

Evergreen Products Group Limited (1962.HK)

09 February 2021

STRONG ORDERS AND IMPROVEMENT OF PRODUCT MIX PAVE THE WAY FOR RECOVERY

Evergreen has issued a profit warning with an expected net loss of around HK\$15.0 million for 2020, as compared to a profit of HK\$86.2 million for 2019. The anticipated loss was mainly attributable to the significant impact of COVID-19, which has resulted in special discounts as well as a change of product mix with reduced sales of human hair extension products. However, the revenue for 2H2020 and 2021 are expected to regain a growth of 36% and 20% respectively. More importantly, its product mix and gross profit margin for 2021 are expected to improve significantly as we foresee salons and hair products stores in the US to get back to normal. Hence, ROE is likely to recover to 17% in 2022. The D2C online business would likely be another driver of its earnings that investors might overlook. We target a fair value of HK\$2.90/share based on a PE of 10x on 2022 earnings.

Revenue regaining growth momentum in 2H2020. The year of 2020 was a challenging year for wig industry. However, Evergreen managed to outperform its peers and maintained a similar level of revenue in 1H2020 with a slight decrease of only 1.9% YoY.

Rating

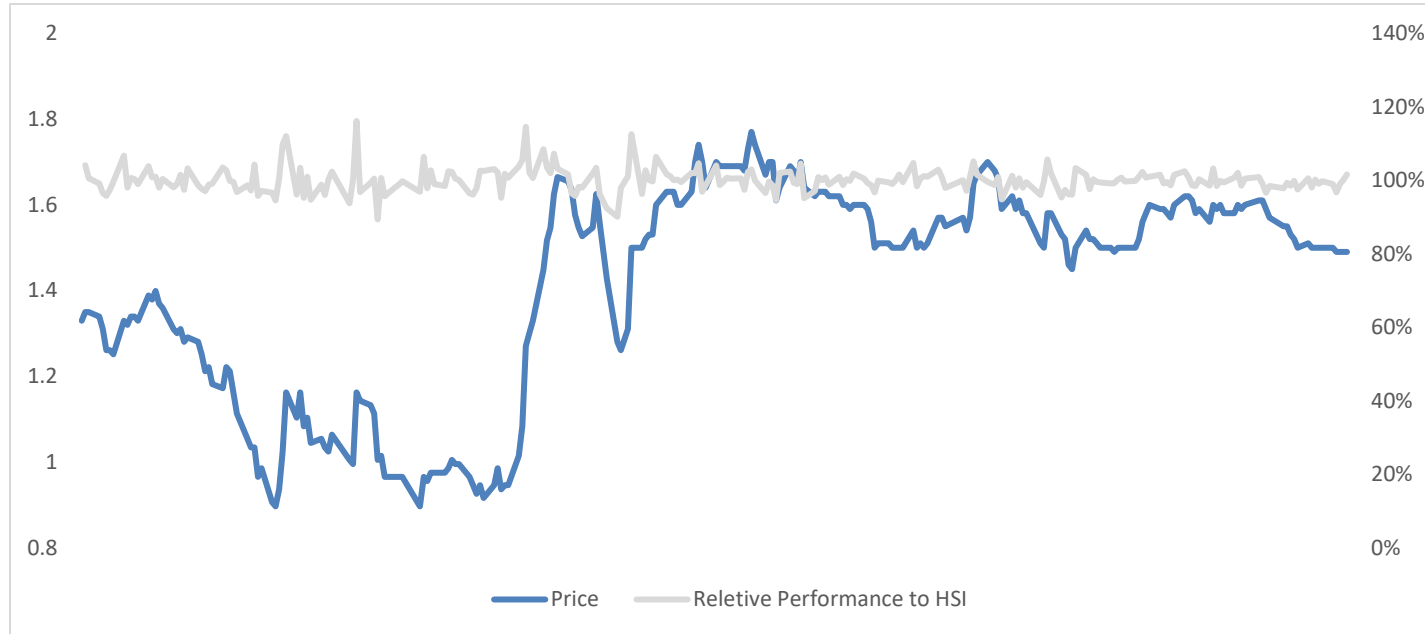
12-month rating	Buy
12m price target	HK\$2.90
Price	HK\$1.41

Trading data

Beta (5Y Monthly)	0.3
52-Week Change	9.63%
HSI 52-Week Change	42.82%
52 Week High	1.82
52 Week Low	0.81
50-Day Moving Average	1.549
200-Day Moving Average	1.583
Avg Vol (3 month)	6.68M
Avg Vol (10 day)	4.8M
Shares Outstanding	686.08M

The decline in revenue in 1H2020 was mainly due to a delay of logistics and delivery. However, the revenue for 2H2020 is expected to turnaround with a growth of 24% due to the fact that the company's production lines in Bangladesh have been less undermined during the pandemic compared to its competitors in Malaysia and China. The CAGR of its revenue is expected to achieve 20% for 2021 and 2022.

GPM recovery driven by product mix improvement. Gross profit margin of human hair products has been significantly higher at a level of 40%-45%, compared to 20%-30% for that of synthetic hair products. Looking ahead to 2021, a larger scale of vaccine penetration rate and the reopening of hair salons are expected to robustly boost the demand for high-end human hair products. The company's production capacity for real human hair products will also be utilized swiftly. We expect the proportion of human hair products to return to 17.2% in 2020, and then to a level of about 25% in 2022.



Founded in 1962, Evergreen Products Group is a leading global manufacturer of hair goods, including wigs, hairpieces, braids, high-end human hair extensions and Halloween products. Its principal market is the United States and products mainly used by women of African descent for daily wear. The production are carried out mainly in Bangladesh and about 5% in China. It has more than 24,000 employees worldwide working in Bangladesh, HongKong, Mainland China, United States, Japan, Thailand and Ukraine etc.

The D2C sales model is likely to be its next earning locomotive. The direct-to-consumer (D2C) online sales model has shown robust growth in the past two years. Under the D2C model, the average product price can be doubled while the operating cost will normally shrink along with the expansion of scale, which will greatly enhance its gross profit margin. In this respect, the company has achieved encouraging results with seven websites and brands currently under operation. In 2020, the traffic of its websites in the United States and Japan has increased by 250% and 300% respectively. We estimate D2C sales for the company to be HK\$55.06 million in 2021, a growth of 393%. Given a likely success of D2C model, the company's overall gross profit margin in 2023 is expected to increase from the current 33% to 57%.

Earnings forecast and valuation. Under the current product mix and business model, we expect the company's ROE in 2022 to return to the level in 2018. Given a higher proportion of sales of high-end human hair products and diminishing pandemic impact, we expect the company's sales to see a strong recovery in 2021 and 2022. Net profit in 2021 and 2022 is estimated to be HK\$127million and HK\$198million respectively. EPS is estimated to be HK\$0.18 and HK\$0.29 respectively. At current price, the share is trading at 6.33x 2021 earnings and 4.86x 2022 earnings. Factoring in COVID-19 impact as well as improving margins driven by high-end human hair extension products, a target price is set at HK\$2.90 per share representing a market value of HK\$1,990 million, based on a PE of 10x on 2022 earnings.

Financial Summary

Year ended 31 Dec	2018A	2019A	2020E	2021E	2022E
Revenue (HKD mn)	732	777	866	989	1,175
Gross Profit (HKD mn)	256	257	188	301	397
Net Profit (HKD mn)	111	90	-15	127	198
YoY Growth (%)	0.75	N/A	N/A	N/A	56.55
Diluted EPS (HKD)	0.18	0.14	-0.02	0.18	0.29
DPS (HKD)	0.07	0.03	N/A	0.04	0.06
Yield (%)	4.45	1.95	N/A	2.62	3.76
ROE (%)	15.61	10.43	N/A	12.50	16.35
P/E (x)	8.36	10.96	N/A	6.33	4.86

Source: Company data and Research

COMPANY OVERVIEW

Evergreen is a leading global manufacturer of hair goods

The company derives revenue from three principal product segments: (i) wigs, hair accessories and others; (ii) high-end human hair extensions; and (iii) Halloween products. In terms of product segment, wigs, hair accessories and others is the company' s key product segment accounting for 71.67% of its total revenue in 2019 while high-end human hair extensions and Halloween products accounting for 23.83% and 4.92% respectively.

Wigs, hair accessories and other



High-end human hair extensions



Halloween products and others

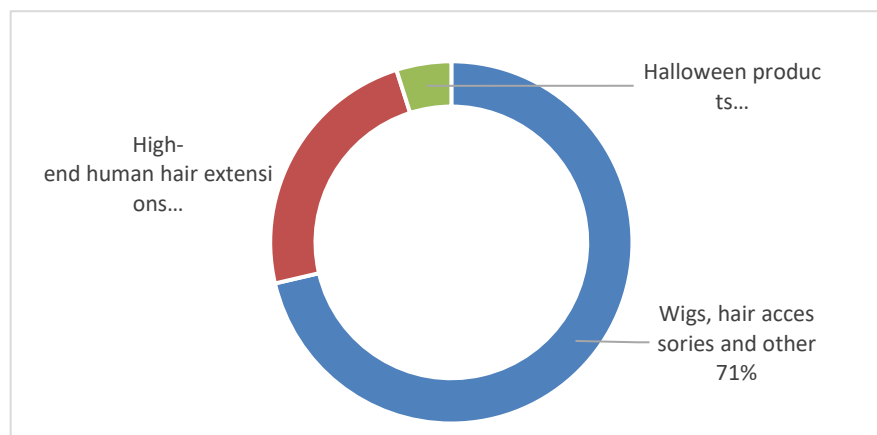


Source: Company website

The United States is the company's principal market. In the financial year of 2019, the revenue contributed by the United States accounted for 78.52% of the company's total revenue, and followed by Germany 9.63%, China 2.27%, the United Kingdom 2.51%, Ukraine 1.37%, Thailand 0.87% and others 4.83%.

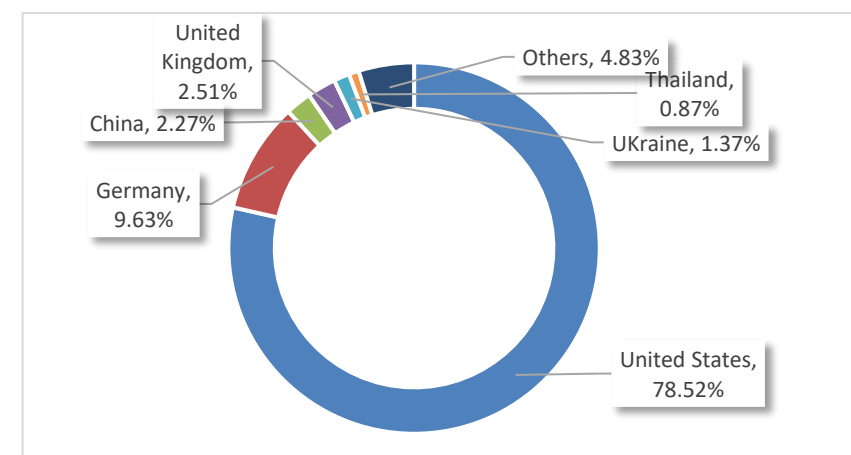
Key operations in China and Bangladesh. The company currently has three production lines in the Mainland China and two production lines in Bangladesh. The two lines in Bangladesh contribute about 95% of the company's total sales. The company has more than 24,000 employees worldwide, located in Bangladesh, HongKong, China, the United States, Japan, Thailand and Ukraine etc.

Revenue by Product



Source : Company Financial Report

Revenue by Region



SALES REGAINING GROWTH MOMENTUM

Outperformed peers. Under the influence of the COVID-19 epidemic, the company's revenue has performed better than its peers and the industry. In the first half of 2020, the company's revenue fell by 1.9% YoY, which significantly outperformed its peers. According to the financial data of Rebecca, which is a key wig supplier in mainland China, its revenue in the first half of 2020 decreased to 499.17 million yuan, a 47.25% plunge from 946.37 million yuan over the same period last year. This was mainly due to the closure of hairdressing shops in some parts of the Mainland China during February to May 2020.

Peer Company Comparison

	Evergreen PG (1962.HK)	Rebecca (600439 SH)
Fiscal year	30-Jun-20	30-Jun-20
Currency	HKD (mn)	RMB (mn)
Revenue	368.2	499.17
Gross Profit	87.55	173.68
Operating Profit	7.1	17.91
Net profit	6.55	17.62
EPS	0.01	0.015
Margins		
GPM	23.8%	34.8%
OPM	1.9%	3.6%
NPM	1.8%	3.5%

Growth changes relative to H12019

Revenue	-1.90%	-47.25%
Gross Profit	-30.30%	-73.64%
Operating Profit	-77%	-85.51%
Net profit	-86.40%	-73.64%

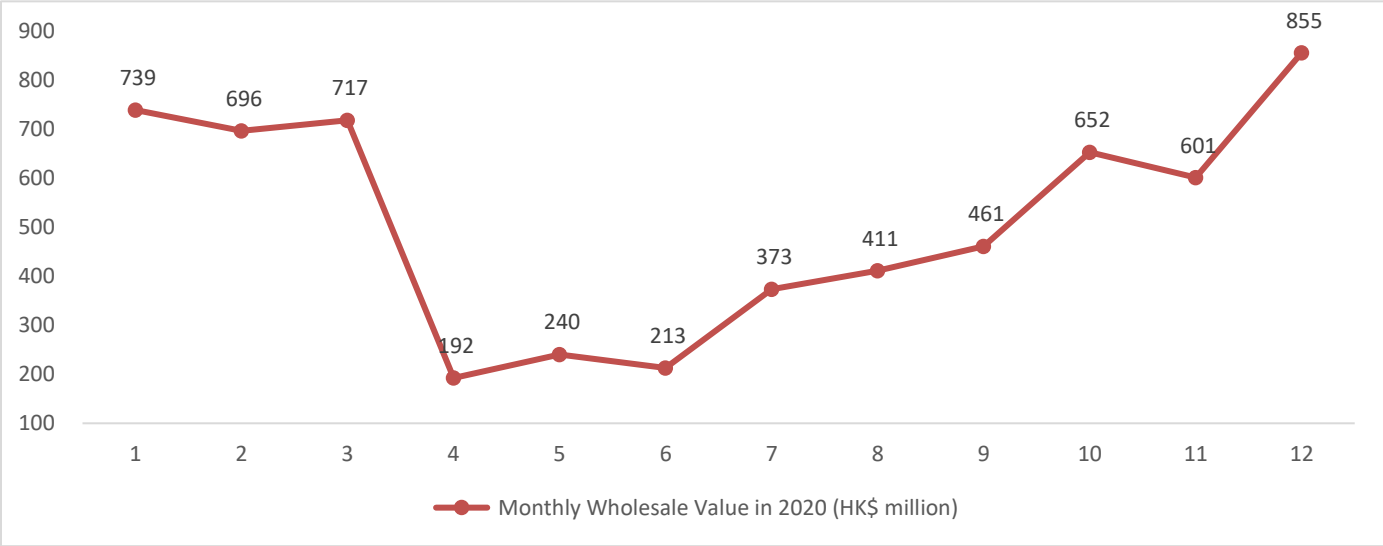
Performance changes by region

America	2.29%	-35.17%
Europe	-60.25%	-60.88%
Africa	-28.22%	-57.37%
China	99.82%	-34.22%

Strong recovery of orders in 2H2020. The impact of COVID-19 deteriorated the company’s operating results in 1H2020 mainly due to a delay of logistics, shipping and delivery. However, as logistics and shipping resume, we see the company’s operation on the track to recovery in Q3 and Q4. Since some of the company’s competitors in certain countries (such as Malaysia, China, etc.) have been relentlessly affected by COVID-19, the company has been able to secure orders for its Bangladesh factory, and hence likely to achieve a 24% growth in revenue in 2H2020.

We expect sales to grow by 20% in 2021. It is underpinned by: (1) Production lines are almost in full capacity (an estimated YoY increase of over 15% in sales for Q1 2021); (2) low base effect (an estimated YoY decrease of approximately 45% in sales for Q2 2020) (3) The injection rate of COVID 19 vaccine in the United States and around the world has increased significantly; and the US economy is likely to recover strongly.

Order Changes in 2020



Source: Company data

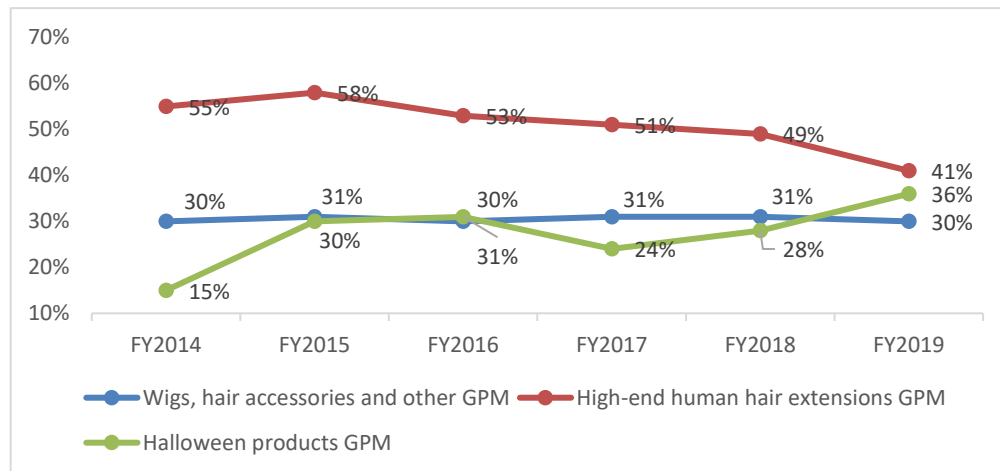
INCREASING SALES OF HIGH-END HUMAN HAIR PRODUCTS TO BOOST GP

High-end human hair products are proved to be lucrative. The average gross profit margin of the company's high-end human hair extension products from 2014 to 2019 was 51.1%, while those of wigs and Halloween products were 30.5% and 27.3% respectively.

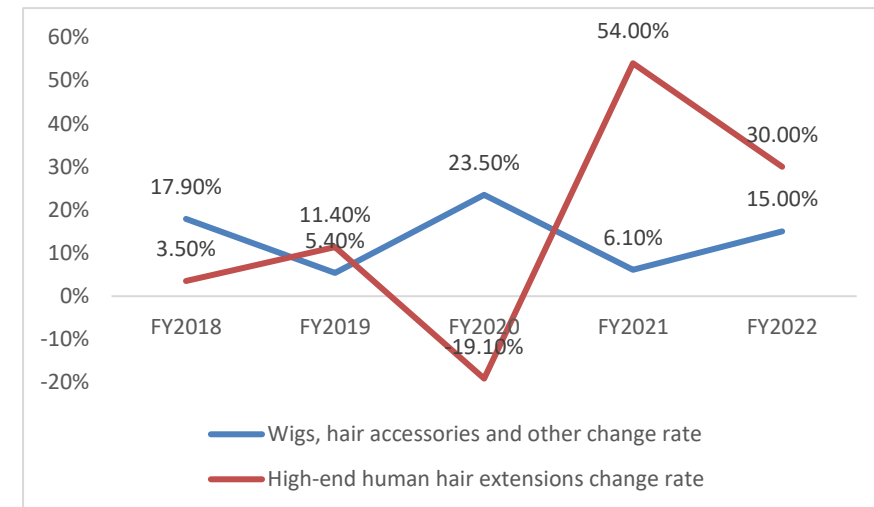
Robust recovery of this segment will likely enhance overall gross profit. The company's sales of high-end human hair products saw a growth of 11.4% in 2019, as compared to a growth of 5.4% for wigs and wig accessories. Given an alleviated impact of COVID-19 and a gradual reopening of the hair salon, the company's sales of high-end human hair have gradually returned to a normal level in 2H2020. The strong demand for high-end human hair products is likely to be the driver of its gross profit in 2021.

Gross profit margin by product

Source: Company data and Research



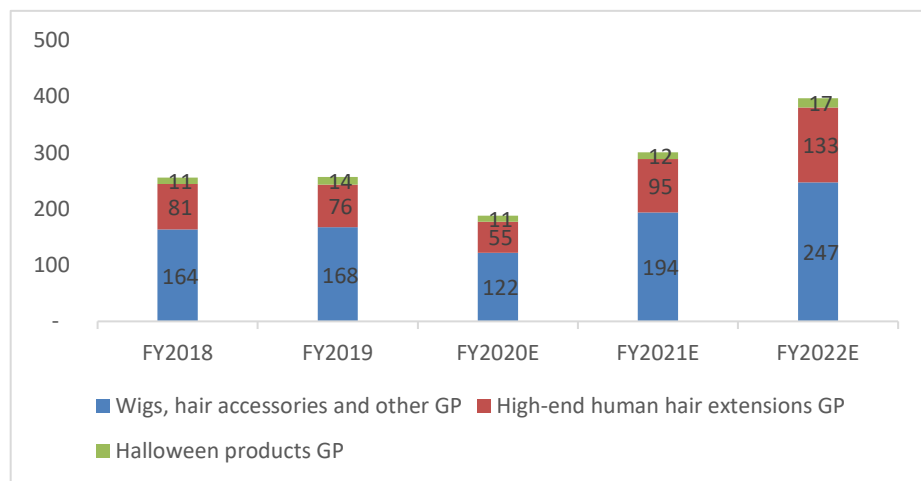
Change by product



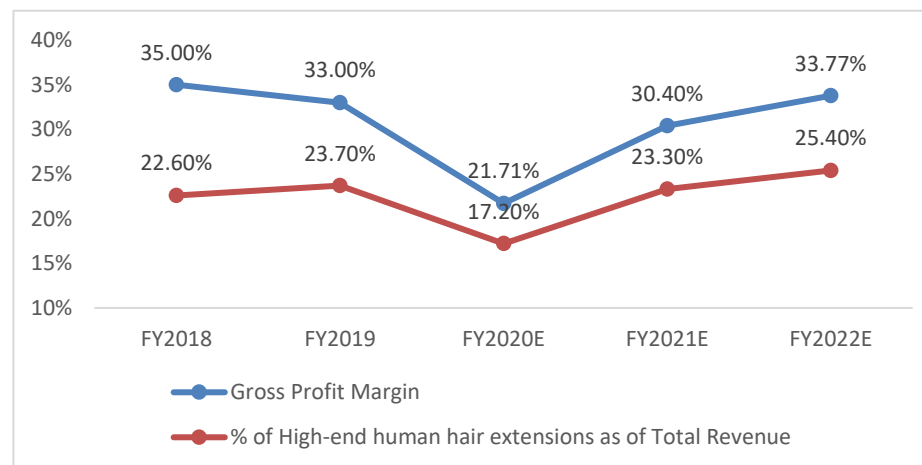
Expansion of production capacity. The Bleaching and Dyeing Complex in Bangladesh for processing human hair has been put into use. Newly hired labors are also allocated to hand-tying factories to produce human hair extension products.

Improvement of product mix. By expanding its production capacity and securing labor force, the company is very likely to enlarge its market share of global high-end human hair products, and to improve its product mix. Sales of high-end human hair products accounted for 13.9% of total in 1H2020. We expect this to be 17.2% in the full year of 2020 and 25% in 2022.

Product structure of gross profit sources (HK\$million)



GPM is affected by Product Mix of human hair products



Source: Company Financial data and Research

D2C SALES MODEL IS EXPECTED TO BE ANOTHER EARNINGS LOCOMOTIVE

The direct-to-consumer (D2C) online sales model has shown vigorous growth. According to the latest report of eMarketer, the traffic of D2C websites has doubled in two years. The global outbreak of pandemic has brought opportunities for the development of online shopping and e-commerce platforms and accelerated the shift towards a more digital world of shopping. According to a survey of INVESP which is a US consumer survey website, the proportion of consumers buying goods from D2C brands is forecast to rapidly increase to 32.5% in the next five years.

D2C model may boost its GPM to 80%. D2C model greatly reduces intermediaries and traditional e-commerce platforms. Evergreen can sell products to retail customers at a price which can be doubled from its current wholesale price. We reckon that a success of D2C model may boost its gross profit margin substantially. According to financial data from MBO, the largest B2C wig supplier in Japan, the GPM of products sold on e-commerce platforms was 80%. According to the interim results of Rebecca, a wig supplier in mainland China, its GPM was 72.37% for its D2C business.

Evergreen focus on developing D2C business in effective ways. 1) it has Established a team focused on e-commerce marketing and analysis, the sales team in the US will cooperate with influencers to enhance its marketing and cross platform digital advertisement campaigns. 2) it has been working with Shadow Factory to use the latest electronic technology (AR augmented reality/VR virtual reality) to develop a self-owned cutting-edge online shopping platform.

Company online brands

NUNIQUE

HPO
HALLOWEEN PARTY ONLINE

wigs2DOLLS.com buy wigs 2 you

KAWAII

wigs2you.com

Cutie Collection
娇滴假发

IS LeSalon
RICKY KWOK

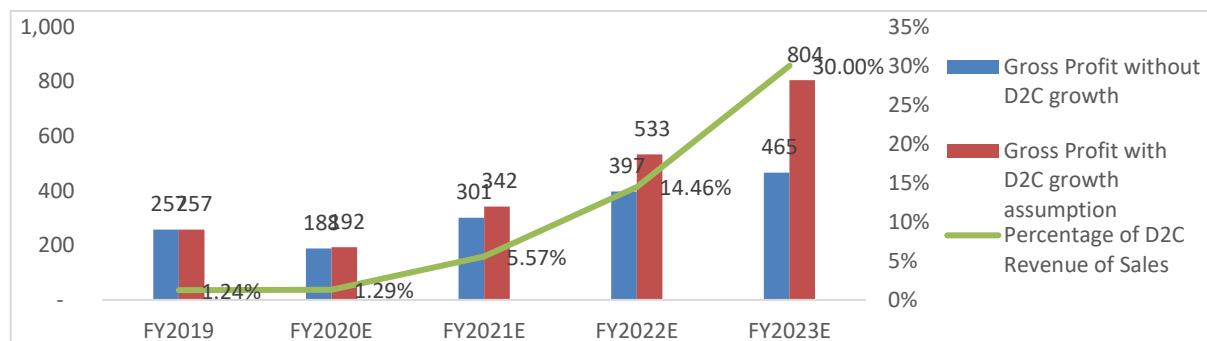
Source: Company data

Achieved encouraging results with increasing D2C sales and its proportion. Evergreen currently operates 7 websites and brands. In 2020, their online traffic in the United States and Japan increased by 250% and 300% respectively. The company is expected to achieve D2C sales of HK\$9.67 million, HK\$11.17 million and HK\$55.06 million respectively from 2019 to 2021. A skyrocketing growth of 393% is anticipated in 2021. D2C is estimated to account for 1.24%, 1.29% and 5.56% of total revenue from 2019 to 2021 respectively.

D2C likely to be the next earnings driver. Based on Evergreen’s results in FY2019 and assuming a 50% contribution from the D2C sales model, its gross profit could have increased from HKD 257 million to HKD 645.7 million, with 2.51 times the actual GPM. In an optimistic scenario, its D2C sales may account for 30% of total sales in 2023 and gross profit margin may be boosted from the current 33% to 57%.

The impact of D2C sales revenue on gross profit (HK\$ million)

Source: Company data and Research



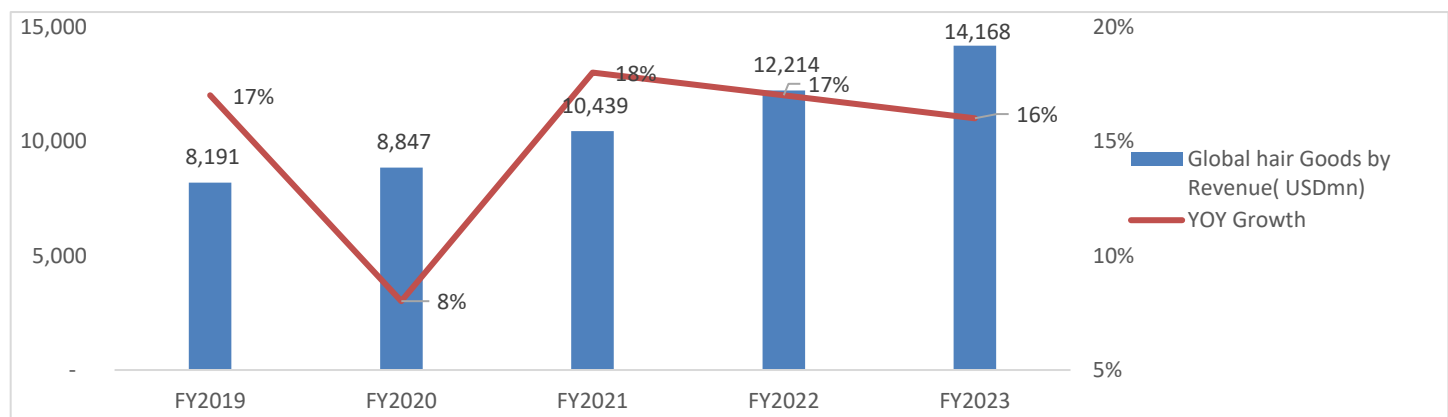
INDUSTRY OVERVIEW

The global hair goods market size is expected to reach US\$14 billion in 2023 at a CAGR of 16.7%

Driven by global economic growth and the increasing popularity of hair goods as fashion accessories among consumers, the demand for hair goods experienced a larger growth on the base of inelastic demand by native African consumers. According to the Frost & Sullivan Report, the global hair goods market size by revenue rapidly expanded from US\$2,487.6 million in 2011 to US\$5,038.7 million in 2016 at a CAGR of 15.2%. Over the next three years, the global hair goods market size is likely to reach US\$14,168million in 2023 at a CAGR of 16.7%.

Hair Goods Market Size by Revenue (Global)

Source: Frost & Sullivan Report

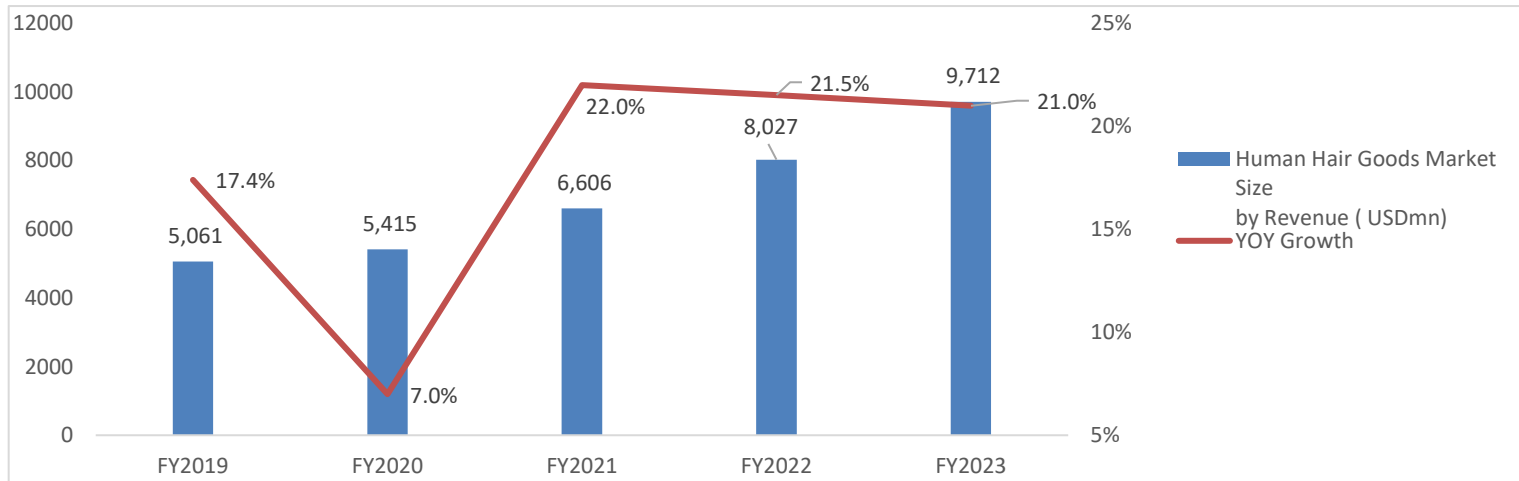


Human hair extension is the fastest growth segment, and the growth trend is likely to continue after the pandemic

The market for human hair goods expanded at a CAGR of 20.7%, increasing from US\$881.5 million in 2011 to US\$2,255.1 million in 2016, according to the Frost & Sullivan Report. The growth of the hair extension market is principally driven by the increase in demand for high-end human hair extension products. The consumption of human hair goods declined sharply in 2020 due to COVID-19. However, it is expected to recover and regain growth momentum in the coming three years. Global market for human hair extensions is expected to continue to grow over the next three years at a CAGR of 17% and reach US\$9,712.7 million in 2023, according to the Frost & Sullivan Report.

Global human hair goods by revenue

Source: Frost & Sullivan Report

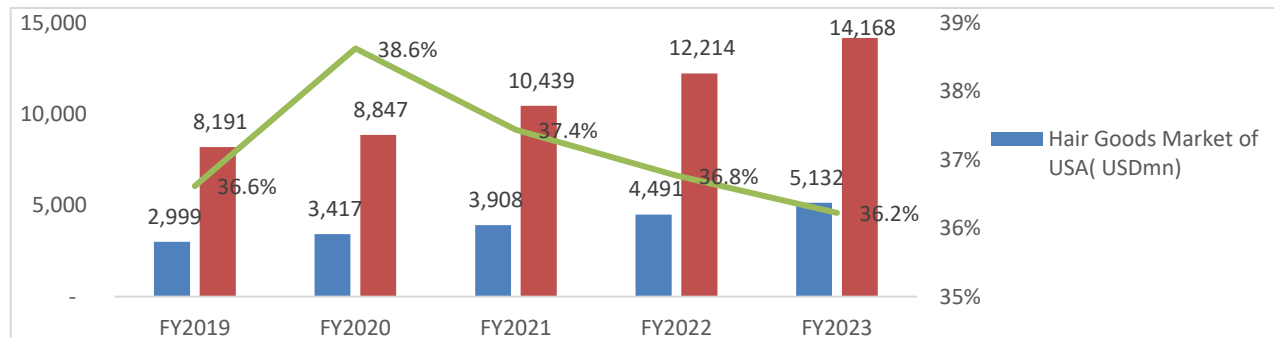


The United States is the largest market for hair goods in the world

The market for hair goods of the United States accounted for 39.8% of the global market in 2016 and grew with a CAGR of 13.7% according to the Frost & Sullivan Report. The majority of hair goods consumption in the United States is by consumers of African descent whose demand for hair goods is relatively inelastic and recurring. Consumption by Caucasian consumers primarily of human hair products, particularly hair extension products, which sell at higher price, also contributed to this market growth. The market size of hair goods in the United States is projected to continue to increase in the coming years, this growth is expected to be driven by the consistently large demand for hair goods from consumers, especially those of African descent, as well as the increasing popularity of Halloween celebrations. The market is forecast to reach US\$5,178.8 million in 2023 at a CAGR of 14.6% from 2017, according to the Frost & Sullivan Report.

Hair Goods Market Size by Revenue (Global and United States)

Source: Frost & Sullivan Report



FINANCIAL FORECAST AND VALUATION

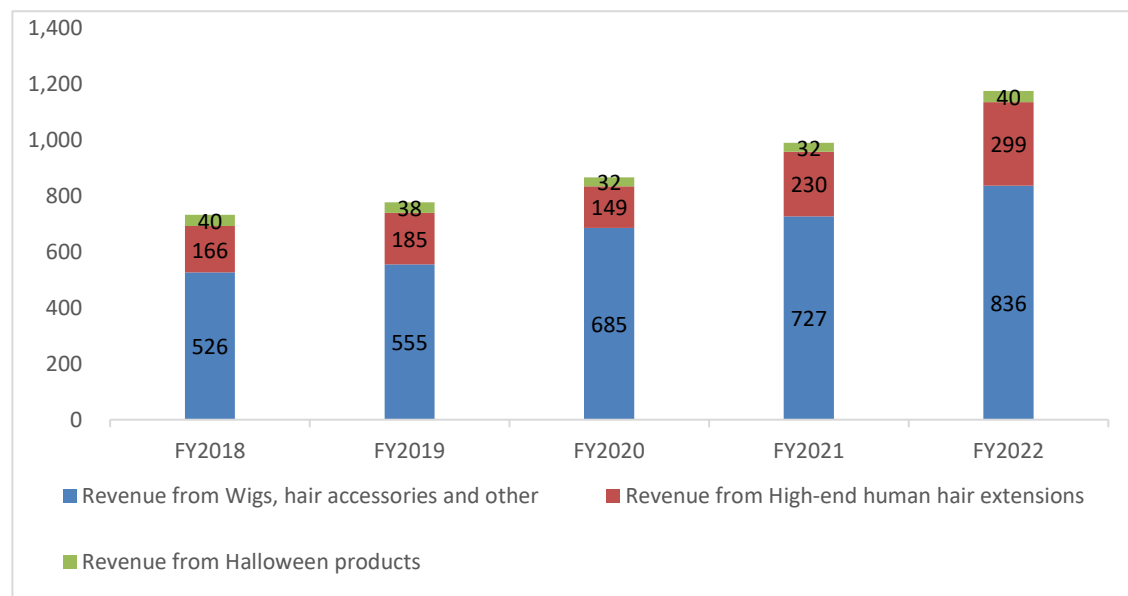
The company recorded a revenue of HK\$368 million in 1H2020, a YoY decrease of 1.9%. The main reason was the outbreak of the COVID-19 pandemic in the United States in the second quarter, delays in order delivery by shipping companies, and other factors that hindered the delivery of orders until the second half of 2020.

The company reported a gross profit of HK\$8.75 million, a YoY decrease of 30.31%. The gross profit margin decreased by 9.7% to 23.8% from 33.5% in the same period of 2019. The main reason was that the company's product portfolio has changed compared with the same period in 2019. The sales of low-end products increased significantly, while the sales of high-end human hair extension products that were more affected by the pandemic decreased.

In 1H2020, the company recorded a net profit of HK\$6.5 million, a YoY decrease of 86.4%. The reason for the further decrease in bottom line was the non-recurring losses incurred by the company's Bangladesh factory during the fire and destruction of certain machinery and inventory. Therefore, we believe that the sharp drop in net profit margin caused by this reason will not have a significant impact in the long-term.

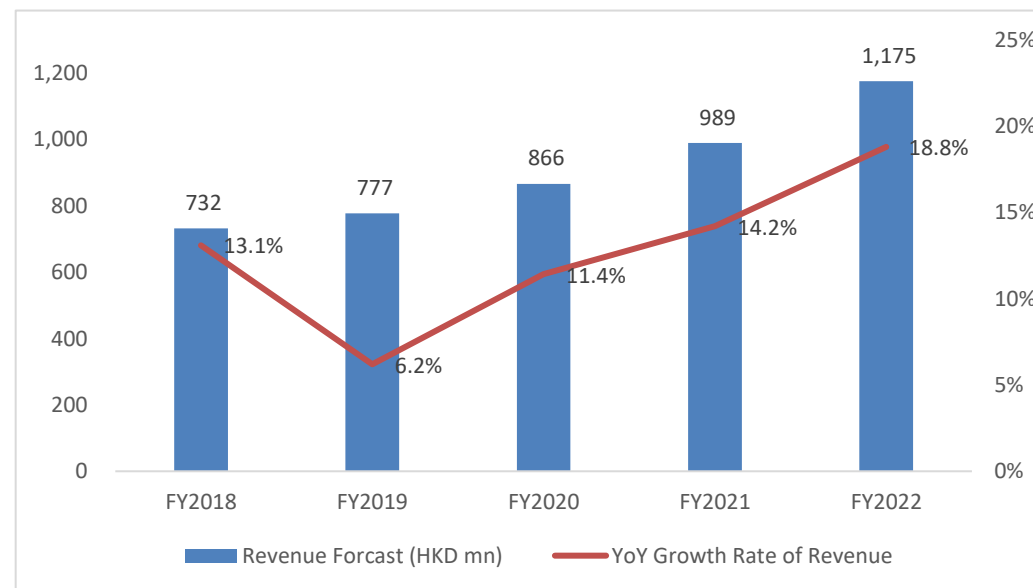
Strong orders to sustain a CAGR of 20% of revenue. Underpinned by its current customer base, the expansion of production capacity of the Bangladesh factory as well as strong orders, the company is expected to achieve a growth of 24% in revenue in 2H2020. Its revenue for FY2020 is estimated to manage a growth of 11.4% to HK\$866mn. The negative impact of COVID-19 will be further diminished in 2021. We therefore expect its revenue in 2021 and 2022 to be HK\$989mn and HK\$1,175.37mn, representing a growth of 14.2% and 18.8% respectively.

Revenue source and structure assumptions (HK\$ million)



Revenue forecast and growth

Source: Company data and Research



Net profit is expected to record a loss of HK\$15 million in 2020. However, we expect a turnaround in 2021 with a net profit of HK\$127 million and HK\$198 million in 2021 and 2022 respectively. A higher growth of 57% is expected in 2022. EPS is estimated at HK\$0.18 and HK\$0.29 respectively. At current price, the share is trading at 6.33x 2021 earnings and 4.86x 2022 earnings. Factoring in COVID-19 impact as well as improving margins driven by high-end human hair extension products, a target price is set at HK\$2.90 per share representing a market value of HK\$1,990 million, based on a PE of 10x on earnings in 2022.

We are optimistic about the company's D2C business model. If the D2C business model is successfully implemented, we are likely to see an increase of the company's revenue by HK\$55-423 million from 2021 to 2023, and the gross profit margin can be propelled from the current 33% to 57%. Therefore, the share is likely to be re-rated upward substantially.

Valuation comparison

Company Name	Listing Code	Market Cap (mn)	P/B	P/S	P/E	EV/EBITDA	Revenue (mn)	Net Income (mn)	EPS	Fiscal year	Currency
Artnature	7823.T	21,265	0.87	0.62	N/A	7.97	3,415	(829)	-25.55	31/03/20	JPY
Godrej	GODREJCP.BO	794,170	1.05	0.80	53.53	36.36	99,108	14,965	14.6	31/03/20	INR
Rebecca	600439.SH	2,751	0.89	2.21	73.64	20.4	1,819	37	0.033	31/12/19	RMB
Evergreen	1962.HK	1,042	1.21	1.34	10.86	7.02	777	87	0.14	31/12/19	HKD

Source: Company data and yahoo Finance

Financial Forecasts

Source: Company data and Research

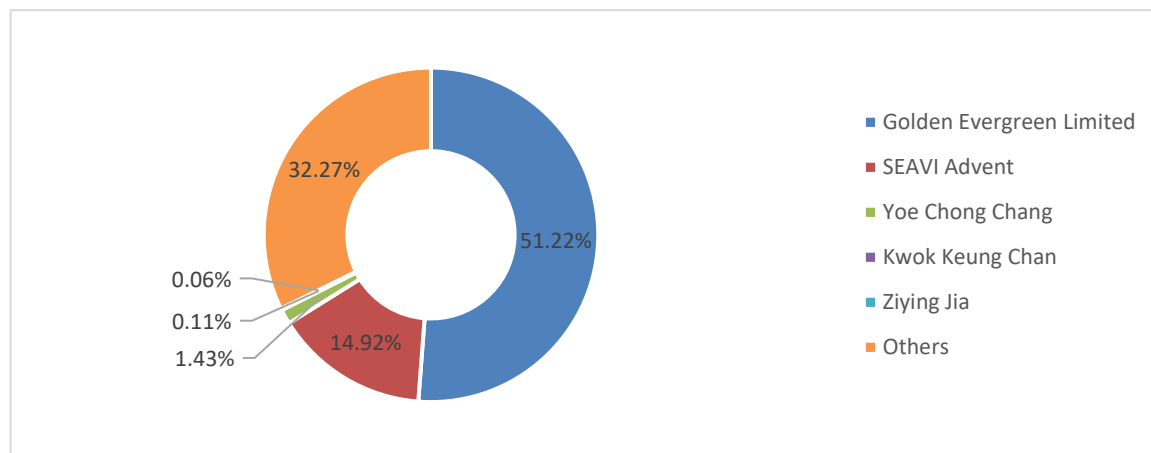
Year end 31 Dec	FY2018	FY2019	FY2020E	FY2021E	FY2022E	Year end 31 Dec	FY2018	FY2019	FY2020E	FY2021E	FY2022E
Income Statement (HKDmn)						(HKD mn)					
Revenue	732	777	866	989	1,175	Total Assets					
COGS	(476)	(520)	(678)	(689)	(778)	+ Cash, Cash Equivalents & STI	69	36	34	67	55
Gross Profit	256	257	188	301	397	+ Accounts & Notes Receiv	162	184	195	234	278
Selling, Distribution & Adm. Expenses	(135)	(146)	(184)	(145)	(157)	+ Inventories	431	477	507	607	721
Operating Profit	120	111	4	156	240	+ Other ST Assets	194	230	244	292	347
Finance costs	(9)	(24)	(19)	(21)	(29)	Total Current Assets	856	926	979	1,199	1,400
Pretax Profit	111	87	(15)	135	211	+ Property, Plant & Equip, Net	572	751	726	702	678
Tax & MI	0	4	-	(8)	(13)	+ LT Investments & Receivables	25	26	26	26	26
Net Profit	111	90	(15)	127	198	+ Other LT Assets	21	20	20	20	20
Basic EPS	0.18	0.15	(0.02)	0.18	0.29	Total Noncurrent Assets	618	796	772	747	723
Dilluted EPS	0.18	0.14	(0.02)	0.18	0.29	Total Assets	1,474	1,722	1,751	1,947	2,123
YoY Growth %						Liabilities & Shareholders' Equity					
Revenue	13%	6%	11%	14%	19%	+ Payables & Accruals	107	117	124	148	176
Gross Profit	11%	0%	-27%	60%	32%	+ ST Debt	647	717	717	717	717
Operating Profit	12%	-8%	-96%	3794%	54%	+ Other ST Liabilities	5	4	4	4	4
Pretax Profit	1%	-22%	N/A	N/A	57%	Total Current Liabilities	759	837	845	869	897
Net Profit	1%	-19%	N/A	N/A	57%	+ LT Debt	0	13	9	59	9
Basic EPS	-25%	-17%	N/A	N/A	57%	+ Other LT Liabilities	5	5	5	5	5
Dilluted EPS	20%	-22%	N/A	N/A	57%	Total Noncurrent Liabilities	5	19	14	64	14
Year end 31 Dec	FY2018	FY2019	FY2020E	FY2021E	FY2022E	Total Liabilities	763	856	858	933	911
Cash from Operating Activities						+ Share Capital & APIC	415	485	485	485	485
+ Net Income	111	90	33	128	206	+ Retained Earnings	285	354	380	501	700
+ Depreciation & Amortization	28	43	44	44	44	+ Other Equity	12	24	24	24	24
+ Non-Cash Items	(15)	(20)	(14)	(48)	(55)	Equity Before Minority Interest	712	863	890	1,011	1,210
+ Chg in Non-Cash Work Cap	(65)	(100)	(34)	(114)	(130)	+ Minority/Non Controlling Interest	(1)	3	3	3	3
Cash from Operating Activities	59	13	29	10	65	Total Equity	711	866	892	1,014	1,213
Cash from Investing Activities						Total Liabilities & Equity	1,474	1,722	1,751	1,947	2,123
+ Change in Fixed & Intang	(163)	(160)	(20)	(20)	(20)	key Assumptions					
+ Net Change in LT Investment	0	0	0	0	0	YoY Growth Rate					
+ Net Cash From Acq & Div	0	0	0	0	0	Revenue	13%	6%	11%	14%	19%
+ Other Investing Activities	(4)	(24)	0	0	0	Wigs, hair accessories and other	18%	5%	24%	6%	15%
Cash from Investing Activities	(167)	(185)	(20)	(20)	(20)	High-end human hair extensions	4%	11%	-19%	54%	30%
Cash from Financing Activities						Halloween products	-2%	-5%	-17%	1%	25%
+ Dividends Paid	(76)	(22)	(7)	(7)	(7)	% to Total Revenue					
+ Cash From (Repayment) Debt	141	49	(5)	50	(50)	Wigs, hair accessories and other	72%	71%	79%	74%	71%
+ Other Financing Activities	23	112	0	0	0	High-end human hair extensions	23%	24%	17%	23%	25%
Cash from Financing Activities	88	140	(12)	44	(56)	Halloween products	6%	5%	4%	3%	3%
Effect of Foreign Exchange Rates	(2)	(0)	0	0	0						
Net Changes in Cash	(22)	(33)	(3)	33	(12)						

APPENDIX: SHAREHOLDER STRUCTURE

Evergreen Holdings directly own approximately 51.22% of the issued share capital of the company by 25 January 2021. Evergreen Holdings is a direct wholly-owned subsidiary of Golden Evergreen. 49% and 51% of the issued share capital of Golden Evergreen are owned by Mr. Chang Chih Lung and Mr. Chang Yoe Chong through FC Investment and CLC Investment. Mr. Chang Chih Lung is the founder, honorary chairman and non-executive director of the company as well as the father of Mr. Chang Yoe Chong. He is responsible for the strategic direction and supervising the management and operation of the company. Mr. Chang Yoe Chong is the chairman, chief executive officer and executive director of the Group in charge of the overall business.

Shareholder structure

Source: Company data and HKEX website



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