Malaysia Company Guide

Lafarge Malaysia

Version 15| Bloomberg: LMC MK | Reuters: LMCE.KL

Refer to important disclosures at the end of this report

DBS Group Research . Equity

20 Sep 2019

HOLD

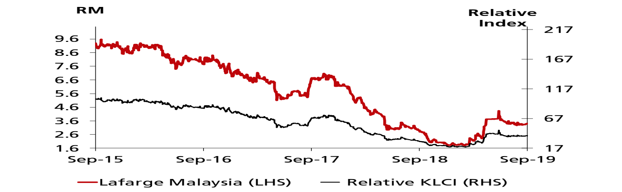
Last Traded Price (19 Sep 2019): RM3.31 (KLCI : 1,596.28)
Price Target 12-mth: RM3.75 (13% upside) (Prev RM3.75)

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

What's New

- Domestic cement demand likely contracted 1HFY19; gradual recovery expected in 2HFY19
- Execution of major construction projects key to boosting demand
- Low cement prices unsustainable in the long run; assume gradual price increase in FY20
- Maintain HOLD with TP of RM3.75

Price Relative



Forecasts and Valuation

FY Dec (RMm)	2018A	2019F	2020F	2021F
Revenue	2,122	2,322	2,553	2,741
EBITDA	(183)	44.8	151	221
Pre-tax Profit	(405)	(167)	(55.2)	22.4
Net Profit	(319)	(129)	(42.5)	17.1
Net Pft (Pre Ex.)	(319)	(129)	(42.5)	17.1
Net Pft Gth (Pre-ex) (%)	(48.4)	59.7	66.9	nm
EPS (sen)	(37.6)	(15.1)	(5.0)	2.01
EPS Pre Ex. (sen)	(37.6)	(15.1)	(5.0)	2.01
EPS Gth Pre Ex (%)	(48)	60	67	nm
Diluted EPS (sen)	(37.6)	(15.1)	(5.0)	2.01
Net DPS (sen)	0.0	0.0	0.0	0.0
BV Per Share (sen)	300	284	279	281
PE (X)	nm	nm	nm	164.9
PE Pre Ex. (X)	nm	nm	nm	164.9
P/Cash Flow (X)	nm	344.9	25.2	16.5
EV/EBITDA (X)	nm	82.4	24.6	16.6
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	1.1	1.2	1.2	1.2
Net Debt/Equity (X)	0.3	0.4	0.4	0.4
ROAE (%)	(11.8)	(5.2)	(1.8)	0.7
Earnings Rev (%):		(9)	16	3
Consensus EPS (sen):		(20.6)	(7.8)	2.10
Other Broker Recs:		B: 0	S: 0	H: 5

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

Project execution key to recovery

Execution of projects key catalyst for demand; maintain HOLD. According to our estimates, domestic cement demand in 1HFY19 contracted by 3-4%. Notwithstanding the weak property market, demand was likely affected by the slow progress of some key infrastructure projects such as the Light Rail Transit 3 (LRT3). Additionally, while the revival of the East Coast Rail Link (ECRL) is positive, the sub-contracting portion to local contractors is only expected in 4Q19 at the earliest. The progress and execution of these construction projects are crucial to drive demand for cement. We expect demand to recover mildly in 2HFY19 before picking up in FY20. By then, all of these projects should hit the ground running.

Where we differ: We are positive that Lafarge Malaysia (LMC) can narrow losses with its continuous cost optimisation and potential increase in cement demand.

Potential catalysts: 1) Increase in cement prices and, 2) faster execution of existing projects to drive demand.

Valuation:

We revise our FY19/20/21 earnings forecast by -9%/16%/3% largely factoring in slow project progress in 1HFY19 before implementation of infrastructure projects gain momentum in FY20. We maintain our HOLD call with an unchanged target price (TP) of RM3.75. Our TP is pegged at P/B of 1.35x, a 10% discount to LMC's 3-year mean of 1.5x.

Key Risks to Our View:

Slowdown in construction works and low cement prices will weigh on demand and compress margins.

At A Glance

Issued Capital (m shrs)	850
Mkt. Cap (RMm/US$m)	2,812 / 672
Major Shareholders (%)	
YTL Cement	77
PNB	12.7
FIL Ltd	7.6
Free Float (%)	5.3
3m Avg. Daily Val (US$m)	0.08
GIC Industry : Materials / Construction & Materials	
Bloomberg ESG disclosure score (2017)^	29.3
- Environmental / Social / Governance	17.1 / 35.1 / 51.8

^ refer to back page for more information

WHAT'S NEW

Demand recovery on the horizon

Domestic cement demand likely contracted in 1HFY19…. Both cement prices and LMC's cement & clinker sales dropped by about 6% y-o-y in 1HFY19. At first glance, this would imply that sales volume was stable but this might not be the case.

We believe that LMC's sales were largely supported by higher clinker export as well as a surge in clinker price from USD42/MT to USD52/MT (23% y-o-y). This is consistent with LMC's previous guidance of leveraging on its Langkawi plant's strategic location to spur export of clinkers due to increasing demand as China reduces its clinker production.

After considering these two factors, we estimate that LMC's domestic sales volume fell by c.3-4%. Given that LMC is the biggest player in the industry and a good proxy for demand, we estimate that overall cement demand in Peninsular Malaysia also contracted by the same quantum.

…but is expected to recover gradually in 2HFY19 before picking up in FY20. Notwithstanding the weak property market, demand was likely affected by the slow progress of some key infrastructure projects such as the LRT3. The project has moved from a PDP to turnkey model and most sub-contractors have not been given clarity on the revised contracts. As such, progress of works has also been slow. Additionally, while the revival of the ECRL is positive, the sub-contracting portion to local contractors is only expected in 4Q19 at the earliest.

In contrast, cement demand in 1HFY18 was supported by big infrastructure projects such as Mass Rapid Transit 2 (MRT 2), ECRL and to some extent LRT 3 (construction works are set to continue in 2HFY19). We expect cement demand to recover gradually in 2HFY19 when work on these projects resume, which is likely to spill over into next year. We expect cement demand to growth by 7% y-o-y in FY20 as the infrastructure projects gain momentum.

Margins to sustain as cost optimisation bears fruit. We are pleased with LMC's improvement in cost control, a key area that its management has been focusing on since last year. This can be seen in the company's improved gross margin and lower operating expenses.

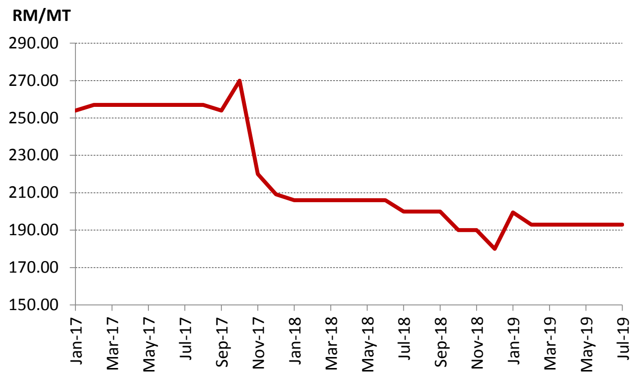
Compared to 1HFY18, LMC's gross margin in 1HFY19 expanded by about 2 percentage points to 10% while its selling, general and administrative (SG&A) expenses dropped 24%. This was mainly attributed to; 1) a Voluntary Separation Scheme (VSS), 2) scheduled major maintenance shutdowns to improve operational efficiency – both were done in 2HFY18 and, 3) lower distribution costs due to better network route optimisation.

In light of LMC's proposal to change its name to "Malayan Cement Bhd", the group may no longer need to pay royalties to LafargeHolcim. This would also improve its margins as royalties are paid at a rate of 2-3% of revenue.

Better synergies with YTL Cement. We believe that the emergence of YTL Cement as Lafarge's new biggest shareholder is a positive development. Synergies between these two entities should lead to better cost control, thus boosting its efficiency. Among other things, immediate cost savings could come from logistics cost as we think that Lafarge and YTL Cement can reduce overlapping routes, which will ultimately result in the optimisation of their network routes

Cement prices remain unchanged but there is a strong case for an increase. As rebate stays high, cement average selling price (ASP) remains low at RM193-195/MT. This has caused industry players to continue reporting losses and this is not sustainable in the long run. It is important to note that the majority of cement players in Malaysia have been in the red over the past few years. At some point, market forces have to come into play and dictate prices. We conservatively assume cement prices to gradually increase to RM200/MT and RM205/MT in FY20 and FY21 respectively.

Bulk cement price



Source: Various, AllianceDBS

Revised earnings forecast. Following demand contraction in 1HFY19 and a mild recovery assumed in 2HFY19, we expect demand to pick up in FY20. Coupled with a projected increase in cement prices, we revised our earnings forecast of FY19/20/21 by -9%/16%/3%.

Maintain HOLD with unchanged TP of RM3.75. Until we see sustainable market recovery and perhaps more clarity from LMC's new management, we keep our HOLD call for the stock with an unchanged TP of RM3.75. Earnings catalysts for the stock are; 1) increased cement prices which are subject to government approval and, 2) faster execution of existing projects.

CRITICAL DATA POINTS TO WATCH

Biggest market share. LMC is the largest cement producer in Malaysia (c.40% market share) with an annual installed production capacity of 8.2m MT of clinker and 14.2m MT of cement. It currently owns three integrated plants in Kanthan, Rawang, and Langkawi, and two cement grinding plants in Pasir Gudang following the acquisition of Holcim (Malaysia). With the emergence of YTL Cement Sdn Bhd as its biggest substantial shareholders, the combined market share of these two players is c.60%.

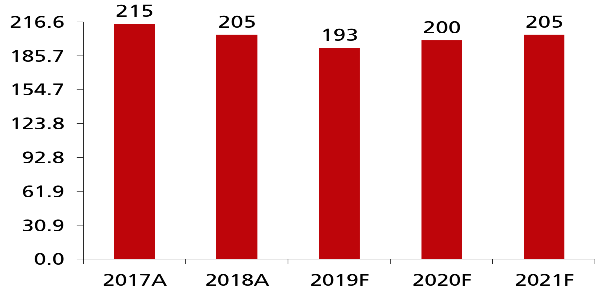
Falling ASP due to excess capacity. From 2013 to 2016, there was a series of capacity expansions undertaken by other Malaysian cement producers - Hume Cement, CIMA and YTL Cement. In total, 4.5m tonnes of new clinker capacity added 25% capacity to the industry. Annual domestic cement demand growth was flattish in FY18, after contracting 6% and 8% in 2016 and 2017 respectively – a far cry from the positive growth of 4-5% p.a. in 2015. This has intensified price competition among the cement producers as they battle for market share. Cement price is currently at RM193/MT but could gradually recover. Industry players have continued to report losses and this is not sustainable in the long run

Switching to cheaper Indonesian coal. The largest cost components in cement production are coal and electricity, constituting about c.40-50% of total production cost. LMC hedges a major portion of its annual coal requirements via fixed-price and index-linked contracts. It has switched to Indonesian coal which is much cheaper than Newcastle coal.

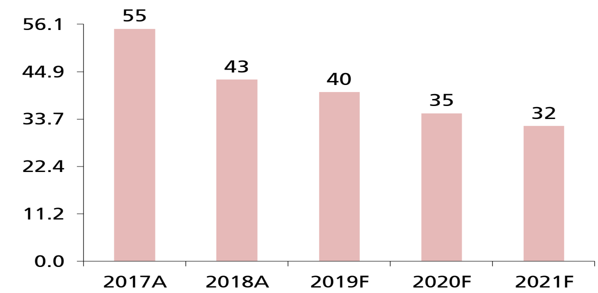
Deteriorating margins due to intense price competition. Prior to FY14, LMC's margins rose on improving ASP, falling coal prices and higher domestic sales. However, margins have weakened significantly since FY18 following intense price competition between industry players. With continuous cost optimisation, LMC has improved its margin despite low cement prices.

Neutral on USD exposure. Payment for coal is mainly in US Dollars (USD), but this is largely offset by USD receipts from cement exports. As such, LMC's earnings should not be adversely affected by fluctuations in the Malaysian Ringgit (MYR)/USD exchange rates.

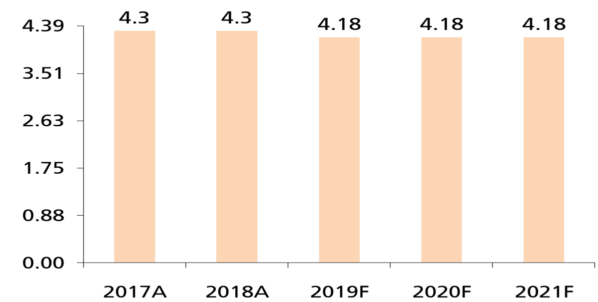
Net cement ASP (RM/tonne)



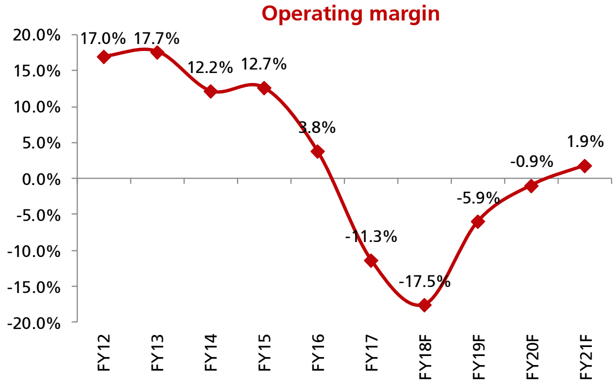
Coal price (USD/tonne)



RM/USD exchange rate

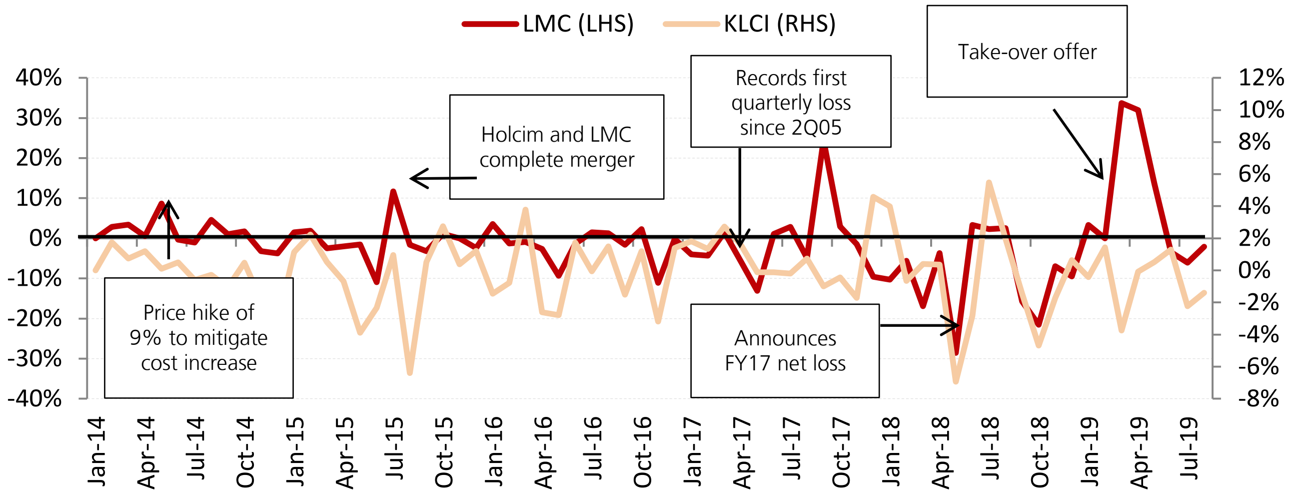


Operating margin



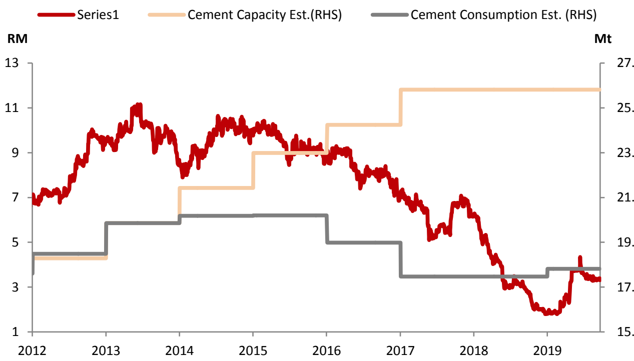
Source: Company, AllianceDBS

Graph 1: LMC's share price movement relative to the FBM KLCI index movement (m-o-m)



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

LMC's share price vs supply-demand gap

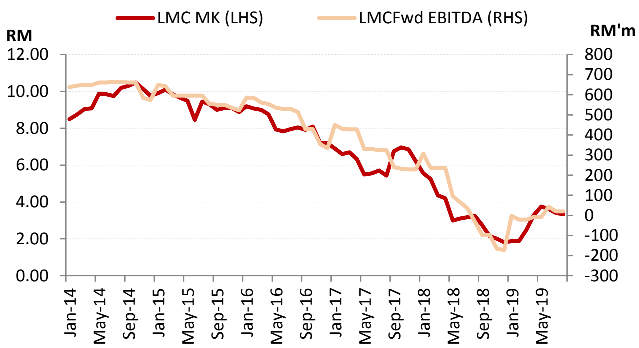


Source: Bloomberg Finance L.P., AllianceDBS

Remarks

Overcapacity has been the main concern in the industry after major players expanded their capacities in the last couple of years. Annual domestic demand growth has been insufficient to absorb the expanded capacity, which caused net selling prices to fall.

LMC's share price vs consensus' EBITDA forecasts



Source: Bloomberg Finance L.P., AllianceDBS

Remarks

LMC's share price performance is highly correlated to its forward EBITDA (correlation of ~ 0.9). Volume recovery and higher ASP will be key indicators to lift itsearnings.

Balance Sheet:

Comfortable gearing. As the group is experiencing a decline in earnings, it might require extra funding for working capital. Its gearing as of FY18 was at 30%.

Capex to normalise after expansion. LMC was in expansion mode in 2016 after building two new cement grinding plants with a total capacity of 1.2m tonnes at Rawang and Kanthan. This enabled 100% utilisation of clinker capacity at both sites to to meet domestic market demand, while lowering logistics and transportation costs without the need to transport cement from its Langkawi plant. Going forward, capital expenditure (capex) is expected to normalise as LMC is now focusing on enhancing efficiency and raising utilisation at its existing plants.

Share Price Drivers:

Outlook for construction and property sectors. Stronger growth in the construction and recovery in property sectors should lift cement demand and reduce excess capacity in the market. This should help improve cement pricing and LMC's profitability.

Cement rebates. As there is no official data on cement sales and pricing in Malaysia, a good indicator is the level of rebates given to dealers. As at 2QFY19, cement rebate was still high at RM160/MT for bulk. We can also gauge competitive pressures in the market by the volatility in rebates.

Key Risks:

Weaker domestic cement demand. LMC has the biggest capacity for cement production in Malaysia. Weak domestic cement demand due to slowing construction activities could negatively affect LMC.

Cement prices to remain low. We assume that cement prices will recover gradually as it is unsustainable at current levels. Failure to increase prices might widen LMC's losses.

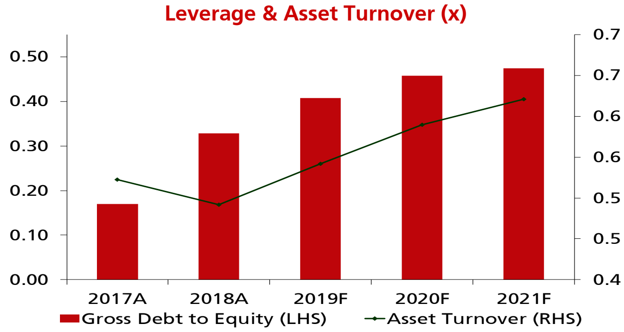
Environmental, Social, Governance:

Focus on safety and sustainability: LMC focuses attention and resources in inculcating positive health and safety behaviors. In addition, LMC has mapped out its near term and long term sustainable goals including strategies to reduce CO2 emissions, transform waste products into resources for the production process and deliver positive change in biodiversity at our main sites.

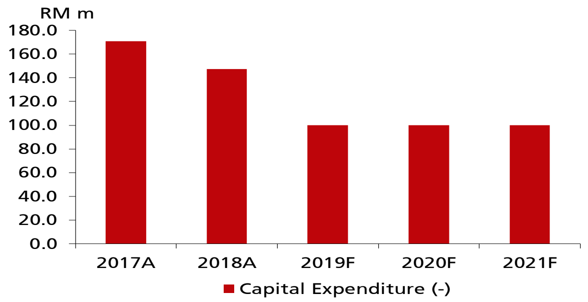
Company Background

Lafarge Malaysia is the largest cement producer in Malaysia with close to 40% market share. With the emergence of YTL Cement Sdn Bhd as its biggest substantial shareholders, the combined market share of these two players is c.60%.

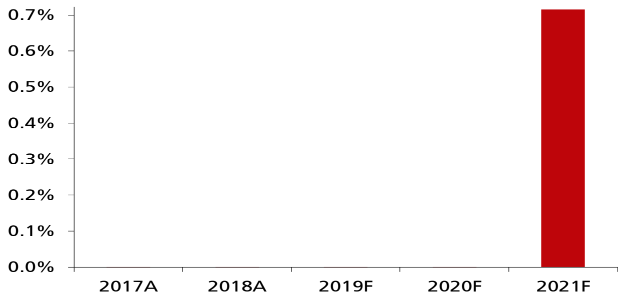
Leverage & Asset Turnover (x)



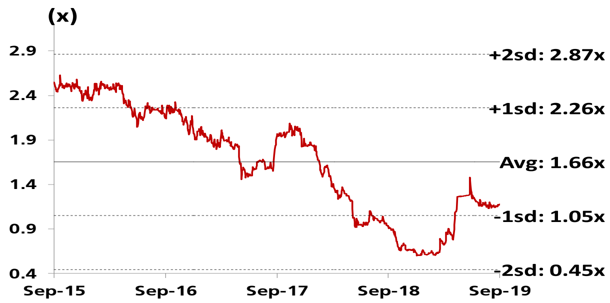
Capital Expenditure



ROE (%)

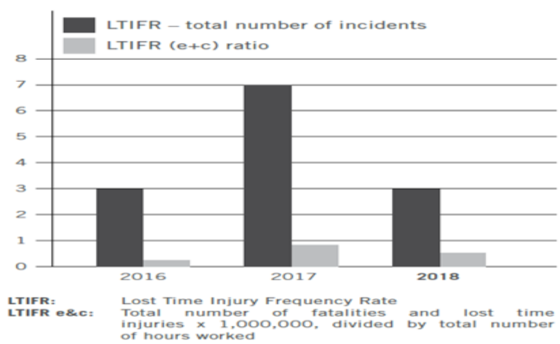


PB Band (x)



Source: Company, AllianceDBS

Environmental, Social, Governance



Source: Company

Key Assumptions

FY Dec	2017A	2018A	2019F	2020F	2021F
Net cement ASP	215	205	193	200	205
Coal price (USD/tonne)	55.0	43.0	40.0	35.0	32.0
RM/USD exchange rate	4.30	4.30	4.18	4.18	4.18

Assume gradual recovery of cement prices

Income Statement (RMm)

FY Dec	2017A	2018A	2019F	2020F	2021F
Revenue	2,249	2,122	2,322	2,553	2,741
Cost of Goods Sold	(1,955)	(2,005)	(2,030)	(2,119)	(2,192)
Gross Profit	**293**	**117**	**292**	**434**	**549**
Other Opng (Exp)/Inc	(547)	(489)	(429)	(457)	(498)
Operating Profit	**(254)**	**(371)**	**(137)**	**(22.4)**	**51.6**
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	(5.0)	(1.9)	2.00	2.00	5.00
Net Interest (Exp)/Inc	(20.0)	(32.2)	(32.1)	(34.8)	(34.2)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**(279)**	**(405)**	**(167)**	**(55.2)**	**22.4**
Tax	65.5	86.5	38.4	12.7	(5.4)
Minority Interest	(1.6)	(0.5)	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	**(215)**	**(319)**	**(129)**	**(42.5)**	**17.1**
Net Profit before Except.	(215)	(319)	(129)	(42.5)	17.1
EBITDA	(49.8)	(183)	44.8	151	221
Growth					
Revenue Gth (%)	(11.9)	(5.6)	9.4	9.9	7.4
EBITDA Gth (%)	nm	(267.1)	nm	237.8	46.2
Opg Profit Gth (%)	(359.2)	46.1	(63.1)	(83.6)	(330.1)
Net Profit Gth (Pre-ex) (%)	nm	(48.4)	59.7	66.9	nm
Margins & Ratio					
Gross Margins (%)	13.0	5.5	12.6	17.0	20.0
Opg Profit Margin (%)	(11.3)	(17.5)	(5.9)	(0.9)	1.9
Net Profit Margin (%)	(9.6)	(15.0)	(5.5)	(1.7)	0.6
ROAE (%)	(7.3)	(11.8)	(5.2)	(1.8)	0.7
ROA (%)	(5.0)	(7.4)	(3.0)	(1.0)	0.4
ROCE (%)	(7.1)	(10.5)	(3.8)	(0.6)	1.1
Div Payout Ratio (%)	N/A	N/A	N/A	N/A	0.0
Net Interest Cover (x)	(12.7)	(11.5)	(4.3)	(0.6)	1.5

Expect EBITDA to turn positive

Source: Company, AllianceDBS

Quarterly / Interim Income Statement (RMm)

FY Dec	2Q2018	3Q2018	4Q2018	1Q2019	2Q2019
Revenue	532	495	548	539	471
Cost of Goods Sold	(506)	(517)	(490)	(470)	(440)
Gross Profit	**26.0**	**(21.6)**	**58.6**	**68.9**	**31.6**
Other Oper. (Exp)/Inc	(125)	(103)	(132)	(104)	(95.5)
Operating Profit	**(99.0)**	**(125)**	**(73.3)**	**(35.5)**	**(63.9)**
Other Non Opg (Exp)/Inc	5.81	22.0	10.4	7.31	13.5
Associates & JV Inc	0.04	(1.2)	1.62	2.63	2.17
Net Interest (Exp)/Inc	(8.7)	(8.2)	(8.4)	(9.0)	(10.0)
Exceptional Gain/(Loss)	(5.8)	(22.0)	(10.4)	(7.3)	(13.5)
Pre-tax Profit	**(108)**	**(134)**	**(80.1)**	**(41.8)**	**(71.7)**
Tax	23.9	25.3	22.8	10.0	8.72
Minority Interest	0.0	0.0	(0.3)	(0.3)	(0.4)
Net Profit	**(83.8)**	**(109)**	**(57.5)**	**(32.1)**	**(63.3)**
Net profit bef Except.	(78.0)	(87.2)	(47.2)	(24.8)	(49.8)
EBITDA	(40.8)	(57.9)	(20.9)	17.8	(4.2)
Growth					
Revenue Gth (%)	(2.7)	(7.0)	10.7	(1.7)	(12.5)
EBITDA Gth (%)	(78.9)	(41.9)	63.9	nm	nm
Opg Profit Gth (%)	34.1	26.3	(41.4)	(51.6)	80.0
Net Profit Gth (Pre-ex) (%)	17.1	11.9	(45.9)	(47.5)	101.3
Margins					
Gross Margins (%)	4.9	(4.4)	10.7	12.8	6.7
Opg Profit Margins (%)	(18.6)	(25.3)	(13.4)	(6.6)	(13.5)
Net Profit Margins (%)	(15.7)	(22.1)	(10.5)	(6.0)	(13.4)

Affected by planned kiln shutdown

Balance Sheet (RMm)

FY Dec	2017A	2018A	2019F	2020F	2021F
Net Fixed Assets	1,810	1,725	1,645	1,574	1,510
Invts in Associates & JVs	20.3	18.3	20.3	22.3	27.3
Other LT Assets	1,481	1,579	1,579	1,578	1,578
Cash & ST Invts	100.0	84.3	111	187	273
Inventory	359	345	378	415	446
Debtors	479	430	464	500	531
Other Current Assets	106	95.1	95.1	95.1	95.1
Total Assets	**4,356**	**4,277**	**4,292**	**4,373**	**4,461**
ST Debt	205	558	708	808	858
Creditor	741	623	616	639	660
Other Current Liab	85.7	83.2	83.2	83.2	83.2
LT Debt	279	280	280	280	280
Other LT Liabilities	189	183	183	183	183
Shareholder's Equity	2,849	2,545	2,417	2,374	2,391
Minority Interests	6.54	5.56	5.56	5.56	5.56
Total Cap. & Liab.	**4,356**	**4,277**	**4,292**	**4,373**	**4,461**
Non-Cash Wkg. Capital	118	164	237	288	329
Net Cash/(Debt)	(384)	(753)	(877)	(900)	(864)
Debtors Turn (avg days)	71.9	78.2	70.2	68.9	68.6
Creditors Turn (avg days)	138.9	137.2	122.2	117.7	117.0
Inventory Turn (avg days)	66.8	70.8	71.3	74.4	77.6
Asset Turnover (x)	0.5	0.5	0.5	0.6	0.6
Current Ratio (x)	1.0	0.8	0.7	0.8	0.8
Quick Ratio (x)	0.6	0.4	0.4	0.4	0.5
Net Debt/Equity (X)	0.1	0.3	0.4	0.4	0.4
Net Debt/Equity ex MI (X)	0.1	0.3	0.4	0.4	0.4
Capex to Debt (%)	35.3	17.6	10.1	9.2	8.8
Z-Score (X)	1.5	1.3	1.5	1.5	1.6

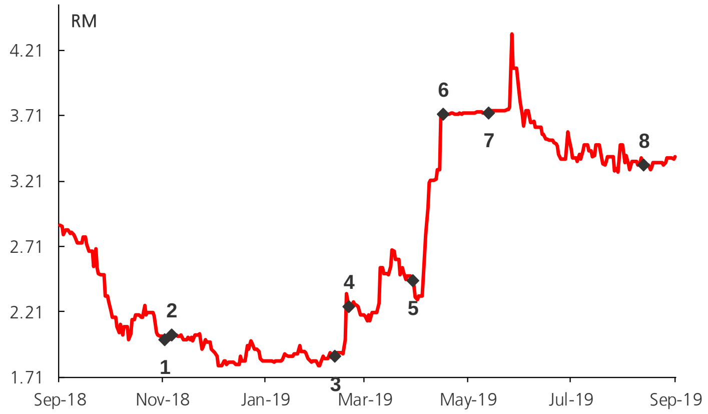
Source: Company, AllianceDBS

Cash Flow Statement (RMm)

FY Dec	2017A	2018A	2019F	2020F	2021F
Pre-Tax Profit	(279)	(405)	(167)	(55.2)	22.4
Dep. & Amort.	209	191	180	172	165
Tax Paid	(39.6)	(4.7)	38.4	12.7	(5.4)
Assoc. & JV Inc/(loss)	5.02	1.92	(2.0)	(2.0)	(5.0)
Chg in Wkg.Cap.	16.4	(17.6)	(73.1)	(50.6)	(40.9)
Other Operating CF	15.4	46.1	32.2	34.8	34.2
Net Operating CF	**(70.5)**	**(185)**	**8.15**	**112**	**170**
Capital Exp.(net)	(171)	(147)	(100.0)	(100.0)	(100.0)
Other Invts.(net)	0.0	0.09	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	16.9	4.03	4.38	6.70	10.4
Net Investing CF	**(154)**	**(143)**	**(95.6)**	**(93.3)**	**(89.6)**
Div Paid	0.0	0.0	0.0	0.0	0.0
Chg in Gross Debt	143	307	150	100	50.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(17.9)	(39.1)	(36.5)	(41.5)	(44.5)
Net Financing CF	**125**	**267**	**114**	**58.5**	**5.49**
Currency Adjustments	(0.8)	0.08	0.0	0.0	0.0
Chg in Cash	(99.8)	(61.1)	26.3	76.8	85.9
Opg CFPS (sen)	(10.2)	(19.7)	9.57	19.1	24.8
Free CFPS (sen)	(28.4)	(39.2)	(10.8)	1.36	8.25

Source: Company, AllianceDBS

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	19 Nov 18	2.00	2.90	HOLD
2:	23 Nov 18	2.03	1.95	HOLD
3:	28 Feb 19	1.87	1.95	HOLD
4:	08 Mar 19	2.25	2.55	HOLD
5:	15 Apr 19	2.45	2.55	HOLD
6:	03 May 19	3.72	3.75	REJECT THE OFFER
7:	30 May 19	3.73	3.75	REJECT THE OFFER
8:	30 Aug 19	3.33	3.75	HOLD

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

Source: AllianceDBS
Analyst: Abdul Azim Muhthar

^ Bloomberg ESG Disclosure Scores rate companies annually based on their disclosure of quantitative and policy-related ESG data. It is based on a scoring scale of 0-100, and calculated using a subset of more than 100 raw data points it collects on ESG. It is designed to measure the robustness of companies' disclosure of ESG information in their reporting/the public domain. Based on Bloomberg disclosures, as of 25 Jan 2019, the global ESG disclosure average score is 24.92 and 22.14, 28.26, 49.97 for Environmental, Social and Governance, respectively.

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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: 19 Sep 2019 23:24:54 (MYT)
Dissemination Date: 20 Sep 2019 17:59:46 (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
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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