4.2	12.9	15.5	9.4	9.9	7.8	7.5	5.1	3.8	0.3	0.3	0.3	0.3	0.2	0.2	6.7%	6.7%	5.4%	6.7%	6.7%	6.7%
COOLPAD	2369 HK	1,646	0.12	(11.1)	(29.8)	(68.8)	5.9	-2.0	-1.9	-	-	-	0.9	0.6	0.4	-	-	-	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
TK GROUP HOLDING	2283 HK	1,483	1.78	1.1	(19.1)	(28.8)	4.9	7.1	5.2	4.5	3.5	2.8	1.2	1.1	0.9	0.8	0.7	0.6	7.9%	5.6%	7.9%	8.4%	12.4%	16.3%
TONGDA GROUP HLD	698 HK	1,195	0.12	(8.9)	(8.9)	(50.8)	2.2	2.5	4.3	4.0	3.1	2.5	0.1	0.1	0.1	0.1	0.1	0.1	7.7%	0.0%	0.0%	6.5%	7.3%	7.3%
CHINA DISPLAY OP	334 HK	888	0.42	3.7	5.0	(17.6)	14.7	31.1	3.8	-	-	-	1.3	1.2	0.9	-	-	-	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
SIM TECH GROUP	2000 HK	679	0.31	(9.0)	0.0	(32.2)	-9.8	-18.9	-2.9	-	-	-	0.4	0.3	0.4	-	-	-	3.3%	0.0%	0.0%	0.0%	0.0%	0.0%
KA SHUI INTL HLD	822 HK	447	0.50	(27.5)	(10.7)	(36.7)	5.0	3.6	3.4	-	-	-	0.5	0.4	0.3	-	-	-	0.0%	6.0%	6.0%	0.0%	0.0%	0.0%
WILLAS-ARRAY ELE	854 HK	364	4.15	0.2	3.8	5.1	-18.6	-4.9	3.8	-	-	-	0.5	0.6	0.5	-	-	-	4.8%	0.0%	8.0%	0.0%	0.0%	0.0%
VESON HOLDINGS L	1399 HK	311	0.29	1.8	0.0	(8.1)	5.2	-5.2	6.1	-	-	-	0.3	0.3	0.2	-	-	-	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
WAI CHI HOLD	1305 HK	299	1.38	(3.5)	(9.8)	9.5	8.1	9.9	5.8	-	-	-	0.4	0.4	0.4	-	-	-	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
PANASIALUM HOLDI	2078 HK	262	0.22	5.8	(4.4)	(14.5)	-0.5	0.3	-0.8	-	-	-	1.1	0.2	0.3	-	-	-	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
VITAL INNOVATION	6133 HK	208	0.25	16.7	10.4	(15.5)	-32.7	-1.9	-8.4	-	-	-	0.3	0.3	0.3	-	-	-	41.7%	0.0%	0.0%	0.0%	0.0%	0.0%
SKY LIGHT HOLDIN	3882 HK	148	0.16	17.4	3.3	(12.9)	-1.8	-2.3	-38.8	-	-	-	0.6	0.7	0.7	-	-	-	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Average		13,742		(0.2)	4.1	(23.5)	13.6	13.4	9.4	11.7	9.5		1.5	1.3	1.1	1.5	1.0	1.1	7.7%	8.3%	5.3%	3.9%	4.7%	5.1%
AAC TECHNOLOGIES	2018 HK	16,992	14.06	(9.4)	(9.1)	(54.4)	6.8	10.1	11.6	17.9	13.8	10.0	0.8	0.7	0.7	0.7	0.6	0.6	2.9%	2.0%	1.3%	0.9%	1.1%	1.6%
Acoustics company																								
PRC peers																								
LUXSHARE PRECI-A	002475 CH	305,990	43.19	22.4	28.8	(23.4)	56.2	37.3	35.5	27.1	20.5	16.6	17.0	13.3	9.1	7.1	5.7	4.6	0.2%	0.3%	0.3%	0.4%	0.5%	0.6%
GOERTEK INC -A	002241 CH	137,439	40.23	13.7	(3.5)	(35.1)	88.7	40.2	25.9	21.1	16.5	13.6	7.4	7.1	5.6	4.0	3.6	3.0	0.3%	0.4%	0.6%	0.8%	1.0%	1.2%
LENS TECHNOLOG-A	300433 CH	66,372	13.35	12.9	21.0	(49.3)	19.0	10.6	26.4	25.4	15.3	11.4	2.7	2.3	1.2	1.3	1.3	1.2	2.2%	3.0%	0.9%	0.9%	1.4%	1.6%
JINLONG MACH-A	300032 CH	5,548	6.91	(0.7)	6.7	(4.6)	101.5	-20.5	-45.3	-	-	-	-	-	-	-	-	-	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Average		128,837		12.1	13.2	(28.1)	66.3	29.3	29.2	24.5	17.4	13.9	9.1	7.6	5.3	4.1	3.5		0.9%	1.2%	0.6%	0.7%	1.0%	1.1%
International peers																								
NIDEC CORP	6594 JP	318,702	534.48	2.0	13.8	(31.2)	40.5	72.8	35.1	35.9	31.4	26.7	4.5	4.6	4.1	4.2	3.8	3.4	0.7%	0.8%	0.8%	0.8%	0.8%	0.9%
DOVER CORP	DOV US	149,783	1,043.42	5.0	2.5	(26.8)	28.5	28.4	17.2	15.7	14.6	13.4	6.4	5.7	4.6	4.1	3.6	3.1	1.5%	1.5%	1.5%	1.5%	1.6%	1.8%
CATCHER TECH	2474 TT	34,211	46.88	7.4	11.8	15.3	12.6	6.4	14.9	15.0	16.8	16.5	0.9	0.8	0.8	0.8	0.8	0.8	5.4%	6.7%	0.0%	5.8%	5.9%	5.9%
ALPS ALPINE CO L	6770 JP	15,955	72.76	(6.6)	(8.3)	16.7	9.3	-51.8	-53.1	14.2	8.7	8.2	0.6	0.6	0.6	0.7	0.6	0.6	4.9%	3.0%	2.0%	1.7%	3.1%	3.4%
KNOWLES CORP	KN US	11,699	127.66	(12.9)	(13.1)	(30.3)	30.2	235.1	10.1	13.1	11.7	-	1.2	1.2	1.0	-	-	-	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
MERRY ELEC	2439 TT	4,573	20.96	8.2	0.6	(14.5)	6.6	12.5	13.9	11.1	10.7	11.5	1.3	1.4	1.4	1.3	1.3	1.3	9.3%	6.5%	5.3%	6.9%	6.1%	6.7%
FOSTER ELECTRIC	6794 JT	1,188	47.53	12.5	19.2	13.4	-8.1	9.6	-4.4	-8.0	45.1	15.0	0.3	0.3	0.3	0.4	0.4	0.4	3.0%	5.3%	2.3%	1.4%	1.2%	1.2%
Average		36,235		2.3	2.1	(4.4)	41.8	48.2	23.1	20.3	19.0	14.7	1.8	1.7	1.5	1.5	1.3		4.8%	4.6%	2.8%	3.4%	3.6%	3.8%
AAC TECHNOLOGIES	2018 HK	16,992	14.06	(9.4)	(9.1)	(54.4)	6.8	10.1	11.6	17.9	13.8	10.0	0.8	0.7	0.7	0.7	0.6	0.6	2.9%	2.0%	1.3%	0.9%	1.1%	1.6%

Source: Bloomberg, CIRL (Peers' market data and valuation are as of Aug 25 market close)

Exhibit 7: AAC 12-month forward P/E Ratio



Source: Bloomberg, CIRL

Risk Factors

Upside risks include: 1) new iPhone sales better than expected; 2) Faster than expected ramp up in optics segment and SLS upgrade in Android camp and 3) Easing Sino-US trade tension

Rating Policy

	Rating	Definition
Stock Rating	Buy	Outperform HSI by 15%
	Neutral	Between -15% ~ 15% of the HSI
	Sell	Underperform HSI by -15%
Sector Rating	Accumulate	Outperform HSI by 10%
	Neutral	Between -10% ~ 10% of the HSI
	Reduce	Underperform HSI by -10%

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Analyst Certification

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