



Company report

PENTAMASTER CORP

(PENT MK EQUITY, PMAS.KL)

31 Mar 2020

Poised for a strong recovery post-Covid-19

BUY

(Initiation)

AmInvestment Bank

www.amequities.com.my

03-2036 2333

Rationale for report: Initiation

Price	RM3.76
Fair Value	RM4.45
52-week High/Low	RM5.58/RM2.35

Key Changes

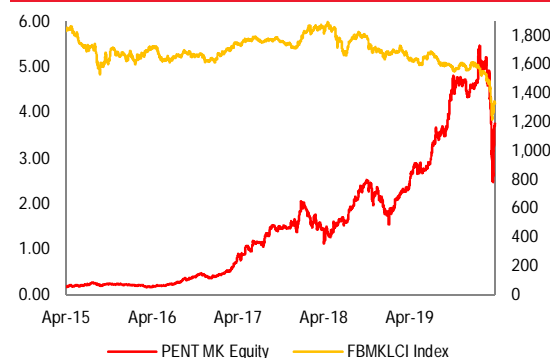
Fair value	Initiation
EPS	Initiation

YE to Dec	FY19	FY20F	FY21F	FY22F
Revenue (RM mil)	490.1	568.2	635.0	704.5
Core net profit (RM mil)	83.0	99.4	111.2	123.5
FD Core EPS (sen)	17.5	20.9	23.4	26.0
FD Core EPS growth (%)	(3.1)	19.7	11.9	11.0
Consensus Net Profit (RM mil)	-	96.9	113.0	129.3
DPS (sen)	1.5	1.8	2.0	2.2
PE (x)	21.5	18.0	16.1	14.5
EV/EBITDA (x)	10.3	8.3	6.8	5.4
Div yield (%)	0.4	0.5	0.5	0.6
ROE (%)	20.9	20.6	19.2	18.0
Net Gearing (%)	nm	nm	nm	nm

Stock and Financial Data

Shares Outstanding (million)	474.9
Market Cap (RM mil)	1,785.5
Book Value (RM/share)	0.92
P/BV (x)	4.1
ROE (%)	20.9
Net Gearing (%)	-
Major Shareholders	Chuah Choon Bin (19.7%) KWAP (6.2%) Prudential PLC (5.1%)
Free Float	62.2
Avg Daily Value (RM mil)	16.2

Price performance	3mth	6mth	12mth
Absolute (%)	(18.3)	(15.3)	60.7
Relative (%)	(0.6)	0.9	98.7



Investment Highlights

- We initiate coverage on Pentamaster Corporation (Pentamaster) with a BUY recommendation. Our fair value of RM4.45/share is pegged to an FY21F PE of 19x, in line with its peer local equipment makers' average forward PE.
- We expect the group to register core net profit earnings of RM99mil, RM111mil and RM124mil respectively for FY20F, FY21F and FY22F.
- Pentamaster is a back-end automated test equipment (ATE) maker in the non-memory ATE and test handlers' market. According to the group, test handlers account for 10–12% of the back-end ATE market.
- Pentamaster is projected to achieve an impressive profit CAGR of 14% from FY19–FY22F riding on the growth in both its automated testing equipment (ATE) and factory automated solutions (FAS) segments, which in turn is driven by growth in key markets such as telecommunications and automotive.
- The following are Pentamaster's key investment merits:
 - Growth driven by the telecommunications and automotive sectors and adoption of Industry 4.0 to benefit consumer and industrial product markets;
 - Revenue growth underpinned by its broadening exposure in 3D sensing technology in VSCEL;
 - Margin expansion amid efforts to diversify across other business segments and customers;
 - Aggressive expansion into the medical segment via its acquisition of TP Concept Sdn Bhd.
- We believe that Pentamaster's medium-term prospects remain positive, despite expectations that its 1QFY20 would be impacted by Covid-19 as the group anticipates a V-shaped recovery in subsequent quarters based on its current order visibility.
- We like Pentamaster due to its positive growth prospects supported by demand for more smart sensors in devices, the upcoming 3D sensing technology wave, trend towards autonomous cars and electric vehicles (EVs) and the adoption of Industry 4.0.

COMPANY OVERVIEW

Pentamaster is an automated manufacturing and technology solutions provider, established in 1995 and headquartered in Penang, Malaysia. A summary of the group's key milestones are as follows:

EXHIBIT 1: KEY BUSINESS MILESTONES & ACHIEVEMENTS

1995	<ul style="list-style-type: none"> Company established and incorporated Pentamaster Technology, marking the commencement of the automated system and equipment business.
1999	<ul style="list-style-type: none"> Awarded 'International Supplier of the Year' for excellence in worldwide process technology from Dell Inc.
2003	<ul style="list-style-type: none"> Pentamaster listed on Second Board of Bursa Malaysia. Awarded Industry Excellence Award by the Ministry of International Trade & Industry of Malaysia (MITI) in the quality management category. Pentamaster Instrumentation established [expansion of automated equipment business].
2004	<ul style="list-style-type: none"> Listing transferred to the Main Board of Bursa Malaysia.
2006	<ul style="list-style-type: none"> Pentamaster Equipment established [commence high precision manufacturing equipment business].
2007	<ul style="list-style-type: none"> 1st representative office established in Shanghai – for customer liaison support to customers in the PRC. Awarded Industry Excellence Award by MITI in quality management category.
2015	<ul style="list-style-type: none"> Pentamaster Equipment developed i-Arms to address manufacturing needs under Industry 4.0 (IR4.0).
2016	<ul style="list-style-type: none"> Pentamaster Equipment granted pioneer status for 10 years. Pentamaster Technology granted pioneer status for smart device test solution for IoT industry and related modules for 10 years.
2017	<ul style="list-style-type: none"> Awarded 2017 Alliance Partner of the Year by the National Instrument Corporation. Named as one of the 200 Asia-Pacific public companies with less than US\$1.0 billion revenue and consistent top- and bottomline growth on Forbes' list of Asia's Best Under A Billion 2017.
2018	<ul style="list-style-type: none"> Listed on the Main Board of the Stock Exchange of Hong Kong Limited. Incorporated a sales and technical support office in California, USA. Named for Forbes' list of Asia's Best Under A Billion 2018. Achieved highest revenue >RM400mil & PAT >RM100mil.
2019	<ul style="list-style-type: none"> Named for Forbes' list of Asia's Best Under A Billion 2019. Acquired TP Concept Sdn Bhd.
2020	<ul style="list-style-type: none"> Awarded The Edge's "Highest Growth in Profit After Tax Over Three Years" and "Highest Returns to Shareholders Over Three Years".

Source: Company, AmInvestment Bank Bhd.

The group has 2 manufacturing facilities in Penang, one in Bayan Lepas and its second plant in Batu Kawan (Exhibits 2 & 3).

EXHIBIT 2: BAYAN LEPAS FACILITY



- 90,310 sqft
- Design centw, prototyping, small to large volume machine build

Source: Company

EXHIBIT 3: BATU KAWAN FACILITY

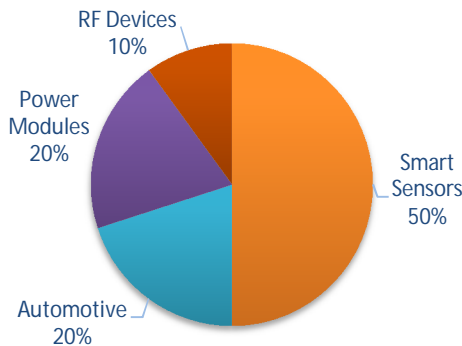


- 97,033 sqft
- High volume machine build and equipment contract manufacturing

Source: Company

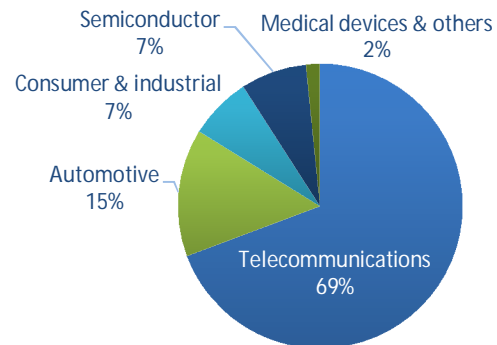
Pentamaster’s key market segments are semiconductor, telecommunications, automotive and medical devices spanning across Asia Pacific, North America and Europe with 90% of its customers being repeat customers. Revenue split by product and by market segment are seen in Exhibits 4 and 5.

EXHIBIT 4: REVENUE BY PRODUCTS



Source: Company, AmlInvestment Bank Bhd.

EXHIBIT 5: REVENUE BY MARKET SEGMENTS



Source: Company, AmlInvestment Bank Bhd.

MANAGEMENT

Non-executive chairman: Chuah Choon Bin

Chuah Choon Bin was appointed to the board of the company on 30 November 2002 and redesignated as the non-executive chairman on 19 December 2017. He is a professional engineer and co-founder of Pentamaster Group. Chuah graduated with a bachelor’s degree (Hons.) and a master’s degree majoring in electronics and electrical from University of Auckland, New Zealand. In 2012, he received an honorary doctorate for his contribution in bioMedical engineering from Allianze University College of Medical Sciences (AUCMS). Prior to the setting up of the group, he served as an automation engineer for National Semiconductor and Intel Technology Malaysia. With his vast experience in the design and manufacturing of automation equipment and vision inspection system, he has developed the group to its present level of success, from a simple automation house to a high-technology group specialising in factory automation equipment and systems and information communication technology solutions for industrial and commercial customers. He also holds directorship in all the subsidiary companies of the company. Chuah is the brother-in-law of Gan Pei Joo.

Executive director: Chuah Chong Ewe

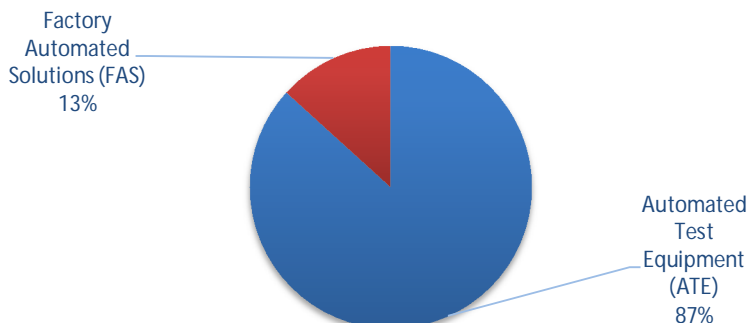
Chuah Chong Ewe was appointed to the board as executive director of the company on 23 June 2015 and is currently the executive director. Graduated with an LLB (Hons) from University of Malaya, Chuah was admitted to the Malaysian Bar on 26 February 1993 as an advocate & solicitor. He has more than 19 years of experience in legal practice. He joined Seal Incorporated Bhd (Seal) in year 2005 as an advisor before being promoted as group CEO. Throughout the years, under his leadership vision and strategic direction, coupled with his strong legal background, he spearheaded the strategic move and transformational restructuring in Seal into profitable net cash position with diversified earnings base, optimal balance sheet structures, and a reflective book value coupled with strategic foreign investors base. He left Seal in October 2014 prior to joining Pentamaster Corporation Bhd as chief executive officer in February 2015.

Chief financial officer: Gan Pei Joo

Gan Pei Joo was appointed as Pentamaster Group's director on 12 June 2017 and was re-designated as executive director on 5 September 2017. She is also the chief financial officer and holds directorship in all the subsidiaries of the group. She commenced her career at PricewaterhouseCoopers in 2000 and last served as a senior associate in 2003 after having acquired extensive auditing and consulting exposure to companies in various industries. She joined Pentamaster Group as the group accountant in 2003 and held various positions prior to her promotion as the group financial controller in 2009. From March 2014 to 19 December 2017, she was an executive director of the company. Gan is primarily responsible for the overall management, corporate affairs, finance, treasury, control functions and budgeting of the group. She graduated with a bachelor's degree of commerce majoring in accounting from Curtin University of Technology, Perth, Australia in February 1999. She was admitted as a member of the Certified Practising Accountants, Australia and a chartered accountant from the Malaysian Institute of Accountants in July and November 2002, respectively. Gan is the sister in-law of Chuah Choon Bin.

SEGMENTAL BREAKDOWN

Pentamaster offers solutions in two segments, namely automated test equipment (ATE) and factory automation solutions (FAS). In FY19, the group's revenue split was 87% ATE and 13% FAS.

EXHIBIT 6: REVENUE BREAKDOWN BY SEGMENT

Source: Company, AmInvestment Bank Bhd.

Automated test equipment (ATE)

In the ATE segment, Pentamaster manufactures both standardised and customised standalone automated equipment for:

- i) semiconductor electronic components testing for smart sensors and integrated circuits (ICs); and
- ii) end products testing for consumer electronics, telecommunication products and LEDs.

The end products' test solutions provide integrated systems comprising electronic hardware, firmware and software to perform tests on end products. The solutions are customised according to the tests and the devices being tested.

EXHIBIT 7: AUTOMATED TEST EQUIPMENT (ATE) PRODUCTS

Category	Semiconductor Electronic Components Testing Solution			
Products and solution	MEMS & Smart Sensor Test Solutions	Automated Vision Inspection Handler Solutions	Intelligent Sorting System	End products Test Solutions
Test subjects	Optoelectronics, light, temperature, sound, distance, pressure and humidity.	Dimension, shape, position and visual defects.	Electrical functional parameters.	LED burn-in and test structures, failure and functional test.

Example of ATE products and solutions:



MEMS MICROPHONE TEST HANDLER



AUTOMATED VISION INSPECTION HANDLER



AUTOMATED TEST AND VISION INSPECTION HANDLER PM35

Source: Company, AmInvestment Bank Bhd.

Factory automated solutions (FAS)

The group customizes and automates manufacturing processes by integrating automated assembly and test modules, material handling equipment, robotics technology, auto inspection and manufacturing executive system (MES). Pentamaster’s proprietary solution i-ARMS is a comprehensive factory automation system that integrates various combinations of FAS modules with other technology components such as vision devices, sensor devices and RFID. FAS modules offer diverse automated functions which can be applied to different processes in a manufacturing line and applications across various industries, including telecommunications, consumer electronics, F&B and medical devices. Examples of FAS modules offered are manufacturing executive system (MES), test modules, high-speed sorters and material handling equipment. Growth in Pentamaster’s FAS solutions is underpinned by an increasing demand for automation solutions in the era of Industry 4.0.

EXHIBIT 8: FACTORY AUTOMATED SOLUTIONS (FAS) PRODUCTS



ASSEMBLY & TEST MODULES



AUTOMATED ASSEMBLY SYSTEM FOR FOOD TRAY



AUTOMATED CONVEYING, BOXING, WEIGHING, SORTING, STORAGE AND PALLETISING SYSTEM

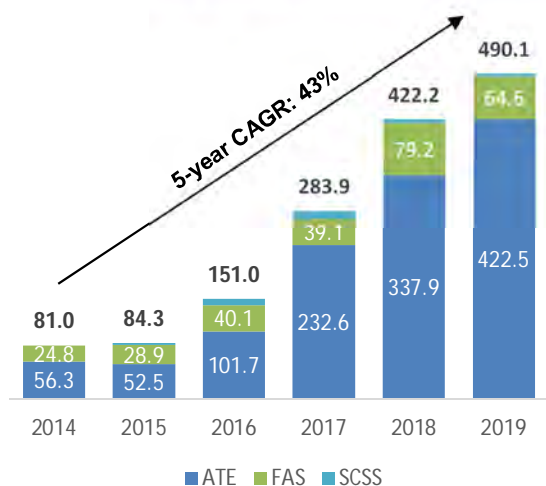
Source: Company.

FINANCIAL REVIEW

In FY19, Pentamaster's revenue rose 16% YoY while PAT soared 45% YoY due to higher ATE sales, which were offset by lower FAS sales, as well as higher operating efficiencies. ATE segment revenue climbed 25% YoY despite being clouded by the US-China trade war due to the continuous demand for smart sensors and wider applications within the telecommunications and automotive segments. Meanwhile, FAS segment revenue dropped 18% YoY as the timing of certain complex projects were delivered beyond the year-end date.

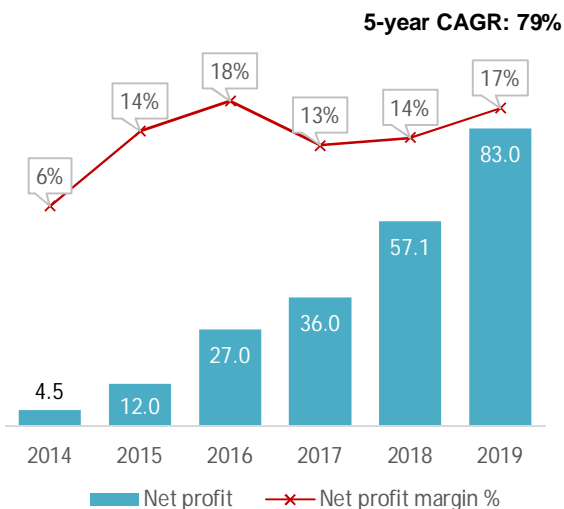
Historically, Pentamaster has shown outstanding growth in both revenue and net profit, showing FY14–FY19 CAGR rates of 45% and 79% respectively.

EXHIBIT 9: REVENUE GROWTH



Source: Company, AmlInvestment Bank Bhd.

EXHIBIT 10: NET PROFIT GROWTH AND MARGINS



Source: Company, AmlInvestment Bank Bhd.

We are projecting FY20F–FY22F net profit to grow by 20%, 12% and 11% respectively. Its order book stood at RM200mil as at 31 December 2019, which was lower than what it was before due to customers' shorter lead times. Pentamaster expects a weaker 1QFY20 impacted by the Covid-19 outbreak as the group was not spared from travel restrictions and logistic delays. However, Pentamaster expects a V-shaped recovery in subsequent quarters based on its current order visibility.

KEY INVESTMENT MERITS

□ Growth driven by telecommunications and automotive sectors, and adoption of Industry 4.0 to benefit consumer and industrial product markets

- **Telecommunications**

Smart devices such as smartphones, tablets and smart watches have multiple sensors imbedded in them to enhance their usability, controllability and management. Examples of sensors are proximity sensors, motion sensors such as accelerometers, gyroscope and magnetometers, multimedia sensors such as camera and fingerprint sensors, barometers, and battery sensors⁽¹⁾. In a typical smartphone, there are at least five sensor modules. Furthermore, with major manufacturers such as Apple, Samsung, Oppo and Huawei launching new smartphone products at least annually and with shorter product cycles as customers switch phones and upgrade their phones, more customers would either opt for better hardware and software offerings or stay up-to-date with recent technology advancements e.g. with 5G phones. This would lead to unprecedented demand in ATEs.

- **Automotive**

In 2016, revenue from automotive semiconductor ICs amounted to US\$22.9 billion with an expected CAGR of 10.3% from 2015 to 2020⁽²⁾. Meanwhile, in 2018, at least 2.1 million electric vehicles (EVs) were on the roads worldwide, with the People's Republic of China (PRC) and the United States accounting for 56.3% and 17.0% of the market respectively⁽³⁾. We believe that the growth of automotive ICs would likely be underpinned by advancements in electro mobility, with any recovery in the auto industry would likely come from PRC's market.

- **Medical devices**

According to the United Nations, the global population of 65 years old and above is growing faster than all other age groups. Data from *World Population Prospects: the 2019 Revision*, suggests that by 2050, one in six people in the world will be over 65 (16%), up from one in 11 or 143 million in 2019 (9%). In 2018, for the first time in history, persons aged 65 or above outnumbered children under five years of age globally, while the number of persons aged 80 years or over is projected to triple to 426 million in 2050 from 143 million in 2019. With expectations of growth in the aging population, semiconductor ICs would play a major role in the healthcare industry due to technological advancements in medical electronics which would allow for remote and real-time collection of patient data.

Source: Company, (1) "Sensors of Smart Devices in the Internet of Everything (IoE) Era: Big Opportunities and Massive Doubts" by Masoud M. et al (2019), (2) "IoT and Automotive to Drive IC Market Growth Through 2020" from IC Insights (accessed June 2017), (3) "Electric Vehicle Sales: Facts and Figures" from Edison Electric (April 2019).

□ **Revenue growth underpinned by its broadening exposure in 3D sensing technology in VCSEL**

In 2018, the group developed two new proprietary products for wafer-level testing, namely the vertical cavity surface emitting laser (VCSEL) probing test machine (model TROOPER) and burn-in test machine (model ZETA). TROOPER allows for only the good dice to flow down to the next phase of the manufacturing process, which will eliminate wastage in manufacturing costs and ensure product quality. Meanwhile, ZETA improves cost effectiveness by enhancing product reliability in the early stage of IC manufacturing process without incurring packaging costs.

VCSEL technology has a dominant presence in application for 3D facial recognition, augmented reality, automotive in-cabin sensing and automotive light detection and ranging (LiDAR). LiDAR is the critical sensor in the successful deployment of self-driving, autonomous and fully electrical vehicles.

Pentamaster is positive on its increased exposure to VCSEL technology as part of its 3D sensor module solutions for the smart mobile segment which will benefit the group's ATE segment.

□ **Aggressive expansion into medical segment via its acquisition of TP Concept**

Pentamaster currently has exposure to the medical segment through its i-ARMS solutions being developed for precision manufacturing automation in the medical field. The group's 90K sqft production space in its Batu Kawan plant caters to the group's FAS segment which targets customers in the medical field.

In September 2019, Pentamaster acquired 100% equity interest in TP Concept Sdn Bhd (TP) for RM21million after signing a shared sale agreement to facilitate the acquisition of all 250,000 shares. TP was incorporated in Malaysia on 3 December 2010 and its principal activity is the manufacturing and assembling of medical machines and manufacturing of die-casting parts.

The acquisition of TP is expected to provide synergistic benefits to Pentamaster which will enhance its medium to long-term financial performance, as it allows the group to diversify and strengthen its capability in the medical segment of the ATE market. The acquisition also comes with a total profit guarantee of RM12mil for FY20 and FY21, translating to a profit guarantee of RM6mil per year of TP, which will contribute positively to Pentamaster's future earnings.

□ **Margin expansion amid efforts to diversify across other business segments and customers**

Pentamaster has shared its three-pronged approach to drive an expansion in its margins by: (i) focusing on higher margin products in order to move up the value chain, (ii) diversify its solutions to other market segments and deepen existing customer ties as the majority of its orders are from repeat customers; (iii) expand customer base to other countries such as China and Taiwan.

VALUATIONS

We like Pentamaster due to its growth prospects supported by demand for more smart sensors in devices, the upcoming 3D sensing technology wave, trend towards autonomous cars and electric vehicles (EVs) and the adoption of Industry 4.0 through its ATE and FAS offerings. We initiate coverage on Pentamaster with a BUY call and a fair value of RM4.45/share, which is pegged to an FY21F PE of 19x, in line with its peer local equipment makers' average forward PE.

EXHIBIT 11: PEER COMPARISON TABLE

Company	Price (RM)	Mkt Cap (RM mil)	P/E (x)		EPS (sen)		EPS Growth		P/B		ROE (%)		DY (%)		EV/EBITDA	
			CY20	CY21	CY20	CY21	CY20	CY21	CY20	CY21	CY20	CY21	CY20	CY21	CY20	CY21
Malaysia																
QES Group Bhd	0.11	75.8	5.6	5.3	1.8	1.9	350.0	5.6	0.7	0.6	13.2	13.7	4.0	4.0	n.m	n.m
ViTrox Corp Bhd	7.36	3,297.3	28.2	23.6	24.8	29.6	46.7	19.4	5.9	5.0	22.1	22.3	1.0	1.2	51.9	34.2
Pentamaster Corp Bhd	3.70	1,780.8	18.1	15.4	20.7	24.3	18.3	17.4	3.4	2.8	20.4	19.8	0.8	1.0	n.m	n.m
Mi Technovation Bhd	1.71	1,262.4	18.0	13.0	9.4	13.0	19.0	38.3	3.1	2.8	17.6	18.9	1.8	2.5	n.m	n.m
Simple average			17.5	14.3	14.2	17.2	108.5	20.1	3.3	2.8						
Market cap weighted avg			23.1	19.1	23.1	26.3	127.5	17.5	3.4	3.0						

Source: Bloomberg, AmInvestment Bank Bhd. Prices as at 27th March 2020.

EXHIBIT 12: PB BAND CHART

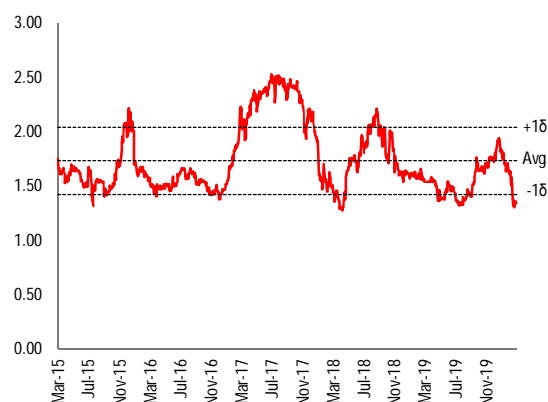


EXHIBIT 13: PE BAND CHART

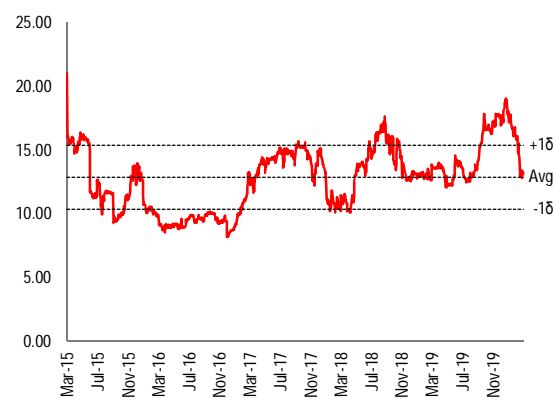


EXHIBIT 14: FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	FY18	FY19	FY20F	FY21F	FY22F
Revenue	422.2	490.1	568.2	635.0	704.5
EBITDA	99.3	132.3	152.2	168.3	184.0
Depreciation/Amortisation	(2.6)	(3.8)	(4.7)	(5.0)	(5.1)
Operating income (EBIT)	96.7	128.5	147.5	163.3	178.9
Other income & associates	-	-	-	-	-
Net interest	2.9	10.4	13.6	16.9	21.1
Exceptional items	-	-	-	-	-
Pretax profit	99.6	138.9	161.1	180.2	200.0
Taxation	(5.6)	(7.8)	(9.0)	(10.1)	(11.2)
Minorities/pref dividends	(36.9)	(48.1)	(52.7)	(58.9)	(65.3)
Net profit	57.1	83.0	99.4	111.2	123.5
Core net profit	57.1	83.0	99.4	111.2	123.5
Balance Sheet (RMmil, YE 31 Dec)	FY18	FY19	FY20F	FY21F	FY22F
Fixed assets	71.7	85.6	98.4	112.6	128.3
Intangible assets	10.8	44.6	43.9	43.1	42.4
Other long-term assets	13.1	35.5	14.0	14.0	14.0
Total non-current assets	95.5	165.7	156.3	169.8	184.7
Cash & equivalent	324.7	423.3	523.4	652.8	797.2
Stock	138.1	59.5	68.9	77.0	85.5
Trade debtors	51.9	65.6	76.0	84.9	94.2
Other current assets	35.8	23.6	21.2	21.2	21.2
Total current assets	550.5	571.9	689.5	836.0	998.0
Trade creditors	40.0	33.0	44.5	49.7	55.2
Short-term borrowings	0.4	0.4	0.4	0.4	0.4
Other current liabilities	127.5	92.2	98.1	151.1	209.7
Total current liabilities	167.9	125.6	142.9	201.2	265.3
Long-term borrowings	3.3	3.0	3.0	3.0	3.0
Other long-term liabilities	0.3	13.0	13.0	13.0	13.0
Total long-term liabilities	3.6	16.0	16.0	16.0	16.0
Shareholders' funds	356.2	436.6	527.5	629.2	742.1
Minority interests	118.2	159.3	159.3	159.3	159.3
BV/share (RM)	1.13	0.92	1.11	1.32	1.56
Cash Flow (RMmil, YE 31 Dec)	FY18	FY19	FY20F	FY21F	FY22F
Pretax profit	99.6	138.9	161.1	180.2	200.0
Depreciation/Amortisation	2.6	3.8	4.7	5.0	5.1
Net change in working capital	(18.6)	9.8	(31.3)	(22.3)	(23.2)
Others	(8.6)	(13.9)	(22.5)	(21.8)	(27.0)
Cash flow from operations	74.9	138.7	112.0	141.1	154.9
Capital expenditure	(28.3)	(14.1)	(17.0)	(19.1)	(21.1)
Net investments & sale of fixed assets	29.5	-	-	-	-
Others	(19.9)	(45.8)	13.8	17.1	21.3
Cash flow from investing	(18.6)	(59.8)	(3.2)	(2.0)	0.2
Debt raised/(repaid)	(0.3)	(0.3)	-	-	-
Equity raised/(repaid)	-	-	-	-	-
Dividends paid	-	-	(8.5)	(9.5)	(10.6)
Others	179.9	21.8	(0.2)	(0.2)	(0.2)
Cash flow from financing	179.6	21.5	(8.7)	(9.7)	(10.7)
Net cash flow	235.9	100.4	100.1	129.4	144.3
Net cash/(debt) b/f	82.2	324.7	423.3	523.4	652.8
Net cash/(debt) c/f	324.7	423.3	523.4	652.8	797.2
Key Ratios (YE 31 Dec)	FY18	FY19	FY20F	FY21F	FY22F
Revenue growth (%)	48.6	16.1	15.9	11.8	10.9
EBITDA growth (%)	116.1	33.2	15.0	10.6	9.3
Pretax margin (%)	23.6	28.3	28.4	28.4	28.4
Net profit margin (%)	13.5	16.9	17.5	17.5	17.5
Interest cover (x)	nm	nm	nm	nm	nm
Effective tax rate (%)	5.6	5.6	5.6	5.6	5.6
Dividend payout (%)	-	8.5	8.5	8.5	8.5
Debtors turnover (days)	40	44	45	46	46
Stock turnover (days)	112	74	41	42	42
Creditors turnover (days)	29	27	25	27	27

Source: Company, AmInvestment Bank Bhd estimates

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