

# Frencken Group Ltd (FRKN SP)

## Ramp up likely from 2-3Q25 onwards

### Positive 2H24 outlook - maintain BUY

We are still not seeing any big ramp up in orders through our channel checks in the semi-con sector and now believe that the much anticipated acceleration in orders will likely occur from 2-3Q25 onwards. We still expect profitability to be stronger in 2H24 vs 1H24 but earnings likely won't be as strong as anticipated due to slower-than expected growth in the life science sector. Hence, we cut our FY24/25E PATMI by 15%/18% respectively, and lower our TP to SGD1.54, pegged to an unchanged 15.5x FY24E P/E. Frencken remains our Top Pick in the Singapore tech sector.

### Semi-con ramp up likely delayed to 2-3Q25

Management expects 2H24E revenue to be higher than 1H24 of SGD372m. Semi-con revenue is also expected to be higher in 2H24 than 1H24. As a result of higher margins from semi-con and better operating leverage, we expect gross and net margins to further improve, as shown in 1H24 when gross margin rose from 12.3% in 1H23 to 14.8% in 1H24 and net margin jumped from 1.5% to 4.8%. However, we believe the much anticipated ramp up in orders will now likely only come in 2Q/3Q25 as we do not see any signs of incoming ramp up yet from our channel checks.

### Life science growth likely slower than expected

The life science segment performed especially well during Covid-19 but is now showing signs of slowing down. As a result, we think that even though there will still be room for growth in this segment, the growth will likely be less than earlier anticipated.

### Still the best of the lot

We continue to like Frencken and believe it will remain a key beneficiary of semiconductor industry recovery. While the majority of its local peers are suffering significant declines in NPAT, Frencken's NPAT is slated to grow strongly in the next few years. It remains our Top Pick in the Singapore tech sector. Our TP of SGD1.54 is based on 15.5x FY24E P/E.

FYE Dec (SGD m)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	786	743	780	858	987
EBITDA	94	80	86	96	110
Core net profit	52	32	43	49	59
Core FDEPS (cts)	12.1	7.6	9.9	11.5	13.8
Core FDEPS growth(%)	(11.8)	(37.4)	31.1	15.8	20.2
Net DPS (cts)	3.6	2.3	3.0	3.5	4.2
Core FD P/E (x)	7.8	17.8	12.8	11.0	9.2
P/BV (x)	1.0	1.4	1.3	1.2	1.1
Net dividend yield (%)	3.9	1.7	2.4	2.7	3.3
ROAE (%)	13.5	8.2	10.2	11.0	12.2
ROAA (%)	7.3	4.4	5.8	6.3	7.1
EV/EBITDA (x)	3.7	6.6	4.1	5.1	3.6
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	44	50	56
MIBG vs. Consensus (%)	-	-	(2.8)	(2.2)	5.6

Jarick Seet  
jarick.seet@maybank.com  
(65) 6321 5848

## BUY

Share Price	SGD 1.27
12m Price Target	SGD 1.54 (+25%)
Previous Price Target	SGD 1.77

### Company Description

Frencken manufactures components and modules for various industries including semiconductor, life sciences, automotive and industrial automation.

### Statistics

52w high/low (SGD)	1.74/1.04
3m avg turnover (USDm)	4.8
Free float (%)	59.8
Issued shares (m)	426
Market capitalisation	SGD541.2M
	USD415M

### Major shareholders:

Micro Compact Sdn. Bhd.	6.2%
Precico Holdings Sdn. Bhd.	6.1%
GOOI FAMILY	5.8%

### Price Performance



	-1M	-3M	-12M
Absolute (%)	2	(22)	8
Relative to index (%)	1	(24)	(4)

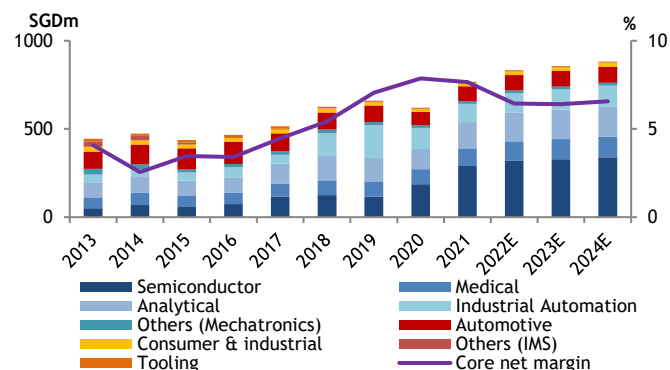
Source: FactSet

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Tear Sheet Insert

## Value Proposition

- Technology hardware manufacturer that specialises in complex components.
- High-mix, low-volume, high complexity for mechatronics segment.
- Customers are sticky, given: i) decades-long working relationships; ii) complementary competencies; and iii) mutual dependency (sole-source for some critical products). We expect Frencken to leverage its relationships with customers to introduce products with greater value-add, in turn driving margins further.

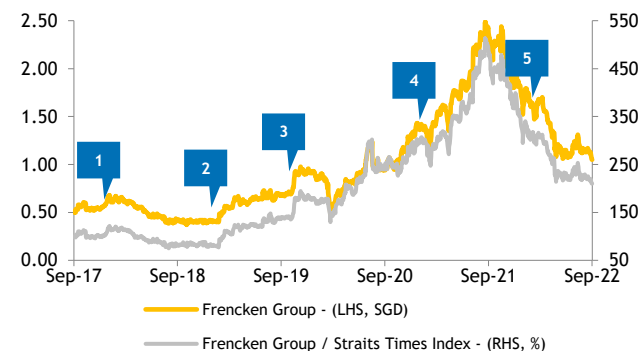
### Diverse end markets



Source: Company

## Price Drivers

### Historical share price trend



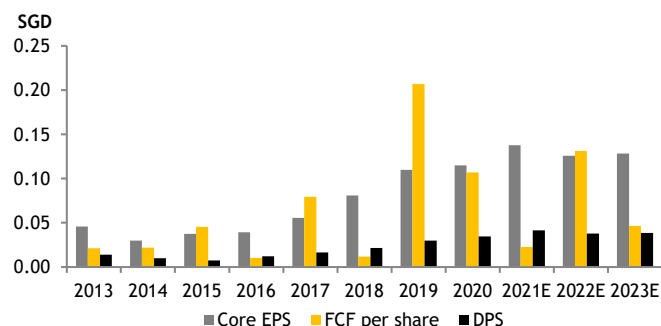
Source: Company, Maybank IBG Research

1. General de-rating of the Singapore tech sector amid initial US-China tensions.
2. Reported FY18 core net profit of SGD34m (+47% YoY) on strength from industrial automation.
3. Reported 3Q19 core net profit of SGD31m (+35%) on strength from industrial automation and semiconductor. General tech sector rerating amid initial signs of global semiconductor recovery.
4. Frencken’s semiconductor segment is a beneficiary of chip shortages.
5. Tech sector derating drove share price lower; 1Q22 net profit fell 12.6% YoY on margin pressures amid inflation and other supply chain challenges.

## Financial Metrics

- Over the medium term, we expect earnings to be driven by revenue growth and margin optimisation through new products and improving efficiencies.
- Net cash balance sheet and strong cash flow should provide resilience amid economic uncertainty.
- Historically pays out 30% of earnings as dividends. We expect this trend to continue.

### EPS, FCF per share and DPS



Source: Company

## Swing Factors

### Upside

- Stronger-than-expected semiconductor and industrial automation contributions.
- Robust margin accretion from new products and improving efficiencies.
- Improving institutional interest, which could help the stock re-rate towards peers’ valuations.

### Downside

- Drop in demand.
- Supply chain disruptions that impede Frencken’s production ability and revenue recognition.
- Lower-than-expected dividend pay-out.

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jarick.seet@maybank.com

Risk Rating & Score <sup>1</sup>	na
Score Momentum <sup>2</sup>	na
Last Updated	na
Controversy Score <sup>3</sup>	na

## Business Model & Industry Issues

- The nature of Frencken’s business in the electronics and automotive manufacturing supply chains exposes it to risks including environmental, workplace safety, and conflict of interest. Frencken has not faced any fines or non-monetary sanctions pertaining environmental nor socioeconomic laws and regulations in 2021.
- From an environment perspective, Frencken’s Eco-PVD offering can be seen as a more environmentally friendly approach for automotive coating. While Frencken does not use recycled materials currently, it may do so in the future subject to customers’ requirements.
- From a governance and socioeconomic perspective, Frencken is adopting industry best practices, including those set by customers, as these facilitate smooth business.

### Material E issues

- Environmental risks - Frencken’s production process involves non-renewable materials and waste generation. Non-compliance of rules and laws may severely impact the environment of local communities.
- In 2021, Frencken had zero fines and non-monetary sanctions for non-compliance with environmental laws and/or regulations.
- Areas for potential improvement include: i) increased use of recycled materials, contingent on customer approval; and ii) increased efficiency of water and electric usage.
- Opportunities - Frencken’s proprietary eco-PVD coating technology is more environmentally friendly than traditional PVD methods. Frencken is optimistic of long term prospects for this offering.

### Material S issues

- Employee health and safety risks. Frencken benchmarks its occupational safety and health practices against industry best practices. E.g. the Bangi (Malaysia) plant is in compliance with Agilent Supplier Environmental, Health and Safety and Social Responsibility guidelines.
- Employee safety remains of paramount importance for Frencken with proper mitigation measures implemented.
- In 2021, Frencken’s injury rate was 0%. (2019: 0.15%). Employees underwent an average of 1.2-17 hours of training in 2021 across technical, occupational health and safety and strategic topics.
- Male employees account for 66% of the workforce.
- Socioeconomic risks. To ensure smooth business operations, Frencken: i) adheres to all applicable laws and regulations; and ii) upholds strong ethical standards. This safeguards trust with stakeholders and avoids liability due to non-compliance.

### Key G metrics and issues

- The board consists of six directors, of whom one is an executive director (CEO), one is a non-executive, non-independent chairman, and four are independent (67%). All directors are male.
- The nominating, audit and remuneration committees are chaired by independent directors.
- Chairman Mr. Gooi Soon Chai’s deemed stake in the company is c.22%.
- Three independent directors have served more than nine years from date of appointments. Frencken states that their independence is not in any way affected by their length of service.
- Professional background of independent directors includes law, accounting, consultancy and electronics engineering.
- Key management/ directors’ compensation accounted for 3.4%/1.4% of total employee compensation in 2021. (2019: 3.8%/ 1.3%).
- Auditor is Deloitte & Touche LLP which was appointed in 2014.
- Former non-independent non-executive chairman Mr. Larry Low resigned in 2016 and pared his stake from 8.14% to 4.74% in 2018. Mr. Low is the father of fugitive Jho Low. However, this development has no impact to the governance nor operations of the company as current management and board are independent of Mr. Low.

<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).

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Quantitative Parameters (Score: 32)						
	Particulars	Unit	2019	2020	2021	Venture SG (2023)
E	Scope 1 emissions	tCO2e	NA	NA	NA	2,659
	Scope 2 emissions	tCO2e	NA	NA	NA	NA
	<b>Total</b>	<b>tCO2e</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>161,054</b>
	Scope 3 emissions (operational)	tCO2e	NA	NA	NA	NA
	<b>Total</b>	<b>tCO2e</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>161,054</b>
	GHG intensity (Scope 1 and 2)	KgCO2e/emp	NA	NA	NA	26.77
	Energy consumption	%/unit of sales	4.38	NA	NA	43.92
	Water consumption	%/unit of sales	0.11	NA	NA	0.25
	Recycled waste generated	Metric tonnes	17	NA	NA	219
S	% of women in workforce	%	34%	31.82%	32%	55%
	Economic value generated and distributed	SGD'000	767.069	786.107	742.859	312322
	Average training hours by gender (women)	Number	6.3	NA	NA	34.8
	New employees hired by gender (women)	%	NA	NA	NA	16%
	Total training hours	hrs	11499	NA	NA	399591.6
	Key operations assessed for risks related to corruption	%	100	100	100	100
G	MD/CEO salary as % of reported net profit	%	4.72	6.44	2.98	2.41
	Board salary as % of reported net profit	%	2.29	2.25	1.7	0.27
	Independent directors on the Board	%	75%	75%	75%	63%
	Female directors on the Board	%	0	0	25%	43%

Qualitative Parameters (Score: 67)	
a)	Is there an ESG policy in place and is there a standalone ESG committee or is it part of the risk committee? <i>Yes, Frencken added Ethical Sustainable Profitable Growth to the tag line, signalling the start of its sustainability journey called "Frencken*Sustain*Life" (FSL). FSL is its Environment Social Governance programme, managed by its board and key management team, which will prioritize returns to stakeholders.</i>
b)	Is the senior management salary linked to fulfilling ESG targets? <i>Yes. The BSC KPI's are accessed on an annual basis during management review meetings.</i>
c)	Does the company follow the task force of climate related disclosures (TCFD) framework for ESG reporting? <i>Yes</i>
d)	Does the company have a mechanism to capture Scope 3 emissions - which parameters are captured? <i>No</i>
e)	What are the 2-3 key carbon mitigation/water/waste management strategies adopted by the company? <i>For new shipments, Frencken reuses cartons and plastic pallets returned by customers. In this way, it aligns with its customer's efforts in reducing plastic and paper waste to landfill as their global supply chain partner. To reduce their carbon footprint and build greater business sustainability, solar energy panels have been installed at its factories in Chuzhou (China), Selangor (Malaysia) and Thailand.</i>
f)	Does carbon offset form part of the net zero/carbon neutrality target of the company? <i>No</i>

Target (Score: 33)		
Particulars	Target	Achieved
Less than 0.20% of water consumption per sale value	0.20%	NA
Less than 7% of electricity consumption per sale value	7.00%	NA
Briefings to present quarterly and FY results	100%	100%
Carbon neutrality/net zero	NA	NA
<b>Impact</b>		
NA		
<b>Overall Score: 41</b>		
As per our ESG matrix, Frencken Group (FRKN SP) has an overall score of 41.		

ESG score	Weights	Scores	Final Score
Quantitative	50%	32	16
Qualitative	25%	67	17
Target	25%	33	8
<b>Total</b>			<b>41</b>

As per our ESG assessment, FRKN has an established framework, internal policies, and tangible medium/long-term targets but needs to make major headway in improving its quantitative "E" metrics, especially disclosing on GHG emissions. FRKN's overall ESG score is 41, which makes its ESG rating below average in our view (average ESG rating = 50).

**Fig 1: Changes in estimates**

	FY24E			FY25E			FY26E		
	New	Old	Chg (%)	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (SGDm)	780.0	854.3	-8.7	858.0	982.4	-12.7	986.7	1,129.8	-12.7
Gross profit (SGDm)	112.9	128.2	-11.9	127.1	150.1	-15.3	149.1	175.5	-15.1
EBIT (SGDm)	56.3	65.8	-14.4	64.4	77.8	-17.1	76.4	91.7	-16.7
EBITDA (SGDm)	86.2	95.7	-9.9	96.1	109.4	-12.2	109.9	125.2	-12.2
Core net profit (SGDm)	42.6	50.5	-15.6	49.3	60.3	-18.3	59.2	71.9	-17.7
EPS (SGD)	0.10	0.12	-15.6	0.12	0.14	-18.3	0.14	0.17	-17.7
			Chg (ppt)			Chg (ppt)			Chg (ppt)
Gross material margin	15.1%	15.6%	-0.4	14.8%	15.7%	-0.9	15.1%	15.7%	-0.6
SGA as % of sales	7.8%	8.2%	-0.4	7.9%	7.9%	0.0	8.0%	8.2%	-0.2

Source: Maybank IBG Research

FYE 31 Dec	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Key Metrics</b>					
P/E (reported) (x)	10.5	13.6	12.7	11.0	9.2
Core P/E (x)	7.8	17.8	12.7	11.0	9.2
Core FD P/E (x)	7.8	17.8	12.8	11.0	9.2
P/BV (x)	1.0	1.4	1.3	1.2	1.1
P/NTA (x)	1.0	1.4	1.3	1.2	1.1
Net dividend yield (%)	3.9	1.7	2.4	2.7	3.3
FCF yield (%)	nm	3.9	27.9	nm	20.7
EV/EBITDA (x)	3.7	6.6	4.1	5.1	3.6
EV/EBIT (x)	5.3	11.4	6.3	7.6	5.2

**INCOME STATEMENT (SGD m)**

Revenue	786.1	742.9	780.0	858.0	986.7
EBITDA	94.4	80.3	86.2	96.1	109.9
Depreciation	(27.8)	(34.0)	(29.9)	(31.7)	(33.5)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	66.6	46.3	56.3	64.4	76.4
Net interest income / (exp)	(3.6)	(4.8)	(4.8)	(4.8)	(4.8)
Associates & JV	0.0	0.0	0.0	0.0	0.0
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	63.0	41.5	51.5	59.6	71.6
Income tax	(11.4)	(9.6)	(8.8)	(10.1)	(12.2)
Minorities	0.2	0.5	(0.2)	(0.2)	(0.2)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	51.9	32.5	42.6	49.3	59.2
Core net profit	51.9	32.5	42.6	49.3	59.2

**BALANCE SHEET (SGD m)**

Cash & Short Term Investments	167.0	142.6	281.0	146.5	240.8
Accounts receivable	123.2	171.2	85.2	196.8	127.6
Inventory	228.8	203.4	162.2	238.4	220.6
Property, Plant & Equip (net)	127.5	129.8	112.4	137.4	162.4
Intangible assets	21.5	21.3	21.3	21.3	21.3
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	57.1	66.9	80.2	81.2	82.2
<b>Total assets</b>	<b>725.2</b>	<b>735.3</b>	<b>742.3</b>	<b>821.7</b>	<b>854.9</b>
ST interest bearing debt	107.7	91.6	91.6	91.6	91.6
Accounts payable	108.3	124.8	101.8	146.5	138.1
LT interest bearing debt	1.1	0.5	0.5	0.5	0.5
Other liabilities	112.0	113.0	113.0	113.0	113.0
<b>Total Liabilities</b>	<b>328.8</b>	<b>330.0</b>	<b>307.0</b>	<b>351.7</b>	<b>343.3</b>
Shareholders Equity	391.9	401.2	431.0	465.5	507.0
Minority Interest	4.5	4.0	4.2	4.4	4.6
<b>Total shareholder equity</b>	<b>396.4</b>	<b>405.3</b>	<b>435.3</b>	<b>470.0</b>	<b>511.6</b>
<b>Total liabilities and equity</b>	<b>725.2</b>	<b>735.3</b>	<b>742.3</b>	<b>821.7</b>	<b>854.9</b>

**CASH FLOW (SGD m)**

Pretax profit	63.0	41.5	51.5	59.6	71.6
Depreciation & amortisation	27.8	34.0	29.9	31.7	33.5
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	(44.1)	(14.8)	90.9	(144.2)	77.6
Cash taxes paid	(8.8)	(11.8)	(8.8)	(10.1)	(12.2)
Other operating cash flow	(0.0)	0.0	0.0	0.0	0.0
Cash flow from operations	37.8	49.0	163.6	(63.0)	170.5
Capex	(41.4)	(26.3)	(12.5)	(56.7)	(58.5)
Free cash flow	(3.6)	22.6	151.1	(119.7)	112.1
Dividends paid	(17.6)	(15.5)	(12.8)	(14.8)	(17.8)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(12.8)	(20.3)	0.0	0.0	0.0
Other invest/financing cash flow	(3.6)	(0.0)	0.0	0.0	0.0
Effect of exch rate changes	(56.7)	(4.9)	0.0	0.0	0.0
Net cash flow	(94.4)	(18.1)	138.4	(134.4)	94.3

FYE 31 Dec	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	2.5	(5.5)	5.0	10.0	15.0
EBITDA growth	(0.5)	(14.9)	7.3	11.5	14.3
EBIT growth	(7.3)	(30.5)	21.6	14.4	18.6
Pretax growth	(10.6)	(34.1)	24.0	15.7	20.1
Reported net profit growth	(11.7)	(37.4)	31.1	15.8	20.2
Core net profit growth	(11.7)	(37.4)	31.1	15.8	20.2
<b>Profitability ratios (%)</b>					
EBITDA margin	12.0	10.8	11.1	11.2	11.1
EBIT margin	8.5	6.2	7.2	7.5	7.7
Pretax profit margin	8.0	5.6	6.6	7.0	7.3
Payout ratio	30.0	30.0	30.0	30.0	30.0
<b>DuPont analysis</b>					
Net profit margin (%)	6.6	4.4	5.5	5.7	6.0
Revenue/Assets (x)	1.1	1.0	1.1	1.0	1.2
Assets/Equity (x)	1.9	1.8	1.7	1.8	1.7
ROAE (%)	13.5	8.2	10.2	11.0	12.2
ROAA (%)	7.3	4.4	5.8	6.3	7.1
<b>Liquidity &amp; Efficiency</b>					
Cash conversion cycle	110.9	126.9	96.7	96.7	96.7
Days receivable outstanding	56.4	71.3	59.2	59.2	59.2
Days inventory outstanding	116.5	120.6	98.6	98.6	98.6
Days payables outstanding	62.1	65.1	61.2	61.2	61.2
Dividend cover (x)	3.3	3.3	3.3	3.3	3.3
Current ratio (x)	1.8	1.9	2.1	2.0	2.1
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	2.2	2.2	2.4	2.3	2.5
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)	18.5	9.6	11.7	13.4	15.9
Debt/EBITDA (x)	1.2	1.1	1.1	1.0	0.8
Capex/revenue (%)	5.3	3.5	1.6	6.6	5.9
Net debt/ (net cash)	(58.2)	(50.6)	(188.9)	(54.5)	(148.8)

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

**Dr Zamros DZULKAFLI**  
Malaysia | Philippines  
(603) 2082 6818  
zamros.d@maybank-ib.com

**Erica TAY**  
China | Thailand  
(65) 6231 5844  
erica.tay@maybank.com

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

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

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

**LEE Jia Yu**  
(65) 6231 5843  
jiayu.lee@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, CFA**  
(65) 6320 1378  
alantau@maybank.com

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

### STRATEGY

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

### FIXED INCOME

**Winson PHOON, FCA**  
Head of Fixed Income  
(65) 6231 5831  
winsonphoon@maybank.com

### PORTFOLIO STRATEGY

**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

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

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

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

**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

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

**Jeremie YAP**  
(603) 2297 8688  
jeremie.yap@maybank-ib.com  
• Oil & Gas - Petrochemicals

**Nur Natasha ARIZA**  
(603) 2297 8691  
natashaariza.aizarizal@maybank-ib.com  
• Healthcare

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

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

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

### SINGAPORE

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

**Eric ONG**  
(65) 6231 5849  
ericong@maybank.com  
• Healthcare - Transport - SMIDs

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

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

**Krishna GUHA**  
(65) 6231 5842  
krishna.guha@maybank.com  
• REITs - Industrials

**Hussaini SAIFEE**  
(65) 6231 5837  
hussaini.saifee@maybank.com  
• Telcos - Internet

### PHILIPPINES

**Kervin Laurence SISAYAN Head of Research**  
(63) 2 5322 5005  
kervin.sisayan@maybank.com  
• Strategy - Banking & Finance - Telcos

**Daphne SZE**  
(63) 2 5322 5008  
daphne.sze@maybank.com  
• Consumer

**Raffy MENDOZA**  
(63) 2 5322 5010  
joserafael.mendoza@maybank.com  
• Property - REITs - Gaming

**Michel ALONSO**  
(63) 2 5322 5007  
michelxavier.alonso@maybank.com  
• Conglomerates

**Germaine GUINTO**  
(63) 2 5322 5006  
germaine.guinto@maybank.com  
• Utilities

### 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 8182  
loi.nguyen@maybank.com  
• Property

**Nguyen Thanh Hai**  
(84 28) 44 555 888 ext 8081  
thanhhai.nguyen@maybank.com  
• Industrials

**Nguyen Thanh Lam**  
(84 28) 44 555 888 ext 8086  
thanhlam.nguyen@maybank.com  
• Retail Research

### INDONESIA

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

**Willy GOUTAMA**  
(62) 21 8066 8688  
willy.goutama@maybank.com  
• Consumer

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

**Paulina MARGARETA**  
(62) 21 8066 8690  
paulina.tjoa@maybank.com  
• Autos - Healthcare

**Jocelyn SANTOSO**  
(62) 21 8066 8689  
jocelyn.santoso@maybank.com  
• Consumer

**Hasan BARAKWAN**  
(62) 21 8066 2694  
hasan.barakwan@maybank.com  
• Metals & Mining - Oil & Gas

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

### THAILAND

**Chak REUNGSINPINYA Head of Research**  
(66) 2658 5000 ext 1399  
chak.reungsinpinya@maybank.com  
• Strategy - Energy

**Jesada TECHAHUDSIN, CFA**  
(66) 2658 5000 ext 1395  
jesada.t@maybank.com  
• Banking & Finance

**Wasu MATTANAPOTCHANART**  
(66) 2658 5000 ext 1392  
wasu.m@maybank.com  
• Telcos - Technology - REITs - Property  
• Consumer Discretionary

**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

**Natchaphon RODJANAROWAN**  
(66) 2658 5000 ext 1393  
natchaphon.rodjanarowan@maybank.com  
• Utilities

**Boonyakorn AMORNSANK**  
(66) 2658 5000 ext 1394  
boonyakorn.amornsank@maybank.com  
• Services

**Nontapat SAHAKITPINYO**  
(66) 2658 5000 ext 2352  
nontapat.sahakitpinyo@maybank.com  
• Healthcare



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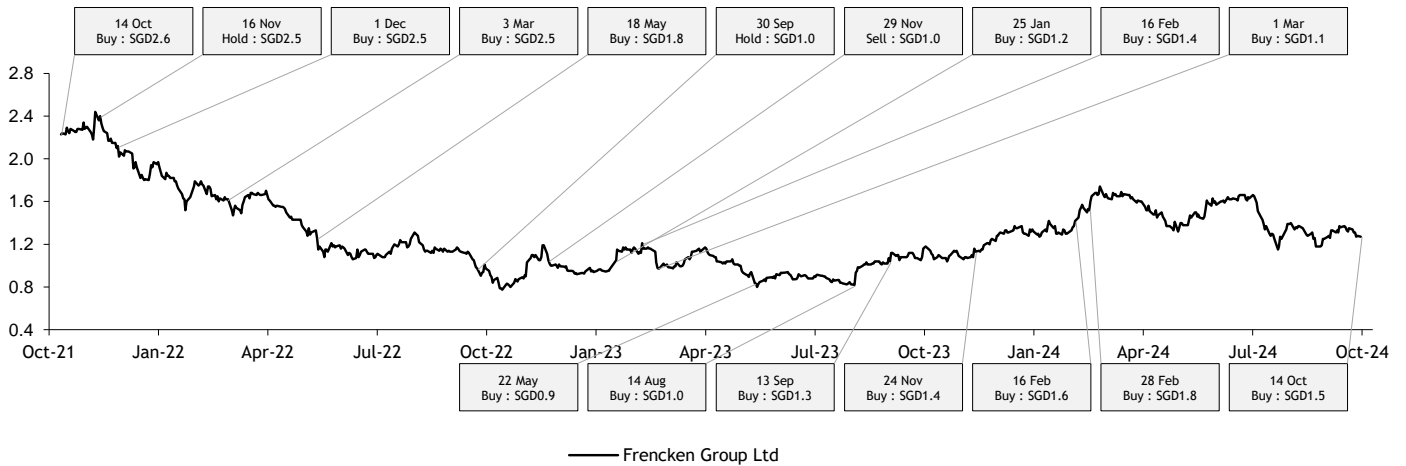
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 **Malaysia**

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**
**Indonesia**

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

**Philippines**

Keith Roy  
keith\_roy@maybank.com  
Tel: (63) 2 5322 3184

**London**

Greg Smith  
gsmith@maybank.com  
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)  
[www.maybank-keresearch.com](http://www.maybank-keresearch.com)