

Far East Horizon Limited (3360 HK)

Rooting in finance, thriving on industrial operation

Initiate with BUY rating and TP at HK\$ 10.4. We believe the industry-leading position of its equipment and hospital operation business, together with its strategically focused sectors in leasing business has made FEH less cyclical and well positioned to welcome a post-pandemic recovery. We expect a 12%/9% revenue/net profit CAGR over FY19-FY22E led by industrial operation (26% revenue CAGR). We think the current valuation is undermining its achievement in industrial operation; the potential spin-off listing of its equipment operation arm could help reveal this hidden value. Our SOTP-derived TP of HK\$ 10.4 implies 0.97x FY21E P/B and 7.2x FY21E P/E.

- **Industrial operation business: Time to harvest.** FEH has achieved rapid expansion in industrial operation by leveraging its deep knowledge gained from 20+ years' experience in leasing business. Specifically, the Company now owns the largest equipment rental company, HCD, in China, and will effectively benefit from fast penetration of AWP and robust infrastructure investment ahead. We also see ongoing integration of its hospital mgmt. to lift its revenue and profitability. We expect gross revenue/gross profit contribution from industrial operation to reach 34%/25% in FY22E from 27%/16% in 1H20.
- **Financial business: Less cyclical focus to support expansion.** Through strategically focusing on nine major sectors, FEH has been maintaining decent NIM and asset quality trend through proactively managing its IEA portfolio. The normalizing monetary policy will potentially favor FEH's yield trend and asset growth as corporates may seek leasing for bank loan alternatives and liquidity facilitation. We expect more allocation to less cyclical sectors, i.e. urban public utility, healthcare and cultural & tourism can help with a stable asset quality ahead.
- **Initiate with BUY.** We expect FEH's net profit will reverse to 2% YoY growth in FY20E from 8% YoY decline in 1H20, and grow at a CAGR of 9% during FY19-FY22E, backed by steady expansion of leasing business and robust growth of equipment operation and hospital management. We expect its ROE to bottom out from 13.9% in FY20E to 15.2% in FY22E. We derive our TP of HK\$ 10.4 from SOTP method, applying 0.85x FY21E P/B to leasing business, a 10x FY21E P/E to industrial operation and 80% valuation discount. Our TP reflects 0.97x FY21E P/B and 7.2x FY21E P/E and implies 26.8% upside. **Key catalyst:** progress in IPO of HCD. **Key risks:** 1) Asset quality deterioration risk; 2) regulation risks; and 3) contracting demand.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	25,379	26,856	28,244	32,938	37,830
YoY growth (%)	35	6	5	17	15
Net profit (RMB)	3,927	4,338	4,408	5,020	6,034
EPS (RMB)	1.02	1.14	1.11	1.26	1.52
YoY growth (%)	21	11	(2)	14	20
Consensus EPS (RMB)	N/A	N/A	1.11	1.29	1.44
P/E (x)	7.0	6.3	6.5	5.7	4.7
P/B (x)	1.00	0.95	0.86	0.77	0.68
Yield (%)	3.7	3.9	4.0	4.5	5.5
ROE (%)	14.8	15.0	13.9	14.2	15.3
Net gearing (%)	81.5	79.6	79.9	80.3	80.3

Source: Company data, Bloomberg, CMBIS estimates

BUY (Initiation)

Target Price	HK\$ 10.40
Up/Downside	26.8%
Current Price	HK\$ 8.20

China Leasing Sector

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Stock Data

Mkt Cap (HK\$ mn)	32,587
Avg 3 mths t/o (HK\$ mn)	77.8
52w High/Low (HK\$)	8.49/4.94
Total Issued Shares (mn)	3,974

Source: Bloomberg

Shareholding Structure

Sinochem Group	23.23%
JPMorgan Chase & Co.	10.54%
DCP	10.38%

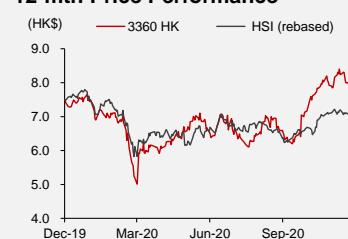
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	3.5%	4.1%
3-mth	24.6%	13.5%
6-mth	22.9%	15.2%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

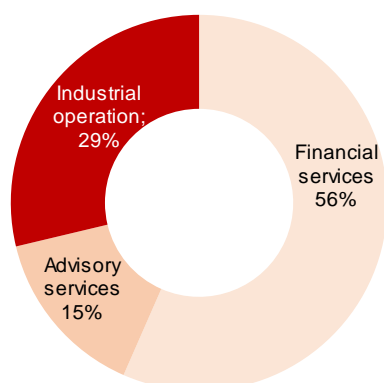
Auditor: Ernst & Young

Contents

Focus Charts	3
Investment Thesis	4
A leasing leader strategically positioning for “Finance + Industrial operation” ...	4
Industrial operation: Time to harvest	6
Financial business: Less cyclical focus to support quality expansion	12
Earnings Forecast.....	15
Financial summary	18
Valuation and peer comparison.....	19
Initiate at BUY with TP of HK\$ 10.4.....	19
Peer comparison: Industrial operation is undervalued	21
Risk Factors	22
Company Background.....	23

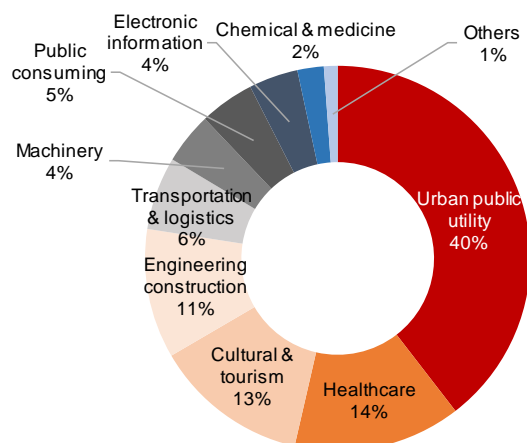
Focus Charts

Figure 1: FY20E revenue mix of FEH



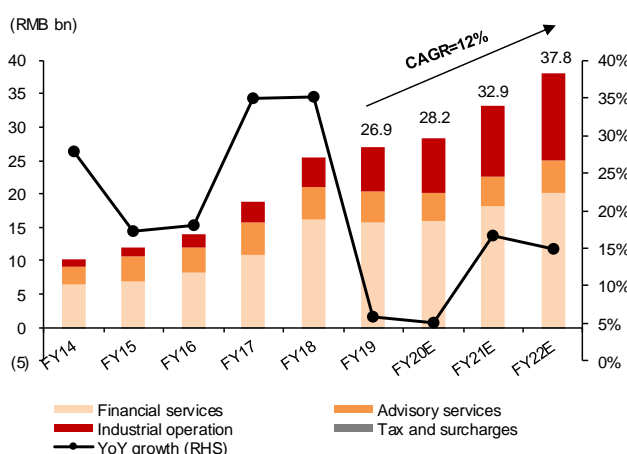
Source: Company data, CMBIS estimates

Figure 2: 1H20 IEA portfolio by industry of FEH



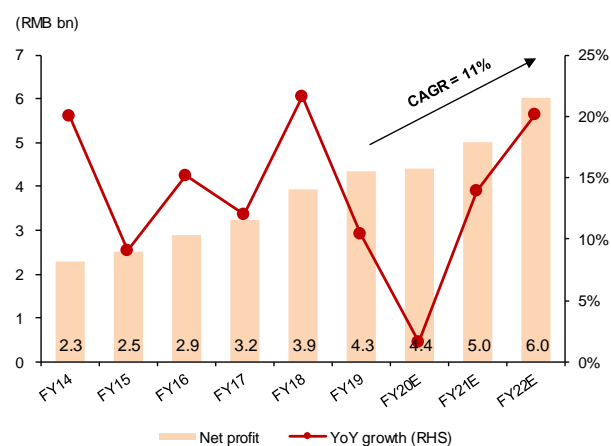
Source: Company data, CMBIS

Figure 3: FEH's revenue trend



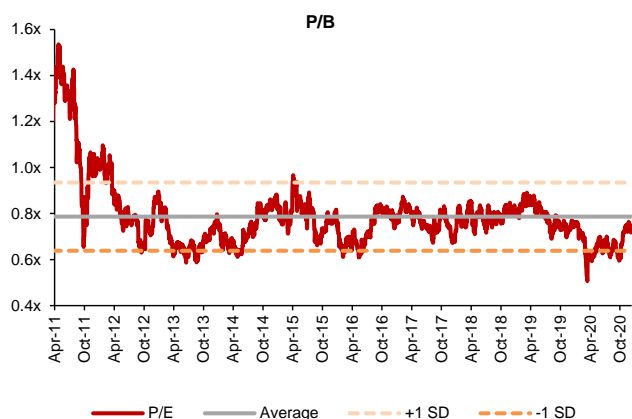
Source: Company data, CMBIS estimates

Figure 4: FEH's net profit and ROE trend



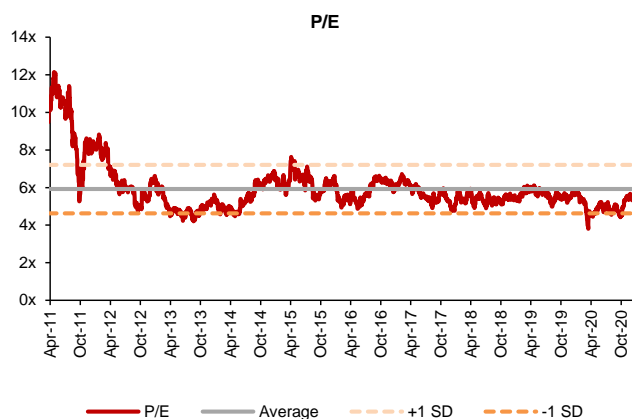
Source: Company data, CMBIS estimates

Figure 5: FEH's 1-year forward P/B



Source: Bloomberg, CMBIS estimates

Figure 6: FEH's 1-year forward P/E



Source: Bloomberg, CMBIS estimates

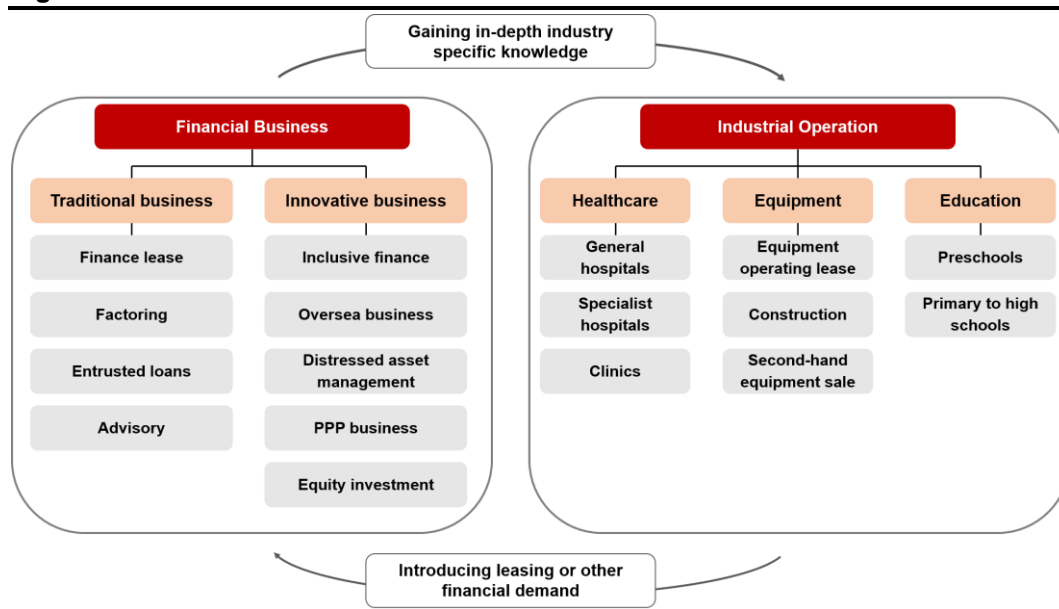
Investment Thesis

A leasing leader strategically positioning for “Finance + Industrial operation”

FEH was the 2nd largest finance lease company in China in terms of 2019 total assets (RMB 261bn). The Company has adopted a “Finance + Industrial operation” strategy, focusing on selectively nine major industries for lease business and three industries for industrial operation, and these two business segments are well synergizing with each other.

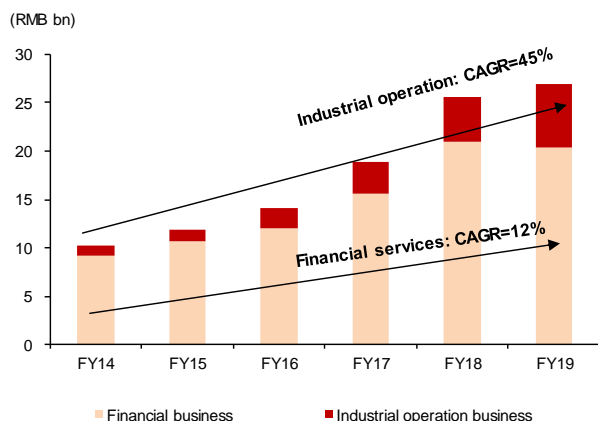
By leveraging its deep industry knowledge gained from 20+ years’ experience in leasing business, the Company has successfully penetrated into industrial operation, principally equipment operating lease, hospital management and school management. After years of secular expansion (FY14-FY19 revenue CAGR at 45%), FEH has become top player in equipment and hospital operation, and the gross revenue/gross profit contribution from industrial operation increased from 10%/5% in FY14 to 27%/16% in 1H20.

Figure 7: Business overview of FEH



Source: CMBIS

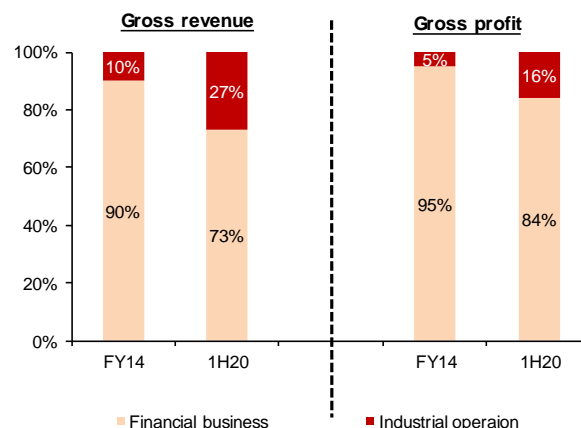
Figure 8: FEH’s gross revenue CAGR by biz segment



Source: Company data, CMBIS

Note: gross revenue refers to revenue before tax and surcharges.

Figure 9: FEH’s gross revenue/gross profit mix



Source: Company data, CMBIS

Note: gross revenue refers to revenue before tax and surcharges.

We think the “Finance + Industrial operation” strategy has helped FEH’s business model grow into a less cyclical one that a typical leasing company should be like. And this strategy as well withstood the test of COVID-19. Through swiftly allocating more of its interest-earning assets (IEA) into urban public utility sector and construction equipment sector, while proactively expanding its equipment operation and promoting its hospital integration, FEH’s net profit decline in 9M20 greatly narrowed from 8% in 1H20. We expect its net profit will reverse to positive growth in FY20E, and achieve higher growth in coming years along with macro recovery.

Figure 10: FEH’s 1H20 results summary and notes on 9M20 operating data

(RMB mn)				
I/S	1H19	1H20	YoY	Notes on 9M20 results
Revenue	14,181	13,275	-6%	Flattish YoY
Financial business	11,243	9,699	-14%	
Incl: Interest income	8,164	7,730	-5%	
Incl: Advisory fees	3,079	1,969	-36%	In good recovery
Industrial operation	2,971	3,620	22%	
Incl: FEH Medical Group	1,332	1,535	15%	+20% YoY to ~RMB 2.5bn
Incl: Horizon Construction Development	1,154	1,398	21%	+30% YoY to ~RMB 2.4bn
Incl: Education institution operation	109	88	-19%	
Cost of sales	(6,162)	(6,501)	5%	
Incl: Interest expenses	(4,191)	(3,980)	-5%	
Incl: industrial operation costs	(1,971)	(2,521)	28%	
Gross profit	8,019	6,774	-16%	
Incl: Net interest income	3,972	3,750	-6%	
Incl: Gross profit of industrial operation	1,000	1,100	10%	
PPoP	5,062	4,481	-11%	
Provision	(1,492)	(1,152)	-23%	
Net profit	2,233	2,056	-8%	YoY decrease greatly narrowed
B/S	FY19	1H20	HoH	
Interest-earning assets	201,121	220,038	9%	+10% vs. YE FY19
Interest-bearing liabilities	162,396	188,183	16%	
Key Ratios	1H19	1H20	YoY	
ROE	15.9%	13.5%	-2.4ppt	
NIM	3.64%	3.51%	-0.1ppt	Remained flat with 1H20
NPA ratio	1.04%	1.13%	0.1ppt	Remained flat with 1H20

Source: Company data, CMBIS

Industrial operation: Time to harvest

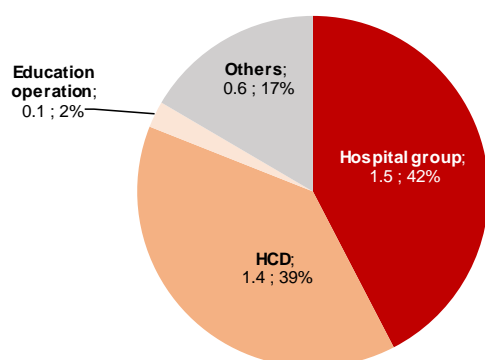
By leveraging its in-depth industry know-how obtained from finance lease experience, FEH expanded its industrial operation business robustly and has achieved stellar growth. Segment revenue registered a CAGR of 45% over FY14 to FY19, outpacing 12% CAGR of financial business (interest income + advisory fees).

Currently, FEH's industrial operation mainly comprises of three businesses: **1) Equipment operation** that conducts operating lease of construction equipment and materials, **2) Healthcare Operation** that manages hospitals, and **3) Education Institution Operation** that runs mid-to high-end pre-school and middle/high schools. As of 1H20, FEH's equipment operation arm held the largest aerial work platforms (AWP) fleet in China (40,000, and exceeding 50,000 in Oct 2020) and its hospital management arm owned the most available beds in the country (>20,000).

We expect equipment operation and healthcare operation to see higher growth potential in coming years harvesting the industry-leading scale and improvement in operating efficiency. We estimate a 26% revenue CAGR of FEH's industrial operation business during FY19-FY22E. Furthermore, **FEH announced on 16 Dec that it would spin off the equipment operation business to go public.** We believe the spin-off listing could further enhance its leadership in equipment rental industry and potentially help boost FEH's valuation.

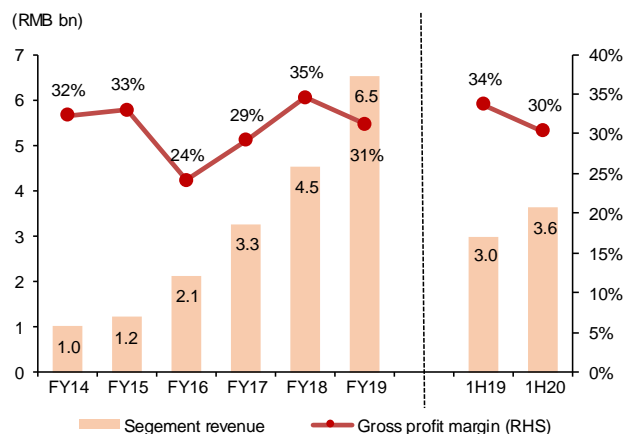
Figure 11: FEH's 1H20 Industrial Operation segment revenue mix

(RMB bn) **1H20 Industrial Operation revenue: RMB 3.6bn**



Source: Company data, CMBIS

Figure 12: FEH's Industrial Operation segment revenue and GPM trend



Source: Company data, CMBIS


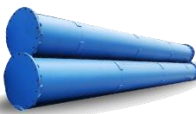
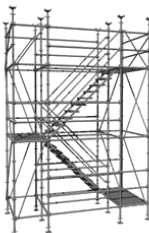


Equipment operation: Emerging giant in equipment operating lease

■ China's No.1 equipment lessor seeking separate listing

FEH operates its equipment operation business through wholly-owned subsidiary Horizon Construction Development (HCD). HCD is primarily engaged in operating lease of construction equipment and materials. As of 1H20, HCD was China's largest construction equipment lessor with RMB 13.0bn total assets.

HCD recorded 41% revenue CAGR over FY15 to FY19 on back of strong growth of its operating lease assets, and **we estimate another 43% revenue CAGR over FY19 to FY22E** on aggressively expanding AWP fleet size.

Figure 13: HCD's equipment leasing product overview

Product for lease	Industrial equipment	Revolving materials	Formwork systems	Road engineering	Power equipment
Product sample					
Scale	40,000	780,000 tons	280,000 tons		
Cases	Operating lease of AWP's and other construction equipment	Construction of rails, ports, bridges and tunnels, pipeline networks, etc.	Construction of factories, buildings, airports, exhibition centers, express ways, etc.	Construction and maintenance of airport runways and highways	Outdoor events, mining, ocean engineering, construction, etc.

Source: Company data, CMBIS

Note: data as of 1H20.

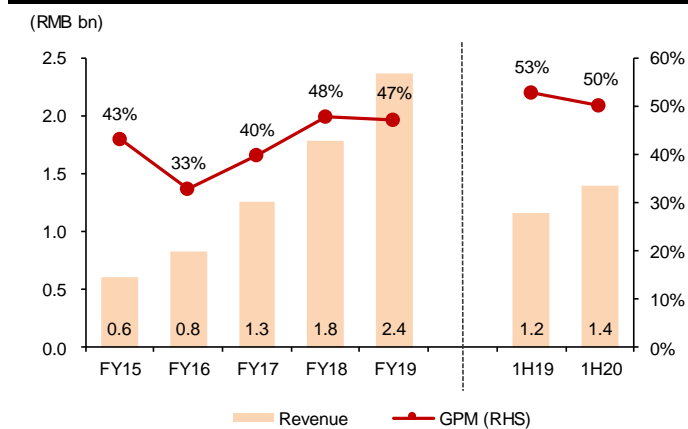
■ Riding on upsurge in AWP demand

HCD has a dominant leadership in AWP leasing market in China, and was ranked 6th among global access equipment rental companies in 2020 by KHL. HCD's AWP fleet size exceeded 50,000 in Oct 2020, and we estimate it to reach 60,000 by the end of 2020E, tripling from that at YE 2019.

AWP is usually used to provide temporary access for people to inaccessible areas at height. This equipment is being widely used in the U.S. and Europe while the penetration rate in China is still low (Fig. 16 & 17). We expect skyrocketing AWP demand in China for the following reasons: **1)** safety, **2)** manpower substitution that improves cost efficiency, **3)** rising infrastructure construction demand as CMBIS macro team projects FAI YoY growth to rebound to 7.0% in 2021E, and **4)** wider application scenarios like apart from construction sites, e.g. warehouses, shopping malls, etc.

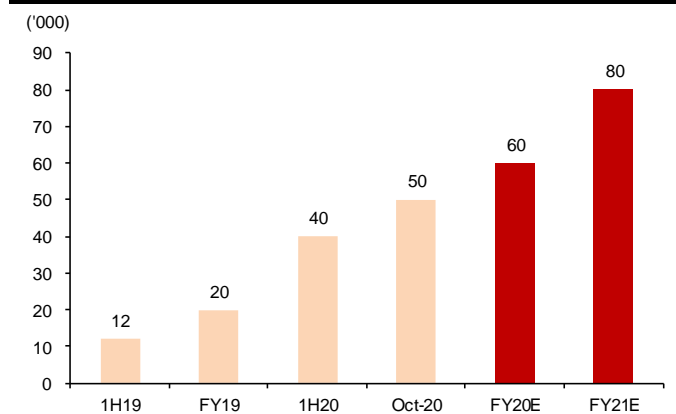
Riding on the upsurge of AWP demands, HCD has established a broad outlet network to support its business expansion, expecting to reach ~200 outlets covering ~130 counties and cities nationwide by the end of 2020E. Offline outlet network is essential to source potential clients and react swiftly to clients' on-site requests. Meanwhile, HCD has also introduced online platform and e-contracts to help improve its operating efficiency.

Figure 14: HCD's revenue and GPM trend



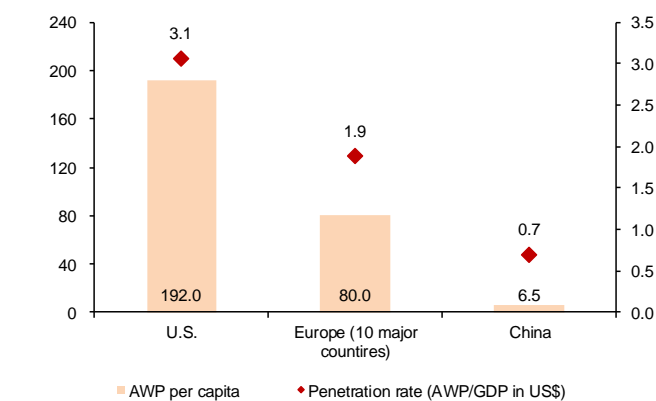
Source: Company data, CMBIS

Figure 15: We expect FEH's AWP fleet to reach 80,000 by the end of FY21E



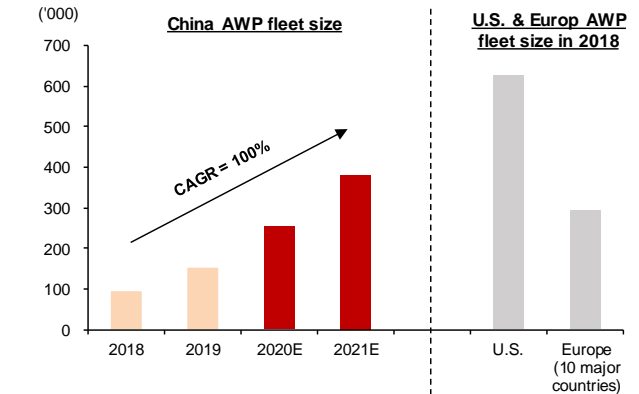
Source: Company data, CMBIS estimates

Figure 16: AWP penetration rate in China was much lower than in U.S. and Europe in 2018



Source: IPAF, CMBIS

Figure 17: China's AWP fleet size is expected to surge to ~400,000 in 2021E yet still lag behind U.S. and Europe



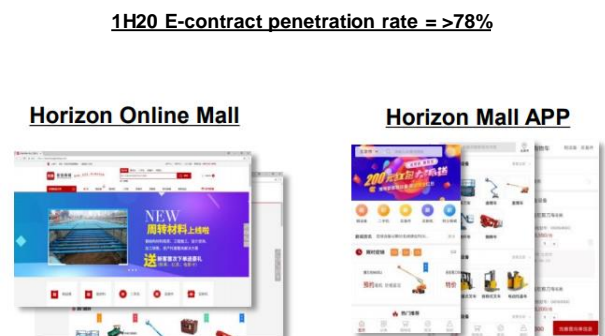
Source: IPAF, CMBIS estimates

Figure 18: HCD's 1H20 offline outlet network



Source: Company data, CMBIS

Figure 19: HCD's 1H20 e-contract penetration rate



Source: Company data, CMBIS

■ One-stop solution to drive margin expansion

Except for equipment operating lease, HCD is also engaged in construction services and equipment sales. The construction services provide clients with construction scheme design especially for large-scale and technically complicated projects, which requires higher entry barriers and could enhance clients' loyalty. Besides, HCD is exploring second-hand equipment sales to Southeastern countries after leases end to seek higher gains within the life-cycle of equipment. We see these businesses have potentially higher gross profit margins, and will drive up HCD's profitability in mid-term.

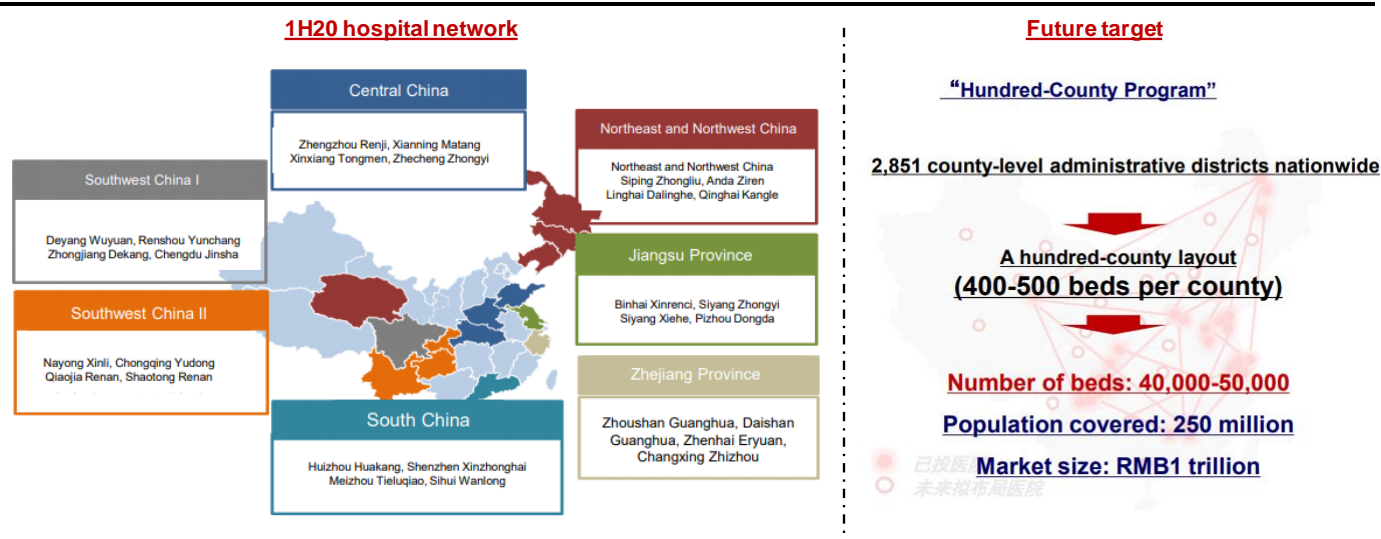
Healthcare operation: Differentiated positioning in a burgeoning market

■ Targeting high quality private hospitals and underserved county population

FEH began its hospital management in 2014. As of 1H20, FEH Medical Group managed 60 hospitals with over 12,000 beds in operation (second in industry) and total 20,000 beds available (first in industry). FEH differentiates its hospital management from large-scale peers by focusing on acquisition of private for-profit hospitals usually with revenue over RMB 100mn in lower-tier cities and counties where good quality medical resources are inadequate. FEH has initiated the "Hundred-County Program" to penetrate into 100 counties in China with its hospitals and achieve 40,000-50,000 beds in operation in mid-term (5-10 years).

We think both county-level hospitals and private hospitals have great potential in China and are benefiting from favorable policies. Fig. 22 data shows that the county-level population are medically underserved. The Government has been promoting the development of county-level hospitals since 2015 and we expect this will continue to be an important task during 14th FYP. Meanwhile, private hospitals, after years of rapid expansion (Fig. 23), are facing marginally tighter regulations that aim to improve the quality of operation, which we believe will benefit leading players like FEH Medical Group.

Figure 20: FEH's 1H20 hospital network and future development target



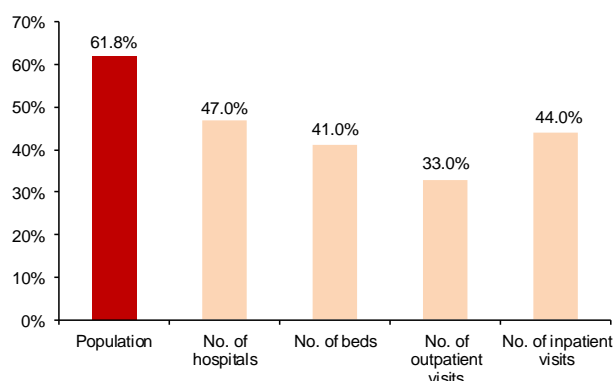
Source: Company data, CMBIS

Figure 21: Comparison of FEH's hospital operation with listed peers

Item	FEH	Genertec Universal	CR Medical
1H20 no. of beds in operation ('000)	12	15	11
1H20 operating revenue (RMB mn)	1,500	1,544	907
1H20 net profit (RMB mn)	53	35	110
Type of operated hospitals	Private hospitals	Reformed public and SOE hospitals	Reformed public and SOE hospitals
Type of operation	Self-managed	Self-managed/IOT/PPP	Self-managed/IOT
Focused area of hospitals	Lower-tier cities and counties	Higher-tier cities	Higher-tier cities

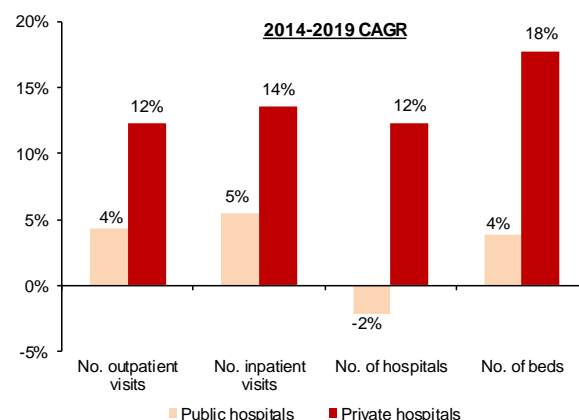
Source: Company data, CMBIS

Note: all financial data for consolidated hospitals.

Figure 22: % of county-level population and medical resources as of China's total shows regional disparity

Source: Wind, CMBIS

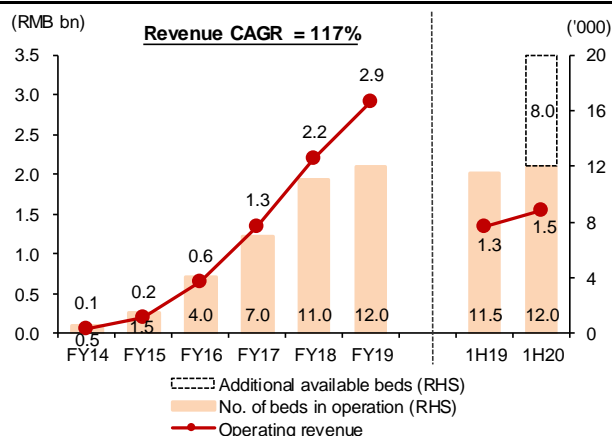
Note: data as of 2018.

Figure 23: Private hospitals has been expanding at a faster speed than public hospitals over 2014 to 2019

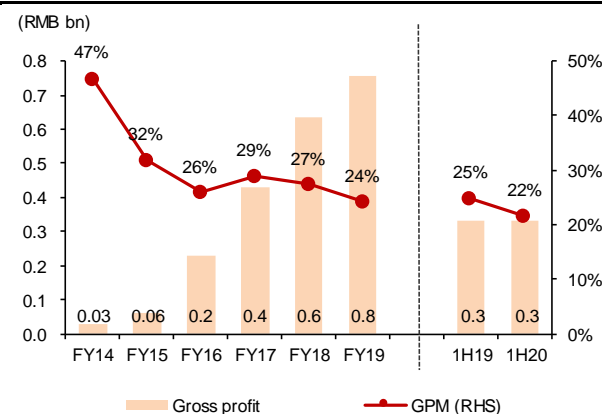
Source: Wind, CMBIS

■ From scale-up to operating efficiency-up

FEH Medical Group has registered a 117% consolidated revenue CAGR during FY14 to FY19 primarily due to its proactive acquisition and rapid scale-up (no. of beds CAGR at 89%). The gross profit margin was on a downward trend as newly acquired hospitals needed time to be integrated. Looking ahead, we believe the improvement of operating efficiency through on-going integration, instead of aggressive external expansion, will become the key to drive up healthcare operation's profitability.

Figure 24: FEH Medical Group's consolidated revenue achieved CAGR of 117% over FY14-FY19

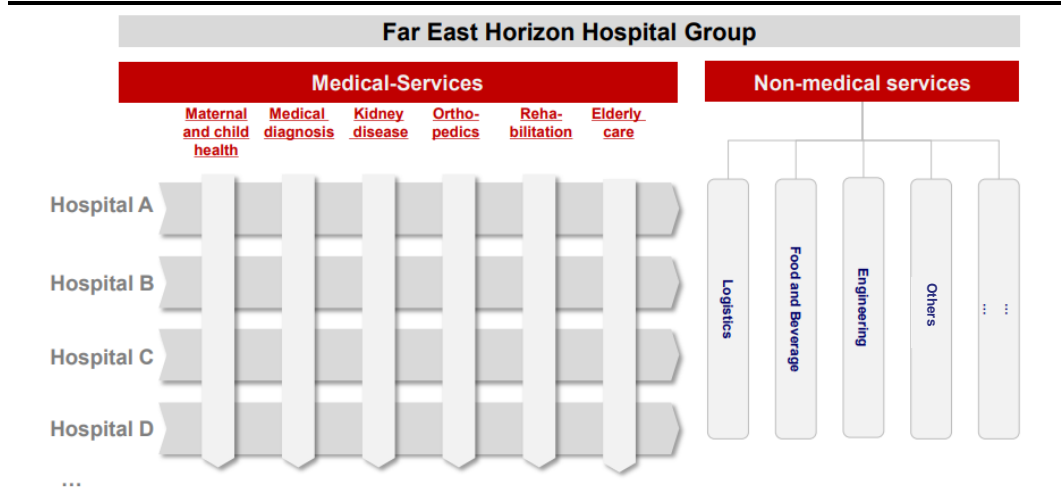
Source: Company data, CMBIS

Figure 25: FEH Medical Group's gross profit and GPM trend

Source: Company data, CMBIS

Fig. 26 illustrates how the integration works. On one hand, FEH Medical Group establishes strategic business units by hospital departments on group level with high caliber talents, in order to enhance the diagnosis and treatment expertise of its managed hospitals. This could both help improve the competitiveness and build the reputation of individual hospital, therefore increases the no. of visits and spending per visit. On the other hand, leveraging its over 20 years' experience in the healthcare industry, FEH Medical Group could help managed hospitals to lower their operating costs through ways such as centralized procurement of medical equipment and construction of operating rooms.

Figure 26: FEH Medical Group's integration model

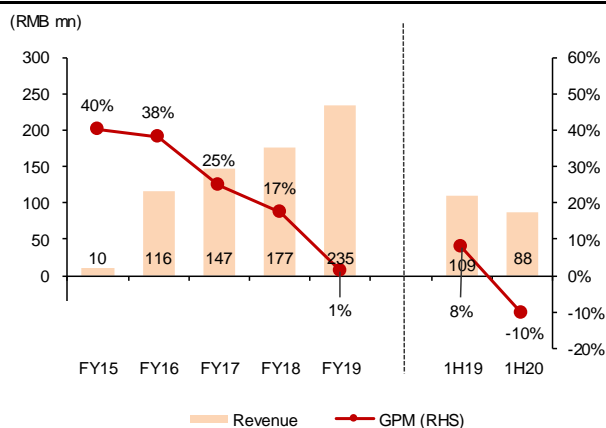


Source: Company data, CMBIS

Education institution operation: waiting for spring to come

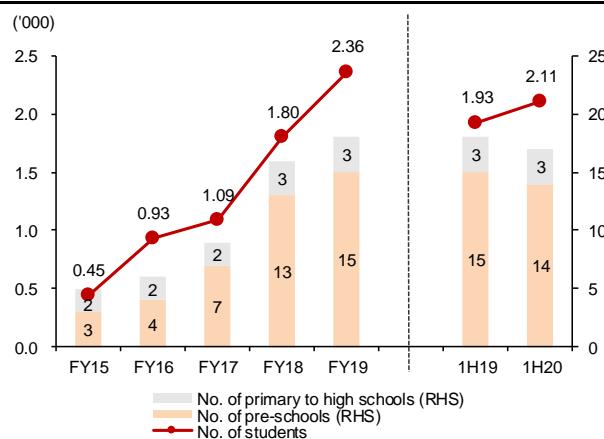
FEH's education institution operation business focuses on high-end K12 and high school management, and saw steady growth in no. of students and revenue through proactive acquisition. The downward GPM trend was caused by fast expansion of new schools that were yet to achieve high operating leverage. In addition, the implementation of the Private Education Promotion Law of the PRC (民促法) since 2018 had limited the profitability of pre-school education and the COVID-19 delayed new semester resulting in lower tuition fees in 1H20. As of 1H20, five out of 14 pre-schools/1 out of the primary and high schools were at mature stage that had better operating efficiency. We expect FEH's school operation to see mild recovery gradually after pandemic.

Figure 27: FEH's school operation revenue and GPM



Source: Company data, CMBIS

Figure 28: No. of students and no. of schools of FEH



Source: Company data, CMBIS

Financial business: Less cyclical focus to support quality expansion

Financial business, i.e. finance lease that earns interest income and advisory services that generate fee income, is the cornerstone of FEH, as we expect it will continue to contribute ~65-70% to the Company's gross revenue despite the rapid growth of industrial operation business. We see recovering leasing demand after COVID-19, rising yield and further room to leverage up will support a 7%/5% CAGR of FEH's financial business revenue/gross profit over FY19-FY22E.

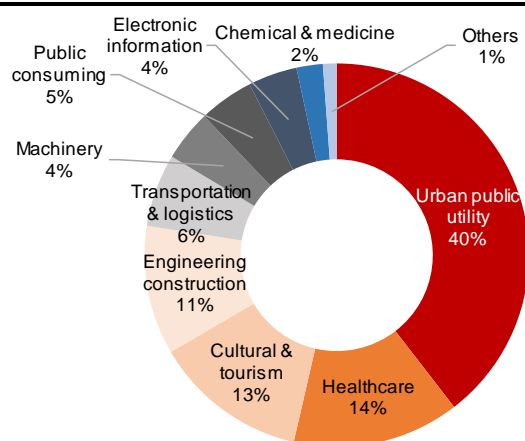
■ Industry-specifying strategy enables flexibility in IEA portfolio management

As FEH adopts an industry-specifying strategy in its business expansion, the Company consistently reviews its lease asset portfolio to make sure that the industries it is engaged in are enjoying strategic opportunities. Currently, FEH focuses its financial business on nine major industries, namely 1) urban public utility, 2) healthcare, 3) cultural & tourism, 4) engineering construction, 5) transportation & logistics, 6) machinery, 7) public consuming, 8) electronic information, 9) chemical & medicine, and others.

As of 1H20, lease assets for clients in urban public utility, healthcare and cultural & tourism, together accounted for 67% of FEH's total IEA portfolio. As the pandemic hindered demand from healthcare and cultural & tourism, FEH proactively increased its exposure to urban public utility and engineering construction which were considered as anti-cyclical, and secured a 10% HoH IEA growth in 1H20.

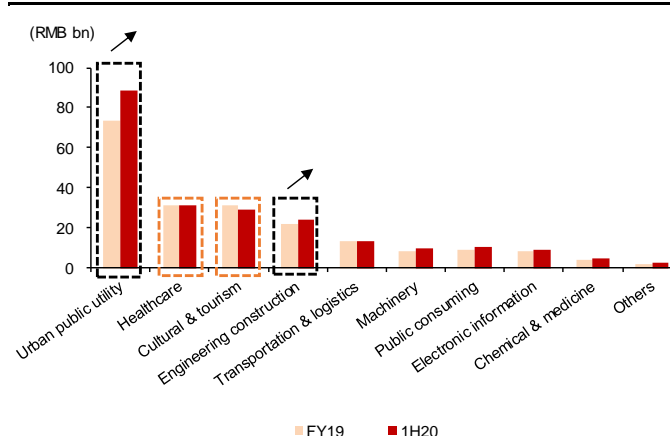
Looking into 2021E, we expect the demand from healthcare and cultural & tourism will recover as macro economy growth picks up and urban public utility will remain a focused area for FEH for its better yield and asset quality.

Figure 29: 1H20 FEH's IEA portfolio; urban public utility, healthcare and cultural & tourism as top 3 industries



Source: Company data, CMBIS

Figure 30: FEH's anti-cyclical management of IEA portfolio in 1H20



Source: Company data, CBIRC, CMBIS

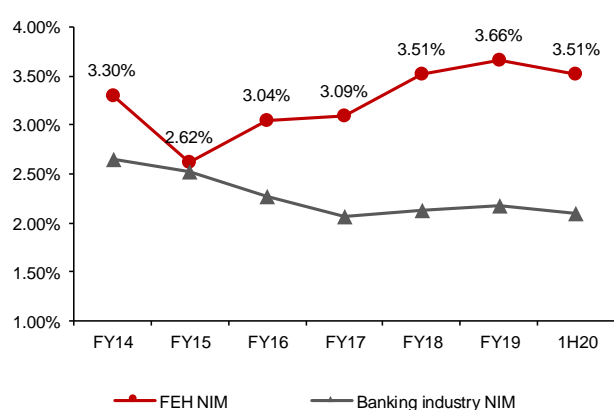
■ NIM to maintain resilient; ample room to leverage up

FEH has been retaining higher-than-banks NIM trend. On the yield side, FEH can charge higher yields due to its different targeted clients base from banks, as well as its stronger pricing capability by leveraging industry knowledge. On the cost side, FEH is able to raise fund by bond or by equity in both onshore and offshore market to support the IEA expansion.

Amid globally easing monetary policy in 2020, FEH actively raised fund using various tools at lower cost (vs. average ILB cost in 2H19 at 4.86%) which we believe could help stabilize its financing cost ahead. As we expect the monetary policy in China to normalize in FY21E, we believe FEH could benefit from higher yields as well as more financing demand from corporates.

FEH maintained a stable leverage despite its steady asset expansion, and was active in issuing ABS to manage its profile. The Company's major domestic leasing subsidiaries also remained leverage well below the regulatory cap (Fig. 34), therefore there is ample room to expand its IEA and improve its profitability. FEH issued two batches of CB in Jul and Dec raising a total US\$ 500mn this year, which will further enhance the Company's equity position if fully converted within five years.

Figure 31: FEH's maintained much high NIM than banks



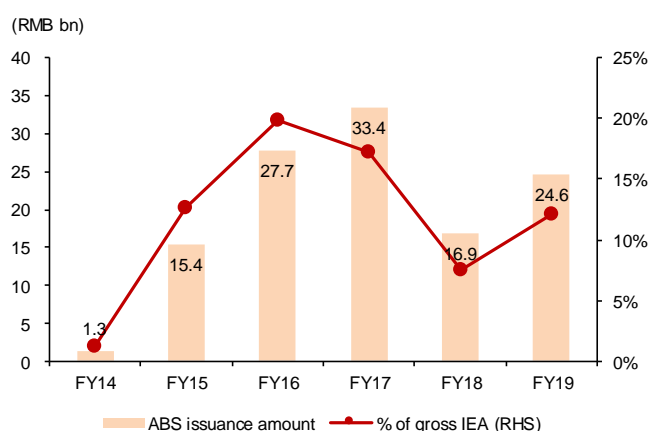
Source: Company data, CBIRC, CMBIS

Figure 32: Some key bond issuance of FEH YTD

Funding type	Issuance time	Amount (bn)	Duration (years)	Coupon rate
Domestic				
Corp. bond	Feb-20	RMB 2	2/3	3.87%/4.13%
Corp. bond	Mar-20	RMB 3	5	3.64%
Corp. bond	Oct-20	RMB 2.5	4	3.91%
Oversea				
MTN	Feb-20	US\$0.3	5	3.375%
CB	Jul-20	US\$0.3	5	2.5%
CB	Dec-20	US\$0.2	5	0.0%

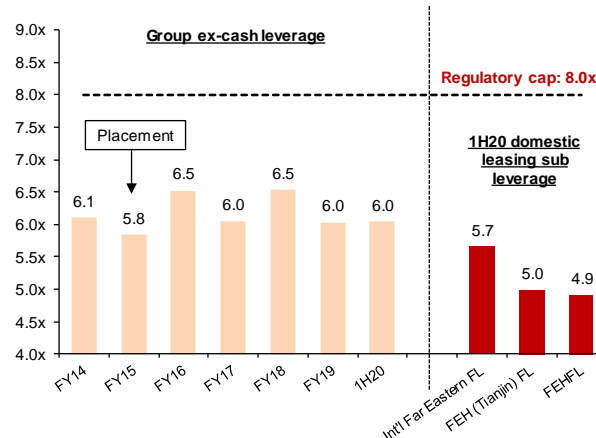
Source: Company data, CMBIS

Figure 33: FEH's ABS issuance



Source: Company data, CMBIS

Figure 34: FEH's leverage remained largely stable



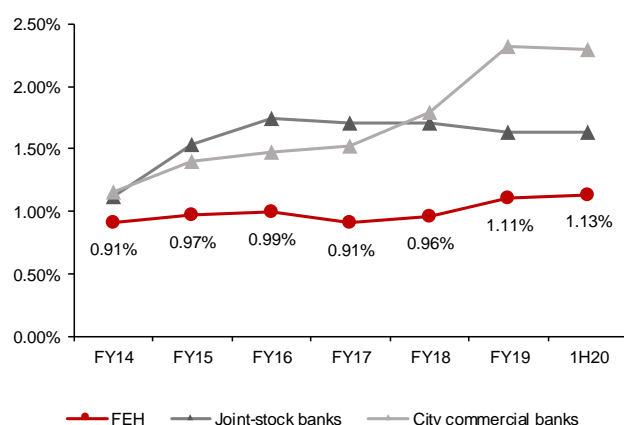
Source: Company data, CMBIS estimates

■ Limited concern over asset quality

FEH has been maintaining a good track record on asset quality throughout the latest credit cycle, as its NPA ratio was consistently lower than those of China's joint-stock banks and city commercial banks, and kept building up its provision buffer to higher-than-banks level.

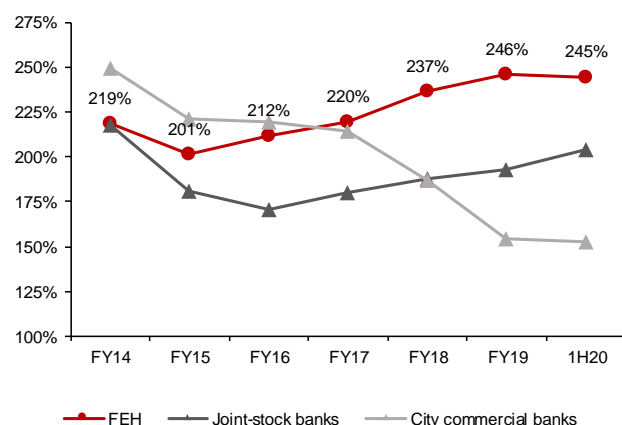
We think this is attributable to **1)** good client base, focusing on mid to large clients in selectively specific industries, many of which are SOEs; **2)** the nature of leasing business, that the lending was collateralized by lease assets, repayment amortized at both interests and principals and the use of lending is limited to the purchasing of assets; **3)** FEH's strict NPA recognition and prudent provision policy; and **4)** FEH's in-depth knowledge of its clients' underlying industry, that enables it to swiftly manage the lending portfolio to de-risk. Going forward, we believe FEH is still able to maintain the asset deterioration risks controllable.

Figure 35: FEH maintained consistently lower NPA ratio than China JSB and city commercial banks...



Source: Company data, CBIRC, CMBIS

Figure 36: ... while kept building up its provision buffer to above-banks level



Source: Company data, CBIRC, CMBIS

■ Innovative financial business may come with surprise

FEH is expanding the service scope of its financial business to meet diversified demand from its clients at different business development stages. These "innovative businesses" began to contribute meaningful profits to FEH since FY19, and we think the gradual expansion of these new services could increase FEH's revenue stream, enhance clients' loyalty as well as boosting its profitability.

Figure 37: FEH's innovative financial business overview

Business	Details	1H20 PAT (RMB bn)	FY19 PAT (RMB bn)
Inclusive finance	Finance lease to MSEs	0.04	0.07
Oversea business	Oversea financing solutions	0.02	N/A
AMC business	Distressed asset management; Investment in six local AMCs	0.19	0.48
PPP business	PPP investment	0.09	0.07
Equity investment	PE investment	0.20	0.10
Subtotal		0.54	0.72

Source: Company data, CMBIS

Earnings Forecast

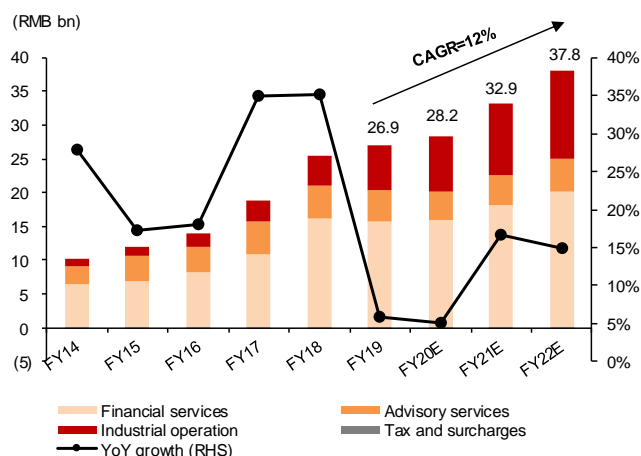
We project FEH's net profit will grow 2%/14% YoY in FY20E/21E to RMB 4.4bn/RMB 5.0bn, as we expect China's economic recovery since 2H20E will extend through 2021E, and will support rising demand for FEH's financial business and industrial operation.

Industrial operation to lead revenue growth

We expect FEH's revenue to grow 5%/17%/15% YoY in FY20E/21E/22E to RMB 28.2bn/32.9bn/37.8bn, and industrial operation business (esp. equipment and hospital operation) to see faster growth than financial business. Our projections are based on following assumptions:

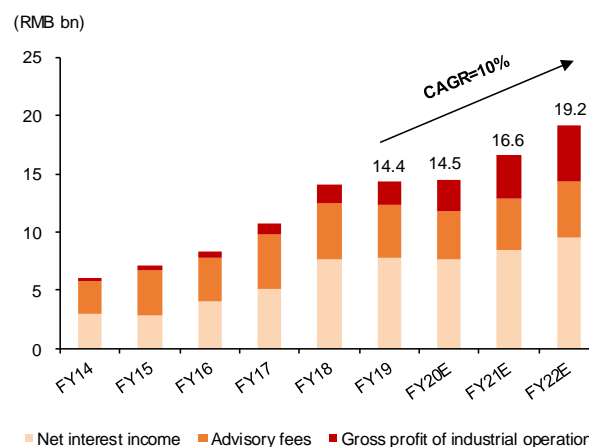
- **Net interest income** will slightly decline 2% in FY20E, due to narrowed NIM amid monetary easing, while will reverse to see 11%/13% YoY growth in FY21E/22E. We expect IEA to continue steady expansion as demand recovers after pandemic and normalizing monetary policy could diverse more financing and liquidity demand to leasing companies.
- **Advisory fees** will trough out from a 9% YoY decrease in FY20E and grow 6%/9% YoY in FY21E/22E as COVID-19's negative impact on on-site advisory business diminishes.
- **Industrial operation** will see robust growth of 26%/29%/23% YoY in FY20E/21E/22E, as we expect HCD and to FEH Medical Group record impressive growth on scale expansion. Meanwhile, we project an upward trend for gross profit margin as hospital integration goes on and rent for equipment operation stabilizes. For education institution operation, we expect mild revenue and margin recovery in FY21E/22E as new institutions mature.

Figure 38: FEH's revenue trend



Source: Company data, CMBIS estimates

Figure 39: FEH's gross profit trend



Source: Company data, CMBIS estimates

Figure 40: Key assumptions for FEH's financial services

(RMB bn)	FY17	FY18	FY19	FY20E	FY21E	FY22E
Interest income (Revenue)	11.0	16.1	15.8	16.0	18.1	20.2
Interest expense (Cost of sales)	(5.8)	(8.5)	(8.0)	(8.4)	(9.7)	(10.7)
Net interest income	5.2	7.6	7.8	7.6	8.4	9.5
Advisory fees	4.6	4.9	4.6	4.2	4.4	4.8
IEA	194	224	203	230	257	285
ILB	145	173	162	192	213	232
Avg. IEA yield	6.55%	7.45%	7.43%	7.41%	7.43%	7.44%
Avg. ILB cost	4.59%	5.17%	4.95%	4.76%	4.78%	4.80%

YoY growth

Interest income (Revenue)	35%	47%	-2%	1%	13%	12%
Interest expense (Cost of sales)	40%	47%	-6%	5%	15%	10%
Net interest income	29%	47%	3%	-2%	11%	13%
Advisory fees	22%	5%	-6%	-9%	6%	9%
IEA	39%	15%	-9%	13%	12%	11%
ILB	35%	19%	-6%	18%	11%	9%

Source: Company data, CMBIS estimates

Figure 41: Key assumptions for FEH's industrial operation business

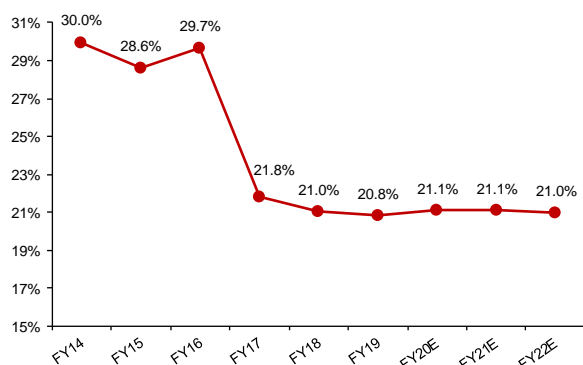
(RMB bn)	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Healthcare operation							
Revenue	0.6	1.3	2.2	2.9	3.3	3.8	4.2
YoY growth		110%	67%	33%	14%	13%	12%
Gross profit margin	27%	30%	28%	26%	24%	24%	25%
Equipment operation							
Revenue	0.8	1.3	1.8	2.4	3.5	5.2	7.0
YoY growth		52%	42%	32%	46%	52%	33%
Gross profit margin	33%	40%	48%	47%	51%	51%	51%
Education operation							
Revenue	0.1	0.1	0.2	0.2	0.2	0.2	0.2
YoY growth		27%	21%	33%	-17%	10%	12%
Gross profit margin	38%	25%	17%	1%	-6%	3%	5%

Source: Company data, CMBIS estimates

■ **Opex stable, credit cost down; net profit growth and ROE to bottom out**

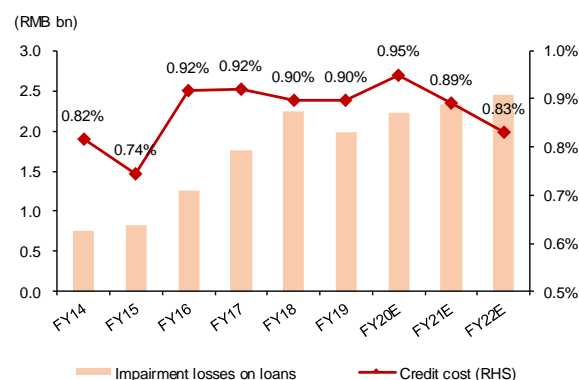
We project a relatively stable cost-to-income ratio, i.e. (S&M exp. + G&A exp.)/revenue, at ~21% during FY20E-22E, as we believe FEH will continue to invest in network expansion for equipment operation to enhance its service capabilities. Meanwhile, as the asset quality overhang from the COVID-19 hit gradually reduces, we expect FEH to record lower credit cost ahead, therefore improves its profitability.

Figure 42: Cost-to-income ratio to stabilize



Source: Company data, CMBIS estimates

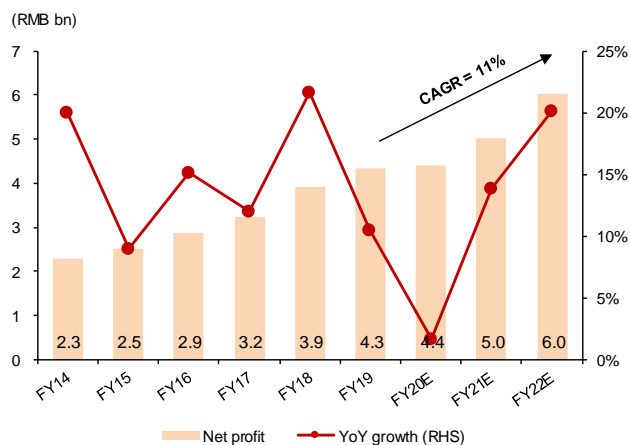
Figure 43: Credit cost to gradually decline



Source: Company data, CMBIS estimates

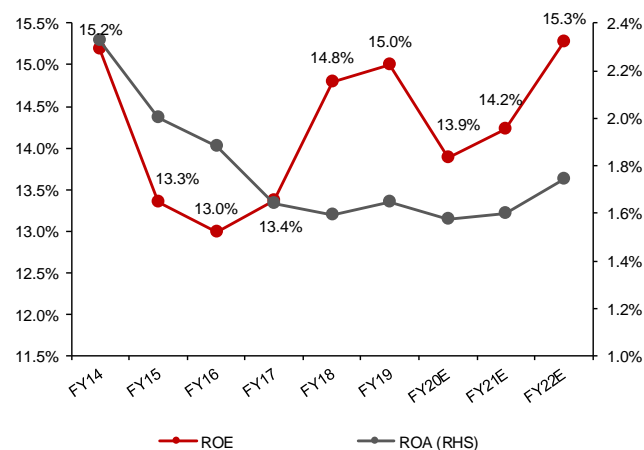
As a result, we expect FEH's net profit to grow 2%/14%/20% in FY20E/21E/22E, and ROE to bottom out to 13.9%/14.2%/15.3%. We expect the Company to maintain its payout ratio at 26% in our forecast period.

Figure 44: FEH's net profit trend



Source: Company data, CMBIS estimates

Figure 45: FEH's ROE and ROA



Source: Company data, CMBIS estimates

Financial summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	25,379	26,856	28,244	32,938	37,830
Finance lease, factoring & loans	16,138	15,842	16,042	18,090	20,191
Advisory services	4,889	4,574	4,168	4,430	4,843
Industrial operation	4,516	6,521	8,147	10,551	12,948
Less: tax and surcharges	(164)	(80)	(113)	(132)	(152)
Cost of sales	(11,484)	(12,525)	(13,949)	(16,522)	(18,880)
Gross profit	13,895	14,331	14,295	16,416	18,950
S&M, G&A exp.	(5,336)	(5,596)	(5,959)	(6,950)	(7,944)
Finance cost	(460)	(461)	(630)	(630)	(575)
Other income and expenses	344	660	1,309	1,228	1,229
Gains from JVs & associates	288	192	451	542	623
PPoP	8,730	9,126	9,466	10,606	12,283
Impairment losses	(2,238)	(1,982)	(2,208)	(2,288)	(2,470)
Pre-tax profit	6,493	7,145	7,258	8,318	9,813
Income tax	(2,104)	(2,317)	(2,353)	(2,697)	(3,182)
Holders of perpetual bonds	(503)	(511)	(519)	(626)	(626)
Minority interest	42	21	23	25	28
Net profit	3,927	4,338	4,408	5,020	6,034

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Cash and restricted cash	10,550	9,956	12,688	12,258	12,483
Financial assets at FVTPL	2,669	4,443	9,700	10,184	10,694
Loans and receivables	220,634	201,121	225,730	252,539	280,058
Inv. in JVs & associates	5,965	7,219	7,383	7,752	8,140
PP&E	9,985	11,583	16,160	19,108	20,296
Other assets	16,167	26,249	26,949	28,359	29,899
Total assets	265,970	260,571	298,609	330,201	361,571
Borrowings	172,515	162,396	191,628	212,707	231,850
Other liabilities	54,362	56,640	58,856	65,373	72,709
Total liabilities	226,877	219,036	250,483	278,080	304,559
Share capital	10,235	10,281	10,300	10,300	10,300
Reserves	17,494	19,847	23,074	26,867	31,534
Shareholders' fund	27,730	30,128	33,374	37,167	41,834
Holders of perpetual bonds	9,790	9,860	12,725	12,725	12,725
Minority interest	1,573	1,546	2,027	2,230	2,453
Total equity	39,093	41,535	48,126	52,122	57,012

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue mix (%)					
Finance lease, factoring & loans	64	59	57	55	53
Advisory services	19	17	15	13	13
Industrial operation	18	24	29	32	34
Less: tax and surcharges	(1)	(0)	(0)	(0)	(0)
YoY growth (%)					
Revenue	35	6	5	17	15
Finance lease, factoring & loans	47	(2)	1	13	12
Advisory services	5	(6)	(9)	6	9
Industrial operation	39	44	25	30	23
Gross profit	30	3	(0)	15	15
PPoP	33	5	4	12	16
Net profit	22	10	2	14	20
Total IEA	15	(9)	13	12	11
Total IBL	19	(6)	18	11	9
Profitability (%)					
Finance lease, factoring & loans					
NIM	3.51	3.66	3.52	3.46	3.51
NIS	2.28	2.48	2.65	2.65	2.64
Industrial operation					
Hospital operation GPM	27.8	25.6	23.9	24.5	25.1
Equipment operation GPM	47.7	47.1	50.5	50.8	51.0
Education operation GPM	17.3	1.1	(6.0)	3.0	5.0
Other operation GPM	81.5	82.7	87.2	87.2	87.2
Pre-tax margin	25.6	26.6	25.7	25.3	25.9
Net profit margin	15.5	16.2	15.6	15.2	15.9
Asset quality (%)					
NPL ratio	0.96	1.11	1.13	1.10	1.05
Provision coverage ratio	237	246	240	246	256
B/S ratios (%)					
ROE	14.8	15.0	13.9	14.2	15.3
ROA	1.6	1.6	1.6	1.6	1.7
Net gearing	81.5	79.6	79.9	80.3	80.3
Per share (RMB)					
EPS	1.02	1.14	1.11	1.26	1.52
DPS	0.26	0.28	0.29	0.33	0.39
BVPS	7.21	7.61	8.40	9.35	10.53

Source: Company data, CMBIS estimates

Valuation and peer comparison

Initiate at BUY with TP of HK\$ 10.4

We initiate FEH with a BUY rating. Our target price of HK\$ 10.4 is derived from SOTP method, applying 0.85x FY21E P/B to its leasing business, a 10x FY21E P/E to its industrial operation business and an 80% conglomerate discount. Our TP reflects 0.97x FY21E P/B and 7.2x FY21E P/E (vs. historical average plus 1SD of 0.93x/7.2x) and implies 27.2% upside.

■ Valuation for financial business

We use GGM to value the financial business of FEH. In GGM, we assume: 1) COE of 14.1%, 2) mid-term sustainable ROE of 12%, and 3) long-term growth rate of 3%. Based on our FY21E estimates BV estimates for financial business, we reach a fair value of RMB 35.9bn for FEH's financial business.

Figure 46: GGM valuation for financial business

GGM assumption	
Risk free rate	1.0%
Expected market return	13.0%
Market risk premium	12.5%
Beta	1.05
Cost of equity	14.1%
Long-term growth rate	3.0%
Sustainable ROE	12.0%
Target P/B (x)	0.85
BV of FY21E financial business (RMB mn)	44,399
Fair value of financial business (RMB mn)	37,698

Source: CMBIS estimates

■ Valuation for industrial operation business

We conservatively apply a 10x FY21E P/E to FEH's operation business as there are few comparable listed peers in China. We assume a blended 7% net profit margin for FEH's operation business, and reach a fair value of RMB 7.5bn. We expect the potential listing of HCD could lift valuation for the industrial operation business.

■ SOTP-derived TP of HK\$ 10.4

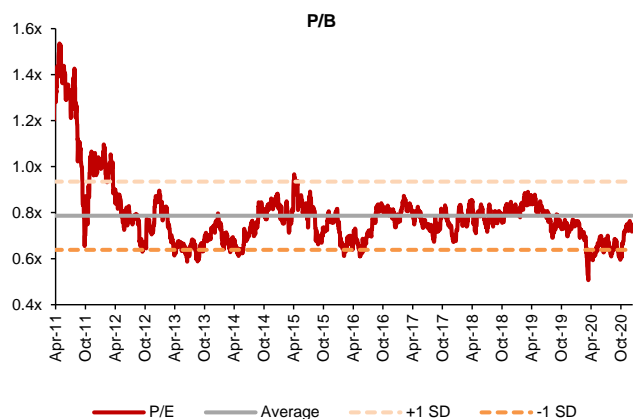
As shown in the following table, our target price for FEH arrives at HK\$ 10.4.

Item	Valuation method	Assumption	Valuation base	Valuation
BV of FY21E financial business (RMB mn)	P/B	0.85x	44,399	37,698
FY21E NP of industrial operation (RMB mn)	P/E	10x	754	7,539
Subtotal (RMB mn)				45,237
% of conglomerate discount (%)		80%		
HK\$/RMB forex rate		0.8774		
Valuation in HK\$ mn				41,246
FY21E WAVG no. of total issued shares (mn)		3,974		
Target price (HK\$)				10.40
Target FY21E P/B				0.97x
Target FY21E P/E				7.2x

Source: CMBIS estimates

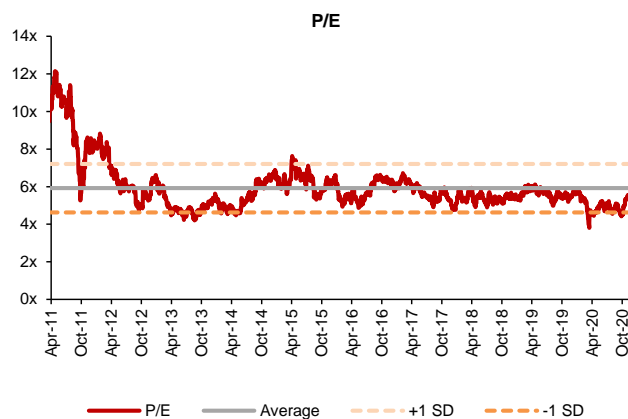
Currently, FEH trades at 0.74x 1-year forward P/B and 5.5x 1-year forward P/E, both below its historical average of 0.78x and 5.7x. Given our projected recovery in earnings and ROE, we believe the Company deserves a re-rating.

Figure 47: FEH's 1-year forward P/B



Source: Bloomberg, CMBIS estimates

Figure 48: FEH's 1-year forward P/E



Source: Bloomberg, CMBIS estimates

Peer comparison: Industrial operation is undervalued

We select several Chinese leasing companies, equipment rental companies, hospital operators and K12 school operators for peer comparison. The following table shows that FEH now trades at similar FY21E P/B as listed leasing companies, but at lower P/E compared with equipment rental companies, hospital operators and K12 school operators. As we expect FEH to earn ~30% of its gross revenue from industrial operation during FY20E to FY22E, we believe the value of the Company's industrial operation business is not fully reflected in its current valuation. The potential spin-off and listing of HCD could possibly help to reveal the hidden value of its equipment operation business as well as boosting the valuation of FEH.

Figure 49: Valuation comp

Company	Ticker	Last price (LCY)	Mkt. Cap (US\$ mn)	P/E (x)		P/B (%)		ROE (%)	
				FY1	FY2	FY1	FY2	FY1	FY2
Far East Horizon	3360 HK	8.22	4,215	6.2	5.5	0.8	0.7	13.9	14.2
Leasing companies									
Haitong Unitrust	1905 HK	1.28	1,360	7.5	7.0	0.6	0.6	8.3	8.4
CDB Financial Leasing	1606 HK	1.16	1,892	6.4	4.8	0.5	0.5	N/A	N/A
Jiangsu Financial leasing	600901 CH	5.71	2,609	8.9	7.5	N/A	N/A	N/A	N/A
Bohai Leasing	000415 CH	2.61	2,470	N/A	N/A	0.3	0.2	20.4	26.0
Average				7.6	6.5	0.5	0.4	14.4	17.2
Equipment rental companies									
Shaanxi Construction Machinery	600984 CH	13.67	2,023	19.2	12.9	2.7	2.2	13.5	16.5
Huatie Emergency Equipment	603300 CH	6.21	858	N/A	N/A	1.6	1.3	17.1	21.2
Average				19.2	12.9	2.2	1.8	15.3	18.8
Hospital operators									
Genertec Universal	2666 HK	5.91	1,308	5.1	4.3	N/A	N/A	15.3	15.6
CR Medical	1515 HK	6.00	1,004	19.3	15.2	1.1	1.1	1.2	N/A
Average				12.2	9.7	1.1	1.1	8.2	15.6
K12 school operators									
Wisdom Education	6068 HK	3.88	1,090	11.5	10.0	2.2	1.9	20.2	20.6
Tianli Education	1773 HK	8.11	2,171	37.8	27.9	5.4	4.7	13.7	17.0
Virscend Education	1565 HK	2.43	968	17.8	12.8	2.3	2.1	13.7	17.3
Maple Leaf	1317 HK	2.15	831	7.9	7.1	1.1	1.0	13.8	14.1
Bright Scholar Education	BEDU US	6.08	731	12.4	9.6	N/A	N/A	13.4	15.0
Average				17.5	13.5	2.7	2.4	15.0	16.8

Source: Bloomberg, CMBIS estimates

Note: all data for financial year.

Risk Factors

Asset quality deterioration risk

FEH earned ~60%/~55% of its revenue/gross profit from financial service in FY19, while IEA accounted for ~80% of its total assets by the end of FY19. The Company's NPL ratio slightly picked up to 1.11%/1.13% at the end of FY19/1H20 from 0.91% at the end of FY17 due to China's macro slowdown and the hit from COVID-19. The Company incurred RMB 2.0bn/RMB 1.2bn impairment losses on IEA in FY19/1H20, eroding 22%/26% of PPOp. Any substantial deterioration of the Company's asset quality will negatively affect its profitability.

Policy risks

After a series of tightening measures since 2018, the leasing industry in China is currently regulated by the CBIRC (China Banking and Insurance Regulatory Commission). The new regulatory regime has set stricter requirement for leasing companies regarding financial leverage, customer concentration, etc. Any regulation changes that could pose pressure on FEH's assets growth, funding resources or expansion of business scope will adversely affect the Company's financial performance and growth prospectus.

FEH is also exposed to policy risks related to industries from which its financial service clients come from and where its industrial operation businesses lie in. For example, the implementation of the Private Education Promotion Law of the PRC (《中華人民共和國民辦教育促進法》) since 2018 limited the profitability of pre-school education which resulted in weakening performance of FEH's education operation business. Any unfavorable policy changes in these industries could potentially hurt the profitability of FEH.

Demand risks

FEH's revenue growth relies on corporate clients' financing demand as well as demand for its industrial operation services, especially demand for construction material and equipment, medical services and pre-school to high school education. For example, corporates' willingness to borrow may weaken during macro downturn, demand for construction materials and equipment may fluctuate along with infrastructure investment cycle. Slower growth or even contracting clients' demand will pose downside risks to our estimates for the Company's revenue and earnings.

Company Background

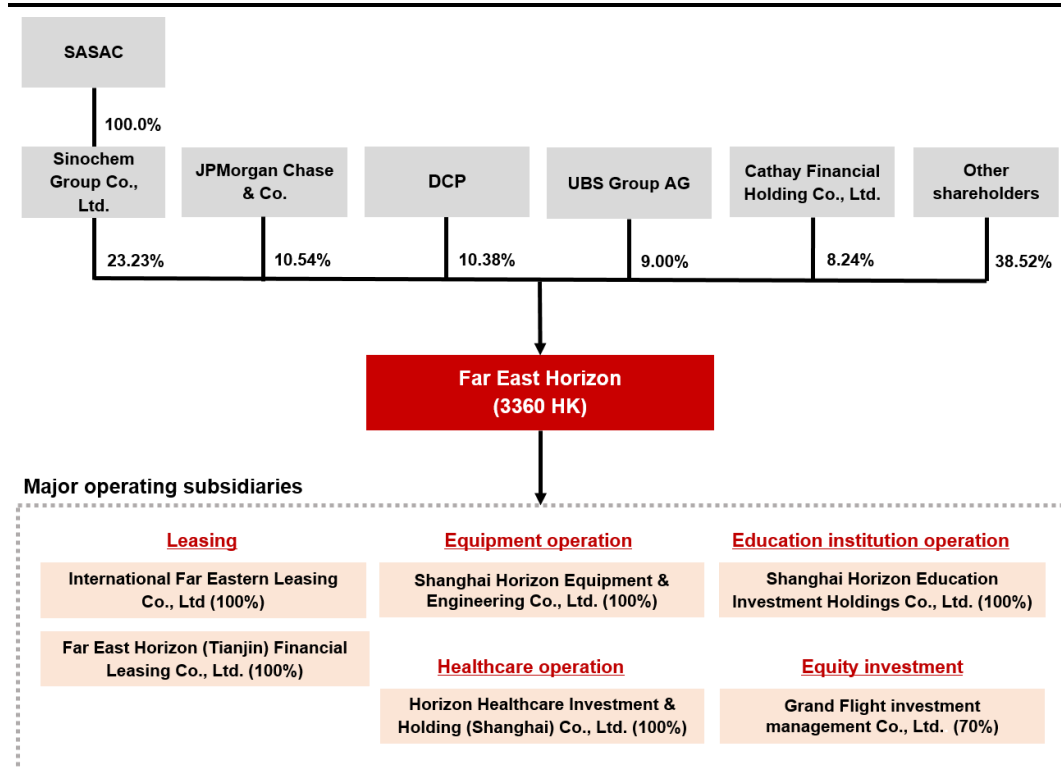
Far East Horizon Limited is a leading integrated industrial service provider in China. The Company is mainly engaged in 1) financial services, i.e. providing mostly corporate clients with finance lease, factoring and financing advisory as well as 2) industrial operations, i.e. operating hospitals, equipment operating lease, schools, etc. The clients of the Company vary in industries, including healthcare, cultural & tourism, engineering construction, machinery, chemical & medicine, electronic information, public consuming, transportation & logistics, urban public utility, etc.

FEH is headquartered in Hong Kong, while has established a nationwide operation network. The Company has business operations centers in Shanghai and Tianjin, and has offices in major cities throughout China.

The history of the Company dates back to 1991, when Sinochem Group, a central SOE in China, China Construction Bank and three Japanese banking institutions jointly established Far Eastern (currently a wholly-owned subsidiary of FEH). Sinochem Group wholly acquired Far Eastern in 2000. In 2008, FEH was incorporated, went through a series of restructuring, and introduced strategic shareholders KKR, GIC and CICC. Later on 30 Mar 2011, FEH was listed on the Main Board of HKEX.

As of 19 Dec 2020, Sinochem Group was the largest single shareholder of FEH, holding 23.23% of the Company's total issued shares. JPMorgan Chase and private equity DCP held 10.54% and 10.47% of its total equity interest, respectively.

Figure 50: Shareholding structure of FEH



Source: HKEx, Company data, CMBIS

Figure 51: Profile of key management

Name	Role	Time of appointment	Working experience
NING Gaoning	Chairman Non-executive director	Dec 2015 Mar 2016	Mr. NING has been the Chairman and the Party Group Secretary of Sinochem Group since Dec 2015 and was appointed as a non-executive director of the Company in Mar 2016. Prior to joining Sinochem, Mr. NING was Chairman of COFCO and worked with China Resources.
KONG Fanxing	Chief Executive Officer Executive Director Vice Chairman	Sep 2009	Mr. KONG was appointed as CEO of the Company in Sep 2009. He joined Sinochem Group in 1991 and has then been with several subsidiaries within the group. Mr. KONG has over 25 years of experience in enterprise management.
WANG Mingzhe	Chief Financial Officer Executive Director	Sep 2009	Mr. WANG was appointed as CFO of the Company in Sep 2009. He joined Far Eastern in Oct 1995 and has worked there since then. Mr. WANG has over 24 years of experience in finance management.
YANG Lin	Non-Executive Director	Oct 2009	Mr. YANG is currently the CFO and Chairman of the budget and evaluation committee of Sinochem Corporation. He joined the Sinochem Group in Jul 1994. Prior to that, he used to work for Siemens AG and Wella AG. Mr. YANG has approximately 24 years of experience in finance and treasury management.
LIU Haifeng David	Non-Executive Director	Oct 2009	Mr. LIU is currently the Executive Chairman of DCP. Previously, he was Partner of KKR, co-Head of KKR Asia PE and CEO of KKR Greater China. Prior to joining KKR, he was a Managing Director and the co-Head of Morgan Stanley Private Equity Asia.
KUO Ming-Jian	Non-Executive Director	Mar 2013	Mr. KUO is currently the Chairman of Cathay United Bank, Chairman of Cathay United Bank (China) and a Director of Cathay Financial Holding Co., Ltd. Previously, he worked for Blackstone Group L.P Great China, H&Q Asia Pacific, and JPMorgan Chase & Co.
John LAW	Non-Executive Director	Oct 2012	Mr. LAW previously worked for J.P. Morgan & Co., Euroclear, Citigroup and IFC.

Source: Company data, CMBIS

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