Singapore Company Guide

AIMS AMP Capital Industrial REIT

Version 2 | Bloomberg: AAREIT SP | Reuters: AART.SI **Refer to important disclosures at the end of this report**

DBS Group Research . Equity 6 Dec 2018

BUY

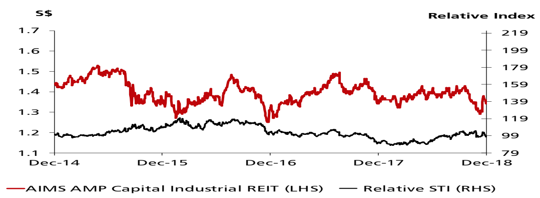
Last Traded Price (5 Dec 2018): S$1.34 (**STI :** 3,155.92)
Price Target 12-mth: S$1.50 (12% upside) (Prev S$1.55)

Analyst
Carmen Tay +65 6682 3719 carmentay@dbs.com
Derek TAN +65 6682 3716 derektan@dbs.com

What's New

- We continue to like AA REIT for its visible pipeline of redevelopment opportunities and untapped GFA
- AIMS Financial Group's recent buyout of AMP Capital's stake a positive move, in our opinion
- A leaner ownership structure promotes agility and speed in execution for further value-accretive and M&A opportunities that may arise
- Maintain BUY; TP adjusted to S$1.50 on more conservative discount rates

Price Relative



Forecasts and Valuation

FY Mar (S$m)	2018A	2019F	2020F	2021F
Gross Revenue	117	115	120	123
Net Property Inc	76.4	75.1	78.2	80.5
Total Return	61.2	63.9	66.4	68.1
Distribution Inc	67.4	70.4	72.6	73.3
EPU (S cts)	9.96	9.32	9.64	9.84
EPU Gth (%)	(6)	(6)	3	2
DPU (S cts)	10.3	10.3	10.5	10.6
DPU Gth (%)	(7)	0	3	1
NAV per shr (S cts)	137	137	137	137
PE (X)	13.4	14.4	13.9	13.6
Distribution Yield (%)	7.7	7.7	7.9	7.9
P/NAV (x)	1.0	1.0	1.0	1.0
Aggregate Leverage (%)	33.4	33.9	34.3	34.4
ROAE (%)	7.2	6.8	7.0	7.2
Distn. Inc Chng (%):		-	-	-
Consensus DPU (S cts):		11.0	11.0	N/A
Other Broker Recs:		B: 2	S: 0	H: 0

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P

A new chapter

Attractive and resilient yields. Being predominantly focused on Singapore, we like AIMS AMP Capital Industrial REIT (AA REIT) for its diversified asset portfolio and attractive exposure to in-demand properties such as business parks and modern ramp-up facilities. Supported by master leases with built-in rental escalations, AA REIT offers investors a higher degree of income certainty ahead of the sector's anticipated recovery in 2020 with attractive dividend yields of 7.7-7.9% p.a. over FY19F-21F.

Where we differ: We see AA REIT as unique for its c.600,000 sqft of untapped gross floor area (GFA) - one of the highest among peers. Given the prime location of selected properties, we believe that the Manager can potentially redevelop these sites into future-proof assets such as data centres and estimate that the unlocking of unutilised GFA could lift its pro forma FY18 revenue and NAV by 15.8% and 7.9% respectively.

Prime acquisition candidate? With consolidations among industrial real estate investment trusts (REITs) in focus, we believe that AA REIT could be a potential target given: (1) the fragmented shareholding structure, (2) access to untapped GFA within the portfolio. Including untapped GFA, AA REIT's implied yield (NPI/EV) of 6.4% would place it at the upper end of its peer range of 5.1-6.6%.

Valuation:

Maintain BUY; DCF-based TP lowered to S$1.50 after raising WACC to 6.7% (from 6.6%), based on terminal growth rate of 1.4%. The redevelopment of AA REIT's under-utilised sites could raise its fair value to S$1.58.

Key Risks to Our View:

Key risks include lower rental income arising from increased competition and prolonged negative rental reversionary trends.

At A Glance

Issued Capital (m shrs)	686
Mkt. Cap (Sm/USm)	919 / 672
Major Shareholders (%)	
Dragon Pacific Assets	10.5
AMP Capital Finance	10.0
APG Aigemene Pensieon Group	8.1
Free Float (%)	68.8
3m Avg. Daily Val (US$m)	0.98
ICB Industry : Financials / Real Estate Investment Trust	

DBS
Live more, Bank less

ed: KK/ sa: YM, CW, CS

WHAT'S NEW

Recap of 2Q19 Results

(+) 2Q19 results in line

- The sequential growth in gross revenue (+1.7% q-o-q to S$29.4m) was driven by a combination of the first full quarter of rental contribution from 51 Marsiling Road and higher contributions from 27 Penjuru Lane arising from improved occupancies.
- Meanwhile, net property income (NPI) was relatively stable at S$19.3m.
- AA REIT's share of results from Australia-based Optus Centre (where it holds a 49% interest) nudged higher to S$3.5m vs S$3.3m in 1Q, mainly due to timing of expenses recovered from the tenant.
- Distribution income was flat q-o-q at S$17.1m in 2Q19, but down c.1.6% compared to a year ago.
- The REIT also maintained a 2.5 Sct DPU for 2Q19 – unchanged compared to the previous quarter, but represents a c.2% decline vs 2.55 Scts in 2Q18.
- 1H19 DPU of 0.5 Scts formed c.49% of our FY19F forecasts, which was in line.
- Typically exhibits an increasing DPU trend through quarters. We believe that there could be room to further raise distributions in subsequent quarters if operational improvements are sustained.

(+/-) Leasing updates reflect operational improvements

- AA REIT continued to post improvements on the occupancy front – raised portfolio occupancy from 91.5% (2Q) to 93.6% (3Q), above the industrial average of 88.7%
- Executed 14 new and renewal leases in 2Q19, representing 27,086 sqm (or c.4.3% of portfolio NLA).
- Rental reversions remain negative at c.9.8% during the quarter, but compares well against double-digit rental reversionary levels in the previous year, reflecting an improving trend.
- Meanwhile, the uptick in occupancy levels should continue to feature positively in AA REIT's top line performance in the upcoming quarters.

(+) Stable asset values; gearing headroom available

- NAV remained stable at S$1.37 per unit as valuations for its Singapore portfolio, which firmed up slightly, were offset by unfavourable foreign exchange (forex) effects on its Australia investments.
- Gearing (A/L) was unchanged at 33.6%, with all-in debt cost of c.3.6. This includes AUD funding for the Optus Centre.
- This implies gearing headroom of >S$150m.

(+/-) Outlook

- As the industrial sector continues to bottom out, we believe that growth over the near-to-medium term will likely be driven by selective redevelopment opportunities, including the unlocking of over 500,000 sqft of untapped GFA.
- Redevelopment of 3 Tuas Ave 2 is ongoing and on track for completion in 2Q19.
- Acquisition opportunities, if they materialise, could also help drive growth.
- We also note the expiry of the Eurochem master lease in 2019, which may experience some slack in occupancy if efforts to re-commit the space do not progress as planned.

Proposed Acquisition of Interests by AIMS Financial Group

(+) Streamlining of ownership structure a positive move

- On 21st Nov 2018, AIMS Financial Group proposed the acquisition of fellow Sponsor, AMP Capital's entire 50% interest in the Manager (AIMS AMP Capital Industrial REIT Management Limited) and 10.26% stake in AA REIT
- Transaction is poised for completion in Dec 2018, which would give AIMS full ownership of the Manager, and raise its effective stake in AA REIT from 7.62% to 17.88%
- We are positive on AIMS' move to acquire AMP Capital's stake in the Manager and REIT, as we believe a streamlining of the ownership structure to a single Sponsor entity would allow the REIT to be more nimble when evaluating further value-accretive opportunities, or mergers and acquisitions (M&A) options ahead, when they arise.

Maintain BUY; TP adjusted to S$1.50 on more conservative discount rates

On 30th Nov, AIMS announced the establishment of a S$750m multi-currency debt issuance programme. In view of the rising rate environment, we have raised our borrowing assumptions by c.50bps to 4.2% to be conservative, which reflects a c.60bps buffer vs its average borrowing cost of 3.6% in Sep 2018.

As a result, our TP is adjusted lower to S$1.50. The redevelopment of AA REIT's underutilised sites could raise its fair value to S$1.58.

Quarterly / Interim Income Statement (S$m)

FY Mar	2Q2018	1Q2019	2Q2019	% chg yoy	% chg qoq
Gross revenue	29.5	28.9	29.4	(0.3)	1.7
Property expenses	(10.1)	(9.5)	(10.1)	0.1	6.6
Net Property Income	19.4	19.4	19.3	(0.5)	(0.7)
Other Operating expenses	(2.4)	(2.3)	(2.4)	1.8	6.0
Other Non Opg (Exp)/Inc	0.42	0.40	(1.6)	-	nm
Net Interest (Exp)/Inc	(4.8)	(4.8)	(4.6)	4.3	4.8
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Net Income	16.4	16.1	14.3	(13.1)	(11.3)
Tax	(0.4)	(0.3)	(0.3)	(18.7)	(6.3)
Minority Interest	0.0	0.0	0.0	-	-
Net Income after Tax	16.0	15.8	14.0	(12.9)	(11.4)
Total Return	1.28	15.8	15.8	nm	0.1
Non-tax deductible Items	15.0	1.37	1.36	(90.9)	(0.8)
Net Inc available for Dist.	16.3	17.1	17.1	5.0	0.0
Ratio (%)					
Net Prop Inc Margin	65.7	67.2	65.6		
Dist. Payout Ratio	100.0	100.0	100.0		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

Lease structure offers stability. Currently, nine out of AA REIT's 25 properties are backed by master lease arrangements with staggered expiries in the coming years. In 4Q18, c.37.7% of gross rental income (GRI) was derived from master leases.

Despite the challenging industry backdrop due to structural demand shifts and net oversupply conditions in recent years, AA REIT's lease structure and diversified trade sector mix have helped to stabilise earnings and DPU. With built-in rental escalations providing a steady and visible growth profile, the master leases should continue to offer investors a higher degree of income certainty and visibility over the medium term.

Recovery in underlying rents as industrial market bottoms out. The industrial market is at the tail end of a spike in supply completions, starting from 2014 and peaking in 2017. As such, landlords are typically still facing an increasingly competitive operating environment, but that should start to abate in 2018 and 2019 when competition from new supply starts to drop.

As supply pressures ease, we believe that AA REIT's well-spread master lease expiries and shorter weighted average lease expiry (WALE) of c.2.6 years (vs industry average of 3.5 years) allows the trust to better ride the anticipated recovery in industrial yields from end-2019/2020.

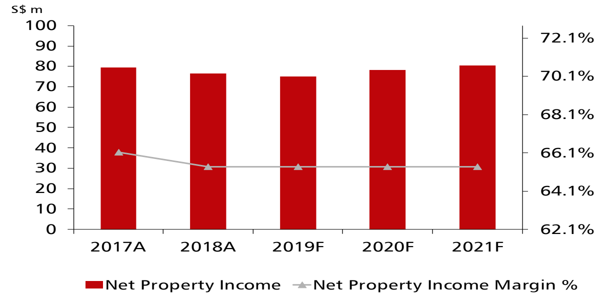
Optimising returns through selective value-accretive divestments. AA REIT has made three divestments to date – all of which were transacted above book value, with divestment premiums of between 2.1% and 27.7%. Capitalising on robust real estate secondary market values, we believe that this will remain a relevant strategy for the REIT going forward.

Untapped GFA could boost NAV by c.8% over the medium term, providing further upside. On 17 May 2018, AA REIT proposed the redevelopment of its 3 Tuas Avenue 2, which will maximise the plot ratio of 1.40 and transform the purpose-built facility into a modern and versatile ramp-up industrial facility. Apart from 3 Tuas Ave 2, we note that there are seven other assets with redevelopment potential as their plot ratios have yet to be maximised.

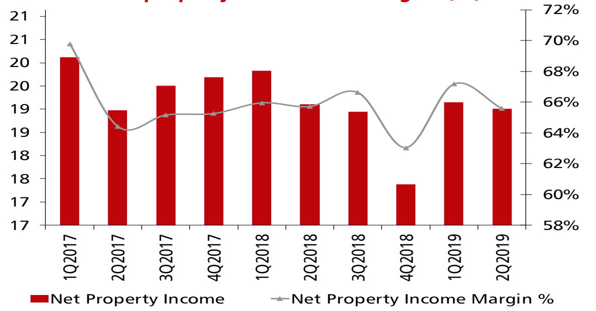
Judging by AA REIT's track record, we believe that it will likely pursue complete redevelopment opportunities in favour of a more resilient, higher-spec portfolio – including data centres (if feasible). Assuming the plot ratio is maximised to include over 600,000 sqft of unutilised GFA, higher rents post redevelopment, constant NPI margin of 70% and cap rate of 6.25-6.5%, we estimate that AA REIT's RNAV would be c.S$1,013 (+7.9% vs reported NAV of S$939m as at end-FY18).

We have yet to factor in upside from these seven prospective sites (refer to table 1) into our estimates and TP of S$1.50.

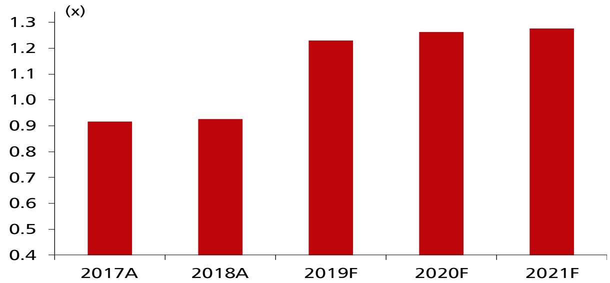
Net property income and margins (%)



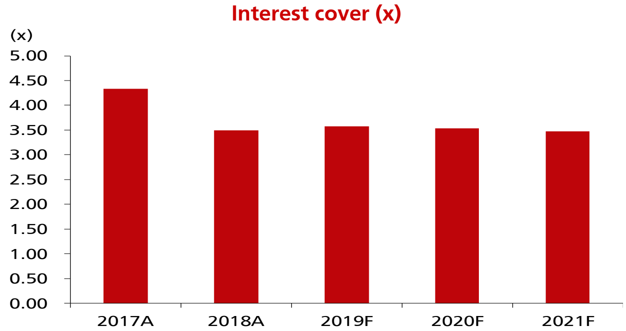
Net property income and margins (%)



Distribution paid / net operating CF



Interest cover (x)



Source: Company, DBS Bank

Table 1: Further upside to capital values given c.600,000 sqft (including 3 Tuas Ave 2) of unutilised GFA

Property Details	Land Area (sqft)	Plot Ratio		GFA (sq ft)			Redevelopment Cost (S$ m)	Book Value (S$ m)		
		Current	Allowable	Current*	Potential#	%Chg		Current*	Potential#	%Chg
(a) Proposed Redevelopment										
3 Tuas Avenue 2	191,626	0.92	1.40	175,821	267,913	*52%*	48.2	18.6	51.0	*174%*
(b) Potential Redevelopments										
2 Ang Mo Kio Street 65	60,388	1.31	2.50	78,846	150,969	*91%*	32.4	15.7	43.0	*173%*
8 Senoko South Road	75,684	1.32	2.50	99,555	189,211	*90%*	35.0	12.3	55.9	*355%*
11 Changi South Street 3	95,073	1.61	2.00	152,711	190,146	*25%*	39.6	21.4	41.8	*95%*
10 Changi South Lane	99,233	1.60	2.50	159,230	248,084	*56%*	46.0	22.3	54.5	*144%*
3 Toh Tuck Link	115,458	1.16	1.60	134,467	184,733	*37%*	40.2	22.5	44.7	*99%*
7 Clementi Loop	107,621	0.91	1.60	97,750	172,193	*76%*	28.7	12.2	37.0	*204%*
541 Yishun Industrial Park A	73,748	1.28	2.50	94,409	184,369	*95%*	36.4	16	54.5	*241%*
			Total (a+b):	992,789	1,587,618	*60%*	308	141	382	*171%*

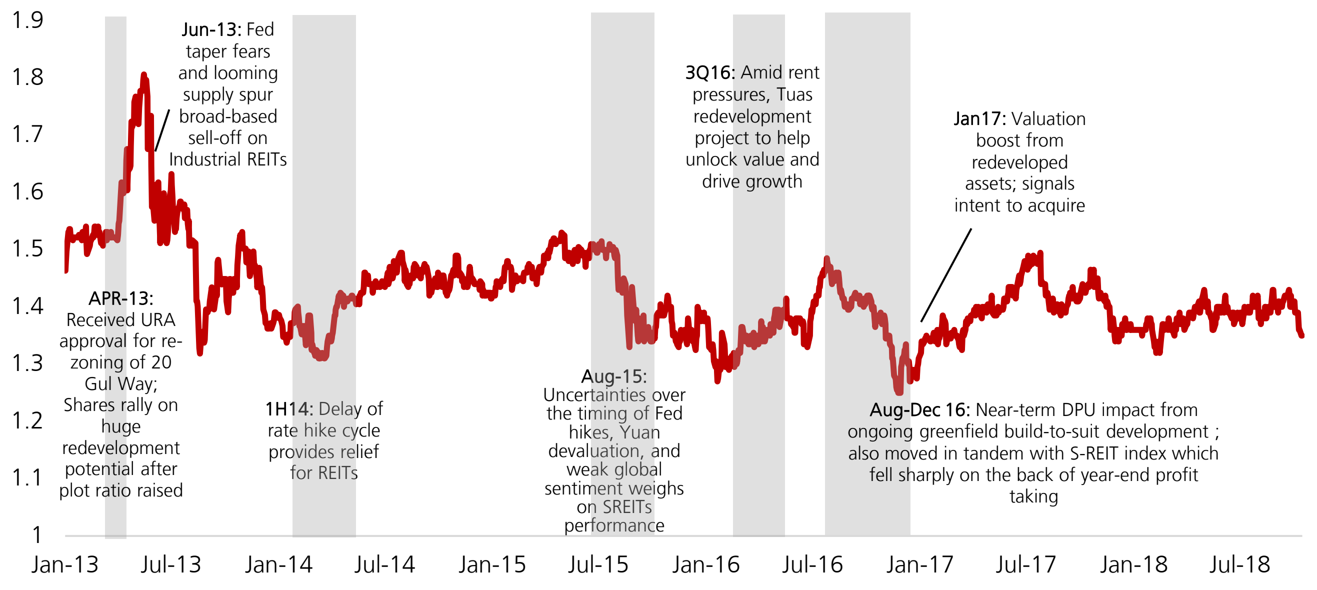
** refers to GFA/ asset value/ GRI prior to redevelopment*

 # refers to GFA/ asset value/ GRI post redevelopment

Source: AA REIT, DBS Bank

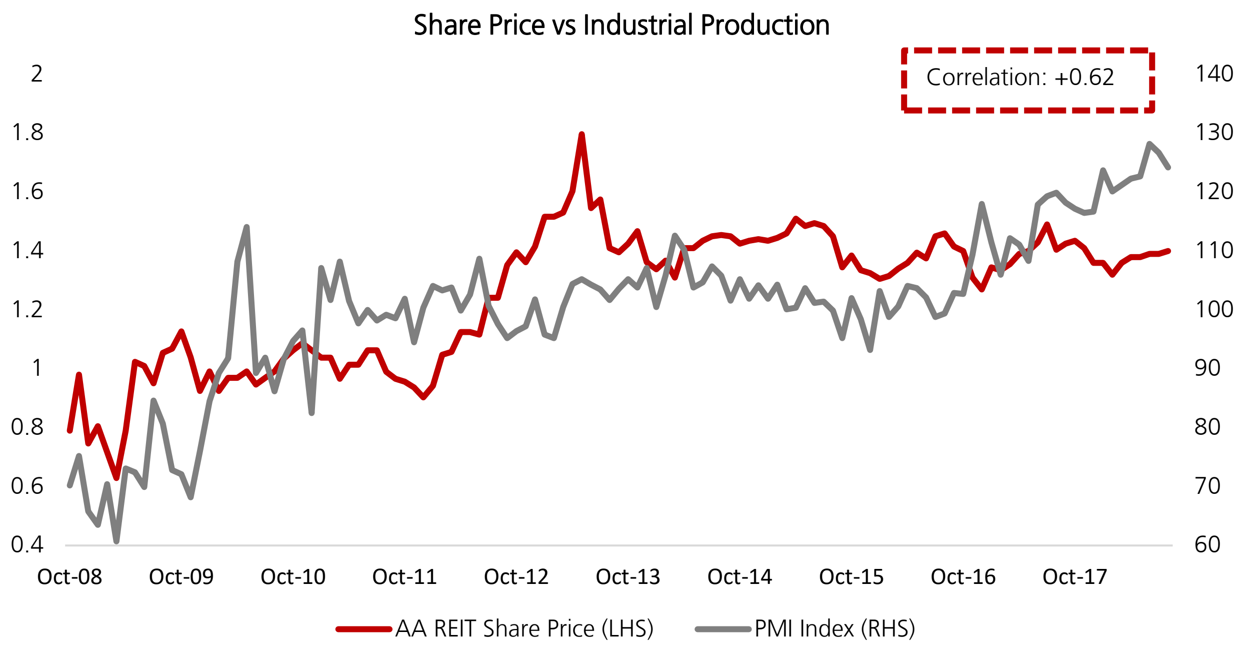
Appendix 1: A look at Company's listed history – what drives its share price?

Figure 1: Share Price History



Source: Bloomberg Finance L.P., DBS Bank

Figure 2: Manufacturing sector business expectations point to improving sentiment



Source: Bloomberg Finance L.P., DBS Bank

Balance Sheet:

Headroom for further yield-accretive opportunities ahead. AA REIT's aggregate leverage (A/L) stood at c.33.6% as at 30 September 2018. Still below the regulatory gearing limit of 45%, we believe that there remains capacity for management to utilise its debt headroom for further redevelopment/greenfield projects or acquisitions.

Share Price Drivers:

Potential takeover target amid global hunt for quality assets. Given the widely anticipated consolidation of industrial REITs, we believe that AA REIT could be a target, given its focus on the high-quality business park space and modern ramp-up facilities. In our estimation, the REIT currently trades at an implied yield of c.6.4% which could grow to c.6.4% (assuming 100% debt funding) if we include the development of its unutilised GFA. This will place AA REIT at the upper end of its peer range of 5.1-6.6%.

Inorganic growth to drive contributions and spur re-rating in share price.

Key Risks:

Concerns over longevity of returns given short land leases in the industrial space. Industrial spaces in Singapore have been characterised by shorter underlying land lease tenures of 30 years vs largely freehold sites in Australia and Europe. While the shorter leases provide investors with a higher yield premium, the decaying nature of such properties could weigh on future valuations and income.

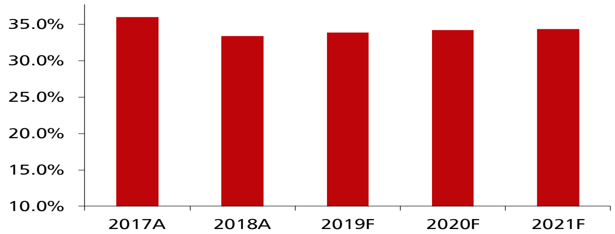
Prolonged negative rental reversionary trends on weaker-than-expected economic outlook. The narrowing supply-demand gap in 2018 and expectations of net absorption turning positive in 2019 bode well for rental and occupancy rates in the medium term. However, the anticipated recovery could be derailed by a slowdown in the global economy given the strong historical correlation between gross domestic product (GDP) and demand for industrial real estate.

Interest rate risk. Rising rate environments are often perceived to be negative for REITs. However, we believe that the impact of rising rates on distributions is largely mitigated, as AA REIT has hedged c.87.3% of its interest costs into fixed rates. The active diversification of funding sources should also help to ease concerns.

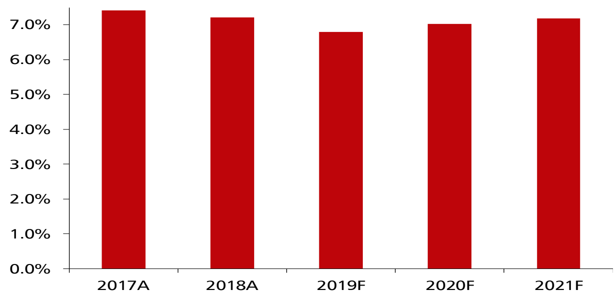
Company Background

AIMS AMP Capital Industrial REIT (AA REIT) is a growing industrial real estate investment trust listed on the mainboard of the Singapore Exchange since April 2007. The principal investment objective of AA REIT is to deliver secure and stable distributions.

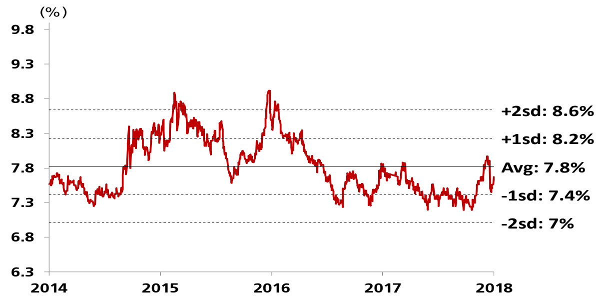
Aggregate leverage (%)



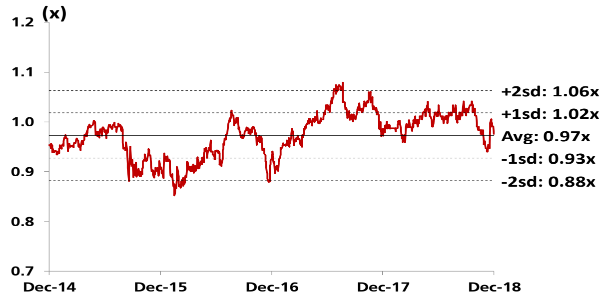
ROE (%)



Distribution yield (%)



PB Band (x)



Source: Company, DBS Bank

Income Statement (S$m)

FY Mar	2017A	2018A	2019F	2020F	2021F
Gross revenue	120	117	115	120	123
Property expenses	(40.7)	(40.5)	(39.8)	(41.5)	(42.6)
Net Property Income	**79.4**	**76.4**	**75.1**	**78.2**	**80.5**
Other Operating expenses	(9.2)	(9.3)	(8.1)	(8.2)	(8.2)
Other Non Opg (Exp)/Inc	0.51	0.36	0.0	0.0	0.0
Net Interest (Exp)/Inc	(16.2)	(19.2)	(18.7)	(19.8)	(20.8)
Exceptional Gain/(Loss)	0.0	1.60	0.0	0.0	0.0
Net Income	**69.3**	**67.3**	**63.9**	**66.4**	**68.1**
Tax	(1.5)	(1.4)	0.0	0.0	0.0
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	**67.8**	**65.9**	**63.9**	**66.4**	**68.1**
Total Return	13.5	61.2	63.9	66.4	68.1
Non-tax deductible Items	(1.9)	(4.2)	6.46	6.20	5.22
Net Inc available for Dist.	70.5	67.4	70.4	72.6	73.3
Growth & Ratio					
Revenue Gth (%)	(3.4)	(2.7)	(1.8)	4.2	2.8
N Property Inc Gth (%)	(3.5)	(3.8)	(1.8)	4.2	2.8
Net Inc Gth (%)	11.5	(2.8)	(3.0)	3.9	2.6
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	66.1	65.4	65.4	65.4	65.4
Net Income Margins (%)	56.4	56.3	55.6	55.4	55.3
Dist to revenue (%)	58.7	57.6	61.3	60.6	59.5
Managers & Trustee's fees	7.6	7.9	7.1	6.8	6.7
ROAE (%)	7.4	7.2	6.8	7.0	7.2
ROA (%)	4.6	4.5	4.3	4.4	4.5
ROCE (%)	4.8	4.6	4.6	4.8	4.9
Int. Cover (x)	4.3	3.5	3.6	3.5	3.5

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Mar	2Q2018	3Q2018	4Q2018	1Q2019	2Q2019
Gross revenue	29.5	28.9	28.0	28.9	29.4
Property expenses	(10.1)	(9.6)	(10.4)	(9.5)	(10.1)
Net Property Income	19.4	19.2	17.7	19.4	19.3
Other Operating expenses	(2.4)	(2.4)	(2.3)	(2.3)	(2.4)
Other Non Opg (Exp)/Inc	0.42	0.30	0.73	0.40	(1.6)
Net Interest (Exp)/Inc	(4.8)	(4.9)	(4.8)	(4.8)	(4.6)
Exceptional Gain/(Loss)	0.0	0.0	1.60	0.0	0.0
Net Income	**16.4**	**15.9**	**19.2**	**16.1**	**14.3**
Tax	(0.4)	(0.2)	(0.6)	(0.3)	(0.3)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	**16.0**	**15.7**	**18.6**	**15.8**	**14.0**
Total Return	1.28	23.7	20.7	15.8	15.8
Non-tax deductible Items	15.0	(6.6)	(2.7)	1.37	1.36
Net Inc available for Dist.	16.3	17.1	18.0	17.1	17.1
Growth & Ratio					
Revenue Gth (%)	(3)	(2)	(3)	3	2
N Property Inc Gth (%)	(4)	(1)	(8)	10	(1)
Net Inc Gth (%)	3	(2)	19	(15)	(11)
Net Prop Inc Margin (%)	65.7	66.6	63.0	67.2	65.6
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

Balance Sheet (S$m)

FY Mar	2017A	2018A	2019F	2020F	2021F
Investment Properties	1,213	1,229	1,244	1,254	1,259
Other LT Assets	235	225	225	225	225
Cash & ST Invts	11.7	17.6	23.3	27.7	31.8
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	5.93	6.53	6.12	6.37	6.56
Other Current Assets	0.0	0.0	0.0	0.0	0.0
Total Assets	**1,465**	**1,478**	**1,498**	**1,513**	**1,522**
ST Debt	82.6	188	188	188	188
Creditor	33.3	28.1	30.1	31.4	32.3
Other Current Liab	0.22	1.12	1.12	1.12	1.12
LT Debt	445	305	320	330	335
Other LT Liabilities	16.0	16.2	16.2	16.2	16.2
Unit holders' funds	888	939	942	946	949
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	**1,465**	**1,478**	**1,498**	**1,513**	**1,522**
Non-Cash Wkg. Capital	(27.6)	(22.7)	(25.1)	(26.2)	(26.9)
Net Cash/(Debt)	(516)	(476)	(485)	(491)	(491)
Ratio					
Current Ratio (x)	0.2	0.1	0.1	0.2	0.2
Quick Ratio (x)	0.2	0.1	0.1	0.2	0.2
Aggregate Leverage (%)	36.0	33.4	33.9	34.3	34.4
Z-Score (X)	1.1	1.1	1.1	1.1	NA

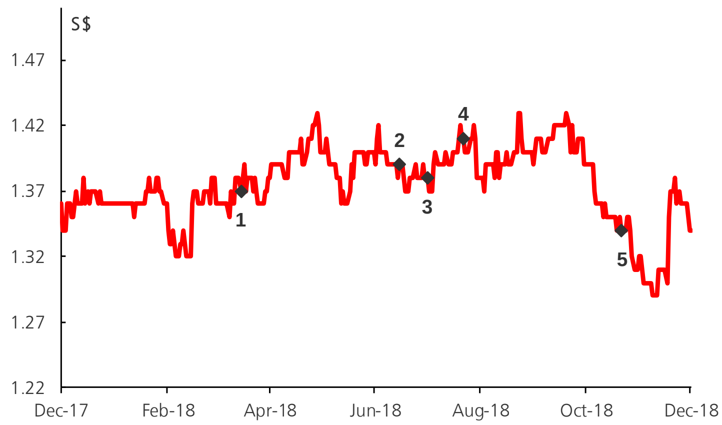
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Mar	2017A	2018A	2019F	2020F	2021F
Pre-Tax Income	69.3	67.3	63.9	66.4	68.1
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	(0.9)	(0.9)	0.0	0.0	0.0
Associates &JV Inc/(Loss)	(14.8)	(17.4)	(15.6)	(16.1)	(16.6)
Chg in Wkg.Cap.	2.63	3.17	2.45	1.02	0.71
Other Operating CF	21.8	21.2	6.46	6.20	5.22
Net Operating CF	**78.1**	**73.3**	**57.2**	**57.5**	**57.4**
Net Invt in Properties	(48.0)	(25.2)	(15.0)	(10.0)	(5.0)
Other Invts (net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	15.0	15.7	15.6	16.1	16.6
Other Investing CF	0.0	0.0	0.0	0.0	0.0
Net Investing CF	**(33.0)**	**(9.5)**	**0.64**	**6.11**	**11.6**
Distribution Paid	(71.5)	(68.0)	(70.4)	(72.6)	(73.3)
Chg in Gross Debt	50.0	(23.9)	15.0	10.0	5.00
New units issued	0.0	54.0	3.33	3.36	3.37
Other Financing CF	0.0	0.0	0.0	0.0	0.0
Net Financing CF	**(21.5)**	**(37.9)**	**(52.0)**	**(59.2)**	**(64.9)**
Currency Adjustments	0.05	(0.2)	0.0	0.0	0.0
Chg in Cash	23.6	25.8	5.78	4.37	4.08
Operating CFPS (S cts)	11.8	10.6	7.99	8.20	8.20
Free CFPS (S cts)	4.72	7.28	6.15	6.89	7.58

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	19 Mar 18	1.37	1.57	NOT RATED
2:	19 Jun 18	1.39	1.55	BUY
3:	05 Jul 18	1.38	1.55	BUY
4:	26 Jul 18	1.41	1.55	BUY
5:	26 Oct 18	1.34	1.55	BUY

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

Source: DBS Bank

Analyst: Carmen Tay
Derek TAN

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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

Completed Date: 6 Dec 2018 17:37:07 (SGT)
Dissemination Date: 6 Dec 2018 17:49:16 (SGT)

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DBS Regional Research Offices

HONG KONG
DBS Bank (Hong Kong) Ltd
Contact: Carol Wu
11th Floor The Center
99 Queen's Road Central
Central, Hong Kong
Tel: 852 3668 4181
Fax: 852 2521 1812
e-mail: dbsvhk@dbs.com

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@dbs.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
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