

Outthink. Outperform.

Indonesia a glimpse to better results ahead

CIMB Niaga released a stronger set of results for 2Q16. We remain convinced that CIMB Group is on track for an earnings recovery and the Group's 2Q16 results could be the catalyst for the re-rating of its currently distressed valuations. Maintain BUY on CIMB with our TP at RM5.00.

A solid quarter for CIMB Niaga

CIMB Niaga reported a 2Q16 net profit of Rp467bn (RM141m), more than quadruple yoy (albeit from a very low base), and 73.6% on a qoq basis. Net interest margin (NIM), surprisingly expanded 58bps yoy and 27bps qoq as the increase in cheaper Current Accounts Savings Accounts (CASA) brought down its cost of fund. Besides the increase in net-interest income, the better net profit was also underpinned by: i) better non-interest income (+29.9% yoy, +4.5% qoq); lower cost-to-income at 49.6%; and iii) lower provisions (-8.5% yoy, -8.9% qoq)

Credit costs remained elevated as economic headwinds persist

Despite a lower provision, the credit cost for CIMB Niaga remained elevated at 282bps (-13bps yoy, -3bps qoq) as the proportion of special mention loans (SML) and non-performing loans (NPL) remained relatively high although it improved slightly in 2Q16 (see Fig 2). Moving forward, management noted that the economic environment in Indonesia remains fragile but the Group is still cautiously optimistic that asset quality would further improve in the coming quarters.

CIMB Group outlook: likely return of RM 1bil quarterly profit

We believe that with easing NIM compression, recovery of non-interest income (one-off dip in 1Q16), continued decline in operating costs and increased contribution from Indonesia operations, CIMB Group's 2Q16 net profit is highly likely to return to the RM 1 billion level last achieved in 1Q14. The stock is currently trading at 0.9 time P/BV multiple, which is more than 1 standard deviation below its 5-year average P/BV multiple of 1.44 time. With the recovery in earnings, we think that there will be room for re-rating over its current P/BV multiple.

Forecasts remain unchanged; Reiterate BUY, TP RM5.00

With its share price trading at distressed level, we reiterate our **BUY** rating on CIMB Group; our Target Price is unchanged at **RM5.00** (based on a 1.0x 2016 P/BV multiple, with ROE assumption at 9.4%).

Downside risks – NIM compression, asset quality deterioration

Key downside risks would include larger than expected NIM compression, deterioration in asset quality as well as any regulatory uncertainty (in particular Indonesia).

Earnings & Valuation Summary

FYE 31 Dec	2014	2015	2016E	2017E	2018E
Total income (RMm)	14,048.0	15,395.8	14,881.9	15,366.1	16,415.3
PPOP (RMm)	5,854.0	5,492.4	7,238.3	7,287.5	7,851.6
Pretax profit (RMm)	4,276.4	3,262.0	5,337.9	5,751.2	6,196.6
Net profit (RMm)	3,106.8	2,849.5	3,982.4	4,290.3	4,622.1
EPS (sen)	37.5	33.6	46.3	49.0	51.8
Core net profit (RMm)	3,155.3	3,411.0	3,982.4	4,290.3	4,622.1
Core EPS (sen)	38.1	40.2	46.3	49.0	51.8
Core EPS growth (%)	(30.6)	5.7	15.1	5.9	5.7
Core PER (x)	12.3	11.6	10.1	9.5	9.0
ROE (%)	9.2	7.3	9.4	9.4	9.5
BVPS (RM)	4.44	4.81	5.07	5.34	5.61
PBV (x)	0.99	0.91	0.87	0.82	0.78
Net DPS (sen)	15.0	14.0	17.0	14.6	15.4
Dividend Yield (%)	3.2	3.0	3.9	3.3	3.5
Affin/Consensus (x)			1.0	1.0	1.0

Source: Company, Affin Hwang estimates

Affin Hwang Investment Bank Bhd (14389-U)
(Formerly known as HwangDBS Investment Bank Bhd)

Company Update

CIMB Group

CIMB MK
Sector: Banking

RM4.39 @ 29 July 2016

BUY (maintain)

Upside 13.9%

Price Target: RM5.00

Previous Target: RM5.00



Price Performance

	1M	3M	12M
Absolute	+0.5%	-6.0%	-15.6%
Rel to KLCI	+0.0%	-4.9%	-12.0%

Stock Data

Issued shares (m)	8,728.9
Mkt cap (RMm)/(US\$m)	38,319.7/9,477.6
Avg daily vol - 6mth (m)	14.6
52-wk range (RM)	3.93-5.4
Est free float	39.1%
BV per share (RM)	4.80
P/BV (x)	0.91
Net cash/ (debt) (RMm) (4Q15)	n.a.
ROE (2016F)	9.4%
Derivatives	Nil
Shariah Compliant	No

Key Shareholders

Khazanah	29.8%
EPF	16.6%
ASB	4.8%

Source: Affin Hwang, Bloomberg

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A solid quarter for CIMB Niaga

Indonesia results a shot in the arm

Net profit of CIMB Niaga continued its recovery trend as it reported a 2Q16 net profit of Rp467bn (RM141m), more than quadruple yoy (albeit from a very low base), and 73.6% on a qoq basis. Net interest margin (NIM), surprisingly expanded 58bps yoy and 27bps qoq as the increase in cheaper Current Accounts Savings Accounts (CASA) brought down its cost of fund.

Besides the increase in net-interest income, non-interest income also came in better for the quarter (+29.9% yoy, +4.5% qoq). Previous cost-cutting initiatives continue to bear fruit as operating expenses remained flat and cost-to-income was reduced to 49.6% (2Q15: 56.1%). Provision also came in lower (-8.5% yoy, -8.9% qoq) to help boost the net profit.

Fig 1: CIMB Niaga Results Comparison

FYE Dec (Rp bil)	2Q16	2Q15	Y-y (%)	1Q16	Q-q (%)	Comments
Interest Income	5,222.0	5,558.0	(6.0)	4,779.6	9.3	
Interest Expense	(2,246.0)	(2,810.0)	(20.1)	(2,557.0)	(12.2)	Changing of deposit mix as CASA rose from 46% in 2Q15 to 52%, resulting in much cheaper cost of funding.
Net Interest Income	2,976.0	2,748.0	8.3	2,837.0	4.9	While loans remained weak (-3.0% yoy, +2.5% qoq), NIM expanded by 58bps yoy and 27bps qoq thanks to lower cost of funds.
Non-Interest Income	748.0	576.0	29.9	716.0	4.5	
Operating Income	3,724.0	3,324.0	38.2	3,553.0	4.8	
Operating Expenses	(1,847.0)	(1,864.0)	(0.9)	(1,822.0)	1.4	Operating costs under control and CIR dropped below 50% mark (49.6%).
Pre-provision Profit	1,877.0	1,460.0	28.6	1,731.0	8.4	
Loan loss provisions	(1,221.0)	(1,335.0)	(8.5)	(1,341.0)	(8.9)	Credit cost remained elevated at 282bps (-13bps yy, -3bps qoq) but is expected to continue improving in the coming quarters.
Pre-Tax Profit	656.0	125.0	424.8	390.0	68.2	
Taxation	(189.0)	(32.0)	490.6	(121.0)	56.2	
Net Profit	467.0	93.0	402.2	269.0	73.6	Net profit continue its recovery yoy and qoq
Core Net Profit	467.0	93.0	402.2	269.0	73.6	
EPS (Rp)	18.6	3.7	398.7	10.7	74.0	
Core EPS (Rp)	18.6	3.7	398.7	10.7	74.0	

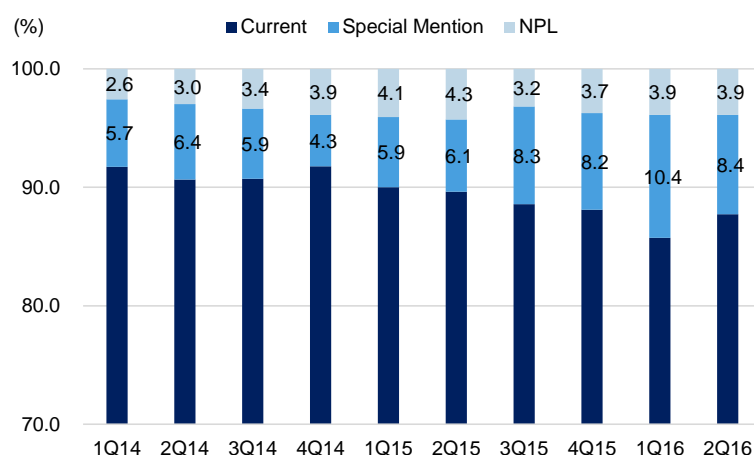
Source: Affin Hwang, Company data

Credit costs remained elevated as economic headwinds persist

Despite a lower provision, the credit cost for CIMB Niaga remained elevated at 282bps (-13bps yoy, -3bps qoq), the proportion of special mention loans (SML) and non-performing loans (NPL) remained relatively high although it improved slightly in 2Q16 (see Fig 2).

Moving forward, management has guided that credit cost for the second half of 2016 is likely to be better. While management noted that the economic environment in Indonesia remained fragile, they are still cautiously optimistic that asset quality would further improve in the coming quarters. There are also encouraging signs whereby the debtors are more willing to restructure their troubled loans based on the terms set by CIMB Niaga.

Fig 2: Special mention loans and NPL remained relatively high



Source: Affin Hwang, Company data

Fig 3: CIMB Niaga key financial ratios

FYE31 Dec	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16
Key Financial Ratios:										
Profitability										
NIMs (%)	5.22	5.24	5.27	5.36	5.22	5.04	5.40	5.25	5.35	5.62
Fee income ratio (%)	25.3	22.8	20.4	20.8	17.8	17.3	15.7	17.7	20.2	20.1
Cost-to-income ratio (%)	50.2	51.7	52.5	50.6	54.3	56.1	62.2	54.5	51.3	49.6
Annualised ROE (%)	16.7	14.5	11.2	8.5	1.2	1.3	6.2	3.3	3.6	5.7
Balance Sheet										
Gross loans (Rp tr)	161.0	164.7	166.8	176.4	176.5	180.8	178.9	177.4	171.0	175.3
Customer deposits (Rp tr)	161.4	165.8	166.8	174.7	181.7	186.0	185.7	178.5	172.7	179.3
Net LDR (%)	98.4	97.8	98.5	99.5	95.8	95.8	94.9	98.0	97.7	96.5
Asset Quality										
Credit cost (bps)	52.0	71.0	125.0	212.0	332.0	295.0	267.0	317.0	285.0	282.0
Gross impaired loan (%)	3.1	3.9	5.4	4.8	5.3	5.7	5.2	5.0	5.0	4.9
Loan loss cover (%)	98.8	86.5	82.9	88.8	102.6	99.6	121.0	111.5	116.1	120.9
Capital Ratios										
Core capital ratio (%)	14.0	13.8	13.8	13.3	14.3	13.8	13.9	14.2	16.0	16.0
Total RWCR	16.4	16.1	16.0	15.6	16.5	16.0	16.0	16.3	18.0	17.6

Source: Affin Hwang, Company data

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Potential additional liquidity ahead

In conjunction with the Indonesian tax amnesty program designed to attract the return of funds not declared to the Indonesian tax authorities, the Indonesian government has appointed CIMB Niaga as one of the perception banks assigned to accommodate such funds repatriated by participating taxpayers in Indonesia's tax amnesty program. Armed with such additional liquidity, CIMB Niaga and the Indonesian banking industry are likely to have greater capacity to grow their loan levels and also potentially see a lower cost of funding.

Corporate Developments

Distribution of CIMB Niaga shares

On a side note, CIMB Group recently announced the details of its proposed distribution of CIMB Niaga shares to its entitled shareholders ("Proposed Dividend-In-Specie"). The Group also includes a proposed monetisation option in which shareholders who are unwilling to receive the dividend-in-specie could receive dividend in cash at Rp504 per CIMB Niaga share. We note that the cash option is at a steep discount to its current market price as CIMB Niaga shares have soared more than 80% to Rp910 since the Group's initial announcement of the Proposed Dividend-In-Specie. In any case, the shareholders are advised to refer to the Group's announcement and take necessary actions including, but not limited to, communicating their intentions to their brokers or custodians in respect of the Proposed Dividend-In-Specie.

Strategic partnership with Fajr Capital

CIMB Group also recently announced the strategic partnership with Fajr Capital to facilitate deal origination, and the cross-distribution and collaborative marketing of the firms' core products and services through their extensive clientele network in the Asia Pacific and the Middle East, respectively.

While the results from this partnership may not be apparent in near term, we believe that this represents another step in the right direction to further optimise its capital. With that, CIMB Group will be able to tap Fajr Capital's network, particularly in Middle East. This also allows CIMB Group to close its office in Bahrain once it has obtained the necessary regulatory approvals while maintaining its presence in the Middle East.

Valuations and Recommendations

CIMB Group outlook: likely return of RM 1bil quarterly profit

We remain convinced that CIMB Group is on track for an earnings recovery. We believe that with easing NIM compression, recovery of non-interest income (one-off dip in 1Q16), continued decline in operating costs and increased contribution from Indonesia operations, CIMB Group's 2Q16 net profit is highly likely to return to the RM1 billion level last achieved in 1Q14.

The stock is currently trading at 0.9 time P/BV multiple, which is more than 1 standard deviation below its 5-years average P/BV multiple of 1.44 time. With the recovery in earnings, we think that there will be room for re-rating over its current P/BV multiple.

Fig 4: Historical P/BV chart



Source: Bloomberg

Forecasts remain unchanged; Reiterate BUY, TP RM5.00

With its share price trading at distressed level, we reiterate our **BUY** rating on CIMB Group, with our Target Price unchanged at **RM5.00** (based on a 1.0x 2016 P/BV multiple, with ROE assumption at 9.4%).

Downside risks – NIM compression, asset quality deterioration

Key downside risks would include larger than expected NIM compression, deterioration in asset quality as well as any regulatory uncertainty (in particularly Indonesia).

CIMB Group – FINANCIAL SUMMARY

Profit & Loss Statement

FYE 31 Dec (RMm)	2014	2015	2016E	2017E	2018E
Interest income	16,059.0	18,098.6	18,800.7	19,975.8	21,781.1
Interest expense	(7,403.5)	(8,761.9)	(9,535.6)	(10,308.5)	(11,148.7)
Net interest income	8,655.5	9,336.7	9,265.0	9,667.3	10,632.3
Islamic banking income	1,461.3	1,569.0	1,584.7	1,600.6	1,616.6
Total non-interest income	3,931.1	4,488.9	4,032.2	4,098.2	4,166.4
Total income	14,048.0	15,394.7	14,881.9	15,366.1	16,415.3
Overhead expenses	(8,292.0)	(9,249.0)	(7,643.6)	(8,078.5)	(8,563.7)
Pre-Prov. Op. Profit	5,854.0	6,145.7	7,238.3	7,287.5	7,851.6
Impaired loan allowances	(1,700.9)	(1,943.5)	(1,984.1)	(1,621.6)	(1,742.0)
Associates contributions	123.4	82.0	83.6	85.3	87.0
Pretax profit	4,276.4	4,284.2	5,337.9	5,751.2	6,196.6
Tax	(1,101.9)	(1,071.0)	(1,334.5)	(1,437.8)	(1,549.2)
Minority interest	(67.7)	(19.1)	(21.0)	(23.1)	(25.4)
Net profit	3,106.8	2,849.5	3,982.4	4,290.3	4,622.1

Balance Sheet Statement

FYE 31 Dec (RMm)	2014	2015	2016E	2017E	2018E
Cash and short-term fund	33,462.8	29,318.8	46,698.4	57,139.6	67,450.5
Deposits with FIs	4,239.0	1,829.5	1,829.5	1,829.5	1,829.5
Securities repurchased	4,758.3	9,714.1	9,811.3	9,909.4	10,008.5
Securities held-for-trading	23,803.8	20,680.3	20,680.3	20,680.3	20,680.3
Securities available-for-sale	32,286.5	32,767.5	36,044.3	39,648.7	43,613.6
Securities held to maturity	18,261.6	25,759.2	25,759.2	25,759.2	25,759.2
Derivative Financial Instrumts	7,182.8	11,708.8	11,708.8	11,708.8	11,708.8
Total current assets	123,994.7	131,778.3	152,531.8	166,675.5	181,050.4
Net loan and advances	258,014.9	290,295.7	317,535.3	340,167.5	367,200.9
Fixed assets	1,607.1	2,529.5	2,529.5	2,529.5	2,529.5
Statutory reserves with BNM	6,841.2	7,699.8	8,090.1	8,906.2	9,826.4
Other assets	13,915.7	19,140.3	20,104.1	21,313.0	22,591.0
Intangible assets	1,850.4	1,820.6	1,820.6	1,820.6	1,820.6
Goodwill	7,911.2	8,297.5	8,297.5	8,297.5	8,297.5
Total assets	414,135.0	461,561.6	510,908.9	549,709.7	593,316.3
Customer deposits	282,068.8	317,423.6	351,745.6	387,224.6	427,236.1
Deposits from other FIs	32,149.8	23,692.0	35,364.8	35,364.8	35,364.8
Repurchase securities	5,735.8	8,527.5	8,527.5	8,527.5	8,527.5
Bills and acceptances	10,710.9	14,468.8	14,468.8	14,468.8	14,468.8
Other funding liabilities	33,994.2	40,779.8	41,016.5	41,016.5	41,016.5
Other liabilities	11,105.6	14,452.9	14,597.4	14,743.4	14,890.9
Total liabilities	375,765.2	419,344.5	465,720.5	501,345.5	541,504.5
Minority interests	830.7	981.9	1,002.9	1,026.0	1,051.4
Preference shares	200.0	200.0	200.0	200.0	200.0
Shareholders' Funds	37,369.4	41,050.8	43,985.5	47,138.3	50,560.5

Quarterly Profit & Loss

FYE 31 Dec (RMm)	4Q14	1Q15	2Q15	3Q15	4Q15
Interest income	4,222.2	4,277.9	4,385.3	4,655.9	4,779.6
Interest expense	(1,980.0)	(2,086.9)	(2,116.6)	(2,239.8)	(2,318.6)
Net interest income	2,242.3	2,191.0	2,268.7	2,416.1	2,461.0
Islamic banking income	377.4	366.9	398.9	386.2	416.9
Total non-interest income	1,052.5	1,122.5	1,165.8	1,038.2	1,163.6
Total income	3,672.1	3,680.3	3,833.4	3,840.5	4,041.6
Overhead expenses	(2,239.2)	(2,339.8)	(2,439.8)	(2,260.5)	(2,211.4)
Operating profit	1,432.9	1,340.6	1,393.7	1,580.0	1,830.2
Loan loss provisioning	(919.2)	(534.3)	(529.0)	(523.7)	(579.2)
Provn for other receivables	(9.0)	5.4	0.1	(7.1)	(28.6)
Impairment loss from securi	(138.9)	(1.7)	(10.1)	1.7	(109.5)
Associates contribution	19.2	13.6	29.1	23.7	19.3
Pretax profit	384.9	823.6	883.7	1,074.5	1,132.2
Taxation	(159.6)	(233.2)	(231.9)	(256.3)	(296.6)
Minority interests	(25.0)	(10.2)	(12.0)	(14.3)	(9.9)
Net profit	200.3	580.1	639.8	803.9	825.7

Key Financial Ratios and Margins

FYE 31 Dec (RMm)	2014	2015	2016E	2017E	2018E
Return and efficiency					
ROE (%)	9.2%	7.3%	9.4%	9.4%	9.5%
ROA (%)	0.8%	0.7%	0.8%	0.8%	0.8%
Average lending yield	4.43%	4.30%	4.21%	4.09%	4.13%
Cost of funds	2.14%	2.22%	2.23%	2.20%	2.20%
NIM post-Islamic banking (%)	2.81%	2.71%	2.43%	2.31%	2.32%
Int income/total income (%)	72.0%	70.8%	72.9%	73.3%	74.6%
Non-interest/total income (%)	28.0%	29.2%	27.1%	26.7%	25.4%
Cost-to-income (%)	56.0%	60.1%	51.4%	52.6%	52.2%

Balance sheet

Loan growth (%)	7.5%	12.5%	9.9%	7.3%	8.1%
Gross Impaired loan ratio (%)	3.1%	3.4%	3.4%	3.4%	3.4%
Gross impaired loan ratio (%)	1.2%	1.6%	1.9%	2.0%	2.1%
Loan loss reserves (%)	82.7%	90.3%	96.2%	98.2%	101.7%
Credit Cost (bps)	58.0	69.1	63.5	47.8	47.7
Deposit growth (%)	7.2%	12.5%	10.8%	10.1%	10.3%
LD ratio (%)	93.8%	91.5%	90.3%	87.8%	85.9%
LD ratio including interbank (%)	84.2%	87.3%	84.5%	83.1%	82.0%

Capital adequacy (Group)

CET1 (%)	10.1%	10.4%	10.7%	11.1%	11.4%
Tier-1 (%)	11.5%	11.8%	12.1%	12.5%	12.8%
Total Capital Ratio (%)	15.1%	15.4%	15.7%	16.1%	16.4%

Investment statistics

PER (X)	11.7	13.1	9.5	9.0	8.5
PBT growth rate (%)	-26.9%	0.2%	24.6%	7.7%	7.7%
Net earnings growth rate (%)	-31.6%	-8.3%	39.8%	7.7%	7.7%
EPS (sen)	37.5	33.6	46.3	49.0	51.8
EPS growth rate (%)	-37.5%	-10.3%	37.7%	5.9%	5.7%
BV/share (RM)	4.44	4.81	5.07	5.34	5.61
P/BV	1.0	0.9	0.9	0.8	0.8
Dividend payout (%)	40.4%	18.0%	30.0%	30.0%	30.0%
NDPS (sen)	15.0	14.0	13.8	14.6	15.4
Net yield (%)	3.4%	3.2%	3.1%	3.3%	3.5%

Loan Breakdown - By Economic Purpose

FYE 31 Dec (RMm)	2014	2015	2016E	2017E	2018E
Securities	19,708	27,168	27,315	29,228	31,273
Transport vehicles	21,338	23,297	24,085	25,290	26,554
Residential properties	66,248	75,495	82,280	88,040	96,844
Non-residential properties	20,637	25,171	28,305	30,286	32,406
Fixed assets	15,761	15,920	18,194	19,104	20,059
Personal use	8,748	10,608	10,813	11,137	11,471
Credit card	7,576	8,843	8,785	9,224	9,685
Consumer durables	595	109	110	110	110
Construction	8,199	9,581	10,082	11,091	12,200
Mergers and acquisitions	5,289	3,617	4,757	4,757	4,757
Working capital	74,273	79,418	91,482	100,631	110,694
Other purpose	16,272	18,596	21,015	22,066	23,169
Islamic loans sold to Cagamas	-	-	-	-	-
Total gross loans	264,644	297,822	327,226	350,964	379,224

Breakdown of loans (%)

Corporate (%)	60.5%	60.3%	61.5%	61.9%	61.9%
Retail (%)	39.5%	39.7%	38.5%	38.1%	38.1%

Source: Affin Hwang, Company data

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Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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