Malaysia Company Guide
Cahya Mata Sarawak

Version 12 | Bloomberg: CMS MK | Reuters: CMSM.KL

Refer to important disclosures at the end of this report

DBS Group Research . Equity

6 Aug 2019

HOLD (downgrade from BUY)

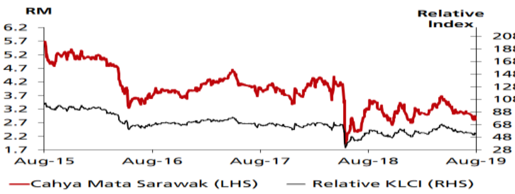
Last Traded Price (5 Aug 2019): RM2.83 (**KLCI :** 1,610.41)
Price Target 12-mth: RM3.10 (10% upside) (Prev RM3.80)

Analyst
Abdul Azim Muhthar +60 32604 3967 azimm@alliancedbs.com

What's New

- Weak ferrosilicon and manganese prices to weigh on associate contributions from OM Sarawak
- This more than offsets improved cement and construction materials business
- Cut FY19-21F earnings by 14-22%; expect earnings to contract 12% in FY19F
- Downgrade to HOLD with lower SOP-based TP of RM3.10

Price Relative



Forecasts and Valuation

FY Dec (RMm)	2018A	2019F	2020F	2021F
Revenue	1,712	1,857	2,268	2,119
EBITDA	450	450	559	569
Pre-tax Profit	372	357	452	438
Net Profit	262	213	245	259
Net Pft (Pre Ex.)	242	213	245	259
Net Pft Gth (Pre-ex) (%)	3.9	(12.0)	15.0	5.4
EPS (sen)	24.4	19.8	22.8	24.1
EPS Pre Ex. (sen)	22.6	19.8	22.8	24.1
EPS Gth Pre Ex (%)	4	(12)	15	5
Diluted EPS (sen)	22.6	19.8	22.8	24.1
Net DPS (sen)	8.00	5.95	6.85	7.22
BV Per Share (sen)	237	251	267	284
PE (X)	11.6	14.3	12.4	11.8
PE Pre Ex. (X)	12.5	14.3	12.4	11.8
P/Cash Flow (X)	24.0	15.9	11.5	12.0
EV/EBITDA (X)	6.5	7.0	6.2	5.7
Net Div Yield (%)	2.8	2.1	2.4	2.6
P/Book Value (X)	1.2	1.1	1.1	1.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	10.7	8.1	8.8	8.7
Earnings Rev (%):		(20)	(22)	(14)
Consensus EPS (sen):		23.6	25.9	27.0
Other Broker Recs:		B: 4	S: 1	H: 2

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

Reversal of fortunes for OM Sarawak

OM Sarawak to drag earnings. We cut our FY19/20/21F earnings by 20%/22%/14 largely to factor in lower contributions from associate OM Sarawak. The weaker associate profits arising from depressed manganese and ferrosilicon prices more than offsets the improved contributions from CMS's cement and construction materials business. As a result, we expect CMS FY19F earnings to contract 12%. We downgrade our call to HOLD with a lower SOP-based target price of RM3.10.

Where we differ: Earnings below consensus. This is largely due to lower OM Sarawak contributions. We expect OM Sarawak contributions to remain weak in the upcoming 2Q19 results.

Potential catalyst: Rollout of more infrastructure projects. While we have factored in improved cement and construction-related contributions, there could be upside on additional infrastructure spending in the run-up to the 2021 Sarawak State election, i.e. increase in building materials demand and ad-hoc jobs. Potential new projects include the Coastal Road and Second Trunk Road packages.

Valuation

As we cut our earnings forecasts and roll forward our valuation to FY20, our SOP-based TP drops to RM3.10. This values the cement business at 13x earnings (RM0.98/share) and the construction/road maintenance/materials segments at 12x earnings (RM1.31/share).

Key Risks to Our View

Slow progress of Pan Borneo and failure to secure state road concession. Delay in Pan Borneo construction projects will adversely impact demand for building materials. Our earnings forecast have already imputed contribution from the state road concession as we believe the group will secure an extension.

At A Glance

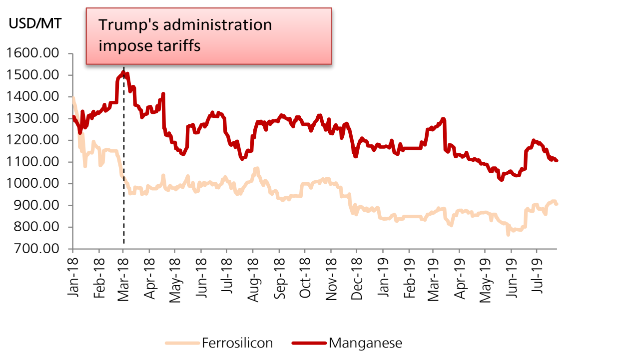
Issued Capital (m shrs)	1,073
Mkt. Cap (RMm/US$m)	3,036 / 726
Major Shareholders (%)	
Majaharta S/B	12.6
Employees Provident Fund	11.6
Lejla Taib	10.4
Free Float (%)	27.3
3m Avg. Daily Val (US$m)	0.72
ICB Industry : Basic Materials / Industrial Metals	

WHAT'S NEW

Limited upside potential

Reversal of fortunes for OM Sarawak in FY19. No thanks to weak manganese and ferrosilicon prices, we believe OM Sarawak will unlikely be able to replicate its stellar performance in FY18. In fact, we project OM Sarawak earnings contribution would contract by 86% y-o-y, mainly due to the decrease in sales volume, and weak manganese and ferrosilicon prices. We understand that this was due to lower demand as a result of market uncertainties, driven by on-going trade war between the US and China. We cut our FY19/20/21F earnings forecast for CMS by 20%/22%/14% on weaker contributions from OM Sarawak. A price recovery for both ferrosilicon and manganese would be required for improved contributions from OM Sarawak. We estimate every USD50 change in prices would impact CMS's earnings by c.9%.

Fall in ferrosilicon and manganese prices coincide with trade war



Source: AllianceDBS, Bloomberg Finance L.P

OM Sarawak capacity expansion could be on the cards? We understand that OM Sarawak is looking to expand to Phase 2 once it secures additional power from Sarawak Energy. We think there could be a good chance for OM Sarawak to secure additional supply. Funding should not be an issue as CMS is currently in a net cash position. If it materializes, the new capacity may be commissioned in FY21F.

Core divisions to support earnings growth. In FY18, CMS's earnings growth was mainly supported by OM Sarawak. The situation now has reversed, as we expect the core traditional business to be in the driving seat. On top of the Pan Borneo project, we expect infrastructure projects funded by the Sarawak's RM9bn state development budget to support earnings.

Cement division: expect improved volumes. We expect the division to do relatively well this year compared to FY18, mainly due to the increase in demand and stable clinker prices. We expect sales volume to be driven by increasing demand from Pan Borneo jobs and infrastructure projects in Sarawak given that owns the only three cement manufacturing plants in Sarawak.

Construction materials and trading division: beneficiary of Pan Borneo Highway. This division should be the biggest beneficiary of the Pan Borneo Highway project given CMS's status as the biggest building material supplier in Sarawak. Like cement, we believe the division will achieve healthy growth in FY19. CMS has taken the necessary steps to meet the huge demand in Sarawak. Among others, the group has firmed up dedicated sources for the supply of quarry sand. The commissioning of a second line at Sibanyis quarry and contribution from the recently acquired Borneo Granite will fill the void left by the closure of Penkuari quarry (due to soil erosion).

Construction division: supported by works on Pan Borneo Highway and Coastal Road project. Earnings growth from the construction division this year will be supported by work progress on the Pan Borneo Highway (Sg. Awik Bridge – Bintangor Junction) and Coastal Road package (Bintulu-Jepak Bridge). These two projects form bulk of its outstanding RM1.5bn construction order book. Additional spending by the state government in the run-up to the 2021 state election could boost earnings further for CMS. The Coastal Road contract packages have not been fully awarded. We believe CMS is well-positioned to win at least one more package. CMS is also a strong contender to win at least one package from the Second Trunk Road contract – which should be announced before end of this year.

Contribution from the state road maintenance division will remain until the end of this year following a 6-month extension by the state government. We believe that CMS is able to secure a renewal for the state road maintenance concession given its strong track record and investments made over the years. However, we are not ruling out potential cut in road length.

Re-rating catalyst needed to boost sentiment; Downgrade to HOLD with lower TP of RM3.10. The weaker associate profits more than offsets the improved contributions from CMS's cement and construction materials business. As a result, we expect CMS earnings to contract 12% in FY19F and believe this is likely to limit near term share price upside for CMS. We downgrade our call to HOLD with a lower SOP-based target price of RM3.10.

SOP-based valuation for CMS

Business division	Valuation Method	Effective stake	Multiple (x)	Valuation (RM m)	Per CMS share	Description
Cement	P/E	100%	13.0	1,050	0.98	13x FY20 P/E
Construction materials	P/E	51%	12.0	494	0.46	12x FY20 P/E
Road maintenance	P/E	100%	12.0	915	0.85	12x FY20 P/E
Property	RNAV			252	0.23	40% discount to estimated market value, less MI
OM Sarawak	P/E	25%	4.0	61	0.06	4x FY20P/E
Sacofa	P/E	50%	15.0	784	0.73	15x FY20P/E
Total value				2,773.8	**3.31**	
25% stake in K&N Kenanga				103.8	0.10	
20% stake in KKB Engineering				70.6	0.07	
Net cash / (net debt)				154.4	0.14	
SOP-based TP					**3.62**	
Holding company discount					15%	
TP					**3.10**	Implied 14x FY19 PE and 1.2x P/B

CRITICAL DATA POINTS TO WATCH

Natural monopoly in Sarawak's cement market. CMS owns the only three cement manufacturing plants in Sarawak with a combined annual capacity of 2.75m MT. Capacity utilisation is now at c.60% after completion of a 1.0m MT cement plant in early 2016. CMS is now well positioned to leverage on the increased construction activities in the state.

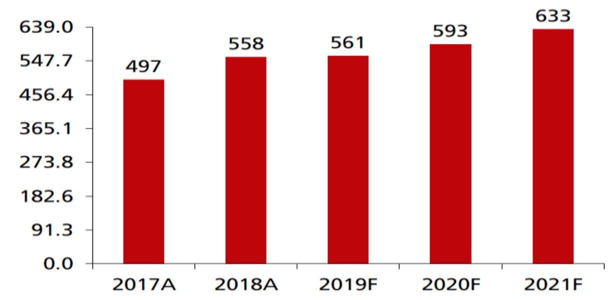
Construction material business supported by Pan Borneo Highway project. CMS is also involved in the manufacturing and trading of other building materials in Sarawak, including concrete products, quarries, premix, and wire mesh (which complements its other divisions). After an exceptionally strong FY14-15, sales in 2017 were impacted by: 1) the closure of Penkuari quarry plant, 2) the shutdown and relocation of a premix plant, and 3) slower implementation of government projects. Operations should return to normal and the performance of this division is set to pick up again in FY19-21 on the back of on-going demand from the massive RM27bn Pan Borneo Highway project.

Awaiting renewal of road maintenance concessions. For the last 15 years, this division was involved in road maintenance works across Sarawak, principally through CMS Roads Sdn Bhd and 51%-owned PPES Works (Sarawak) Sdn Bhd. The former maintains approximately 5,500km of state roads, and the latter about 200km of federal roads. However, these concessions have expired. In June 2019, the state government granted a 6-month extension to CMS to maintain the state roads in Sarawak. Given its proven track record and investments made over the years in plant and machinery, there is a fair chance that these concessions will be renewed. However, we do not rule out a possibility of cut in length of roads under the concession.

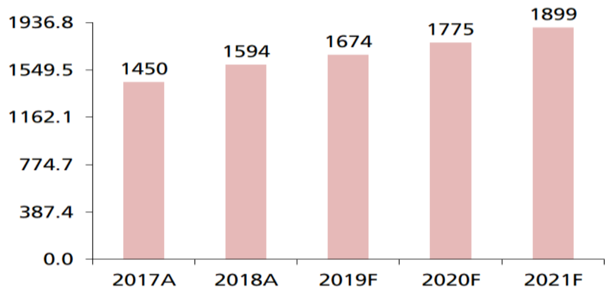
25%-associate OM Sarawak owns a greenfield ferrosilicon (FeSi) and manganese alloy (SiMn) smelter in Samalaju, Sarawak. The remaining 75% stake is held by OM Holdings Ltd, an Australian-listed vertically-integrated miner, smelter and trader of manganese and other ores/alloys. Phase 1 has a total of 16 units of furnaces, of which 10 units are allocated for the production of FeSi while the remaining six units are allocated for the production of manganese alloy. We expect earnings contribution from the company to be impacted by weak ferrosilicon and manganese prices due to trade war. It is ready to expand to Phase 2 pending the move to secure additional power

Malaysian Phosphate Additives (or MPA that is located in Sarawak) – 60% stake. The project is now implemented in two phases. Total investment for phase 1 amounts to approximately RM1bn, to be funded via a mixture of equity and long-term loan. Phase one construction is underway and scheduled for completion by end-2020.

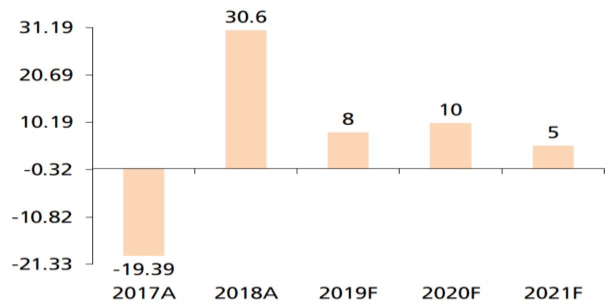
Cement revenue



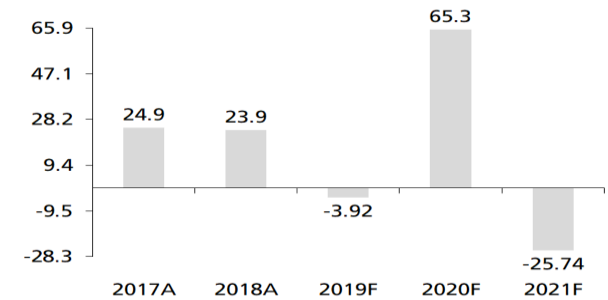
Cement production (MT)



Construction materials revenue (y-o-y growth)

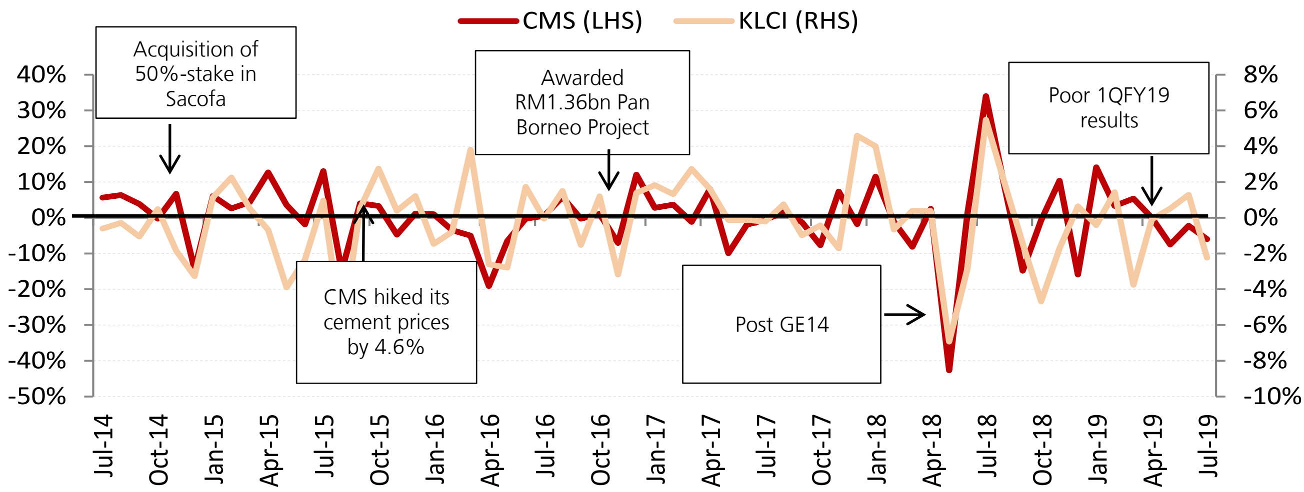


Road maintenance revenue (y-o-y growth)



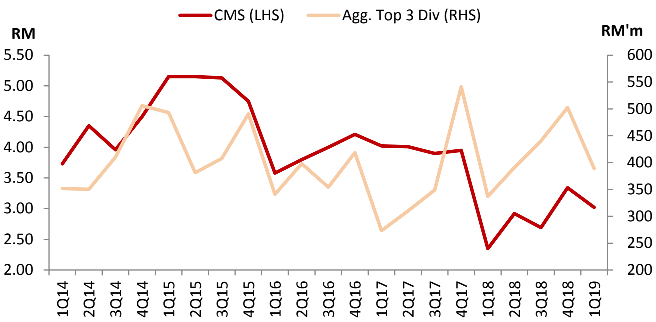
Source: Company, AllianceDBS

Graph 1: CMS's share price movements relative to FBM KLCI index movements (m-o-m)



Source: Company, Bloomberg Finance L.P., AllianceDBS

CMS's share price vs sales of top 3 divisions

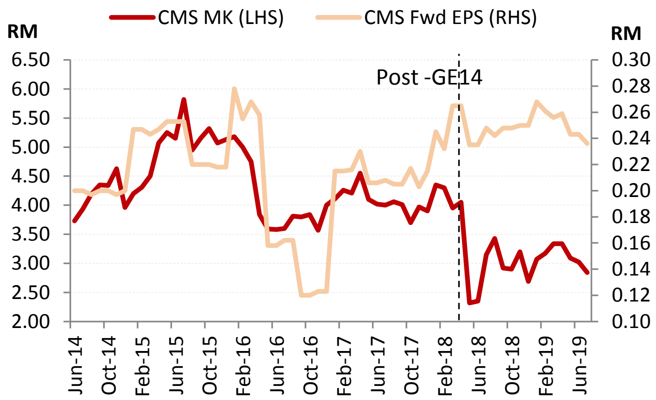


Source: Bloomberg Finance L.P., AllianceDBS

Remarks

Cement, construction materials and road maintenance are main contributors to the group's earnings (c.80%). We expect these segments to reap the benefits from the Pan Borneo project as well as other infrastructure spending by the state government.

CMS's share price vs consensus' EPS forecasts



Source: Bloomberg Finance L.P., AllianceDBS

Remarks

CMS's share price performance has a strong correlation to market expectations for its forward earnings . Apart from the performance of core divisions, its associates such as OM Sarawak play an important role in driving up its earnings. That being said, we saw its share price tumble post-GE14 due to poor market sentiment despite recording healthy EPS growth in FY18.

Balance Sheet:

Remains in net cash position. As at end-March 2019, CMS's balance sheet remained strong with a net cash position of RM35m and investment securities of RM102m. Its gross gearing level is expected to increase due to funding for MPA.

Higher capex in FY19-20 due to MPA. The annual capex for CMS is approximately RM80m. Given that the construction of MPA is underway and scheduled for completion and commissioning at end-2020, we assume a total capex of RM1bn to be spent in FY19 and FY20.

Share Price Drivers:

Further development activities in Sarawak. CMS's three core divisions are largely tied to infrastructure development activities in Sarawak. Increase in infrastructure project awards in Sarawak in the run-up to the 2021 state election will present more work opportunities and increase in building material demand.

Demand from Pan Borneo Highway project. All 11 work packages under Phase 1 have been launched and actual construction work started in 2017. The project is slightly behind schedule and expected to pick up in FY20. CMS is expected to benefit from its status as one of the major suppliers of building materials in Sarawak.

Key Risks:

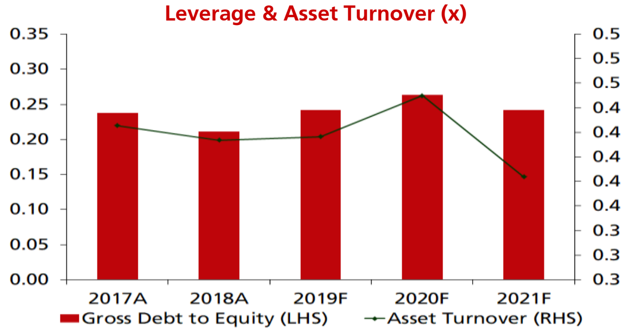
Raw material costs. Fluctuations in raw material costs (i.e. coal, steel) will impact the margins for the cement and building material division. Forex will also play a role as some raw materials are transacted in USD (such as coal and imported clinker).

Slow progress of Pan Borneo and failure to secure state road concession. Any delay in Pan Borneo construction projects will adversely impact the demand for building materials. Our earnings forecast have already imputed contribution from the state road maintenance concession as we believe the group will secure an extension.

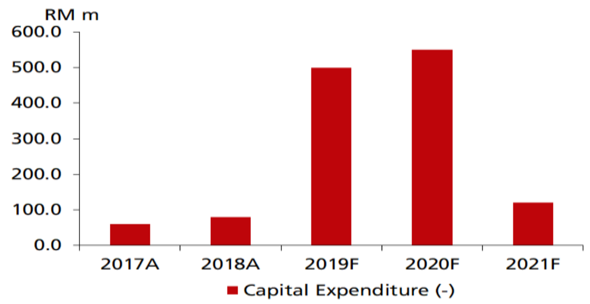
Company Background

CMS is the natural monopoly producer of cement in the state of Sarawak. It is also involved in the manufacturing of building materials, road maintenance, property development, etc.

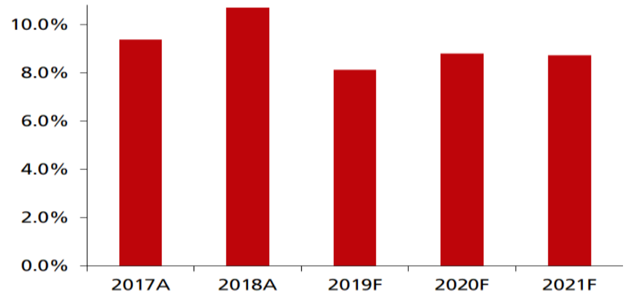
Leverage & Asset Turnover (x)



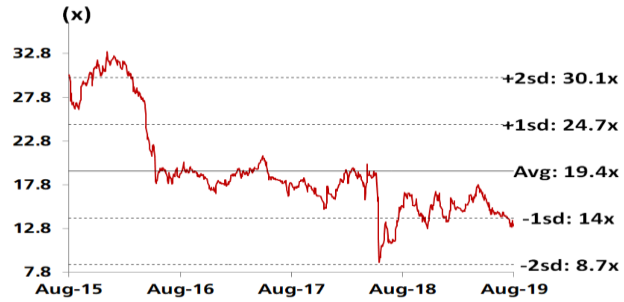
Capital Expenditure



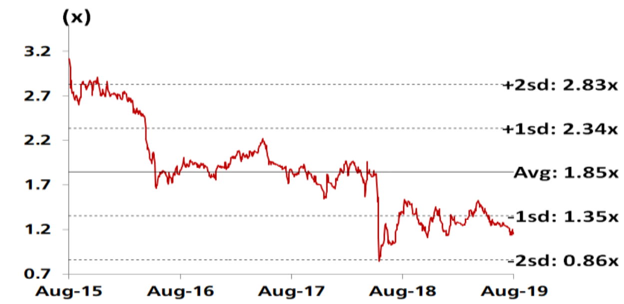
ROE (%)



Forward PE Band (x)



PB Band (x)



Key Assumptions

FY Dec	2017A	2018A	2019F	2020F	2021F
Cement production (MT)	1,450	1,594	1,674	1,775	1,899
Construction materials revenue (y-o-y growth)	(19.4)	30.6	8.00	10.0	5.00

Segmental Breakdown

FY Dec	2017A	2018A	2019F	2020F	2021F
Revenues (RMm)					
Cement	497	558	561	593	633
Construction materials	428	559	604	664	698
Road maintenance	447	554	533	880	654
Others	199	132	150	120	125
Total	**1,606**	**1,712**	**1,857**	**2,268**	**2,119**
PBT (RMm)					
Cement	101	90.1	99.1	106	114
Construction materials	59.7	71.3	90.6	106	105
Road maintenance	90.2	90.4	95.9	167	124
Others	71.8	120	71.3	72.6	95.4
Total	**323**	**372**	**357**	**452**	**438**
PBT Margins (%)					
Cement	20.4	16.2	17.7	17.9	18.0
Construction materials	13.9	12.7	15.0	16.0	15.0
Road maintenance	20.2	16.3	18.0	19.0	19.0
Total	**20.1**	**21.7**	**19.2**	**20.0**	**20.7**

Driven by higher demand

Largely due to lower OM contribution

Income Statement (RMm)

FY Dec	2017A	2018A	2019F	2020F	2021F
Revenue	1,606	1,712	1,857	2,268	2,119
Cost of Goods Sold	(1,245)	(1,368)	(1,480)	(1,788)	(1,655)
Gross Profit	**361**	**344**	**378**	**479**	**464**
Other Opng (Exp)/Inc	(59.6)	(62.0)	(46.8)	(54.4)	(71.4)
Operating Profit	**302**	**282**	**331**	**425**	**393**
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	72.6	105	58.8	67.6	89.1
Net Interest (Exp)/Inc	(23.7)	(34.3)	(32.8)	(40.2)	(43.7)
Exceptional Gain/(Loss)	(20.0)	19.8	0.0	0.0	0.0
Pre-tax Profit	**331**	**372**	**357**	**452**	**438**
Tax	(83.8)	(75.1)	(71.5)	(92.4)	(83.8)
Minority Interest	(33.8)	(35.1)	(72.2)	(115)	(96.0)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	**213**	**262**	**213**	**245**	**259**
Net Profit before Except.	233	242	213	245	259
EBITDA	432	450	450	559	569
Growth					
Revenue Gth (%)	3.5	6.6	8.5	22.1	(6.6)
EBITDA Gth (%)	16.0	4.0	0.1	24.2	1.8
Opg Profit Gth (%)	(7.0)	(6.6)	17.3	28.5	(7.5)
Net Profit Gth (Pre-ex) (%)	37.8	3.9	(12.0)	15.0	5.4
Margins & Ratio					
Gross Margins (%)	22.5	20.1	20.3	21.1	21.9
Opg Profit Margin (%)	18.8	16.5	17.8	18.7	18.5
Net Profit Margin (%)	13.3	15.3	11.5	10.8	12.2
ROAE (%)	9.4	10.7	8.1	8.8	8.7
ROA (%)	5.6	6.3	4.8	4.9	4.7
ROCE (%)	7.1	6.4	6.9	8.0	7.0
Div Payout Ratio (%)	40.2	32.8	30.0	30.0	30.0
Net Interest Cover (x)	12.8	8.2	10.1	10.6	9.0

Source: Company, AllianceDBS

Quarterly / Interim Income Statement (RMm)

FY Dec	1Q2018	2Q2018	3Q2018	4Q2018	1Q2019
Revenue	355	395	465	496	418
Cost of Goods Sold	(308)	(298)	(362)	(400)	(350)
Gross Profit	47.0	97.3	103	96.1	68.5
Other Oper. (Exp)/Inc	(19.9)	(10.6)	(6.1)	(1.8)	(10.8)
Operating Profit	27.1	86.7	97.0	94.3	57.7
Other Non Opg (Exp)/Inc	(8.2)	(7.3)	(11.8)	(20.8)	(26.6)
Associates & JV Inc	37.5	40.0	24.1	6.08	13.4
Net Interest (Exp)/Inc	0.59	(0.3)	(0.2)	(9.0)	(1.9)
Exceptional Gain/(Loss)	0.0	0.0	4.26	15.6	19.9
Pre-tax Profit	56.9	119	113	86.1	62.4
Tax	(13.4)	(18.6)	(21.2)	(20.9)	(13.8)
Minority Interest	(4.6)	(8.8)	(14.1)	(8.1)	(8.0)
Net Profit	39.0	91.6	78.0	57.1	40.7
Net profit bef Except.	39.0	91.6	73.8	41.6	20.8
EBITDA	71.6	135	125	96.6	62.4
Growth					
Revenue Gth (%)	(37.6)	11.3	17.7	6.7	(15.8)
EBITDA Gth (%)	(44.1)	88.0	(7.4)	(22.5)	(35.4)
Opg Profit Gth (%)	(58.7)	219.7	11.9	(2.8)	(38.8)
Net Profit Gth (Pre-ex) (%)	(51.7)	135.3	(19.5)	(43.6)	(50.0)
Margins					
Gross Margins (%)	13.2	24.6	22.2	19.4	16.4
Opg Profit Margins (%)	7.6	21.9	20.8	19.0	13.8
Net Profit Margins (%)	11.0	23.2	16.8	11.5	9.7

Balance Sheet (RMm)

FY Dec	2017A	2018A	2019F	2020F	2021F
Net Fixed Assets	989	1,022	1,461	1,945	1,977
Invts in Associates & JVs	925	1,004	1,062	1,130	1,219
Other LT Assets	140	137	137	137	137
Cash & ST Invts	1,110	1,102	1,072	1,056	1,323
Inventory	294	334	363	443	414
Debtors	271	314	341	416	389
Other Current Assets	358	282	288	234	224
Total Assets	4,087	4,194	4,723	5,360	5,683
ST Debt	51.7	53.9	53.9	53.9	53.9
Creditor	525	455	520	627	581
Other Current Liab	112	109	209	309	409
LT Debt	585	563	705	848	840
Other LT Liabilities	131	97.8	97.8	97.8	97.8
Shareholder's Equity	2,350	2,549	2,698	2,870	3,051
Minority Interests	333	367	439	554	650
Total Cap. & Liab.	4,087	4,194	4,723	5,360	5,683
Non-Cash Wkg. Capital	285	366	263	156	36.4
Net Cash/(Debt)	473	485	313	154	429
Debtors Turn (avg days)	66.8	62.3	64.3	60.9	69.3
Creditors Turn (avg days)	143.3	137.0	125.3	121.6	140.7
Inventory Turn (avg days)	73.7	87.9	89.6	85.4	99.7
Asset Turnover (x)	0.4	0.4	0.4	0.4	0.4
Current Ratio (x)	2.9	3.3	2.6	2.2	2.3
Quick Ratio (x)	2.0	2.3	1.8	1.5	1.6
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	9.4	12.9	65.9	61.0	13.4
Z-Score (X)	3.2	3.2	3.2	3.2	3.1

Increase due to MPA

Source: Company, AllianceDBS

Cash Flow Statement (RMm)

FY Dec	2017A	2018A	2019F	2020F	2021F
Pre-Tax Profit	331	372	357	452	438
Dep. & Amort.	57.9	62.8	60.5	66.5	87.3
Tax Paid	(77.2)	(78.2)	(71.5)	(92.4)	(83.8)
Assoc. & JV Inc/(loss)	(72.6)	(105)	(58.8)	(67.6)	(89.1)
Chg in Wkg.Cap.	(54.6)	(95.5)	(70.0)	(67.6)	(50.3)
Other Operating CF	97.9	(29.7)	(26.0)	(26.0)	(50.0)
Net Operating CF	**282**	**127**	**191**	**265**	**252**
Capital Exp.(net)	(60.0)	(79.7)	(500)	(550)	(120)
Other Invts.(net)	(86.3)	(7.2)	0.0	0.0	0.0
Invts in Assoc. & JV	0.81	28.3	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	90.5	(12.1)	100	100	120
Net Investing CF	**(55.0)**	**(70.6)**	**(400)**	**(450)**	**0.0**
Div Paid	(67.7)	(86.0)	(63.9)	(73.6)	(77.6)
Chg in Gross Debt	(115)	(19.8)	143	143	(7.4)
Capital Issues	0.0	(17.7)	0.0	0.0	0.0
Other Financing CF	478	11.4	102	102	102
Net Financing CF	**296**	**(112)**	**180**	**171**	**16.6**
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	523	(55.9)	(28.8)	(14.0)	269
Opg CFPS (sen)	31.4	20.7	24.3	31.0	28.2
Free CFPS (sen)	20.7	4.40	(28.8)	(26.5)	12.3

Capex for MPA

Source: Company, AllianceDBS

Target Price & Ratings History

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	27 Aug 18	3.50	4.00	BUY
2:	29 Nov 18	3.34	4.00	BUY
3:	11 Jan 19	3.25	4.00	BUY
4:	27 Feb 19	3.07	4.00	BUY
5:	14 Mar 19	3.39	4.00	BUY
6:	16 May 19	3.23	3.80	BUY

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

Source: AllianceDBS
Analyst: Abdul Azim Muhthar

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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 share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 6 Aug 2019 00:18:27 (MYT)
Dissemination Date: 6 Aug 2019 09:26:05 (MYT)

Sources for all charts and tables are AllianceDBS unless otherwise specified.

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DBS Regional Research Offices

HONG KONG
DBS (Hong Kong) Ltd
Contact: Carol Wu
13th Floor One Island East,
18 Westlands Road,
Quarry Bay, 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

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
Securities and Exchange Commission, Thailand

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: indonesiaresearch@dbs.com