

China / Hong Kong Company Guide

Kingsoft Corp

Version 4 | Bloomberg: 3888 HK EQUITY | Reuters: 3888.hk

Refer to important disclosures at the end of this report

DBS Group Research . Equity

12 Jan 2018

BUY

Last Traded Price (11 Jan 2018): HK\$28.35 (HSI : 31,120)

Price Target 12-mth: HK\$34.00 (20% upside) (Prev HK\$29.00)

Analyst

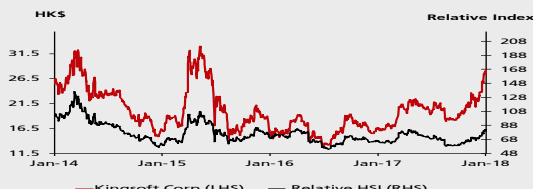
Susanna CHUI +852 2820 4611 susanna_chui@db.com

Tsz Wang TAM CFA, +852 2971 1772 tszwangtam@db.com

What's New

- **JX1 Mobile has regained its Top 10 ranking in mobile games in November 2017, after launching a revamped version**
- **JX2 Mobile has started closed-beta testing, and we expect it to be launched in mid-2018.**
- **Valuation of Kingsoft's stake in Kingsoft Cloud in series D is 73% higher than that in series C**
- **Revised down FY17F/18F net profit by 15%/16% and up 19F net profit by 15%, in view of later-than-expected launch of JX2 Mobile and JX3 Mobile; reiterate BUY with TP lifted from HK\$29 to HK\$34, as we revised up Kingsoft Cloud's valuation**

Price Relative



Forecasts and Valuation

FY Dec (RMB m)	2016A	2017F	2018F	2019F
Turnover	8,282	5,211	6,901	9,446
EBITDA	263	1,473	1,783	2,758
Pre-tax Profit	(124)	1,046	1,417	2,416
Net Profit	(271)	929	1,268	2,149
Net Profit Gth (Pre-ex) (%)	N/A	N/A	36.5	69.4
EPS (RMB)	(0.21)	0.72	0.98	1.67
EPS (HK\$)	(0.25)	0.87	1.18	2.01
EPS Gth (%)	N/A	N/A	36.5	69.4
Diluted EPS (HK\$)	(0.25)	0.87	1.18	2.01
DPS (HK\$)	0.11	0.11	0.11	0.11
BV Per Share (HK\$)	7.19	7.93	8.98	10.83
PE (X)	nm	32.7	24.0	14.2
P/Cash Flow (X)	33.7	25.1	23.1	14.9
P/Free CF (X)	66.6	32.7	32.1	19.8
EV/EBITDA (X)	100.2	17.2	13.5	8.1
Net Div Yield (%)	0.4	0.4	0.4	0.4
P/Book Value (X)	4.0	3.6	3.2	2.6
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	(3.4)	11.2	13.7	19.8
Earnings Rev (%)		(15)	(16)	15
Consensus EPS (RMB)		1.46	1.07	1.47
Other Broker Recs:		B: 16	S: 0	H: 1

Source of all data on this page: Company, DBSV, Thomson Reuters, HKEX

The best is yet to come - JX3 Mobile

Dual growth engines of online games and Kingsoft Cloud. We have a BUY on Kingsoft, which is a leading client-end game developer in China. We like Kingsoft's strong PC game IP, JX series (劍俠系列), which continues to succeed in mobile games and has become a near-term earnings driver. We also see strong potential for Kingsoft Cloud, with next round financing as share price catalyst.

Where we differ. The best is yet to come - JX3 Mobile. Many investors are concerned with JX1 Mobile's (劍俠情緣1手遊) slowdown and Kingsoft's mobile game pipeline. JX1 Mobile has gone back to the Top 10 mobile games in China on the iOS platform in November 2017, after launching revamped version on 29 October. JX2 Mobile (劍俠情緣2手遊) has started closed-beta testing in December, and we expect it to be launched in mid-2018. Much-anticipated JX3 Mobile (劍俠情緣3手遊, converted from JX3 Online, a top 10 PC game in China) has started testing in December as well. Kingsoft has also built up a good track record in publishing. Monthly gross billing of its licensed Eudemons Mobile (魔域手遊, developed by NetDragon), which was launched on 18 October, exceeded Rmb100m in the first month. We expect Kingsoft's online game revenue to deliver an FY16-19F CAGR of 30%.

Other critical factors. Kingsoft Cloud's next round financing or turnaround to be the next share price catalyst. We expect Kingsoft's revenue from WPS and cloud to deliver an FY16-19F CAGR of 44%, with increasing market share from 7.5% in FY16 to 15.0% in FY19F. Kingsoft Cloud completed its series D financing in December 2017. Kingsoft's 52% stake in Kingsoft Cloud was valued at US\$987m in series D, which is 73% higher than that in series C financing, and represents c.20% of Kingsoft's market capitalisation. Next round financing or turnaround will be a catalyst to Kingsoft's valuation.

Valuation:

Our TP of HK\$34 is derived from SOTP valuation: (1) 15x FY18F PE for online games (HK\$14); (2) 10x FY18F PE for Cheetah and WPS (HK\$5); (3) Valuation from series D financing for Kingsoft Cloud (HK\$6); (4) Market capitalisation for 21Vianet and Xunlei (HK\$2); and (5) FY18F net cash (HK\$7).

Key Risks to Our View:

Competition from other developers' PC-to-mobile games; competition from other leading IaaS providers.

At A Glance

Issued Capital (m shrs)	1,311
Mkt. Cap (HK\$m/US\$m)	37,233 / 4,759
Major Shareholders	
Lei Jun (%)	27.1
Kau Pak Kwan (%)	8.3
Tencent Holdings Limited (%)	8.2
Free Float (%)	56.4
3m Avg. Daily Val. (US\$m)	41.9
ICB Industry : Technology / Software & Computer Services	

CRITICAL FACTORS TO WATCH

Critical Factors

Online games' APA and ARPU growth

Average paying accounts (APA) and average revenue per paying user (ARPU) are key indicators of online game revenue. Online games' monthly APA/ARPU increased 55%/20% in FY16, after Kingsoft successfully converted its flagship JX series PC games into JX 1 Mobile (劍俠情緣 1 手遊). JX Mobile has ranked among top 10 mobile games in China on iOS for 12 months. JX2 Mobile (劍俠情緣 2 手遊) started its closed-beta testing in December, and we expect it to be launched in mid-2018. Much anticipated JX3 Mobile (劍俠情緣 3 手遊, which is converted from JX3 Online, a top 10 PC game in China) has started testing in December as well. We expect online games' monthly APA to deliver an FY16-19F CAGR of 5%, after rapid-growing JX 1 mobile gamers, and ARPU to deliver an FY16-19F CAGR of 24%, driven by the much-anticipated launch of JX3 Mobile. We expect Kingsoft's online game revenue to deliver an FY16-19F CAGR of 30%.

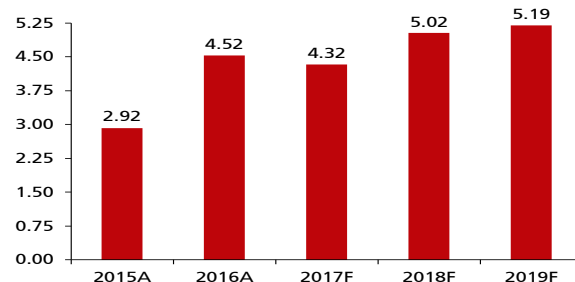
Cheetah's revenue per mobile MAU growth

Cheetah's mobile MAU is mainly monetised via advertisements. We expect Cheetah's mobile monthly active users (MAU) to deliver an FY16-19F CAGR of -5%, with its transition from utility apps, such as Clean Master and CM Security, to content apps, such as Live.me, but We Cheetah's revenue per mobile MAU to deliver an FY16-19F CAGR of 17%, with ramp-up of Live.me's monetisation. We expect Cheetah's revenue to deliver an FY16-19F CAGR of 12%.

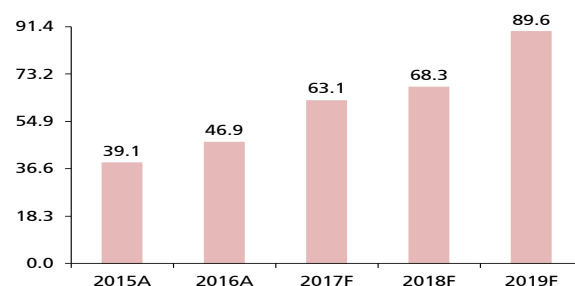
Kingsoft Cloud's market share growth

Market share will improve Kingsoft Cloud's margins from economies of scale. Kingsoft Cloud is solidifying its position in games and videos, and expanding to the healthcare and government sectors. We expect Kingsoft's revenue from WPS and cloud to deliver an FY16-19F CAGR of 44%, driven by Kingsoft Cloud's market share rise in China's IaaS market from 8% in FY16 to 15% in FY19F.

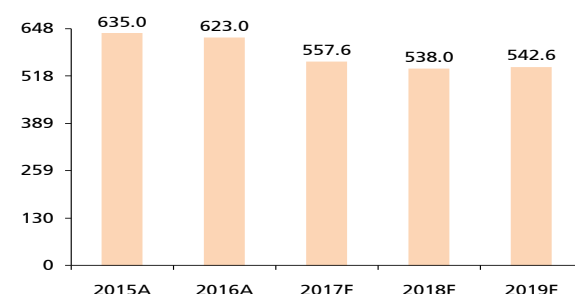
Online game's monthly average paying accounts (APA, m)



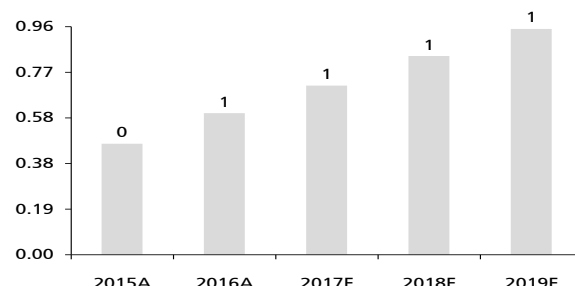
Online game's monthly average revenue per paying user (ARPU, Rmb)



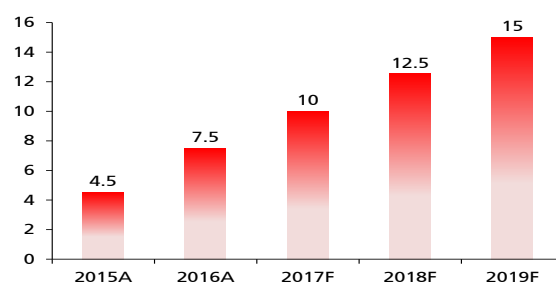
Cheetah's mobile monthly active users (MAU, m)



Cheetah's revenue per mobile MAU (Rmb)



Kingsoft Cloud's market share (%)



Source: Company, DBS Vickers

Balance Sheet:

Net cash position. As of December 2016, Kingsoft had a net cash position of Rmb6.0bn (Rmb4.0bn debt and Rmb10.0bn cash). This is attributed to its capex of Rmb445m mainly on Kingsoft Cloud, versus Rmb902m operating cash inflows in FY16.

Share Price Drivers:

JX3 mobile and Eudemons Mobile continues to succeed. We expect Kingsoft's revenue from online games to deliver an FY16-19F CAGR of 28.1%, mainly driven by both an expanding paying gamer base, and ARPU. Its self-developed JX3 Mobile (劍網3 手游) and licensed Eudemons Mobile (魔域 手游, developed by NetDragon (777.HK)), to be launched in 3Q17F, will provide upside to the forecasts.

Kingsoft Cloud's next round financing or turnaround to be a mid-term catalyst. We expect Kingsoft's revenue from WPS and cloud to deliver an FY15-18F CAGR of 44.2%, with improving margins from economies of scale. The capital market also has a very positive view on Kingsoft Cloud. Kingsoft's 52% stake in Kingsoft Cloud was valued at US\$572m in series C and C+ financing, which is ~20% of Kingsoft's market capitalisation. Next round financing or turnaround will be a catalyst to Kingsoft's valuation.

Cheetah rekindles monetisation momentum. We expect Cheetah's mobile monthly active users (MAU) to deliver an FY16-19F CAGR of 1.8%, with its transition from utility apps, such as Clean Master and CM Security, to content apps, such as Live.me and News Republic since 2016. We expect revenue per mobile MAU to deliver an FY16-19F CAGR of 18.8%, with the surprise ramp-up of Live.me's monetisation.

Key Risks:

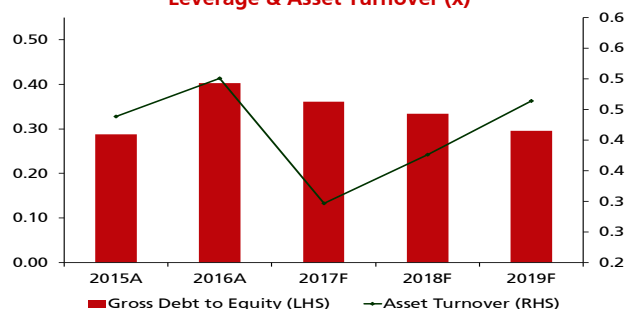
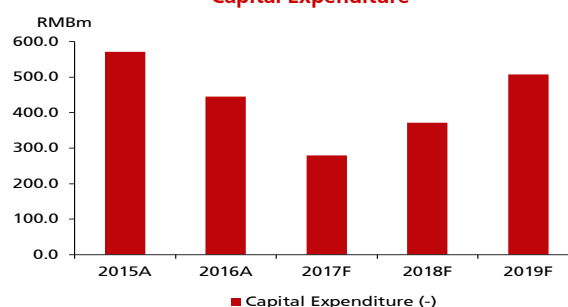
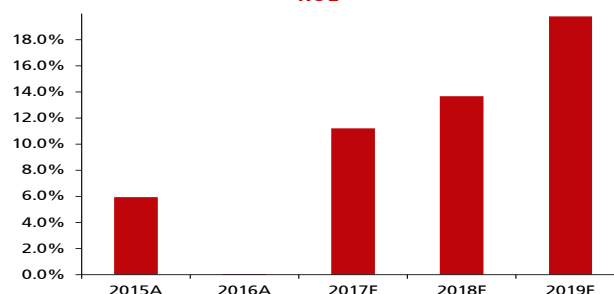
JX series mobile games may not be successful. Competition from other developers, especially those with strong intellectual property (IP), may hinder the success of Kingsoft's PC-to-mobile games.

Intensifying competition from other leading IaaS providers. Competition from leading IaaS providers, such as AliCloud, could hinder Kingsoft Cloud from gaining market share to improve margins from economies of scale.

Cheetah's potential failure of strategy. Cheetah is expanding content apps, such as Live.me. Competition from other mobile apps could result in softening mobile MAU and revenue per mobile MAU.

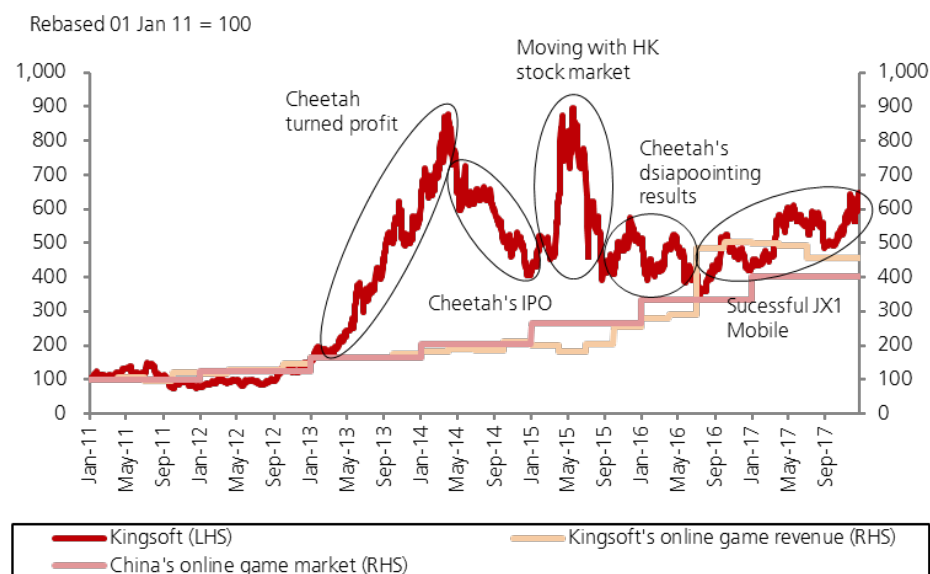
Company Background

Established in 1988, Kingsoft is an incubator of new Internet and mobile Internet ventures, with four key assets: (1) WPS, a first mover and a leading office software suite in China, (2) online games, one of the first movers and a leading online game developer in China, with flagship PC game - JX Online 3 (劍俠情緣 III), (3) Cheetah, the largest mobile utility app provider in the world, with flagship apps - Clean Master and CM Security, and (4) Kingsoft Cloud, China's fifth largest IaaS provider. Jun Lei (雷軍), Chairman, is the co-founder of the company.

Leverage & Asset Turnover (x)**Capital Expenditure****ROE****Forward PE Band****PB Band**

Source: Company, DBS Vickers

Kingsoft's share price vs. Kingsoft's online game revenue and China's online game market



Source: Bloomberg Finance L.P., Company, National Bureau of Statistics of China, DBS Vickers

Key assumptions

Rmb m	FY15	FY16F	FY17F	FY18F	FY19F
Revenue					
Online games	1,369	2,546	3,272	4,115	5,588
Kingsoft Cloud and WPS	746	1,288	1,939	2,785	3,858
Total	2,114	3,834	5,211	6,901	9,446
Growth					
Online games	9.3%	86.0%	28.5%	25.8%	35.8%
Kingsoft Cloud and WPS	76.1%	72.7%	50.6%	43.7%	38.5%
Total	26.2%	81.3%	35.9%	32.4%	36.9%

Source: Company, DBS Vickers

Sum-of-the-parts (SOTP) valuation

Business segment	FY18F Revenue (Rmb m)	Normalised NPM	New Normalised net profit (Rmb m)	Stake	Valuation (Rmb m)	Valuation per share (HKD)	Valuation method
Online games	4,115	35%	1,440	76%	16,421	14.3	15x FY18F PER
Cheetah Mobile	5,395	15%	809	47%	3,804	3.3	10x FY18F PER
WPS	951	25%	238	69%	1,640	1.4	10x FY18F PER
Cloud				52%	6,696	5.8	Implied valuation from D round financing
21Vianet				11%	745	0.6	Market capitalisation
Xunlei				11%	1,137	1.0	Market capitalisation
Net Cash					8,127	7.1	as at FY18F
Total Valuation						34	

Source: Company, DBS Vickers

Key Assumptions

FY Dec	2015A	2016A	2017F	2018F	2019F
Online game's monthly average paying accounts (APA, m)	2.9	4.5	4.3	5.0	5.2
Online game's monthly average revenue per paying user (ARPU, Rmb)	39.1	46.9	63.1	68.3	89.6
Cheetah's mobile monthly active users (MAU, m)	635.0	623.0	557.6	538.0	542.6
Cheetah's revenue per mobile MAU (Rmb)	0.5	0.6	0.7	0.8	1.0
Kingsoft Cloud's market share (%)	4.5	7.5	10.0	12.5	15.0

Source: Company, DBS Vickers

Segmental Breakdown (RMB m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Revenues (RMB m)					
Online games	1,369	2,546	3,272	4,115	5,588
Cheetah Mobile	3,562	4,449	N/A	N/A	N/A
Kingsoft Cloud and WPS	746	1,288	1,939	2,785	3,858
Total	5,676	8,282	5,211	6,901	9,446
Operating profit (before unallocated expenses) (RMB m)					
Online games	515	1,280	1,636	2,058	2,794
Cheetah Mobile	743	628	477	674	929
Kingsoft Cloud and WPS	(3)	(77)	(296)	(584)	(959)
Total	1,255	1,830	1,817	2,148	2,764
Operating profit (before unallocated expenses) Margins (%)					
Online games	37.6	50.3	50.0	50.0	50.0
Cheetah Mobile	20.9	14.1	N/A	N/A	N/A
Kingsoft Cloud and WPS	(0.4)	(6.0)	(15.3)	(21.0)	(24.9)
Total	22.1	22.1	34.9	31.1	29.3

Source: Company, DBS Vickers

Income Statement (RMB m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Revenue	5,676	8,282	5,211	6,901	9,446
Cost of Goods Sold	(1,319)	(2,662)	(2,148)	(3,270)	(4,471)
Gross Profit	4,357	5,620	3,063	3,631	4,975
Other Opng (Exp)/Inc	(3,546)	(4,363)	(2,128)	(2,435)	(2,920)
Operating Profit	811	1,256	934	1,196	2,055
Other Non Opg (Exp)/Inc	(342)	(1,473)	(200)	(200)	(200)
Associates & JV Inc	(43)	34	225	318	439
Net Interest (Exp)/Inc	116	59	87	102	123
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	542	(124)	1,046	1,417	2,416
Tax	(201)	(168)	(157)	(213)	(362)
Minority Interest	27	22	40	64	95
Preference Dividend	0	0	0	0	0
Net Profit	369	(271)	929	1,268	2,149
Net Profit before Except.	369	(271)	929	1,268	2,149
EBITDA	748	263	1,473	1,783	2,758
Growth					
Revenue Gth (%)	69.4	45.9	(37.1)	32.4	36.9
EBITDA Gth (%)	(22.1)	(64.8)	459.4	21.1	54.7
Opg Profit Gth (%)	14.3	55.0	(25.6)	28.0	71.8
Net Profit Gth (%)	(52.0)	N/A	N/A	36.5	69.4
Margins & Ratio					
Gross Margins (%)	76.8	67.9	58.8	52.6	52.7
Opg Profit Margin (%)	14.3	15.2	17.9	17.3	21.8
Net Profit Margin (%)	6.5	(3.3)	17.8	18.4	22.7
ROAE (%)	5.9	(3.4)	11.2	13.7	19.8
ROA (%)	2.9	(1.6)	5.3	6.9	10.6
ROCE (%)	4.7	9.3	5.5	6.6	10.2
Div Payout Ratio (%)	29.2	N/A	12.4	9.1	5.4
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS Vickers

Interim Income Statement (RMB m)

FY Dec	1H2015	2H2015	1H2016	2H2016	1H2017
Revenue	2,392	3,285	3,517	4,766	2,498
Cost of Goods Sold	(531)	(789)	(1,030)	(1,632)	(998)
Gross Profit	1,861	2,496	2,486	3,133	1,499
Other Oper. (Exp)/Inc	(1,523)	(2,022)	(2,083)	(2,280)	(1,021)
Operating Profit	338	473	403	853	479
Other Non Opg (Exp)/Inc	(105)	(237)	(261)	1,331	1,608
Associates & JV Inc	(21)	(22)	(32)	66	230
Net Interest (Exp)/Inc	59	57	35	24	38
Exceptional Gain/(Loss)	0	0	(848)	(1,696)	(1,696)
Pre-tax Profit	271	271	(701)	583	668
Tax	(61)	(139)	(83)	(85)	(94)
Minority Interest	(1)	29	112	(90)	(76)
Net Profit	209	161	(672)	413	507
Net profit bef Except.	209	161	207	1,836	1,942
Growth					
Revenue Gth (%)	67.7	70.7	47.0	45.1	(29.0)
Opg Profit Gth (%)	3.1	23.8	19.4	80.3	18.7
Net Profit Gth (%)	(42.8)	(60.3)	N/A	157.1	N/A
Margins					
Gross Margins (%)	77.8	76.0	70.7	65.8	60.0
Opg Profit Margins (%)	14.1	14.4	11.5	17.9	19.2
Net Profit Margins (%)	8.7	4.9	(19.1)	8.7	20.3

Source: Company, DBS Vickers

Quarterly Income Statement (RMB m)

FY Dec	3Q2016	4Q2016	1Q2017	2Q2017	3Q2017
Revenue	2,227	2,539	1,213	1,284	1,303
Cost of Goods Sold	(786)	(846)	(509)	(489)	(559)
Gross Profit	1,441	1,693	704	796	744
Other Oper. (Exp)/Inc	(1,109)	(1,171)	(459)	(562)	(572)
Operating Profit	332	522	245	233	172
Other Non Opg (Exp)/Inc	664	666	776	833	831
Associates & JV Inc	37	29	138	91	138
Net Interest (Exp)/Inc	11	13	15	23	24
Exceptional Gain/(Loss)	(848)	(848)	(848)	(848)	(848)
Pre-tax Profit	197	386	330	338	323
Tax	(35)	(49)	(46)	(48)	(45)
Minority Interest	(18)	(72)	(42)	(35)	(34)
Net Profit	146	267	246	260	250
Net profit bef Except.	836	1,000	967	975	966
EBITDA	0	0	0	0	0

Growth (QoQ)

Revenue Gth (%)	26.2	14.0	(52.2)	5.9	1.4
EBITDA Gth (%)	N/A	N/A	N/A	N/A	N/A
Opg Profit Gth (%)	110.7	57.4	(53.0)	(4.9)	(26.2)
Net Profit Gth (%)	(118.1)	83.5	(7.8)	5.5	(3.7)

Growth (YoY)

Revenue Gth (%)	47.8	42.8	(30.7)	(27.2)	(41.5)
EBITDA Gth (%)	N/A	N/A	N/A	N/A	N/A
Opg Profit Gth (%)	98.6	70.3	(0.2)	48.3	(48.1)
Net Profit Gth (%)	206.4	136.3	84.2	N/A	71.9

Margins

Gross Margins (%)	64.7	66.7	58.0	61.9	57.1
Opg Profit Margins (%)	14.9	20.5	20.2	18.2	13.2
Net Profit Margins (%)	6.5	10.5	20.3	20.2	19.2

Source: Company, DBS Vickers

Balance Sheet (RMB m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Net Fixed Assets	966	1,098	1,021	1,060	1,223
Invt in Associates & JVs	324	572	572	572	572
Other LT Assets	3,552	2,804	2,639	2,542	2,530
Cash & ST Invt	8,833	10,198	11,105	12,295	14,161
Inventory	5	11	9	14	19
Debtors	966	1,774	1,116	1,478	2,024
Other Current Assets	837	1,122	1,122	1,122	1,122
Total Assets	15,485	17,579	17,585	19,083	21,650
ST Debt	147	380	239	316	433
Creditors	185	560	452	688	941
Other Current Liab	2,372	2,791	2,281	2,336	2,486
LT Debt	2,710	3,647	3,647	3,647	3,647
Other LT Liabilities	159	199	191	232	341
Shareholder's Equity	7,871	7,887	8,701	9,854	11,887
Minority Interests	2,041	2,115	2,074	2,010	1,916
Total Cap. & Liab.	15,485	17,579	17,585	19,083	21,650
Non-Cash Wkg. Capital	(749)	(444)	(486)	(411)	(263)
Net Cash/(Debt)	5,976	6,172	7,220	8,332	10,082
Debtors Turn (avg days)	44.3	60.4	101.2	68.6	67.7
Creditors Turn (avg days)	48.4	61.4	113.0	74.3	74.2
Inventory Turn (avg days)	2.3	1.4	2.2	1.5	1.5
Asset Turnover (x)	0.4	0.5	0.3	0.4	0.5
Current Ratio (x)	3.9	3.5	4.5	4.5	4.5
Quick Ratio (x)	3.6	3.2	4.1	4.1	4.2
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	20.0	11.1	7.2	9.4	12.4
Z-Score (X)	NA	NA	NA	NA	NA

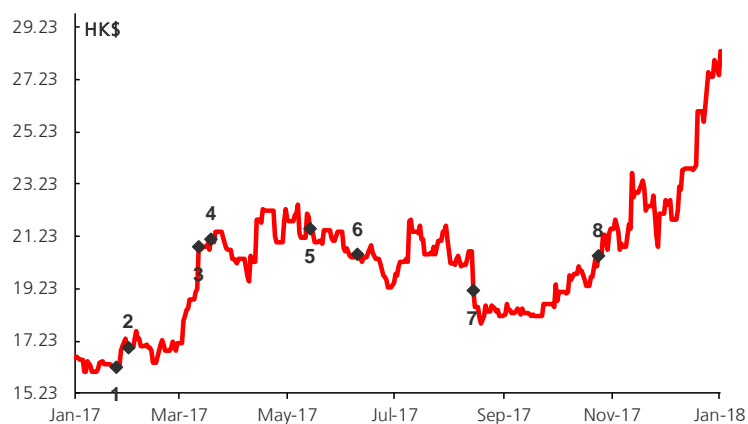
Source: Company, DBS Vickers

Cash Flow Statement (RMB m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Pre-Tax Profit	542	1,076	1,046	1,417	2,416
Dep. & Amort.	322	446	513	469	464
Tax Paid	(201)	(168)	(157)	(213)	(362)
Assoc. & JV Inc/(loss)	43	(34)	(225)	(318)	(439)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	469	(419)	33	(35)	(38)
Other Operating CF	0	0	0	0	0
Net Operating CF	1,176	902	1,211	1,320	2,041
Capital Exp.(net)	(570)	(445)	(280)	(371)	(508)
Other Invt.(net)	(2,211)	(587)	0	0	0
Invt in Assoc. & JV	(219)	(214)	225	318	439
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	101	3	8	(40)	(107)
Net Investing CF	(2,899)	(1,243)	(47)	(92)	(176)
Div Paid	(108)	(116)	(116)	(116)	(116)
Chg in Gross Debt	49	1,169	(141)	77	117
Capital Issues	3,048	403	0	0	0
Other Financing CF	513	95	0	0	0
Net Financing CF	3,502	1,552	(256)	(38)	1
Currency Adjustments	0	0	0	0	0
Chg in Cash	1,780	1,210	907	1,190	1,866
Opg CFPS (RMB)	0.56	1.02	0.91	1.05	1.61
Free CFPS (RMB)	0.48	0.35	0.72	0.74	1.19

Source: Company, DBS Vickers

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

Source: DBSVHK

Analyst: Susanna CHUI

DBSVHK recommendations are based on Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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DBS Vickers (Hong Kong) Limited18th Floor Man Yee building, 68 Des Voeux Road Central, Central, Hong Kong

Tel: (852) 2820-4888, Fax: (852) 2868-1523

Company Regn. No. 31758

DBS Regional Research Offices

HONG KONG**DBS Vickers (Hong Kong) Ltd****Contact: Carol Wu**

18th Floor Man Yee Building

68 Des Voeux Road Central

Central, Hong Kong

Tel: 852 2820 4888

Fax: 852 2863 1523

e-mail: dbsvhk@db.com

Participant of the Stock Exchange of Hong Kong Ltd

MALAYSIA**AllianceDBS Research Sdn Bhd****Contact: Wong Ming Tek (128540 U)**

19th Floor, Menara Multi-Purpose,

Capital Square,

8 Jalan Munshi Abdullah 50100

Kuala Lumpur, Malaysia.

Tel.: 603 2604 3333

Fax: 603 2604 3921

e-mail: general@alliancedbs.com

SINGAPORE**DBS Bank Ltd****Contact: Janice Chua**

12 Marina Boulevard,

Marina Bay Financial Centre Tower 3

Singapore 018982

Tel: 65 6878 8888

Fax: 65 65353 418

e-mail: equityresearch@db.com

Company Regn. No. 196800306E

INDONESIA**PT DBS Vickers Sekuritas (Indonesia)****Contact: Maynard Priajaya Arif**

DBS Bank Tower

Ciputra World 1, 32/F

Jl. Prof. Dr. Satrio Kav. 3-5

Jakarta 12940, Indonesia

Tel: 62 21 3003 4900

Fax: 6221 3003 4943

e-mail: research@id.dbsvickers.com

THAILAND**DBS Vickers Securities (Thailand) Co Ltd****Contact: Chanpen Sirithanarattanakul**

989 Siam Piwat Tower Building,

9th, 14th-15th Floor

Rama 1 Road, Pathumwan,

Bangkok Thailand 10330

Tel. 66 2 857 7831

Fax: 66 2 658 1269

e-mail: research@th.dbs.com

Company Regn. No 0105539127012

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