

NetLink Trust (NETLINK SP)

Post-Initiation FAQ

Resistant to operational risks; maintain BUY.

Following our recent *initiation* of NetLink, we summarise key issues raised by investors and maintain our positive view on its underlying defensive business. We believe our forecast of a 95% fibre connection penetration rate by FY21E is viable and that 5G is more likely an opportunity than threat. Maintain our DDM-based (COE of 6%, LTG 0%) TP of SGD0.93 and BUY. Any challenge to its current level of regulated returns is the main risk to our outlook.

Fibre the only way to go

With 82% of fixed-broadband subscribers on fibre vs a 95% fixed-broadband household penetration, a critical element of our forecasts is the migration of all fixed broadband to fibre. We note that Singtel and StarHub have stopped marketing their non-fibre broadband services; with the latter announcing the end of further cable-based deployment in Apr 2018. Some 97% of Singtel's fixed-broadband subscribers were on fibre as of June. The rest will likely migrate by year-end. Essentially, as subscribers' contracts end, typically after two years, the option for faster fibre at similar pricing should make the shift enticing and likely.

5G more opportunity than threat?

We believe 5G in its current form in Singapore is not a major threat to fibre-broadband demand. Given pervasive fixed-broadband and WiFi availability, telco incumbents are not as keen on the fixed-wireless-substitute attributes of 5G, unlike other fixed-broadband-challenged countries. In our initiation report (p 10), we discussed a scenario of NetLink becoming a 5G champion, as it has for fixed broadband. In this scenario, there is upside to capex that provides guaranteed returns.

Interest rates' short- & long-term implications

We acknowledge that higher interest rates could dampen NetLink's relative yield attractiveness. However, if such an environment is prolonged into its mid-period and end-period regulatory review, it creates the possibility of an upward revision in its current 7% pretax WACC-regulated return.

FYE Mar (SGD m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	299	229	335	359	382
EBITDA	223	166	236	254	270
Core net profit	79	50	70	81	94
Core EPS (cts)	2.0	1.3	1.8	2.1	2.4
Core EPS growth (%)	97.0	(35.7)	40.2	16.4	15.7
Net DPS (cts)	0.0	3.2	4.6	4.8	5.1
Core P/E (x)	na	63.7	43.7	37.6	32.5
P/BV (x)	na	1.0	1.0	1.0	1.1
Net dividend yield (%)	na	4.0	5.9	6.1	6.6
ROAE (%)	2.6	1.6	2.2	2.7	3.2
ROAA (%)	1.9	1.2	1.6	1.9	2.2
EV/EBITDA (x)	15.9	21.6	14.9	13.9	13.1
Net gearing (%) (incl perps)	16.0	13.3	15.3	16.1	16.9
Consensus net profit	-	-	72	81	92
MKE vs. Consensus (%)	-	-	(2.6)	0.5	2.5

Luis Hilado
luishilado@maybank-ke.com.sg
(65) 6231 5848

BUY

Share Price	SGD 0.79
12m Price Target	SGD 0.93 (+18%)
Previous Price Target	SGD 0.93

Company Description

NetLink NBN Trust designs, builds, owns and operates the passive fibre network infrastructure of Singapore's Next Gen NBN.

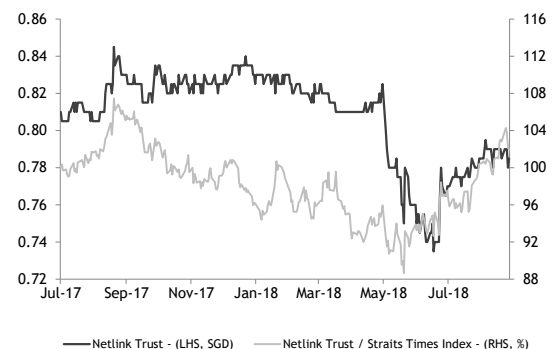
Statistics

52w high/low (SGD)	0.84/0.74
3m avg turnover (USDm)	3.0
Free float (%)	74.3
Issued shares (m)	3,897
Market capitalisation	SGD3.1B
	USD2.2B

Major shareholders:

Singapore Telecommunications Ltd.	24.8%
Veritas Asset Management LLP	1.9%
The Vanguard Group, Inc.	1.8%

Price Performance



	-1M	-3M	-12M
Absolute (%)	1	3	(5)
Relative to index (%)	3	10	(4)

Source: FactSet

Companies mentioned:

Singtel - ST SP, SGD3.15, HOLD, TP SGD3.46
StarHub - STH SP, SGD1.65. BUY, TP SGD1.96

Fig 1: Sensitivity analysis: residential is a significant driver

Variable	FY19E	FY20E	FY21E
5% Change in residential rev			
Revenue	3.1%	3.2%	3.2%
EBITDA	3.6%	11.2%	3.6%
Core profit	13.5%	11.9%	10.9%
TP (SGD / unit)	5.4%		
5% Change in non-residential rev			
Revenue	0.5%	0.5%	0.5%
EBITDA	0.5%	7.9%	0.6%
Core profit	2.0%	1.8%	1.7%
TP (SGD / unit)	1.0%		
5% Change in NBAP/segment rev			
Revenue	0.1%	0.1%	0.1%
EBITDA	0.1%	7.5%	0.2%
Core profit	0.5%	0.6%	0.5%
TP (SGD / unit)	0.3%		
5% Change in manholes/ducts rev			
Revenue	0.5%	1.0%	1.0%
EBITDA	0.6%	8.6%	1.1%
Core profit	2.2%	3.8%	3.3%
TP (SGD / unit)	1.5%		

Source: Company data, Maybank Kim Eng

Fig 2: MKE is in line with consensus

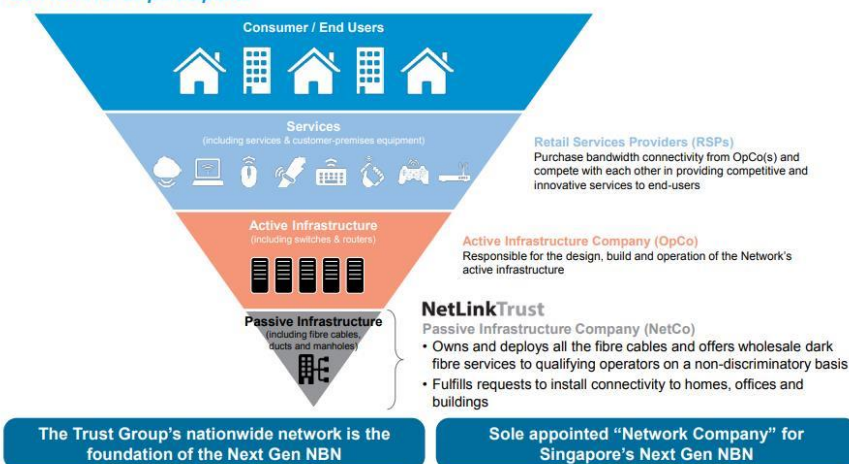
(end-Mar, SGD m)	FY19E	FY20E	FY21E
Revenue (MKE)	335	359	382
EBITDA (MKE)	236	254	270
Core profit (MKE)	70	81	94
TP (SGD / unit)	0.93		
Revenue (cons)	342	360	373
EBITDA (cons)	244	258	270
Core profit (cons)	72	81	92
TP (SGD / unit)	0.90		
MKE vs cons (Revenue)	-2.1%	-0.2%	2.2%
MKE vs cons (EBITDA)	-3.1%	-1.6%	-0.3%
MKE vs cons (core profit)	-2.6%	0.5%	2.5%
MKE vs cons (TP)	2.2%		

Source: Company data, Maybank Kim Eng, Factset

Fig 3: Fibre broadband food chain

Next Gen NBN industry structure

The Next Gen NBN industry comprises three distinct layers to ensure open access to the Next Gen NBN for all participants

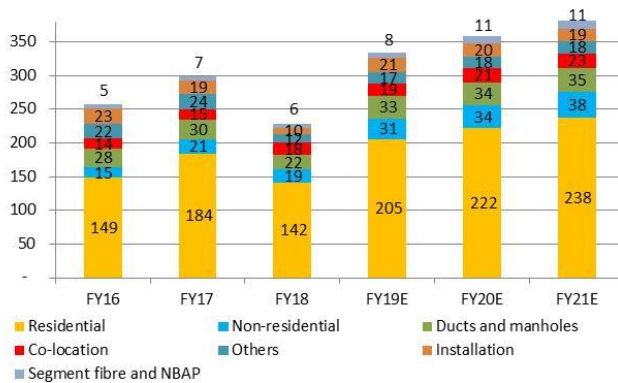


Source: Company data

Value Proposition

- NetLink operates the sole passive backbone for the nationwide fibre network of Singapore with a mandated 100% of homes passed.
- With this virtual monopoly position, more than 90% of revenues fall under a return on asset base (RAB) tariff regime based on a 7% pre-tax WACC. Tariffs are set over a five-year period with current rates set until Dec 2022.
- Residential connection revenue represents the bulk (c60%) of the business.
- Non-residential and duct and manhole connection revenues are the next largest revenue components at a combined c18% of total.

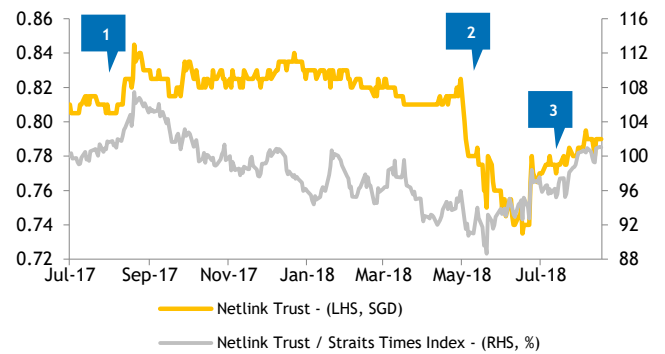
Revenue breakdown (SGD m) - residential matters most



Source: Company

Price Drivers

Historical share price trend



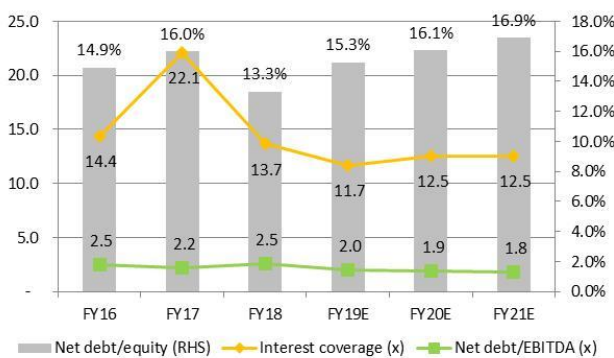
Source: Company, Maybank Kim Eng

- Share price stabilizing programme exercised until 17 Aug 2017.
- 4QFY18 profit 6% below prospectus estimates due to installation revenue shortfall.
- 1QFY19 above management forecasts for the period.

Financial Metrics

- NetLink's balance sheet is at an efficient level to support its policy of 100% payout of its cash available for distribution (i.e. essentially free cash flow).
- Following FY19E's SGD86m capex we assume SGD60m per year until FY22E. Management guidance is at SGD40m-60m per year.
- We expect refinancing of loans as they mature in FY21E.
- Investments outside the current core business are unlikely and would require unit holder approval.

Healthy balance sheet to support DPU



Source: Company

Swing Factors

Upside

- Stronger-than-expected demand may enable an increase in regulated capex that will provide additional guaranteed returns.
- Increased business expansion outside the CBD could provide new non-residential connections in areas where NetLink is the virtual sole fibre provider.
- Market earnings risk-aversion cycles could boost interest in NetLink's stable returns.

Downside

- Any downward revision in the regulated returns during the next review period impacts long-term fair value.
- Pricing competition in the non-residential segment.
- Rising interest rate cycle would reduce the attractiveness of NetLink and similar stocks in the same asset class.

FYE 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Key Metrics					
P/E (reported) (x)	na	64.3	43.7	37.6	32.5
Core P/E (x)	na	63.7	43.7	37.6	32.5
P/BV (x)	na	1.0	1.0	1.0	1.1
P/NTA (x)	na	1.4	1.0	1.0	1.1
Net dividend yield (%)	na	4.0	5.9	6.1	6.6
FCF yield (%)	na	nm	4.4	5.8	6.3
EV/EBITDA (x)	15.9	21.6	14.9	13.9	13.1
EV/EBIT (x)	44.5	66.0	42.9	36.7	32.3

INCOME STATEMENT (SGD m)

Revenue	299.2	228.6	334.8	358.9	381.7
Gross profit	0.0	0.0	334.8	358.9	381.7
EBITDA	223.2	166.3	236.5	253.8	269.6
Depreciation	(143.3)	(111.8)	(154.2)	(157.7)	(160.1)
Amortisation	(10.0)	(3.2)	0.0	0.0	0.0
EBIT	79.9	54.5	82.2	96.1	109.5
Net interest income / (exp)	(10.1)	(12.2)	(20.2)	(20.2)	(21.5)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	1.5	1.5	1.5
Pretax profit	70.8	43.8	63.5	77.4	89.5
Income tax	8.6	6.1	6.3	3.9	4.5
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	79.4	50.0	69.8	81.3	94.0
Core net profit	79.4	50.0	69.8	81.3	94.0

BALANCE SHEET (SGD m)

Cash & Short Term Investments	15.9	166.4	201.2	193.4	97.1
Accounts receivable	55.7	64.2	93.0	99.7	106.0
Inventory	5.5	3.9	5.7	6.1	6.5
Property, Plant & Equip (net)	3,059.5	3,210.7	3,143.0	3,045.3	2,945.2
Intangible assets	1,009.6	839.7	840.4	840.4	840.4
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	91.4	92.1	92.2	92.2	92.2
Total assets	4,237.6	4,377.1	4,375.5	4,277.0	4,087.4
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	18.8	15.1	76.3	81.5	87.0
LT interest bearing debt	507.6	588.7	668.7	668.7	580.0
Other liabilities	640.0	599.0	566.0	566.0	566.0
Total Liabilities	1,166.8	1,202.7	1,310.6	1,315.8	1,232.5
Shareholders Equity	3,070.8	3,174.4	3,064.9	2,961.2	2,854.8
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	3,070.8	3,174.4	3,064.9	2,961.2	2,854.8
Total liabilities and equity	4,237.6	4,377.1	4,375.5	4,277.0	4,087.4

CASH FLOW (SGD m)

Pretax profit	70.8	43.8	63.5	77.4	89.5
Depreciation & amortisation	153.3	115.0	154.2	157.7	160.1
Adj net interest (income)/exp	(10.0)	(20.4)	20.2	20.2	21.5
Change in working capital	(13.8)	25.1	(3.4)	(1.9)	(1.3)
Cash taxes paid	5.1	11.5	0.0	0.0	0.0
Other operating cash flow	(4.8)	(22.2)	(13.9)	(16.4)	(17.1)
Cash flow from operations	195.6	158.5	220.7	237.1	252.8
Capex	(117.3)	(212.2)	(86.6)	(60.0)	(60.0)
Free cash flow	78.3	(53.7)	134.1	177.1	192.8
Dividends paid	(80.0)	0.0	(179.4)	(185.0)	(200.3)
Equity raised / (purchased)	0.0	2,334.7	0.0	0.0	0.0
Change in Debt	0.0	(1,019.5)	80.0	0.0	(88.7)
Other invest/financing cash flow	10.0	(1,074.7)	0.0	0.0	0.0
Effect of exch rate changes	(30.8)	0.0	0.0	0.0	0.0
Net cash flow	(32.5)	166.4	34.8	(7.9)	(96.3)

FYE 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Key Ratios					
Growth ratios (%)					
Revenue growth	16.4	(23.6)	46.4	7.2	6.4
EBITDA growth	20.5	(25.5)	42.2	7.3	6.2
EBIT growth	118.3	(31.8)	50.9	16.9	14.0
Pretax growth	175.4	(38.1)	44.9	21.9	15.7
Reported net profit growth	97.2	(37.1)	39.8	16.3	15.7
Core net profit growth	97.2	(37.1)	39.8	16.3	15.7
Profitability ratios (%)					
EBITDA margin	74.6	72.7	70.6	70.7	70.6
EBIT margin	26.7	23.8	24.6	26.8	28.7
Pretax profit margin	23.7	19.2	19.0	21.6	23.5
Payout ratio	0.0	nm	nm	227.6	213.1
DuPont analysis					
Net profit margin (%)	26.6	21.9	20.9	22.6	24.6
Revenue/Assets (x)	0.1	0.1	0.1	0.1	0.1
Assets/Equity (x)	1.4	1.4	1.4	1.4	1.4
ROAE (%)	2.6	1.6	2.2	2.7	3.2
ROAA (%)	1.9	1.2	1.6	1.9	2.2
Liquidity & Efficiency					
Cash conversion cycle	nm	nm	nm	nm	nm
Days receivable outstanding	62.9	94.5	84.6	96.7	97.0
Days inventory outstanding	nm	nm	nm	nm	nm
Days payables outstanding	nm	nm	nm	nm	nm
Dividend cover (x)	nm	0.4	0.4	0.4	0.5
Current ratio (x)	0.8	3.9	3.4	3.2	2.2
Leverage & Expense Analysis					
Asset/Liability (x)	3.6	3.6	3.3	3.3	3.3
Net gearing (%) (incl perps)	16.0	13.3	15.3	16.1	16.9
Net gearing (%) (excl. perps)	16.0	13.3	15.3	16.1	16.9
Net interest cover (x)	7.9	4.5	4.1	4.7	5.1
Debt/EBITDA (x)	2.3	3.5	2.8	2.6	2.2
Capex/revenue (%)	39.2	92.8	25.9	16.7	15.7
Net debt/ (net cash)	491.7	422.3	467.5	475.4	482.9

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

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
leejuye@maybank-ke.com.sg

Dr Zamros DZULKAFLI

(603) 2082 6818
zamros.d@maybank-ib.com

Ramesh LANKANATHAN

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

FX

Saktiandi SUPAAT

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

Christopher WONG

(603) 2297 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

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, CFE

(603) 2297 8694
nikmohdihsan.ra@maybank-ib.com

SINGAPORE

Neel SINHA

Head of Research

(65) 6231 5838 neelsinha@maybank-ke.com.sg
• Strategy • Industrials
• 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

LAI Gene Lih

(65) 6231 5832 laigenelih@maybank-ke.com.sg
• Technology

HONG KONG / CHINA

Mitchell KIM

Head of Research

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

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

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 tonyren@kimeng.com.hk
• Healthcare & Pharmaceutical

Wendy LI

(852) 2268 0647 wendyli@kimeng.com.hk
• Consumer & Auto

INDIA

Jigar SHAH

Head of Research

(91) 22 6623 2632 jigar@maybank-ke.co.in
• Strategy • Oil & Gas • Automobile • Cement

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

Isnapura 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 • Services

Ornmongkol TANTITANATORN

(66) 2658 6300 ext 1395
ormmongkol.t@maybank-ke.co.th
• Power & Utilities • Infrastructure

Surachai PRAMUALCHAROENKIT

Head of Retail Research
(66) 2658 5000 ext 1470
Surachai.p@maybank-ke.co.th
• Auto • Conmat • Contractor • Steel

Ekachai TARAPORNITIP

Deputy Head

(66) 2658 5000 ext 1530
Ekachai.t@maybank-ke.co.th

Sutthichai KUMWORACHAI

Deputy Head

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

Suttatip PEERASUB

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

Temporn TANTIVIVAT

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

Jaroopan WATTANAWONG

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

Sorrbahol VIRAMETEEKUL

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

Wijit ARAYAPISIT

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

Kritsapong PATAN

(66) 2658 5000 ext 1310
kritisapong.p@maybank-ke.co.th
• Chartist

Apisit PATTARASAKOLKIAT

(66) 2658 5000 ext 1405
apisit.p@maybank-ke.co.th
• Chartist

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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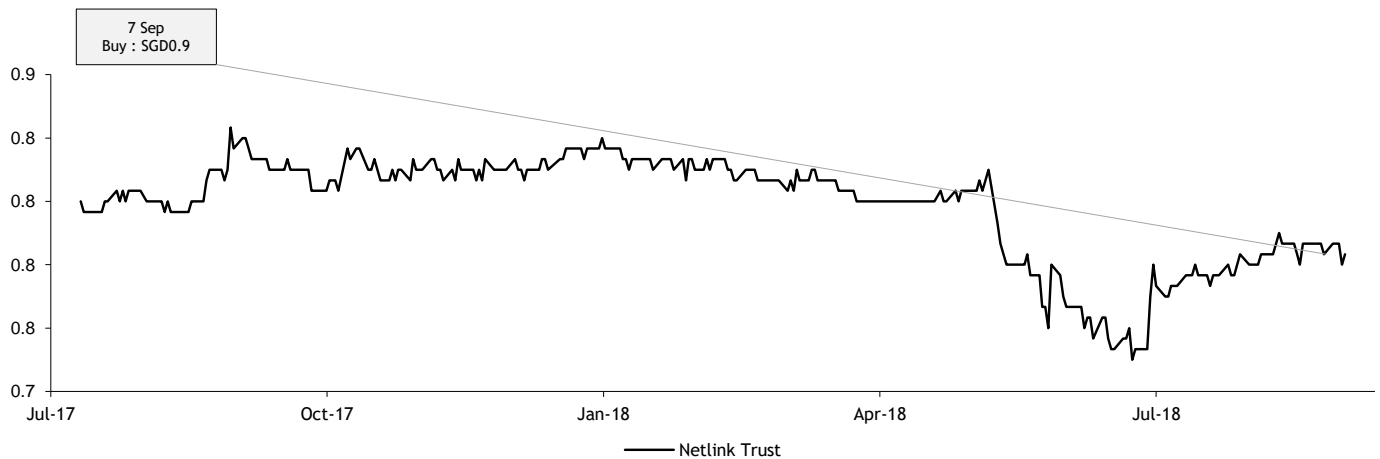
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Malaysia

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


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


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


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


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


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)


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


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


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

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

Philippines

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


North Asia Sales Trading

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

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