

DBS Group (DBS SP)

Solid Outlook But Fairly Valued

HOLD

Share Price SGD 30.84
 12m Price Target SGD 30.80 (-0%)
 Previous Price Target SGD 29.66

Growth story intact

The 1Q18 results demonstrate DBS's ability to generate earnings growth in the current business environment. However, following the 24% YTD increase, we find the shares fairly valued on our revised estimates. Reported 1Q18 earnings beat Bloomberg consensus, but were in-line after stripping out a SGD86m gain from the divestment of a Hong Kong property. 1Q18 core PATMI of SGD1.4b (+19.8% QoQ, +18.6% YoY) met our expectation at 22% of our previous FY18E forecast. Because of a higher interest rate outlook, we have lifted our net profit estimates for FY19/20E by 4%/5%, sustainable ROE by 14.7% from 14.3%, but left unchanged our COE at 10.5% and growth 3.5%. As a result, our TP is slightly raised to SGD30.80 based on 1.6x FY18E P/BV (unchanged), close to 2SD above its historical mean of 1.2x to reflect higher ROEs.

Active liability management, NIMs to expand

We raised net interest income by 2-5% for FY18-20E after factoring in a higher SIBOR forecast in FY18/19E of 1.65%/1.90% (from 1.55%/1.75% previously) per our Singapore economist. While interest rates have increased, DBS's funding cost for customer deposits has not significantly widened, reflecting its active liability management. Between 1Q15 and 1Q18, SIBOR/LIBOR/HIBOR increased 63/166/81bps respectively, but DBS's funding cost rose by 5bps. With repricing intervals working their way through and funding costs manageable, we estimate NIMs will expand to 1.85%/1.92%/1.96% for FY18-20E from 1.81%/1.84%/1.88% previously.

Benign credit environment

1Q's SP/loans fell to 20bps (4Q17: 25bps, 1Q17: 26bps). We raised allowances by 4-25% for FY18-20E assuming gradual rate hikes, and estimate credit costs at 17-20bps. We assume a benign credit environment with no significant asset quality deterioration given the improvement in FCF for corporates. For every 10bps increase in credit costs, we estimate net profit during FY18-20E may decline by ~5%.

Maintain HOLD; Shares fairly valued

Maintain HOLD as the shares are fairly valued. However, healthy dividend yields of ~4% should lend support to share price. Key risks to our call: 1) lower revenue; 2) higher costs; and 3) higher allowances.

| FYE Dec (SGD m) | FY16A | FY17A | FY18E | FY19E | FY20E |
|------------------------|--------|--------|--------|--------|--------|
| Operating income | 11,489 | 12,274 | 13,868 | 15,509 | 17,073 |
| Pre-provision profit | 6,517 | 7,069 | 8,250 | 9,880 | 11,170 |
| Core net profit | 4,200 | 4,277 | 6,338 | 7,715 | 8,694 |
| Core EPS (SGD) | 1.6 | 1.7 | 2.5 | 3.0 | 3.4 |
| Core EPS growth (%) | (4.4) | 1.2 | 48.2 | 21.7 | 12.7 |
| Net DPS (SGD) | 0.6 | 1.4 | 1.2 | 1.2 | 1.2 |
| Core P/E (x) | 18.7 | 18.5 | 12.5 | 10.2 | 9.1 |
| P/BV (x) | 1.8 | 1.7 | 1.6 | 1.5 | 1.3 |
| Net dividend yield (%) | 1.9 | 4.6 | 3.9 | 3.9 | 3.9 |
| Book value (SGD) | 17.02 | 17.80 | 19.11 | 20.86 | 22.99 |
| ROAE (%) | 10.2 | 9.7 | 13.4 | 15.1 | 15.5 |
| ROAA (%) | 0.9 | 0.9 | 1.2 | 1.3 | 1.4 |
| Consensus net profit | - | - | 5,830 | 6,585 | 7,143 |
| MKE vs. Consensus (%) | - | - | 10.9 | 17.7 | 22.3 |

Ng Li Hiang

nghiang@maybank-ke.com.sg

(65) 6231 5840

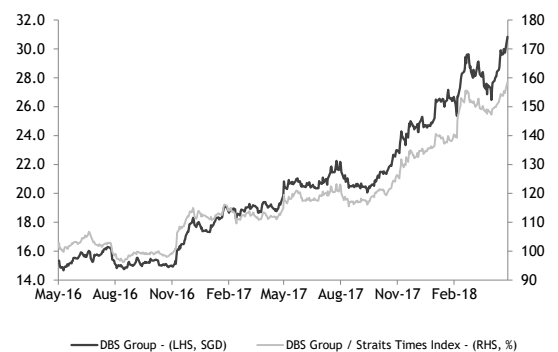
Statistics

| | |
|------------------------|----------------------|
| 52w high/low (SGD) | 30.84/19.86 |
| 3m avg turnover (USDm) | 126.0 |
| Free float (%) | 69.8 |
| Issued shares (m) | 2,479 |
| Market capitalisation | SGD76.5B USD57.3B |

Major shareholders:

| | |
|---------|-------|
| Temasek | 29.0% |
| --- | --- |

Price Performance



| | | | |
|-----------------------|-----|-----|------|
| | -1M | -3M | -12M |
| Absolute (%) | 12 | 16 | 59 |
| Relative to index (%) | 6 | 14 | 40 |

Source: FactSet

Fig 1: Revisions to estimates

| DBS | Revised | | | Previous | | |
|-------------------------|----------|----------|----------|----------|----------|----------|
| | 2018E | 2019E | 2020E | 2018E | 2019E | 2020E |
| (SGD m) | | | | | | |
| Net interest income | 9,210.2 | 10,315.7 | 11,370.9 | 9,021.1 | 9,838.3 | 10,856.6 |
| Non-interest income | 4,571.9* | 5,192.8 | 5,702.0 | 4,737.7 | 5,213.1 | 5,701.9 |
| Total income | 13,782.1 | 15,508.5 | 17,073.0 | 13,758.9 | 15,051.4 | 16,558.6 |
| Expenses | 5,618.1 | 5,628.2 | 5,903.0 | 5,618.1 | 5,628.2 | 5,903.0 |
| Allowances | 567.2 | 684.3 | 821.2 | 455.5 | 590.2 | 786.5 |
| Net profit [^] | 6,337.6 | 7,715.4 | 8,694.4 | 6,427.7 | 7,403.2 | 8,281.9 |
| Revisions (%) | | | | | | |
| Net interest income | 2.1 | 4.9 | 4.7 | | | |
| Non-interest income | (3.5) | (0.4) | 0.0 | | | |
| Total income | 0.2 | 3.0 | 3.1 | | | |
| Expenses | 0.0 | 0.0 | 0.0 | | | |
| Allowances | 24.5 | 15.9 | 4.4 | | | |
| Net profit [^] | (1.4) | 4.2 | 5.0 | | | |

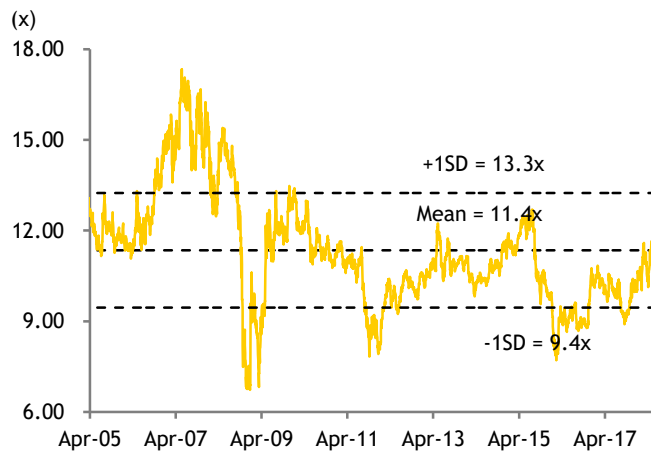
Source: Maybank Kim Eng. [^]Net profit excludes one-offs and preference share dividends. *Excludes a one-off gain of SGD86m from divestment of a Hong Kong property.

Fig 1: Quarterly profit and loss summary

| SGD m (FYE Dec) | 1Q17 (SGD m) | 4Q17 (SGD m) | 1Q18 (SGD m) | QoQ % | YoY % | % of FY | FY18E (SGD m) | Comments |
|------------------------------------|-----------------|-----------------|-----------------|-------------|-------------|-----------|------------------|---|
| Net interest income | 1,831 | 2,097 | 2,128 | 1.5 | 16.2 | 23 | 9,210 | NIM rose 5bps QoQ/9bps YoY to 1.83%. Customer spreads now at 2.09%. |
| Non-interest income | 1,055 | 958 | 1,146 | 19.6 | 8.6 | 25 | 4,572 | Led by higher fee and commission income (+17% QoQ, +12% YoY) and trading income (+61% QoQ, +36% YoY). 1Q18 excludes a one-off gain of SGD86m from the divestment of a Hong Kong property related to the sale of one floor of the asset. |
| Total income | 2,886 | 3,055 | 3,274 | 7.2 | 13.4 | 24 | 13,782 | |
| Less: Overhead expenses | (1,258) | (1,387) | (1,410) | 1.7 | 12.1 | 25 | (5,618) | 1Q17, 4Q17 and 1Q18 include ANZ integration costs of SGD10m, SGD30m and SGD12m, respectively. |
| Pre-provision profit | 1,628 | 1,668 | 1,864 | 11.8 | 14.5 | 23 | 8,164 | |
| Less: Allowances | (200) | (225) | (164) | (27.1) | (18.0) | 29 | (567) | |
| Operating profit | 1,428 | 1,443 | 1,700 | 17.8 | 19.0 | 22 | 7,597 | |
| Associates | - | - | - | n.a. | n.a. | n.a. | - | |
| Pre-tax profit | 1,428 | 1,443 | 1,700 | 17.8 | 19.0 | 22 | 7,597 | |
| Less: Tax | (195) | (224) | (247) | 10.3 | 26.7 | 23 | (1,078) | 1Q17, 4Q17 and 1Q18 exclude tax on one-time items of SGD45m, SGD6m and SGD2m, respectively. |
| Effective tax rate (%) | (13) | (15) | (14) | | | | (14) | |
| Profit after tax | 1,233 | 1,219 | 1,453 | 19.2 | 17.8 | 22 | 6,519 | |
| Minorities | (33) | (31) | (30) | (3.2) | (9.1) | 21 | (144) | |
| Core net profit[^] | 1,200 | 1,188 | 1,423 | 19.8 | 18.6 | 22 | 6,376 | It met 22% of our previous FY18E forecast. |

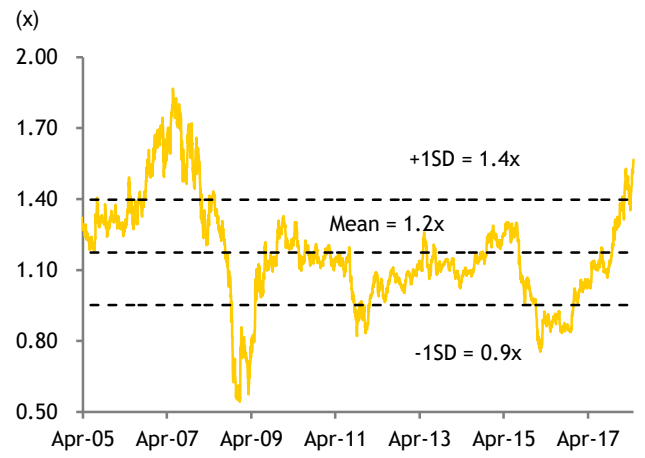
Source: Company, Maybank Kim Eng. [^]Net profit excludes one-offs.

Fig 2: DBS's 12M forward rolling PER band



Source: Bloomberg, Maybank Kim Eng

Fig 3: DBS's 12M forward rolling P/BV band

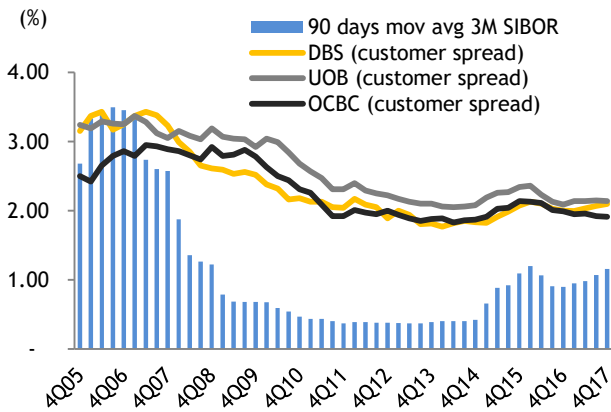


Source: Bloomberg, Maybank Kim Eng

Value Proposition

- Largest Singapore bank by assets, with strength in large corporate loans. Over 50% market share of SGD CASA deposits explains its low funding costs.
- Most aggressive of the three in regional expansion and wealth management; Helps strengthen market leadership.
- Trade loans, especially China-related, important in recent times. A 67% decline since Jun 2014 necessitates a switch to alternative sources of growth.
- Asset quality concerns on O&G exposure eased. Largest exposure of the three to O&G upstream/support services segment, at 3% of loans.

DBS's customer spreads at 2.09% in 1Q18

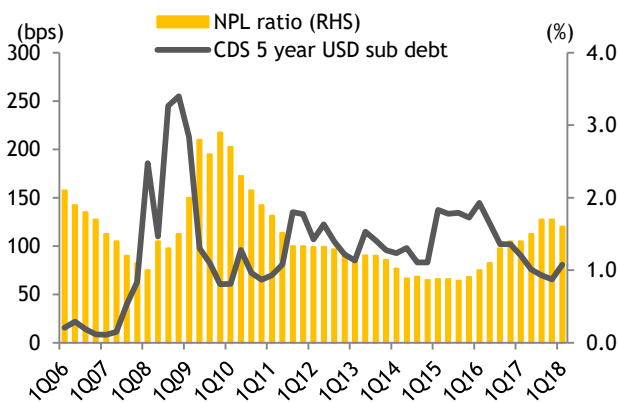


Source: Bloomberg, Companies

Financial Metrics

- Asset quality: Group NPL ratio at 1.6% in 1Q18.
- Fully-loaded CET1 ratio at 14% in 1Q18. With comfort level at 12.5%, there is scope for capital management and dividend upside.
- Expect -9% loan growth for FY18-20E.
- Expect NIMs to be 1.85%/1.92%/1.96% for FY18/19/20E.
- We forecast FY18/19/20E ROEs at ~13-15%.
- Cost of capital bears watching for the sector. Contagion risks may be reflected in corporate papers or CDS.

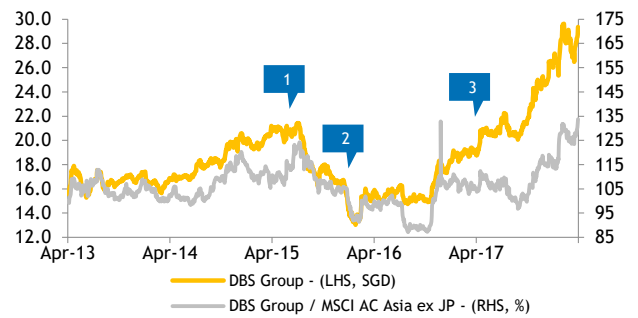
NPL ratio tracked CDS spreads after a 1-year lag during GFC



Source: Bloomberg, Company

Price Drivers

Historical share price



Source: FactSet, Maybank Kim Eng

1. Record earnings with robust lending and stable asset quality following strong 1Q15, despite declining trade loans.
2. Sharp CNY devaluation in August. O&G, commodities and China's NPL worries.
3. Share price rallied on positive sentiment from expectation of Fed rate hike, USD strength and oil.

Swing Factors

Upside

- Ability to reprice loans at higher interest rates and lower costs of funding from large pool of CASA deposits.
- Higher non-interest income from wealth-management and Manulife bancassurance businesses.
- Sharp and sustained rebound in commodity prices.
- Asset quality better than expected with no major credit slippages and proactive loan restructuring.
- Higher demand for domestic mortgages from easing of cooling measures.
- Translation benefits from appreciation of USD/HKD.

Downside

- Highest asset-quality risks from exposure to North and South Asia and O&G sector.
- Sharp decline in the value of securities and shocks in fixed-income portfolio.
- Job losses in Singapore become pervasive, hurting mortgage portfolio.
- Lack of liquidity of a funding currency.
- Emergence of dominant financial competitor in Singapore.
- Capital-raising by peers.

| FYE 31 Dec | FY16A | FY17A | FY18E | FY19E | FY20E |
|---------------------------------------|------------------|------------------|------------------|------------------|------------------|
| Key Metrics | | | | | |
| Core P/E (x) | 18.7 | 18.5 | 12.5 | 10.2 | 9.1 |
| Core FD P/E (x) | 18.7 | 18.5 | 12.5 | 10.2 | 9.1 |
| P/BV (x) | 1.8 | 1.7 | 1.6 | 1.5 | 1.3 |
| P/NTA (x) | 2.1 | 2.0 | 1.8 | 1.6 | 1.5 |
| Net dividend yield (%) | 1.9 | 4.6 | 3.9 | 3.9 | 3.9 |
| INCOME STATEMENT (SGD m) | | | | | |
| Interest income | 9,748.0 | 10,833.0 | 13,063.3 | 14,863.5 | 16,689.0 |
| Interest expense | (2,443.0) | (3,042.0) | (3,853.0) | (4,547.8) | (5,318.0) |
| Net interest income | 7,305.0 | 7,791.0 | 9,210.2 | 10,315.7 | 11,370.9 |
| Net insurance income | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net fees and commission | 2,331.0 | 2,622.0 | 3,176.3 | 3,615.9 | 4,023.3 |
| Other income | 1,853.0 | 1,861.0 | 1,481.6 | 1,577.0 | 1,678.8 |
| Total non-interest income | 4,184.0 | 4,483.0 | 4,657.9 | 5,192.8 | 5,702.0 |
| Operating income | 11,489.0 | 12,274.0 | 13,868.1 | 15,508.5 | 17,073.0 |
| Staff costs | (2,725.0) | (2,825.0) | (2,915.7) | (3,030.9) | (3,150.6) |
| Other operating expenses | (2,247.0) | (2,380.0) | (2,702.3) | (2,597.4) | (2,752.4) |
| Operating expenses | (4,972.0) | (5,205.0) | (5,618.1) | (5,628.2) | (5,903.0) |
| Pre-provision profit | 6,517.0 | 7,069.0 | 8,250.1 | 9,880.3 | 11,170.0 |
| Loan impairment allowances | (1,434.0) | (1,894.0) | (567.2) | (684.3) | (821.2) |
| Other allowances | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Associates & JV income | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pretax profit | 5,083.0 | 5,175.0 | 7,682.8 | 9,196.0 | 10,348.8 |
| Income tax | (723.0) | (671.0) | (1,075.6) | (1,287.4) | (1,448.8) |
| Minorities | (122.0) | (133.0) | (143.6) | (155.1) | (167.5) |
| Discontinued operations | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported net profit | 4,238.0 | 4,371.0 | 6,463.6 | 7,753.4 | 8,732.4 |
| Core net profit | 4,200.0 | 4,277.0 | 6,337.6 | 7,715.4 | 8,694.4 |
| Preferred Dividends | 38.0 | 38.0 | 38.0 | 38.0 | 38.0 |
| BALANCE SHEET (SGD m) | | | | | |
| Cash & deposits with banks | 30,018.0 | 35,975.0 | 36,874.4 | 37,796.2 | 38,741.1 |
| Sec. under resale agreements | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Derivatives financial assets | 25,757.0 | 17,585.0 | 17,936.7 | 18,295.4 | 18,661.3 |
| Dealing securities | 10,020.3 | 11,925.9 | 12,522.2 | 13,148.3 | 13,805.7 |
| Available-for-sale securities | 23,380.7 | 27,827.1 | 29,218.5 | 30,679.4 | 32,213.3 |
| Investment securities | 45,417.0 | 55,589.0 | 58,368.5 | 61,286.9 | 64,351.2 |
| Loans & advances | 301,516.0 | 323,099.0 | 351,790.2 | 382,255.2 | 417,957.9 |
| Central bank deposits | 26,840.0 | 26,463.0 | 28,335.7 | 30,585.5 | 38,310.5 |
| Investment in associates/JVs | 890.0 | 783.0 | 783.0 | 783.0 | 783.0 |
| Insurance assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Fixed assets | 1,572.0 | 1,233.0 | 1,245.3 | 1,257.8 | 1,270.4 |
| Intangible assets | 5,117.0 | 5,165.0 | 5,165.0 | 5,165.0 | 5,165.0 |
| Other assets | 11,042.0 | 12,066.0 | 12,246.8 | 12,604.5 | 13,105.0 |
| Total assets | 481,570.0 | 517,711.0 | 554,486.2 | 593,857.2 | 644,364.5 |
| Deposits from customers | 347,446.0 | 373,634.0 | 404,795.1 | 436,935.8 | 478,881.6 |
| Deposits from banks & FIs | 15,915.0 | 17,803.0 | 18,693.2 | 20,001.7 | 21,601.8 |
| Derivatives financial instruments | 24,497.0 | 18,003.0 | 18,543.1 | 19,099.4 | 19,672.4 |
| Subordinated debt | 3,102.0 | 1,138.0 | 1,138.0 | 1,138.0 | 1,138.0 |
| Other securities in issue | 27,745.0 | 40,716.0 | 40,716.0 | 40,716.0 | 40,716.0 |
| Other borrowings | 4,115.0 | 3,773.0 | 3,058.1 | 3,120.4 | 3,185.9 |
| Insurance liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other liabilities | 13,592.0 | 14,654.0 | 16,189.5 | 16,988.5 | 17,827.0 |
| Total liabilities | 436,412.0 | 469,721.0 | 503,133.0 | 537,999.8 | 583,022.6 |
| Share capital | 2,549.0 | 2,563.9 | 2,563.9 | 2,563.9 | 2,563.9 |
| Reserves | 40,248.0 | 43,082.1 | 46,430.9 | 50,919.7 | 56,387.3 |
| Shareholders' funds | 42,797.0 | 45,646.0 | 48,994.9 | 53,483.6 | 58,951.3 |
| Preference shares | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Minority interest | 2,361.0 | 2,344.0 | 2,358.4 | 2,373.9 | 2,390.6 |
| Total equity | 45,158.0 | 47,990.0 | 51,353.2 | 55,857.5 | 61,341.9 |
| Total liabilities & equity | 481,570.0 | 517,711.0 | 554,486.2 | 593,857.2 | 644,364.5 |

| FYE 31 Dec | FY16A | FY17A | FY18E | FY19E | FY20E |
|------------------------------|-------|-------|-------|-------|-------|
| Key Ratios | | | | | |
| Growth (%) | | | | | |
| Net interest income | 2.9 | 6.7 | 18.2 | 12.0 | 10.2 |
| Non-interest income | 9.4 | 7.1 | 3.9 | 11.5 | 9.8 |
| Operating expenses | 1.5 | 4.7 | 7.9 | 0.2 | 4.9 |
| Pre-provision profit | 8.2 | 8.5 | 16.7 | 19.8 | 13.1 |
| Core net profit | (1.9) | 1.8 | 48.2 | 21.7 | 12.7 |
| Gross loans | 6.5 | 7.3 | 8.8 | 8.6 | 9.3 |
| Customer deposits | 8.5 | 7.5 | 8.3 | 7.9 | 9.6 |
| Total assets | 5.2 | 7.5 | 7.1 | 7.1 | 8.5 |
| Profitability (%) | | | | | |
| Non-int. income/Total income | 36.4 | 36.5 | 33.6 | 33.5 | 33.4 |
| Average lending yields | 2.40 | 2.43 | 2.62 | 2.77 | 2.87 |
| Average cost of funds | 0.65 | 0.74 | 0.85 | 0.94 | 1.02 |
| Net interest margin | 1.80 | 1.75 | 1.85 | 1.92 | 1.96 |
| Cost/income | 43.3 | 42.4 | 40.5 | 36.3 | 34.6 |
| Liquidity (%) | | | | | |
| Loans/customer deposits | 86.8 | 86.5 | 86.9 | 87.5 | 87.3 |
| Asset quality (%) | | | | | |
| Net NPL | 1.6 | 1.9 | 1.3 | 1.4 | 1.5 |
| Gross NPL | 1.6 | 1.9 | 1.3 | 1.4 | 1.5 |
| (SP+GP)/average gross loans | 0.3 | 0.5 | 0.2 | 0.2 | 0.2 |
| Loan loss coverage | 96.9 | 84.7 | 115.7 | 93.9 | 82.4 |
| Capital adequacy (%) | | | | | |
| CET1 | 14.1 | 14.3 | 13.5 | 13.7 | 14.0 |
| Tier 1 capital | 14.7 | 15.1 | 14.2 | 14.4 | 14.6 |
| Risk-weighted capital | 16.2 | 15.9 | 15.0 | 15.1 | 15.4 |
| Returns (%) | | | | | |
| ROAE | 10.2 | 9.7 | 13.4 | 15.1 | 15.5 |
| ROAA | 0.9 | 0.9 | 1.2 | 1.3 | 1.4 |
| Shareholders equity/assets | 8.9 | 8.8 | 8.8 | 9.0 | 9.1 |

Source: Company; Maybank

Research Offices

REGIONAL

Sadiq CURRIMBHOY
Regional Head, Research & Economics
(65) 6231 5836
sadiq@maybank-ke.com.sg

WONG Chew Hann, CA
Regional Head of Institutional Research
(603) 2297 8686
wchewh@maybank-ib.com

ONG Seng Yeow
Regional Head of Retail Research
(65) 6231 5839
ongsengyeow@maybank-ke.com.sg

TAN Sin Mui
Director of Research
(65) 6231 5849
sinmui@kimeng.com.hk

ECONOMICS

Suhaimi ILIAS
Chief Economist
Malaysia | Philippines | China
(603) 2297 8682
suhaimi_ilias@maybank-ib.com

CHUA Hak Bin
Regional Thematic Macroeconomist
(65) 6231 5830
chuahb@maybank-ke.com.sg

LEE Ju Ye
Singapore
(65) 6231 5844
leejuy@maybank-ke.com.sg

Dr Zamros DZULKAFLI
(603) 2282 6818
zamros.d@maybank-ib.com

Ramesh LANKANATHAN
(603) 2297 8685
ramesh.l@maybank-ib.com

FX

Saktiandi SUPAAT
Head, FX Research
(65) 6320 1379
saktiandi@maybank.com.sg

Christopher WONG
(65) 6320 1347
wongkl@maybank.com.sg

Leslie TANG
(65) 6320 1378
leslietang@maybank.com.sg

Fiona LIM
(65) 6320 1374
fionalim@maybank.com.sg

STRATEGY

Sadiq CURRIMBHOY
Global Strategist
(65) 6231 5836
sadiq@maybank-ke.com.sg

Willie CHAN
Hong Kong / Regional
(852) 2268 0631
williechan@kimeng.com.hk

FIXED INCOME

Winson Phoon, ACA
(65) 6231 5831
winsonphoon@maybank-ke.com.sg

Se Tho Mun Yi
(603) 2074 7606
munyi.st@maybank-ib.com

MALAYSIA

WONG Chew Hann, CA *Head of Research*
(603) 2297 8686 wchewh@maybank-ib.com
• Strategy

Desmond CH'NG, ACA
(603) 2297 8680
desmond.chng@maybank-ib.com
• Banking & Finance

LIAW Thong Jung
(603) 2297 8688 tjliaw@maybank-ib.com
• Oil & Gas Services- Regional

ONG Chee Ting, CA
(603) 2297 8678 ct.ong@maybank-ib.com
• Plantations - Regional

Mohshin AZIZ
(603) 2297 8692 mohshin.aziz@maybank-ib.com
• Aviation - Regional • Petrochem

YIN Shao Yang, CPA
(603) 2297 8916 samuel.y@maybank-ib.com
• Gaming - Regional • Media

TAN Chi Wei, CFA
(603) 2297 8690 chiwei.t@maybank-ib.com
• Power • Telcos

WONG Wei Sum, CFA
(603) 2297 8679 weisum@maybank-ib.com
• Property

LEE Yen Ling
(603) 2297 8691 lee.yl@maybank-ib.com
• Building Materials • Glove • Ports • Shipping

Ivan YAP
(603) 2297 8612 ivan.yap@maybank-ib.com
• Automotive • Semiconductor • Technology

Kevin WONG
(603) 2082 6824 kevin.wong@maybank-ib.com
• REITs • Consumer Discretionary

LIEW Wei Han
(603) 2297 8676 weihan.l@maybank-ib.com
• Consumer Staples

Adrian WONG
(603) 2297 8675 adrian.wkj@maybank-ib.com
• Constructions • Healthcare

Jade TAM
(603) 2297 8687 jade.tam@maybank-ib.com
• Media • Building Materials

Mohd Hafiz Hassan
(603) 2082 6819 mohdhafiz.ha@maybank-ib.com
• Small & Mid Caps

TEE Sze Chiah *Head of Retail Research*
(603) 2082 6858 szechiah.t@maybank-ib.com

Nik Ihsan Raja Abdullah, MSTA, Cfte
(603) 2297 8694
nikmohdihsan.ra@maybank-ib.com

SINGAPORE

Neel SINHA *Head of Research*
(65) 6231 5838 neelsinha@maybank-ke.com.sg
• Strategy
• SMID Caps - Regional

CHUA Su Tye
(65) 6231 5842 chuasutye@maybank-ke.com.sg
• REITs

Derrick HENG, CFA
(65) 6231 5843 derrickheng@maybank-ke.com.sg
• Property • REITs (Office)

Luis HILADO
(65) 6231 5848 luishilado@maybank-ke.com.sg
• Telcos

John CHEONG, CFA
(65) 6231 5845 johncheong@maybank-ke.com.sg
• Small & Mid Caps • Healthcare • Transport

NG Li Hiang
(65) 6231 5840 nglihiang@maybank-ke.com.sg
• Banks

LAI Gene Lih
(65) 6231 5832 laigenetih@maybank-ke.com.sg
• Technology

HONG KONG / CHINA

Christopher WONG
(852) 2268 0652
christopherwong@kimeng.com.hk
• HK & China Properties

Jacqueline KO, CFA
(852) 2268 0633 jacquelineko@kimeng.com.hk
• Consumer Staples & Durables

Ka Leong LO, CFA
(852) 2268 0630 kll@kimeng.com.hk
• Consumer Discretionary & Auto

Mitchell KIM
(852) 2268 0634 mitchellkim@kimeng.com.hk
• Internet & Telcos

Ricky NG, CFA
(852) 2268 0689 rickyng@kimeng.com.hk
• Regional Renewables
• HK & China Properties

Sonija LI, CFA, FRM
(852) 2268 0641 sonijali@kimeng.com.hk
• Gaming

Stefan CHANG, CFA
(852) 2268 0675 stefanchang@kimeng.com.hk
• Technology - Regional

Tony REN, CFA
(852) 2268 0640 tonnyren@kimeng.com.hk
• Healthcare & Pharmaceutical

INDIA

Jigar SHAH *Head of Research*
(91) 22 6623 2632 jigar@maybank-ke.co.in
• Strategy • Oil & Gas • Automobile • Cement

Vishal MODI
(91) 22 6623 2607 vishal@maybank-ke.co.in
• Banking & Financials

Neerav DALAL
(91) 22 6623 2606 neerav@maybank-ke.co.in
• Software Technology • Telcos

Vishal PERIWAL
(91) 22 6623 2605 vishalperiwa@maybank-ke.co.in
• Infrastructure

INDONESIA

Isnaputra ISKANDAR *Head of Research*
(62) 21 8066 8680
isnaputra.iskandar@maybank-ke.co.id
• Strategy • Metals & Mining • Cement

Rahmi MARINA
(62) 21 8066 8689
rahmi.marina@maybank-ke.co.id
• Banking & Finance

Aurellia SETIABUDI
(62) 21 8066 8691
aurellia.setiabudi@maybank-ke.co.id
• Property

Janni ASMAN
(62) 21 8066 8687
janni.asman@maybank-ke.co.id
• Cigarette • Healthcare • Retail

PHILIPPINES

Minda OLONAN *Head of Research*
(63) 2 849 8840
minda_olonan@maybank-atrke.com
• Strategy

Katherine TAN
(63) 2 849 8843
kat_tan@maybank-atrke.com
• Banks • Construction

Luis HILADO
(65) 6231 5848 luishilado@maybank-ke.com.sg
• Telcos

Romel LIBO-ON
(63) 2 849 8844
romel_libo-on@maybank-atrke.com
• Property

THAILAND

Maria LAPIZ *Head of Institutional Research*
Dir (66) 2257 0250 | (66) 2658 6300 ext 1399
Maria.L@maybank-ke.co.th
• Strategy • Consumer • Materials • Property/Ind. Estates • Oil & Gas • Telcos

Tanawat RUENBANTERNG
(66) 2658 6300 ext 1394
Tanawat.R@maybank-ke.co.th
• Banks & Diversified Financials

Ornmongkol TANTITANATORN
(66) 2658 6300 ext 1395
ormmongkol.t@maybank-ke.co.th
• Oil & Gas

Sukit UDOMSIRIKUL *Head of Retail Research*
(66) 2658 5000 ext 5090
Sukit.u@maybank-ke.co.th

Ekachai TARAPORN TIP *Deputy Head*
(66) 2658 5000 ext 1530
Ekachai.t@maybank-ke.co.th

Surachai PRAMUALCHAROENKIT
(852) 2268 0641 surachai.p@maybank-ke.co.th
• Auto • Conmat • Contractor • Steel

Suttatip PEERASUB
(66) 2658 5000 ext 1430
suttatip.p@maybank-ke.co.th
• Media • Commerce

Sutthichai KUMWORACHAI
(66) 2658 5000 ext 1400
sutthichai.k@maybank-ke.co.th
• Energy • Petrochem

Termporn TANTIVIVAT
(66) 2658 5000 ext 1520
termporn.t@maybank-ke.co.th
• Property

Jaroontan WATTANAWONG
(66) 2658 5000 ext 1404
jaroontan.w@maybank-ke.co.th
• Transportation • Small cap

Sorabhol VIRAMETEEKUL *Head of Digital Research*
(66) 2658 5000 ext 1550
sorabhol.v@maybank-ke.co.th
• Food, Transportation

Wijit ARAYAPISIT
(66) 2658 5000 ext 1450
wijit.a@maybank-ke.co.th
• Strategist

VIETNAM

LE Hong Lien, ACCA
Head of Institutional Research
(84 28) 44 555 888 x 8181
lien.le@maybank-kimeng.com.vn
• Strategy • Consumer • Diversified

THAI Quang Trung, CFA,
Deputy Head, Institutional Research
(84 28) 44 555 888 x 8180
trung.thai@maybank-kimeng.com.vn
• Real Estate • Construction • Materials

LE Nguyen Nhat Chuyen
(84 28) 44 555 888 x 8082
chuyen.le@maybank-kimeng.com.vn
• Oil & Gas

NGUYEN Thi Ngan Tuyen,
Head of Retail Research
(84 28) 44 555 888 x 8081
tuyen.nguyen@maybank-kimeng.com.vn
• Food & Beverage • Oil & Gas • Banking

TRUONG Quang Binh,
Deputy Head, Retail Research
(84 28) 44 555 888 x 8087
binh.truong@maybank-kimeng.com.vn
• Rubber Plantation • Tyres & Tubes • Oil & Gas

TRINH Thi Ngoc Diep
(84 28) 44 555 888 x 8208
diep.trinh@maybank-kimeng.com.vn
• Technology • Utilities • Construction

NGUYEN Thi Sony Tra Mi
(84 28) 44 555 888 x 8084
mi.nguyen@maybank-kimeng.com.vn
• Port Operation • Pharmaceutical
• Food & Beverage

NGUYEN Thanh Lam
(84 28) 44 555 888 x 8086
thanhlam.nguyen@maybank-kimeng.com.vn
• Technical Analysis

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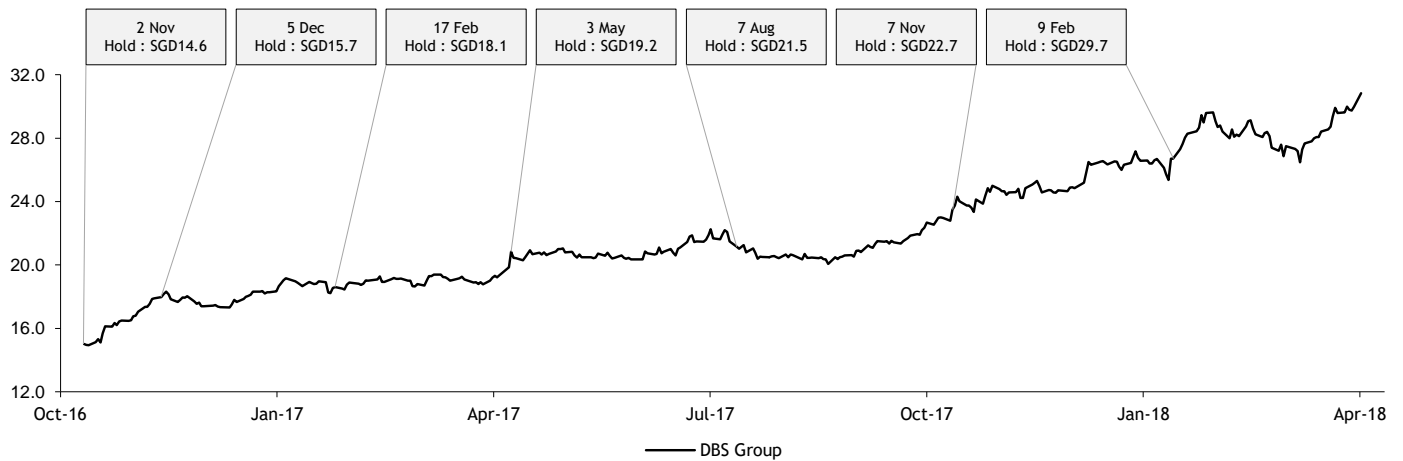
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Malaysia

Maybank Investment Bank Berhad
(A Participating Organisation of
Bursa Malaysia Securities Berhad)
33rd Floor, Menara Maybank,
100 Jalan Tun Perak,
50050 Kuala Lumpur
Tel: (603) 2059 1888;
Fax: (603) 2078 4194

Stockbroking Business:
Level 8, Tower C, Dataran Maybank,
No.1, Jalan Maarof
59000 Kuala Lumpur
Tel: (603) 2297 8888
Fax: (603) 2282 5136


Philippines

Maybank ATR Kim Eng Securities Inc.
17/F, Tower One & Exchange Plaza
Ayala Triangle, Ayala Avenue
Makati City, Philippines 1200

Tel: (63) 2 849 8888
Fax: (63) 2 848 5738


South Asia Sales Trading

Kevin Foy
Regional Head Sales Trading
kevinfoy@maybank-ke.com.sg
Tel: (65) 6636-3620
US Toll Free: 1-866-406-7447

Malaysia

Joann Lim
joann.lim@maybank-ib.com
Tel: (603) 2717 5166

Indonesia

Hariato Liong
harianto.liong@maybank-ke.co.id
Tel: (62) 21 2557 1177

New York

James Lynch
jlynch@maybank-keusa.com
Tel: (212) 688 8886

Vietnam

Patrick Mitchell
patrick.mitchell@maybank-kimeng.com.vn
Tel: (84)-8-44-555-888 x8080


Singapore

Maybank Kim Eng Securities Pte Ltd
Maybank Kim Eng Research Pte Ltd
50 North Canal Road
Singapore 059304

Tel: (65) 6336 9090


Hong Kong

Kim Eng Securities (HK) Ltd
28/F, Lee Garden Three,
1 Sunning Road, Causeway Bay,
Hong Kong

Tel: (852) 2268 0800
Fax: (852) 2877 0104


Thailand

Maybank Kim Eng Securities
(Thailand) Public Company Limited
999/9 The Offices at Central World,
20th - 21st Floor,
Rama 1 Road Pathumwan,
Bangkok 10330, Thailand

Tel: (66) 2 658 6817 (sales)
Tel: (66) 2 658 6801 (research)


North Asia Sales Trading

Andrew Lee
andrewlee@kimeng.com.hk
Tel: (852) 2268 0283
US Toll Free: 1 877 837 7635

Thailand

Tanasak Krishnasreni
Tanasak.K@maybank-ke.co.th
Tel: (66)2 658 6820

London

Mark Howe
mhowe@maybank-ke.co.uk
Tel: (44) 207-332-0221

India

Sanjay Makhija
sanjaymakhija@maybank-ke.co.in
Tel: (91)-22-6623-2629

Philippines

Keith Roy
keith_roy@maybank-atrke.com
Tel: (63) 2 848-5288


London

Maybank Kim Eng Securities
(London) Ltd
PNB House
77 Queen Victoria Street
London EC4V 4AY, UK

Tel: (44) 20 7332 0221
Fax: (44) 20 7332 0302


Indonesia

PT Maybank Kim Eng Securities
Sentral Senayan III, 22nd Floor
Jl. Asia Afrika No. 8
Gelora Bung Karno, Senayan
Jakarta 10270, Indonesia

Tel: (62) 21 2557 1188
Fax: (62) 21 2557 1189


Vietnam

Maybank Kim Eng Securities Limited
4A-15+16 Floor Vincom Center Dong
Khoi, 72 Le Thanh Ton St. District 1
Ho Chi Minh City, Vietnam

Tel : (84) 844 555 888
Fax : (84) 8 38 271 030


New York

Maybank Kim Eng Securities USA
Inc
400 Park Avenue, 11th Floor
New York, New York 10022,
U.S.A.

Tel: (212) 688 8886
Fax: (212) 688 3500


India

Kim Eng Securities India Pvt Ltd
2nd Floor, The International,
16, Maharishi Karve Road,
Churchgate Station,
Mumbai City - 400 020, India

Tel: (91) 22 6623 2600
Fax: (91) 22 6623 2604


Saudi Arabia

In association with
Anfaal Capital
Villa 47, Tujjar Jeddah
Prince Mohammed bin Abdulaziz
Street P.O. Box 126575
Jeddah 21352

Tel: (966) 2 6068686
Fax: (966) 26068787