

Alibaba (9988 HK/BABA US)

Holding up

- Setbacks in business spin-offs led to concerns on shareholders' return
- Business largely on track in 3Q23 with ongoing profitability improvement
- Undemanding valuation implies valuation recovery potential in the medium term

Concerns on shareholders' return. The Company's decision not to proceed with the full spin-off of Cloud Intelligence Group and to suspend the IPO of Freshippo raised concerns over near-term shareholders' return. While the management reiterated its long-term commitment to increase shareholders' return, we believe it could take time for the market to access such potentials.

Business largely on track in 3Q23. In 3Q23, Alibaba reported 8.5% YoY and 16.8% YoY in revenue and core net profit growth. Among segments, International Digital Commerce/Cainiao/Local Consumer Service reported strong revenue growth of 53%/25%/16%, mitigating the tepid increase in Taobao and Tmall/Cloud at 4%/2% YoY. The Company has been repositioning its Taobao/Tmall platform to enhance price competitiveness and user experiences via AI, which led to some improvement in user time spent, number of buyers, and order volume. In addition, profitability of most business segments continued to improve during the quarter. As a result, core net margin rose from 16.6% in 3Q22 to 17.8% in 3Q23.

Recommendation. After recent share price corrections, the counter is currently trading at an undemanding valuation of c. 8x FY3/25E core P/E. While near-term volatility might still persist, current valuation implies rooms of recovery potential in the medium term, in our view. Our latest SOTP-based TPs for Alibaba-SW/ADR (9988 HK/BABA US) are HK\$110/US\$113, which imply 11.9x/12.1x FY3/25E core P/E respectively.

Results and Valuation

FY end Mar 31	FY22A	FY23A	FY24E	FY25E
Revenue (RMB mn)	853,062	868,687	942,779	1,052,097
Chg (% YoY)	18.9	1.8	8.5	11.6
Net profit (RMB mn)	61,959	72,509	113,928	122,465
Chg (% YoY)	(58.8)	17.0	57.1	7.5
Core net profit (RMB mn)	143,515	143,991	161,760	174,724
Chg (% YoY)	(19.8)	0.3	12.3	8.0
Underlying EPS (RMB)	2.9	3.5	5.6	6.0
Chg (% YoY)	(58.7)	20.3	62.1	7.5
Core EPS (RMB)*	6.6	6.8	7.9	8.5
Chg (% YoY)	(19.1)	3.5	15.6	8.0
Core P/E (x)- ADR*	10.7	10.3	8.9	8.3
Core P/E (x)-SW share*	10.4	10.0	8.7	8.0
ROAE (%)	5.8	6.6	9.9	10.1
ROAA (%)	3.7	4.2	6.4	6.4

1 ADR = 8 ordinary shares

*Excluding share-based compensation, impairments, fair value changes of investment, etc.

Source (s): Bloomberg, ABCI Securities estimates

Company Report Nov 20, 2023

Rating: BUY

Rating (SW-share): BUY

TP (SW-share): HK\$ 110

Rating (ADR): BUY

TP (ADR): US\$ 113

Analyst : Steve Chow

Tel: (852) 2147 8809

stevechow@abci.com.hk

Price (ADR/SW-share)	US\$77.6/ HK\$74.4
Est. share price return (ADR/SW-share)	45.4%/47.8%
Est. dividend yield (ADR/SW-share)	1.7%/1.9%
Est. total return (ADR/SW-share)	47.1%/49.7%
Last Rating & TP (ADR/SW-share)	US\$138/ HK\$135

Previous Report Date Aug 18, 2023

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (HK\$) (SW-share)	118.5/69.8
52Wk H/L (US\$) (ADR)	121.3/74.5
Issued shares (mn)	20,526
Market cap (HK\$ mn) (based on SW-share price)	1,527,134
3-mth avg daily turnover (HK\$ mn) (SW-share)	3,079
3-mth avg daily turnover (US\$ mn) (ADR)	1,133
Major shareholder(s) (%): SoftBank	2.0%*

Source(s): Bloomberg, HKEx, Companies,

*ABCI Securities estimates

Business largely on track

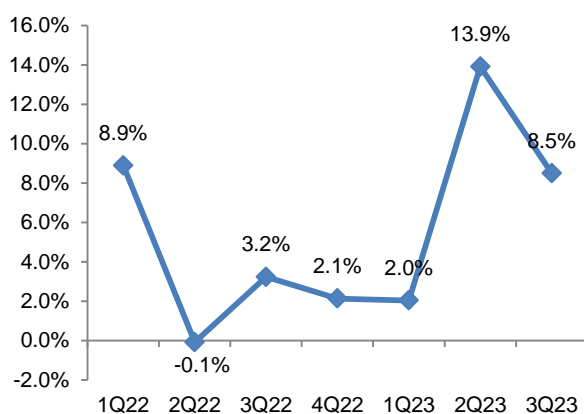
In 3Q23 (2QFY3/24), Alibaba's revenue increased by 8.5% YoY to RMB 225bn, in line with market expectation (RMB224bn). Core net profit was up 16.8% YoY to RMB 40.1bn, in line with market expectation (RMB40.0bn).

Among its major business segment, revenue of Taobao and Tmall went up by a mere 4% YoY during the quarter, compared with the 12% growth in the previous quarter, due to higher base and overall moderating consumption growth in recent months. Nevertheless, the Company has been repositioning its platform to enhance price competitiveness and introduce various AI initiatives to improve user experiences, which led to increase in user time spent, number of buyers, and order volume, according to the management. International Digital Commerce remained strong with 53% YoY revenue growth, driven by 28% order growth of retail platforms such as AliExpress, Lazard, and Trendyol. Local Consumer Service revenue grew 16% YoY, driven by 20% YoY order growth, while Cainiao reported a revenue growth of 25% YoY. Cloud intelligence's revenue growth remained weak at 2% YoY during the quarter due to ongoing business adjustment of project-based cloud services.

In terms of segment profitability, adjusted EBITA margin of Taobao and Tmall went down from 48.7% in 3Q22 to 48.2% in 3Q23 on increased promotions, in our view. On a positive note, International Digital Commerce and Local Consumer Service reported 49% YoY and 23% YoY reductions in adjusted EBITA losses. In addition, Cainiao's adjusted EBITA margin improved from 0.7% in 3Q22 to 4.0% in 3Q23. Cloud's adjusted EBITA margin improved from 3.6% in 3Q22 to 5.1% in 3Q23. Overall, segment-adjusted EBITA margin improved from 17.8% in 3Q22 to 18.5% in 3Q23, while core net margin improved from 16.6% in 3Q22 to 17.8% in 3Q23.

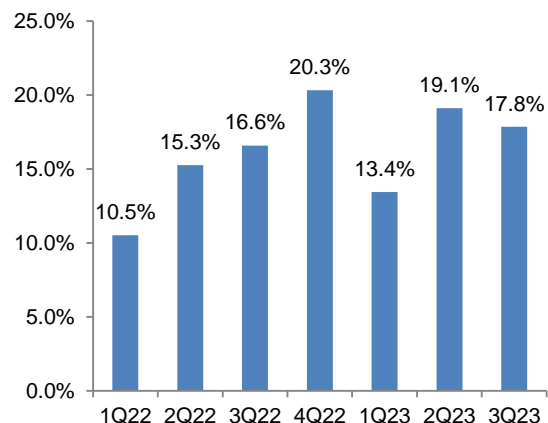
In addition, we believe export control of advanced computing chips by the US has led to some uncertainties in Cloud's business and the market will likely take on a wait-and-see attitude towards the potential impact. Having said that, Cloud revenue contribution to Alibaba, similar to International Digital Commerce and Cainiao, is only at low-teens level.

Exhibit 1: Revenue growth trend



Source(s): Company, ABCI Securities

Exhibit 2: Core net margin trend



Source(s): Company, ABCI Securities

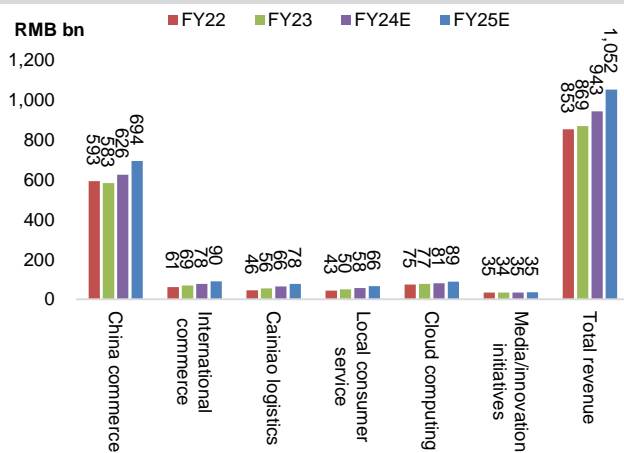
Financial Outlook

We expect revenue to grow at 10% CAGR in FY3/23-25E.

China commerce revenue would expand at 9% CAGR in FY3/23-25E, driven by 6% CAGR in customer management revenue and 12% CAGR in direct sales and others revenue during the same period.

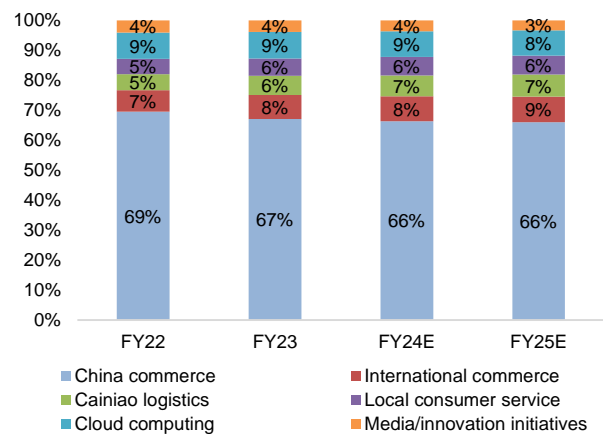
For other businesses, we expect International Digital Commerce to grow at 14% CAGR in FY3/23-25E, with Cainiao and Local Consumer Services expanding at 18% and 15% CAGRs in FY3/23-25E. In addition, Cloud and DME (Digital Media and Entertainment)/Innovation Initiatives & Others would grow at 8% and 8% CAGRs in FY3/23-25E.

Exhibit 3: Revenue outlook



Source(s): Company, ABCI Securities estimates

Exhibit 4: Revenue mix outlook



Source(s): Company, ABCI Securities estimates

Gross margin: We expect gross margin to rebound to 37.1% in FY3/25E vs. 36.7% in FY3/23 on better cost control.

Product development expense: We project non-GAAP product development expenses/sales ratio at 5.5% in FY3/25E vs. 5.0% in FY3/23, indicating ongoing R&D investments in AI as well as new services for merchants and consumers to increase loyalty.

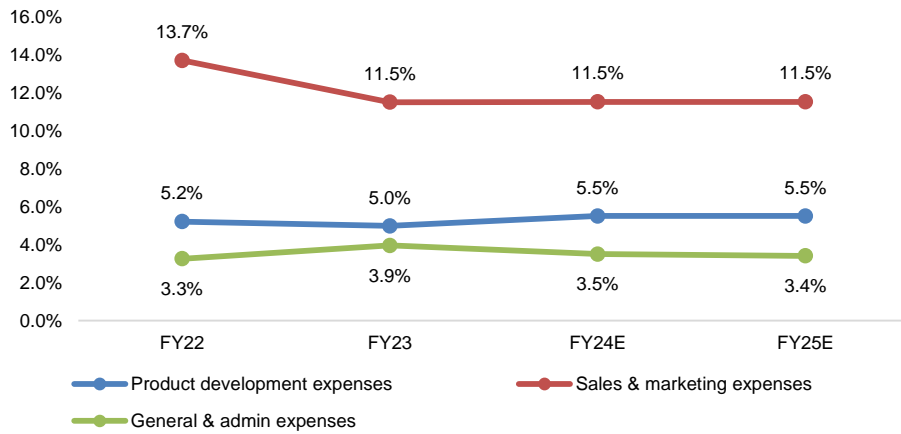
Sales and marketing expenses: We estimate non-GAAP sales and marketing expenses/sales ratio to maintain largely stable at 11.5% in FY3/24E and FY3/25E.

General & admin expenses: We expect non-GAAP general & admin expenses/sales ratio to be 3.4% in FY3/25E vs. 3.9% in FY3/23.

We expect core net margin (excl. impacts of share-based compensation and other non-operating items) to be 16.6% in FY3/25E, same as that in FY3/23. This implies a FY3/23-25E core net profit CAGR of 10%.



Exhibit 5: Non-GAAP* cost trend (% of revenue)



* Excluding impacts of share-based compensation and other non-operating items

Source(s): Company, ABCI Securities estimates



Valuation and TP

We trim our SOTP-based TPs to HK\$ 110 for Alibaba-SW (9988 HK) and US\$ 113 for Alibaba-ADR (BABA US) to reflect the lackluster consumer sentiment in the e-commerce market. Our TP for Alibaba-SW (9988 HK) implies 11.9x FY3/25E core P/E.

In our view, cancellation of Cloud spin-off has raised concerns over shareholders' return outlook. On a positive note, the Company announced its first annual dividend of US\$ 1.0 per ADS. Looking forward, the management plans to increase shareholders' return via various means such as increasing ROIC to double-digit levels, disposal of non-core assets, share repurchase, dividend, among others. Having said that, we believe it could take time for the market to gain confidence in the execution of such plans and their effectiveness in raising shareholders' return.

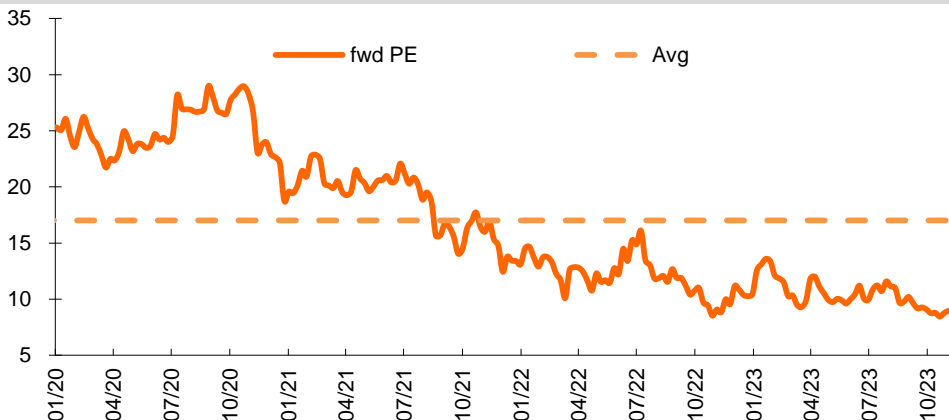
The counter is currently trading at an undemanding valuation of about 8x FY3/25E core P/E. While near-term volatility might still persist, we believe current valuation implies room for recovery potential in the medium term. In our view, potential rooms and pace for valuation recovery in coming months would depend on 1) overall market sentiment; 2) near-term business outlook; 3) proposals of concrete plans to raise shareholders' return.

Exhibit 6: SOTP-based TP for Alibaba-SW (9988 HK)

	HKD per share	% of total	Remarks
China Commerce	59	54.1%	7x FY3/25E P/E
International Commerce	5	4.3%	1x FY3/25E P/S
Cainiao	2	2.0%	0.8x FY3/25E P/S
Local Consumer Service	3	2.4%	1x FY3/25E P/S
Cloud	4	3.4%	0.8x FY3/25E P/S
Digital Media and Entertainment/Innovation Initiatives	2	1.7%	1x FY3/25E P/S
Investments	16	14.1%	Latest book value with a 40% discount
Net cash	20	17.9%	Latest book value
Total	110		

Source(s): ABCI Securities estimates

Exhibit 7: Alibaba's fwd. core P/E



Source(s): Bloomberg, ABCI Securities



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ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

Alibaba (9988 HK/ BABA US, BUY)

China Internet Sector

Nov 20, 2023

Exhibit 8: Alibaba-SW (9988 HK)- TP changes (HK\$ per share)

Old	New	Methodology- old	Methodology new
135	110	SOTP	SOTP; TP implies 11.9x FY3/25E core P/E vs.14.6x previously

Source(s): ABCI Securities estimates



Appendix: Company profile

Business
<ul style="list-style-type: none"> ● After recent strategic restructuring, Alibaba now consists of six major business groups (Cloud intelligence, Taobao/Tmall, Local Consumer Service, Cainiao, International Digital Commerce, and Digital media and Entertainment), each with independent management teams and public listing potentials (except for Taobao/Tmall which will remain wholly owned). ● Taobao/Tmall: Largest ecommerce platform in China with estimated market share at the mid-40s level; we estimate its market share has been dropping in recent years due to rising competition from emerging players such as Pinduoduo (PDD US) and short-video platforms. Estimated annual active buyers around 1bn in China. Estimated GMV per buyer around CNY9K in 2022, versus about CNY3.3K for Pinduoduo and about CNY6K for another e-commerce platform. ● International Digital Commerce: Lazada, AliExpress, Trendyol, etc. ● Local Consumer Service: “To-Home” business of Ele.me and the “To-Destination” business of Amap. Revenue size about one third of Meituan’s local service business. ● Cainiao: External customers account for about 70% of revenue ● Cloud Intelligence: Largest public cloud platform in China with about 33% market share ● Digital Media and Entertainment : Youku, Damai and Alibaba Pictures ● Other business include Sun Art, Freshippo, Alibaba Health, Lingxi Games, Intime, Fliggy, etc ● Alibaba decided not to participate in Ant’s repurchase plan of up to 7.6% of stake. As a result, Alibaba’s effective stakes on Ant is likely to increase from current 33% level. ● In 3Q23, Ant Group repurchased approximately 7% equity interest from its existing shareholders and the shares repurchased were allocated to the employee incentive plans of Ant Group. Alibaba’s equity interest in Ant Group on a fully diluted basis remains unchanged at 33%.
Financials
<ul style="list-style-type: none"> ● Taobao/Tmall contributes most of Alibaba’s operating profit, while other businesses are either loss-making or has minimal profit contribution. On a positive note, profitability of these business units is improving recently. ● Profit contribution from Ant Group at low-teens level. ● Core net margin dropped from high-20s years ago to high-teens level currently due to industry competition and ongoing investments into various new business initiatives. ● Strong balance sheet with about RMB373bn net cash and RMB489bn equity investment in Sep 2023. ● The company has set up a capital management committee to undertake a comprehensive capital management plan to enhance shareholder value, such as capital market transactions, shareholder return initiatives, subsidiary equity incentive plans, fundraisings, IPOs and spin-offs. ● Full spin-off of cloud was cancelled due to business uncertainties arising from recent expansion of US restrictions on export of advanced computing chips. IPO of Freshippo has been put on hold due to market conditions.
Management and shareholder
<ul style="list-style-type: none"> ● Softbank has monetized a significant amount of its c. 13.9% stake in Alibaba via forward contracts. We estimate its effective economic interest on Alibaba has been reduced to low-single-digit levels. Besides, there are no other shareholders holding more than 5% stakes. ● Alibaba’s partnership structure limits the ability of its shareholders to influence corporate matters, such as nominating and electing directors. For example, its Articles of Association allow the Alibaba Partnership to nominate



or, in limited situations, appoint a simple majority of board of directors. There are total 28 partners and election of new partners requires the approval of at least 75% of all of the partners.

- **Jack Ma** stepped down as Chairman in 2019. He will also give up its voting control on Ant Group after Ant's restructuring.
- A series of **management changes** recently arising from strategic reorganization. In June 2023 ,Daniel Zhang, who succeed Jack's Chairman role since 2019, resigned as Group Chairman and took up the role of Chairman and CEO of Cloud Intelligence Group, while Joseph Tsai succeeded Zhang as the new Group Chairman. Yet only after three months, Daniel Zhang has stepped down from his role of Chairman and CEO of Cloud Intelligence Group in Sept 2023, which came at a surprise to the market.

Shareholders' return

- Declaration of **annual cash dividend** for fiscal year 2023 of US\$ 1 per ADS.
- The company has kept upsizing its **share repurchase program** in recent years. As of Sept 30, 2023, there was about US\$ 14.6bn remained under the current program, effective through Mar 2025. The company has repurchased c. 4.8% outstanding shares in 2022.
- **Potential increase in shareholder return** arising from organization restructure such as spin-off, asset disposal, IPOs, etc.
- Potential increase in shareholders return constrained by availability of **offshore cash**

Corporate governance/information disclosure

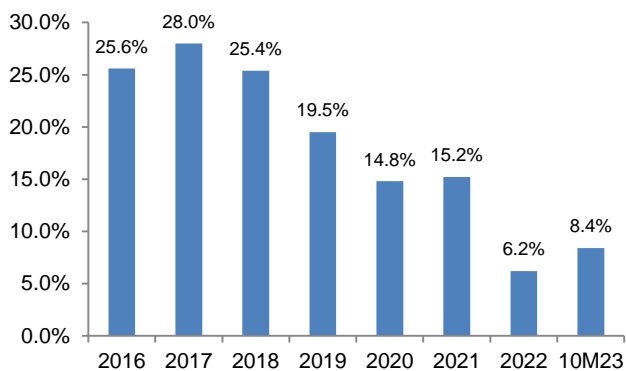
- RMB18.2bn Antitrust fine in 2021
- Ant Group: Listing suspended in 2020 and RMB 7.07bn regulatory fine in 2023.
- Increase information disclosure as a result of strategic reorganization
- Various ESG initiatives in recent years

Source(s):Companies, ABCI Securities

Appendix: E-commerce industry profile

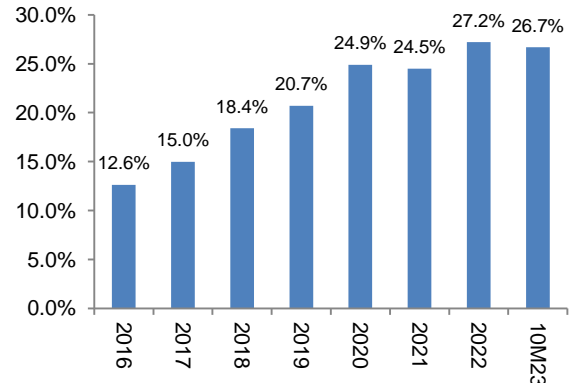
- **China's online sales growth has turned steadier** after years of development. According to NBS, online sales of physical goods grew by 8.4% YoY in 10M23. In particular, 8.4% industry growth rate in 10M23 was lower than the 10.8% industry growth rate in 1H23, indicating a slowdown in recent months.
- By product category, online sales of food products, groceries, and apparel rose 11.3%, 8.2%, and 7.6% in 10M23.
- **Online shopping penetration rate was generally in an uptrend** in recent months, indicating an ongoing consumption shift from offline to online.
- **Live-streaming e-commerce** has been fast growing in recent years. In 9M23, live-streaming e-commerce sales rose by 60.6% YoY and accounted for 18.3% of total online sales, according to Ministry of Commerce. Short video platforms such as Douyin and Kuaishou (1024 HK) are major players in this emerging segment, leading to competitive pressure to traditional e-commerce platforms. On the other hand, Alibaba has been actively developing live-streaming business to defend its market position.
- Major e-commerce platforms are **increasing their sales and marketing effort** by raising user incentives and price subsidies. In our view, **online shoppers have turned price-sensitive** in past years due to the pandemic and soft economic environment, prompting e-commerce platforms to enhance price competitiveness.
- In terms of market share, we estimate that Alibaba is still the largest e-commerce platform with mid-40s market share, versus Pinduoduo (mid-20s), Platform A (low-20s), Douyin (high-single-digit), and Kuaishou (mid-single-digit).
- Over the past few years, **Pinduoduo and short-video platforms (Douyin and Kuaishou) are gaining market shares**. Common features of these platforms: 1) Product offers are generally low prices; 2) More interactive features (social e-commerce, live streaming, etc) than traditional search-based e-commerce format.

Exhibit 9: Online sales of physical goods growth



Source(s): NBS, ABCI Securities

Exhibit 10: Online shopping penetration rate



Source(s): NBS, ABCI Securities



Financial Forecast

Consolidated income statement (FY22A-FY25E)

FY Ended Mar 31 (RMB mn)	FY22A	FY23A	FY24E	FY25E
Total revenue	853,062	868,687	942,779	1,052,097
Cost of sales	(539,450)	(549,695)	(586,863)	(662,276)
Gross profit	313,612	318,992	355,916	389,821
Product development expenses	(55,465)	(56,744)	(66,316)	(74,006)
Selling & marketing expenses	(119,799)	(103,496)	(112,390)	(125,422)
General & admin expenses	(31,922)	(42,183)	(41,449)	(45,203)
Amortization/Impairment	(36,788)	(16,218)	(14,142)	(14,729)
Operating Profits	69,638	100,351	121,618	130,460
Interest and investment income	(15,702)	(11,071)	9,500	9,500
Interest expenses	(4,909)	(5,918)	(5,800)	(5,800)
Other income	10,523	5,823	5,500	5,500
Share of results of equity investees	14,344	(8,063)	2,500	5,000
Profit before tax	73,894	81,122	133,318	144,660
Tax	(26,815)	(15,549)	(26,664)	(28,932)
Profit after tax	47,079	65,573	106,655	115,728
Minority interests	15,170	7,210	7,466	6,944
Accretion of mezzanine equity	(290)	(274)	(192)	(207)
Profits attributable to ordinary shareholders	61,959	72,509	113,928	122,465
Share-based compensation	23,971	30,831	32,997	36,823
Amortization and impairment	51,911	37,855	24,142	24,729
Gains on disposals/reevaluation of investments	21,671	13,857	(9,500)	(9,500)
Other non-core items	(15,997)	(11,061)	192	207
Non-GAAP profits attributable to ordinary shareholders (Core net profit)	143,515	143,991	161,760	174,724
Growth				
Total revenue (%)	18.9	1.8	8.5	11.6
Gross Profits (%)	5.9	1.7	11.6	9.5
Operating Profits (%)	(22.3)	44.1	21.2	7.3
Net profit (%)	(58.8)	17.0	57.1	7.5
Core net profit (%)	(19.8)	0.3	12.3	8.0
Operating performance				
Operating margin (%)	8.2	11.6	12.9	12.4
Net margin (%)	7.3	8.3	12.1	11.6
Core net margin (%)	16.8	16.6	17.2	16.6

Note. Individual items may not sum to total due to rounding differences

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (FY22A-FY25E)

As of Mar 31 (RMB mn)	FY22A	FY23A	FY24E	FY25E
Fixed assets	171,806	176,031	178,031	179,531
Investments	443,253	453,117	460,617	470,617
Other non-current assets	441,959	425,930	421,788	422,059
Total non-current assets	1,057,018	1,055,078	1,060,436	1,072,207
Cash & equivalents	189,898	193,086	233,618	315,200
Restricted cash and escrow receivables	37,455	36,424	38,245	40,157
Short-term investments and investment securities	265,187	331,384	351,384	371,384
Prepayments, deposits & other assets	145,995	137,072	150,779	165,857
Total current assets	638,535	697,966	774,027	892,599
Total assets	1,695,553	1,753,044	1,834,463	1,964,806
Accrued expenses, accounts payable and other liabilities	271,460	275,950	271,210	302,658
Other payables & accruals	21,753	12,543	13,170	13,829
Borrowings and notes	8,841	12,266	20,266	28,266
Deferred revenue	66,983	71,295	75,422	84,168
Merchants deposits	14,747	13,297	13,962	14,660
Total current liabilities	383,784	385,351	394,031	443,580
Borrowings and notes	132,503	149,088	154,088	159,088
Other non-current liabilities	97,073	95,684	98,771	102,013
Total non-current liabilities	229,576	244,772	252,859	261,101
Total liabilities	613,360	630,123	646,890	704,681
Net current assets	254,751	312,615	379,996	449,018
Mezzanine equity	9,655	9,858	10,050	10,257
Equity attributable to shareholders	948,479	989,657	1,061,583	1,140,871
Non-controlling interests	124,059	123,406	115,940	108,996
Total equity	1,072,538	1,113,063	1,177,523	1,249,867

Note. Individual items may not sum to total due to rounding differences

Individual items may varies from reported figures due to rounding differences/definition differences

Source(s): Company, ABCI Securities estimates

Consolidated cash flows statement (FY22A-FY25E)

As of Mar 31 (RMB mn)	FY22A	FY23A	FY24E	FY25E
Net income	47,079	65,573	106,655	115,728
Depreciation and amortization	48,065	46,938	42,142	43,229
Other non-cash adjustments	65,765	123,759	30,497	31,823
Change in working capital	(18,150)	(36,518)	(11,761)	27,801
Operating cash flow	142,759	199,752	167,532	218,582
Investing cash flow	(198,592)	(135,506)	(65,000)	(70,000)
Financing cash flow	(64,449)	(65,619)	(62,000)	(67,000)
Net cash flows	(120,282)	(1,373)	40,532	81,582

Note. Individual items may not sum to total due to rounding differences

Individual items may varies from reported figures due to rounding differences/definition differences

Source(s): Company, ABCI Securities estimates

Risk factors

Market competition

The ecommerce industry is highly competitive, with companies contending on commission rate, promotion discount, brand advertising, technological investment, and more.

Slowdown in ecommerce consumption

As the industry is dependent on consumer spending, any significant slowdown of consumption in China would hamper the Group's performance. In the long term, we believe consumption growth in domestic market would converge with income growth, which is usually in line with GDP growth.

Loss making segments

Some business segments such as International Digital Commerce, Local Consumer Service, and Digital Media and Entertainment recorded loss from operations. If their losses enlarge, overall business performance will be adversely affected.

Non-GAAP financials

Ecommerce platforms generally disclosed the non-GAAP financial metrics, such as the non-GAAP net profit, to supplement its GAAP financial measures. Historically, there were differences between its GAAP net profit and non-GAAP net profit due to inclusion of items such as share-based compensation and other non-core items in the former.

Among these items, share-based compensation expense is related to various factors including price movement of ordinary shares, expected volatility, risk-free interest rate, etc.

While investors tend to exclude these items when performing analysis given their non-cash nature, we believe these non-GAAP financial measures should only serve as references.



Disclosures

Analyst Certification

The analyst, CHOW Sau Shing, primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company(ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

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Definition of equity rating

Rating	Definition
Buy	Stock return rate \geq Market return rate ($\sim 9\%$)
Hold	- Market return rate ($\sim 9\%$) \leq Stock return rate $<$ Market return rate ($\sim 9\%$)
Sell	Stock return $<$ - Market return ($\sim 9\%$)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2006 (HSI total return index 2006-22 averaged at 8.4%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.

Tel: (852) 2147 8863