

Chong Hing Bank (1111 HK)

Share Price: HKD27.10

MCap (USD): 1.5B

Hong Kong

Target Price: HKD22.40(-17%)

ADTV (USD): 1M

Banks

SELL

 (Unchanged)

Potential capital replenishment

- Maintain SELL with higher TP of HKD22.40 due to strong loan growth and widening NIM in coming years.
- Limited ROE accretive impact on capital replenishment.
- Heavy selling pressure from LCHI shareholders.

What's New

Aggressive utilization of deposits. Loan growth recovered to 15.1% YoY in 2013. Chong Hing Bank (CHB) also reduced competition for time deposits in 2013. As such, its L/D ratio leaped to 62.9% in Dec 2013 (57.5% in Dec 2012). This helped widen its NIM from 1.10% in 2012 to 1.26% in 2013 (1.34% in 2H13). CHB will continue to expand its lending business. We therefore raise our NIM forecast from 1.17% to 1.35-1.37% for 2014-15. We also raise our net interest income forecast by 22-23% p.a. for 2014-15.

Potential selling pressure from shareholders of LCHI. Liu Chong Hing Investment (LCHI) currently holds 37.9m CHB shares (8.7% stake). To maintain the public float of CHB, LCHI announced it will distribute 1 CHB share for every 10 LCHI shares held by its shareholders. We see chance for LCHI shareholders to sell their CHB shares after 5 May 2014.

Potential capital replenishment in 2015-16. With aggressive expansion in lending business, we forecast CHB's CET1 CAR will fall below 10% by end-Dec 2016. Yuexiu Group may replenish CHB's equity capital through new shares issued to third parties. If we assume Yuexiu Group's stake in CHB is reduced to 51% (through the issue of 205m new shares), we estimate this will have limited ROE accretive effect to CHB (~70bps assuming a RoRWA of 1.22%).

What's Our View

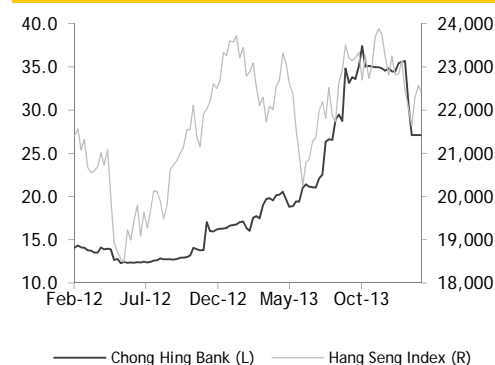
Reiterate SELL. With higher NIM and loan growth projections, we raise our 2015 net profit forecast by 52.8%. We also raise the long-term ROE assumption in our GGM to 10%. We derive a higher TP of HKD22.40, equivalent to a projected Dec 2014 P/B of 1.2x.

FYE Dec (HKD m)	FY12A	FY13A	FY14E	FY15E	FY16E
Operating income	1,323	1,442	1,654	1,775	1,911
Pre-provision profit	534	660	837	917	1,010
Core net profit	532	545	671	833	913
Core EPS (HKD)	1.2	1.3	1.5	1.9	2.1
Core EPS growth (%)	(4.1)	2.3	23.1	24.2	9.5
Net DPS (HKD)	0.5	0.5	5.1	0.8	0.8
Core P/E (x)	22.1	21.6	17.6	14.1	12.9
P/BV (x)	1.6	1.5	1.4	1.4	1.3
Net dividend yield (%)	1.7	1.7	19.0	2.8	3.1
Book value (HKD)	16.95	17.77	18.70	19.85	21.11
ROAE (%)	7.5	7.2	8.5	9.9	10.2
ROAA (%)	0.7	0.7	0.7	0.9	0.9

Key Data

52w high/low (HKD)	37.40/15.58
Free float (%)	58.5
Issued shares (m)	435
Market capitalization	HKD11.8B
Major shareholders:	
-China State-Owned Assets Supervision & /	20%
-Liu Chong Hing Investment Ltd.	12%
-Mitsubishi UFJ Financial Group, Inc.	10%

Share Price Performance



	1 Mth	3 Mth	12 Mth
Absolute(%)	(24.0)	(22.5)	72.8
Relative to country (%)	(23.9)	(18.2)	73.5

Maybank vs Market

	Positive	Neutral	Negative
Market Recs	1	0	1
	Maybank Consensus		% +/-
Target Price (HKD)	22.40	23.97	(6.5)
2014 PATMI(HKDm)	2,637	494	433.7
2015 PATMI(HKDm)	833	545	52.9

Source: FactSet; Maybank

Steven ST Chan
(852) 2268-0645
stevenchan@kimeng.com.hk

2013 Results Review

- Net profit was HKD557m for 2013, up 2.6% YoY. This was higher than our forecast (HKD490m). Major discrepancies include higher net interest margin (NIM) and stronger loan growth.
- Total loans rebounded by 15.1% YoY in 2013 (+8.8% HoH in 1H13; -5.2% YoY in 2012). Key drivers include trade finance and offshore loans. Direct China loans recorded a decline of -22% YoY while Macau loans surged by 174.5% YoY in 2013. Together, these loans accounted for 2.8% of CHB's total loans in Dec 2013.
- NIM widened from 1.19% in 1H13 to 1.34% in 2H13 (1.26% in 2013 vs. 1.10% in 2012). CHB benefited from a decline in HKD funding costs, a shift towards high-yield assets and rising loan-to-deposit (L/D) ratio in 2013. Its L/D ratio leaped from 57.5% in Dec 2012 to 62.9% in Dec 2013.
- Net fees recovered by 10.9% YoY in 2013 (-13.0% YoY in 2012). This was mainly driven by securities brokerage fees, credit card fees and wealth management fees.
- Cost-income ratio declined to 54.2% in 2013 (59.6% in 2012). Total expenses fell 0.9% YoY in 2013, mainly due to the non-recurrence of set up costs for wealth management business (~HKD50M) as reported in 2012. There was a one-off legal-related expense related to the acquisition of CHB's shares by Yuexiu Group (~HKD40m). As such, "other expenses" fell 3.9% YoY during 2013. As CHB did not open any new outlets (51 branches in Hong Kong and 1 branch in China), there was limited rise in staff costs and premises and equipment expenses in 2013.
- Minimal loan impairment charges of HKD35m in 2013 (net write-back in loan loss provisions of HKD65m in 2012). The NPL ratio reduced slightly from 0.06% in Dec 2012 to 0.04% in Dec 2013. This was mainly related to property investment lending in Hong Kong. Rescheduled loans also increased by HKD52m YoY in 2013, mainly related to a few merchandise trading companies. There was no increase in impaired loans in both China and Macau. CHB maintained its collective loan impairment allowance ratio at 0.42% in Dec 2013.
- CET1 CAR increased slightly to 10.8% in Dec 2013 (10.6% in Dec 2012). We estimate that total risk-weighted assets accounted for 65.9% of total assets in Dec 2013, similar to the level in Dec 2012, implying limited change in the risk appetite of CHB.

Figure 1: Summary of income statements

(HKD m)	1H12	2H12	1H13	2H13	2H13 vs 1H13 (%)	2H13 vs 2H12 (%)	2012	2013	2013 vs 2012 (%)
Net interest income	401	436	476	538	13.2%	23.4%	837	1,014	21.2%
Net fee income	92	97	106	104	-1.7%	6.7%	189	210	10.9%
Other operating income	152	145	112	106	-5.2%	-26.8%	297	218	-26.5%
Total Operating Income	644	679	693	749	7.9%	10.3%	1,323	1,442	9.0%
Total Operating Expenses	(387)	(402)	(358)	(423)	18.2%	5.4%	(789)	(782)	-0.9%
Operating Profit	257	277	335	325	-3.0%	17.4%	534	660	23.6%
Loan Impairment Loss	34	31	(18)	(18)	0.3%	na	65	(35)	na
Post-provision profit	292	308	318	308	-3.2%	-0.1%	599	625	4.3%
Other income	7	4	3	9	179.4%	141.3%	11	13	14.8%
Associate profits	10	26	8	24	184.6%	-7.4%	36	32	-10.9%
Profit Before Tax	309	337	329	341	3.4%	1.0%	646	670	3.6%
Tax	(49)	(54)	(53)	(59)	12.3%	10.6%	(103)	(112)	9.1%
Net Profit	260	284	276	281	1.7%	-0.9%	543	557	2.6%
Net Interest Margin (%)	1.06	1.13	1.19	1.34			1.10	1.26	
Cost-income Ratio (%)	60.1	59.2	51.7	56.6			59.6	54.2	

Source: Company data, Maybank Kim Eng

Valuation and recommendation

After factoring in higher NIM and loan growth projections, we raise our net profit forecast for CHB by 52.8% for 2015. We forecast its core net profit will grow at 18.8% CAGR during 2013-16. As such, we forecast its core ROE will rebound to about 10% during 2015-16. However, further expansion of CHB after 2016 will depend on its equity capital replenishment as we estimate its CET1 CAR will drop below 10% by end-Dec 2016.

We raise our long-term ROE assumption from 7% to 10% in our Gordon Growth Model (GGM). This is higher than its historic average ROE of 6.3% during 2002-12. We derive a higher TP of HKD22.40 (previously: HKD18.31), which is based on a fair Dec 2014 P/B of 1.2x. This is also higher than its historic average P/B of 1.2x during 2002-12. We maintain our SELL rating on CHB. Key upside risks to our rating include significant revenue synergies between CHB and Yuexiu Group and asset injections to CHB by Yuexiu Group.

Figure 2: CHB - Change in net profit and EPS forecasts

	Net profit (HKDm)			EPS (HKD)		
	2013F	2014F	2015F	2013F	2014F	2015F
Previous	494	545	594	1.14	1.25	1.37
New	2,637	833	913	6.06	1.92	2.10
% change	433.7%	52.8%	53.6%	433.7%	52.8%	53.6%

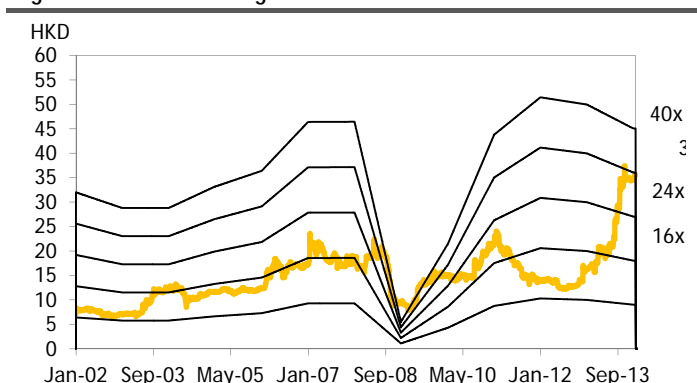
Source: Company data, Maybank Kim Eng

Figure 3: CHB - Gordon Growth Model

Implied ROE		8.00%	9.00%	10.00%	11.00%	12.00%
Long term dividend payout ratio (k)	40.0%					
Cost of Equity (CoE= Rf + Rm * B)	9.3%					
Long term sustainable growth (g)	6.0%					
Discount rate (CoE - g)	3.3%					
Target P/B (x): (ROE * k) / (CoE - g)		0.96	1.08	1.20	1.32	1.44
Dec14F BVPS	18.70					
Target price based on 1.2x Dec14F P/B		17.92	20.16	22.40	24.64	26.88

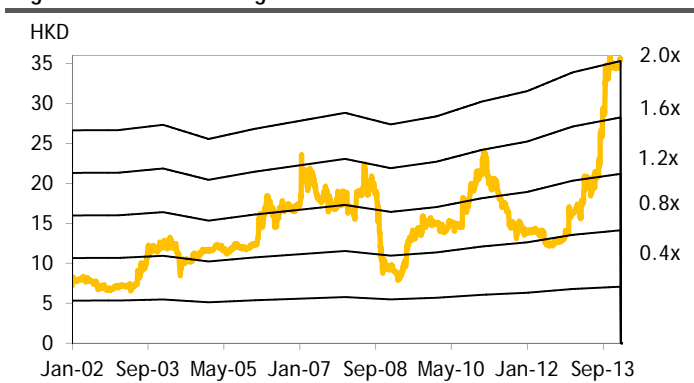
Source: Company data, Maybank Kim Eng

Figure 4: CHB - trading P/E bands



Source: Company data, Maybank Kim Eng

Figure 5: CHB - trading P/B bands



Source: Company data, Maybank Kim Eng

FYE 31 Dec (HKD m)	FY12A	FY13A	FY14E	FY15E	FY16E
Key Metrics					
Core P/E (x)	22.1	21.6	17.6	14.1	12.9
Core FD P/E (x)	na	na	na	na	na
P/BV (x)	1.6	1.5	1.4	1.4	1.3
P/NTA (x)	na	na	na	na	na
Net dividend yield (%)	1.7	1.7	19.0	2.8	3.1
Income Statement					
Interest income	1,564	1,596	1,819	1,997	2,178
Interest expense	(727)	(581)	(620)	(706)	(782)
Net interest income	837	1,014	1,199	1,291	1,396
Net insurance income	0	0	0	0	0
Net fees and commission	189	210	232	257	284
Other income	297	218	222	227	231
Total non-interest income	486	428	455	484	515
Operating income	1,323	1,442	1,654	1,775	1,911
Staff costs	(454)	(464)	(487)	(512)	(537)
Other operating expenses	(334)	(318)	(330)	(346)	(364)
Operating expenses	(789)	(782)	(817)	(858)	(901)
Pre-provision profit	534	660	837	917	1,010
Loan impairment allowances	65	(35)	(66)	(80)	(93)
Other allowances	0	0	0	0	0
Associates & JV income	36	32	35	39	43
Pretax profit	646	670	2,772	876	959
Income tax	(103)	(112)	(135)	(43)	(47)
Minorities	0	0	0	0	0
Discontinued operations	0	0	0	0	0
Reported net profit	543	557	2,637	833	913
Core net profit	532	545	671	833	913
Balance Sheet					
Cash & deposits with banks	22,121	24,066	24,772	25,892	27,550
Dealing securities	1,401	262	262	262	262
Investment securities	13,822	13,760	16,750	11,965	11,832
Loans & advances	42,111	46,075	50,864	56,665	63,215
Central bank deposits	0	0	0	0	0
Investment in associates/JVs	183	199	199	199	199
Insurance assets	0	0	0	0	0
Fixed assets	1,066	775	813	854	897
Intangible assets	0	0	0	0	0
Other assets	51	51	51	51	51
Total assets	80,755	85,188	93,712	95,889	104,006
Deposits from customers	67,509	71,165	75,441	80,453	87,876
Deposits from banks & FIs	2,277	2,931	2,931	2,931	2,931
Subordinated debt	0	0	0	0	0
Other borrowings	0	0	0	0	0
Insurance liabilities	0	0	0	0	0
Other liabilities	3,595	3,360	7,206	3,870	4,017
Total liabilities	73,381	77,456	85,577	87,254	94,824
Share capital	218	218	218	218	218
Reserves	7,157	7,514	7,917	8,417	8,964
Shareholders' funds	7,374	7,732	8,134	8,634	9,182
Preference shares	0	0	0	0	0
Minority interest	0	0	0	0	0
Total equity	7,374	7,732	8,134	8,634	9,182
Total liabilities & equity	80,755	85,188	93,711	95,889	104,006

FYE 31 Dec (HKD m)	FY12A	FY13A	FY14E	FY15E	FY16E
Key Ratios					
Growth (%)					
Net interest income	2.6	21.2	18.3	7.6	8.1
Non-interest income	(2.7)	(12.0)	6.3	6.4	6.5
Operating expenses	1.9	(0.9)	4.5	5.0	5.0
Pre-provision profit	(1.3)	23.6	26.7	9.5	10.2
Core net profit	(4.1)	2.3	23.1	24.2	9.5
Gross loans	(5.2)	15.1	11.1	11.4	(7.4)
Customer deposits	4.2	5.4	6.0	6.6	9.2
Total assets	4.3	5.5	10.0	2.3	8.5
Profitability (%)					
Non-int. income/Total income	36.7	29.7	27.5	27.3	26.9
Average lending yields	2.06	1.98	2.05	2.12	2.17
Average cost of funds	1.00	0.77	0.77	0.83	0.86
Net interest margin	1.10	1.26	1.35	1.37	1.39
Cost/income	59.6	54.2	49.4	48.3	47.1
Liquidity (%)					
Loans/customer deposits	57.8	63.1	66.1	69.1	58.5
Asset quality (%)					
Net NPL	na	na	na	na	na
Gross NPL	0.1	0.1	0.1	0.1	0.1
(SP+GP)/average gross loans	(0.2)	0.1	0.1	0.2	0.2
Loan loss coverage	801.9	905.0	930.0	960.0	990.0
Capital adequacy (%)					
CET1	10.6	10.8	10.4	10.2	9.9
Core capital	10.6	10.8	10.4	10.2	9.9
Risk-weighted capital	15.3	14.6	13.9	13.5	12.9
Returns (%)					
ROAE	7.5	7.2	8.5	9.9	10.2
ROAA	0.7	0.7	0.7	0.9	0.9
Shareholders equity/assets	9.1	9.1	8.7	9.0	8.8

Research Offices

REGIONAL

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) 6432 1453
ongsengyeow@maybank-ke.com.sg

Alexander GARTHOFF
Institutional Product Manager
(852) 2268 0638
alexgarthoff@kimeng.com.hk

ECONOMICS

Suhaimi ILIAS
Chief Economist
Singapore | Malaysia
(603) 2297 8682
suhaimi_ilias@maybank-ib.com

Luz LORENZO
Philippines
(63) 2 849 8836
luz_lorenzo@maybank-atrke.com

Tim LEELAHAPHAN
Thailand
(662) 658 1420 tim.l@maybank-ke.co.th

JUNIMAN
Chief Economist, BI
Indonesia
(62) 21 29228888 ext 29682
Juniman@bankbii.com

Josua PARDEDE
Economist / Industry Analyst, BI
Indonesia
(62) 21 29228888 ext 29695
JPardede@bankbii.com

MALAYSIA

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

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 - Regional • Shipping

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 & REITs

LEE Yen Ling
(603) 2297 8691 lee.yl@maybank-ib.com
• Building Materials • Glove Producers

CHAI Li Shin
(603) 2297 8684 lishin.c@maybank-ib.com
• Plantation • Construction & Infrastructure

KANG Chun Ee
(603) 2297 8675 chunee@maybank-ib.com
• Consumer

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

LEE Cheng Hooi Regional Chartist
(603) 2297 8694
chenghooi.lee@maybank-ib.com

Tee Sze Chiah Head of Retail Research
(603) 2297 6858 szechiah.t@maybank-ib.com

HONG KONG / CHINA

Howard WONG Head of Research
(852) 2268 0648
howardwong@kimeng.com.hk
• Oil & Gas - Regional

Alexander LATZER
(852) 2268 0647
alexanderlatzer@kimeng.com.hk
• Metals & Mining - Regional

Jacqueline KO, CFA
(852) 2268 0633 jacquelineko@kimeng.com.hk
• Consumer

Karen KWAN
(852) 2268 0640 karenkw@kimeng.com.hk
• Property & REITs

Osbert TK TANG, CFA
(86) 21 5096 8370
osberttang@kimeng.com.hk
• Transport & Industrials

Philip TSE, CFA FRM
(852) 2268 0643 philiptse@kimeng.com.hk
• Property & REITs

Ricky WK NG, CFA
(852) 2268 0689 rickyng@kimeng.com.hk
• Utilities & Renewable Energy

Simon QIAN, CFA
(852) 2268 0634
simonqian@kimeng.com.hk
• Telecom & Internet

Steven ST CHAN
(852) 2268 0645 stevenchan@kimeng.com.hk
• Banking & Financials

Warren LAU
(852) 2268 0644
warrenlau@kimeng.com.hk
• Technology - Regional

William YANG
(852) 2268 0675
williamyang@kimeng.com.hk
• Technology - Regional

INDIA

Jigar SHAH Head of Research
(91) 22 6623 2601
jigar@maybank-ke.co.in
• Oil & Gas • Automobile • Cement

Anubhav GUPTA
(91) 22 6623 2605
anubhav@maybank-ke.co.in
• Metal & Mining • Capital Goods • Property

Urmil SHAH
(91) 22 6623 2606 urmil@maybank-ke.co.in
• Technology • Media

SINGAPORE

NG Wee Siang Head of Research
(65) 6432 1467 ngweesiang@maybank-ke.com.sg
• Banking & Finance

Gregory YAP
(65) 6432 1450 gyap@maybank-ke.com.sg
• SMID Caps - Regional
• Technology & Manufacturing • Telcos

Wilson LIEW
(65) 6432 1454 wilsonlie@maybank-ke.com.sg
• Property Developers

ONG Kian Lin
(65) 6432 1470 ongkianlin@maybank-ke.com.sg
• S-REITs

James KOH
(65) 6432 1431 jameskoh@maybank-ke.com.sg
• Consumer - Regional

YEAK Chee Keong, CFA
(65) 6432 1460
yeakcheekeong@maybank-ke.com.sg
• Offshore & Marine

Derrick HENG
(65) 6432 1446 derrickheng@maybank-ke.com.sg
• Transport (Land, Shipping & Aviation)

WEI Bin
(65) 6432 1455 weibin@maybank-ke.com.sg
• Commodity • Logistics • S-chips

John CHEONG
(65) 6432 1461 johncheong@maybank-ke.com.sg
• Small & Mid Caps • Healthcare

INDONESIA

Willianto IE Head of Research
(62) 21 2557 1125
willianto.ie@maybank-ke.co.id
• Strategy

Rahmi MARINA
(62) 21 2557 1128
rahmi.marina@maybank-ke.co.id
• Banking & Finance

Aurellia SETIABUDI
(62) 21 2953 0785
aurellia.setiabudi@maybank-ke.co.id
• Property

Anthony YUNUS
(62) 21 2557 1136
anthony.yunus@maybank-ke.co.id
• Consumer • Poultry

Isnapura ISKANDAR
(62) 21 2557 1129
isnaputra.iskandar@maybank-ke.co.id
• Metals & Mining • Cement

Pandu ANUGRAH
(62) 21 2557 1137
pandu.anugrah@maybank-ke.co.id
• Infrastructure • Construction • Transport

Janni ASMAN
(62) 21 2953 0784
janni.asman@maybank-ke.co.id
• Cigarette • Healthcare • Retail

PHILIPPINES

Luz LORENZO Head of Research
(63) 2 849 8836
luz_lorenzo@maybank-atrke.com
• Strategy

Laura Dy-LIACCO
(63) 2 849 8840
laura_dyliacco@maybank-atrke.com
• Utilities • Conglomerates • Telcos

Loveil SARREAL
(63) 2 849 8841
loveil_sarreal@maybank-atrke.com
• Consumer • Media • Cement

Rommel RODRIGO
(63) 2 849 8839
rommel_rodrigo@maybank-atrke.com
• Conglomerates • Property • Gaming
• Ports/ Logistics

Katherine TAN
(63) 2 849 8843
kat_tan@maybank-atrke.com
• Banks • Construction

Ramon ADVIENTO
(63) 2 849 8845
ramon_adviento@maybank-atrke.com
• Mining

THAILAND

Maria LAPIZ Head of Institutional Research
Dir (66) 2257 0250 | (66) 2658 6300 ext 1399
Maria.L@maybank-ke.co.th
• Consumer / Materials

Jesada TECHAHUSDIN, CFA
(66) 2658 6300 ext 1394
Jesada.T@maybank-ke.co.th
• Financial Services

Kittisorn PRUITIPAT, CFA, FRM
(66) 2658 6300 ext 1395
Kittisorn.P@maybank-ke.co.th
• Real Estate

Sittichai DUANGRATTANACHAYA
(66) 2658 6300 ext 1393
Sittichai.D@maybank-ke.co.th
• Services Sector

Sukit UDOMSIRIKUL Head of Retail Research
(66) 2658 6300 ext 5090
Sukit.u@maybank-ke.co.th

Mayuree CHOWVIKARAN
(66) 2658 6300 ext 1440
mayuree.c@maybank-ke.co.th
• Strategy

Padon VANNARAT
(66) 2658 6300 ext 1450
Padon.v@maybank-ke.co.th
• Strategy

Surachai PRAMUALCHARONKIT
(66) 2658 6300 ext 1470
Surachai.p@maybank-ke.co.th
• Auto • Conmat • Contractor • Steel

Suttatip PEERASUB
(66) 2658 6300 ext 1430
suttatip.p@maybank-ke.co.th
• Media • Commerce

Sutthichai KUMWORACHAI
(66) 2658 6300 ext 1400
sutthichai.k@maybank-ke.co.th
• Energy • Petrochem

Termporn TANTIVIVAT
(66) 2658 6300 ext 1520
termporn.t@maybank-ke.co.th
• Property

Woraphon WIROONSRI
(66) 2658 6300 ext 1560
woraphon.w@maybank-ke.co.th
• Banking & Finance

Jaroopan WATTANAWONG
(66) 2658 6300 ext 1404
jaroopan.w@maybank-ke.co.th
• Transportation • Small cap

Chatchai JINDARAT
(66) 2658 6300 ext 1401
chatchai.j@maybank-ke.co.th
• Electronics

VIETNAM

LE Hong Lien, ACCA
Head of Institutional Research
(84) 844 55 58 88 x 8181
lien.le@maybank-kimeng.com.vn
• Strategy • Consumer • Diversified • Utilities

THAI Quang Trung, CFA, Deputy Manager,
Institutional Research
(84) 844 55 58 88 x 8180 trung.thai@maybank-
kimeng.com.vn
• Real Estate • Construction • Materials

TRUONG Thanh Hang
(84) 844 55 58 88 x 8085 hang.truong@maybank-
kimeng.com.vn
• Consumer

Le Nguyen Nhat Chuyen
(84) 844 55 58 88 x 8082 chuyen.le@maybank-
kimeng.com.vn
• Oil & Gas

NGUYEN Thi Ngan Tuyen, Head of Retail Research
(84) 8 44 555 888 x 8081
tuyen.nguyen@maybank-kimeng.com.vn
• Food & Beverage • Oil&Gas • Banking

NGUYEN Trung Hoa, Dy Head of Retail Research
(84) 8 44 555 888 x 8088
hoa.nguyen@maybank-kimeng.com.vn
• Macro • Steel • Real estate

TRINH Thi Ngoc Diep
(84) 4 44 555 888 x 8208
diep.trinh@maybank-kimeng.com.vn
• Technology • Utilities • Construction

TRUONG Quang Binh
(84) 4 44 555 888 x 8087
binh.truong@maybank-kimeng.com.vn
• Rubber plantation • Tyres and Tubes • Oil&Gas

PHAM Nhat Bich
(84) 8 44 555 888 x 8083
bich.pham@maybank-kimeng.com.vn
• Consumer • Manufacturing • Fishery

NGUYEN Thi Sony Tra Mi
(84) 8 44 555 888 x 8084
mi.nguyen@maybank-kimeng.com.vn
• Port operation • Pharmaceutical
• Food & Beverage

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 **Malaysia**

Maybank Investment Bank Berhad
(A Participating Organisation of
Bursa Malaysia Securities Berhad)
33rd Floor, Menara Maybank,
100 Jalan Tun Perak,
50050 Kuala Lumpur
Tel: (603) 2059 1888;
Fax: (603) 2078 4194

Stockbroking Business:
Level 8, Tower C, Dataran Maybank,
No. 1, Jalan Maarof
59000 Kuala Lumpur
Tel: (603) 2297 8888
Fax: (603) 2282 5136

 **Philippines**

Maybank 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

 **South Asia Sales Trading**

Kevin FOY
kevinfoy@maybank-ke.com.sg
Tel: (65) 6336-5157
US Toll Free: 1-866-406-7447

 **Singapore**

Maybank Kim Eng Securities Pte Ltd
Maybank Kim Eng Research Pte Ltd
9 Temasek Boulevard
#39-00 Suntec Tower 2
Singapore 038989

Tel: (65) 6336 9090
Fax: (65) 6339 6003

 **Hong Kong**

Kim Eng Securities (HK) Ltd
Level 30,
Three Pacific Place,
1 Queen's Road East,
Hong Kong

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

 **Thailand**

Maybank Kim Eng Securities
(Thailand) Public Company Limited
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)

 **North Asia Sales Trading**

Alex TSUN
alextsun@kimeng.com.hk
Tel: (852) 2268 0228
US Toll Free: 1 877 837 7635

 **London**

Maybank Kim Eng Securities
(London) Ltd
6/F, 20 St. Dunstan's Hill
London EC3R 8HY, UK

Tel: (44) 20 7621 9298
Dealers' Tel: (44) 20 7626 2828
Fax: (44) 20 7283 6674

 **Indonesia**

PT Maybank Kim Eng Securities
Plaza Bapindo
Citibank Tower 17th Floor
Jl Jend. Sudirman Kav. 54-55
Jakarta 12190, Indonesia

Tel: (62) 21 2557 1188
Fax: (62) 21 2557 1189

 **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

 **New York**

Maybank Kim Eng Securities USA
Inc
777 Third Avenue, 21st Floor
New York, NY 10017, 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

 **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