

Hosa International Limited

Cash rich swimwear leader

To summarize...

- Market leader in China indoor sports wear.
- Three-year net earnings CAGR of 111.4% between FY08A and FY11A.
- Lucrative profitability with GP margin at 62.2%.
- Indoor sports sector in China has high growth potential
- Net cash position of RMB648.8m
- Undervalued at FY11A ex-cash PER of 4.4x.

Investment case. Being the market leader in China indoor sports wear sector, Hosa International's net earnings have been skyrocketing, with three-year CAGR of 111.4%, between FY08A and FY11A. The group's GP has been expanding rapidly during the track record period and reached 62.2% for FY11A; thanks to the strategy of shifting product mix toward premium functional products with higher ASP and GP. Going forward, we expect the group's bottom line to be driven by the strong organic growth in demand for indoor sportswear in China, expansion in sales network, and margin enhancement on launching more high-end indoor sports wear products with higher ASP. The group had a strong and simple balance sheet, with net cash position of RMB648.8m and no long term debt and convertible notes; that said, it has enough cash for expansion and potential M&A. Trading at FY11A ex-cash PER of 4.4x, valuation of the group has been underestimated, in our opinion.

Hosa International



Source: the company

A market leader. Hosa was the largest indoor sportswear brand in terms of 2010 ex-factory sales in China. According to Frost & Sullivan, in terms of domestic ex-factory revenue, Hosa was the largest swimwear brand in China's mid-to high (retail label price above RMB295.0 per set) swimwear market, occupying 23.5% of the market shares.

China's swimwear: Top five brands by domestic ex-factory revenue in 2010

Brand	Market share (%)
Hosa	6.1
Arena	2.6
Zoke	2.4
Speedo	2.3
Heatwave	1.6
Total ex-factory revenue of top five brands	15.0

Source: Frost & Sullivan

Please refer to important disclosures at the end of this report

Ticker	2200 HK
Rating	Not Rated
Price (HK\$)	1.92
Target Price (HK\$)	-
12m Price Range (HK\$)	1.28-2.06
Market cap. (US\$m)	393.8
Daily t/o (US\$m)	0.1
Free float (%)	25

Financial summary

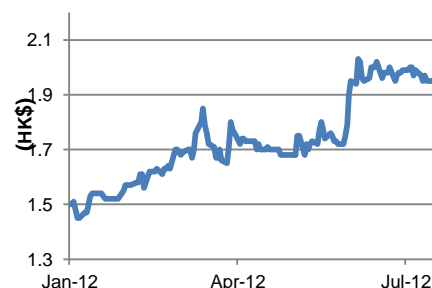
Year to Dec	09A	10A	11A
Turnover (RMB)	159.2	347.8	695.2
Net Profit (RMB)	28.7	116.1	273.7
EPS (RMB)	0.020	0.100	0.220
P/E (x)	98.7	23.6	10.7
P/B (x)	23.48	9.52	3.28
EV/EBITDA (x)	105.2	25.2	7.2
Yield (%)	-	-	4.4
ROE (%)	47.6	55.6	46.6
ROCE (%)	-	113.1	58.7
N. Gear. (%)	Cash	Cash	Cash

Source: Company

	12F	13F	14F
Consensus EPS (RMB)	0.26	0.23	-
Previous EPS (RMB)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(6.6)	13.3	-
Actual price changes (%)	(2.5)	12.9	-



Source: Bloomberg

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Meanwhile, it was the largest brand in mid-to-high end fitness wear market in China, with market share of 19.4%.

China's fitness wear market: Top five brands by domestic ex-factory revenue in 2010

Brand	Market share (%)
Hosa	4.6
Zoke	2.1
Sunyoga	2.1
Decathlon	2.1
Pieryoga	1.9
Total ex-factory revenue of top five brands	12.8

Source: Frost & Sullivan

Hosa was also the leading brand name in sports underwear market in China, capturing the largest market share of 31.1% among all domestic and multinational sports underwear brands in China in 2010.

China's sports underwear market: Top five brands by domestic ex-factory revenue in 2010

Brand	Market share (%)
Hosa	31.1
Adidas	4.9
Nike	3.2
LYY	2.1
Aimer	1.6
Total ex-factory revenue of top five brands	42.9

Source: Frost & Sullivan

Extensive sales network. The group's extensive sales network consisted of 29 distributors and 63 respective sub-distributors with POS of 1,212, covering 28 provinces, autonomous regions and municipalities. Among its POS, 906 are counters in department stores, 68 are professional retail outlets in indoor sports premises, such as gym and pool, and 238 POS are Hosa specialty stores. The majority of the group's retail outlets are located in China's first-tier cities, and as a market leader, it is well positioned to expand into China's second- and third-tier cities and capture these growing markets in their early development stage.

China's sports underwear market: Top five brands by domestic ex-factory revenue in 2010

Region	Provinces municipalities and autonomous regions	No. of			Sales	Sales
		distributors	sub-distributors	retail outlets	FY11A (RMB m)	FY10A (RMB m)
Northern China	Beijing, Tianjin Shanxi Shandong Hebei Ningxia Inner Mongolia	8	22	363	217.8	68.6
North Eastern China	Liaoning Jilin Heilongjiang	2	2	79	61.8	25.3
Eastern China	Shanghai Zhejiang Jiangsu Anhui	6	8	284	128.1	46.7
Western China	Sichuan Chongqing Guizhou Shaanxi Yunnan	4	21	159	70.3	35.0
Central China	Hubei Henan Hunan Jiangxi	4	6	166	86.2	30.1
Southern China	Guangdong Fujian Hainan Guangxi	4	4	161	109.0	65.3
Online sales		1			17.0	25.8
Total		29	63	1,212	690.3	296.8
Overseas sales					4.9	51.0
Total sales					695.2	347.8

Source: the company

Multiple marketing channels The group has been promoting its Hosa brand as a symbol for active, fashionable and healthy lifestyles and the premier brand for indoor sportswear products through various marketing channels, including event sponsorships, marketing at sports and recreational facilities and retail outlets, and media advertising.

Over years, the group has conducted and sponsored a number of large events, including the Miss Bikini International Pageant, Miss Asia, Asia Super Model Contest, Hosa Cup National Aerobic Gymnastics Contest, Hosa Cup China Swimwear Design Contest and National Fitness Walk for the promoting Hosa brand. In 2011, the group conducted and sponsored a number of events, including:

- The China-Tianjin regional contest for the 61st Miss World Pageant
- Global final contest for the 2011 World Super Model Contest,
- The final contest for the China Super Model Contest,
- The Sanya Women' s Open for the 2011 World Beach Volleyball Tournament,
- The China-Shanghai Jinshan Open for the 2011 Swatch — Fivb World Beach Volleyball Tournament, Beijing station for the Swatch 2011 International Beach Volleyball League Grand Slam.
- Hosa Cup China Swimwear Design Contest
- Hosa Health & Care Charity Day
- Miss Asia
- 36th Miss Bikini Finale
- Hosa Cup China Swimwear Design Contest 2011
- Hosa Yoga Assembly

Event sponsorships and marketing



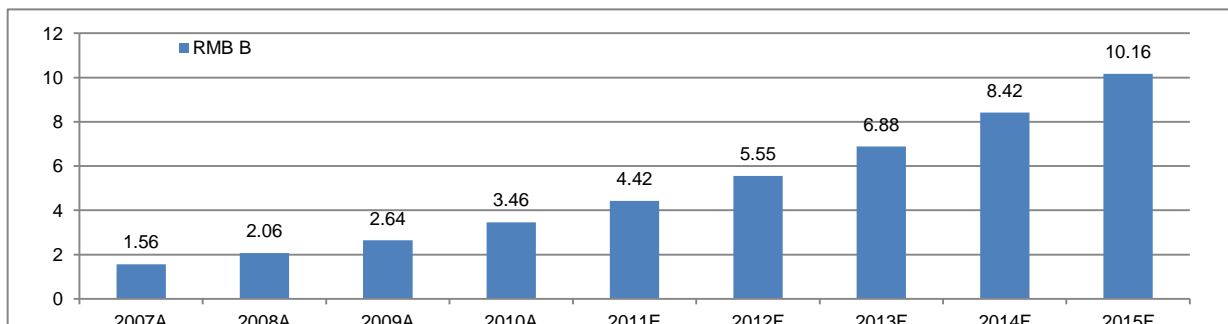
Source: the company

Just as other sportswear and sport equipment brand, the group does promote Hosa brand over the mainstream media. Further, the group places advertisements, promotional materials and products for sale at sports and recreational facilities, such as professional sports stadiums, fitness gyms, aquatic facilities and vacation resorts, to maximize the exposure of Hosa brand to target consumers. The group leverage on the promotion platform of Hosa Fitness Gyms by conducting promotional events and engaging fitness trainers to serve as spokespersons for Hosa brand. Hosa Fitness Gym is a separated entity of the group, which is owned by Beijing Aiya. In return, Beijing Aiya is owned by the group's major shareholders Mr. Shi Hongliu, Mr. Shi Hongyan, and Ms. Xu Jinfeng, the spouse of Mr. Shi Hongyan. Hosa Fitness Gym has been developing and operating a fitness club chain with more than 50 fitness clubs covering Beijing, Tianjin, Hubei, Sichuan, Gansu, Shandong and Liaoning.

Innovation. In 2010, the group's fitness wear products were recognized as one of China's Top Ten Innovative Sports Products. As of 31 December 2011, the group had 86 research, design and development personnel. The R&D team has been working closely with Italian and French fashion consulting firms to conduct market research and product design. Furthermore, the group has established long-term collaborative relationships with well-known international suppliers of fibers and fabric products, such as Lycra fibers and Coolmax fabric; thus, the group's R&D team has access to newest products as well as information on the latest fibers technologies in the market. Since the group's R&D team coordinates closely with the production team, the group is capable to launch new products in 15 days. To strengthen its R&D capability, the group is developing a new R&D headquarter in Beijing which is expected to commence operation in this year.

Market with strong growth potential. The indoor sportswear industry in China has developed rapidly in China, with a CAGR of 30.5% from 2007 to 2010. The Chinese indoor sportswear market achieved revenue of RMB3.46b in 2010.

Indoor sportswear market: ex-factory revenue (China), 2007–2015E



Source: Frost & Sullivan

Even the total indoor sportswear per capita expenditure in China was about US\$1.3 only in 2010, much lower than that in other developed countries, it demonstrated a strong growth potential with annualized growth rate of 30.4% for 2010.

Increase in disposable income and rapid urbanization are the major boosters of demand growth. Further, the initiatives by national and local tourism authorities to promote sport activities for a healthier population are also the catalyst for the general prosperity of the sports industry. Consumption of indoor sportswear also grows alongside with the increase in health awareness. Increase in indoor sport facilities and prevalence of indoor sports such as yoga and body building also boost the demand for indoor sportswear. According to Frost & Sullivan, the indoor sportswear market is expected to reach RMB10.16b by 2015F, representing a five-year CAGR of 24.0%.

Growth drivers for swimwear. The swimwear market sector accounted for 46.7% of the indoor sportswear market in China in 2010. It grew at a three-year CAGR of 24.0% between 2007 and 2010, from RMB849.4m to RMB1,617.7m. Frost & Sullivan projected that the China's swimwear market will grow at a five-year CAGR of 19.4% and reach RMB3,930.1m by 2015. Drivers of the Chinese swimwear market include:

- 1.) Increase in number of indoor aquatic facilities available within urban community establishments and at vacation resorts
- 2.) Increase in leisure travelling has been creating more opportunities for people to engage in aquatic activities.
- 3.) Seasons for swimwear have been extended, as more people swim in the winter and spend their vacations at hot springs. The national and local tourism authorities have initiated several programs, such as annual hot spring festivals in Chongqing and Hubei Province, to promote hot spring tourist sites throughout China.

Growth drivers for fitness wear and sports underwear. Between 2007 and 2010, China's fitness wear market grew at a three-year CAGR of 37.2%, from RMB575.4m to RMB1,485.5m. Frost & Sullivan expected China's fitness wear sector to reach RMB5,043.8m by 2015, representing a five-year CAGR of 27.7%.

In 2010, the sports underwear market sector accounted for 10.4% of the indoor sportswear market in China. Between 2007 and 2010, China's underwear market increased at a three-year CAGR of 39.3%, from RMB132.9m to RMB358.8m. The sports underwear sector in China is expected to reach RMB1,188.1m by 2015, representing a five-year CAGR of 27.1%, according to Frost & Sullivan's projection.

The demand for fitness wear and sports underwear in China are expected to be boosted by a number of factors, include:

- 1.) More Chinese exercise in gym as westerners.
- 2.) More fitness centers and gymnasiums have opened across the country, especially in first-tier cities and after the 2008 Beijing Olympic Games. These facilities serve not only as venues for sports activities, but also as sales channel for fitness wear.
- 3.) The rapid growth in the number of fitness centers and gymnasiums.
- 4.) The increasing prevalence of wearing professional fitness attires to engage in exercise.
- 5.) The advancement in the functional fabric technology results in better sportswear and sports underwear products.

Operation overview

Distribution network. As of the end of FY11A, the group had 29 distributors and 63 respective sub-distributors selling its products. The group authorizes its distributors to develop and expand the network of respective sub-distributors for operation of authorized retail outlets. The group's number of outlets increased from 505 as of the end of 2008 to 1,212 as of the end of 2011. The group's sales network covers 28 provinces, autonomous regions and municipalities. In general, the group has four types of retail outlets:

Department stores. Most of the group's distributors and their respective sub-distributors enter into concessionaire agreements with department stores to secure a retail floor area for selling Hosa branded products.

Professional retail channels. Some of the group's distributors and sub-distributors also market the Hosa branded products at professional retail channels, including club stores, gyms, swimming pools and vacation resorts.

Hosa specialty stores. Hosa specialty stores are stand alone stores that specialize in the sales of Hosa branded product, operated by the group's distributors and sub-distributors.

Online sales. In late 2010, the group engaged one distributor to operate the online sales of Hosa branded products through Hosa online shops, which are established on third-party online sales platforms.

Management of distribution network. The group divides China market in six regions, and each region has been assigned a sales work force to oversee and manage the regional distribution network. Each sales work force visits distributors on a monthly basis to ensure that they comply with the terms of the distribution agreement. For monitoring performance of distributors and inventory control, distributors are required to submit weekly and monthly sales reports. Headquarters also provides various training and support for distributors.

The group only enters into distribution contracts with distributors and does not do so with sub-distributors. Thus, it relies on distributors to engage, administrate and oversee sub-distributors. Nevertheless, it does provide distributors with a sub-distribution agreement template outlining the group's standards and requirements for their reference. Distributors are required to ensure that their respective sub-distributors follow the operation manual provided by the head office and comply with the pricing policies, customer service policies, retail outlet design and promotional materials set by the head office.

Distribution agreement. The group select distributor based on criteria such as the scale of its sales channels, local recognition and business network; managerial capabilities, capital resources, experience and ability to secure appropriate retail locations for outlets. The group enters distribution agreement with each distributor. Principal terms of the agreement include:

- 1.) Product and regional authorization. Distributors are required to sell only authorized Hosa branded products at their Hosa retail outlets or Hosa online shops. Unless with the group's approval, they are prohibited to sell other branded products at Hosa retail outlets or Hosa online shops. Furthermore, distributors are prohibited from directly or indirectly selling Hosa branded products outside their designated regions.
- 2.) Purchase targets. Distributors commit minimum purchase targets for each season and for the duration of the agreement. Following the sales fair for a new season, distributors' initial purchase order must account for at least 70% of their purchase target for the season. Confirmed purchase orders are non-cancellable.
- 3.) Wholesale discount. The wholesale discount for procurement from distributors is separately negotiated and agreed upon with each distributor and specified in the distribution agreement or purchase order.
- 4.) Development and management of sub-distributors and retail outlets. Distributors are often required to meet targets for developing sub-distributors and retail outlets within specified regions. Before they establish new outlets, they are required to submit written requests to the head office for approval. Distributors are also responsible for ensuring the sub-distributors comply with the group's guideline; and protecting the group's intellectual property and brand image. In addition, distributors are responsible for the settlement of all disputes and debts between themselves and their respective sub-distributors.
- 5.) Transportation and insurance. Distributors are generally responsible for the transportation expenses and insurance costs associated with the delivery of the products.
- 6.) Sales support. The group is responsible for the provision of strategic guidance, training materials, information on products and relevant market information.
- 7.) Undertakings. Distributors undertake to comply with the sales and pricing policies and customer service policies set by the group. They must adopt standardized outlet design developed by the group and use promotional materials provided by the group. The group requires its distributors to regularly submit sales reports and to collect such reports from their respective sub-distributors for review.
- 8.) Product exchange and sales return. Distributors are allowed to exchange or return to products with quality defects caused by the group.
- 9.) Confidentiality. Distributors are required to maintain the confidentiality of sales and management policies, corporate strategies, pricing terms and discount as well as various information and guidelines, even after the termination of the agreement.
- 10.) Agreement renewal. The term of the distribution agreement is generally one year.

Trade fairs. Most of the Hosa branded new products are launched for sales to distributors through sales fairs, which the group conducts twice a year for the spring/summer and fall/winter seasons. For each season, sales fairs consist of one national sales fair followed by regional sales fairs. Distributors, their sub-distributors and retail outlets' personnel are invited to attend these sales fairs, where they review products for the upcoming season. Distributors, after collecting orders from their respective sub-distributors, will place orders to the group following the sales fairs. Their initial purchase order must account for at least 70% of their purchase target for the season. Confirmed purchase orders are non-cancellable.

Other than introducing new products to distributors and sub-distributors at the sales fairs, the group also introduces sales management policies, retail outlet image, and sales targets for the season. The group finalizes contracts with distributors and offer training in sales, marketing and product knowledge for them. It also collects feedback from distributors and sub-distributors and exchange ideas with them regarding the market and fashion trends during the sales fairs.

Based on orders received following the sales fairs, the group formulates production schedules for the upcoming season. Senior management team reviews orders received, discusses internally and finalizes the production quantity, types and schedule, and then confirms with distributors before mass production.

Production. The group manufactures most of its products at its owned manufacturing facilities located in Jinjiang, Fujian Province. The factory complex occupies 24,243 square meters of land and contains an office building, a clothing plant, a sewing and stitching plant, storage space and dormitories for employees and management. The group also outsource some of its production includes the processing of some fabric materials as well as the procurement of certain finished products; and purchases all of its accessories products requirement and a small portion of our swimwear, fitness wear and sports underwear products from external contracted manufacturers

Pricing Policies. The group price its products based on several factors, including the demands of target consumers and the prices of similar products offered by counterparts. Any price adjustments are based on factors such as production costs, prices set by competitors, inventory levels, market response to existing retail prices and anticipated market trends and expected customer demand. The group sells its products to distributors at a discount to suggested retail price.

R&D. As of 31 December 2011, the group had 86 research, design and development personnel, including clothing designers, pattern designers, style consultants, body function analysts and other personnel for the production of prototypes. Its R&D team is comprised of five teams including swimwear team, fitness wear team, sports underwear product categories team, general design team and technology research and development team. The group also collaborates with Italian and French fashion consulting firms, who support the group's R&D team in creating product designs.

The group conducts semiannual prototypes fair twice a year. Thousands of product prototypes are presented at each semiannual prototypes fair, and approximately half of which are selected for further production. Selected prototype products then undergo modifications in their design based on seasonal product needs and feedback from distributors and professional advisers. The finalized products are then introduced at sales fairs for ordering by distributors and sub-distributors. The group's fitness wear products were recognized in 2010 as one of China's Top Ten Innovative Sports Products (十大體育用品最具創新產品), in recognition for its technological capabilities and innovation.

Financial Overview

Financial Summary

	FY08A	FY09A	FY10A	FY11A
Turnover (RMB m)	204.6	159.2	347.8	695.2
Growth (%)	-	(22.2)	118.5	99.9
Gross profit (RMB m)	62.3	62.9	169.4	432.6
GP (%)	30.4	39.5	48.7	62.2
Pre-tax profit (RMB m)	26.6	27.2	108.8	315.7
Profit from discontinued operation (RMB m)	0.7	0.8	4.1	-
Gain on disposal of assets (RMB m)	-	-	17.6	-
Net profit (RMB m)	29.0	28.7	116.1	273.7
Growth (%)	-	(1.0)	304.7	135.8
Cash generated from operations (RMB m)	(35.1)	(68.4)	107.4	309.3
Receivable turnover days	50	94	99	104
Inventory turnover days	87	253	123	105
Net debt/cash (RMB m)	(11.1)	(98.0)	22.9	648.8
Total asset (RMB m)	210.7	360.3	533.4	1,043.8
Equity (RMB m)	91.9	120.6	297.4	877.2
Net debt to asset (%)	5.3	27.2	-	-
Net debt to equity (%)	12.0	81.2	-	-
EPS (RMB)	0.02	0.02	0.10	0.22
Growth (%)	-	-	400.0	120.0

Source: the company

Solid track record. Between FY08A and FY11A, the group's turnover increased at a CAGR of 50.3%, while its net profit surged at a CAGR of 111.4%. The strong growth in the group's turnover was driven by the increase in number of distributors and POS in its sales network.

The group adopted the distributorship model since 2010, and its sales network has been expanding rapidly. Skyrocketing net profit growth over the track recorded period is attributable to repositioning product portfolio toward premium functional products with higher ASP and GP.

Turnover by product types (RMB m)

(RMB m)	FY08A	FY09A	FY10A	FY11A
Swimwear	59.8	70.6	143.5	237.2
Fitness wear	87.3	31.3	73.8	155.3
Sports underwear	54.5	52.9	111.6	270.3
Accessories	3.0	4.3	18.9	32.4
Total	204.6	159.2	347.8	695.2

Source: the company

Revenue breakdown. Revenue from the sales of sports underwear accounted for about 39.0% of the group's total turnover in FY11A, followed by swimwear (34.1%) and fitness wear (22.3%). Fitness wear had the highest GP of 66.9%, followed by 64.8% for swimwear and 57.0% of sports underwear. ASP of all the group's major products categories were on the uptrend during the track record period, as a result of upgrading products portfolio to premium functional products. Alongside with the growth in ASP, the group's GP margin has been expanding during the track record period.

Products' # unit sold, ASP and GP (Domestic sales)

	FY08A	FY09A	FY10A	FY11A
Swimwear	2.2	2.6	4.0	3.7
ASP (RMB)	27.6	27.4	35.9	64.4
GP (%)	41.8	46.3	58.8	64.8
Fitness wear	3.4	0.6	1.4	2.1
ASP (RMB)	25.4	51.1	51.7	73.8
GP (%)	45.2	45.5	50.0	66.9
Sports underwear	1.4	1.4	2.0	3.3
ASP (RMB)	37.9	39.0	55.4	80.9
GP (%)	37.2	40.4	47.1	57.0
Accessories	0.14	0.25	0.70	0.95
ASP (RMB)	21.1	17.4	26.9	34.2
GP (%)	59.3	17.1	55.4	65.4

Source: the company

Net cash position. The group went public in December 2011 by offering 400m new shares at HK\$1.6 each and raised net proceeds of RMB488.6m. Further, the group had strong operating cash inflow of RMB309.3m for FY11A. Thus, as of the end of FY11A, the group was in a net cash position of RMB648.8m, or about RMB0.4 per share, sufficient for its expansion and potential M&A.

Table 5. Valuation Comparison

Company name	Ticker	Mkt cap (US\$m)	Last Price (Local)	His P/E (x)	1-Yr P/E (x)	2-Yr P/E (x)	PB (x)	Est ROE (%)
ANTA	2020 HK	1,502.9	4.70	6.1	6.7	7.7	1.6	28.7
XTEP INTERNATIONAL	1368 HK	694.7	2.49	4.6	5.0	5.1	1.1	11.3
LI NING CO LTD	2331 HK	633.5	4.68	10.4	16.7	11.9	1.2	26.6
361 DEGREES	1361 HK	522.2	1.97	2.9	3.8	3.8	1.0	1.4
CHINA DONGXIANG	3818 HK	489.8	0.69	31.4	9.9	8.7	0.5	31.3
HOSA	2200 HK	393.8	1.92	-	7.5	7.0	2.9	20.7
PEAK SPORT	1968 HK	357.7	1.33	2.9	4.4	4.1	0.6	26.1
Average				9.7	7.7	6.9		

Source: Bloomberg

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