

# XD Inc (2400 HK)

## Steady Game Revenue Growth, TapTap MAUs Growth Beats Expectation

Hong Kong | Game Sector | Update Report

25 Sept 2020

### Investment Summary

#### 1H20 interim result overview

The 1H20 Revenue of XD Inc. was RMB 1.44 billion (+10.0% yoy). The revenue contributed by game operating business was RMB 1.19 billion (+8.1% yoy). Within the game operating business, the revenue of online game operating business was RMB 1.11 billion (+3.8% yoy). The rise was mainly attributed to the solid performance of Sausage Man (香腸派對) in 1H20. But the solid performance of Sausage Man (香腸派對) was partly offset by decreases of revenue from games under maturity stage, such as Ragnarok M (仙境傳說). In addition, the revenue contributed by premium game operation was RMB 50.5 million (+98.4% yoy), mainly attributed by the solid performance of new game Juicy Realm (惡果之地) and old game Muse Dash (喵斯快跑). On the other hand, the company's revenue from information services in 1H20 was RMB 252 million (+19.9% yoy), and contributed 17.6% of the company's total revenue. The yoy increase was mainly attributed by the huge increase in MAUs of TapTap platform in 1H20. As affected by the quarantine, the MAUs of TapTap platform in 1H20 was 24.8 million (+51.9% yoy).

The company's GP in 1H20 was RMB 826 million (-5.9% yoy), with GPM at 57.3% (-9.7ppt yoy). The GPM of game business in 1H20 was 51.3% (-11.3ppt yoy). The decrease was mainly attributed by the fact that the contribution from game operating revenue recognized on a gross basis to total game operating revenue has increased from 49.2% to 73.1%. On the other hand, The GPM of information services in 1H20 was 85.5% (-4.2ppt yoy). The decrease was mainly attributed by the fact the increase in cost as a result of TapTap MAUs increase was higher than the corresponding revenue increase. The Adjusted NP attributed to parent in 1H20 was RMB 207 million (-12.7% yoy)

#### The growth of MAUs on TapTap platform in 1H20 higher than our expectation, the number of game downloads in 1H20 has also increased significantly

The MAUs of TapTap platform in 1H20 was 24.8 million (+51.9% yoy). The huge increase was mainly attributed by 1) the improving exclusive content on TapTap platform 2) the increasing time spent online by netizens during the quarantine 1H20. The company has launched many exclusive contents on TapTap in 1H20, including "Pasical's Wager" (帕斯卡契約), which is a Chinese game appeared at the Apple Conference. In July 2020, TapTap also exclusively released a free-to-play game "Canal Towns" (江南百景圖) on PRC Android platform. The game has more than 5 million downloads on the platform in the first month since launched. We believe "Canal Towns" (江南百景圖) will be served as a great Case study for TapTap platform and help attract more exclusive distribution rights of third party quality games for TapTap platform. With the increase of more high quality content on the platform, the MAUs and advertisement revenue of TapTap will also likely to rise. The number of downloads and TapTap posts in 1H20 also increased by 26.4%/143.0% yoy. The number of TapTap posts grew faster than the MAUs' growth, which indicates that the degree of user participation of users from TapTap has also increased in 1H20. In 2H20, it is expected that the user accounts of Sausage Man (香腸派對) will be connected with the TapTap accounts. The user accounts of Human Fall Flat (人類跌落夢境), a highly anticipated game planned to be issued in 2H20, will also be connected with the TapTap accounts. We strongly believe this will further increase the degree of user participations of TapTap Platform.

Despite the huge increase in TapTap MAUs in 1H20, the ARPU of TapTap platform has decreased significantly, from RMB 12.9/ 6 months in 1H19 dropped to RMB 10.2/ 6 months, down by 21% yoy. The drop was mainly attributed by 1) the desire to advertise from the small/mid-tier advertising company has dropped significant in 1H20, since there weren't

### Accumulate (Upgrade)

CMP HKD 39.85

(Closing price as of 23 Sept)

TARGET HKD 43.25(+8.5%)

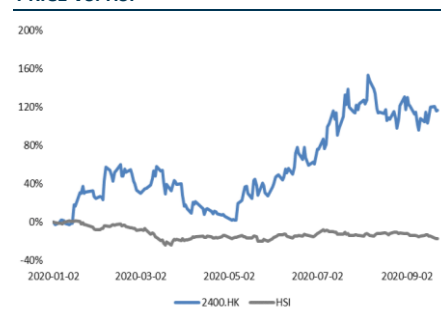
#### COMPANY DATA

O/S SHARES (MN) :	454
MARKET CAP (HKD MN) :	18,323
52 - WK HI/LO (HKD):	47.90/11.26

#### SHARE HOLDING PATTERN, %

Happy Today Holding Limited	37.17
Aiks Danger Inc	15.93
Jiexin Holdings Limited	8.87
IGG Inc	5.81

#### PRICE VS. HSI



Source: Company Data, Phillip Securities

#### KEY FINANCIALS

CNY mn	FY19	FY20E	FY21E	FY22E
Net Sales	2,838	3,374	4,342	5,326
Adj. Net Profit	405	457	680	994
Adj. EPS	1.14	1.04	1.50	2.19
Adj. P/E, x	31.4	34.6	24.0	16.4
BVPS	6.44	8.05	9.68	12.42
P/BV, x	5.6	4.5	3.7	2.9
ROE (%)	22.5	16.1	19.3	22.0
ROA (%)	17.9	13.6	16.4	18.9

Market closing price as of 23th Sept

Source: Company Data, Phillip Securities Est.

#### Research Analyst

Kevin Chiu (+ 852 2277 6514)

kevinchiu@phillip.com.hk

much new games issued in 1H20 2) the increase in MAUs in 1H20 was mainly driven by the addition of new users, and the advertisement placing accuracy of TapTap on new users was relatively lower than old users. Hence, dragging down the overall ARPU. With the increase of supply of new games on TapTap in 2H20 as well as the gradual improvement of advertisement placing accuracy of TapTap on new users, we believe that the new users on TapTap will bring significant commercial value to the company in the long term, and ARPU is also expected to recover.

In August 2020, the company has further acquired YiWan's 18.34% shares and reached 74.12% totally. The company has spent a total of RMB 330 million in this acquisition. After the acquisition, the company is expected to further enhance its synergies with TapTap platform.

### **Steady Growth in online game's revenue, the company is expected to launch 3 self-developed games in the next year**

The company's online game operating revenue in 1H20 was RMB 1.11 billion (+3.8% yoy). Despite the impressive performance of Ulala (不休的烏拉拉), Sausage Man (香腸派對) and Lan Yan Qing Meng (藍顏清夢) in 1H20, the growth of online game operating revenue was still rather slow. It was mainly because Ragnarok M (仙境傳說), the game that contributed the most revenue in 2019, is already under its maturity stage, hence a significant drop in revenue of the game. It is expected the company will launch a huge update version of the game in 2H20, which is likely to extend the life cycle and revenue contribution of the game. In order to increase R&D capabilities, the company has expanded their R&D team in 1H20, by adding 618 R&D employees comparing to 1H19. Among them, 250 employees are mainly focusing on game development. Currently, there are 11 games are under development by the company, 3 of them are expected to be launching in 1H21, including ARPG game Torchlight: Infinity (火炬之光: 無限), simulation game Fantasy World (心動小鎮) (previously name as 創想世界) and MMORPG game Project A (tentative name). Project A was developed by Ragnarok M (仙境傳說)'s development team and is the company's largest game since Ragnarok M (仙境傳說) in terms of capital investment. We are expecting an impressive performance of the game after it is launched.

### **Valuation**

After considering 1) the revenue growth of online game operating business is slower than expected 2) the revenue growth of premium game operating business is higher than expected 3) the GPM of the company is lower than expectation 4) the R&D expenses increase as a result of the expansion of R&D team 5) the S&M expense ratio of 1H20 is lower than expectation 6) the decrease in minority interest as a result of the increase in Yiwan's stake, we have lowered the company's 2020/2021/2022 Adjusted EPS to RMB 1.04/1.50/2.19. By considering that long term commercial value brought by the huge increase in MAUs of TapTap platform, we have raised the company's target 2021 PE ratio to 26x. We have raised the target price to HKD 43.25 (+8.5%), with corresponding 2020/2021 adjusted P/E ratio of 37.6x/26.0x. We upgrade the rating to "Accumulate".

Figure 1: Comparable valuation

Company	Stock code	Closing Price	Market Cap	PE				PB				
				TTM	2019A	2020E	2021E	TTM	2019A	2020E	2021E	
		(listed currency)	(RMB mn)									
<b>HK stocks</b>												
XD INC	2400 hk equity	39.85	15,858	35.6x	32.0x	31.6x	23.2x	-	7.5x	5.6x	4.5x	
TENCENT	700 hk equity	514.00	4,316,300	41.1x	45.6x	35.5x	28.6x	8.0x	10.2x	7.7x	6.1x	
NETEASE INC	9999 HK equity	149.40	452,346	1.1x	-	24.6x	21.7x	0.2x	-	6.3x	5.5x	
FRIENDTIMES	6820 hk equity	2.45	4,697	10.2x	-	8.7x	6.7x	3.6x	-	2.2x	1.7x	
NETDRAGON	777 hk equity	16.52	8,164	10.8x	9.0x	9.4x	7.4x	1.3x	1.3x	1.2x	1.1x	
ZENGAME	2660 hk equity	1.07	955	5.6x	-	-	-	1.6x	-	-	-	
ARCHOSAUR GAMES	9990 hk equity	23.60	16,865	-	-	26.3x	15.2x	-	-	4.7x	3.4x	
IDREAMSKY	1119 hk equity	4.74	5,274	16.4x	9.2x	10.4x	9.0x	1.4x	-	1.2x	1.1x	
CMGE	302 hk equity	3.62	7,392	24.1x	11.3x	9.4x	7.4x	2.1x	2.2x	1.7x	1.5x	
IGG INC	799 HK equity	9.06	9,764	6.3x	9.7x	7.4x	8.4x	3.1x	4.0x	2.8x	2.2x	
				<b>Average</b>	<b>16.8x</b>	<b>19.5x</b>	<b>18.1x</b>	<b>14.2x</b>	<b>2.7x</b>	<b>5.1x</b>	<b>3.7x</b>	<b>3.0x</b>
				<b>Median</b>	<b>10.8x</b>	<b>10.5x</b>	<b>10.4x</b>	<b>9.0x</b>	<b>1.8x</b>	<b>4.0x</b>	<b>2.8x</b>	<b>2.2x</b>
<b>A stocks</b>												
WUHU SANQI	002555 CH equity	40.93	86,454	30.9x	40.7x	29.1x	24.7x	10.6x	11.3x	8.8x	6.8x	
GIANT NETWORK	002558 CH equity	19.81	40,103	45.8x	36.0x	36.3x	30.2x	4.8x	-	3.5x	3.1x	
ZHEJIANG CENTURY	002602 CH equity	10.44	77,805	25.5x	25.9x	19.8x	16.0x	2.6x	3.8x	3.1x	2.7x	
PERFECT WORLD	002624 CH equity	33.60	65,172	38.3x	43.7x	26.4x	21.6x	6.0x	6.6x	5.2x	4.2x	
G-BITS NETWORK	603444 CH equity	622.00	44,700	49.9x	49.4x	38.1x	30.7x	13.5x	13.4x	11.2x	8.8x	
				<b>Average</b>	<b>38.1x</b>	<b>39.1x</b>	<b>30.0x</b>	<b>24.7x</b>	<b>7.5x</b>	<b>8.7x</b>	<b>6.4x</b>	<b>5.1x</b>
				<b>Median</b>	<b>38.3x</b>	<b>38.4x</b>	<b>27.7x</b>	<b>23.2x</b>	<b>5.4x</b>	<b>6.6x</b>	<b>4.3x</b>	<b>3.7x</b>
<b>US stocks</b>												
EA	EA US equity	131.02	256,974	19.1x	33.4x	28.0x	23.9x	4.9x	7.5x	5.6x	4.6x	
NINTENDO	NTDOY US equity	71.50	511,492	-	-	3.8x	18.7x	-	-	0.5x	-	
SONY CORP	SNE US equity	78.70	674,015	-	12.5x	17.7x	19.3x	-	2.8x	-	2.0x	
ACTIVISION BLIZZARD	ATVI US equity	82.65	433,259	36.4x	37.3x	25.6x	24.7x	4.7x	5.0x	4.3x	3.8x	
				<b>Average</b>	<b>27.8x</b>	<b>27.8x</b>	<b>18.8x</b>	<b>21.6x</b>	<b>4.8x</b>	<b>5.1x</b>	<b>3.5x</b>	<b>3.5x</b>
				<b>Median</b>	<b>27.8x</b>	<b>33.4x</b>	<b>21.7x</b>	<b>21.6x</b>	<b>4.8x</b>	<b>5.0x</b>	<b>4.3x</b>	<b>3.8x</b>

 As of 23<sup>th</sup> Sept Closing Price, US stocks closing price as of 22<sup>nd</sup> Sept

Source: Bloomberg

## Risk

1) The tightening on Game regulations 2) The Games underperform comparing to expectation 3) The MAUs growth of TapTap platform is less than expectation

## Financial Statements

### Key Financial Data

FYE DEC	FY18	FY19	FY20E	FY21E	FY22E
<b>Valuation Ratio</b>					
Adjusted P/E ratio, x	NA	31.44	34.63	23.95	16.38
P/B ratio, x	NA	5.57	4.46	3.70	2.89
<b>Per share data (RMB)</b>					
Adjusted EPS	NA	1.14	1.04	1.50	2.19
Book value per share	NA	6.44	8.05	9.68	12.42
<b>Growth &amp; Margin</b>					
Revenue Growth	40.4%	50.4%	18.9%	28.7%	22.7%
Operating income growth	188.5%	37.0%	15.0%	48.9%	46.3%
Adjusted Net income Growth	146.5%	41.0%	12.7%	49.0%	46.2%
Gross Profit Margin	58.9%	62.4%	60.7%	61.6%	64.2%
Operating profit Margin	20.5%	18.6%	18.0%	20.9%	24.9%
Adjusted Net Profit Margin	15.2%	14.3%	13.5%	15.7%	18.7%
<b>Key Ratios</b>					
ROE	26.3%	22.5%	16.1%	19.3%	22.0%
ROA	20.5%	17.9%	13.6%	16.4%	18.9%

Market closing price as of 23<sup>th</sup> Sept

### Consolidated Statement of Profit or Loss

(RMB million)	2016	2017	2018	2019	2020E	2021E	2022E
<b>Revenues</b>	765.5	1,344.4	1,887.1	2,838.1	3,374.0	4,341.5	5,326.2
<b>Cost of Sale</b>	(424.8)	(741.7)	(776.3)	(1,066.3)	(1,327.1)	(1,667.8)	(1,908.9)
<b>Gross Profit</b>	340.7	602.7	1,110.8	1,771.8	2,046.9	2,673.7	3,417.3
Selling and marketing expenses	(186.3)	(244.4)	(448.0)	(745.1)	(674.8)	(868.3)	(1,065.2)
Research and development expenses	(79.4)	(117.4)	(197.8)	(317.6)	(539.8)	(651.2)	(745.7)
General and administrative expenses	(66.7)	(83.8)	(107.3)	(202.7)	(236.2)	(260.5)	(292.9)
Net impairment losses on financial assets	(0.7)	(1.0)	(0.3)	(1.9)	-	-	-
Fair value changes on investments measured at fair value through P&L	(15.6)	(21.1)	(3.4)	8.2	-	-	-
Others	50.6	(1.1)	32.4	16.6	12.4	12.4	12.4
<b>Operating Income</b>	42.6	133.9	386.4	529.3	608.5	906.1	1,325.9
Finance income	1.2	3.0	5.0	8.3	14.7	20.8	28.2
Finance costs	(2.0)	(2.1)	(2.3)	(3.0)	(3.0)	(3.0)	(3.0)
Share of results of investments accounted for using equity method	(18.5)	7.6	0.3	10.8	-	-	-
<b>Profit before income tax</b>	23.3	142.5	389.4	545.4	620.2	923.9	1,351.1
Income tax expense	0.0	(21.9)	(36.7)	(32.0)	(49.6)	(73.9)	(108.1)
<b>Profit of the year</b>	23.4	120.5	352.7	513.4	570.6	850.0	1,243.0
Profit attributed to Non Controlling interest	1.8	(3.9)	(67.7)	(166.9)	(114.1)	(170.0)	(248.6)
<b>Profit attributed to Parents</b>	25.2	116.6	285.0	346.6	456.5	680.0	994.4
<b>Adj Profit attributed to Parents</b>	25.2	116.6	287.4	405.2	456.5	680.0	994.4
<b>Adj EPS</b>				1.14	1.04	1.50	2.19

**Consolidated statement of Financial Position**

(RMB million)	2016	2017	2018	2019	2020E	2021E	2022E
<b>Non Current Assets</b>							
PPE	20.9	29.1	45.6	86.9	141.0	228.8	371.1
Intangible assets	104.0	175.0	192.2	198.9	209.6	220.8	232.6
Prepayments, deposits and other assets	29.1	14.0	65.0	74.2	85.3	95.5	105.1
Others	184.8	120.2	145.7	131.7	461.9	461.9	461.9
<b>Total Non Current Assets</b>	<b>338.8</b>	<b>338.2</b>	<b>448.4</b>	<b>491.7</b>	<b>897.8</b>	<b>1,006.9</b>	<b>1,170.6</b>
<b>Current Assets</b>							
Trade receivables	60.0	216.0	449.1	406.1	609.3	784.0	961.8
Cash and cash equivalents	178.1	578.0	573.2	1,336.9	2,039.1	2,717.1	3,741.9
Others	133.1	178.4	254.0	631.3	651.4	669.9	687.1
<b>Total Current Assets</b>	<b>371.2</b>	<b>972.3</b>	<b>1,276.3</b>	<b>2,374.3</b>	<b>3,299.7</b>	<b>4,170.9</b>	<b>5,390.8</b>
<b>Total Asset</b>	<b>710.0</b>	<b>1310.6</b>	<b>1724.7</b>	<b>2866.1</b>	<b>4197.5</b>	<b>5177.9</b>	<b>6561.5</b>
<b>Equity</b>							
Share capital	-	-	-	0.3	0.3	0.3	0.3
Reserve	499.8	838.0	1,077.9	1,871.6	3,018.6	3,698.6	4,693.0
Non Controlling Interest	10.1	119.8	264.6	414.7	528.8	698.8	947.4
<b>Total Equity</b>	<b>509.9</b>	<b>957.8</b>	<b>1,342.6</b>	<b>2,286.5</b>	<b>3,547.7</b>	<b>4,397.7</b>	<b>5,640.7</b>
<b>Total Non Current Liabilities</b>	<b>35.4</b>	<b>27.1</b>	<b>39.8</b>	<b>25.2</b>	<b>25.2</b>	<b>25.2</b>	<b>25.2</b>
<b>Current liabilities</b>							
Trade payables	23.8	124.7	101.3	200.8	215.4	270.7	309.8
Other payables and accruals	69.8	59.6	83.9	151.7	205.8	279.2	378.7
Others	71.0	141.5	157.2	201.8	203.4	205.1	207.0
<b>Total Current Liabilities</b>	<b>164.7</b>	<b>325.7</b>	<b>342.4</b>	<b>554.3</b>	<b>624.6</b>	<b>755.0</b>	<b>895.5</b>
<b>Total Liabilities</b>	<b>200.1</b>	<b>352.8</b>	<b>382.1</b>	<b>579.5</b>	<b>649.8</b>	<b>780.2</b>	<b>920.7</b>
<b>Total Equity and Liabilities</b>	<b>710.0</b>	<b>1310.6</b>	<b>1724.7</b>	<b>2866.1</b>	<b>4197.5</b>	<b>5177.9</b>	<b>6561.5</b>

**Cash Flow Statement**

(RMB million)	2016	2017	2018	2019	2020E	2021E	2022E
<b>Profit before income tax</b>	<b>23.3</b>	<b>142.5</b>	<b>389.4</b>	<b>545.4</b>	<b>620.2</b>	<b>923.9</b>	<b>1,351.1</b>
Depreciation and amortization	35.5	55.9	74.5	107.8	122.3	155.9	208.5
change in working capital	(60.8)	60.3	(290.3)	143.7	(153.0)	(62.8)	(54.5)
Others	(6.7)	37.1	(.0)	63.9	(72.5)	(101.9)	(142.9)
<b>Net cash generated from operating activities</b>	<b>(8.7)</b>	<b>295.7</b>	<b>173.6</b>	<b>860.8</b>	<b>517.1</b>	<b>915.1</b>	<b>1,362.2</b>
Capex	(34.3)	(34.8)	(173.0)	(139.9)	(171.6)	(239.3)	(347.2)
Others	108.5	(96.8)	(26.6)	(328.8)	(330.2)	-	-
<b>Cashflow from investing activities</b>	<b>74.2</b>	<b>(131.5)</b>	<b>(199.6)</b>	<b>(468.6)</b>	<b>(501.8)</b>	<b>(239.3)</b>	<b>(347.2)</b>
Proceed of share issuance	-	-	-	629.3	690.6	-	-
Others	(10.6)	249.1	1.3	(266.5)	(3.7)	2.3	9.8
<b>Cashflow from operating activities</b>	<b>(10.6)</b>	<b>249.1</b>	<b>1.3</b>	<b>362.8</b>	<b>686.9</b>	<b>2.3</b>	<b>9.8</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>55.0</b>	<b>413.3</b>	<b>(24.8)</b>	<b>755.0</b>	<b>702.2</b>	<b>678.0</b>	<b>1,024.9</b>
Cash at beginning	114.5	178.1	578.0	573.2	1,336.9	2,039.1	2,717.1
Foreign exchange	8.6	(13.5)	20.0	8.7	-	-	-
<b>Cash and cash equivalents at the end of the year</b>	<b>178.1</b>	<b>578.0</b>	<b>573.2</b>	<b>1,336.9</b>	<b>2,039.1</b>	<b>2,717.1</b>	<b>3,741.9</b>

### PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm$ 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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**Contact Information (Regional Member Companies)**

## SINGAPORE

**Phillip Securities Pte Ltd**

250 North Bridge Road, #06-00 Raffles City Tower,  
Singapore 179101

Tel : (65) 6533 6001 Fax: (65) 6535 3834

[www.phillip.com.sg](http://www.phillip.com.sg)

## INDONESIA

**PT Phillip Securities Indonesia**

ANZ Tower Level 23B, Jl Jend Sudirman Kav 33A,  
Jakarta 10220, Indonesia

Tel (62) 21 5790 0800 Fax: (62) 21 5790 0809

[www.phillip.co.id](http://www.phillip.co.id)

## THAILAND

**Phillip Securities (Thailand) Public Co. Ltd.**

15th Floor, Vorawat Building, 849 Silom Road,  
Silom, Bangrak, Bangkok 10500 Thailand

Tel (66) 2 2268 0999 Fax: (66) 2 2268 0921

[www.phillip.co.th](http://www.phillip.co.th)

## UNITED STATES

**Phillip Futures Inc.**

141 W Jackson Blvd Ste 3050  
The Chicago Board of Trade Building  
Chicago, IL 60604 USA

Tel (1) 312 356 9000 Fax: (1) 312 356 9005

## MALAYSIA

**Phillip Capital Management Sdn Bhd**

B-3-6 Block B Level 3, Megan Avenue II,  
No. 12, Jalan Yap Kwan Seng, 50450 Kuala Lumpur

Tel (60) 3 2162 8841 Fax (60) 3 2166 5099

[www.poems.com.my](http://www.poems.com.my)

## CHINA

**Phillip Financial Advisory (Shanghai) Co. Ltd.**

No 436 Heng Feng Road, Green Tech Tower Unit 604  
Shanghai 200 070

Tel (86) 21 5169 9400 Fax: (86) 21 6091 1155

[www.phillip.com.cn](http://www.phillip.com.cn)

## FRANCE

**King & Shaxson Capital Ltd.**

3rd Floor, 35 Rue de la Bienfaisance  
75008 Paris France

Tel (33) 1 4563 3100 Fax : (33) 1 4563 6017

[www.kingandshaxson.com](http://www.kingandshaxson.com)

## AUSTRALIA

**PhillipCapital Australia**

Level 10, 330 Collins Street  
Melbourne VIC 3000 Australia

Tel: (61) 3 9618 8238 Fax: (61) 3 9200 2277

[www.phillipcapital.com.au](http://www.phillipcapital.com.au)

## HONG KONG

**Phillip Securities (HK) Ltd**

11/F United Centre 95 Queensway Hong Kong

Tel (852) 2277 6600 Fax: (852) 2868 5307

[www.phillip.com.hk](http://www.phillip.com.hk)

## JAPAN

**Phillip Securities Japan, Ltd**

4-2 Nihonbashi Kabutocho, Chuo-ku  
Tokyo 103-0026

Tel: (81) 3 3666 2101 Fax: (81) 3 3664 0141

[www.phillip.co.jp](http://www.phillip.co.jp)

## INDIA

**PhillipCapital (India) Private Limited**

No. 1, 18th Floor, Urmi Estate, 95 Ganpatrao Kadam Marg,  
Lower Parel West, Mumbai 400013

Tel: (9122) 2300 2999 Fax: (9122) 6667 9955

[www.phillipcapital.in](http://www.phillipcapital.in)

## UNITED KINGDOM

**King & Shaxson Ltd.**

6th Floor, Candlewick House, 120 Cannon Street  
London, EC4N 6AS

Tel (44) 20 7929 5300 Fax: (44) 20 7283 6835

[www.kingandshaxson.com](http://www.kingandshaxson.com)

## SRI LANKA

**Asha Phillip Securities Limited**

Level 4, Millennium House, 46/58 Navam Mawatha,  
Colombo 2, Sri Lanka

Tel: (94) 11 2429 100 Fax: (94) 11 2429 199

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