Technology

Singapore

Frencken Group Ltd (FRKN SP)

Building a war chest for growth

BUY

Share Price	SGD 2.40
12m Price Target	SGD 3.32 (+42%)
Previous Price Target	*SGD 3.70*

War chest for both organic and inorganic expansion

Frencken has completed a SGD100m placement, which garnered strong support from institutional, accredited and other investors. The proceeds are earmarked for both organic and inorganic expansion to add new growth catalysts. We believe that management is preparing a war chest for the multi-year growth that lies ahead, especially with its European and South East Asian (SEA) customers in the semi-con space. Maintain BUY with a lower TP of SGD3.32 from SGD3.70 on 22.5x FY27E P/E after accounting for dilution of the placement.

Inflection point from 2H26E onwards

We expect its European semi-con orders to rebound strongly in 2H26E, as inventories would have been depleted by 1H26. We expect strong order growth from the deep ultraviolet (DUV) and extreme ultraviolet (EUV segments), especially in 2027, for new products (NPI) which could add SGD50-100m of revenue. We expect higher margins at both the gross and net levels from operating leverage and higher semi-con revenue content.

Adding recurring semi-con revenue

We believe that Frencken is building a war chest that will likely lead to strategic investments and acquisitions, potentially within 2 years and it could be multiple acquisitions which could introduce new capabilities or generate more revenue that are recurring in nature, especially in the tech/semi-con space. We believe this will be a huge positive for Frencken.

Time to ride the upside

We believe Frencken is a key beneficiary of the recovery in the semi-conductor industry. We expect the ramp up in 2H26E to potentially offset the weakness in 1H26 and still result in a positive year for Frencken.

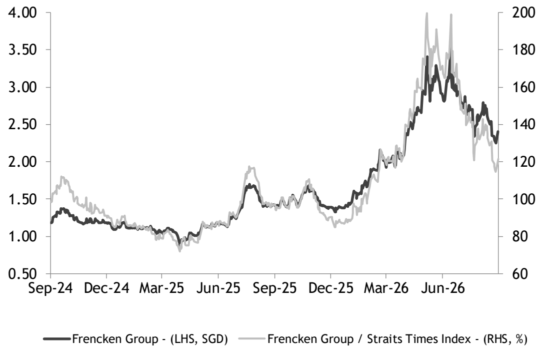
Company Description

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

Statistics

52w high/low (SGD)	3.54/1.33
3m avg turnover (USDm)	11.8
Free float (%)	59.8
Issued shares (m)	474
Market capitalisation	SGD1.1B
	USD898M
Major shareholders:	
GOOI FAMILY	9.4%
Micro Compact Sdn. Bhd.	6.2%
Precico Holdings Sdn. Bhd.	6.1%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(7)	(18)	69
Relative to index (%)	(8)	(28)	25

Source: FactSet

FYE Dec (SGD m)	FY24A	FY25A	FY26E	FY27E	FY28E
Revenue	794	865	904	1,040	1,196
EBITDA	91	89	92	116	132
Core net profit	37	39	45	63	75
Core FDEPS (cts)	8.7	9.1	10.5	14.7	17.6
Core FDEPS growth(%)	14.3	5.4	15.0	40.1	19.6
Net DPS (cts)	2.6	2.7	2.9	4.0	4.8
Core FD P/E (x)	13.0	15.1	22.8	16.3	13.6
P/BV (x)	1.1	1.2	2.2	2.1	1.9
Net dividend yield (%)	2.3	2.0	1.2	1.7	2.0
ROAE (%)	8.9	8.6	9.2	11.9	13.1
ROAA (%)	5.0	5.3	5.7	7.5	8.3
EV/EBITDA (x)	4.5	5.1	10.2	8.6	7.3
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	45	50	55
MIBG vs. Consensus (%)	-	-	(0.2)	25.4	38.4

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Tear Sheet Insert

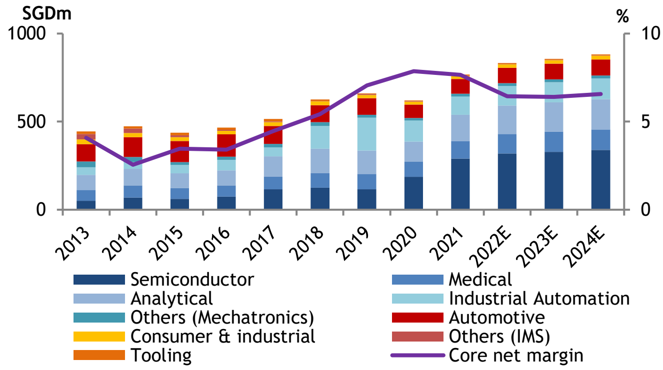
Jarick Seet
jarick.seet@maybank.com
(65) 6321 5848

Co. Reg No: 198700034E
MICA (P) : 099/03/2012

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 higher.

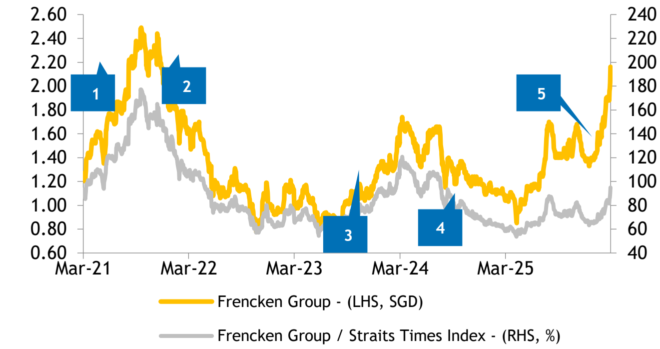
Diverse end-markets



Source: Company

Price Drivers

Historical share price trend



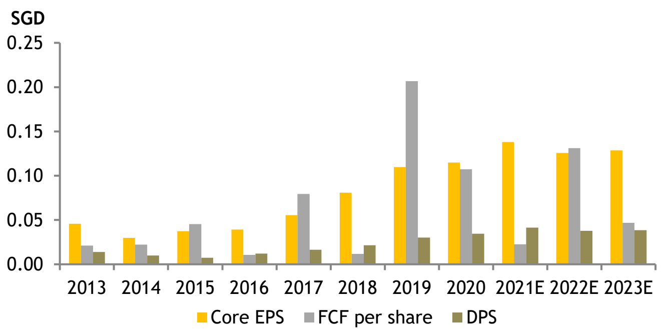
Source: Company, Maybank IBG Research

1. Covid-19 drove higher demand for electronics, semi-con.
2. Tech sector de-rating drove share price lower; profit fell on margin pressures amid inflation and other supply chain challenges.
3. Strong surge in semi-con demand.
4. US implemented global tariffs.
5. Global AI demand drove global equipment players higher.

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.

jarick.seet@maybank.com

ESG@MAYBANK IBG

jarick.seet@maybank.com

Risk Rating & Score[1]	na
Score Momentum[2]	na
Last Updated	na
Controversy Score[3]	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.

[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).

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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
	Total	**tCO2e**	**NA**	**NA**	**NA**	**161,054**
	Scope 3 emissions (operational)	tCO2e	NA	NA	NA	NA
	Total	**tCO2e**	**NA**	**NA**	**NA**	**161,054**
	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?

*Yes. Frencken added Ethical Sustainable Profitable Growth to its 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.*

b) Is the senior management salary linked to fulfilling ESG targets?

Yes. The BSC KPI's are accessed on an annual basis during management review meetings.

c) Does the company follow the task force of climate related disclosures (TCFD) framework for ESG reporting?

Yes

d) Does the company have a mechanism to capture Scope 3 emissions - which parameters are captured?

No

e) What are the 2-3 key carbon mitigation/water/waste management strategies adopted by the company?

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.

f) Does carbon offset form part of the net zero/carbon neutrality target of the company?

No

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
Impact		
NA		
Overall Score: 41		
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
Total			**41**

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).

FYE 31 Dec	FY24A	FY25A	FY26E	FY27E	FY28E
Key Metrics					
P/E (reported) (x)	16.0	14.0	25.3	18.0	15.1
Core P/E (x)	13.0	15.1	25.3	18.0	15.1
Core FD P/E (x)	13.0	15.1	22.8	16.3	13.6
P/BV (x)	1.1	1.2	2.2	2.1	1.9
P/NTA (x)	1.1	1.2	2.2	2.1	1.9
Net dividend yield (%)	2.3	2.0	1.2	1.7	2.0
FCF yield (%)	7.3	14.8	6.5	nm	4.4
EV/EBITDA (x)	4.5	5.1	10.2	8.6	7.3
EV/EBIT (x)	8.0	8.5	16.1	12.4	10.2
INCOME STATEMENT (SGD m)					
Revenue	794.3	865.1	904.1	1,039.7	1,195.6
EBITDA	91.3	89.4	92.0	115.5	132.2
Depreciation	(39.8)	(35.9)	(33.5)	(35.3)	(37.1)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	51.5	53.4	58.5	80.3	95.2
Net interest income /(exp)	(5.5)	(4.1)	(4.1)	(4.1)	(4.1)
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	46.0	49.4	54.5	76.2	91.1
Income tax	(9.4)	(10.1)	(9.3)	(13.0)	(15.5)
Minorities	0.5	(0.2)	(0.2)	(0.2)	(0.2)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	37.1	39.1	45.0	63.1	75.4
Core net profit	37.1	39.1	45.0	63.1	75.4
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	159.2	161.9	222.3	164.0	191.5
Accounts receivable	137.8	138.9	158.3	183.5	209.6
Inventory	226.5	198.5	228.5	255.1	299.1
Property, Plant & Equip (net)	120.0	117.0	85.8	110.8	135.8
Intangible assets	22.0	24.3	24.3	24.3	24.3
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	69.7	99.6	113.7	113.7	113.7
Total assets	**735.1**	**740.2**	**832.8**	**851.4**	**973.9**
ST interest bearing debt	86.5	21.7	21.7	21.7	21.7
Accounts payable	94.5	101.9	162.8	137.0	206.6
LT interest bearing debt	0.1	0.6	0.6	0.6	0.6
Other liabilities	117.0	137.0	137.0	137.0	137.0
Total Liabilities	**297.6**	**261.4**	**322.2**	**296.5**	**366.0**
Shareholders Equity	434.0	475.3	506.8	550.9	603.7
Minority Interest	3.5	3.6	3.8	4.0	4.2
Total shareholder equity	**437.5**	**478.9**	**510.6**	**554.9**	**607.9**
Total liabilities and equity	**735.1**	**740.2**	**832.8**	**851.4**	**973.9**
CASH FLOW (SGD m)					
Pretax profit	46.0	49.4	54.5	76.2	91.1
Depreciation & amortisation	39.8	35.9	33.5	35.3	37.1
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	(29.7)	29.4	(2.5)	(77.7)	(0.4)
Cash taxes paid	(8.1)	(11.1)	(9.3)	(13.0)	(15.5)
Other operating cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	48.1	103.5	76.2	20.9	112.2
Capex	(13.0)	(16.6)	(2.2)	(60.3)	(62.1)
Free cash flow	35.1	86.9	74.0	(39.4)	50.2
Dividends paid	(9.7)	(11.1)	(13.5)	(18.9)	(22.6)
Equity raised / (purchased)	0.1	0.0	100.0	0.0	0.0
Change in Debt	(5.9)	(31.5)	0.0	0.0	0.0
Other invest/financing cash flow	(0.0)	(1.8)	0.0	0.0	0.0
Effect of exch rate changes	3.9	0.0	0.0	0.0	0.0
Net cash flow	23.4	42.5	160.5	(58.3)	27.5

FYE 31 Dec	FY24A	FY25A	FY26E	FY27E	FY28E
Key Ratios					
Growth ratios (%)					
Revenue growth	6.9	8.9	4.5	15.0	15.0
EBITDA growth	13.8	(2.2)	2.9	25.6	14.4
EBIT growth	11.2	3.7	9.6	37.2	18.5
Pretax growth	10.8	7.2	10.3	39.9	19.5
Reported net profit growth	14.3	5.4	15.0	40.1	19.6
Core net profit growth	14.3	5.4	15.0	40.1	19.6
Profitability ratios (%)					
EBITDA margin	11.5	10.3	10.2	11.1	11.1
EBIT margin	6.5	6.2	6.5	7.7	8.0
Pretax profit margin	5.8	5.7	6.0	7.3	7.6
Payout ratio	30.0	30.0	30.0	30.0	30.0
DuPont analysis					
Net profit margin (%)	4.7	4.5	5.0	6.1	6.3
Revenue/Assets (x)	1.1	1.2	1.1	1.2	1.2
Assets/Equity (x)	1.7	1.6	1.6	1.5	1.6
ROAE (%)	8.9	8.6	9.2	11.9	13.1
ROAA (%)	5.0	5.3	5.7	7.5	8.3
Liquidity & Efficiency					
Cash conversion cycle	125.8	113.0	96.7	96.7	96.7
Days receivable outstanding	70.0	57.6	59.2	59.2	59.2
Days inventory outstanding	114.0	103.1	98.6	98.6	98.6
Days payables outstanding	58.1	47.7	61.2	61.2	61.2
Dividend cover (x)	3.3	3.3	3.3	3.3	3.3
Current ratio (x)	2.2	2.7	2.5	2.8	2.5
Leverage & Expense Analysis					
Asset/Liability (x)	2.5	2.8	2.6	2.9	2.7
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)	9.4	13.1	14.4	19.8	23.4
Debt/EBITDA (x)	0.9	0.2	0.2	0.2	0.2
Capex/revenue (%)	1.6	1.9	0.2	5.8	5.2
Net debt/ (net cash)	(72.6)	(139.6)	(200.1)	(141.7)	(169.3)

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

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

Azril ROSLI
Malaysia | Philippines | Global
(603) 2082 6818
azril.rosli@maybank-ib.com

Luong Thu Huong
(65) 6231 8467
hana.thuhuong@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
alanlau@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

SE THO Mun Yi, CFA
(603) 2630 2541
munyi.st@maybank-ib.com

Erine YU
(603) 2074 7606
erine.yu@maybank.com

PORTFOLIO STRATEGY

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

Sean LIM
(603) 2297 8888
lim.tzekhang@maybank.com

Benjamin HO
(852) 2268 0641
benjaminhoyin.ho@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

LIM Sue Lin, *Head of Research*
(603) 2297 8612
suelin.lim@maybank-ib.com
• Equity Strategy

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

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 • Construction
• Aviation • Non-Bank Financials

TAN Chi Wei, CFA
(603) 2297 8690
chiwei.t@maybank-ib.com
• Utilities • 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
• REITs

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

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 • Media

Lucas SIM
(603) 2082 6824
lucas.sim@maybank-ib.com
• Technology (EMS)

THONG Kei Jun
(603) 2297 8677
keijun.thong@maybank-ib.com
• Renewable Energy

Justin YEOH
(603) 2082 8676
justin.yeoh@maybank-ib.com
• Technology (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

Aseela ZAHARI
(603) 2082 8767
aseela.za@maybank-ib.com
• Retail Research

Amirul RUSYDY, CMT
(603) 2297 8694
rusydy.azizi@maybank.com
• Chartist

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

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 • Consumer

TOH Xuan Hao
(65) 6231 5820
xuanhao.toh@maybank.com
• Financials • SMIDs

LIU Miaomiao
(65) 6231 5845
miaomiao.liu@maybank.com
• REITs

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

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

Ronalyn Joyce LALIMO
(63) 2 5322 5009
rona.lalimo@maybank.com
• Industrials • Tourism

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

Vu Viet Linh
(84 28) 44 555 888 ext 8201
vietlinh.vu@maybank.com
• Strategy

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

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

Faiq ASAD
(62) 21 8066 8692
faiq.asad1@maybank.com
• Banking & Finance

Kevin HALIM
(62) 21 8066 2687
kevin.halim@maybank.com
• Property • Cement

Jennifer HENRY
(62) 21 8066 8689
jennifer.henry@maybank.com
• Consumer

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 TECHAHUSDIN, 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 (Software) • REITs
• Property • Consumer Discretionary

Suttatip PEERASUB
(66) 2658 5000 ext 1430
suttatip.p@maybank.com
• Consumer Staples & Discretionary

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

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

Nontapat SAHAKITPINYO
(66) 2658 5000 ext 2352
nontapat.sahakitpinyo@maybank.com
• Healthcare • Construction • Insurance
• Industrial Estate

Yugi TAKESHIMA
(66) 2658 5000 ext 1530
yugi.takeshima@maybank.com
• Technology (EMS & Semicon) • Automotive
• Industrials

Tanida JIRAPORNKASEMSUK
(66) 2658 5000 ext 1396
tanida.jirapornkasemsuk@maybank.com
• Food & Beverage

Aomsub NGOWSIRI
(66) 2658 5000 ext 2518
aomsub.ngowsiri@maybank.com
• Industrials

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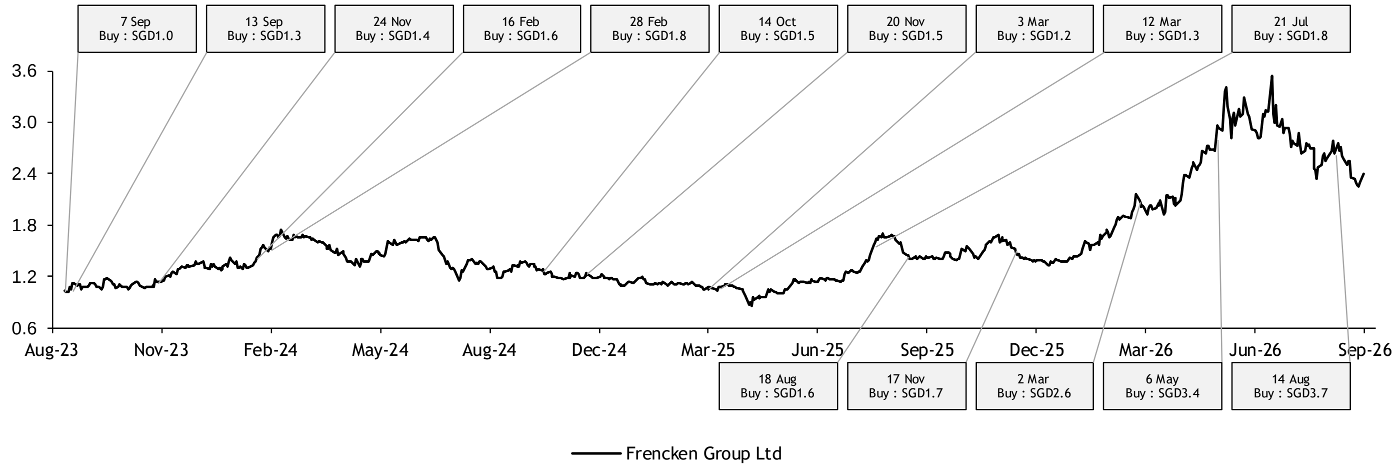

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Malaysia

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

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

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

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

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

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

Thailand

Maybank Securities (Thailand) PCL
999/9 The Offices at Central World,
20th - 21st Floor,
Rama 1 Road Pathumwan,
Bangkok 10330, Thailand

Tel: (66) 2 658 6817 (sales)
Tel: (66) 2 658 6801 (research)

Vietnam

Maybank 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

Sales Trading

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

London
Greg Smith
gsmith@maybank.com
Tel: (44) 207 332 0221

Philippines
Keith Roy
keith_roy@maybank.com
Tel: (63) 2 5322 3184

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

www.maybank.com/investment-banking
mibgresearch.maybank.com