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Macro Strategy

Russia-Ukraine crisis and sector implications

- **Macro:** The tensions could disrupt commodity supply, raise inflation and slow growth. US & China should be more resilient with US dollar and RMB both strengthening. Investors focus on dynamics of geopolitical tensions, US inflation and China's growth.
- **Strategy:** China/HK stock market is more defensive than US/Europe. Geopolitical events only have short-lived impact. We suggest taking profit on international/HK banks, getting ready to sell oil stocks into strength and accumulating internet, consumption & infrastructure sectors.
- **Technology:** there is limited disruption to semi and smartphone/PC supply chain. Our analysis suggested Xiaomi has 5%/2% smartphone exposure to Russia/Ukraine, and Lenovo has 2% PC exposure to Russia in 2021.
- **Renewables:** Prices face upside pressure as LNG importers and gas operation companies may see cost pressure. But gas operation companies have great potential in expanding renewable & value added business.
- **Banking & insurance:** Banks and insurance have limited business or exposure in Russia & Ukraine. The sanctions on Russia may facilitate renminbi settlement in long-term, providing benefit for Chinese banks.
- **Software & IT services:** Data center supply chain could be affected. Ukraine supply over 70% of neon which is used in chip-making. Possible chip shortage may lengthen server delivery for IDCs like GDS (GDS US), 21Vianet (VENT US), ChinData (CD US) and Shanghai Athub (603881 CH).
- **Internet:** Internet companies have very limited business exposure to Russia or Ukraine. The impact is through the sentiment channel as investors shift from growth stocks to safe havens.
- **Property:** It may worsen the US bond refinancing condition for developers; but unfair pricing provide short-term profitable names including Longfor (960.HK), CR MixC (1209.HK) and Greentown Management (9979.HK).
- **Capital goods:** Construction machinery/HDT has limited exposure in Russia & Ukraine, but may see higher material cost. EU nations may want to reduce reliance on Russian energy supply in future, positive for solar power sector.
- **Auto:** The tensions would cause export slowdown, FX losses and supply chain instability. Russia is the 3rd largest export market for China's auto sector. Great Wall (2333 HK / 601633 CH) has assets in Russia. Russia and Ukraine are important exporters for some noble gases.
- **Healthcare:** We see very limited impact as only few pharmaceutical companies conduct very small scale of MRCT in Ukraine. Tigermed (300347 CH / 3347 HK) is conducting one clinical trial in Ukraine.
- **Consumer discretionary:** We see mild impact on home appliance sector in term of softening demand in Europe and rising material costs. The impact on sportswear sector and catering sector should be limited.
- **Consumer staples:** There is not too much impact on F&B stocks as majority of the demand and supply is domestic.

Bingnan Ye, Ph.D

Daniel So, CFA

Alex Ng

Lily Yang, Ph.D

Gigi Chen

Eric Wang

Marley Ngan

Sophie Huang

Jeffrey Zeng

Wayne Fung, CFA

Shi JI, CFA

Jill Wu, CFA

Walter Woo

Joseph Wong

Wenjing Dou, CFA

Benchen Huang

Andy Wang

Megan Xia

Xiao Xiao

Eason Xu

Impact on Global Economy

| Bingnan YE, PhD / bingnan@cmbi.com.hk (852) 3761 8967

US and Russia tries to maximize pressure on each other before negotiating. US and EU increased pressure on Russia as they planned to ban some Russian banks from the SWIFT messaging system and freeze the Russian central bank's international reserve. These measures would bring Russia's financial system to the brink of collapse. In response, Russian President Putin told his top defense to put nuclear forces in a special regime of combat duty. As Russia and Ukraine plans to talk, stakeholders may start to negotiate while maximizing pressure on each other.

The Russia-Ukraine crisis could disrupt commodity supply and push up inflation, with uncertainty in the magnitude of the impact. Russia is an important supplier of oil, gas, wheat, nickel, palladium and chemical fertilizer, especially for some EU nations. The geopolitical tensions with new sanctions on Russia would disrupt commodity supply and increase commodity inflation. Both US and EU faces the political pressure in inflation control. By carefully choosing the names of banks in the sanction list, US and EU try to maximize impact on Russia and minimize impact on EU nations. In the base scenario, there will be a balance and energy prices would have a moderate upside room in next several weeks. But there is still some uncertainty about the impact of the sanctions as well as about possible increase of oil production in Iran, OPEC and US.

The Russia-Ukraine crisis could slow global economic growth with a recession risk for some nations. The geopolitical crisis with sanctions on Russia would cause a deep recession for Russia. Meanwhile, it may also pose a recession risk for some EU nations like Germany and Italy by causing energy supply disruptions. According to ECB's estimation, a 10% decline of gas supply would lower Eurozone's GDP growth by 0.7 ppt. In addition, the geopolitical crisis would also hurt growth through the confidence channel and wealth effect. Global stock markets have experienced sharp declines recently. Business and household may cut or postpone their capital expenditures in face of rising uncertainty.

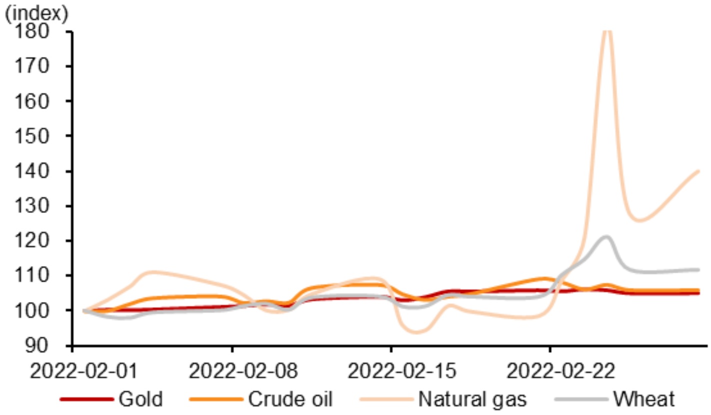
Global central banks would face the twin challenge of inflation control and growth stabilization. The geopolitical crisis increases the stagflation risk for global economy. Global central banks face a dilemma with the twin challenge of inflation control and growth stabilization. The Russia-Ukraine conflict may not change US Fed's plan in the March meeting, but it injects additional uncertainty for commodity inflation and global economy. ECB would be more difficult to balance the inflation control and economic growth stabilization.

G2 economies should be more resilient to Russia-Ukraine tensions as RMB and USD strengthen at the same time. The Russia-Ukraine tensions have a more severe impact on Europe than on G2 countries. Recently, both US dollar index and renminbi index have strengthened. A share market has also performed better than most other stock markets recently. First, A share market experienced a noticeable correction from January to early February. Second, Chinese policymakers will inject more liquidity supply and launch more supportive policy to boost market confidence. Thirdly, investors believe the Russia-EU tensions would give China a better position to expand business cooperation with both Russia and EU.

Stock market is gradually priced in worse cases as investors focus on three key factors. As the Russia-Ukraine tensions escalate, stock market performance continues to be restrained by the risk aversion sentiment. Looking forward, global stock markets are priced in worse cases as investors focus on three key factors. First is how the Russia-

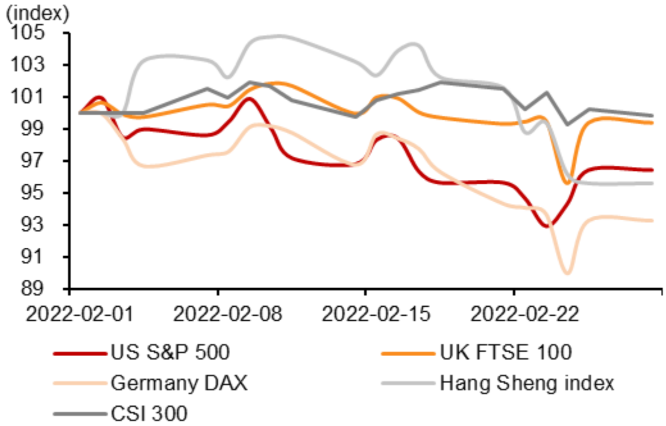
Ukraine crisis will evolve and when we can emerge from the geopolitical tensions. Second is when the high inflation in the US will decline. Higher commodity prices would push up the inflation, causing policy tightening and earnings deterioration. Third is when the Chinese economy will stabilize or rebound. Historical experience shows local wars outside the homeland only have a short-lived impact on the stock market of a large economy. Domestic fundamentals like inflation, business cycle and policy cycle have a bigger and longer impact on the stock market.

Figure 1: Selected Commodity Prices



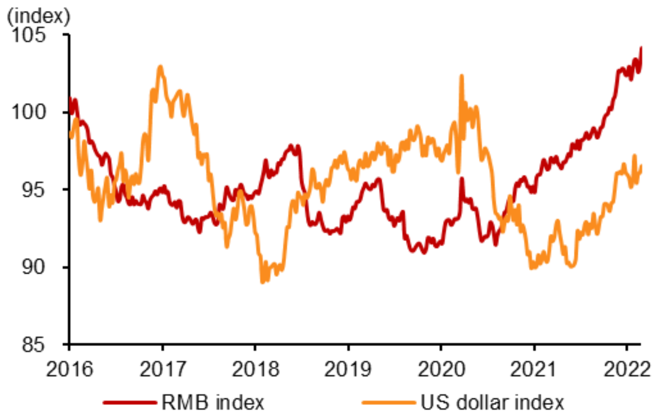
Source: Bloomberg, CMBIGM estimates

Figure 2: Global Stock Markets



Source: Bloomberg, CMBIGM estimates

Figure 3: RMB index and US$ index



Source: CMBIGM estimates

Impact on Stock Market

| Daniel SO, CFA / danielso@cmbi.com.hk (852) 3900 0857

China/HK stock market is more defensive than U.S./Europe, due to:

1) Distant geographically, and thus minimal risks of getting involved in the warfare (compared to NATO members) and nuclear leakage (in the unlikely cases that nuclear power plants in Ukraine are damaged or Russia uses nuclear weapons);
2) Much less risk of energy shortage than Europe, induced by sanctions on Russia;
3) Easing monetary policy (PBOC) vs. tightening (the West);
4) Distressed valuation in HK (HSI P/B at 1.0x) vs fairly rich in U.S.

The impact form geopolitical events on markets not directly involved is usually short-lived. For example, during Russia's annexation of Crimea in Feb-Mar 2014, the HSI retreated by 8%, and then rebounded by 10% in the following month.

The West is trying to avoid direct military conflict with Russia. President Biden has said the U.S. won't send troops to Ukraine, and other NATO members have similar stance, and thus, as things stand, the risk of sparking a World War is very low. The West is primarily using sanctions and diplomacy to deal with this crisis. While sanctions will inevitably have repercussions on the West themselves, politicians will have carefully calculated the negative impact before implementing such measures. In any case, the direct impact on the fundamentals of China/HK stock market would be lower than on the West, although short-term fluctuations in risk appetite will bring volatility in every market.

Sector strategy in HK market:

1) **Take profit on International/HK Banks:** stock prices have surged by 30-40% in the past few months, driven by rate hike expectations. But the Russia-Ukraine crisis may complicate the interest rate paths in the West, and so optimism on NIM-expansion may cool somewhat.
2) **Get ready to sell Oil stocks into strength:** oil & gas prices might have some more upside if the crisis doesn't ease anytime soon. But when it does ease, the sector will probably retreat rapidly. Besides, release of strategic oil reserves by some countries and the potential resumption of supply from Iran might cap the upside in oil prices.
3) **Accumulate Internet, China Consumer & Infrastructure sectors,** as their fundamentals have little relevance to Russia-Ukraine, and have upward potential due to regulatory risks gradually easing, impact from COVID abating, and pro-growth policies by Beijing, respectively.

Key uncertainties:

- **Positive:** Will the imminent talk between Ukraine and Russia lead to ceasefire?
- **Negative:** Will Russia escalate by using more devastating weapons or even nuclear weapons (tail risk)?

Impact on China Technology Sector

| Alex NG / alexng@cmbi.com.hk (852) 3900 0881
| Lily YANG, Ph.D / lilyyang@cmbi.com.hk (852) 3916 3716

Implications of Russia-Ukraine Conflict

Overall, we expect no major disruption in supply chain from Russia-Ukraine conflict. While duration and extent of the conflict are still to be determined, elevated geopolitical risk will lead to sector volatility into earnings season in the near term.

Our analysis suggested that **Xiaomi** (1810 HK, BUY) has 5%/2% of smartphone shipment exposure to Russia/Ukraine, while **Lenovo** (992, NR) has 2% of PC shipment exposure to Russia in 2021. In terms of revenue, we estimate these regions contributed to 4%/1% of Xiaomi/ Lenovo's revenue in 2021.

Semiconductor sector:

Ukraine is a major supplier of inert gases like neon (70% of global shr) and Russian for precious metals like palladium (40% of global shr) used in semi manufacturing. Industry leaders (e.g. Intel, Micro, Samsung, UMC) commented last week that inventory is built up and other gas suppliers will shift production capacity. Supply chain views this event as an expected potential supply disruption and become more proactive to reduce supply impact.

- Elevated tensions will lead to price hike of inert gases and potential cost inflation of semi production.
- Recent export restrictions to Russia (e.g. US, Japan) may cause ripple effects and negatively affect wafer capacity/production along supply chain.
- If the conflict lasts for longer than expected, supply chain will boost inventory stocking and ongoing chip shortage will intensify. Currently, memory players have 6-8 week inventory of key inert gas (vs 4-wk normally).
- Defence-related semi names may benefit from higher defence spending due to geopolitical tensions. Germany recently announced to boost defence spending in 2022.

Smartphone/PC sectors:

Smartphone: Russia/Ukraine accounted for 2%/0.4% (31mn/6mn unit) of global smartphone market in 2021, based on our estimates. Xiaomi is ranked No.3/No.1 in Russia/Ukraine in 2021 (~13%/45% mkt shr). We estimate Russia/Ukraine accounted for 5%/2% of Xiaomi's shipment, representing 4%/3% of its revenue/OP in 2021.

- **Russia's Top 5 brands (4Q21):** Samsung, Apple, Xiaomi, Realme and Honor (36%/18%/13%/8%/4% mkt share, based on IDC).
- **Ukraine's Top 5 brands (3Q21):** Xiaomi, Samsung, Oppo, Transsion and HMD (45%/28%/6%/6%/3% mkt share, based on Canalys).
- **Xiaomi/Apple exposure:** Xiaomi and Apple have 5%/2% and 2%/0.3% shipment exposure to Russia/Ukraine respectively. Xiaomi has cancelled its scheduled Redmi Note 11 launch event in Ukraine this week.

PC/tablets: Russia/Ukraine accounted for 2%/1% (1.9mn/0.97mn unit) of global PC/tablet market in 2021. Lenovo is ranked No.1 in Russia in 2021 with (19% mkt shr), and Russia contributed 2%/1% of Lenovo's 2021 shipment/revenue based on IDC.

- **Russia's Top 5 brands (4Q21)**: Lenovo, Acer, ASUS, HP and Samsung (19%, 13%, 12%, 11% and 11% mkt shr), based on IDC.
- **Lenovo exposure:** Lenovo has 2%/4% of PC shipment to Russia/C&E Europe in 2021.

Impact on China Renewables Sector

| Megan XIA / meganxia@cmbi.com.hk (852) 3900 0836

Oil sector

Russia-Ukraine tensions lead to higher oil price worldwide, WTI oil price soar to 96 USD/barrel and Brent oil price up to 99 USD/barrel recently. Related oil companies like China's three major oil companies (NOCs) - CNPC (857 HK, NR), CNOOC (883 HK, NR), CPCC (386 HK, NR) may benefit from higher oil price.

Gas Sector

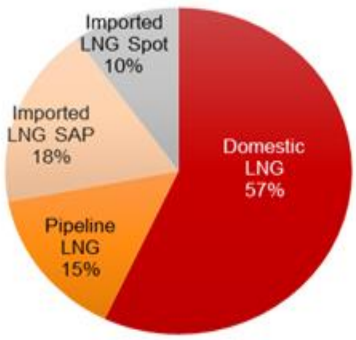
- Russia-Ukraine tensions are lifting European and global natural gas prices.
- The influence of Russia-Ukraine tensions on China's natural gas imports will be relatively negative, putting pressure on the profit of upstream LNG importers and downstream city gas companies.
- The rising global LNG price may affect the imported LNG cost of China's three major oil companies like CNPC (867 HK, NR), CNOOC (883 HK, NR), etc. Furthermore, downstream city gas companies like ENN (2688 HK, NR), China Gas (384 HK, NR), CRG (1193 HK, NR) ' dollar margins and profits may be minimized in the short term.
- However, gas companies still have significant growth potentials for involvement in renewable and value-added business based on their excellent client base. For instance, ENN (2688 HK, NR)'s Integrated-Energy Business generate nearly 10% revenue in 2020. CRG (1193 HK, NR) also establishes a new-energy department, and its value-added business may be the new growth engine in future.

Figure 4: City gas companies' LNG source(2021)

Gas Companies	Imported Piped LNG&Domestic LNG (%)	Imported LNG SPA&Imported LNG Spot (%)
ENN(2688.HK)	80-90%	10.00%
China Gas(384.HK)	over 90%	8.00%
CRG(1193.HK)	80-90%	10%-13%
Tianlun (1600.HK)	100%（Domestic）	NA
Source: CMBIS, Gas companies,Bloomberg		

Source: Bloomberg, CMBIGM estimates

Figure 5: China's natural gas sources (2020)



Source: Bloomberg, CMBIGM estimates

Wind Power Sector

- Russia-Ukraine tensions have limited impact on Wind Power Sector as the business in Ukraine only accounts for a small share, the sector is still on the decent growth momentum.
- Recently, China's macroeconomic planning agency has announced another batch of renewable energy projects, focusing on adding a total of 455 gigawatts of clean electricity generation capacity by 2030. The projects will benefit China Long Yuan (916 HK, NR) and Goldwind (2208 HK, NR)for further enhancing wind power generation demands and increasing installed capacity.

Impact on Banking & Insurance Sector

| Gigi CHEN / gigichen@cmbi.com.hk (852) 3916 3739
| Eric WANG / ericwang@cmbi.com.hk (852) 3900 0892

Russia-Ukraine crisis will post limited direct impacts on Chinese banks and insurers, in our view. Geographically, major Chinese banks and insurers have not established branches in the war zone. Based on our channel check, most of foreign loan issued in Russia and Ukraine is lending to Chinese borrowers who operate business in these two countries. Although there is no detailed data on the scale of China's loan balance to Ukraine and Russia borrowers, we estimate the exposure is manageable, and we see no materialized impacts on Chinese banks' asset quality. Major Chinese insurers' primary insurance and reinsurance exposures to Ukraine and Russia are also minimal. On bond investment, according to our channel check, sovereign and sub-sovereign bond of Russia and Ukraine hold by Chinese banks are quite limited, the impacts on their portfolio are minimal.

US and EU sanction Russia by removing some of its banks from SWIFT name list. Currently approximately 20% of Russia domestic transaction is conducted via its own financial transfer system, SPFS. We believe the rest of domestic transactions will soon shift from SWIFT to SPFS. On global transaction front, the sanctioned Russia banks may try to use CIPS (Cross-border interbank payment system) which is established by China. Currently, most CIPS transactions, which are quoting US$, still rely on SWIFT code, but Russia-China settlement can be conducted through PVP agreement (non-US dollar settlement) via CFETS instead of SWIFT. However, the volume through PVP will be limited in short term. The SWIFT sanction on Russia may push China to accelerate the expansion of RMB settlement and CIPS. In a longer run, we think Chinese banks will benefit from a growing CIPS and developing E-CNY, which help to mitigate the political risks by providing an alternative way on global transaction.

Impact on China Software & IT Services

| Marley NGAN / marleyngan@cmbi.com.hk (852) 3916 3719

Data center supply chain could be negatively affected

- Neon is being used during chip-making process and that Ukrainian companies manufacture >70% of Neon globally.
- Semiconductor supply chain does not expect direct production disruption at current stage given inventory buffer but chip price could go up further.
- If situation persists, chip shortage may lengthen server delivery schedule and hence affecting move-in/ utilization for IDC such as **GDS (GDS US, BUY), 21Vianet (VNET US, NR), ChinData (CD US, NR) and Shanghai Athub (603881 CH, NR).**

Impact on China Internet Sector

| Sophie HUANG / sophiehuang@cmbi.com.hk (852) 3900 0889

- Recent Russia-Ukraine crisis would have minimal direct financial impact on Internet Sector, given majority of internet names are domestic players with no exposure to Russia/Ukraine.
- Some ecommerce & game players (e.g. BABA, Tencent, NetEase) have biz/ games published in Russia/Ukraine, but the impact could be <1%.
- However, Russia-Ukraine crisis would hurt sector sentiment and further prevent valuation multiple rebound, as investors tend to shift into safe havens from growth stocks.

Impact on China Property Sector

| **Jeffrey ZENG / jeffreyzeng@cmbi.com.hk (852) 3916 3727**
| **XIAO Xiao / xiaoxiao@cmbi.com.hk (852) 3761 8952**

- The property sector is also under pressure from the Russia-Ukraine crisis, we believe the direct impact would be making the USD bond refinancing situation worse.
- Some opportunities arise as a number of stocks are being priced unfairly, we believe there are some short-term profitable names including:
- **1) Longfor (960 HK, BUY)** – solid performance in 2021 and Longfor Intelligent Living's IPO spin-off expected in April or May 2022.
- **2) CR MixC (1209 HK, BUY)** – The mainland pandemic situation is under control in the short term, especially in Shenzhen, which is beneficiary towards CR MixC.
- **3) Greentown Management (9979 HK, BUY)** – Solid performance. Moreover, the Company's Shanghai-Hong Kong Stock Connect will be effective on 7 Mar. Using Greentown-affiliated companies as a reference, their southbound funds generally account for 9%.

Impact on China Capital goods Sector

| **Wayne FUNG, CFA / waynefung@cmbi.com.hk (852) 3900 0826**

Construction machinery / HDT – Russia and Ukraine are not the key markets for the Chinese players. All the stocks under our coverage have insignificant exposure in Russia and Ukraine (<2% based on our estimates). The potential risk is more on the cost side in a worst-case scenario that the supply of iron ore in Russia and Ukraine is severely interrupted that may push up the global price of steel products. Steel accounts for roughly 15-20% of construction machinery's production cost.

Solar power equipment – There is no direct impact given that Russia and Ukraine are two insignificant export markets of China solar products. In the medium term, European countries will likely reduce the reliance on Russian energy supply and diversify the energy source (e.g. switching to solar power and LNG). This will offer upside for China solar product demand (Note: In 2021, Europe accounted for 44% of China solar module export).

Company	Ticker	Business exposure in Russia & Ukraine
SANY International	631 HK	Around 1% of total revenue.
Zoomlion	1157 HK / 000157 CH	Around 1% of total revenue.
Zhejiang Dingli	603338 CH	Insignificant. The regions have not been the focus of the Company for years.
Sinotruk	3808 HK	<2% based on our estimate.
SANY Heavy	600031 CH	Insignificant.
Weichai Power	2338 HK / 000338 CH	(1) The book value of KAMAZ Weichai (JV with KAMAZ) was only RMB41mn (Jun 21) which is insignificant compared with Weichai's book value of RMB100bn; (2) KION had only 6% revenue generated from Eastern Europe. We estimate Weichai's total exposure in Russia and Ukraine to be low single digit.
Jiangsu Hengli	601100 CH	No revenue generated from the regions.
Zhejiang Jingsheng	300316 CH	No revenue generated from the regions.

Source: Company data, CMBIGM estimates

Impact on China Auto Sector

| SHI JI, CFA / Shiji@cmbi.com.hk (852) 3761 8728
| DOU Wenjing, CFA / douwenjing@cmbi.com.hk (86) 188 0197 0256

- We believe the recent Russia-Ukraine crisis may hit the auto sector in terms of exports, FX losses, and supply chain stability.
- i) Export. Russia is one of China auto industry's major export markets (the 3rd largest in 2021). Chery sold about 41,000 units of passenger vehicles in Russia in 2021, the most among Chinese OEMs. Great Wall Motor (2333 HK/601633 CH, BUY/BUY) and Geely (175 HK, HOLD) sold about 39,000 units and 25,000 units, respectively. Most Chinese automakers export vehicles to Russia via CBU or CKD, except Great Wall which has a plant in Russia with an annual production capacity of 80,000 units.
- ii) FX losses. Ruble's depreciation against RMB may result in forex losses should the crisis persist. That could dent Chinese automakers with heavier assets in Russia, such as Great Wall. In 1Q20, Great Wall booked about RMB 600mn when ruble depreciated about 20% against RMB. Geely has hedged its ruble exposure but it may not be 100% protected, as hedging ruble is more difficult than hedging other more popular currencies.
- iii) Supply chain stability: noble gases, metals and auto parts. Russia and Ukraine are important exporters for some noble gases, like Ne, which are indispensable for chip manufacturing. Although some companies and associations claim that the impact is limited given sufficient inventories, we see higher uncertainties in the chip supply. Prices of some raw materials for auto parts such as aluminium, nickel and palladium could rise amid the new sanctions given Russia accounts for a significant portion of these metals. In addition, factories in eastern Germany operated by Volkswagen AG and Renault SA will suspend operations for a few days in early March because of a shortage of parts made in Ukraine, according to Bloomberg. This could weigh on some parts makers even without any exposure in Ukraine, if the production of assembly plants that these parts makers supply halts.

Impact on China Healthcare Sector

| Jill WU, CFA / jillwu@cmbi.com.hk (852) 3900 0842 / 150 1250 1640
| Benchen HUANG / huangbenchen@cmbi.com.hk (86) 185 1505 6146
| Andy WANG / andywang@cmbi.com.hk (852) 3657 6288

- Russia-Ukraine crisis would have limited impacts on China Healthcare sector, in our view. Specifically, pharmaceutical companies conducting MRCTs (Multi-region clinical trials) and clinical CROs assisting in these trials might face disturbs on clinical operations.
- As the largest clinical CRO in China, Tigermed (300347 CH; 3347 HK) generates immaterial revenue from Europe. In 2019, foreign regions excluding US only contributed 15% of Tigermed's total revenue. As far as we know, Tigermed is conducting one clinical trial in Ukraine for a COVID-19 related project, which has already completed patient enrollment.
- Several Chinese pharmaceutical companies are conducting MRCTs in Ukraine. However, the number of clinical sites in Ukraine typically accounts for a single-digit percentage of the total number of clincial sites. Thus, we believe the disturbs of clinical operations in Ukraine will not impact the overall progress of MRCTs.

Impact on Consumer Discretionary Sector

| Walter WOO / walterwoo@cmbi.com.hk (852) 3761 8776

Home appliance sector (-ve) - this is the most affected sector.

- **Supply chain:** We believe Haier, Midea, JS Global and Vesync has no factories in Ukraine or Russia, while Midea does have one in Belarus, but we believe the production capacity is mainly for Russia and Belarus, and if not, the orders can still be shifted to other regions.
- **Sales mix:** Vesync has the highest sales mix from Europe (~12%), vs JS Global's ~10%, Haier's ~8% and Midea (CMBI est.)'s ~10% in FY20. But Eastern Europe (such as Ukraine, Russia, etc.) should not account for more than 2% in our view. If the tension in Europe continue to escalate, consumer spending may be somewhat hindered.
- **Costs:** This is the most affected part for home appliance sector, as the pressure of inflation continues to pile up. Metal prices had notably increased by ~7% YTD (copper +1%, Aluminum+12%, Stainless steel+11%, cold-strip steel+3%), even though plastic prices and freight rate stayed largely flattish YTD, we believe it could still trend up in the coming months, since oil and natural gas prices had surged by ~28% YTD (natural gas+23%, Brent+32%, WTI+29%) already. Based on our rough estimates, additional 5-10% of raw material costs increases in FY22E can be there and could translate into 2ppt to 4ppt drags on NP margins if no counter measures taken.

Sportswear sector (neutral) – limited impact.

- Sales mix: Only Anta and Xtep has certain sales to overseas (via Amer sports and K-Swiss & Palladium), but sales from Eastern Europe (Ukraine and Russia) are like non-existences. Amer has some sales to Finland and Bulgaria (on top of France, Germany and Austria) but the mix is only ~5% (CMBI est.).

Catering sector (neutral) – limited impact.

- Costs: this is the only concern so far, we believe if the prices of overseas sourced ingredient had too much increases, brands can replace those with domestic sources, hence limiting overall impact.

Impact on Consumer Staples Sector

| Joseph WONG / josephwong@cmbi.com.hk (852) 3900 0838

- We expect limited impact to F&B stocks.
- Majority of the demand and supply is domestic.

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CMB International Global Markets Limited

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

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