

AEM Holdings (AEM SP)

Keep the faith

Opportunity to BUY the dip

AEM's FY22 revenue guidance of SGD670-720m (c'sus: SGD728m, ours: SGD753m) and expectations of margin compression may be perceived negatively. Given the stock's 32% rally in the past 3 months, profit taking may ensue. As fundamentals are intact and as we see potential for further positive guidance revisions as FY22 progresses, our forecasts and TP are unchanged. We see corrections, if any, as opportunities to BUY the dip.

We see room for positive guidance revisions in FY22

AEM has historically been conservative in guidance - especially at the start of the year. We expect positive guidance revisions throughout the year. For FY22, we expect demand for the AEM's new generation equipment to be underpinned by Sapphire Rapids and Alder Lake - Intel's new generation data centre and client products - which are Intel's first mass produced heterogeneously packaged chips (which we believe require greater reliance on system level test). In our view, Intel's planned USD7b spending in Penang over 10 years is positive, and not factored in the guidance as the new facility only broke-ground in Dec'21.

Mitigating measures for margin risks

If AEM was conservative on revenue guidance - we believe this may be due to wariness towards supply chain uncertainties. On cost-driven margin pressure, we highlighted such risks in Nov'21 and cut our FY22E net margin assumption from 16.7% to 16.1% in Dec'21. As the latter is still higher than the 15.2% that we are forecasting for FY21E, the remaining risk is if we underestimate margin compression. On the flip side, mitigating measures to this are: i) margin pressures offset by operating leverage gains if FY22 revenue turns out stronger than we expect, and/or ii) FY21A margins pan out better than our FY21E.

Next catalyst

We believe positive commentary from AEM surrounding capacity expansion may be a catalyst for the stock to re-rate higher, as this will likely further confirm demand strength. Other risks to our view include i) worsening of supply chain challenges, and/ or ii) weak demand for Sapphire Rapids/ Alder Lake chips.

FYE Dec (SGD m)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	323	519	539	753	854
EBITDA	70	122	109	156	184
Core net profit	53	98	82	122	143
Core FDEPS (cts)	19.4	35.1	26.3	39.0	45.9
Core FDEPS growth(%)	58.3	80.9	(25.1)	48.1	17.9
Net DPS (cts)	5.1	9.0	7.1	9.8	11.6
Core FD P/E (x)	10.4	9.8	19.8	13.4	11.4
P/BV (x)	4.1	4.5	4.3	3.5	2.8
Net dividend yield (%)	2.5	2.6	1.4	1.9	2.2
ROAE (%)	47.3	56.4	28.0	28.9	27.6
ROAA (%)	29.1	34.6	18.3	19.2	19.0
EV/EBITDA (x)	6.3	6.7	12.5	8.8	6.9
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	85	122	137
MKE vs. Consensus (%)	-	-	(3.5)	0.0	4.2

Gene Lih Lai, CFA
laigenelih@maybank.com
(65) 6231 5832

BUY

Share Price	SGD 5.22
12m Price Target	SGD 6.23 (+21%)
Previous Price Target	SGD 6.23

Company Description

AEM manufactures equipment used in the semiconductor back-end process

Statistics

52w high/low (SGD)	5.35/3.38
3m avg turnover (USDm)	8.7
Free float (%)	86.4
Issued shares (m)	312
Market capitalisation	SGD1.6B
	USD1.2B

Major shareholders:

Temasek Holdings Pte Ltd. (Investment Ma	8.9%
Aberdeen Standard Investments (Asia) Ltd	6.0%
Employees Provident Fund	5.0%

Price Performance



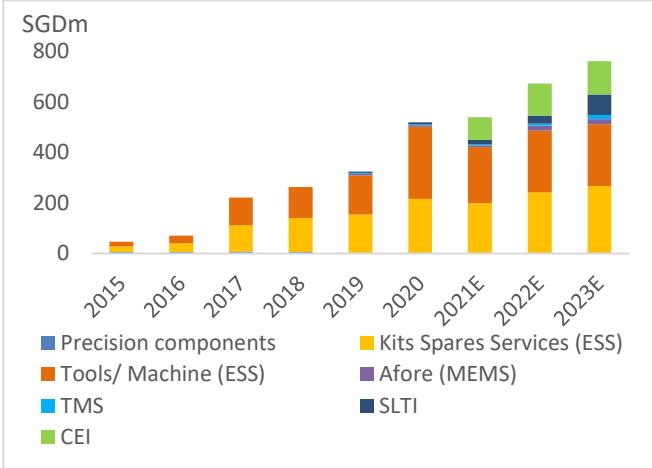
	-1M	-3M	-12M
Absolute (%)	1	32	42
Relative to index (%)	(2)	28	32

Source: FactSet

Value Proposition

- Back-end test-equipment manufacturer that has co-developed the HDMT handler for Intel.
- Leading-edge HDMT technology has helped its core customer achieve 2x savings in chip-testing costs.
- AEM provides strong synergies like field-service capabilities and manufacturing scale for the high-tech companies that it acquires.
- High single-customer and product risks.

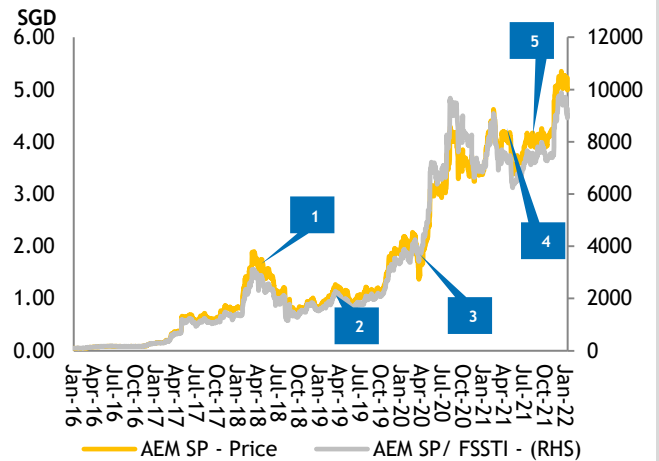
Share of new revenue sources progressively growing



Source: Company, Maybank IBG Research

Price Drivers

Historical share price trend



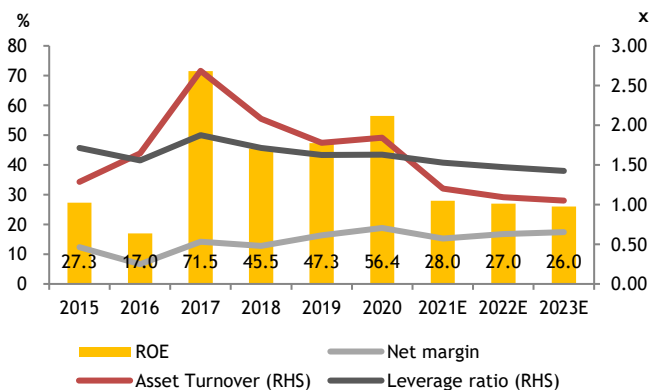
Source: Company, FactSet, Maybank IBG Research

1. Novo Tellus distributes AEM shares in-specie to investors; Core customer announces 10nm delay.
2. AEM's core customer denies rumours from tech-blog SemiAccurate that its 10nm process was cancelled.
3. Through 2020, AEM announced several positive guidance revisions, catalysing rallies
4. Announced FY21 revenue guidance of SGD460-520m, which the market perceived as a disappointment.
5. Announced placement to Temasek.

Financial Metrics

- Over time, we expect increasing contributions from non-Intel revenue sources.
- AEM is not a capex-intensive company. Improved cash-flow from 2016 levels has allowed AEM to pursue highly synergistic acquisitions.
- Training a batch of engineers during pre-production ramp up could take 5-6 months. During such time, staff costs could be elevated and profitability could temporarily decline.
- Adopted 25% dividend payout ratio policy in 2017.

DuPont ROE



Source: Company, Maybank IBG Research

Swing Factors

Upside

- Revenue expansion from securing new customers or wallet expansion/increased orders from existing customers.
- Synergistic and accretive acquisitions.
- Positive customer-related news flow that could catalyse improved orders for AEM, such as capacity expansion or launch of new chips.

Downside

- Order cancellation, delays and earnings misses.
- Emerging technology from rivals that could erode AEM's competitive position with customer(s).
- Erosion in the competitive advantages of the core customer as a result of company specific or industry related developments.

Risk Rating & Score ¹	23.1 (Medium)
Score Momentum ²	NA
Last Updated	11 November 2020
Controversy Score ³ (Updated: 9 Feb 2019)	0 - No Reported Incident

Business Model & Industry Issues

- As an equipment maker, AEM is inherently exposed to environmental, workplace safety, and socio-economic risks. AEM has had zero incidences of environmental non-compliance, as well as zero substantiated cases of corruption and legal compliance issues in 2020.
- From an environmental and social perspective, AEM screens all of its suppliers. AEM constantly strives to be more efficient with electricity usage, and ensures employees are well trained and remunerated fairly.
- AEM is recognised for good transparency with shareholders, while still being able to balance business requirements (e.g. respecting non-disclosure agreements).
- AEM has several new products in the pipeline and it is engaging customers for more. In our view, this is the key for economic sustainability, as well as for development of its own employees.

Material E issues

- AEM's environmental exposure is through energy, water and inputs (fabricated parts and electronics).
- AEM adheres to all National Environment Agency laws and regulations and has not had incidences of environmental non-compliance over the past 10 years.
- Emissions intensity ratio improved to 0.007588 MT/SGD'000 in 2020 (FY19: 0.010349)
- AEM screens suppliers for negative environmental and social impacts, including pollutions, biodiversity loss, global warming, incidences of child labour, breaches of customer privacy, and more. All eight key fabrication suppliers and 23 key standard part suppliers were found to have no negative environmental or social impacts.

Material S issues

- AEM values talent retention. One approach is through wages. In Malaysia, where around a-third of production takes place, AEM's entry wage for production workers have been higher than the minimum wage at least since 2017, to retain employees. Entry wages are also higher than minimum wages in the US and China.
- Workforce diversity. AEM is an equal-opportunities employer. Management are hired from local communities and consists of various nationalities. 86% of management are local across AEM's footprint globally.
- Workplace safety. AEM trains its employees on health and safety work practices. In 2018, there was 1 minor injury.
- In 2020, average training per employee was 8.6 hours, or 5016 hours in total, to equip staff with skills across technical, project management and software domains.
- Females comprise 22 of the total work force, and 19-25% of new hires since 2017. Turnover rate per month was 0.9% a month, exceeding target of 1.5%. FY21 target is 1.25% a month. Turnover range was 1.1-2.1% in FY17-19.

Key G metrics and issues

- The board has seven directors, of which one is the executive chairman, four are independent directors (57%), and two are non-independent, non-executive. All the directors are male.
- The audit & risk management, remuneration, and nominating committees are chaired by independent directors. The strategy committee, which works with management on long-term strategic planning, is chaired by the executive chairman.
- Key management compensation (comprising the Board and senior management) accounted for 13% of staff costs in 2020 (2019:17%).
- In 2019, AEM won "Most Transparent Company Award, Technology" and was runner up for the "Singapore Corporate Governance Award" by SIAS. AEM regularly updates on its sales guidance and orders received and it's active in engaging with the investment community.
- Zero substantiated cases of corruption or legal compliance issues in 2020. There was one case of whistleblowing in 2020, but upon investigation, it was concluded to be unsubstantiated.

AEM was granted two patents in 2019, and the staff involved were rewarded. AEM views its considerable engineering development revenue as a positive sign of customer satisfaction and relationship.

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).

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Metrics					
P/E (reported) (x)	6.2	8.4	18.4	13.3	11.3
Core P/E (x)	10.3	9.7	18.4	13.3	11.3
Core FD P/E (x)	10.4	9.8	19.8	13.4	11.4
P/BV (x)	4.1	4.5	4.3	3.5	2.8
P/NTA (x)	4.1	4.5	4.3	3.5	2.8
Net dividend yield (%)	2.5	2.6	1.4	1.9	2.2
FCF yield (%)	11.1	8.2	nm	7.3	9.5
EV/EBITDA (x)	6.3	6.7	12.5	8.8	6.9
EV/EBIT (x)	6.9	7.2	14.1	9.6	7.4
INCOME STATEMENT (SGD m)					
Revenue	323.1	519.0	538.5	752.7	854.0
EBITDA	69.5	121.6	108.9	156.1	183.7
Depreciation	(4.4)	(6.1)	(8.7)	(8.4)	(9.3)
Amortisation	(1.5)	(2.3)	(3.6)	(3.6)	(3.6)
EBIT	63.6	113.2	96.6	144.1	170.7
Net interest income / (exp)	(0.2)	0.4	0.8	0.8	0.8
Associates & JV	0.5	0.2	1.5	1.5	1.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	63.9	113.8	98.9	146.4	172.5
Income tax	(11.0)	(16.2)	(16.8)	(24.9)	(29.3)
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	52.9	97.6	82.0	121.5	143.2
Core net profit	52.9	97.6	82.0	121.5	143.2
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	107.7	134.8	217.6	300.9	414.1
Accounts receivable	28.0	47.6	70.5	94.5	92.7
Inventory	57.5	79.7	130.7	163.4	153.2
Property, Plant & Equip (net)	6.4	8.1	28.5	28.1	26.8
Intangible assets	19.0	56.2	95.4	95.4	95.4
Investment in Associates & JVs	4.6	4.7	11.0	12.5	13.5
Other assets	4.9	4.5	7.1	7.1	7.1
Total assets	228.0	335.5	560.8	701.8	802.6
ST interest bearing debt	0.0	0.0	7.0	7.0	7.0
Accounts payable	73.1	83.7	90.1	140.0	133.4
LT interest bearing debt	0.0	0.0	60.5	60.5	60.5
Other liabilities	20.0	40.0	29.0	29.0	29.0
Total Liabilities	93.6	124.1	186.1	236.0	229.4
Shareholders Equity	134.3	211.4	374.7	465.8	573.2
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	134.3	211.4	374.7	465.8	573.2
Total liabilities and equity	228.0	335.5	560.8	701.8	802.6
CASH FLOW (SGD m)					
Pretax profit	63.9	113.8	98.9	146.4	172.5
Depreciation & amortisation	5.9	8.4	12.3	12.0	12.9
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	2.3	(27.2)	(77.6)	(6.8)	5.4
Cash taxes paid	(5.8)	(8.8)	(12.2)	(24.9)	(29.3)
Other operating cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	65.8	86.0	19.9	125.2	160.6
Capex	(5.1)	(7.9)	(29.0)	(8.0)	(8.0)
Free cash flow	60.7	78.1	(9.1)	117.2	152.6
Dividends paid	(10.5)	(22.2)	(21.9)	(30.4)	(35.8)
Equity raised / (purchased)	0.0	4.9	103.1	0.0	0.0
Change in Debt	(0.3)	0.0	67.4	0.1	0.0
Other invest/financing cash flow	(1.3)	(34.7)	(56.7)	(3.6)	(3.6)
Effect of exch rate changes	0.2	0.0	0.0	0.0	0.0
Net cash flow	48.9	26.1	82.9	83.3	113.2

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Ratios					
Growth ratios (%)					
Revenue growth	23.2	60.6	3.8	39.8	13.5
EBITDA growth	65.8	74.9	(10.5)	43.4	17.7
EBIT growth	58.8	77.9	(14.6)	49.2	18.5
Pretax growth	59.9	78.1	(13.1)	48.1	17.9
Reported net profit growth	58.1	84.3	(15.9)	48.1	17.9
Core net profit growth	58.1	84.3	(15.9)	48.1	17.9
Profitability ratios (%)					
EBITDA margin	21.5	23.4	20.2	20.7	21.5
EBIT margin	19.7	21.8	17.9	19.2	20.0
Pretax profit margin	19.8	21.9	18.4	19.4	20.2
Payout ratio	26.0	25.4	25.0	25.0	25.0
DuPont analysis					
Net profit margin (%)	16.4	18.8	15.2	16.1	16.8
Revenue/Assets (x)	1.4	1.5	1.0	1.1	1.1
Assets/Equity (x)	1.7	1.6	1.5	1.5	1.4
ROAE (%)	47.3	56.4	28.0	28.9	27.6
ROAA (%)	29.1	34.6	18.3	19.2	19.0
Liquidity & Efficiency					
Cash conversion cycle	5.2	15.0	59.2	64.1	54.2
Days receivable outstanding	27.7	26.2	39.5	39.5	39.5
Days inventory outstanding	80.2	78.3	113.4	113.4	108.5
Days payables outstanding	102.7	89.5	93.7	88.8	93.7
Dividend cover (x)	3.8	3.9	4.0	4.0	4.0
Current ratio (x)	2.2	2.4	3.7	3.4	4.2
Leverage & Expense Analysis					
Asset/Liability (x)	2.4	2.7	3.0	3.0	3.5
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	na	na	na	na
Debt/EBITDA (x)	0.0	0.0	0.6	0.4	0.4
Capex/revenue (%)	1.6	1.5	5.4	1.1	0.9
Net debt/ (net cash)	(107.7)	(134.8)	(150.2)	(233.4)	(346.6)

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

Dr Zamros DZULKAFLI
(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
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

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
msshafiqk.abkadir@maybank-ib.com
• Healthcare • Software

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

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

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

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

Fiorenzo de JESUS
(63) 2 8849 8846
fiorenzo.dejesus@maybank.com
• Utilities

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 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.com
• Banking & Finance

Willy GOUTAMA
(62) 21 8066 8600
willy.goutama@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 TARAPORNIT *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 TFE

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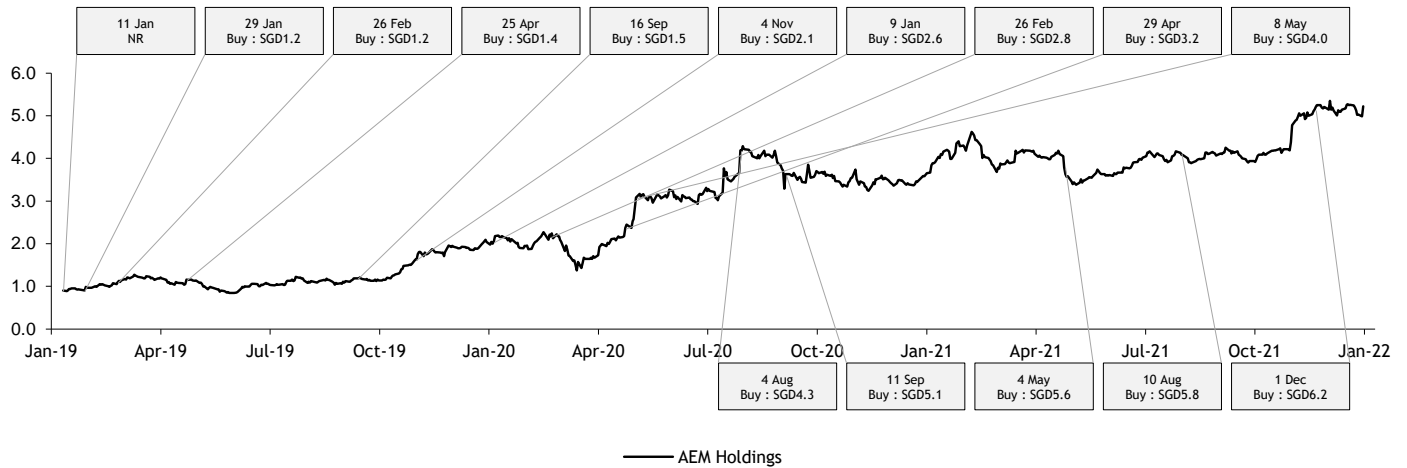
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Historical recommendations and target price: AEM Holdings (AEM SP)



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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 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


Sales Trading

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

Indonesia
Helen Widjaja
helen.widjaja@maybank.com
(62) 21 2557 1188

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

Tel: (65) 6336 9090


Hong Kong

MIB Securities (Hong Kong) Limited
28/F, Lee Garden Three,
1 Sunning Road, Causeway Bay,
Hong Kong

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


Thailand

Maybank 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)


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 Sekuritas Indonesia
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 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

MIB Securities India Pte. 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