



August 20, 2014
Company Report
Rating: **HOLD**
TP: HK\$ 2.30

Share price (HK\$) 2.15
Est. share price return 7.0%
Est. dividend yield 5.6%
Est. total return 12.6%

Previous Rating & TP BUY; HK\$ 3.60
Previous Report Date Feb 27, 2013

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Key Data

52Wk H/L(HK\$)	2.90/2.01
Issued shares (mn)	9,162
Market cap (HK\$ mn)	19,697
3-mth avg daily turnover (HK\$ mn)	19.1
Major shareholder(s) (%): Sinochem Group	62.90

Source(s): Company, Bloomberg, ABCI Securities

FY13 Revenue breakdown (%)

Property Development	46.9
Property Leasing	6.0
Hotels	9.9
Land Development	34.6
Others	2.6

Source(s): Company, ABCI Securities

Share performance (%)

	Absolute	Relative*
1-mth	0.5	(6.2)
3-mth	(1.6)	(10.6)
6-mth	(7.7)	(17.0)

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg, ABCI Securities

Franshion (817 HK)
Disappointing 1H14 presales; downgrade to **HOLD**

- 1H14 core profit grew 14% YoY to HK\$ 2.1bn. Margin erosion and higher gearing are concerns to investors
- Management guided margin and gearing should improve in 2H14 due to booking of high-margin projects and proceeds from Jinmao Investment spin-off
- 1H14 presales dropped 11.9% YoY to RMB 6.5bn while land sales declined 53% YoY to RMB 1.3bn. Management is confident about meeting 80% of initial RMB 30bn presales target. We think the market would react negatively to the lower presales guidance
- Downgrade to **HOLD** from Buy with a revised TP of HK\$ 2.30 (from HK\$ 3.60) based on a 60% (from 40%) discount to NAV.

1H14 core profit up 14% YoY to HK\$ 2.1bn. Franshion's core profit rose 14% YoY to HK\$ 2,082mn, as revenue jumped 24% YoY to HK\$ 13.8bn. Performances of the Group's four major businesses were mixed. Revenue from property sales rose 83% YoY to HK\$ 8.2bn as GFA delivered surged almost 5 times to 0.32mn sqm; revenue from primary land development declined 22% YoY to HK\$ 3.7bn but ASP rose almost 24% YoY to RMB 2,917/sqm; revenue from property leasing was slightly below expectation as growth slowed from 13% YoY in FY13 to 11% in 1H14; results of hotel business were mediocre as revenue rose a tepid 2% YoY despite the fact that new hotel (Hyatt Regency Chongming) had commenced operation in Mar 2014.

Management reassured investors despite weaker-than-expected margin and gearing. 1) **On margin erosion** - although gross margin remained above industry average at 39.4%, it represented a material drop of 4.1ppt YoY, mainly driven by low-margin residential projects in Chongqing and Changsha. EBIT margin also slid 5.1ppt YoY to 32.0%, as SG&A expenses went up 43% YoY. Selling expense-to-presale ratio increased from 2.8% in 1H13 to 4.7% in 1H14, as marketing activities were escalated upon market correction. However, management commented that more high-margin projects (e.g. Beijing Jinmao Palace, Shanghai Int'l Shipping Centre, etc.) with GP margins in the 35%-50% range will be booked in 2H14; 2) **Net gearing (exclude MI) increased to 88.1% in June 14** from 62.6% in Dec 13 because of the attributable land capex of RMB 7.5bn in 1H14. However management said that the HK\$ 3bn proceeds from Jinmao Investment spin-off should lower gearing level in 2H.

2014 sales target of RMB 30bn remains a challenge. We think the biggest disappointment is from the presales side. Franshion's 1H14 presales dropped 11.9% YoY to RMB 6,549mn, driven by the 2.4% YoY decline in GFA delivered and 9.8% drop in ASP. 1H14 primary land sales also decreased 53% YoY to RMB 1,266mn, or 16% of 2014 land sales target of RMB 8bn. (Continue next page)

Results and Valuation

FY ended Dec 31	2012A	2013A	2014E	2015E	2016E
Revenue (HK\$ mn)	17,176	20,719	30,933	39,546	44,770
Chg (% YoY)	160.6	20.6	49.3	27.8	13.2
Core net profit (HK\$ mn)	2,154	2,910	3,198	4,613	5,383
Chg (% YoY)	48.0	35.1	9.9	44.2	16.7
Core EPS (HK\$)	0.23	0.30	0.32	0.46	0.53
Chg (% YoY)	39.6	30.7	8.9	40.3	15.6
BVPS (HK\$)	2.58	3.07	3.30	3.64	4.07
Chg (% YoY)	11.5	18.8	7.5	10.4	11.7
Core PE (x)	9.4	7.2	6.6	4.7	4.1
PB (x)	0.8	0.7	0.7	0.6	0.5
ROE (%)	8.9	10.0	10.3	13.5	14.1
ROA (%)	2.6	2.4	2.4	3.2	3.6
DPS (HK\$)	0.07	0.10	0.12	0.16	0.16
Dividend yield (%)	3.3	4.4	5.6	7.4	7.4
Net gearing (%)	51.3	62.6	76.3	27.3	(23.2)

*Net gearing=Net debt/Total Shareholders' equity
Source(s): Bloomberg, ABCI Securities estimates

In July 2014, Franshion presales continued to drop 70% YoY to RMB 398mn, and no land sales were registered. Management commented achieving the initial target of RMB 30bn presales (RMB 22bn from property sales and RMB 8bn from land sales) would be challenging in the current environment. The Group is more confident about reaching 80% of the original target (i.e. RMB 24bn, of which RMB 6bn from land sales) this year.

Exhibit 1: Franshion's 1H14 results

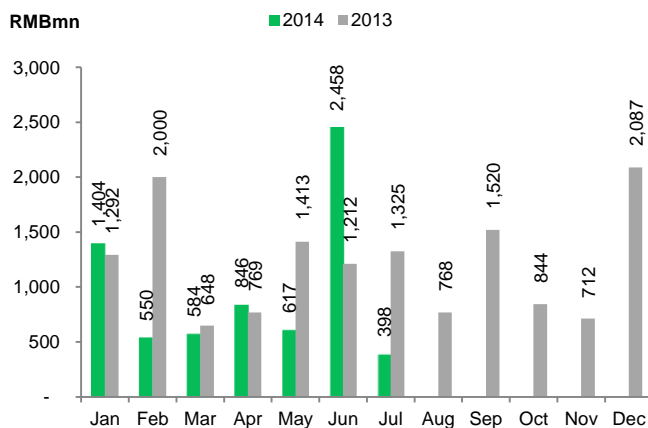
P&L	1H14	1H13	YoY
	HK\$ mn	HK\$ mn	Chg (%)
Turnover	13,819	11,132	24
Property sales+ land development	8,194	4,478	83
Primary land development	3,654	4,707	(22)
Property leasing	696	629	11
Hotel	1,058	1,042	2
Others	218	276	(21)
Cost of Sales & direct operating costs	(8,378)	(6,295)	33
Gross Profit	5,441	4,837	12
Gross Margin (%)	39.4	43.5	(4.1ppt)
Selling and distribution costs	(305)	(208)	46
Administrative expense	(708)	(499)	42
EBIT	4,429	4,130	7
EBIT Margin (%)	32.0	37.1	(5.1ppt)
Other income, gains and losses	217	145	50
Fair value gain of investment properties	2,097	587	257
Other exceptional items	0	142	(100)
Share of profit from JCE/ Associates	(1)	1	(144)
Finance cost	(915)	(603)	52
Profit before tax	5,828	4,403	32
Tax	(1,966)	(1,718)	14
- LAT	(331)	(681)	(51)
- Enterprise tax	(1,634)	(1,037)	58
Profit after tax	3,862	2,685	44
Minority Interest	(212)	(450)	(53)
Net profit	3,650	2,235	63
Underlying net profit	2,082	1,827	14

Source(s): Company

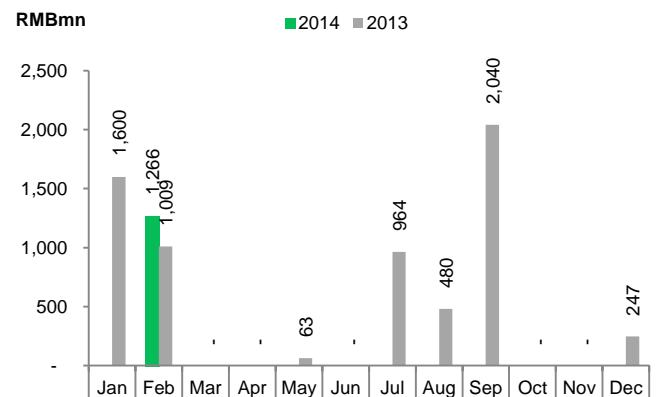
Exhibit 2: Franshion's 1H14 operating statistics

Operating statistics	1H14	1H13	YoY Chg
Contracted GFA ('000 sqm)	0.26	0.26	(2)
Contracted ASP (RMB/sqm)	25,229	27,960	(10)
Presales (RMB mn)	6,459	7,334	(12)
GFA Delivered (mn sqm)	0.32	0.06	414
Booked ASP (HK\$/sqm)	25,895	72,762	(64)
Property sales booked (HK\$ mn)	8,194	4,478	83
Land sold (mn sqm)	1.00	1.56	(36)
Booked ASP (HK\$/sqm)	3,660	3,010	22
Land sales (HK\$ mn)	3,654	4,707	(22)
Gross margin by segment	1H14	1H13	YoY Chg (ppt)
Property sales	32.0%	48.0%	(16 ppt)
Land development	44.0%	31.0%	+13ppt
Property leasing	90.0%	90.0%	-
Hotel	52.0%	53.0%	(1ppt)
Balance sheet	Jun 14	Dec 13	HoH %
	HKDm	HKDm	
Gross debt	45,567	35,806	27
Cash	14,144	14,793	(4)
Net debt	31,423	21,013	50
Net gearing- include perpetual instrument (%)	88.1	62.6	+25.5ppt

Source(s): Company

Exhibit 3: Franshion's presales performance (residential and commercial) in 2013-Jul 2014


Source(s): Company

Exhibit 4: Franshion's land sales in 2013-Jul 2014


Source(s): Company

Spin-off of Jinmao Investment (JI) failed to boost share price. Although market expected the recent spin-off of Jinmao Investment (6139 HK) by Franshion would help realize the value of the Group's hotel portfolio, Franshion's share price rose 3% only since JI's listing on July 2, 2014 (HSI was up 8% during same period). In fact, we believe various yield enhancement mechanisms provided by Franshion to JI could be a burden to the Group: 1) **Distribution guarantee for 2014:** Franshion made a guarantee that the annualized distributions for 2014 to the holders of the stapled securities will not be less than HK\$ 960mn. Any shortfall will be paid by Franshion to the



securities holders; 2) **Shortfall payments for initial start-up hotels:** to reduce the operational risks for the hotels under development or with a short operating history (Hyatt Chongming), Franshion agreed that if the actual EBITDA of these hotels are less than HK\$ 220mn in FY15-17, the shortfall will be compensated by Franshion.

In 1H14, JI's EBITDA dropped 17% YoY to HK\$ 460mn while core net profit plunged 58% YoY to HK\$84mn, mainly due to the HK\$ 33mn listing fees and HK\$ 88mn pre-opening expenses for hotels under development. JI is likely to require the Group's support as financial performance is still weak.

Exhibit 5: Financial information of Jinmao Investment

HKDm	2011	2012	2013	1H13	1H14	YoY
Revenue	2,686	2,649	2,634	1,316	1,357	3.1%
<i>YoY chg</i>		<i>(1.4%)</i>	<i>(0.6%)</i>			
Hotels	2,134	2,010	1,958	999	1,009	1.0%
Rental	418	491	503	244	273	11.6%
Others	134	148	173	73	76	4.0%
EBITDA	1,105	1,093	1,068	553	460	(16.8%)
<i>YoY chg</i>		<i>(1.0%)</i>	<i>(2.3%)</i>			
<i>EBITDA margin</i>	<i>41.1%</i>	<i>41.3%</i>	<i>40.6%</i>	<i>42.0%</i>	<i>33.9%</i>	
Depreciation	(215)	(216)	(216)	(115)	(125)	8.8%
EBIT	890	877	852	438	335	(23.6%)
Others exceptional items (fair value gains of IP etc.)	122	454	849	63	1,244	1861.8%
Finance cost	(502)	(536)	(334)	(168)	(148)	(11.8%)
Profit before tax	510	795	1,368	333	1,430	329.4%
Tax	(159)	(156)	(354)	(86)	(413)	382.3%
Profit after tax	351	639	1,013	247	1,017	311.1%
Minority interest	(41)	-	-	-	-	
Net profit	310	639	1,013	247	1,017	311%
Core profit	218	298	376	200	84	(58%)
<u>Distributable income</u>						
EBITDA	1,105	1,093	1,068	553	460	(16.8%)
Actual finance cost paid	(457)	(492)	(305)	(216)	(183)	(14.9%)
Actual tax paid	(95)	(79)	(93)	(64)	(100)	56.7%
Distributable income	552	522	671	274	176	(35.5%)

Source(s): Company

Exhibit 6: Hotel portfolio - operating statistics

	No. of Rooms	Occupancy (%)			Average daily rate (RMB)		
		2012	2013	YoY (ppt)	2012	2013	YoY (%)
Grand Hyatt Shanghai	555	60	58.6	(1.4)	2,060	2,053	0%
The Westin Beijing Chaoyang	550	76.5	71.7	(4.8)	1,893	1,709	(10%)
JW Marriot Shenzhen	411	71.5	75.0	4.0	1,260	1,301	3%
The Ritz Carlton Sanya	450	62.1	69.1	7.0	3,788	3,471	-8%
Hilton Sanya Resorts and Spa	501	59.2	65.8	6.6	2,282	2,085	-9%
Weighted avg		65.8	67.6	1.8	2,210	2,014	-9%

Source(s): Company

Exhibit 7: Hotel portfolio - EBITDA breakdown

HK\$ mn	2011	2012	2013
Grand Hyatt Shanghai	165	146	123
The Westin Beijing Chaoyang	134	164	110
JW Marriot Shenzhen	90	96	105
The Ritz Carlton Sanya	265	228	222
Hilton Sanya Resorts and Spa	175	144	134
EBITDA- Hotels	829	779	694
EBITDA- Rental and others	275	314	374
Total EBITDA	1,105	1,093	1,068

Source(s): Company

Downgrade to HOLD on weak results. As Franshion's overall presales performance was much slower than expected in 1H14, we cut our FY14E/15E core profit forecasts by 3% and 20%. We also adjust down our NAV forecast to HK\$5.78 (from HK\$6.03) to factor in the spin-off of JI and lower-than-expected presales. We also increase our discount to 60% (from 40%) as we expect its above-average valuation in the sector will no longer be sustainable after the spin-off of its valuable investment property portfolio to JI. We downgrade Franshion from Buy to **HOLD** with TP at HK\$ 2.30 (from HK\$ 3.60).



Exhibit 8: Franshion's FY14E NAV

	Attr. GFA (M sqm)	Net assets value (HKD m)	% of total	Valuation Methodology	Implied value per sqm (HKD)
Property development					
Beijing	0.8	11,866	14%	DCF at WACC of 9.6%	14,088
Shanghai	0.6	17,548	21%		31,125
Changsha	1.5	2,541	3%		1,730
Suzhou	0.3	1,989	2%		7,259
Chongqing	1.1	6,472	8%		5,661
Others	2.6	10,311	12%		4,006
Subtotal	5.7	50,727	60%		8,864
Primary Land Development	4.1	14,470	17%	Mkt value	3,564
Investment Properties	0.5	12,433	15%	7.5% cap rate on net rental income	
Hotels		7,119	8%	Market value of 67% stake in Jinmao Investment	
Total 2014E GAV		84,750	100%		
2014E Net debt (including Perpetual convertible securities)		(31,780)	-37%		
Total 2014E NAV		52,970	63%		
No. of share outstanding		9,161			
NAV per share (HKD)		5.78			
Target discount (%)		60%			
Target Price (HKD)		2.30			
WACC	9.6%				
Cost of debt	6.5%				
Cost of equity	15.0%				
Debt / (Debt + Equity)	53%				

Source(s): Company, ABCI Securities estimates



Consolidated income statement (2012A-2016E)

FY Ended Dec 31 (HK\$ mn)	2012A	2013A	2014E	2015E	2016E
Revenue	17,176	20,719	30,933	39,546	44,770
Cost of sales	(9,977)	(11,519)	(16,860)	(21,780)	(23,921)
Gross Profit	7,199	9,200	14,073	17,765	20,849
SG&A expenses	(1,407)	(1,785)	(2,359)	(2,900)	(3,190)
EBIT	5,792	7,415	11,714	14,866	17,659
Finance cost	(986)	(1,325)	(1,650)	(1,758)	(1,758)
Share of profit of associates	2	2	-	-	-
Other income/ (expenses)	284	524	383	591	1,091
Fair value gain of investment properties	1,626	1,831	-	-	-
Disposal/one-off items	5	-	-	-	-
Profit before tax	6,723	8,448	10,446	13,699	16,993
Tax	(2,783)	(3,393)	(4,646)	(6,522)	(8,110)
Profit after tax	3,940	5,055	5,800	7,177	8,883
Minority interest	(563)	(807)	(2,602)	(2,564)	(3,500)
Reported net profit	3,378	4,247	3,198	4,613	5,383
Less: exceptional items	(1,223)	(1,337)	-	-	(0)
Underlying net profit	2,154	2,910	3,198	4,613	5,383
Per share					
Underlying EPS (HKD)	0.23	0.30	0.32	0.46	0.53
DPS (HKD)	0.07	0.10	0.12	0.16	0.16
Payout ratio (%)	31%	32%	37%	35%	30%
BVPS (HKD)	2.58	3.07	3.30	3.64	4.07
Growth %					
Revenue	160.6%	20.6%	49.3%	27.8%	13.2%
Gross Profit	101.4%	27.8%	53.0%	26.2%	17.4%
EBIT	139.7%	28.0%	58.0%	26.9%	18.8%
Underlying net profit	48.0%	35.1%	9.9%	44.2%	16.7%
Margin %					
Gross margin	41.9%	44.4%	45.5%	44.9%	46.6%
Gross margin (post-LAT)	19.3%	15.0%	20.4%	23.5%	25.2%
EBIT margin	33.7%	35.8%	37.9%	37.6%	39.4%
Core net margin	15.8%	17.8%	18.8%	18.1%	19.8%
Key assumptions					
Presales (HKDm)	13,230	18,384	27,167	36,014	36,106
GFA sold (m sqm)	0.31	0.57	1.09	1.12	0.81
ASP (HKD/sqm)	43,009	32,087	24,923	32,222	44,310
Booked Sales (HKD)	10,796	9,708	19,345	30,404	35,344
GFA delivered (m sqm)	0.46	0.22	0.65	1.06	0.90
Booked ASP (HKD/sqm)	23,328	44,144	29,822	28,812	39,161

Source: Company, ABCI Securities estimates



Consolidated balance sheet (2012A-2016E)

As of Dec 31 (HK\$ mn)	2012A	2013A	2014E	2015E	2016E
Current assets	38,199	46,720	41,808	58,609	78,522
Cash	12,888	14,490	13,311	29,924	50,411
Restricted cash	576	303	303	303	303
Trade & other receivables	2,003	4,202	4,202	4,202	4,202
Properties under development	10,384	10,714	10,714	10,714	10,714
Properties held for sale	3,078	5,915	5,915	5,915	5,915
Land under development	6,696	5,163	1,430	1,617	1,044
Other current assets	12,348	17,011	13,278	13,466	12,893
Non-current assets	44,303	74,123	93,789	84,046	69,654
Property, plant & equipment	6,956	7,495	8,026	8,548	9,063
Properties under development	13,047	33,318	52,453	44,188	29,281
Land under development	5,408	4,549	4,549	2,549	2,549
Investment properties	16,575	22,018	22,018	22,018	22,018
Investment in Associate and JCE	39	42	42	42	42
Other non-current assets	2,279	6,700	6,700	6,700	6,700
Total Assets	82,502	120,843	135,597	142,655	148,176
Current Liabilities	25,726	39,604	46,809	48,517	46,984
Short term borrowings	8,952	6,139	11,139	11,139	11,139
Trade & other payables	6,233	9,504	9,504	9,504	9,504
Pre-sales deposits	8,235	16,749	18,954	20,663	19,129
Other current liabilities	2,306	7,212	7,212	7,212	7,212
Non-current liabilities	22,273	34,020	34,020	34,020	34,020
Long term borrowings	19,323	29,667	29,667	29,667	29,667
Other payables	-	-	-	-	-
Other non-current liabilities	2,950	4,353	4,353	4,353	4,353
Total Liabilities	47,999	73,624	80,829	82,537	81,004
Net Assets	34,503	47,219	54,768	60,117	67,172
Shareholders Equity	24,290	28,974	31,072	34,219	38,136
Perpetual Convertible Securities	4,588	4,588	4,588	4,588	4,588
Minority Interest	5,625	13,658	19,108	21,310	24,448
Total Equity	34,503	47,219	54,768	60,117	67,172
Key ratio					
Gross debt (HKDm)	28,275	35,806	40,806	40,806	40,806
Net debt (HKDm)	14,811	21,013	27,192	10,579	(9,908)
Net gearing (%)	51%	63%	76%	27%	(23%)
Presales / Total assets (x)	0.16	0.15	0.20	0.25	0.24

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2012A-2016E)

FY ended Dec 31 (HK\$ mn)	2012A	2013A	2014E	2015E	2016E
EBITDA	6,022	7,684	11,991	15,151	17,953
Change in Working Capital	(4,186)	(10,505)	(12,357)	12,681	14,840
Tax payment	(1,137)	(2,365)	(4,646)	(6,522)	(8,110)
Operating Cashflow	699	(5,186)	(5,013)	21,310	24,683
Purchase of PP&E	(310)	(808)	(808)	(808)	(808)
Addition of Investment Properties	(20)	0	0	0	0
Investment in Associate/ JCE	0	0	0	0	0
Proceeds from Disposals	0	0	0	0	0
Others	(968)	32	383	591	1,091
Investing Cashflow	(1,298)	(776)	(425)	(217)	283
Debt raised	16,488	25,961	10,000	10,000	10,000
Debt repaid	(13,369)	(21,339)	(5,000)	(10,000)	(10,000)
Interest expenses	(949)	(1,947)	(2,490)	(2,652)	(2,652)
Equity raised	0	0	0	0	0
Convertible securities coupon payments	(317)	(317)	(312)	(312)	(312)
Dividend to shareholders	(366)	(641)	(1,099)	(1,466)	(1,466)
Others	(222)	5,848	3,160	(50)	(50)
Financing Cashflow	1,264	7,564	4,259	(4,480)	(4,480)
Net cash inflow/ (outflow)	665	1,602	(1,179)	16,613	20,487
Cash- beginning	12,224	12,888	14,490	13,311	29,924
Cash- year-end	12,888	14,490	13,311	29,924	50,411

Source(s): Company, ABCI Securities estimates

Disclosures

Analyst Certification

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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return – 6% \leq Stock return < Market return rate
Sell	Stock return < Market return – 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2009-2013

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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