

Malaysia Marine Heavy Engr (MMHE MK)

ESG: Good now, better next

Maintain BUY and MYR0.85 TP

MMHE, a constituent of the FTSE4Good Index Series, has established its ESG framework, which is broadly in line with its parent company's (MISC, PETRONAS) and is comparatively ahead of the majority of MY O&G PLCs. It is in the midst of establishing its sustainability initiatives/targets-based strategic priorities, earmarked for publication in its next annual report. It has an earnings turnaround storyline, is cash-rich and undeservedly undervalued. Our TP is pegged to 0.8x EV/ order backlog of MYR1.2b.

Decent ESG traction to-date

MMHE's sustainability direction is broadly aligned to its parent company's (PETRONAS, MISC) roadmap (e.g. net zero by 2050). It has been consistent in tracking and disclosing its ESG data, especially its natural capitals since 2014. Its sustainability highlights to-date include: (i) banning the usage of polystyrene in the yard (2018), (ii) partnering Smulders Projects Belgium NV (Smulders) to target offshore wind farm fabrication and assembly fabrication and assembly works in Asia (2019) and (iii) installing rooftop solar on its premises (2020), to name a few.

Further fine-tuning expected

While its ESG progress has been commendable, we expect to see further improvement from here. For a start, MMHE has yet to establish a baseline target, climate goals aspiration and decarbonisation roadmap. Setting up: (i) a more comprehensive 'E' agenda (carbon reduction, offsets, carbon neutral, energy transition/ decarbonisation) and (ii) short-/mid-/long-term sustainability framework would be well-received.

Earnings turnaround remains key

ESG aside, operations/ earnings turnaround remain MMHE's key priority. The sub-par FY21 performance is well-flagged, affected by the supply chain disruption and Covid-19 pandemic. Focus is on its recovery effort and orderbook growth. Some tenders (Marjoram, FPSO Limbayong) have been pushed back to 2022 while some notable ones may come in 2H21 (i.e. offshore wind-farm). Winning some of these projects will be a positive. Our model imputes a MYR1.4b new order intake in FY21 (79% covered to-date), on the back of a MYR10b tender pipeline.

FYE Dec (MYR m)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	1,010	1,567	1,431	1,629	1,650
EBITDA	47	126	(42)	148	154
Core net profit	(20)	63	(116)	72	77
Core EPS (sen)	(1.3)	4.0	(7.3)	4.5	4.8
Core EPS growth (%)	nm	nm	nm	nm	6.7
Net DPS (sen)	0.0	0.0	0.0	0.0	0.0
Core P/E (x)	nm	11.4	nm	8.7	8.2
P/BV (x)	0.6	0.4	0.4	0.3	0.3
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
ROAE (%)	(1.4)	(18.3)	(10.3)	4.0	4.1
ROAA (%)	(0.6)	2.0	(3.9)	2.4	2.5
EV/EBITDA (x)	19.2	2.6	nm	2.2	1.5
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	(187)	28	26
MKE vs. Consensus (%)	-	-	(2.2)	158.6	197.2

Liaw Thong Jung
tjliaw@maybank-ib.com
(603) 2297 8688

BUY

Share Price	MYR 0.40
12m Price Target	MYR 0.85 (+115%)
Previous Price Target	MYR 0.85

Company Description

MMHE is involved in the offshore fabrication and marine repair services operations

Statistics

52w high/low (MYR)	0.72/0.37
3m avg turnover (USDm)	0.2
Free float (%)	18.1
Issued shares (m)	1,600
Market capitalisation	MYR632.0M
	USD151M

Major shareholders:

MISC Bhd.	66.5%
TechnipFMC Plc	8.5%
Urusharta Jamaah Sdn. Bhd.	5.1%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(10)	7	(1)
Relative to index (%)	(7)	6	3

Source: FactSet

Link to sector note:

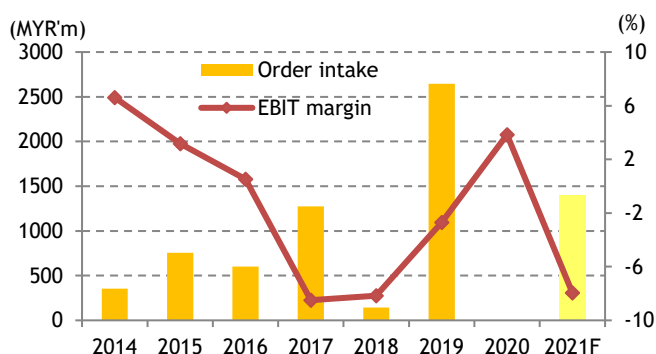
[Malaysia Oil & Gas - Fabrication players: Assessing the ESG roadmaps & prospects | POSITIVE](#)

ESG@MKE
Tear Sheet Insert

Value Proposition

- Malaysia's largest and most sophisticated offshore fabrication operator engaged in: (i) engineering & construction; and (ii) marine repair & conversion works.
- Indirectly owned by PETRONAS via its ownership of MISC; a unique distinction in the industry, as almost all of the reputable regional yards are independently-run.
- Although unwritten, such parentage tends to offer an advantage over PETRONAS-related tender bids. A privatisation possibility, based on current depressed price.
- Faces orderbook replenishment risk and margin compression issues. Returns have been compressed by the severe cyclical headwinds with ROIC retreating to below WACC.

Snapshot of order intake and EBIT margin

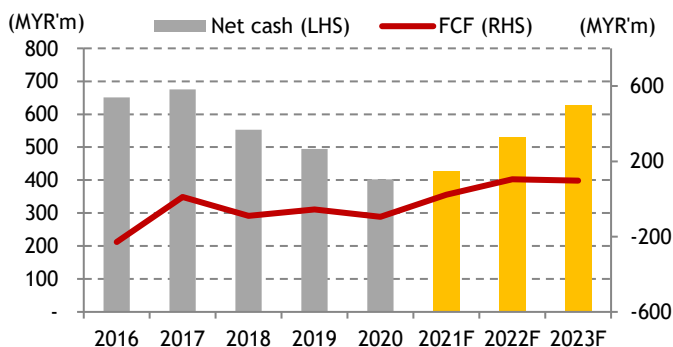


Source: Company

Financial Metrics

- Order backlog, margins, order replenishment and opex are MMHE's key earnings drivers.
- Current order backlog of MYR1.9b offers a 3-year visibility with EBIT margin of 3-5%.
- On a cost cutting, cash flow preservation and yard optimisation drive.
- Tender pipeline is on the rise. MMHE remains net cash and as such, room for bank and bond financing is abundant.
- As earnings and cash flow are depressed in this cycle, MMHE will offer leverage to any technical rebound in oil prices and new job wins.

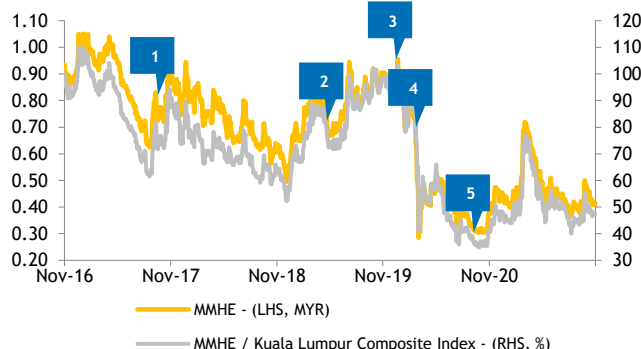
Net cash level & FCF trend



Source: Company

Price Drivers

Historical share price trend



Source: Company, Maybank Kim Eng

1. Wan Mashitah becomes MD, CEO.
2. Signs Long Term Offshore Agreement (LTOA) with Aramco.
3. Secures Kasawari CPP EPCIC job in Aug 2019.
4. OPEC+ alliance breaks up in Mar 2020.
5. En. Pandai Othman replaced the retiring Wan Mashitah as MD, CEO; effective 1 Oct 2020.

Swing Factors

Upside

- Rebound in crude oil prices a near term stock driver.
- Recovery in order replenishment and margin expansion are key catalysts.
- Though unlikely in our view, a potential privatisation exercise would likely generate excitement.

Downside

- Further weakness in oil price will hurt share price performance.
- Execution mishap, cost overruns and / or absence of new orders will cause adverse reaction.
- Acquisition of non-core assets or ill-usage of capex will not be well received, particularly at this point of industry cycle.

ESG@MKE

tjliaw@maybank.com

Risk Rating & Score ¹	NA
Score Momentum ²	NA
Last Updated	NA
Controversy Score ³ (Updated: NA)	NA

Business Model & Industry Issues

- Has been consistently tracking and disclosing its natural capitals since 2014 and banned the usage of polystyrene in the yard in 2018. That said, it has yet to establish a baseline target, climate goals aspiration and decarbonisation roadmap.
- Setting up: (i) a more comprehensive 'E' targets/ agenda (i.e. baseline, reduction, offsets, carbon neutral, energy transition/ decarbonisation) and (ii) short-/mid-/long-term sustainability framework would be well-received.
- Has started to integrate ESG factors into its energy transition plans. MMHE has begun to green its operations, by venturing into offshore wind EPC opportunities (but not on a BOO model yet), installing rooftop solar panels at its premises, to name a few.
- Its ESG disclosures, progress and aspirations tend to be broadly aligned to its parent company's (MISC, PETRONAS) roadmap.
- MMHE is a constituent of the FTSE4Good Index Series.

Material E issues

- GHG emissions (tonnes CO₂e) in 2020: (i) Scope 1: 9,672, (ii) Scope 2: 36,031. Refrigerant consumption: 3,415 kg.
- Consumed: (i) 52,677 MWh of electricity, (ii) 1,028 tonnes CO₂e of gas, (iii) 23,303 litres of petrol, (iv) 1.9m litres of diesel & (v) 497,177 m³ of water. Discharged 94.3 m³ of waste water and managed 13,936 MT of hazardous waste (76.9% was Spent Copper Slag) in 2020.
- Recorded 12.9m man-hours and 17.3m safe man-hours in 2020. Continued to maintain a good safety record. Achieved zero Lost Time injury frequency, zero total recordable fatality and 0.23 total recordable cases.
- Green initiatives: (i) 1 office is Green Seal Green Office certified (7 offices pending), (ii) used 5,775 units of LED light bulbs in the yard, (iii) 113 units of motion sensors installed for office toilets and streetlights and (iv) 7 buildings installed with solar panel, with a total capacity of 8WP, which is expected to save an estimated MYR8.5m over 21 years and reduce 7.0k tonnes of CO₂ p.a.

Material S issues

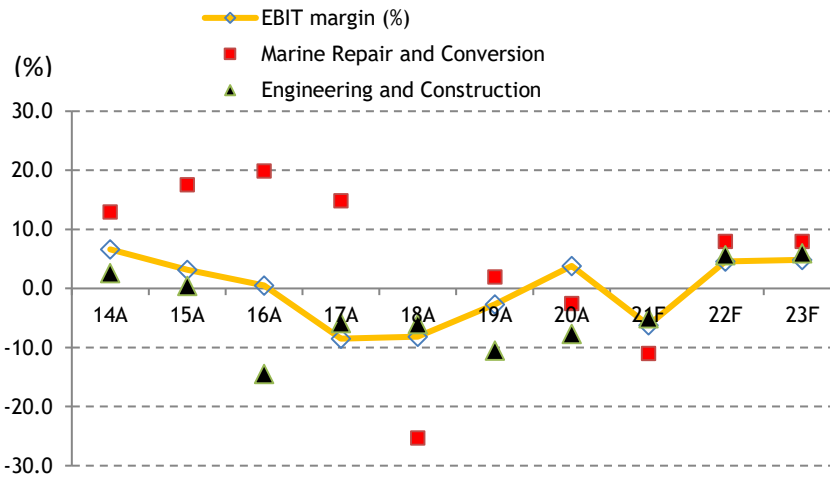
- Employed 2,625 staff (2,211 technical; 414 non-technical), with a 10% turnover rate in 2020.
- 48:52 of its staff are permanent: contract workers and female employees made up 18% of its workforce in 2020.
- Age diversity: 5%/ 25%/ 57%/ 13% of its employees are baby boomers/ Gen-X/ millennials/ post millennials.
- Recorded 73.9k total hours of employees (41.7 hours per staff) training in 2020.
- Labour practice standards: No child or forced labour, against discriminatory practices, right to minimum wage.
- It is ISO 45001:2018, 14001:2015, 9001:2015, 3834-2:2005 & 29001:2020 & EN 1090-1:2009 + A1:2011 certified.
- A recipient of the: (i) Gold Class 1 in Malaysian Society for Occupational Safety and (ii) Health (MSOSH) Occupational Safety and Health (OSH) in 2020.

Key G metrics and issues

- Adopts these policies: (i) Code of Conduct & Business Ethics, (ii) whistleblowing, (iii) anti-bribery & corruption (ABC), (iv) no gift, (v) no conflict of interest, (vi) corporate privacy, (vii) public position and (viii) human rights commitment, to name a few.
- MMHE's board comprises 9 directors - 4 Independent Non-Executive Director (INEDs; incl. chairman), 1 Senior Independent Non-Executive Director (SINED), 3 Non-Independent Non-Executive Directors (NINEDs) and 1 Non-Independent Executive Director (NIED; MD & CEO).
- A very experienced board with a good mix of tenure of service - 56% are above 60 years old and 33%/ 33%/ 33% have served <1/ 2-4 years/ >5 years respectively.
- A male-dominated board. Only 1 out of 9 of its BODs is female represented (11%), below the 30% threshold.
- The BOD's total remuneration packages of MYR2.2m for 2020 accounted for 1.7% of the Group's EBITDA.
- Its Audit Committee is made up of 1 SINED, 2 INEDs and 1 NINED.
- Its Nomination & Remuneration Committee is made up of 1 SINED, 1 INED and 1 NINED.
- Its Risk Committee is made up of 2 INEDs & 1 NINED.
- MMHE is audited by Ernst & Young PLT (EY), one of the Big Four accounting firms in the world, since 2004. EY has a policy ensuring its partner does not stay beyond 7 years at the assigned Company, to ensure independence.
- PETRONAS is a major shareholder of MMHE, being the holding company of MISC. MISC, in turn owns a 66.5% stake in MMHE.
- Related party transactions (RPTs) in 2020 mainly consisted of provision of services for repairs, engineering and construction works, conversion of vessels and drydocking to other related companies of ultimate holding company (MYR1.1b).

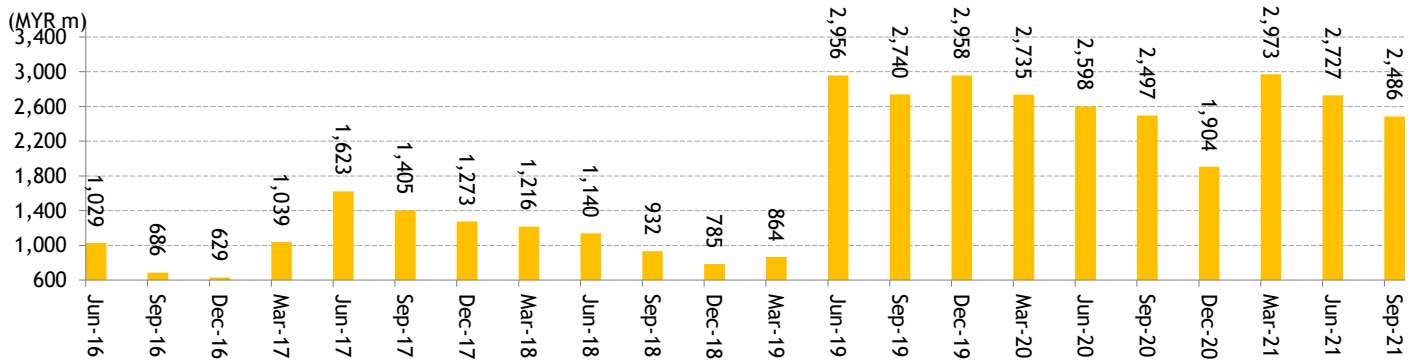
¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven 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).

EBIT margins



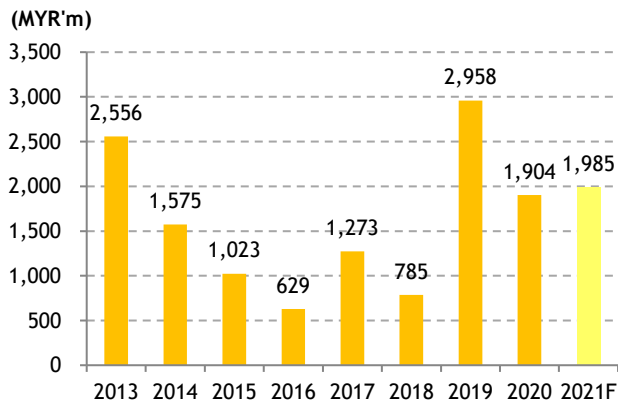
Source: Company, Maybank KE

Heavy engineering order backlog (MYR'm)



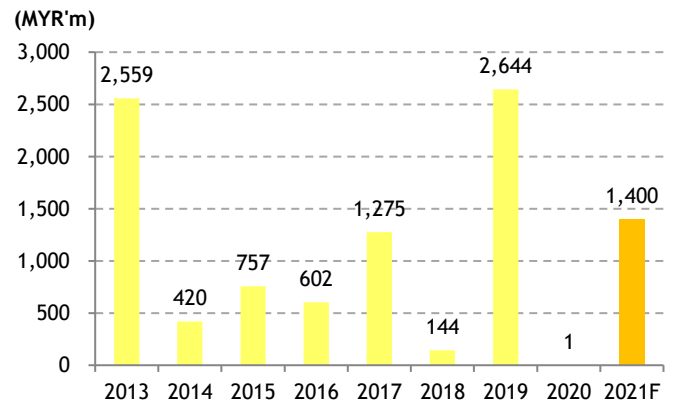
Sources: Company

Order backlog



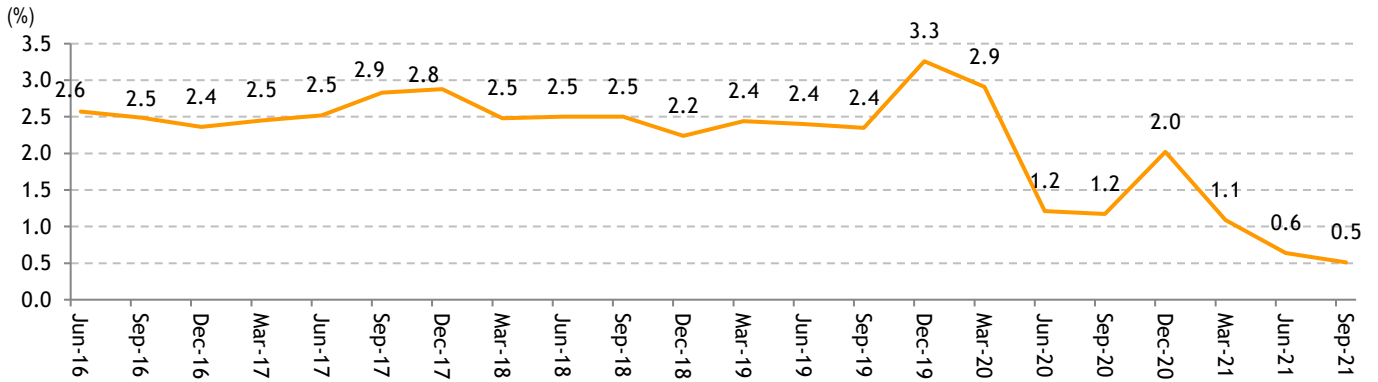
Source: Company, Maybank KE

Order intake



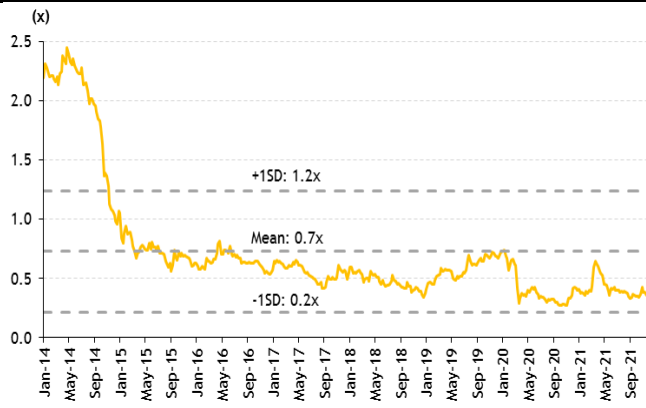
Source: Company, Maybank KE

Foreign shareholding (%) ex Technip's 8.5% strategic stake



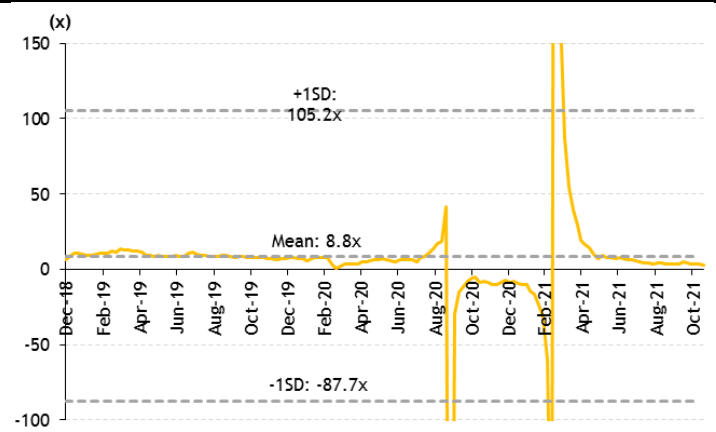
Sources: Company

1-year forward PBV



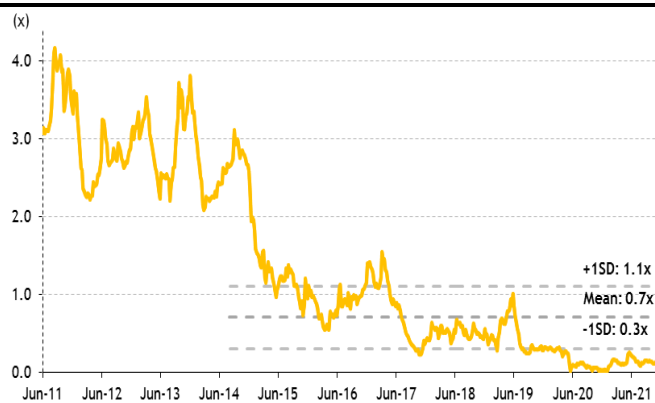
Source: Company, Maybank KE

1-year forward EV/ EBITDA



Source: Company, Maybank KE

1-year forward EV/ order backlog



Source: Company, Maybank KE

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Metrics					
P/E (reported) (x)	nm	nm	nm	8.7	8.2
Core P/E (x)	nm	11.4	nm	8.7	8.2
P/BV (x)	0.6	0.4	0.4	0.3	0.3
P/NTA (x)	0.6	0.4	0.4	0.3	0.3
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
FCF yield (%)	nm	nm	nm	19.6	15.1
EV/EBITDA (x)	19.2	2.6	nm	2.2	1.5
EV/EBIT (x)	nm	5.4	nm	4.3	2.8

INCOME STATEMENT (MYR m)

Revenue	1,009.5	1,566.8	1,430.9	1,629.2	1,650.4
EBITDA	47.1	126.2	(42.3)	147.8	154.1
Depreciation	(74.4)	(66.2)	(71.5)	(72.9)	(74.3)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	(27.3)	60.0	(113.7)	74.9	79.8
Net interest income / (exp)	0.0	(0.9)	(2.5)	(2.5)	(2.5)
Associates & JV	1.3	(0.2)	0.0	0.0	0.0
Exceptionals	(13.8)	(460.2)	(75.0)	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	(39.8)	(401.3)	(191.2)	72.4	77.3
Income tax	5.5	0.0	0.0	0.0	0.0
Minorities	(0.0)	4.5	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	(34.2)	(396.8)	(191.2)	72.4	77.3
Core net profit	(20.4)	63.4	(116.2)	72.4	77.3

BALANCE SHEET (MYR m)

Cash & Short Term Investments	673.9	651.1	439.8	563.3	659.0
Accounts receivable	504.1	591.7	540.4	615.3	623.3
Inventory	4.4	4.9	9.3	10.6	10.7
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	1,704.5	1,578.5	1,567.1	1,554.2	1,539.8
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	9.1	8.9	8.9	8.9	8.9
Other assets	322.0	311.3	311.3	311.3	311.3
Total assets	3,218.0	3,146.3	2,876.7	3,063.6	3,153.1
ST interest bearing debt	0.0	20.8	20.8	20.8	20.8
Accounts payable	645.5	904.3	825.8	940.3	952.6
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	178.9	227.6	227.6	227.6	227.6
Other liabilities	12.0	28.0	28.0	28.0	28.0
Total Liabilities	836.5	1,180.6	1,102.2	1,216.7	1,228.9
Shareholders Equity	2,372.3	1,961.0	1,769.8	1,842.2	1,919.5
Minority Interest	9.2	4.7	4.7	4.7	4.7
Total shareholder equity	2,381.4	1,965.7	1,774.5	1,846.9	1,924.2
Total liabilities and equity	3,218.0	3,146.3	2,876.7	3,063.6	3,153.1

CASH FLOW (MYR m)

Pretax profit	(39.8)	(401.3)	(191.2)	72.4	77.3
Depreciation & amortisation	74.4	66.2	71.5	72.9	74.3
Adj net interest (income)/exp	(2.0)	(1.0)	0.0	0.0	0.0
Change in working capital	62.2	154.3	(31.5)	38.3	4.1
Cash taxes paid	5.5	0.0	0.0	0.0	0.0
Other operating cash flow	0.7	1.2	0.0	0.0	0.0
Cash flow from operations	123.2	135.6	(151.3)	183.6	155.7
Capex	(178.4)	(230.4)	(60.0)	(60.0)	(60.0)
Free cash flow	(55.2)	(94.8)	(211.3)	123.6	95.7
Dividends paid	0.0	0.0	0.0	0.0	0.0
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	130.5	69.5	0.0	0.0	0.0
Other invest/financing cash flow	(3.0)	2.4	0.0	0.0	0.0
Effect of exch rate changes	(2.0)	(1.0)	0.0	0.0	0.0
Net cash flow	70.4	(23.9)	(211.3)	123.6	95.7

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Ratios					
Growth ratios (%)					
Revenue growth	3.6	55.2	(8.7)	13.9	1.3
EBITDA growth	nm	167.9	nm	nm	4.3
EBIT growth	nm	nm	nm	nm	6.5
Pretax growth	nm	nm	nm	nm	6.7
Reported net profit growth	nm	nm	nm	nm	6.7
Core net profit growth	nm	nm	nm	nm	6.7
Profitability ratios (%)					
EBITDA margin	4.7	8.1	nm	9.1	9.3
EBIT margin	nm	3.8	nm	4.6	4.8
Pretax profit margin	nm	nm	nm	4.4	4.7
Payout ratio	0.0	0.0	0.0	0.0	0.0
DuPont analysis					
Net profit margin (%)	nm	nm	nm	4.4	4.7
Revenue/Assets (x)	0.3	0.5	0.5	0.5	0.5
Assets/Equity (x)	1.4	1.6	1.6	1.7	1.6
ROAE (%)	(1.4)	(18.3)	(10.3)	4.0	4.1
ROAA (%)	(0.6)	2.0	(3.9)	2.4	2.5
Liquidity & Efficiency					
Cash conversion cycle	(74.4)	(60.7)	(85.8)	(100.4)	(107.3)
Days receivable outstanding	205.8	125.9	142.4	127.7	135.1
Days inventory outstanding	2.1	1.1	1.9	2.6	2.8
Days payables outstanding	282.2	187.7	230.1	230.7	245.2
Dividend cover (x)	nm	nm	nm	nm	nm
Current ratio (x)	1.8	1.3	1.1	1.2	1.3
Leverage & Expense Analysis					
Asset/Liability (x)	3.8	2.7	2.6	2.5	2.6
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)	nm	65.9	na	30.1	32.1
Debt/EBITDA (x)	3.8	2.0	nm	1.7	1.6
Capex/revenue (%)	17.7	14.7	4.2	3.7	3.6
Net debt/ (net cash)	(495.0)	(402.7)	(191.4)	(314.9)	(410.7)

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

FX

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

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

TAN Yanxi
(65) 6320 1378
tanymx@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 FARAH
(603) 2297 8675
nurfarahsyifaa.mohamadfuad@maybank-ib.com
• Construction • Renewable Energy • REITs

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

Shafiq KADIR
(603) 2297 8691
msshafiq.abkadir@maybank-ib.com
• Healthcare

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
• Charitist

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

Miguel SEVIDAL
(63) 2 8849 8844
miguel.sevidal@maybank.com
• REITs • Property

VIETNAM

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

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

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

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

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

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

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

INDIA

Jigar SHAH *Head of Research*
(91) 22 4223 2632 jigarsh@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
(91) 21 8066 8689
rahmi.marina@maybank.com
• Banking & Finance

Willy GOUTAMA
(62) 21 8066 8500
willygoutama@maybank.com
• Consumer

Farah OKTAVIANI
(62) 21 8066 8691
farah.oktaviani@maybank.com
• 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

Jaroopan WATTANAWONG
(66) 2658 5000 ext 1404
jaroopan.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 TFE

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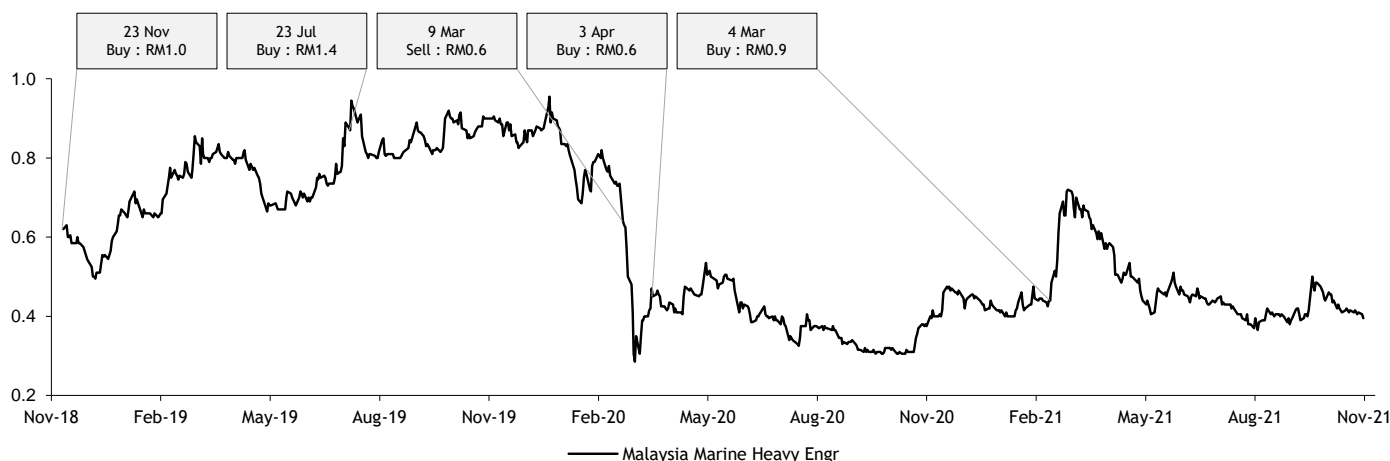
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Malaysia

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
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


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


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

Tel: (966) 920023423


Sales Trading

Kevin Foy
Regional Head Sales Trading
kevinfoy@maybank.com
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

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