

## Petronas Gas (PTG MK)

# Seemingly not that bad

### A better-than-expected tariff outcome?

PTG's RP2 tariff outcome appears better relative to our expectation, with higher-than-expected transport tariff offsetting lower Pengerang regas tariff. Regulatory details remained undisclosed at the time of writing. Maintain HOLD with a higher MYR17.40 TP (+2%) following our initial round of earnings revisions. We prefer Gas Malaysia (GMB MK, BUY, CP: MYR3.25, TP: MYR3.80) among the gas utilities.

### Transport tariff decline not as steep

Transport tariff for RP2 (2023-2025) has been set at MYR1.069/GJ/day, a 5.8% decrease from MYR1.129/GJ/day in RP1. This is better than our expectation of a c.20% decline (recall there is a scheduled RAB step-down in place). Regulatory details have not been disclosed, thus it is unclear whether the higher-than-expected tariff is due to WACC/capex (earnings-accretive) or opex (earnings-neutral). Separately, RP2 regas tariff for the Melaka and Pengerang plants have been set at MYR3.455/GJ/day (unchanged) and MYR3.165/GJ/day (-9.2%) respectively.

### Awaiting further details

Note that under the regulator's tariff determination model, revenue (and thus tariff) is a function of 1) regulated WACC, 2) capex (the RAB earns a return) and 3) opex (merely a pass-through and is thus earnings neutral). During the previous tariff review (RP1), the inclusion of internal gas consumption (opex) was a major driver of tariff movement. We expect PTG to likely provide more details in due course.

### Raising earnings

We raise FY23/24 earnings forecasts by 3% each (FY22 is unchanged) to reflect the latest transport and regas tariffs. Our TP (DCF-based assuming 7.2% WACC and 2% long-term growth) is consequently raised to MYR17.40 (from MYR17.00). With the RP2 transport tariff overhang now out of the way, PTG's earnings profile has reverted to being stable, in our view.

FYE Dec (MYR m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	5,592	5,649	5,898	5,760	5,760
EBITDA	3,543	3,603	3,486	3,464	3,513
Core net profit	1,995	2,020	1,716	1,893	1,924
Core EPS (sen)	100.8	102.1	86.7	95.6	97.2
Core EPS growth (%)	5.8	1.2	(15.1)	10.3	1.6
Net DPS (sen)	127.0	82.0	72.0	72.0	72.0
Core P/E (x)	17.0	17.6	19.7	17.8	17.5
P/BV (x)	2.7	2.7	2.5	2.4	2.3
Net dividend yield (%)	7.4	4.6	4.2	4.2	4.2
ROAE (%)	15.5	15.5	13.0	13.9	13.6
ROAA (%)	10.5	10.8	8.8	9.4	9.3
EV/EBITDA (x)	9.7	9.9	9.6	9.6	9.4
Net gearing (%) (incl perps)	1.1	net cash	net cash	net cash	net cash
Consensus net profit	-	-	1,762	1,907	1,929
MKE vs. Consensus (%)	-	-	(2.6)	(0.8)	(0.3)

Tan Chi Wei, CFA  
chiwei.t@maybank-ib.com  
(603) 2297 8690

# HOLD

Share Price	MYR 17.04
12m Price Target	MYR 17.40 (+6%)
Previous Price Target	MYR 17.00

### Company Description

Petronas Gas is the gas infrastructure arm of national oil company PETRONAS.

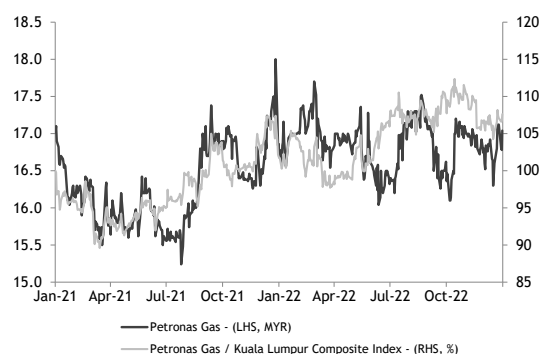
### Statistics

52w high/low (MYR)	17.70/16.04
3m avg turnover (USDm)	2.6
Free float (%)	33.9
Issued shares (m)	1,979
Market capitalisation	MYR33.7B
	USD7.7B

### Major shareholders:

Government of Malaysia	51.0%
Employees Provident Fund	14.5%
Kumpulan Wang Persaraan	10.0%

### Price Performance



	-1M	-3M	-12M
Absolute (%)	2	3	1
Relative to index (%)	2	(1)	6

Source: FactSet

ESG@MAYBANK IBG

Tear Sheet Insert

# ESG@MAYBANK IBG

chiwei.t@maybank.com

<b>Risk Rating &amp; Score<sup>1</sup></b>	31.4 (High)
<b>Score Momentum<sup>2</sup></b>	-0.4
<b>Last Updated</b>	28 Jul 2022
<b>Controversy Score<sup>3</sup></b> (Updated: 27 Jul 2022)	1 - OSH (employee) Incidents

## Business Model & Industry Issues

- Midstream energy companies are viewed as enablers of fossil fuels, and thus face some degree of environmental scrutiny. Nevertheless, gas is the cleanest of fossil fuels and is thus deemed as more palatable for the environment.
- The main uses of gas in Malaysia are for electricity generation and industrial heating. Given the limited developmental potential of renewables and the prevailing structure of PPAs, gas will continue to feature very prominently in Malaysia for at least the next decade. The risk of stranded assets is thus low. As the gas infrastructure arm of national oil company PETRONAS, we do not expect PTG to deviate from its gas-centric business scope in the foreseeable future.
- Transactions with parent PETRONAS (also PTG’s largest customer) are done on commercial terms. However, with parent PETRONAS being entirely government-owned, PTG’s operations and profitability are inevitably affected by government policies. Notably, the government’s implementation of Third-Party Access (for national gas supply security) had adversely impacted PTG’s transportation tariffs. Separately, PTG has had to dispose its Sarawak pipelines to the Sarawak state oil entity.
- PTG scores above-average in our proprietary scoring methodology (see next page) with an overall score of 55/100.

### Material E issues

- Within the energy space, gas is the cleanest of fossil fuels and is thus deemed more palatable for the environment relative to other fuel types (such as coal or oil).
- PTG’s GHG emission was up from 3.7mt CO2e in 2020 to 4.8mt CO2e on the back of economic reopening. PTG has set an annual emission cap of 5.0mt CO2e until 2024 and has been proactive with the installation of solar PV, air emission monitoring and emission reduction systems.
- PTG’s utilities division runs a co-generation plant, which is more fuel efficient relative to conventional combined-cycle gas plants.
- Through the offering of LNG bunkering services at its Pengerang regasification facility, PTG is playing its part to promote the use of gas/LNG (which is environmentally cleaner than bunker fuel) in the shipping world.

### Material S issues

- PTG’s pipelines are relatively dated. There has not been any material expansion of PTG’s pipelines in the past decade. Thus, the typical native land encroachment issues faced by pipeline companies do not presently apply to PTG.
- Health and safety risks are managed in accordance with prevailing PETRONAS group-wide requirements. There have not been major health and safety mishaps (no fatalities) in recent years. Two incidents of injuries were nevertheless reported in 2019.
- PTG has implemented various CSR programmes in the areas of education, environment and social support, in collaboration with Yayasan PETRONAS (the CSR arm of parent PETRONAS) and other NGOs.
- The male-female split of PTG’s workforce stood at 88%-12% as at 2021. Female representation at the management level stood at a more commendable 44%.

### Key G metrics and issues

- Being part of the PETRONAS group (51%-owned), PTG’s governance practices are heavily influenced by parent PETRONAS.
- The Board currently has 10 Directors, comprising of 1 Executive Director (CEO/MD, a PETRONAS appointee), 3 Non-Independent Non-Executive Directors (including the chairman, all PETRONAS appointees) and 6 Independent Non-Executive Directors.
- There are presently 4 women on the Board (40% representation). PTG is supportive of the 30% female representation threshold at the Board.
- PTG discloses only the remuneration details of its CEO. In 2021, the CEO’s remuneration of MYR1.2m amounted to <0.1% of PTG’s net profit.
- PTG has been audited by KPMG for at least the past decade.
- PTG has not undertaken any material M&As in recent years. Transactions with parent PETRONAS (also PTG’s largest customer) are done on commercial terms.
- With parent PETRONAS being entirely government-owned, PTG’s operations and profitability are inevitably affected by government policies. The government’s implementation of Third-Party Access to enhance gas supply security had adversely impacted PTG’s transportation tariffs. Separately, PTG has had to dispose its Sarawak pipelines to the Sarawak state oil entity.
- PTG does not have a formal dividend policy, having in the past maintained a c.70% payout ratio. Nevertheless, it has in recent years adopted a more aggressive stance on capital management, having declared special dividends in 2019, 2020 and 2021 respectively.

<sup>1</sup>**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. <sup>2</sup>**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. <sup>3</sup>**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).

Quantitative parameters (Score: 19)						
	Particulars	Unit	2019	2020	2021	Tenaga (TNB MK)
E	Scope 1 emissions	m tCO2e	4.29	3.63	4.74	39.80
	Scope 2 emissions	m tCO2e	0.07	0.07	0.04	0.19
	Scope 3 emissions	m tCO2e	N/A	N/A	N/A	N/A
	<b>Total</b>	<b>m tCO2e</b>	<b>4.36</b>	<b>3.70</b>	<b>4.78</b>	<b>39.99</b>
	GHG intensity (Processing)	tCO2e/tonne	0.23	0.25	0.25	N/A
	GHG intensity (Utilities)	tCO2e/MWh	0.24	0.23	0.23	0.55
	Energy intensity (Processing)	GJ/tonne	1.84	1.93	1.90	N/A
	Energy intensity (Utilities)	GJ/tonne	1.29	1.23	1.22	N/A
	Freshwater withdrawals	cu m	7.4	6.9	7.9	N/A
	Number of environmental incidents	number	0	1	0	N/A
S	Hazardous waste recycled	%	48%	65%	57%	N/A
	NOx emissions	tonne	13,849	7,134	7,499	N/A
	% of women in workforce	%	13.0%	13.1%	11.6%	22.1%
	% of women in management roles	%	33.3%	33.3%	44.4%	23.1%
G	Lost time injury frequency (LTIF) rate	number	0.21	0.00	0.09	1.03
	Recordable case frequency	number	0.42	0.18	0.09	N/A
	MD/CEO salary as % of reported net profit	%	0.08%	0.07%	0.06%	0.14%
	Independent directors on the Board	%	50%	50%	60%	67%
	Female directors on the Board	%	50%	50%	40%	33%

Qualitative Parameters (Score: 83)	
a) Is there an ESG policy in place and whether there is a standalone ESG committee or is it part of a risk committee?	<i>Yes. It has a Sustainable Development Working Committee headed by the MD/CEO.</i>
b) Is the senior management salary linked to fulfilling ESG targets?	<i>Yes. Sustainability is one of eight material matters incorporated into management's KPIs.</i>
c) Does the company follow the task force of climate related disclosures (TCFD) framework for ESG reporting?	<i>Not yet. Management is aiming for TCFD alignment by 2023.</i>
e) Does the company have a mechanism to capture Scope 3 emissions - which parameters are captured?	<i>No. But Scope 2 and 3 emissions are inherently insignificant for a gas utility.</i>
f) What are the 2-3 key carbon mitigation/water/waste management strategies adopted by the company?	<i>PTG has invested in flare reduction and energy efficiency initiatives, and has begun to supply carbon dioxide (previously a waste product) to customers.</i>
g) Does carbon offset form part of the net zero/carbon neutrality target of the company?	<i>Yes</i>

Target (Score: 100)		
Particulars	Target	Achieved
Net-zero carbon emissions by 2050	2050	N/A
Annual emission cap limit of 5m tCO2e to 2024	5.0 m	4.8 m
Phase out R22 refrigerants by 2030	2030	N/A
Recycling rate of hazardous waste in 2024	61%	57%
TCFD alignment by 2023	2023	N/A
Zero fatalities, major fires, major loss of primary containment, major security incidents in 2025	0	0
<b>Impact</b>		
NA		
<b>Overall score: 55</b>		
As per our ESG matrix, PTG has an overall score of 55.		

ESG score	Weights	Scores	Final Score
Quantitative	50%	19	9
Qualitative	25%	83	21
Target	25%	100	25
<b>Total</b>			<b>55</b>

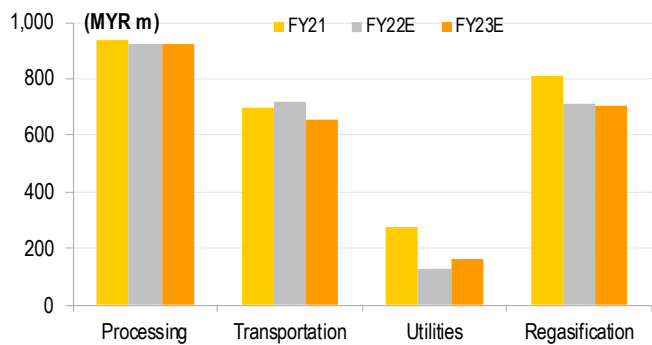
As per our ESG assessment, PTG has an established framework, internal policies, and tangible mid/long-term targets. PTG's overall ESG score is 55, which makes its ESG rating above average in our view (average ESG rating = 50; refer to Appendix I for our ESG Assessment Scoring).

**Fig 1: Transport RAB step-down schedule**

Year	Weight - replacement value (W <sub>RV</sub> )	Weight - historical cost (W <sub>HC</sub> )
2019 (Trial year)	100%	0%
2020 (RP1)	100%	0%
2021 (RP1)	80%	20%
2022 (RP1)	60%	40%
2023 (RP2)	40%	60%
2024 (RP2)	20%	80%
2025 (RP2)	0%	100%
2026 (RP3)	0%	100%

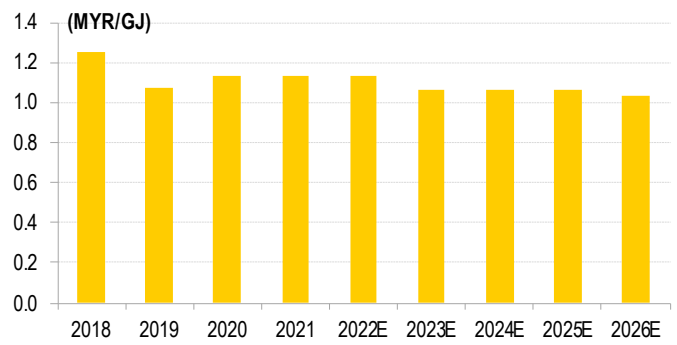
$NOPAT = W_{RV} \times (WACC \times Asset_{RV}) + W_{HC} \times (WACC \times Asset_{HC})$   
 Source: Energy Commission

**Fig 2: PTG's segmental EBIT (FY21-23E)**



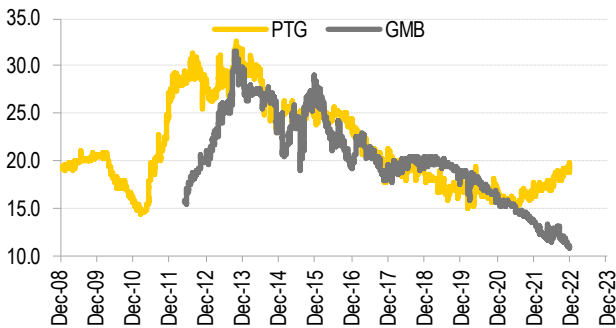
Source: Company, Maybank KE

**Fig 3: PTG's transportation tariff**



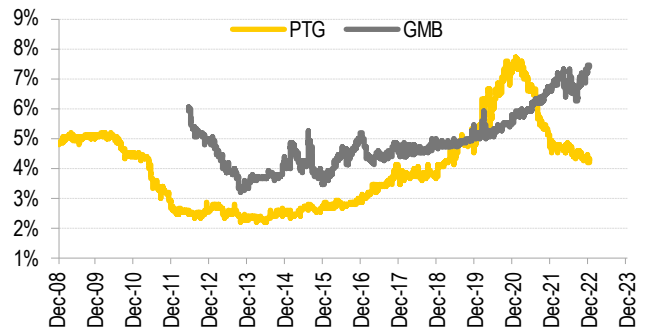
Source: Company, Maybank KE

**Fig 4: Trailing PER**



Source: Company, Maybank IBG Research

**Fig 5: Trailing net yield**



Source: Company, Maybank IBG Research

**Risk statement**

There are several risk factors for our earnings estimates, target price and rating for PTG. Regulatory developments, such as the determination of regulated returns, have a direct impact on earnings. Unscheduled outages could also result in earnings losses for PTG.

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Key Metrics</b>					
P/E (reported) (x)	16.2	16.2	19.7	17.8	17.5
Core P/E (x)	17.0	17.6	19.7	17.8	17.5
P/BV (x)	2.7	2.7	2.5	2.4	2.3
P/NTA (x)	2.7	2.7	2.5	2.4	2.3
Net dividend yield (%)	7.4	4.6	4.2	4.2	4.2
FCF yield (%)	7.1	5.9	4.6	5.0	5.2
EV/EBITDA (x)	9.7	9.9	9.6	9.6	9.4
EV/EBIT (x)	13.6	13.6	13.6	13.7	13.4

**INCOME STATEMENT (MYR m)**

Revenue	5,592.1	5,648.6	5,897.7	5,760.4	5,760.4
EBITDA	3,543.5	3,602.7	3,485.5	3,463.5	3,512.8
Depreciation	(1,016.9)	(983.0)	(1,008.7)	(1,023.2)	(1,040.5)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	2,526.6	2,619.7	2,476.8	2,440.3	2,472.3
Net interest income / (exp)	(98.9)	(90.7)	(95.0)	(97.4)	(96.4)
Associates & JV	159.8	157.1	143.1	150.2	155.5
Exceptionals	22.7	(44.5)	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	2,610.2	2,641.7	2,524.9	2,493.1	2,531.5
Income tax	(527.9)	(530.3)	(714.5)	(515.4)	(522.7)
Minorities	(72.7)	(122.5)	(94.6)	(85.1)	(85.1)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	2,009.6	1,988.9	1,715.8	1,892.5	1,923.6
Core net profit	1,995.3	2,020.0	1,715.8	1,892.5	1,923.6

**BALANCE SHEET (MYR m)**

Cash & Short Term Investments	3,138.9	3,782.5	4,055.3	4,464.9	4,923.0
Accounts receivable	744.5	889.6	937.2	915.4	915.4
Inventory	44.9	46.0	49.5	48.4	48.4
Property, Plant & Equip (net)	13,216.2	13,272.4	13,463.7	13,690.5	13,900.0
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	773.7	856.8	892.4	931.2	972.9
Other assets	426.4	338.9	338.9	338.9	338.9
<b>Total assets</b>	<b>18,344.6</b>	<b>19,186.1</b>	<b>19,737.0</b>	<b>20,389.2</b>	<b>21,098.4</b>
ST interest bearing debt	145.2	168.2	252.1	335.9	419.8
Accounts payable	839.1	1,069.0	1,113.9	1,087.9	1,087.9
LT interest bearing debt	3,134.3	3,278.9	3,362.8	3,446.6	3,530.4
Other liabilities	1,258.0	1,330.0	1,330.0	1,330.0	1,330.0
<b>Total Liabilities</b>	<b>5,376.1</b>	<b>5,846.6</b>	<b>6,059.2</b>	<b>6,200.9</b>	<b>6,368.6</b>
Shareholders Equity	12,634.8	13,098.6	13,389.7	13,857.5	14,356.5
Minority Interest	333.8	240.9	288.2	330.8	373.4
<b>Total shareholder equity</b>	<b>12,968.5</b>	<b>13,339.5</b>	<b>13,677.9</b>	<b>14,188.3</b>	<b>14,729.8</b>
<b>Total liabilities and equity</b>	<b>18,344.6</b>	<b>19,186.1</b>	<b>19,737.0</b>	<b>20,389.2</b>	<b>21,098.4</b>

**CASH FLOW (MYR m)**

Pretax profit	2,610.2	2,641.7	2,524.9	2,493.1	2,531.5
Depreciation & amortisation	1,016.9	983.0	1,008.7	1,023.2	1,040.5
Adj net interest (income)/exp	98.9	90.7	95.0	97.4	96.4
Change in working capital	203.7	(27.0)	(6.3)	(3.0)	0.0
Cash taxes paid	(390.4)	(436.5)	(714.5)	(515.4)	(522.7)
Other operating cash flow	(168.3)	(116.0)	(143.1)	(150.2)	(155.5)
Cash flow from operations	3,371.0	3,135.9	2,764.7	2,945.2	2,990.1
Capex	(955.7)	(1,028.4)	(1,200.0)	(1,250.0)	(1,250.0)
Free cash flow	2,415.3	2,107.4	1,564.7	1,695.2	1,740.1
Dividends paid	(2,611.9)	(1,523.6)	(1,424.7)	(1,424.7)	(1,424.7)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(597.6)	261.6	167.7	167.7	167.7
Other invest/financing cash flow	(88.6)	(201.9)	(34.9)	(28.6)	(25.1)
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	(882.8)	643.6	272.9	409.6	458.1

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	2.5	1.0	4.4	(2.3)	0.0
EBITDA growth	1.6	1.7	(3.3)	(0.6)	1.4
EBIT growth	7.4	3.7	(5.5)	(1.5)	1.3
Pretax growth	6.0	1.2	(4.4)	(1.3)	1.5
Reported net profit growth	3.8	(1.0)	(13.7)	10.3	1.6
Core net profit growth	5.8	1.2	(15.1)	10.3	1.6
<b>Profitability ratios (%)</b>					
EBITDA margin	63.4	63.8	59.1	60.1	61.0
EBIT margin	45.2	46.4	42.0	42.4	42.9
Pretax profit margin	46.7	46.8	42.8	43.3	43.9
Payout ratio	125.1	81.6	83.0	75.3	74.1
<b>DuPont analysis</b>					
Net profit margin (%)	35.9	35.2	29.1	32.9	33.4
Revenue/Assets (x)	0.3	0.3	0.3	0.3	0.3
Assets/Equity (x)	1.5	1.5	1.5	1.5	1.5
ROAE (%)	15.5	15.5	13.0	13.9	13.6
ROAA (%)	10.5	10.8	8.8	9.4	9.3
<b>Liquidity &amp; Efficiency</b>					
Cash conversion cycle	(42.6)	(61.3)	(69.0)	(70.9)	(70.0)
Days receivable outstanding	54.7	52.1	55.8	57.9	57.2
Days inventory outstanding	7.5	5.7	5.7	6.0	5.9
Days payables outstanding	104.8	119.1	130.5	134.7	133.2
Dividend cover (x)	0.8	1.2	1.2	1.3	1.4
Current ratio (x)	3.9	3.6	3.5	3.7	3.8
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	3.4	3.3	3.3	3.3	3.3
Net gearing (%) (incl perps)	1.1	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	1.1	net cash	net cash	net cash	net cash
Net interest cover (x)	25.6	28.9	26.1	25.0	25.6
Debt/EBITDA (x)	0.9	1.0	1.0	1.1	1.1
Capex/revenue (%)	17.1	18.2	20.3	21.7	21.7
Net debt/ (net cash)	140.5	(335.3)	(440.5)	(682.4)	(972.8)

Source: Company; Maybank IBG Research

## 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  
leejuy@maybank.com

**Dr Zamros DZULKAFI**  
(603) 2082 6818  
zamros.d@maybank-ib.com

**Fatin Nabila MOHD ZAINI**  
(603) 2297 8685  
fatinnabila.mohdzaini@maybank-ib.com

**Brian LEE Shun Rong**  
(65) 6231 5846  
brian.lee1@maybank.com

**Luong Thu Huong**  
(65) 6231 8467  
hana.thuhoang@maybank.com

### FX

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

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

**Alan Lau**  
(65) 6320 1378  
alanelau@maybank.com

**Shaun Lim**  
(65) 6320 1371  
shaunlim@maybank.com

### STRATEGY

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

### FIXED INCOME

**Winston PHOON, FCA**  
Head of Fixed Income  
(65) 6340 1079  
winstonphoon@maybank.com

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

### PORTFOLIO STRATEGY

**CHAN Han Chin**  
(603) 2297 8888  
hanchin.chan@maybank-ib.com

**ONG Seng Yeow**  
(65) 6231 5839  
ongsengyeow@maybank.com

### MIBG SUSTAINABILITY RESEARCH

**Jigar SHAH**  
Head of Sustainability Research  
(91) 22 4223 2632  
jigars@maybank.com

**Neerav DALAL**  
(91) 22 4223 2606  
neerav@maybank.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

### 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

**Nur Farah SYIFAA**  
(603) 2297 8675  
nurfarahsyifaa.mohamadfuad@maybank-ib.com  
• Renewable Energy • REITs

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

**Shafiq KADIR, CFA**  
(603) 2297 8691  
msshafiqk.abkadir@maybank-ib.com  
• Healthcare • Software

**LOH Yan Jin**  
(603) 2297 8687  
lohyanjin.loh@maybank-ib.com  
• Ports • Shipping

**Eugene HOO Yee Hui**  
(603) 2082 6819  
eugene.hoo@maybank.com

**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

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

**Kelvin TAN**  
(65) 6231 5837 kelvintan1@maybank.com  
• Telcos • Industrials

**LI Jialin**  
(65) 6231 5845 jialin.li@maybank.com  
• REITs

**Jarick SEET**  
(65) 6231 5848 jarick.seet@maybank.com  
• Technology

### 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 • Gaming

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

### THAILAND

**Jesada TECHAHUSDIN, CFA**  
(66) 2658 6300 ext 1395  
jesada.t@maybank.com  
• Banking & Finance

**Yuwanee PROMMAPORN**  
(66) 2658 6300 ext 1393  
Yuwanee.P@maybank.com  
• Services • Healthcare

**Wasu MATTANAPOTCHANART**  
(66) 2658 6300 ext 1392  
wasu.m@maybank.com  
• Telcos

**Surachai PRAMUALCHAROENKIT**  
(66) 2658 5000 ext 1470  
Surachai.p@maybank.com  
• Auto • Conmat • Contractor • Steel

**Suttatip PEERASUB**  
(66) 2658 5000 ext 1430  
suttatip.p@maybank.com  
• Food & Beverage • Commerce

**Jaroonpan WATTANAWONG**  
(66) 2658 5000 ext 1404  
jaroonpan.w@maybank.com  
• Transportation • Small cap

### INDONESIA

**Jeffrosenberg CHENLIM** *Head of Research*  
(62) 21 8066 8680  
Jeffrosenberg.lim@maybank.com  
• Strategy • Banking & Finance

**Willy GOUTAMA**  
(62) 21 8066 8500  
willy.goutama@maybank.com  
• Consumer

**Richard SUHERMAN**  
(62) 21 8066 8691  
richard.suherman@maybank.com  
• Metals & Mining

**Etta Rusdiana PUTRA**  
(62) 21 8066 8683  
etta.putra@maybank.com  
• Telcos

**Satriawan, CTA**  
(62) 21 8066 8682  
satriawan@maybank.com  
• Chartist

### VIETNAM

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

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

**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 Discretionary

**Tran Thi Thanh Nhan**  
(84 28) 44 555 888 ext 8088  
nhan.tran@maybank.com  
• Consumer Staples

**Nguyen Le Tuan Loi**  
(84 28) 44 555 888 ext 8088  
loi.nguyen@maybank.com  
• Industrials

**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  
• Chartist

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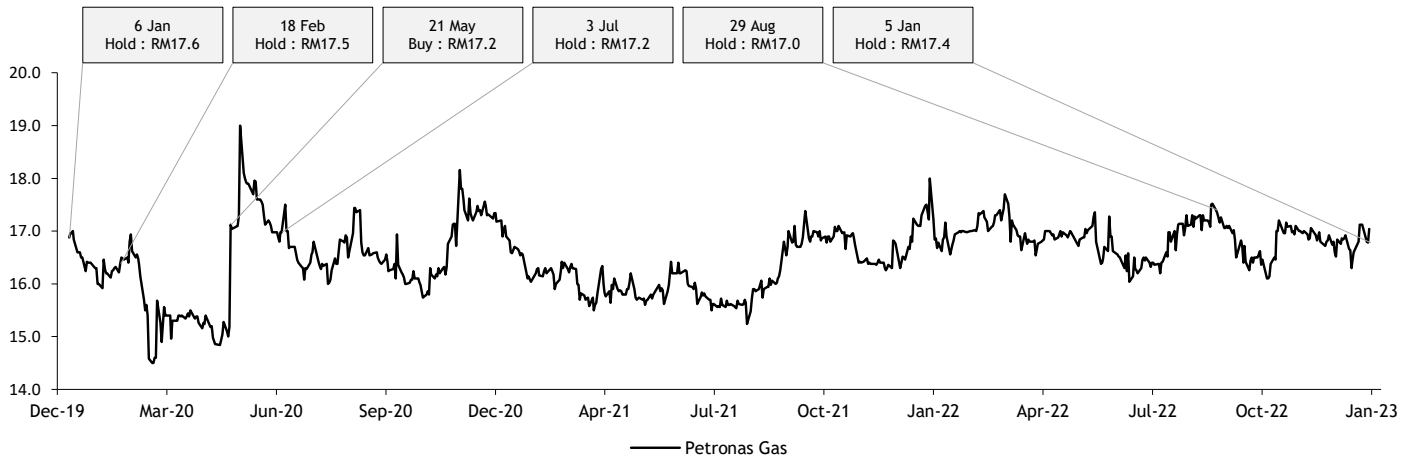
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**Malaysia**

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 Securities Pte Ltd  
 Maybank Research Pte Ltd  
 50 North Canal Road  
 Singapore 059304

Tel: (65) 6336 9090

**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

**Thailand**

Maybank Securities (Thailand) PCL  
 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 Securities (London) Ltd  
 PNB House  
 77 Queen Victoria Street  
 London EC4V 4AY, UK

Tel: (44) 20 7332 0221  
 Fax: (44) 20 7332 0302

**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

**Vietnam**

Maybank Securities Limited  
 Floor 10, Pearl 5 Tower,  
 5 Le Quy Don Street,  
 Vo Thi Sau Ward, District 3  
 Ho Chi Minh City, Vietnam

Tel : (84) 28 44 555 888  
 Fax : (84) 28 38 271 030

**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

**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

**Philippines**  
 Keith Roy  
 keith\_roy@maybank.com  
 Tel: (63) 2 848-5288

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

**India**  
 Sanjay Makhija  
 sanjaymakhija@maybank.com  
 Tel: (91)-22-6623-2629

[www.maybank.com/investment-banking](http://www.maybank.com/investment-banking)  
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