Singapore Industry Focus

Singapore Hospitality

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DBS Group Research . Equity

10 Mar 2021

Right time to pick up fallen angels

- International travel to pick up more meaningfully towards 2H21, catalysed by "bubble" travels
- Herd immunity threshold could be achieved by 3Q21/end-2021 for selected large domestic markets like US and UK, implying a faster rebound in travel
- Valuations attractive at 0.82x P/NAV despite book devaluation; recovery prospects overlooked
- Maintain Overweight, picks ART and CDLHT

Ready for lift-off; pent-up travel demand to drive an accelerating growth outlook. We are near the starting line where travellers are waiting for the travel "green-light". This optimism is driven by the process of inoculation of the public globally with UK and US leading the way. While we believe that governments are likely to remain cautious about relaxing their borders (in the near term), Singapore will set the tone for establishing future international travel protocols. We see catalysts and remain optimistic on the take-up in the (i) "Bubble" travel facility Connect@Changi which will build confidence and strengthen current travel protocols, (ii) hosting of the World Economic Forum (although delayed) in August this year, which will spark the start of more MICE events later in 2H21.

Three-pronged recovery from large domestic overseas markets. While S-REITs' geographically diversified portfolios were no defence in the global lockdown in 2020, we see brighter times in 2H21 as most room inventories have reopened, enabling most hospitality players to capture the upturn in travel. With safe travel protocols a priority, we believe that higher-quality lodging will be preferred among travellers. We believe that the good progress made in the progressive vaccine roll-out will drive a restart in domestic travel (ART, FHT, ARAUS to lead) ahead of a gradual return in domestic leisure boosted by government initiatives. While a rebound will be gradual, the rate of growth will likely accelerate (Singapore Hospitality: Waiting for lift-off).

Valuations down but not out. The figures declined 4.4-13.5% in the latest round of valuations, led by overseas hotels. Despite the NAV de-rating, the sector continues to trade conservatively within the mean to -1 standard deviation (SD) levels. While recovery prospects had been priced in for the other sectors (trading at -1% to -20% of pre-pandemic levels), the hotels continue to be overlooked by the market at -27% compared to their historical mean. We believe it is time to embrace these fallen angels as they find their wings once more. Top picks remain to be ART (TP: S$1.20) and CDLHT (TP: S$1.35).

STI : 3,108.53

Analyst
Geraldine WONG +65 6682 3719
geraldinew@dbs.com

Derek TAN +65 6682 3716
derektan@dbs.com

STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
Ascott Residence Trust	1.05	2,421	1.20	(2.9)	(12.1)	BUY
CDL Hospitality Trusts	1.23	1,115	1.35	(7.0)	(9.8)	BUY
Far East Hospitality Trust	0.585	851	0.70	(8.7)	(4.2)	BUY
Frasers Hospitality Trust	0.505	720	0.70	(5.6)	(23.5)	BUY
ARA US Hospitality Trust (US$)	0.50	284	0.69	1.0	(29.3)	BUY

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 9 Mar 2021

Legend:
ART: Ascott Residence Trust
AUHT: ARA US Hospitality Trust
CDLHT: CDL Hospitality Trust
FHT: Frasers Hospitality Trust
FEHT: Far East Hospitality Trust

DBS
Live more, Bank less

ed: TH/ sa: PY, CS

Time to shine

It is time for the Hospitality S-REITs time to shine. The hospitality S-REIT subsector is poised to see better times come 2H21, while expectations and share prices saw a correction in recent times as Singapore border restrictions were tightened on the back of a recent spike in COVID-19 cases globally. That said, with the recent approval of a third vaccine by Johnson & Johnson (J&J) in the US and ongoing mass inoculation of the public globally, we believe that the time to regain flight will not be too far away.

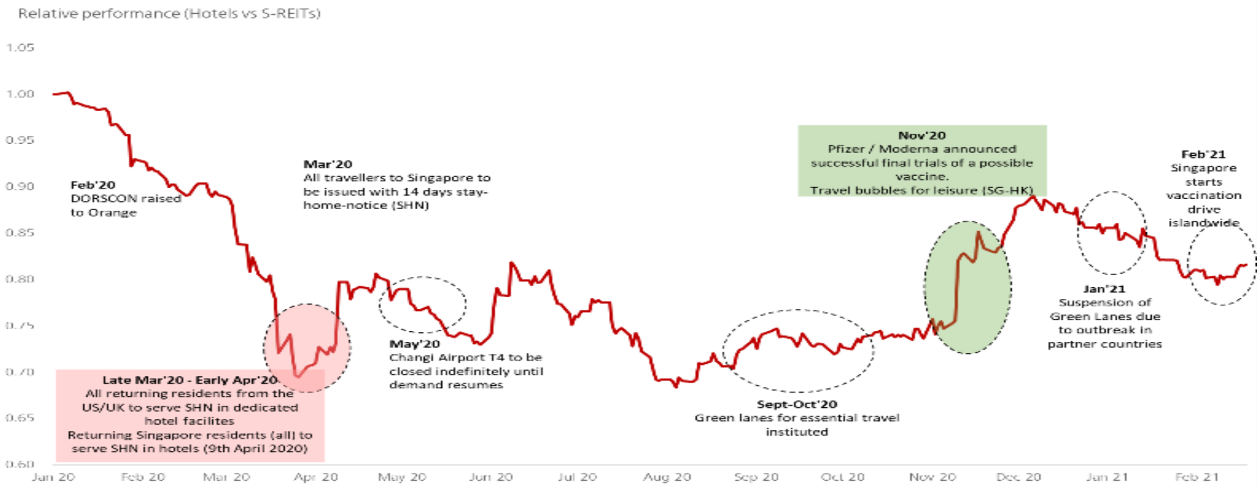
Business "bubble" travellers touching down in March 2021. The first batch of business "bubble" travellers can be expected to arrive in Singapore as early as March and reside in Connect@Changi, a purpose-built short-stay accommodation situated within Singapore expo. Connect@Changi is a pilot project first unveiled in December 2020, to allow "business, official and high economic value travellers" to fly into Singapore for up to 14 days. Rates start from S$384 for 24 hours and stays are limited to two weeks. Strict protocols will be enforced where travellers will be tested on arrival and at regular intervals throughout their stay. They will be allowed to meet locals/residents through special function rooms with air-tight glass panels.

Conservative approach to start of international business travel is well warranted to gain confidence. Connect@Changi is backed by Temasek and a collaboration between several government-linked entities including Sheares Healthcare Group, CapitaLand's The Ascott, and Changi Airport Group to name a few. The pilot project will feature an initial 150 guest rooms and 40 meetings room, to be ramped up to 660 guest rooms and 170 meetings rooms in May and scaled up to full capacity later this year to accommodate 1,300 guests.

A vote of confidence with the World Economic Forum (WEF) to be held in August 2021. In our view, the facility provides an insight into how future border opening protocols will be built upon, especially in the near term. These measures in place will have to grow to accommodate the WEF. The 2020 WEF was held in Davos (Switzerland) and hosted over 3,000 participants from 117 countries. Although the scale of the WEF in August 2021 will be smaller, we believe that Singapore's testbed in launching Connect@Changi project will give attendees confidence in committing their physical attendance for the event, which will be a big boost to Singapore's statue as a safe hub and events venue in the medium term.

Hotels may jump on this new "travel bubble" scheme. Although, the travel bubble will likely be kept within the Changi precinct at the start and for the WEF to potentially be held at Marina Bay Sands (MBS), there may be a chance for other hotel operators to be appointed as "bubble hotels" to cater to these travellers, towards the medium term. While the implementation is uncertain for now, the added source of revenues will be positive for hoteliers as most rely on (i) weekend staycations, and (ii) government quarantine business to fill their rooms, for now. Expect incremental room demand to benefit the hoteliers with Singapore exposure such as Far East Hospitality Trust (100% exposure to Singapore), CDL Hospitality Trust (66%), Frasers Hospitality Trust (36%) and Ascott Residence Trust (17%).

Relative performance (Hotels vs S-REITs)



Source: DBS bank

Travelling in a post-COVID world

Maintaining optimism on large domestic markets to emerge ahead of the pack. We maintain our view per outlook report Singapore Hospitality: Waiting for lift-off and we see the recovery being led by overseas large domestic markets hinged on the fact that the overseas hotels will be breaking out of a trough year last and domestic travel will likely lead the recovery in 2021. Three sweet spots we see fronting the recovery trend are:

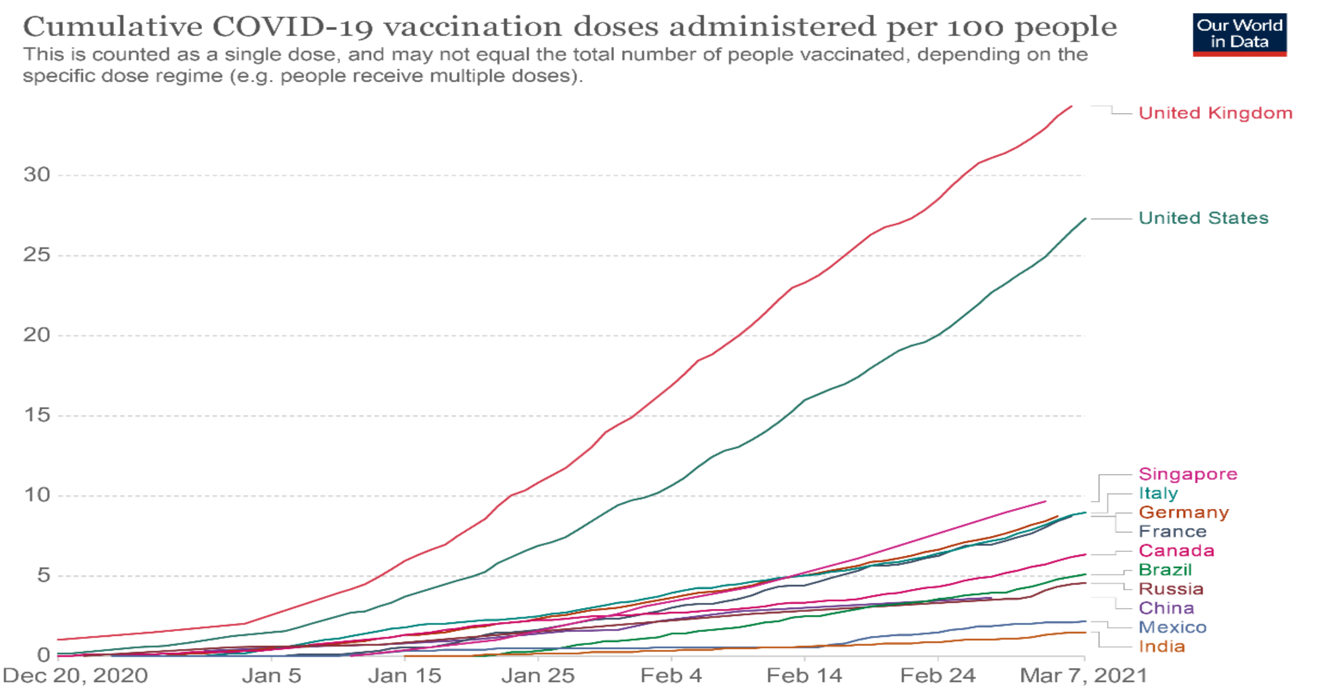
(a) **Attaining herd immunity by end-2021? Not too far-fetched for certain countries.**

Herd immunity a realisable target. Vaccination targets worldwide continue to drive towards herd immunity where at least 60-80% of the population has vaccine coverage, according to various online sources. Singapore, which started its vaccination drive two months ago, is aiming to have its entire population vaccinated by 3Q21. Nations far and wide have set forth similar vaccine targets including large population regions such as the US and EU which had been undoubtedly worse hit by the pandemic. According to S&P, the EU, UK and US could vaccinate 70% of their populations by July this year, subjected to sufficient vaccine production.

UK and US lead the vaccination pack. To date, the UK and US continue to lead the vaccination progress globally and have already administered c.34 and c.27 doses per 100 people, according to data from Our World In Data. Domestic travel restrictions should ease alongside the vaccination roll-out as domestic tourism campaigns will likely follow suit closely to aid sectors that had been at the forefront of the pandemic woes.

Looking ahead, we believe the US and much of Europe are poised to emerge from COVID-19 with their vaccination efforts making good progress. The US and UK are leading the race to achieve country herd immunity among the major developed economies. The approval of the single-dose J&J vaccine in the US will further accelerate the vaccination process as more than 20 million doses are expected to be delivered by end-March. Together with the warming weather in the northern hemisphere, the US and Europe look well positioned to control the COVID-19 pandemic. In Singapore, vaccinations are also progressing well at 9.66 doses/100 people in early March. Reports are also showing that vaccinations are being brought forward due to the arrival of more vaccine supplies.

Vaccination progress around the world; Singapore administered 9.7 doses/100 people



Source: One World in Data, DBS Bank

(b) Emerging from a breakeven standstill; higher preference for quality lodging in domestic markets.

Domestic travel markets are at the cusps of recovery. Hotels within large domestic markets are in the early tides of recovery based on our observation where hotels are either still operationally closed or are still ascertaining a breakeven level of room demand. We think that the trend will only be upwards from here given the rock-bottom performance in 2H20. With more room inventory now opened as of end-2020, most hotels are in the "ramp-up" stage but ready to welcome guests once domestic travel restrictions are lifted. The focus of travel in the post-COVID-19 world will be one that is based on safety, hygiene with mass gatherings and events unlikely to be allowed in the near term.

Ascott Residence Trust (ART) and Frasers Hospitality Trust (FHT) have bigger exposure to large global domestic markets. Moreover, with the slow re-bloom of domestic travel, hygiene and safety standards will be a top priority for travelers. In this respect, we think lodging assets within the S-REIT space will stand to benefit at the expense of smaller independent, non-branded hotels. Hotels within the S-REIT space primarily consist of quality assets within the premier category of lodging and service provision (above economy status) managed by renowned hotel operators, or are steered towards the longer-stay lodging segments such as service residences where average room stays are usually above one month, either of which will be much preferred by post-pandemic travellers.

In the US, we believe that ARA US Hospitality Trust (AUHT) is best placed to ride this trend given its portfolio of select-service hotels, which cater to the no-frills travel segment. We believe that the REIT remains ahead of peers in the full-service segment which is facing a more challenging reopening due to its operational format. According to STR (December 2020), the percentage of room closed for the full-service hotels are more than double that for select-service and limited-service hotels.

(c) Government-led tourism campaigns to boost tourism spending

Government support should end by 1H21. Most of the hospitality S-REITs have been able to count on the local governments for some support currently when travel is restricted. In Singapore, Australia and even in selected cities in the UK, the hospitality S-REITs have been able to leverage on the government quarantine business where the entire hotel or part of the hotels are blockbooked for quarantine or "stay-home-notice" purposes. While this is expected to taper off somewhat, it is a good source of business in the near term.

Tourism restart in Singapore. Locally, we are well-versed with the SG Re-discover initiative, where S$320 million in credits have been set aside to encourage Singaporeans to spend on attractions, hotel stays and tours, and have been one of the key initiatives boosting domestic staycation demand.

Japan rolled out a similar domestic campaign named "Go To Travel" in late July last year, but has since suspended the campaign two months later as confirmed cases reached a new high. Ironically, the campaign was mocked as the "Go To Hospital" campaign by internet naysayers, which again shows the delicate balance required in the approach to such campaigns.

While the attention of government officials has been much focused on doling out vaccinations currently, tourism campaigns will definitely be within the playing cards towards year-end once nations cross the herd immunity hurdle. Countries with large domestic tourism markets will likely see added incentives by the authorities to spur room demand to support hard-hit domestic travel sectors.

Among the hotel S-REITs, ART and FHT have the largest exposures to domestic markets at 72% and 59% respectively.

Summary of geographic exposures by asset valuation

	Others		Domestic markets				
	Singapore	Rest of Asia	China	Japan	UK/ Europe	US	Australia / New Zealand
Ascott Residence Trust	17%	11%	8%	20%	19%	12%	13%
CDL Hospitality Trust	66%	5%	0%	3%	16%	0%	10%
Frasers Hospitality Trust	36%	6%	0%	9%	18%	0%	32%
Far East Hospitality Trust	100%	0%	0%	0%	0%	0%	0%
ARA US Hospitality Trust	0%	0%	0%	0%	0%	100%	0%
Average exposure	40%	7%	4%	13%	16%	6%	14%

Source: Various companies, DBS Bank

Summary of exposures by key markets and other catalysts we see

	Domestic Markets	Singapore	Others	Key earnings drivers
ARA US Hospitality Trust	100%			• A rebound in operational metrics in 2021. • Lower gearing through asset revaluations or potential fund-raisings to execute on strategic portfolio additions.
Ascott Residence Trust	72%	17%	11%	• Portfolio rejuvenation to add resilience by increasing average length of room stay. • Reopening of hotels (10 temporarily closed as at end December 2020) to add to operating cash flows. • Gearing up for acquisitions (e.g. US multi-family portfolio).
CDL Hospitality Trust	29%	66%	5%	• Singapore hotels and Europe rebound to drive earnings. • Sales proceeds from divestment to contribute as dividend top-up.
Frasers Hospitality Trust	59%	36%	6%	• Stability from Australia and Singapore market (>60% revenue exposure) through government bookings to benefit the REIT in 2021. • Potential asset-recycling activities.
Far East Hospitality Trust	0%	100%	0%	• Near-term staycation business to support revenues in 2021. • Sentosa hotel to potentially turn profitable in 2021-2022.
Average exposure	53%	40%	7%	

Source: Various companies, DBS Bank

How are our hoteliers coping?

Balanced demand drivers. Locally, our hoteliers are balancing between occupancy from government quarantine business, corporate bookings and local staycations (especially on weekends and school holidays). While many hotels that are currently under the Singapore government block booking are operating at full occupancy, these contracts are due to expire between end-1Q21 and 2Q21, although the possibility of an extension is highly likely. Given the stale state of border reopening measures and the suspension of reciprocal green lanes, alternative demand drivers still look lacklustre for the industry. This means that hoteliers will likely remain cost conscious in order to maintain margins and profitability as that demand will continue a slow and steady climb.

Fixed sponsor income continues to be a key pillar of cash flow support. The hospitality S-REITs (ART, FEHT, CDLHT and FHT), can look towards their sponsors (master lessee) for income support (on the fixed rent components) which limits earnings downside. In addition, the government will be extending its financial assistance and grants, such as the Job Support Scheme, by another six months.

What can we expect this year? RevPAR and Occupancy snapshot

	RevPAR			Occupancy			Forward Guidance	Risks
	2020	2019	y-o-y (%)	2020	2019	y-o-y (%)		
ART	59	151	*-61%*	n.a.	n.a.		• Portfolio occupancy increased q-o-q to c.45% this quarter, an indication that the freeze in travel demand in 3Q20 is starting to thaw, and the worse is over. • Maiden acquisition within the student accommodation asset class signals ART's intention to increase the average length of its portfolio stay to add resilience post-COVID, sponsor's US multi-family assets may be acquired in the near future. • Recent portfolio restructuring is on a short lease basis and positions the REIT to improve its operational performance in the coming upcycle in travel demand.	• Headwinds to persist in laggard markets including Europe, Japan and South Korea. • Ten out of ART's 102 properties remain temporarily closed currently and have yet to meet a breakeven level of room demand. • Short-term lease restructuring likely to take a toll on 2021 revenue.

Source: Various companies, DBS Bank

<table>
<tr><th rowspan="2"></th><th colspan="3">RevPAR</th><th colspan="3">Occupancy</th><th rowspan="2">Forward Guidance</th><th rowspan="2">Risks</th></tr>
<tr><th>2020</th><th>2019</th><th>y-o-y (%)</th><th>2020</th><th>2019</th><th>y-o-y (%)</th></tr>
<tr><td>CDLHT</td><td>79</td><td>162</td><td>-51%</td><td>78%</td><td>87%</td><td>-10%</td><td>Potential extension of the government quarantine business in Singapore and New Zealand should support near-term earnings.</td><td>Most of the government quarantine business is expected to taper off from 1Q21 onwards, but we believe there is an opportunity for an extension through 1H21.</td></tr>
<tr><td>FEHT</td><td>71</td><td>142</td><td>-50%</td><td>85%</td><td>89%</td><td>-4%</td><td>Six hotels are currently still on government contracts, which are expected to cease at end-1Q21, although the potential for extension remains high.
Three hotels that are not on government contracts are seeing tapering demand from corporate guests, which is partly neutralised by rising demand from domestic staycations.</td><td>Room supply glut in the market a risk for Singapore Hotels as government contracts fall off sequentially in 2Q21 and may result in suppressed ADRs in the market.</td></tr>
<tr><td>FHT</td><td>159</td><td>251</td><td>-37%</td><td>76%</td><td>87%</td><td>-12%</td><td>Australia and Singapore leading the recovery, steadily improving RevPAR q-o-q.
These two markets make up more than 60% of FHT's portfolio NPI and gross revenue, which should help alleviate the lower-performing markets of UK and Japan.
Singapore hotels Intercontinental and Frasers Suites are prime candidates to capture corporate demand once the MICE engine restarts in Singapore towards end-2021.</td><td>Room supply glut in the market a risk for Singapore Hotels as government contracts fall off sequentially in 2Q21 and may result in suppressed ADRs in the market.</td></tr>
</table>

Source: DBS Bank, Companies

	RevPAR			Occupancy			Forward Guidance	Risks
	2020	2019	y-o-y (%)	2020	2019	y-o-y (%)		
ARAHT	42	94	*-55%*	41%	77%	*-47%*	• ARAHT's portfolio had fully resumed operations in July 2020 since a peak closure in March. • Ramp-up costs incurred in FY20 in the hotel reopenings to maintain the hotels in a ready state for guests during the spring break holiday period (March – April).	• Holiday demand is set to rebound strongly this year which is especially positive for ARAHT's domestic-focused portfolio (c.95% exposure based on FY19 figures). • Gearing for FY20 ended at 48.2%, which is the highest among Singapore-listed peers in the hospitality sector and close to the 50% limit set by MAS.

Source: DBS Bank, Companies

How the balance sheets stack up

Capital values held up better for Singapore assets... On a full-year basis, valuations across the hoteliers fell between 4.4% and 13.5% on a portfolio-wide level. Two key observations made from the valuation reporting are that Singapore hotels generally held up better in terms of capital values in comparison to overseas assets, and long-stay lodging segments saw a smaller dip relative to hotels.

ART's portfolio valuation declined 7% y-o-y led by US assets (-17%), China (-11%) and UK (-11%); markets that have more management contracts are likely due for a reset in cashflow projections from valuers. Valuation for Singapore assets remained flat at -1% y-o-y with capital value holding up better than expected. On a similar note, FHT's Singapore assets (-4.7% y-o-y) held up better in comparison to their overseas peers (-4.7% to -11% y-o-y).

.. and longer-stay lodging segments. FEHT's serviced residences segment declined by only 3.2% y-o-y as opposed to the wider portfolio which declined 4.4% y-o-y. This is attributed to the better underlying performance for the serviced residences (FY20 RevPAR declined 13% to S$159) as opposed to hotels (FY20 RevPAR declined 50% y-o-y to S$71).

Gearing generally within a comfortable range. The average leverage in the sector increased by c.290bps to 40.1% or c.230bps to 38.1% (ex ARA US Hospitality Trust) from September-December 2020. Some of the hoteliers had taken steps to pare down debts in response to an uptick in gearing and thus saw flattish q-o-q leverage despite a general decline in portfolio value.

Based on our sensitivity analysis on the sector prior to a FY20 re-rating in values, the assets have to decline by more than 20% for gearing to trigger the MAS limit of 50%. As written previously, a valuation dip (-4.4% to -13.5% in 2020) is unlikely given (i) the tight cap rates for transactions in Singapore (hotels are transacted at < 3% yield) and (ii) cashflows are not as severely impacted given the government business in 2020.

Sharpest portfolio devaluation given full exposure in US a concern to ARAHT. On the flip side of the coin, capital values for overseas market had been hammered, with US valuations seeing the largest dip. ART reported a 17% contraction in the value of its US assets, while ARAHT's portfolio valuation retreated 13.5% y-o-y. This had taken a toll on ARAHT's balance sheet given its full exposure to the US market and an acquisition made last year that was fully debt-funded.

Gearing for the REIT ended FY20 at 48.2%, among the highest within the broader S-REIT sector and close to the 50% gearing limit set by MAS. We understand that covenant waivers are in place until June 2021 and funding restrictions may be imposed after the expiry of the waivers or when gearing breaches the 50% mark. As such, we think that ARAHT will likely be handicapped in raising additional debt this year and a rebound in valuation will be essential to ease financial fluidity for the REIT come end-2021. This will be much dependent on recovery prospects along the way.

Gearing sensitivity to asset declines (prior full-year valuation numbers)

	Leverage Sep'20	Leverage Dec'20	Portfolio Devaluation (FY20)	Asset Decline -5%	-10%	-15%	-20%	-25%	-30%
ART	36.1%	36.3%	-7.0%	38%	40%	42%	44%	46%	49%
CDLHT	37.1%	37.5%	-5.1%	39%	40%	42%	44%	47%	49%
FEHT	39.2%	40.9%	-4.4%	41%	44%	46%	49%	52%	56%
FHT	35.9%	37.7%	-5.9%	38%	40%	42%	44%	47%	50%
ARAUS	42.5%	48.2%	-13.5%	45%	47%	50%	53%	57%	61%

Source: Companies, DBS Bank

Financial metrics comparison between FY2020 and FY2019

	ART	CDLHT	FEHT	FHT	ARAHT
FY2020					
Gearing	36.30%	37.50%	40.90%	37.70%	48.20%
Average cost of debt (%)	1.8%	1.9%	2.4%	2.3%	3.4%
Interest Cover (x)	2.2	2.2	2.4	2.3	n.a.
Weighted Ave Debt Expiry (yrs)	2.9	2.4	2.3	3.6	3.0
FY2019					
Gearing	33.60%	35.40%	39.20%	35.10%	43.00%
Average cost of debt (%)	2.0%	2.2%	2.9%	2.5%	3.5%
Interest Cover (x)	5.6	6.1	n.a.	4.7	4.5
Weighted Ave Debt Expiry (yrs)	3.4	2.9	3.3	4.6	3.3

Source: Companies, DBS Bank

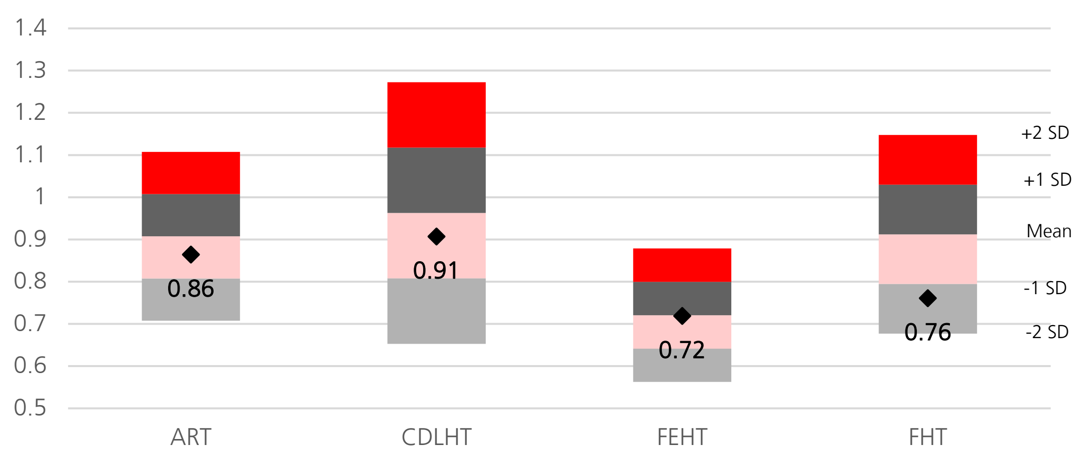
Valuations

Fallen angels no more. Hotels has been no doubt the worst-performing sector in terms of share price since the onset of the pandemic. The hotels are still down 27% in share prices since end-2019, with the US hotel sector (ARAHT) trading at approximately half of pre-COVID levels. Recovery prospects had been priced in to a larger extent for the other sectors, which have recovered to -7% (office), -20% (retail) and -0.5% (industrial) of pre-COVID levels as at end-2019.

Current price-to-NAV hovers around the mean to -1 SD range for the sector and still remains at attractive levels despite the recent round of devaluation. NAV should also trade up once hotel valuations re-rate by end-2021.

Maintain Overweight on sector; ART and CDLHT as our top sector picks. We anticipate the sector to re-rate strongly once domestic travel demand can be ascertained towards year-end. While the sector will likely be repriced as a basket, we prefer Ascott Residence Trust (BUY, TP: S$1.20) and CDL Hospitality Trust (BUY, TP: S$1.35) as our top sector picks by virtue of their diversified portfolio holdings with substantial exposure to large domestic travel markets.

5-year historical P/NAV trading band vs current P/NAV



Source: DBS Bank

DBS Bank recommendations are based on an 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 share price catalysts within this time frame)

**Share price appreciation + dividends*

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Sources for all charts and tables are DBS Bank 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
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
Co. Regn No. 198401015984
(128540-U)

SINGAPORE
DBS Bank Ltd
Contact: Janice Chua
12 Marina Boulevard,
Marina Bay Financial Centre Tower 3
Singapore 018982
Tel: 65 6878 8888
e-mail: groupresearch@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