

Hartalega (HART MK)

Challenging ASP outlook

ASP downtrend to continue; D/G to SELL

We believe the strong 1QFY3/22 earnings performance will not be sustainable as ASP has been trending downward since May 21 on rising competition especially in the nitrile glove segment. We lower our FY22-24 earnings forecasts by -1% to -62% after lowering our utilisation rate and ASP assumptions. We downgrade Hartalega to SELL with a new TP of MYR3.99 (from MYR6.74) on an unchanged 19.4x CY23 PER (-1SD of historical mean).

ASP expected to only normalise in early 2022

Hartalega have been guiding for a weaker ASP outlook since 2Q21. ASP is expected to decline 30% between 1QFY22 and 2QFY22 and may only normalise in early 2022, returning to pre-COVID levels by mid-2022. Due to the stricter SOPs, it is currently operating at only 70% of its capacity, utilizing 60% of its workforce. Due to the unexpected 2-week shut down of operations in early July and stricter SOPs under the National Recovery Plan phase 1 that led to lower production, some of its buyers have shifted some of their orders to China in order to mitigate the supply risks, we understand.

China, a threat that cannot be ignored

Aggressive capacity expansion by the Chinese glove makers would likely lead to oversupply by 2023. To seize market share, the Chinese glove makers are pricing their gloves competitively in Europe. The Chinese glove makers are expected to contribute to 23% of the world's glove supply by 2022 (from 16% now) while Malaysia's market share is expected to shrink to 60% in 2022, from 67%.

Earnings adjustments

We lower our FY22/23/24 earnings forecasts by -1%/-60%/-33% to factor in: (i) lower utilisation rate of 70% (from 80%) for 4Q21, 80% (from 85%) for FY23 and 85% (from 93%) for FY24, and (ii) lower FY22/23/24 effective ASP assumptions of USD61.4/23.9/23.2 (from USD62.6/37.2/28.5) per k pcs. Post-earnings downgrade, our TP is lowered to MYR3.99 (from MYR6.74) on an unchanged 19.4x CY23 PER.

FYE Mar (MYR m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	2,924	6,696	7,683	3,911	4,442
EBITDA	724	4,065	4,755	1,032	1,124
Core net profit	435	2,975	3,485	666	716
Core FDEPS (sen)	12.9	86.6	101.5	19.4	20.8
Core FDEPS growth(%)	(5.5)	569.9	17.1	(80.9)	7.5
Net DPS (sen)	7.5	50.2	58.8	11.2	12.1
Core FD P/E (x)	53.2	10.3	5.8	30.4	28.3
P/BV (x)	9.1	6.1	3.1	3.0	2.9
Net dividend yield (%)	1.1	5.6	10.0	1.9	2.1
ROAE (%)	18.1	76.8	61.0	10.1	10.4
ROAA (%)	13.8	58.6	46.6	8.3	8.8
EV/EBITDA (x)	31.7	6.9	3.6	16.2	14.9
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	3,890	1,211	925
MKE vs. Consensus (%)	-	-	(10.4)	(45.0)	(22.6)

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

SELL

[Prior:HOLD]

Share Price MYR 5.89
 12m Price Target MYR 3.99 (-30%)
 Previous Price Target MYR 6.74

Company Description

Hartalega is the world's largest nitrile medical gloves producer.

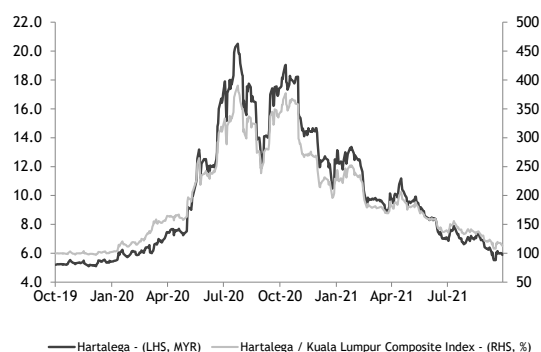
Statistics

52w high/low (MYR)	19.04/5.53
3m avg turnover (USDm)	10.1
Free float (%)	34.3
Issued shares (m)	3,428
Market capitalisation	MYR20.2B USD4.8B

Major shareholders:

Hartalega Industries Sdn. Bhd.	34.3%
Employees Provident Fund	8.6%
BNP Paribas Wealth Management	8.2%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(12)	(16)	(65)
Relative to index (%)	(10)	(19)	(66)

Source: FactSet

Link to sector note:

Malaysia Gloves Sector - Not the time for bottom fishing | D/G NEGATIVE

ESG@MKE
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weisum@maybank-ib.com

Risk Rating & Score ¹	17.6 (Low)
Score Momentum ²	+0.0
Last Updated	21 July 2021
Controversy Score ³ (Updated: 30 Jul 2021)	3 - Human rights (employee incidents)

Business Model & Industry Issues

- Hartalega has continued to retain its SEDEX membership and remains a constituent of FTSE4Good Bursa Malaysia. Social compliance audits are regularly conducted by its internal team as well as external parties, based on the Business Social Compliance Initiative (BSCI) and SEDEX Members Ethical Trade Audits (SMETA).
- Similar to the other glove players, Hartalega relies on the migrant workers for the production of its gloves. Given the ever-changing regulations and standards on workers' welfare, the industry faces rising social compliance cost. However, as the entire industry faces the same challenges, we expect the glove-makers to pass on the higher compliance cost.
- ESG risk should fall on a yearly basis as it invests in automation to improve efficiency and reduce dependency on manual labour. Hartalega's vision is for humanless factories in the foreseeable future.

Material E issues

- To reduce the consumption of energy and water, Hartalega deploys a high level of automation at its plants and also taps into alternative energy sources (i.e. cogeneration and biomass power plants). In FY20, its natural gas, electricity and water consumption per unit of production were reduced by 15%, 24% and 2% respectively.
- It also put in place a waste reduction programme. In FY20, its scheduled and non-scheduled waste disposal per unit of production reduced by 26% and 12% respectively.
- Additionally, its state-of-the-art water treatment plants allow for 100% self-treated water. For effluent water discharge, Hartalega maintains its Standard A rating, which is the highest benchmark determined by the Department of Environment (DOE).
- Hartalega received ISO 14001:2015 certification in 2017.

Material S issues

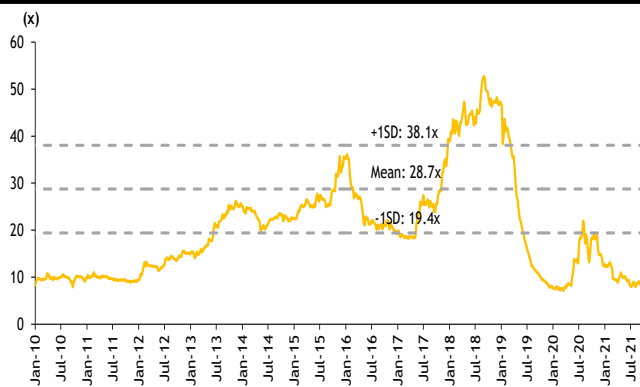
- Hartalega regularly carries out social compliance audits, which are in accordance with internationally recognised standards, including the SEDEX Member Ethical Trade Audit (SMETA) and Business Social Compliance Initiative (BSCI).
- Hartalega implemented Zero Recruitment Cost Policy since 2019, which ensures that its migrant workers are not required to pay recruitment fees to agencies/third parties during the recruitment process. For migrant workers that joined Hartalega prior to its Zero Recruitment Cost Policy, Hartalega will reimburse the recruitment fees paid by the migrant workers (totalling up to MYR40m) from 4Q20 (over a period of 24 months).
- Its migrant workers are paid no less than the minimum rates stipulated in Malaysian laws. The migrant workers are also eligible for cash bonuses of up to 3.5 months and annual increments of up to 7%.
- The overtime hours are paid at rates in accordance with the Malaysia Employment Act. Its workers typically perform 70 hours of overtime per month, which is below the limit of 104 hours allowed by Malaysia's labour laws.
- Its hostels also exceed the minimum standard enforced by Malaysia's Department of Labour.

Key G metrics and issues

- The current board consists of 8 members, out of which, 5 members (or 63% of board, minimum requirement is 50%) are Independent Non-Executive Directors (INEDs).
 - Mr Kuan Kam Hon is the Executive Chairman of Hartalega and his total remuneration package for FY20 was MYR7.7m (or 1.8% of FY20 net profit).
 - As at 22 Jun 2020, Mr Kuan Kam Hon's family (the largest substantial shareholder) holds 48.9% stake in Hartalega and has 3 board seats (or 38% of board representation).
 - The service of Dato' Tan Guan Cheong (INED) will exceed 9 years in 2021 and the shareholders have approved his service at the recent AGM in Sep 2020.
 - Hartalega has 3 female directors on the board, representing 38% of the board (minimum requirement is 30%).
 - Its audit and remuneration committees are made up by the same 4 INEDs.
 - Its risk management committee is made up of 4 INEDs and 1 Executive Director.
 - Deloitte PLT has been Hartalega's external auditor since 2014.
 - The Group has a Whistleblowing Policy in place, whereby the reports are lodged to an independent third-party outsourced service provider via email and/or website ("Hartalega Speak Up), which are available in multiple languages (i.e. English, Bahasa Malaysia, Burmese, Bengali and Nepali).
 - Hartalega has had no governance issues in the past. The only related party transactions were the dividend and interest income received from subsidiaries.
 - The growth of the Group has been organic and hence, no business acquisitions.
- Its products have never been reprimanded by the authorities or its customers.

¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Harta: Historical 1-year forward PER mean (2014-2018; pre-Covid-19)



Source: Bloomberg, Company, Maybank Kim Eng (chart)

Upside risks

(i) USA reinstates the punitive import tariffs on China's exam and non-medical gloves, which may result in China losing competitive edges and market share in the US. Presently, the import tariff on China's runner examination gloves has reduced to zero (from 7.5% under the 'Phase 1' trade deal in Jan 2020 - the original import tariff was 15% in Sep 2019), (ii) Raw material prices decline faster than ASP, (iii) Higher demand/consumption for gloves from non-healthcare industries post pandemic.

FYE 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
Key Metrics					
P/E (reported) (x)	41.4	15.7	5.8	30.2	28.1
Core P/E (x)	52.9	10.3	5.8	30.2	28.1
Core FD P/E (x)	53.2	10.3	5.8	30.4	28.3
P/BV (x)	9.1	6.1	3.1	3.0	2.9
P/NTA (x)	9.2	6.2	3.1	3.0	2.9
Net dividend yield (%)	1.1	5.6	10.0	1.9	2.1
FCF yield (%)	2.8	10.1	13.7	3.8	1.4
EV/EBITDA (x)	31.7	6.9	3.6	16.2	14.9
EV/EBIT (x)	38.4	7.2	3.7	19.9	18.6

INCOME STATEMENT (MYR m)

Revenue	2,924.3	6,695.9	7,683.0	3,910.5	4,442.5
EBITDA	724.2	4,064.5	4,754.6	1,032.1	1,123.6
Depreciation	(125.1)	(137.4)	(164.9)	(192.4)	(219.9)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	599.1	3,927.1	4,589.6	839.7	903.7
Net interest income / (exp)	(7.6)	(0.9)	23.8	30.2	31.9
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	(90.0)	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	556.3	3,813.4	4,613.4	869.9	935.6
Income tax	(120.4)	(909.8)	(1,107.2)	(200.1)	(215.2)
Minorities	(1.1)	(18.2)	(21.4)	(4.1)	(4.4)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	434.8	2,885.4	3,484.8	665.7	716.0
Core net profit	434.8	2,975.4	3,484.8	665.7	716.0

BALANCE SHEET (MYR m)

Cash & Short Term Investments	305.0	2,668.7	3,337.5	3,753.9	3,662.2
Accounts receivable	503.1	1,065.5	1,222.6	622.3	707.0
Inventory	276.1	646.7	742.1	377.7	429.1
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	2,002.1	2,156.4	2,541.5	2,899.0	3,229.1
Intangible assets	28.8	32.6	32.6	32.6	32.6
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	202.5	262.1	262.1	262.1	262.1
Total assets	3,317.6	6,832.1	8,138.3	7,947.6	8,322.0
ST interest bearing debt	85.4	105.0	105.0	105.0	105.0
Accounts payable	276.0	1,059.3	970.3	493.9	561.0
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	188.6	241.7	141.7	141.7	141.7
Other liabilities	223.0	427.0	427.0	427.0	427.0
Total Liabilities	773.0	1,833.0	1,644.0	1,167.6	1,234.8
Shareholders Equity	2,541.0	4,974.8	6,448.7	6,730.3	7,033.1
Minority Interest	3.6	24.2	45.6	49.7	54.1
Total shareholder equity	2,544.6	4,999.0	6,494.3	6,780.0	7,087.2
Total liabilities and equity	3,317.6	6,832.1	8,138.3	7,947.6	8,322.0

CASH FLOW (MYR m)

Pretax profit	556.3	3,813.4	4,613.4	869.9	935.6
Depreciation & amortisation	125.1	137.4	164.9	192.4	219.9
Adj net interest (income)/exp	7.6	0.9	(23.8)	(30.2)	(31.9)
Change in working capital	(20.3)	(146.6)	(341.5)	488.3	(68.8)
Cash taxes paid	(72.7)	(730.8)	(1,107.2)	(200.1)	(215.2)
Other operating cash flow	59.7	13.3	0.0	0.0	0.0
Cash flow from operations	655.7	3,087.7	3,305.9	1,320.3	839.6
Capex	(3.1)	(2.2)	(550.0)	(550.0)	(550.0)
Free cash flow	652.6	3,085.5	2,755.9	770.3	289.6
Dividends paid	(249.0)	(604.2)	(2,010.9)	(384.2)	(413.2)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(78.1)	80.9	(100.0)	0.0	0.0
Other invest/financing cash flow	(170.9)	(204.6)	23.8	30.2	31.9
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	154.6	2,357.6	668.8	416.4	(91.7)

FYE 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
Key Ratios					
Growth ratios (%)					
Revenue growth	3.4	129.0	14.7	(49.1)	13.6
EBITDA growth	7.6	461.2	17.0	(78.3)	8.9
EBIT growth	5.2	555.5	16.9	(81.7)	7.6
Pretax growth	1.0	585.6	21.0	(81.1)	7.5
Reported net profit growth	(4.5)	563.6	20.8	(80.9)	7.5
Core net profit growth	(4.5)	584.3	17.1	(80.9)	7.5
Profitability ratios (%)					
EBITDA margin	24.8	60.7	61.9	26.4	25.3
EBIT margin	20.5	58.6	59.7	21.5	20.3
Pretax profit margin	19.0	57.0	60.0	22.2	21.1
Payout ratio	57.7	59.5	57.7	57.7	57.7
DuPont analysis					
Net profit margin (%)	14.9	43.1	45.4	17.0	16.1
Revenue/Assets (x)	0.9	1.0	0.9	0.5	0.5
Assets/Equity (x)	1.3	1.4	1.3	1.2	1.2
ROAE (%)	18.1	76.8	61.0	10.1	10.4
ROAA (%)	13.8	58.6	46.6	8.3	8.8
Liquidity & Efficiency					
Cash conversion cycle	60.6	15.3	12.6	62.9	39.9
Days receivable outstanding	59.2	42.2	53.6	84.9	53.9
Days inventory outstanding	45.5	60.2	88.9	71.5	45.3
Days payables outstanding	44.1	87.1	129.9	93.5	59.3
Dividend cover (x)	1.7	1.7	1.7	1.7	1.7
Current ratio (x)	2.7	3.1	4.1	5.7	5.4
Leverage & Expense Analysis					
Asset/Liability (x)	4.3	3.7	5.0	6.8	6.7
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	78.6	nm	na	na	na
Debt/EBITDA (x)	0.4	0.1	0.1	0.2	0.2
Capex/revenue (%)	0.1	0.0	7.2	14.1	12.4
Net debt/ (net cash)	(31.0)	(2,322.0)	(3,090.8)	(3,507.2)	(3,415.5)

Source: Company; Maybank

Research Offices

ECONOMICS

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

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

LEE Ju Ye
Singapore | Thailand | Indonesia
(65) 6231 5844
leejuye@maybank.com

Linda LIU
Singapore | Vietnam |
Cambodia | Myanmar | Laos
(65) 6231 5847
lindaliu@maybank.com

Dr Zamros DZULKAFI
(65) 2082 6818
zamros.d@maybank-ib.com

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

FX

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

Christopher WONG
(65) 6320 1378
wongkl@maybank.com.sg

TAN Yanxi
(65) 6320 1378
tanyx@maybank.com.sg

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

STRATEGY

Anand PATHMAKANTHAN
ASEAN
(603) 2297 8783
anand.pathmakanthan@maybank-ib.com

FIXED INCOME

Winson PHOON, ACA
(65) 6340 1079
winsonphoon@maybank.com

SE THO Mun Yi
(603) 2074 7606
munyi.st@maybank-ib.com

REGIONAL EQUITIES

Anand PATHMAKANTHAN
Head of Regional Equity Research
(603) 2297 8783
anand.pathmakanthan@maybank-ib.com

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

ONG Seng Yeow
Research, Technology & Innovation
(65) 6231 5839
ongsengyeow@maybank.com

MALAYSIA

Anand PATHMAKANTHAN *Head of Research*
(603) 2297 8783
anand.pathmakanthan@maybank-ib.com
• Strategy

WONG Chew Hann, CA
(603) 2297 8686
wchewh@maybank-ib.com
• Non-Bank Financials (stock exchange)
• Construction & Infrastructure

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

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

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

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

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 • Glove

Jade TAM
(603) 2297 8687 jade.tam@maybank-ib.com
• Consumer Staples & Discretionary

Fahmi FARID
(603) 2297 8676 fahmi.farid@maybank-ib.com
• Software

Syifaa' Nur FARAHA
(603) 2297 8675
nurfarahsyifaa.mohamadfuad@maybank-ib.com
• Construction • Renewable Energy

Arvind JAYARATNAM
(603) 2297 8692
arvind.jayaratnam@maybank.com
• Ports • Shipping
• Petrochemicals • Technology

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
• Chartist

Amirah AZMI
(603) 2082 8769 amirah.azmi@maybank-ib.com
• Retail Research

SINGAPORE

Thilan WICKRAMASINGHE *Head of Research*
(65) 6231 5840 thilanw@maybank.com
• Banking & Finance - Regional
• Consumer

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

LAI Gene Lih, CFA
(65) 6231 5832 laigenelih@maybank.com
• Technology • Healthcare

Kareen CHAN
(65) 6231 5926 kareench@maybank.com
• Transport • Telcos • Consumer

Eric ONG
(65) 6231 5924 ericong@maybank.com
• SMIDs

Matthew SHIM
(65) 6231 5929
matthewshim@maybank.com
• REITs

PHILIPPINES

Jacqui de JESUS *Head of Research*
(63) 2 8849 8840
jacqui.dejesus@maybank.com
• Strategy • Conglomerates

Rachelleen RODRIGUEZ, CFA
(63) 2 8849 8843
rachelleen.rodriguez@maybank.com
• Banking & Finance • Transport • Telcos

Daphne SZE
(63) 2 8849 8847
daphne.sze@maybank.com
• Consumer

VIETNAM

Quan Trong Thanh *Head of Research*
(84 28) 44 555 888 ext 8184
thanh.quan@maybank-kimeng.com.vn
• Banks

Hoang Huy, CFA
(84 28) 44 555 888 ext 8181
hoanghuy@maybank-kimeng.com.vn
• Strategy • Technology

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

Nguyen Thi Sony Tra Mi
(84 28) 44 555 888 ext 8084
mi.nguyen@maybank-kimeng.com.vn
• Consumer

Tyler Manh Dung Nguyen
(84 28) 44 555 888 ext 8085
dung.nguyen@maybank-kimeng.com.vn
• Utilities • Property

Tran Thi Thu Thao
(84 28) 44 555 888 ext 8180
thao.tran@maybank-kimeng.com.vn
• Industrials

Nguyen Thi Ngan Tuyen
Head of Retail Research
(84 28) 44 555 888 ext 8081
tuyen.nguyen@maybank-kimeng.com.vn
• Retail Research

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

INDIA

Jigar SHAH *Head of Research*
(91) 22 4223 2632 jigars@maybank.com
• Strategy • Oil & Gas • Automobile • Cement

Neerav DALAL
(91) 22 4223 2606 neerav@maybank.com
• Software Technology • Telcos

Vikram RAMALINGAM
(91) 22 4223 2607
vikram@maybank.com
• Automobile • Media

INDONESIA

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

Willy GOUTAMA
(62) 21 8066 8500
willy.goutama@maybank-ke.co.id
• Consumer

Farah OKTAVIANI
(62) 21 8066 8691
farah.oktaviani@maybank-ke.co.id
• Construction

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

Jesada TECHAHUSDIN, CFA
(66) 2658 6300 ext 1395
jesada.t@maybank-ke.co.th
• Banking & Finance

Kaushal LADHA, CFA, CESGA
(66) 2658 6300 ext 1392
kaushal.l@maybank-ke.co.th
• Oil & Gas - Regional
• Petrochemicals - Regional
• Utilities

Vanida GEISLER, CPA
(66) 2658 6300 ext 1394
vanida.g@maybank-ke.co.th
• Property • REITs

Yuwanee PROMMAPORN
(66) 2658 6300 ext 1393
yuwanee.p@maybank-ke.co.th
• Services • Healthcare

Ekachai TARAPORNITP *Head of Retail Research*
(66) 2658 5000 ext 1530
ekachai.t@maybank-ke.co.th

Surachai PRAMUALCHAROENKIT
(66) 2658 5000 ext 1470
surachai.p@maybank-ke.co.th
• Auto • Conmat • Contractor • Steel

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

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

Thanatphat SUKSRICHAVALIT
(66) 2658 5000 ext 1401
thanatphat.s@maybank-ke.co.th
• Media • Electronics

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

Theerasate PROMPONG
(66) 2658 5000 ext 1400
theerasate.p@maybank-ke.co.th
• Equity Portfolio Strategist

Apiwat TAVESIRIVATE
(66) 2658 5000 ext 1310
apiwat.t@maybank-ke.co.th
• Chartist and TFX

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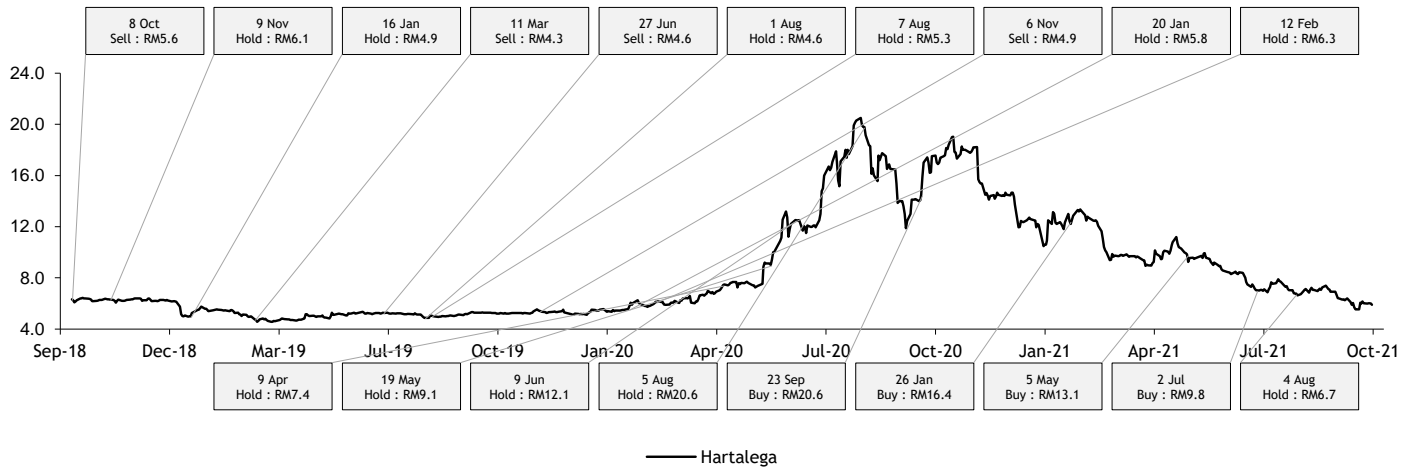
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 **Malaysia**

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 8849 8888
Fax: (63) 2 8848 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

Indonesia

Iwan Atmadjaja
iatmadjaja2@bloomberg.net
(62) 21 8066 8555

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

 **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

London

Greg Smith
gsmith@maybank-ke.co.uk
Tel: (44) 207-332-0221

India

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

 **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
1101, 11th floor, A Wing, Kanakia
Wall Street, Chakala, Andheri -
Kurla Road, Andheri East,
Mumbai City - 400 093, India

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

 **Saudi Arabia**

In association with
Anfaal Capital
Ground Floor, KANOO Building
No.1 - Al-Faisaliyah, Madina Road,
P.O.Box 126575 Jeddah 21352
Kingdom of Saudi Arabia

Tel: (966) 920023423