

# AAC Technologies (2018 HK)

## Outlook remains challenging; Maintain Sell

AAC reported another disappointing 2Q with NP decline of 48% YoY (-62% YoY in 1Q), 38%/41% below our/consensus estimates, mainly due to GPM significant decline to 25% (vs 31% for our est.) on intense competition across all segments. Given share loss in haptics/acoustics, limited spec upgrade and iPhone shipment downside, we trimmed FY19-21E EPS by 15-25%, and cut our TP to HK\$29.6 (20% downside) based on 12.5x FY20E P/E. Maintain Sell.

- 2Q miss on worse-than-expected GPM.** Despite stabilized revenue in 2Q (+1% YoY), AAC's 2Q net profit slumped 48% YoY thanks to GPM reaching historical low at 25.0% (vs 35.2%/30.1% in 2Q18/1Q19). By segment, acoustics (48% of sales) and haptics/casings (39%) declined 6.2%/2.5% YoY, while optics (7%) maintained strong growth with 74% YoY and MEMs (4%) grew 37% YoY. Mgmt. expected optics to become strategic key growth driver, and acoustics upgrade will drive margin recovery in 2H19E.
- Optics is the only bright spot but too small to move the needle.** AAC optics grew 74% YoY in 2Q, and mgmt. guided plastic lens shipment will double to 60kk/60-70kk per month in 4Q19E/1Q20E (vs 30kk/m in 2Q19). As for WLG lens, mgmt. believed it will be widely adopted in 1) periscope lens, 2) main-cam for 64MP/128MP and 3) under-display camera for better transparency. AAC has recruited 100 employees under training in Denmark now and targeted to commerce WLG mass production in 4Q19E.
- Acoustics SLS upgrade and stepper motor/x-axis haptic in 2H19.** Gross margin for both acoustics and haptics/casings reached historical low at 27.1% in 2Q, well below 37.2%/32.9% and 41.1%/32.2% in FY18/1Q19. AAC's entry-level SLS penetrated into 50% of Android shipments (vs 35% in 1Q), and mgmt. expected to reach 70% in 4Q19E, driving 2H19E GPM recovery. As for haptics/casings, AAC expected stepper/x-axis motors to penetrate into more Android models, and automation/integration will boost GPM ahead.
- Our EPS are 26%-34% below consensus; Trimmed TP to HK\$29.6.** We believe AAC is still in transition period beyond acoustics/haptics slowdown. We cut our EPS by 15-25% to reflect 2Q miss and lower overall GPM despite stronger optics. We revised down our TP to HK\$29.6 based on 12.5x FY20E P/E, in-line with 1-sd below 5-yr average P/E. Maintain Sell. Upside risks include stronger lens demand, better iPhone sales and less margin pressure.

### Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	21,119	18,131	16,398	18,327	19,780
YoY growth (%)	36.2	(14.1)	(9.6)	11.8	7.9
Net income (RMB mn)	5,325	3,796	1,959	2,575	2,862
EPS (RMB)	4.36	3.12	1.62	2.12	2.36
YoY growth (%)	32.8	(28.5)	(48.1)	31.4	11.2
P/E (x)	7.6	10.6	20.5	15.6	14.0
P/B (x)	2.3	2.1	2.0	1.9	1.7
Yield (%)	4.1	5.4	2.8	2.1	2.3
ROE (%)	30.3	20.0	9.9	12.0	12.2
Net gearing (%)	13	9	20	29	25

Source: Company data, CMBIS estimate

### SELL (Maintain)

Target Price	HK\$29.6
(Previous TP)	HK\$34.58
Current Price	HK\$36.95
Up/Downside	-20.0%

### China Technology Sector

#### Alex Ng

Tel: (852) 3900 0881

Email: alexng@cmbi.com.hk

#### Iris Zhang

Tel: (852) 3761 8780

Email: iriszhang@cmbi.com.hk

#### Stock Data

Mkt. Cap. (HK\$m)	44,654
Avg. 3mths t/o (HK\$m)	269.33
52W High/Low (HK\$)	88.75/34.85
Total Issued Shares (mn)	1,218.0
Source: Bloomberg	

#### Shareholding Structure

Chunyuan Wu	21.75%
Zhengmin Pan	19.24%
JPMorgan Chase	11.87%
Source: HKEx	

#### Share Performance

	Absolute	Relative
1-mth	-17.2%	-10.0%
3-mth	-10.4%	-6.7%
6-mth	-38.0%	-31.8%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

#### Auditor: Deloitte Touche Tohmatsu

#### Related Reports:

- AAC Tech (2018 HK) – 1H Preview – 12 Aug 2019
- China Tech – Global landscape is at inflection point – 18 Jun 2019

## Earnings Revision

Figure 1: 2Q19 results review

RMB mn	2Q18	1Q19	2Q19	QoQ	YoY	CMBI estimates		Consensus	
						2Q19E	Diff %	2Q19E	Diff %
Revenue	3,786	3,753	3,815	2%	1%	3,547	8%	3,953	-4%
Gross Profit	1,331	1,129	955	-15%	-28%	1,120	-15%	1,177	-19%
Operating Profit	766	488	354	-27%	-54%	613	-42%	662	-47%
Net profit	653	432	338	-22%	-48%	548	-38%	578	-41%
EPS (RMB)	0.54	0.80	0.85	-22%	-48%	0.45	-38%	0.47	-40%
Gross Margin	35.2%	30.1%	25.0%			31.6%	-6.5 ppt	31.4%	-6.3 ppt
Operating Margin	20.2%	13.0%	9.3%			17.3%	-8 ppt	16.8%	-7.5 ppt
Net Margin	17.2%	11.5%	8.9%			15.5%	-6.6 ppt	14.6%	-5.8 ppt

Source: Company data, Bloomberg, CMBIS

Figure 2: Revenue breakdown

RMB mn	FY17	FY18	1Q19	2Q19	3Q19E	4Q19E	FY19E	FY20E	FY21E
<b>Revenue</b>									
Dynamic components	9,580	8,675	1,880	1,766	2,452	1,716	7,813	7,775	8,488
MEMS components	848	814	154	226	242	182	804	924	1,063
Haptics & RF	10,341	7,882	1,530	1,500	1,546	1,866	6,443	7,331	7,236
Others (incl. optics)	350	760	189	323	338	489	1,338	2,296	2,992
<b>Total</b>	<b>21,119</b>	<b>18,131</b>	<b>3,753</b>	<b>3,815</b>	<b>4,577</b>	<b>4,253</b>	<b>16,398</b>	<b>18,327</b>	<b>19,780</b>
<b>Revenue mix</b>									
Dynamic components	45%	48%	50%	46%	54%	40%	48%	42%	43%
MEMS components	4%	4%	4%	6%	5%	4%	5%	5%	5%
Haptics & RF	49%	43%	41%	39%	34%	44%	39%	40%	37%
Others (incl. optics)	2%	4%	5%	8%	7%	11%	8%	13%	15%
<b>YoY Growth (%)</b>									
Dynamic components	20%	-9%	-22%	-6%	-2%	-9%	-10%	0%	9%
MEMS components	58%	-4%	-14%	37%	-10%	-10%	-1%	15%	15%
Haptics & RF	49%	-24%	-20%	-2%	-19%	-26%	-18%	14%	-1%
Others (incl. optics)	364%	117%	36%	61%	75%	115%	76%	72%	30%
<b>Total</b>	<b>36%</b>	<b>-14%</b>	<b>-19%</b>	<b>1%</b>	<b>-6%</b>	<b>-12%</b>	<b>-10%</b>	<b>12%</b>	<b>8%</b>
<b>Gross profit margin</b>									
Dynamic components	40.8%	37.2%	32.9%	27.1%	29.0%	30.0%	29.7%	30.0%	31.0%
MEMS components	22.4%	26.6%	18.0%	27.2%	29.0%	29.0%	26.4%	26.0%	28.0%
Haptics & RF	43.6%	41.1%	32.3%	27.1%	29.5%	30.7%	29.9%	31.1%	31.2%
Others (incl. optics)	22.3%	7.6%	-5.0%	2.0%	15.0%	25.0%	12.7%	25.0%	25.0%
<b>Total</b>	<b>41.3%</b>	<b>37.2%</b>	<b>30.1%</b>	<b>25.0%</b>	<b>28.1%</b>	<b>29.7%</b>	<b>28.3%</b>	<b>29.6%</b>	<b>30.0%</b>

Source: Company data, CMBIS

Figure 3: P&L forecast

RMB mn	FY17	FY18	1Q19	2Q19	3Q19E	4Q19E	FY19E	FY20E	FY21E
<b>Revenue</b>	<b>21,119</b>	<b>18,131</b>	3,753	3,815	4,577	4,253	<b>16,398</b>	<b>18,327</b>	<b>19,780</b>
...YoY	36.2%	-14.1%	-19.1%	0.8%	-6.0%	-12.1%	-9.6%	11.8%	7.9%
Cost of sales	(12,399)	(11,388)	(2,623)	(2,860)	(3,289)	(2,991)	(11,763)	(12,897)	(13,843)
<b>Gross profit</b>	<b>8,720</b>	<b>6,743</b>	<b>1,129</b>	<b>955</b>	<b>1,288</b>	<b>1,262</b>	<b>4,635</b>	<b>5,430</b>	<b>5,937</b>
GPM (%)	41.3%	37.2%	30.1%	25.0%	28.1%	29.7%	28.3%	29.6%	30.0%
...YoY	35.3%	-22.7%	-36.0%	-28.3%	-28.6%	-31.6%	-31.3%	17.1%	9.3%
SG&A	(975)	(966)	(230)	(182)	(220)	(259)	(891)	(953)	(1,029)
...% of rev	-4.6%	-5.3%	-6.1%	-4.8%	-4.8%	-6.1%	-5.4%	-5.2%	-5.2%
R&D	(1,664)	(1,512)	(412)	(419)	(366)	(340)	(1,537)	(1,558)	(1,681)
...% of rev	-7.9%	-8.3%	-11.0%	-11.0%	-8.0%	-8.0%	-9.4%	-8.5%	-8.5%
<b>Operating profit</b>	<b>6,081</b>	<b>4,265</b>	<b>488</b>	<b>354</b>	<b>702</b>	<b>662</b>	<b>2,206</b>	<b>2,919</b>	<b>3,227</b>
OPM (%)	28.8%	23.5%	13.0%	9.3%	15.3%	15.6%	13.5%	15.9%	16.3%
...YoY	34.7%	-29.9%	-59.0%	-53.8%	-40.2%	-41.6%	-48.3%	32.3%	10.5%
<b>Net profit</b>	<b>5,325</b>	<b>3,796</b>	<b>432</b>	<b>338</b>	<b>641</b>	<b>661</b>	<b>1,959</b>	<b>2,575</b>	<b>2,862</b>
NPM (%)	25.2%	20.9%	11.5%	8.9%	14.0%	15.5%	11.9%	14.0%	14.5%
...YoY	32.3%	-28.7%	-61.6%	-48.2%	-34.2%	-36.7%	-48.4%	31.4%	11.2%

Source: Company data, CMBIS

## Our FY20-21E EPS are 26-34% below consensus

We cut our EPS by 15-25% to reflect 2Q19 miss and lower overall GPM despite stronger optics. Our EPS are lower than consensus by 26-34% mainly due to more conservative gross margin and revenue estimates for acoustics/haptics segment.

**Figure 4: Earnings revision**

RMB mn	New			Old			Change (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	16,398	18,327	19,780	16,473	17,669	18,653	-0.5%	3.7%	6.0%
Gross Profit	4,640	5,435	5,943	5,305	5,993	6,401	-12.5%	-9.3%	-7.2%
Operating Profit	2,206	2,919	3,227	2,919	3,601	3,896	-24.4%	-19.0%	-17.2%
Net profit	1,959	2,575	2,862	2,626	3,126	3,394	-25.4%	-17.6%	-15.7%
EPS (RMB)	1.62	2.12	2.36	2.16	2.57	2.79	-25.0%	-17.2%	-15.2%
Gross Margin	28.3%	29.6%	30.0%	32.2%	33.9%	34.3%	-3.9 ppt	-4.3 ppt	-4.3 ppt
Operating Margin	13.5%	15.9%	16.3%	17.7%	20.4%	20.9%	-4.3 ppt	-4.5 ppt	-4.6 ppt
Net Margin	11.9%	14.0%	14.5%	15.9%	17.7%	18.2%	-4 ppt	-3.6 ppt	-3.7 ppt

Sources: Company data, CMBIS

**Figure 5: CMBI estimates vs consensus**

RMB mn	CMBI			Consensus			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	16,398	18,327	19,780	17,564	19,196	20,762	-7%	-5%	-5%
Gross Profit	4,640	5,435	5,943	5,897	6,653	7,227	-21%	-18%	-18%
Operating Profit	2,206	2,919	3,227	3,393	4,160	4,755	-35%	-30%	-32%
Net profit	1,959	2,575	2,862	2,985	3,496	3,856	-34%	-26%	-26%
EPS (RMB)	1.62	2.12	2.36	2.45	2.90	3.21	-34%	-27%	-26%
Gross Margin	28.3%	29.6%	30.0%	33.6%	34.7%	34.8%	-5.3 ppt	-5 ppt	-4.8 ppt
Operating Margin	13.5%	15.9%	16.3%	19.3%	21.7%	22.9%	-5.9 ppt	-5.7 ppt	-6.6 ppt
Net Margin	11.9%	14.0%	14.5%	17.0%	18.2%	18.6%	-5 ppt	-4.2 ppt	-4.1 ppt

Source: Bloomberg, CMBIS

## Valuation

### Maintain Sell with TP HK\$29.6 (20% downside)

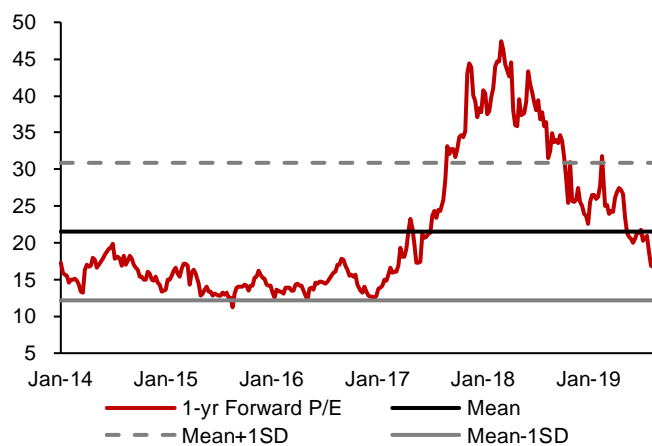
We revised down our TP to HK\$29.6 based on 12.5x FY20E P/E, in-line with 1-sd below 5-yr average P/E. We believe AAC is still in transition period beyond acoustics/haptics slowdown. We assign lower-than-historical-average target multiple, mainly due to slower earnings growth, weakening industry positioning and ROE contraction in FY20-21E. Upside risks include stronger lens demand, better iPhone sales and less margin pressure.

Figure 6: Peers' valuation

Company	Ticker	Rating	Market Cap US\$(mn)	Price (LC)	TP (LC)	Up/Down -side	P/E (x)		P/B (x)		ROE (%)	
							FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
<b>Global Connector Company</b>												
AAC Tech	2018 HK	Sell	5694.15	37.0	29.6	-20%	20.5	15.6	2.0	1.9	9.9	12.0
Goertek	002241 CH	Hold	6467.02	14.1	9.1*	-36%	37.1	32.8	2.8	2.7	7.6	8.1
Luxshare	002475 CH	Buy	19393.09	25.7	32.1	25%	27.6	20.1	5.2	4.2	18.9	20.8
Merry	2439 TT	NR	954.38	145.5	NA	NA	10.5	10.5	2.4	2.4	26.0	26.1
Nidec	6594 JP	NR	39274.13	14,045	NA	NA	35.1	30.0	4.1	3.7	12.2	13.3
Alps	6770 JP	NR	3625.90	1,763	NA	NA	13.6	10.8	1.0	0.9	8.4	8.9
<b>Average</b>							<b>23.2</b>	<b>19.5</b>	<b>3.0</b>	<b>2.7</b>	<b>14.7</b>	<b>15.8</b>
<b>HK-listed Components</b>												
AAC Tech	2018 HK	Sell	5694.15	37.0	43.3	17%	15.3	12.9	2.3	2.3	15.0	17.8
FIT Hon Teng	6088 HK	Buy	2966.02	3.4	3.8	10%	11.4	10.0	1.4	1.2	12.1	12.2
Sunny Optical	2382 HK	Buy	14686.02	105.0	114.0	9%	30.1	21.8	8.7	6.8	28.8	31.2
TK Group	2283 HK	Buy	361.27	3.4	4.5	33%	7.4	6.1	2.2	2.2	29.7	35.7
Tongda	698 HK	Buy	479.22	0.6	0.9	57%	4.5	3.8	0.5	0.5	11.7	12.8
BYDE	285 HK	Hold	3034.12	10.6	10.4	-2%	14.6	10.2	1.3	1.1	8.6	11.2
Q tech	1478 HK	Buy	1079.53	7.4	9.5	28%	18.2	14.0	3.0	2.5	16.4	18.0
FIH Mobile	2383 HK	NR	747.07	1.5	NA	NA	-	-	-	-	-	-
Truly	732 HK	NR	427.82	1.0	NA	NA	4.4	4.5	0.4	0.4	5.1	8.3
SMIC	981 HK	NR	5739.65	8.9	NA	NA	81.2	56.8	1.0	0.9	1.2	1.6
YOFC	6869 HK	NR	2491.15	12.9	NA	NA	11.9	9.2	1.1	1.0	10.2	9.6
O-NET	877 HK	NR	411.66	3.9	NA	NA	11.4	9.8	1.2	1.1	10.9	11.6
Ju Teng	3336 HK	NR	245.40	1.7	NA	NA	6.7	5.1	0.3	0.3	4.5	5.6
Cowell	1415 HK	NR	131.48	1.2	NA	NA	8.8	6.1	0.4	0.4	5.8	5.8
<b>Average</b>							<b>16.1</b>	<b>12.2</b>	<b>1.7</b>	<b>1.5</b>	<b>11.4</b>	<b>13.0</b>

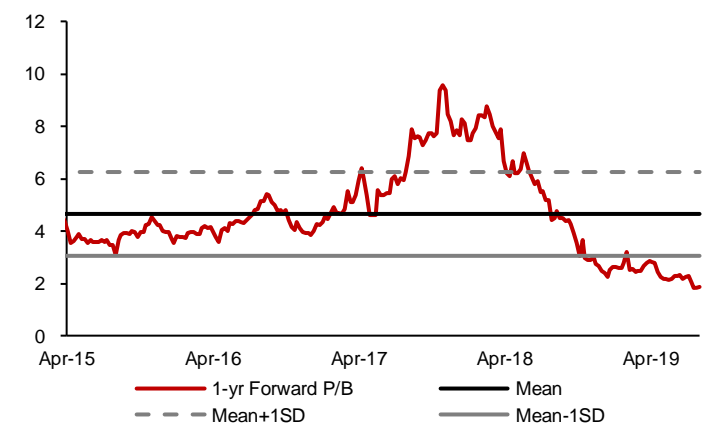
Source: Bloomberg, CMBIS, \* TP under review

Figure 7: 12M forward P/E band



Source: Company data, CMBIS

Figure 8: 12M forward P/B band



Source: Company data, CMBIS

## Financial Summary

Income statement						Cash flow summary					
YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E	YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Revenue</b>	21,119	18,131	16,398	18,327	19,780	<b>Profit before taxation</b>	5,996	4,310	2,238	2,926	3,252
COGS	(12,399)	(11,388)	(11,763)	(12,897)	(13,843)	Depreciation	1,306	1,750	1,739	1,953	2,168
<b>Gross profit</b>	<b>8,720</b>	<b>6,743</b>	<b>4,635</b>	<b>5,430</b>	<b>5,937</b>	Change in working capital	(1,602)	1,149	61	(1,348)	769
Selling and marketing	(365)	(317)	(275)	(312)	(336)	Others	(413)	(420)	(69)	(100)	(144)
Administrative	(610)	(650)	(616)	(641)	(692)	<b>Net cash from operating</b>	<b>5,287</b>	<b>6,789</b>	<b>3,970</b>	<b>3,431</b>	<b>6,045</b>
R&D	(1,664)	(1,512)	(1,537)	(1,558)	(1,681)	Capex	(3,900)	(2,941)	(2,100)	(3,000)	(3,000)
<b>Operating profit</b>	<b>6,081</b>	<b>4,265</b>	<b>2,206</b>	<b>2,919</b>	<b>3,227</b>	Other	(1,109)	(658)	68		
Financial cost	(165)	(218)	(230)	(230)	(230)	<b>Net cash from investing</b>	<b>(5,009)</b>	<b>(3,599)</b>	<b>(2,032)</b>	<b>(3,000)</b>	<b>(3,000)</b>
Other income/(losses)	80	264	262	236	255	Net borrowings	2,362	(555)			
<b>Pre-tax profit</b>	<b>5,996</b>	<b>4,310</b>	<b>2,238</b>	<b>2,926</b>	<b>3,252</b>	Interest paid	(165)	(216)	(230)	(230)	(230)
Tax	(671)	(514)	(279)	(351)	(390)	Dividend paid	(1,662)	(2,182)	(1,125)	(824)	(916)
Minority interest	1	-	-	-	-	Other	(549)	(294)			
<b>Net profit</b>	<b>5,325</b>	<b>3,796</b>	<b>1,959</b>	<b>2,575</b>	<b>2,862</b>	<b>Net cash from financing</b>	<b>(14)</b>	<b>(3,247)</b>	<b>(1,355)</b>	<b>(1,053)</b>	<b>(1,145)</b>
						<b>Net change in cash</b>	<b>264</b>	<b>(57)</b>	<b>583</b>	<b>(622)</b>	<b>1,899</b>
						Cash at beg of year	3,864	4,034	4,059	4,642	4,019
						Exchange difference	(95)	81	0	0	0
						<b>Cash at end of year</b>	<b>4,034</b>	<b>4,059</b>	<b>4,642</b>	<b>4,019</b>	<b>5,919</b>

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E	YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Current assets</b>	14,607	11,985	12,313	13,309	14,938	<b>Sales mix (%)</b>					
Cash & equivalents	4,034	4,126	4,642	4,019	5,919	Dynamic components	45.4	47.8	47.6	42.4	42.9
Trade and other rev.	7,155	4,474	6,091	5,439	7,051	MEMS (microphone)	4.0	4.5	4.9	5.0	5.4
Inventories	3,398	3,319	1,515	3,785	1,904	Electro. (haptics)	49.0	43.5	39.3	40.0	36.6
Other current assets	20	65	65	65	65	Other	1.7	4.2	8.2	12.5	15.1
<b>Non-current assets</b>	16,115	17,884	18,245	19,291	20,124	<b>Growth (%)</b>					
PPE	13,526	15,440	15,801	16,847	17,680	Revenue	36.2	(14.1)	(9.6)	11.8	7.9
Lease prepayments	538	622	622	622	622	Gross profit	35.3	(22.7)	(31.3)	17.1	9.3
Intangible assets	256	367	367	367	367	Operating Income	34.7	(29.9)	(48.3)	32.3	10.5
Other non-curr. assets	1,795	1,455	1,455	1,455	1,455	Net profit	32.3	(28.7)	(48.4)	31.4	11.2
<b>Total assets</b>	<b>30,722</b>	<b>29,869</b>	<b>30,557</b>	<b>32,600</b>	<b>35,061</b>	<b>Profitability (%)</b>					
<b>Current liabilities</b>	11,097	8,317	8,171	8,463	8,978	Gross Margin	41.3	37.2	28.3	29.6	30.0
Short-term borrowings	4,349	3,493	3,493	3,493	3,493	Operating Margin	28.8	23.5	13.5	15.9	16.3
Trade & other payables	6,369	4,548	4,422	4,692	5,191	Net margin	25.2	20.9	11.9	14.0	14.5
Tax payables	332	205	185	207	224	<b>Balance sheet ratios</b>					
Other current liabilities	47	71	71	71	71	Net debt/total equity (x)	0.1	0.1	0.1	0.1	0.0
<b>Non-current liabilities</b>	<b>2,074</b>	<b>2,618</b>	<b>2,618</b>	<b>2,618</b>	<b>2,618</b>	Current ratio (x)	1.3	1.4	1.5	1.6	1.7
Government grants	87	118	118	118	118	Receivable turnover days	88	88	90.0	90.0	90.0
Deferred tax liabilities	46	72	72	72	72	Inventory turnover days	89	89	75.0	75.0	75.0
Other non-current liab.	1,941	2,429	2,429	2,429	2,429	Payable turnover days	85	85	70.0	70.0	70.0
<b>Total liabilities</b>	<b>13,171</b>	<b>10,935</b>	<b>10,789</b>	<b>11,081</b>	<b>11,596</b>	<b>Returns (%)</b>					
Share capital	99	99	99	99	99	ROE	30.3	20.0	9.9	12.0	12.2
Reserves	17,452	18,835	19,669	21,420	23,366	ROA	17.3	12.7	6.4	7.9	8.2
Minority interest						<b>Per share data (RMB)</b>					
<b>Shareholders' equity</b>	<b>17,551</b>	<b>18,934</b>	<b>19,768</b>	<b>21,519</b>	<b>23,465</b>	EPS	4.36	3.12	1.62	2.12	2.36
<b>Total equity &amp; liabilities</b>	<b>30,722</b>	<b>29,869</b>	<b>30,557</b>	<b>32,600</b>	<b>35,061</b>	DPS	1.36	1.79	0.93	0.68	0.76

Source: Company data, CMBIS estimates

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## CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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