# 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 <u>highlighted</u> 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				
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

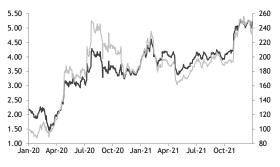
### **Company Description**

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



AEM Holdings - (LHS, SGD) AEM Holdings / Straits Times Index - (RHS, %)

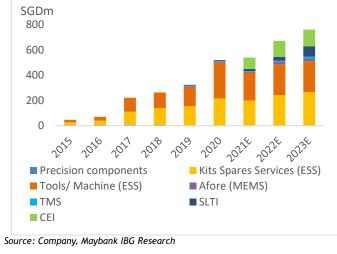
	-1M	-3M	-12M
Absolute (%)	1	32	42
Relative to index (%)	(2)	28	32
Source: FactSet			



# Value Proposition

- Back-end test-equipment manufacturer that has codeveloped 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.





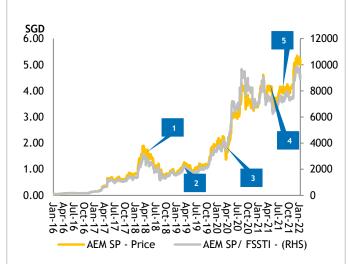
# **Financial Metrics**

- 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.

#### х % 80 3.00 70 2.50 60 2.00 50 1.50 40 30 1.00 20 0.50 10 7.0 71 45.5 47.3 56 28.0 27.00 0.00 2015 2016 2017 2018 2019 2020 2021E 2022E 2023E ROF Net margin Asset Turnover (RHS) 🗕 Leverage ratio (RHS) 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.

# 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.

laigenelih@maybank.com

### DuPont ROE

ESG@MKE

laigenelih@maybank.com

Risk Rating & Score <sup>1</sup>	23.1 (Medium)
Score Momentum <sup>2</sup>	NA
Last Updated	11 November 2020
Controversy Score <sup>3</sup> (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.

<u>Raisk Rating & Score</u> - 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. <u>Score</u> <u>Momentum</u> - indicates changes to the company's score since the last update - a <u>negative</u> integer indicates a company's improving risk score; a <u>positive</u> integer indicates a deterioration. <u>Score</u> - 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.
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	170.3
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	0.0 146.4	172.
Income tax	(11.0)	(16.2)	96.9 (16.8)	(24.9)	(29.3
Minorities	(11.0) 0.0	(16.2)	(16.8)	(24.9)	(29.3
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	52.9	97.6	82.0	121.5	143.3
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.
Accounts receivable	28.0	47.6	70.5	94.5	92.
Inventory	57.5	79.7	130.7	163.4	153.2
Property, Plant & Equip (net)	6.4	8.1	28.5	28.1	26.
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.
Other assets	4.9	4.5	7.1	7.1	7.
Total assets	228.0	335.5	560.8	701.8	802.0
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	802.0
CASH FLOW (SGD m)					
Pretax profit	63.9	113.8	98.9	146.4	172.
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.
Change in working capital	2.3	(27.2)	(77.6)	(6.8)	5.
Cash taxes paid	(5.8)	(8.8)	(12.2)	(0.8)	(29.3
Other operating cash flow	(5.8)	(8.8)	0.0	(24.9)	(29.3
Cash flow from operations	65.8	86.0	19.9	125.2	160.
Capex Froe cash flow	(5.1)	(7.9) 78 1	(29.0)	(8.0) 117.2	(8.0
Free cash flow	60.7	78.1	(9.1)	117.2	152.
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.
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.
Net cash flow	48.9	26.1	82.9	83.3	113.

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.	
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.	
Days payables outstanding	102.7	89.5	93.7	88.8	93.3	
Dividend cover (x)	3.8	3.9	4.0	4.0	4.(	
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 gearing (%) (excl. perps)	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

#### FΧ

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

(603) 2297 8916 samuel.y@maybank-ib.con
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 8500 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 TARAPORNTIP 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

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

Thanatphat SUKSRICHAVALIT (66) 2658 5000 ext 1401 thanaphat.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 TFEX

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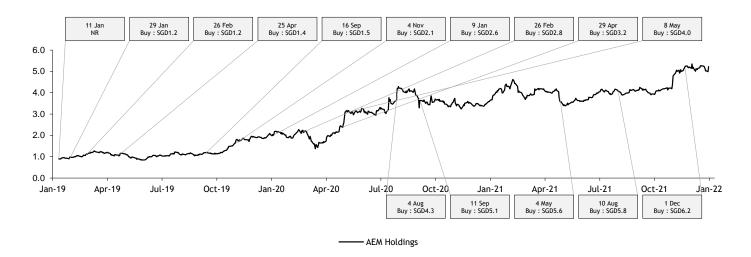
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#### Historical recommendations and target price: AEM Holdings (AEM SP)



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BUY	Return	is expec	teo	d to	be	above	10% in	the next	12 m	onths (ind	ludin	ng c	livio	dend	s)	
	_															

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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

London

India Sanjay Makhija

Greg Smith

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

sanjaymakhija@maybank.com

Tel: (91)-22-6623-2629

Maybank Securities (Thailand) Public Company Limited 999/9 The Offices at Central World, 20<sup>th</sup> - 21<sup>st</sup> 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, 22<sup>nd</sup> 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, 11<sup>th</sup> 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

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