

# Sterlite Technologies (SOTL IN)

## Strong Order Visibility

### Cut TP for lower OF prices but maintain BUY

3QFY19 EPS was in line with our expectation but ahead of the Street's. 9M EPS forms 72% of our FY19E EPS. A 124% YoY increase in its order book and commissioning of new optical-fibre (OF) capacity suggest FY20 could be another strong year. OF prices have softened of late due to delays in tendering in China. We cut FY19-21E EPS by 3-5% for this and generally lowering of service EBITDA margins. This lowers our TP by 6% to INR450, still at 12.5x FY20E EBITDA, a 20% premium over its 2-year average to factor in its growth potential. Maintain BUY with catalysts expected from continued pick up in order book and OF capacity addition. Risks to our view include slowdown in 4G/5G deployment.

### Growing service buffer for product-related risks

SOTL aspires to be a network solutions company. Reflecting this, service revenue formed more than 30% of its 3Q revenue, up from 20-25% in 3QFY18. Services also formed 50% of its order book, up from 30% last year. It is also working on proof of concept on data networks for a domestic telco and an international telco. We forecast that services will form 28% of its revenue in FY20E. We believe services will help reduce its product-related risks.

### FY20 to be strong year for products & services

Even after lowering OF prices by 7-12% to USD7.4-7.6/fibre km (fkm) for FY20-21E, our forecasts suggest a 36.6% YoY increase in FY20E revenue. SOTL commissioned its first 10m fibre km (fkm) capacity in Dec 2018. The other 10m fkm should be operational by Jun 2019. 2HFY20 would have the full benefit of this capacity. The company intends to add 2m fkm to its Italy-based OF cable capacity, to 5m. Additionally, its Indian Navy contract is expected to peak in FY20.

### China risks manageable at the moment

Delays in China Mobile's tender for OF have driven down prices. Management shared that a 15-20% increase in glass-preform supply over demand could drag down OF prices. Glass preform is a critical raw material for OF. The above seems unlikely as per industry reports, considering the importance of OF for 4G/5G networks. Also, China forms a meagre 5-6% of SOTL's revenue.

FYE Mar (INR m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	25,936	32,055	48,360	66,063	73,688
EBITDA	5,189	7,494	11,694	15,784	18,135
Core net profit	2,014	3,343	5,528	7,689	9,068
Core EPS (INR)	5	8	14	19	23
Core EPS growth (%)	30.0	64.9	65.3	39.1	17.9
Net DPS (INR)	1	2	4	5	6
Core P/E (x)	24.9	37.5	20.5	14.8	12.5
P/BV (x)	5.7	10.7	7.3	5.4	4.2
Net dividend yield (%)	1.0	0.6	1.3	1.8	2.1
ROAE (%)	25.5	32.5	40.4	42.1	37.6
ROAA (%)	7.3	10.1	12.2	13.0	13.2
EV/EBITDA (x)	11.5	18.0	11.3	8.3	7.2
Net gearing (%) (incl perps)	99.4	70.3	105.6	73.3	50.7
Consensus net profit	-	-	5,383	6,704	8,136
MKE vs. Consensus (%)	-	-	2.7	14.7	11.5

Neerav Dalal  
neerav@maybank-ke.co.in  
(91) 22 6623 2606

# BUY

Share Price	INR 283
12m Price Target	INR 450 (+59%)
Previous Price Target	INR 480

### Company Description

SOTL provides transmission solutions for the telecom industry. It offers a range of end-to-end optical fibers for a variety of applications.

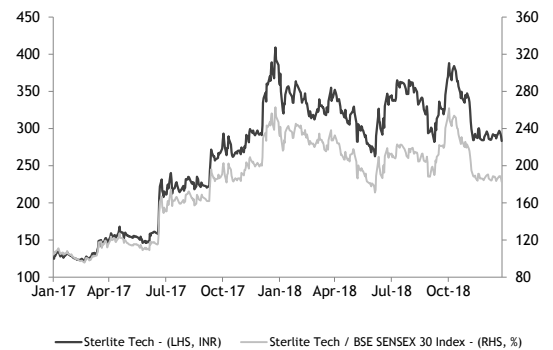
### Statistics

52w high/low (INR)	388/263
3m avg turnover (USDm)	6.6
Free float (%)	44.0
Issued shares (m)	402
Market capitalisation	INR114.0B USD1.6B

### Major shareholders:

Twinstar Overseas Ltd.	52.0%
L&T Investment Management Ltd.	3.6%
Life Insurance Corp. of India	2.2%

### Price Performance



	-1M	-3M	-12M
Absolute (%)	(0)	(13)	(28)
Relative to index (%)	(2)	(19)	(28)

Source: FactSet

### Cut EPS by 3-6%

We lower OF prices by 7-12% to USD7.4-7.6 fkm for FY20-21E. This reduces our revenue by 2-3%. We also lower EBITDA margins by 80-100bps to factor the OF price cut and lowering of service EBITDA margin by 100bps to 13% in line with management guidance. Ceteris paribus, a 10% change in OF prices affects our EPS by 4%. Overall, we cut EPS by 3-6%.

Fig 1: Earnings and TP changes

FYE March (INRm)	FY19E		Chg (%)	FY20E		Chg (%)	FY21E		Chg (%)
	New	Old		New	Old		New	Old	
Revenue	48,360	48,360	0	66,063	67,148	-2	73,688	75,847	-3
EBITDA	11,694	12,205	-4	15,784	16,614	-5	18,135	19,425	-7
EBITDAM	24.2%	25.2%	-100bp	23.9%	24.7%	-80bp	24.6%	25.6%	-100bp
Net profit	5,528	5,778	-4	7,689	7,927	-3	9,068	9,616	-6
EPS (INR)	13.8	14.4	-4	19.2	19.8	-3	22.6	24.0	-6
Net debt	17,628	17,373	1	16,434	15,822	4	14,799	13,573	9
TP (INR)	450	480	-6						

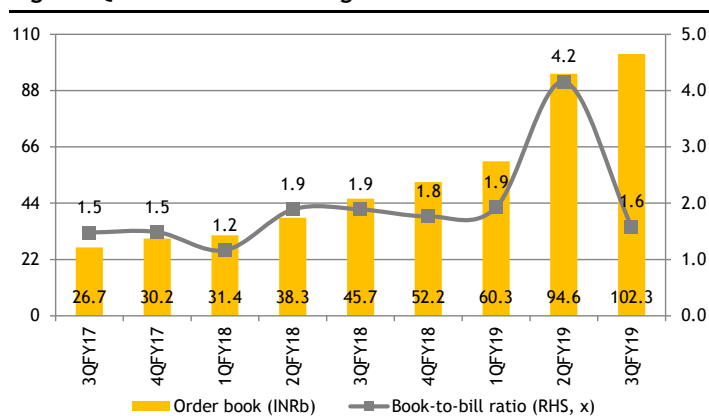
Source: Maybank Kim Eng

Fig 2: Revenue & EBITDA by segment

Particulars	FY17	FY18	FY19E	FY20E	FY21E
<b>Revenue</b>					
Products	18,828	24,059	36,894	47,037	54,810
OF & OFC	15,456	18,930	30,064	39,326	46,911
Copper cables	3,372	5,129	6,830	7,711	7,898
System integration & software	7,108	7,996	11,466	19,026	18,878
<b>Total</b>	<b>25,936</b>	<b>32,055</b>	<b>48,360</b>	<b>66,063</b>	<b>73,688</b>
<b>EBITDA</b>					
Products	4,440	6,457	10,204	13,130	15,465
OF & OFC	4,103	5,841	9,180	11,973	14,280
Copper cables	337	615	1,024	1,157	1,185
System integration & software	749	1,037	1,490	2,654	2,670
<b>Total</b>	<b>5,189</b>	<b>7,494</b>	<b>11,694</b>	<b>15,784</b>	<b>18,135</b>

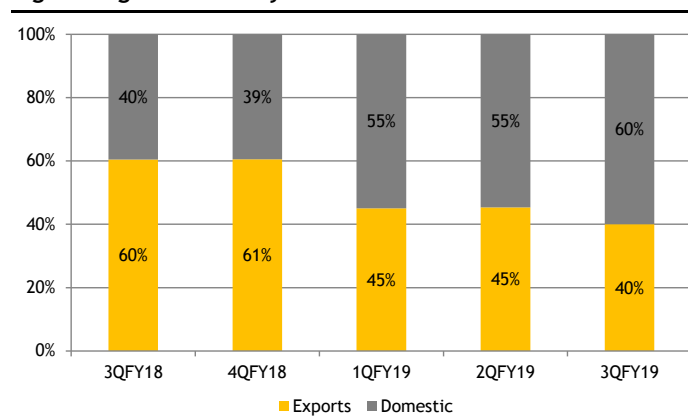
Source: Company, Maybank Kim Eng

Fig 3: 3QFY19 order book surged 124% YoY



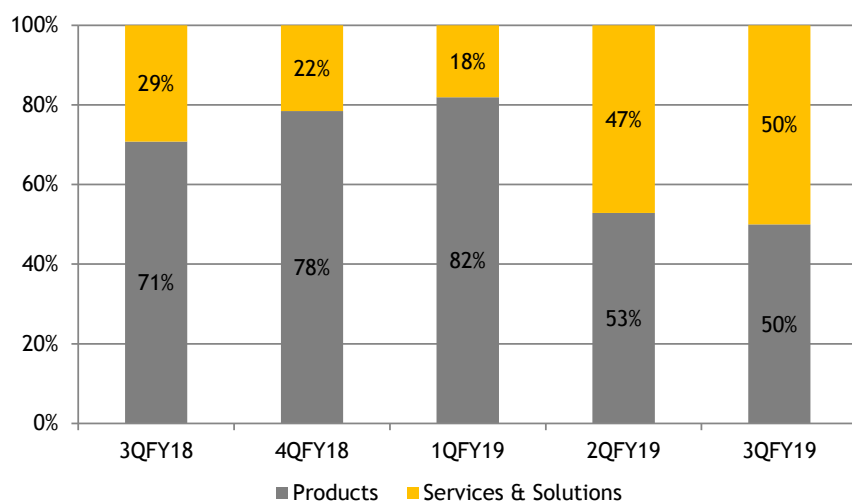
Source: Company

Fig 4: Large Indian Navy contract boosted service order book



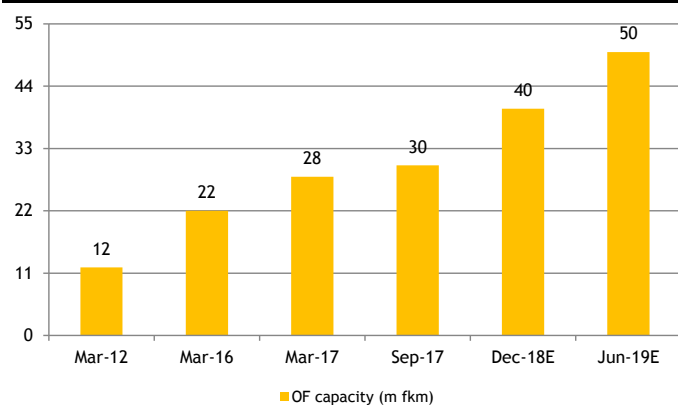
Source: Company

Fig 5: Indian Navy order lifted domestic revenue



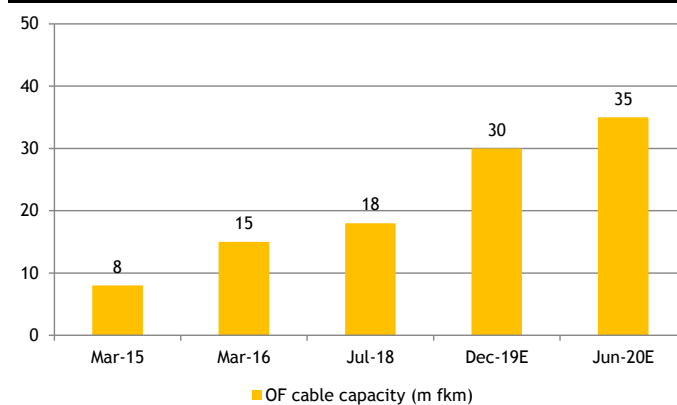
Source: Company

Fig 6: OF expansion to be completed by Jun 2019E



Source: Company

Fig 7: OF cable capacity to more than double by Jun 2020E



Source: Company

Fig 8: Peer comparison

Company name	Bbg		TP	Mkt cap	ROE	EPS CAGR	EV/EBITDA (x)			P/E (x)				
	Code	Curr					CMP	Rating	(INR)	(USDm)	FY19E	FY18-21E	FY19E	FY20E
Sterlite Technologies	SOTL	IN	283	BUY	450	1,647	40.4%	39%	11.3	8.3	7.2	20.5	14.8	12.5
Fujikura	5803	JT	457	NR	NR	1,232	6.2%	3%	6.2	5.8	5.5	8.8	6.9	6.4
Prysmian	PRY	IM	18	NR	NR	4,368	17.9%	19%	10.0	8.1	7.4	12.9	9.9	8.6
Corning	GLW	US	29	NR	NR	23,460	11.3%	9%	8.7	7.9	7.8	16.4	14.2	13.2
Yangtze Optical Fibre	6869	HK	22	NR	NR	3,449	25.4%	17%	10.6	9.2	7.7	9.7	8.7	7.5
Finolex Cables	FNXC	IN	423	NR	NR	912	15.7%	14%	13.4	11.7	10.3	17.1	14.9	13.2
Vindhya Telelinks	VT	IN	1,699	NR	NR	284	NA	NA	NA	NA	NA	NA	NA	NA
<b>Average of peers</b>							<b>15.3%</b>	<b>12%</b>	<b>9.8</b>	<b>8.5</b>	<b>7.7</b>	<b>13.0</b>	<b>10.9</b>	<b>9.8</b>

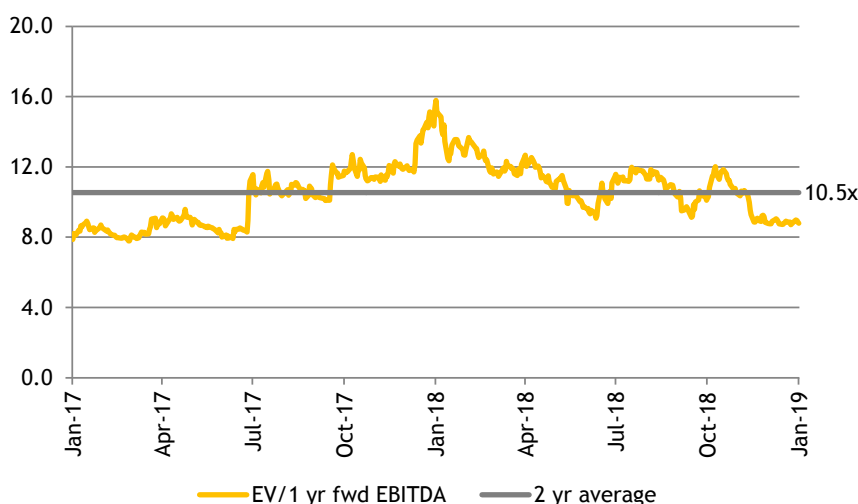
Source: Bloomberg, MKE

Fig 9: Results summary

FY Mar (INRm)	Quarterly					Cumulative		
	3QFY19	3QFY18	% YoY	2QFY19	% QoQ	9MFY19	9MFY18	% YoY
<b>Revenue</b>	<b>13,349</b>	<b>8,352</b>	<b>59.8</b>	<b>10,843</b>	<b>23.1</b>	<b>32,961</b>	<b>23,589</b>	<b>40</b>
Cost of sales, ex depr	(7,793)	(4,259)	83.0	(5,680)	37.2	(17,737)	(11,986)	48
Selling, admn. & R&D exp.	(2,617)	(2,076)	26.1	(2,430)	7.7	(7,103)	(6,312)	13
<b>EBITDA</b>	<b>2,939</b>	<b>2,017</b>	<b>45.7</b>	<b>2,733</b>	<b>7.5</b>	<b>8,121</b>	<b>5,290</b>	<b>54</b>
Depreciation	(512)	(448)	14.4	(492)	4.2	(1,452)	(1,297)	12
<b>Operating profit</b>	<b>2,427</b>	<b>1,569</b>	<b>54.7</b>	<b>2,241</b>	<b>8.3</b>	<b>6,669</b>	<b>3,993</b>	<b>67</b>
Other income / expense	104	67	55.0	60	74.4	237	221	7
Interest expensed	(274)	(257)	6.4	(244)	12.4	(748)	(786)	-5
<b>Pretax Profit</b>	<b>2,257</b>	<b>1,379</b>	<b>63.7</b>	<b>2,057</b>	<b>9.7</b>	<b>6,158</b>	<b>3,428</b>	<b>80</b>
Tax	(760)	(387)	96.4	(652)	16.6	(1,960)	(970)	102
Minority interests	(41)	(91)	-54.9	(93)	-55.8	(222)	(240)	-8
<b>Recurring net profit</b>	<b>1,456</b>	<b>901</b>	<b>61.6</b>	<b>1,313</b>	<b>10.9</b>	<b>3,976</b>	<b>2,219</b>	<b>79</b>
Exceptional items	0	0	n.a.	0	n.a.	-	-	n.a.
<b>Net profit</b>	<b>1,456</b>	<b>901</b>	<b>61.6</b>	<b>1,313</b>	<b>10.9</b>	<b>3,976</b>	<b>2,219</b>	<b>79</b>
Recurring EPS (INR)	3.6	2.2	61.0	3.3	10.9	9.9	5.5	78
Gross Margin (%)	37.8	43.6	-680bp	43.1	-550bp	41.8	43.7	-190bp
EBITDA Margin (%)	22.0	24.1	+210bp	25.2	-320bp	24.6	22.4	+220bp
EBIT Margin (%)	18.2	18.8	-60bp	20.7	-250bp	20.2	16.9	+330bp
Tax rate (%)	33.7	28.1	+560bp	31.7	+200bp	31.8	28.3	+350bp

Source: Company

Fig 5: 1-year forward EV/EBITDA

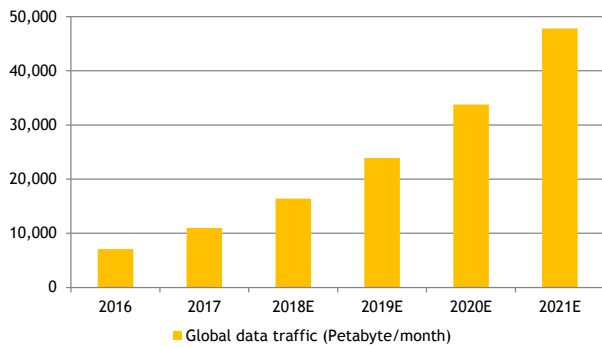


Source: Bloomberg, Maybank Kim Eng

## Value Proposition

- SOTL is one of only eight fully integrated optic fibre manufacturers globally.
- SOTL dominates India's optic fibre market with a 40% share and has a 6% share of the global market.
- High investments and low initial returns are entry barriers.
- Optic fibre cable demand is increasing at a 17% CAGR (2013-17) backed by the upgrade of telco networks and building fibre-to-the-home networks.
- Increase in capacity will change the outlook for returns. OF capacity will increase to 50m fkm by Jun '19 from 30m fkm currently and OF cable capacity to 35m fkm by Jun'20 from 18m fkm currently.

### Global data traffic growth (Petabytes/month)

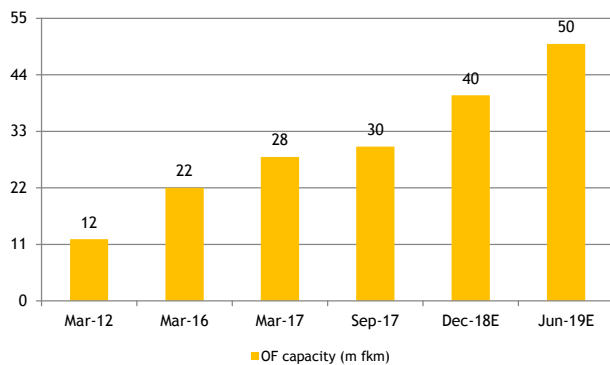


Source: Cisco Visual Networking Index Forecast

## Financial Metrics

- As per Cisco Visual Networking Index Forecast data traffic in India is expected to increase 365% over the next five years, boosting optic fibre demand.
- High EBITDA margin of 30% on optic fibre is sustainable. SOTL will retain cost advantage as new capacity will take at least 3-4 years to come on stream.
- SOTL's earnings visibility is improving with entry into network design business, which will also reduce the dependence on product business.
- Net D/E is comfortable at 0.73x for FY20E. This will remain steady despite capex plan.

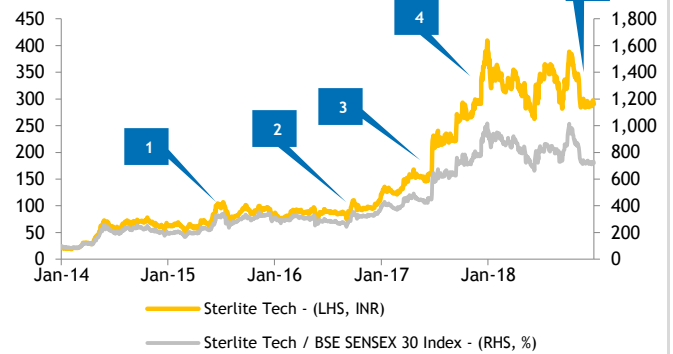
### SOTL: Planned optical fibre capacity additions



Source: Company

## Price Drivers

### Historical share price trend



Source: Company, Maybank Kim Eng, Factset

1. SOTL announced spin-off of the power business with guaranteed buyback by promoters at a fair value.
2. The share price is adjusted to give the effect of a de-merger of the power business.
3. Announces expansion on OF capacity of 50m fkm from 30m fkm.
4. Stock continues to re-rate as the company outperforms on its quarterly performance
5. Fears of fall in optical fibre prices due to delay in China Mobile tender

## Swing Factors

### Upside

- New order wins in network design segment.
- Faster than expected commissioning of new OF capacity.
- Demand pick-up in optic fibre cables volume in India.

### Downside

- Slowdown in global demand for OF and OF cable.
- Delay in commissioning of capacity.
- USD/INR appreciation to impact earnings owing to increasing exports dependence.

FYE 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Key Metrics</b>					
P/E (reported) (x)	19.4	29.3	20.5	14.8	12.5
Core P/E (x)	24.9	37.5	20.5	14.8	12.5
P/BV (x)	5.7	10.7	7.3	5.4	4.2
P/NTA (x)	5.7	10.7	7.3	5.4	4.2
Net dividend yield (%)	1.0	0.6	1.3	1.8	2.1
FCF yield (%)	5.5	2.2	nm	4.4	5.2
EV/EBITDA (x)	11.5	18.0	11.3	8.3	7.2
EV/EBIT (x)	16.6	23.8	14.2	10.4	8.9
<b>INCOME STATEMENT (INR m)</b>					
Revenue	25,935.6	32,054.9	48,359.9	66,062.7	73,687.7
Gross profit	11,456.8	14,074.9	19,227.0	26,849.3	29,765.6
EBITDA	5,189.1	7,493.5	11,694.1	15,784.1	18,134.7
Depreciation	(1,592.3)	(1,822.1)	(2,380.9)	(3,138.3)	(3,475.0)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	3,596.8	5,671.4	9,313.2	12,645.8	14,659.7
Net interest income / (exp)	(1,229.3)	(1,038.3)	(1,104.8)	(1,868.8)	(1,921.3)
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	234.5	392.7	333.8	367.2	403.9
Pretax profit	2,602.0	5,025.8	8,542.3	11,144.1	13,142.2
Income tax	(396.6)	(1,331.5)	(2,733.5)	(3,064.6)	(3,614.1)
Minorities	(191.6)	(351.0)	(280.8)	(390.6)	(460.6)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	2,013.8	3,343.3	5,527.9	7,688.9	9,067.5
Core net profit	2,013.8	3,343.3	5,527.9	7,688.9	9,067.5
<b>BALANCE SHEET (INR m)</b>					
Cash & Short Term Investments	1,724.2	2,934.8	1,728.0	1,341.0	1,976.4
Accounts receivable	6,912.1	8,712.8	13,911.8	19,004.3	21,197.8
Inventory	3,334.9	3,378.5	4,836.0	6,606.3	7,368.8
Property, Plant & Equip (net)	12,750.5	15,171.7	20,190.8	21,195.0	24,515.0
Intangible assets	1,035.7	739.3	4,250.4	4,250.4	4,250.4
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	3,318.0	6,180.3	8,934.7	12,133.6	13,511.4
<b>Total assets</b>	<b>29,075.4</b>	<b>37,117.4</b>	<b>53,851.6</b>	<b>64,530.6</b>	<b>72,819.8</b>
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	4,486.4	6,561.8	9,040.9	12,397.5	13,698.0
LT interest bearing debt	10,924.7	11,775.4	19,355.6	17,775.4	16,775.4
Other liabilities	4,412.0	6,208.0	8,760.0	11,930.0	13,159.0
<b>Total Liabilities</b>	<b>19,822.7</b>	<b>24,544.7</b>	<b>37,156.7</b>	<b>42,103.2</b>	<b>43,632.0</b>
Shareholders Equity	8,800.7	11,753.2	15,594.6	20,936.6	27,236.3
Minority Interest	452.0	819.5	1,100.3	1,490.9	1,951.5
<b>Total shareholder equity</b>	<b>9,252.7</b>	<b>12,572.7</b>	<b>16,694.9</b>	<b>22,427.4</b>	<b>29,187.8</b>
<b>Total liabilities and equity</b>	<b>29,075.4</b>	<b>37,117.4</b>	<b>53,851.6</b>	<b>64,530.6</b>	<b>72,819.8</b>
<b>CASH FLOW (INR m)</b>					
Pretax profit	2,602.0	5,025.8	8,542.3	11,144.1	13,142.2
Depreciation & amortisation	1,592.3	1,822.1	2,380.9	3,138.3	3,475.0
Adj net interest (income)/exp	1,110.4	901.8	771.0	1,501.6	1,517.4
Change in working capital	427.2	203.8	(4,379.0)	(3,535.1)	(1,805.0)
Cash taxes paid	(763.3)	(1,106.8)	(2,733.5)	(3,064.6)	(3,614.1)
Other operating cash flow	(83.6)	469.4	0.0	0.0	0.0
Cash flow from operations	4,885.0	7,316.1	4,581.5	9,184.4	12,715.6
Capex	(2,144.6)	(4,577.0)	(6,400.0)	(4,142.5)	(6,795.0)
Free cash flow	2,740.4	2,739.1	(1,818.5)	5,041.9	5,920.6
Dividends paid	(709.2)	(380.8)	(1,687.3)	(2,347.0)	(2,767.8)
Equity raised / (purchased)	6.2	14.7	0.8	0.0	0.0
Change in Debt	37.9	(184.0)	7,580.2	(1,580.2)	(1,000.0)
Other invest/financing cash flow	(1,159.5)	(978.4)	(5,282.0)	(1,501.6)	(1,517.4)
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	915.8	1,210.6	(1,206.8)	(387.0)	635.4

FYE 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	14.0	23.6	50.9	36.6	11.5
EBITDA growth	13.0	44.4	56.1	35.0	14.9
EBIT growth	7.8	57.7	64.2	35.8	15.9
Pretax growth	12.9	93.2	70.0	30.5	17.9
Reported net profit growth	31.0	66.0	65.3	39.1	17.9
Core net profit growth	31.0	66.0	65.3	39.1	17.9
<b>Profitability ratios (%)</b>					
EBITDA margin	20.0	23.4	24.2	23.9	24.6
EBIT margin	13.9	17.7	19.3	19.1	19.9
Pretax profit margin	10.0	15.7	17.7	16.9	17.8
Payout ratio	24.7	24.0	26.0	26.0	26.0
<b>DuPont analysis</b>					
Net profit margin (%)	7.8	10.4	11.4	11.6	12.3
Revenue/Assets (x)	0.9	0.9	0.9	1.0	1.0
Assets/Equity (x)	3.3	3.2	3.5	3.1	2.7
ROAE (%)	25.5	32.5	40.4	42.1	37.6
ROAA (%)	7.3	10.1	12.2	13.0	13.2
<b>Liquidity &amp; Efficiency</b>					
Cash conversion cycle	58.8	39.4	34.5	39.8	44.3
Days receivable outstanding	96.4	87.7	84.2	89.7	98.2
Days inventory outstanding	76.7	74.8	55.3	57.1	62.2
Days payables outstanding	114.4	123.1	105.0	107.0	116.1
Dividend cover (x)	4.0	4.2	3.8	3.8	3.8
Current ratio (x)	1.7	1.7	1.7	1.6	1.6
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	1.5	1.5	1.4	1.5	1.7
Net gearing (%) (incl perps)	99.4	70.3	105.6	73.3	50.7
Net gearing (%) (excl. perps)	99.4	70.3	105.6	73.3	50.7
Net interest cover (x)	2.9	5.5	8.4	6.8	7.6
Debt/EBITDA (x)	2.1	1.6	1.7	1.1	0.9
Capex/revenue (%)	8.3	14.3	13.2	6.3	9.2
Net debt/ (net cash)	9,200.5	8,840.6	17,627.6	16,434.4	14,799.0

Source: Company; Maybank

## Research Offices

### REGIONAL

**Sadiq CURRIMBHOY**  
Regional Head, Research & Economics  
(65) 6231 5836  
sadiq@maybank-ke.com.sg

**WONG Chew Hann, CA**  
Regional Head of Institutional Research  
(603) 2297 8686  
wchewh@maybank-ib.com

**ONG Seng Yeow**  
Regional Head of Retail Research  
(65) 6231 5839  
ongsengyeow@maybank-ke.com.sg

### ECONOMICS

**Suhaimi ILIAS**  
Chief Economist  
Malaysia | Philippines | China  
(603) 2297 8682  
suhaimi\_ilias@maybank-ib.com

**CHUA Hak Bin**  
Regional Thematic Macroeconomist  
(65) 6231 5830  
chuahb@maybank-ke.com.sg

**LEE Ju Ye**  
Singapore  
(65) 6231 5844  
leejuye@maybank-ke.com.sg

**Linda LIU**  
Singapore  
(65) 6231 5847  
lindaliu@maybank-ke.com.sg

**Dr Zamros DZULKAFLI**  
(603) 2297 6818  
zamros.d@maybank-ib.com

**Ramesh LANKANATHAN**  
(603) 2297 8685  
ramesh@maybank-ib.com

### FX

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

**Christopher WONG**  
(65) 6320 1347  
wongkl@maybank.com.sg

**Leslie TANG**  
(65) 6320 1378  
leslietang@maybank.com.sg

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

### STRATEGY

**Sadiq CURRIMBHOY**  
Global Strategist  
(65) 6231 5836  
sadiq@maybank-ke.com.sg

**Willie CHAN**  
Hong Kong / Regional  
(852) 2268 0631  
williechan@kimeng.com.hk

### FIXED INCOME

**Winson PHOON, ACA**  
(65) 6231 5831  
winsonphoon@maybank-ke.com.sg

**Se Tho Mun Yi**  
(603) 2074 7606  
munyi.st@maybank-ib.com

### MALAYSIA

**WONG Chew Hann, CA** *Head of Research*  
(603) 2297 8686 wchewh@maybank-ib.com  
• Strategy

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

**LIAW Thong Jung**  
(603) 2297 8688 tjliaw@maybank-ib.com  
• Oil & Gas Services - Regional

**ONG Chee Ting, CA**  
(603) 2297 8678 ct.ong@maybank-ib.com  
• Plantations - Regional

**Mohshin AZIZ**  
(603) 2297 8692 mohshin.aziz@maybank-ib.com  
• Aviation - Regional • Petrochem

**YIN Shao Yang, CPA**  
(603) 2297 8916 samuel.y@maybank-ib.com  
• Gaming - Regional • Media

**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

**LEE Yen Ling**  
(603) 2297 8691 lee.yl@maybank-ib.com  
• Glove • Ports • Shipping • Healthcare

**Ivan YAP**  
(603) 2297 8612 ivan.yap@maybank-ib.com  
• Automotive • Semiconductor • Technology

**Kevin WONG**  
(603) 2082 6824 kevin.wong@maybank-ib.com  
• REITs • Consumer Discretionary

**Adrian WONG, CFA**  
(603) 2297 8675 adrian.wkj@maybank-ib.com  
• Constructions

**Jade TAM**  
(603) 2297 8687 jade.tam@maybank-ib.com  
• Consumer Staples

**Mohd Hafiz HASSAN**  
(603) 2082 6819 mohdhafiz.ha@maybank-ib.com  
• Building Materials • Small & Mid Caps

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

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

**Nik Ihsan RAJA ABDULLAH, MSTA, CFTe**  
(603) 2297 8694  
nikmohdihsan.ra@maybank-ib.com

### SINGAPORE

**Neel SINHA** *Head of Research*  
(65) 6231 5838 neelsinha@maybank-ke.com.sg  
• Strategy • Industrials  
• SMID Caps - Regional

**CHUA Su Tye**  
(65) 6231 5842 chuasutye@maybank-ke.com.sg  
• REITs

**Luis HILADO**  
(65) 6231 5848 luishilado@maybank-ke.com.sg  
• Telcos

**LAI Gene Lih, CFA**  
(65) 6231 5832 laigenelih@maybank-ke.com.sg  
• Technology

### INDIA

**Jigar SHAH** *Head of Research*  
(91) 22 6623 2632 jigar@maybank-ke.co.in  
• Strategy • Oil & Gas • Automobile • Cement

**Neerav DALAL**  
(91) 22 6623 2606 neerav@maybank-ke.co.in  
• Software Technology • Telcos

**Vishal PERIWAL**  
(91) 22 6623 2605  
vishalperiwal@maybank-ke.co.in  
• Infrastructure

### INDONESIA

**Isnaputra ISKANDAR** *Head of Research*  
(62) 21 8066 8680  
isnaputra.iskandar@maybank-ke.co.id  
• Strategy • Metals & Mining • Cement

**Rahmi MARINA**  
(62) 21 8066 8689  
rahmi.marina@maybank-ke.co.id  
• Banking & Finance

**Aurellia SETIABUDI**  
(62) 21 8066 8691  
aurellia.setiabudi@maybank-ke.co.id  
• Property

**Janni ASMAN**  
(62) 21 8066 8687  
janni.asman@maybank-ke.co.id  
• Cigarette • Healthcare • Retail

### PHILIPPINES

**Minda OLANAN** *Head of Research*  
(63) 2 849 8840  
minda\_olanan@maybank-atrke.com  
• Strategy • Conglomerates

**Katherine TAN**  
(63) 2 849 8843  
kat\_tan@maybank-atrke.com  
• Banks • Conglomerates • Ports

**Luis HILADO**  
(65) 6231 5848 luishilado@maybank-ke.com.sg  
• Telcos

**Romel LIBO-ON**  
(63) 2 849 8844  
romel\_libo-on@maybank-atrke.com  
• Property

**Kayzer LLANDA**  
(63) 2 849 8839  
Kayzer\_llanda@maybank-atrke.com  
• Utilities

### 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

**Teerapol Udomvej, CFA**  
(66) 2658 6300 ext 1394  
teerapol.U@maybank-ke.co.th  
• Healthcare

**Graeme Cunningham, CFA**  
(66) 2658 6300 ext 1393  
Graeme.c@maybank-ke.co.th  
• Banking & Finance

**Surachai PRAMUALCHAROENKIT**  
*Head of Retail Research*  
(66) 2658 5000 ext 1470  
Surachai.p@maybank-ke.co.th  
• Auto • Conmat • Contractor • Steel

**Ekachai TARAPORNTIP** *Deputy Head*  
(66) 2658 5000 ext 1530  
ekachai.t@maybank-ke.co.th

**Sutthichai KUJWORACHAI** *Deputy Head*  
(66) 2658 5000 ext 1400  
sutthichai.k@maybank-ke.co.th  
• Energy • Petrochem

**Suttatip PEERASUB**  
(66) 2658 5000 ext 1430  
suttatip.p@maybank-ke.co.th  
• Media • Commerce

**Termporn TANTIVIVAT**  
(66) 2658 5000 ext 1520  
termporn.t@maybank-ke.co.th  
• Property

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

**Sorrahhol VIRAMETEEKUL**  
*Head of Digital Research*  
(66) 2658 5000 ext 1550  
sorrahhol.v@maybank-ke.co.th  
• Food, Transportation

**Wijit ARAYAPISIT**  
(66) 2658 5000 ext 1450  
wijit.a@maybank-ke.co.th  
• Strategist

**Kritsapong PATAN**  
(66) 2658 5000 ext 1310  
kritisapong.p@maybank-ke.co.th  
• Chartist

**Apisit PATTARASAKOLKIAT**  
(66) 2658 5000 ext 1405  
apisit.p@maybank-ke.co.th  
• Chartist

### VIETNAM

**LE Hong Lien, ACCA**  
*Head of Institutional Research*  
(84 28) 44 555 888 x 8181  
lien.le@maybank-kimeng.com.vn  
• Strategy • Consumer • Diversified

**THAI Quang Trung, CFA,**  
*Deputy Head, Institutional Research*  
(84 28) 44 555 888 x 8180  
trung.thai@maybank-kimeng.com.vn  
• Real Estate • Construction • Materials

**LE Nguyen Nhat Chuyen**  
(84 28) 44 555 888 x 8082  
chuyen.le@maybank-kimeng.com.vn  
• Oil & Gas

**NGUYEN Thi Ngan Tuyen,**  
*Head of Retail Research*  
(84 28) 44 555 888 x 8081  
tuyen.nguyen@maybank-kimeng.com.vn  
• Food & Beverage • Oil&Gas • Banking

**TRUONG Quang Binh,**  
*Deputy Head, Retail Research*  
(84 28) 44 555 888 x 8087  
binh.truong@maybank-kimeng.com.vn  
• Rubber Plantation • Tyres & Tubes • Oil & Gas

**TRINH Thi Ngoc Diep**  
(84 28) 44 555 888 x 8208  
diep.trinh@maybank-kimeng.com.vn  
• Technology • Utilities • Construction

**NGUYEN Thi Sony Tra Mi**  
(84 28) 44 555 888 x 8084  
mi.nguyen@maybank-kimeng.com.vn  
• Port Operation • Pharmaceutical  
• Food & Beverage

**NGUYEN Thanh Lam**  
(84 28) 44 555 888 x 8086  
thanhlam.nguyen@maybank-kimeng.com.vn  
• Technical Analysis



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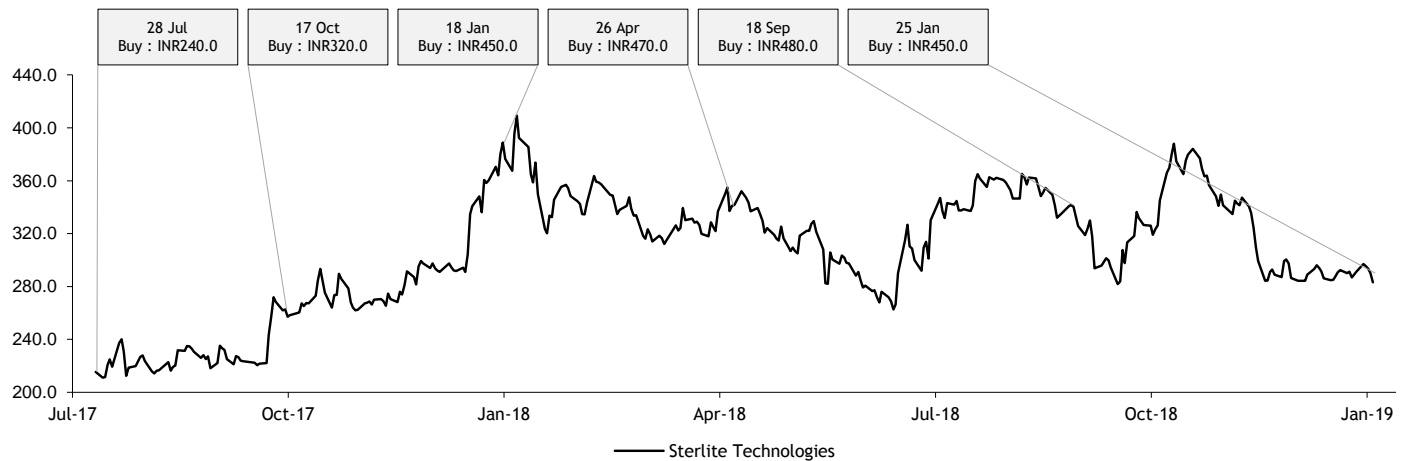
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**Malaysia**

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

Tel: (65) 6336 9090


**Hong Kong**

Kim Eng Securities (HK) Ltd  
28/F, Lee Garden Three,  
1 Sunning Road, Causeway Bay,  
Hong Kong

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


**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 Kim Eng Securities  
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


**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**

Kim Eng Securities India Pvt Ltd  
2nd Floor, The International,  
16, Maharishi Karve Road,  
Churchgate Station,  
Mumbai City - 400 020, India

Tel: (91) 22 6623 2600  
Fax: (91) 22 6623 2604


**Philippines**

Maybank ATR Kim Eng Securities Inc.  
17/F, Tower One & Exchange Plaza  
Ayala Triangle, Ayala Avenue  
Makati City, Philippines 1200

Tel: (63) 2 849 8888  
Fax: (63) 2 848 5738


**Thailand**

Maybank Kim Eng 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)


**Vietnam**

Maybank Kim Eng 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


**Saudi Arabia**

*In association with*  
**Anfaal Capital**  
Villa 47, Tujjar Jeddah  
Prince Mohammed bin Abdulaziz  
Street P.O. Box 126575  
Jeddah 21352

Tel: (966) 2 6068686  
Fax: (966) 26068787


**South Asia Sales Trading**

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

**Indonesia**

Hariato Liong  
harianto.liong@maybank-ke.co.id  
Tel: (62) 21 2557 1177

**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


**North Asia Sales Trading**

Andrew Lee  
andrewlee@kimeng.com.hk  
Tel: (852) 2268 0283  
US Toll Free: 1 877 837 7635

**London**

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

**India**

Sanjay Makhija  
sanjaymakhija@maybank-ke.co.in  
Tel: (91)-22-6623-2629