AmInvestment Bank

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STRATEGY

Watch out for carbon pricing introduction

1,630

End-2022 FBMKLCI target (pts)

(Lowered)

Alex Goh

alexgoh@ambankgroup.com

03-20362280

Rationale for report: Market update

Investment Highlights

- **Carbon pricing initiatives**. Together with Bursa Malaysia, AmInvestment Bank recently organised an investors' webinar titled "Carbon Pricing Instruments to Support Net Zero Ambitions" which was presented by ERM, the world's largest pure play environmental, health and safety, risk and sustainability consultancy. The objectives were to introduce investors in Malaysia to existing global and domestic carbon pricing instruments, provide a high-level overview of recent carbon pricing developments and opportunities globally and in Malaysia to support climate and net-zero ambitions.

- **Offering financial incentives to decarbonise**. Carbon pricing is an instrument capturing the external cost of greenhouse gas (GHG) emissions and ties them to their sources through a price on the emission of carbon dioxide (CO2). This creates an economic signal to regulate and reduce GHG emissions while providing a strong financial incentive to divest from a high-emission fossil fuels-based technology towards cleaner technology.

- **Emphasising government, business and investment prerogatives**. Governments tend to adopt a "polluter pays" principle which can be a source of revenue for budgets to support climate projects that may be not commercially attractive yet. For businesses, the mechanism evaluates the impact of mandatory carbon prices on operations, identifying potential climate risks and opportunities. Investors analyse the potential impact of climate change policies on their investment portfolios, allowing the reassessment of investment strategies and reallocation of capital toward low-carbon activities.

- **Opting between ETS and carbon tax**. In 2021, carbon pricing initiatives, including for international aviation, covered 11.6 gigatonnes of CO2 or 21.5% of global GHG emissions. The 2 types of carbon pricing mechanisms are: i) emissions trading systems (ETS), or commonly referred as cap-and-trade, that limit the total GHG emission levels and allow industries with low emissions to sell their extra allowances to larger emitters; and ii) carbon tax which directly sets a price by defining a tax rate on GHG emissions.

- **Encouraging voluntary initiatives**. Carbon offsets and renewable energy certificates (REC) are being used by companies to meet mandatory targets under the domestic carbon pricing policy or voluntary commitments such as carbon neutrality and net-zero claims when an organisation cannot reduce its direct or indirect GHG emissions. Carbon offsetting involves purchasing the equivalent (tCO2e) in carbon reduction credits from external parties to compensate for its own carbon emissions. However, carbon insetting means investing in sustainable initiatives and practices to reduce carbon emissions within its own value chain.

- **ICP adoption**. Multinationals have increasingly begun adopting internal carbon pricing (ICP) mechanisms voluntarily to value their GHG emissions in driving positive changes as the cost assigned to each tonne of carbon can be factored into business and investment decisions, thereby incentivising efficiency and enabling low-carbon innovations. These include using an internal tax, shadow price or implicit carbon price. In 2020, the number of companies in Asia adopting ICP reached 796, above Europe's 661 and North America's 359 (Exhibit 2).

- **Reducing Malaysia's carbon intensity.** Malaysia, the fourth largest ASEAN GHG emitter with 240mil CO2 released in 2018, has ratified both the Kyoto Protocols (1997) and Paris Agreements (2015). In the 12th Malaysia Plan, the government pledged to become a carbon-neutral country by 2050, committing to reduce its carbon intensity (against GDP) by 45% in 2030 compared to the 2005 level, of which 35% will be unconditional with 10% conditional to financing and technology transfer by developed countries. For Peninsular Malaysia, the government declared a renewable energy mix of 31% by 2025 and 40% by 2035.

- **Endorsed voluntary ETS**. While a Malaysian carbon tax framework has yet to be announced, a voluntary domestic emissions trading scheme has been endorsed by the Ministry of Environment and Water (KASA). Hence international voluntary carbon offsetting programmes such as Verra and Gold Standard, and REC have established a presence in Malaysia. ERM expects the government to take 2–3 years to implement the carbon tax/ETS policies, and another 3–5 years to implement its objectives.

- **Expanding ESG champions**. Given the growing importance of ESG prerogatives, we have added another 7 stocks to our list of champions, which now include Petronas Chemicals Group, Petronas Gas, IHH Healthcare, Westports, Inari Amertron, Sunway Holdings and Astro (Exhibit 10). These companies have ESG scores of 4 stars and demonstrate strong commitments towards sustainable business models and initiatives.

- **Bargain valuations emerge** as the FBMKLCI has fallen by 9.5% YTD to 1,419 currently, close to our year-end worst-case scenario of 1,415 based on 2 standard deviations below its 5-year median forward PE of 16.3x (Exhibit 8). This was driven by the continuation of foreign net equity sales of RM145mil this month to date following the RM1.3bil net foreign outflow in June amid low liquidity (Exhibit 5). As a comparison, the FBMKLCI's median was 1,525 at a forward PE of 17.6x in 2020 when the Covid-19 pandemic caused Malaysia's GDP to drop by 5.6%. Meanwhile, our economist maintains a 2022F GDP growth of 5.6% and year-end USD/MYR target of 4.20.

- **Lowered base-case end-2022 FBMKLCI target at 1,630 (from an earlier 1,745)**, pegged to 0.5 standard deviation below its 5-year median at 16.3x from no discount earlier, on growing concerns that our 2023F earnings growth of 8% (Exhibit 7) could be eroded by higher operational and inflationary costs as the government proposes new mechanisms to reduce subsidies and raise federal revenues (such as GST reintroduction) against the backdrop of a prolonged Ukraine-Russia military conflict, heightened global recessionary possibilities and domestic political noises. Near term, fund flow volatility could continue to drive the index within a wide range of 1,400 to 1,600.

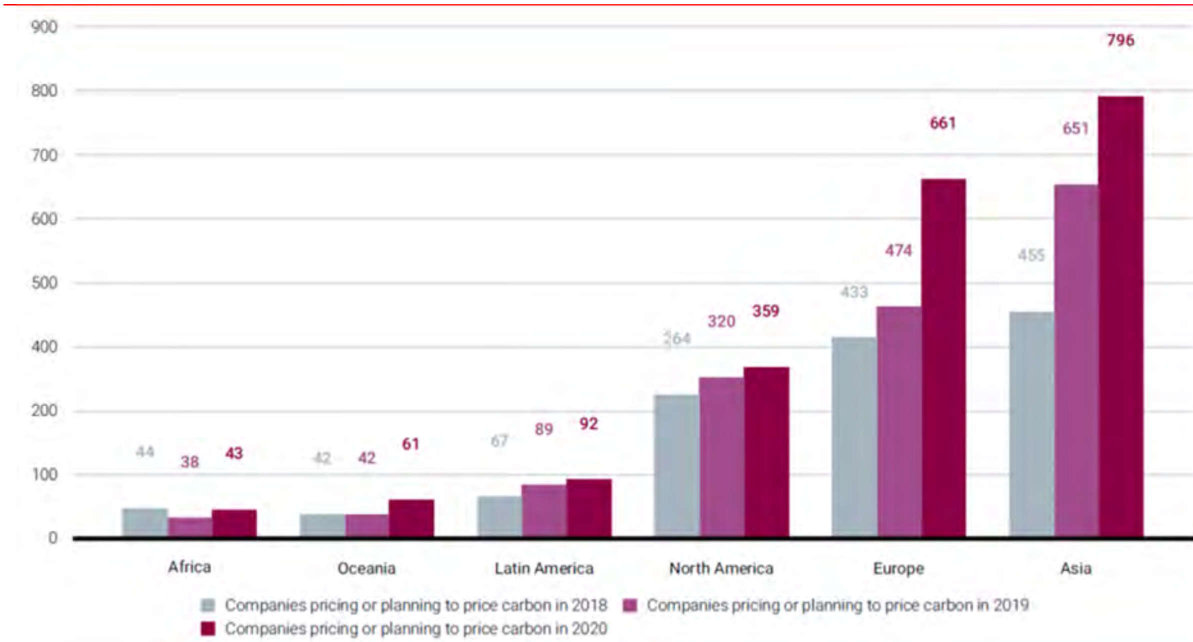
EXHIBIT 1: SUMMARY OF REGIONAL/ NATIONAL REGULATORY UPDATES ON CARBON PRICING

	Carbon Tax		Carbon Trading (ETS)		Carbon Price Floor/ Ceiling (Hybrid Approach)	
	Current	Projected	Current	Projected	Current	Projected
EU	N/A*	N/A	EUR 24.84 (USD 27.81) (average 2019 price)	N/A	No explicit price	Prices may provide a limited incentive for companies to undertake longer term investments to reduce emissions.
China	N/A	N/A	CNY 78.60 (USD 11.37) (average 2019 price)	N/A	N/A	• Verified emissions data in a compliance year • Direct price stabilization measures
Thailand	N/A	N/A	N/A	T-VER T-VETS	N/A	N/A
Singapore	$5 per tonne of GHG emissions (tCO2e) from 2019 to 2023	Plans to increase between $10 and $15 per tonne of GHG emissions by 2030	N/A	N/A	N/A	Focus shifting towards: • Energy consumption • Lower carbon emissions • Market incentive for R&D in energy efficiency • Stimulate growth in green industries
Indonesia	IDR 30,000 per metric tonne CO2-e (approximately USD 2.1/t CO2-e)	N/A	Indonesia ran a voluntary ETS Pilor in the power sector from March to August 2021	N/A	N/A	N/A

**Note: No EU wide carbon tax although some member countries have their own carbon tax e.g. Finland, Norway, Sweden, Netherlands and Switzerland*

Source: ERM

EXHIBIT 2: GROWTH OF COMPANIES ADOPTING INTERNAL CARBON PRICING MECHANISMS



Source: ERM

EXHIBIT 3: CARBON PRICING APPROACHES

	Internal Tax/Fee/Cap	Shadow Price	Implicit Carbon Price
Definition	**A monetary value** attached to each metric ton of emissions charged to business units for their emissions.	**A theoretical internal cost** of carbon applied in project planning processes to test the feasibility of capital expenditure and R&D investment decisions.	**The value of past measures and initiatives** implemented to reduce a company's greenhouse gas emissions and/or comply with climate policies and regulations
Objectives	**To create a dedicated revenue or investment** stream that can fund projects to help meet a company's greenhouse gas reduction targets, and establish a common business "language" internally to address climate change.	**To screen potential business risks** of future carbon regulations, build a business case to shift investments to low-carbon options.	**Identify marginal abatement costs (MACC)** of mitigating greenhouse gas emissions and complying with climate policies and regulations.
Price Range	\$5–\$20 per tCO2e	\$0.3–\$906 per tCO2e	No revealed prices or price ranges
Investment and Revenue Allocation	**Yes. Revenues used to fund sustainability projects**, realized as an actual monetary transaction between business unit(s) and the department collecting the fee.	**None. A theoretical price that is not collected**, but which guides future investments and research and development activities toward low-carbon alternatives.	**No. There is no reinvestment or revenue allocation** since the price is derived retroactively.
Benefits	Sends a clear signal to targeted audience.	Determine resilience of investments. Test investments' to better manage future risks.	Viewed as benchmark for introducing internal carbon pricing program.
Challenges	Internal buy-in becomes challenging since emission intensive activities or business units will bear the brunt.	A notional price may not trigger the investment shift.	Can be calculated retroactively. Not seen as influencer as other two approaches.
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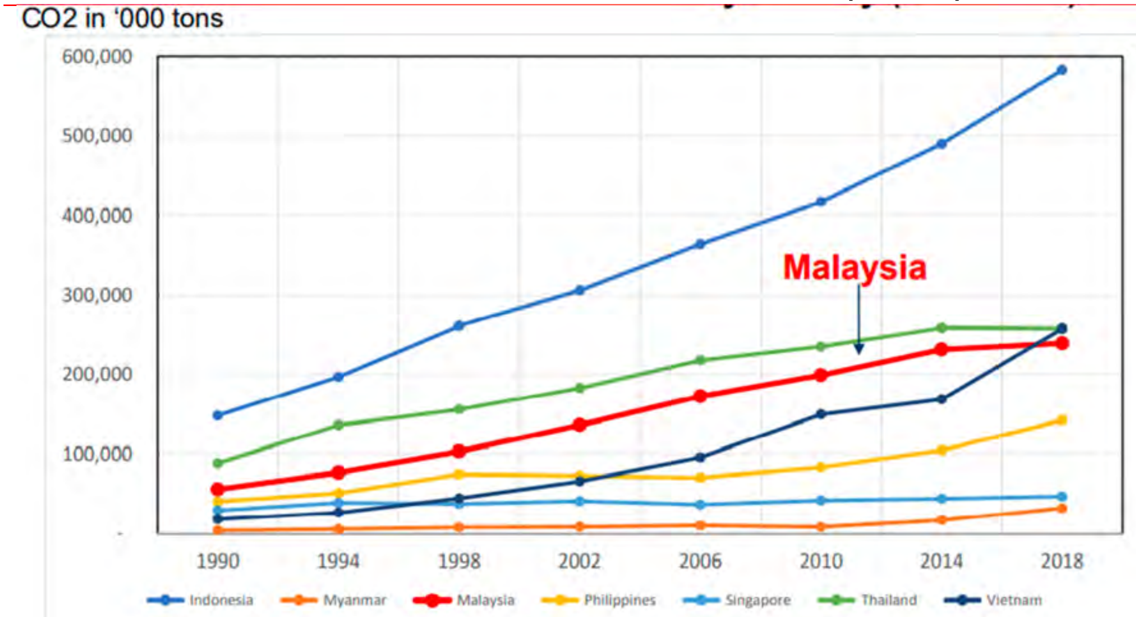
Company	Microsoft	Taiwan Mobile, GC, BT, Singtel, SCG, INDORAMA VENTURES	vodafone

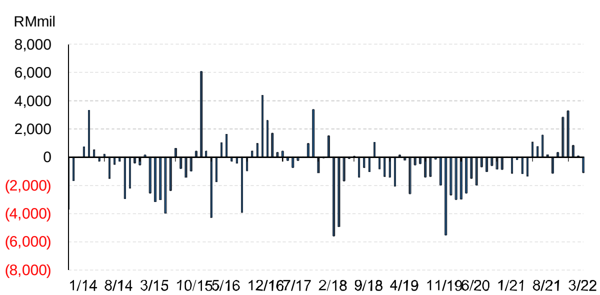
Source: ERM

EXHIBIT 4: CO2 EMISSIONS IN ASEAN BY COUNTRY (1990–2018)



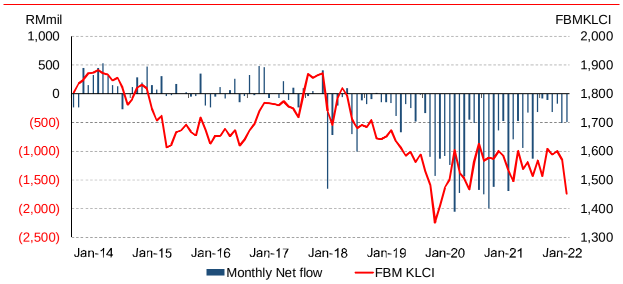
Source: ERM/World Bank

EXHIBIT 5: MONTHLY NET FOREIGN EQUITY FLOWS TO MALAYSIA



Source: Bursa Malaysia/AmInvestment Bank

EXHIBIT 6: COMBINED LOCAL INSTITUTIONAL & FOREIGN EQUITY NET FLOWS VS. FBMKLCI



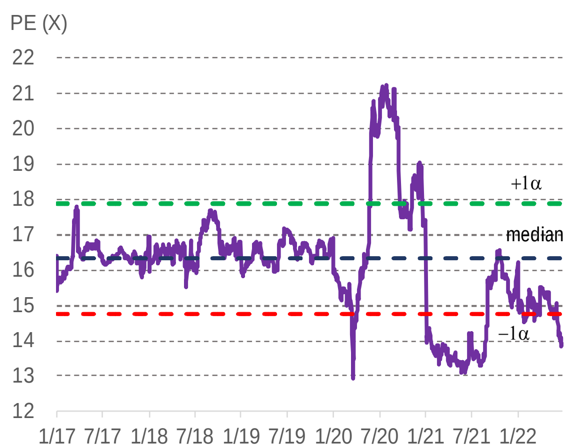
Source: AmInvestment Bank/Bursa Malaysia/Bloomberg

EXHIBIT 7: SECTORAL BREAKDOWN OF FBMKLCI EPS GROWTH AND PE

	SECTORAL WEIGHTING (%)	EPS GROWTH (%)			PE (X)	
		2021 A	2022 F	2023 F	2022 F	2023 F
ALL SECTORS		61.9	(16.1)	9.4	14.9	13.8
FBM KLCI @		34.6	0.6	8.0	13.5	12.5
Automobile	0.9	58.9	9.8	8.8	4.6	4.2
Building Material	0.2	<-100.0	>100.0	84.8	200.5	108.5
Construction	1.7	13.3	86.7	15.3	12.6	10.9
Consumer	8.0	16.4	9.7	26.7	25.7	20.3
Financial Services	33.4	41.0	11.8	11.3	15.4	13.9
Glove	2.0	>100.0	(90.3)	(10.8)	15.4	17.2
Healthcare	5.8	>100.0	16.4	22.3	28.4	23.3
Manufacturing	1.0	12.9	(25.5)	31.2	16.1	12.2
Media	0.5	(7.5)	1.0	1.5	9.9	9.8
Oil & Gas	11.2	90.4	8.8	2.5	9.8	9.6
Plantation	8.2	>100.0	15.0	(36.0)	11.4	17.8
Power	5.1	15.4	4.8	18.1	10.5	8.9
Property	3.0	45.9	26.0	15.6	11.1	9.6
REITs	1.3	(13.2)	41.0	17.6	18.7	15.9
Services	0.0	(19.6)	(13.5)	42.6	33.5	23.5
Stock Exchange	0.5	(5.9)	(32.6)	2.5	21.5	21.0
Technology	2.5	50.5	25.2	20.3	23.9	19.9
Telecommunication	9.3	0.9	2.3	15.3	21.1	18.3
Transportation & Logistics	5.5	(27.1)	41.3	55.3	25.1	16.1

Source: AmInvestment Bank

EXHIBIT 8: FBMKLCI'S 1-YEAR FORWARD PE



Source: AmInvestment Bank/Bloomberg

EXHIBIT 9: FOREIGN SHAREHOLDING IN MALAYSIAN EQUITIES

Source: AmInvestment Bank/Bursa Malaysia

EXHIBIT 10: ESG CHAMPIONS

Company	Sector	Market Cap RMmil	Share price RM/share	Fair value RM/share	Upside %	Rationale
Maybank	Banking	102,630	8.58	10.30	20.0	Low exposure to ESG vulnerable sectors, received a rating of 'AA' in the MSCI ESG Ratings assessment. Consistently been included in the FSTE4Good indices for 8 straight years which reflects recognition of its sustainability efforts and practices.
Petronas Chemicals Group	Oil & Gas	72,960	8.34	11.30	35.5	Established Net Zero Carbon Emissions 2050 Roadmap which targets to achieve net-zero carbon emissions by 2050. Also committed to transitioning to a New Plastic Economy and circular economy to ensure sustainable consumption and production of plastic. One of the top 10 companies in the FTSE4Good Index and a member of the Dow Jones Sustainability World Index.
Petronas Gas	Oil & Gas	32,451	16.40	20.05	22.3	Already part of the energy transition with natural gas having a low carbon footprint in the power generation process. Petronas Gas also adheres to GHG emissions limit of 5 million tonnes of Co2 equivalent together with continuous emissions reduction efforts that include flare reduction and improvement of energy efficiency and plant reliability. Included in FTSE4Good Index and ranked top 26-50% by ESG Ratings in FBM EMAS.
IHH Healthcare	Healthcare	56,954	6.33	7.00	10.6	Reducing water and electricity consumption throughout all operations such as standardising use of lighting & air-conditioning with optimal ranges, sensor faucets and high-efficiency toilets. Operates Malaysia's First Green Hospital – Pantai Hospital Laguna Merbok, which achieved GBI Silver certification in In 2014, becoming the first purpose-built hospital to incorporate green technologies and design into its construction and operations in Malaysia. Its innovations include green vehicle charging stations, condensate water harvesting, solar hot water for showers and LED façade lighting. All plastic cutlery has been replaced with wooden cutlery at the hospital cafeteria.
Telekom Malaysia	Telco	20,230	5.13	7.08	38.0	Spearheads the National Fiberisation & Connectivity Plan to rural and unreached communities, implementation of energy efficiency and sustainable systems and significant corporate/social contributions.
Westports Holdings	Port	12,310	3.61	4.76	31.9	Adopts initiatives to disclose greenhouse gas (GHG) emissions each year and introduced carbon pricing mechanism in 2020, reduce air pollution, water polution, and noise pollution, minimise long term effect of biodiversity loss (Mangarove Forests) and ensure that major supply chain partners adhere to all social standards stipulated by Malaysian Labour Law and the International Labour Organisation. Recognised by APEC Port Services Networtk Green Port 2020 as one of 8 global green ports; secured ISO 45001:2018 and MSOSH OSH Gold Class 2 Award Winner for 2021.
Inari Amertron	Technology	9,490	2.60	3.72	43.1	Highly committed in employee wellbeing and supply chain management. In addition, the group has ongoing investment in environmental technologies such as solar panels to lower carbon intensity. Inari was included into FTSE4GOOD Bursa Malaysia Index since Jun 2020 and is a corporate member of Climate Governance Malaysia to promote sustainability performance.
Sunway Holdings	Property	8,092	1.63	2.27	39.3	Targeting zero carbon emmission by 2050 and has incorporated sustainable financing consideration into capital management strategies via the issuance of sustainability-linked bond . Also, been recognised both locally and internationally for sustainability efforts. Listed in FTSE5Good Bursa Malaysai Index since 2016 and ranked by FTSE Russell EGS Ratings in FBM Emas.
Yinson Holdings	Oil & Gas	6,044	1.90	3.61	90.0	Aiming to invest in up to 3GW of renewable energy by 2023 and already has stakes in 330MW solar projects and multiple green technology start-ups. A constituent of the FTSE4Good Index and ranked top 26-50% by ESG Ratings in FBM EMAS.
Sunway REIT	REIT	5,137	1.47	1.76	19.7	Targeting zero carbon emmission by 2050 and has incorporated sustainable financing consideration into capital management strategies via the issuance of sustainability-linked bond . Also, been recognised both locally and internationally for sustainability efforts. Listed in FTSE5Good Bursa Malaysai Index since 2016 and ranked by FTSE Russell EGS Ratings in FBM Emas.
Astro	Media	4,693	0.90	1.20	33.3	Generated 1.6mil kWh of solar energy, reduced GHG emissions by 6% to 23,955 tCO2e and electricity consumption by 7% to 31mil kW while airing over 11,600 hours of Public Service Announcements to amplify community messages in 2021.Included in the top 10% of media companies in 2021 for FTSE4Good Index and top 10% of all companies globally by Sustainalytics.

Source: AmInvestment Bank

EXHIBIT 11: OVERWEIGHT SECTORS

Sector	Rationale	BUYs
Automobile	Industry sales expected to rebound in 2022 as the supply chain normalises and consumers' confidence gradually recovers. The government' decision to allow prospective buyers who have placed orders before 30 June 2022 and register their vehicles before 31 March 2023 to enjoy the sales tax exemption bodes well for the sector. This will provide a 9-month sales visibility for the sector while preventing a hard industry sales landing as automakers will have time to replenish their order book.	Bermaz Auto, MBM Resources, UMW
Banking	Interest rate uptrend benefitting the interest income of banks with lower provisions ahead supported by potential reversals of management overlays from an improving trend of loans under repayment assistance (RA). Also, with improved earnings visibility, we are seeing normalising dividend payouts by banks.	MayBank, CIMB, RHB
Media	Attractive FY24F PE of 10.4x for Astro and FY23F PE of 6.4x for MPR. We expect adex recovery as Malaysia transitions to endemic phase and borders reopen.	Astro
Oil & Gas	Robust earnings growth from elevated oil prices supported by prolonged supply disruptions and past under-investment. Companies with direct exposure to the upstream production and the FPSO subsector would be the biggest beneficiaries.	Dialog Group, Petronas Gas, Yinson
Ports	While contraction is likely in 2Q22 from supply chain disruptions arising from stringent lockdown measures in Shanghai and Ukraine-Russia war, we expect a recovery in 2H22. Looking beyond the short-term impact, the resilient outlook for the port sector in the region is underpinned by global trade and investments in the manufacturing sector that generate inbound and outbound throughput. There have been significant relocations of the manufacturing base by MNCs out of China to the region due to rising labour and land costs, exacerbated by the US-China trade war.	Westports
Power	Tenaga's rate of return is protected by the government's incentive-based regulatory framework, with higher coal and gas prices passed to consumers.	Tenaga Nasional
Technology	Robust structural semiconductor demand growth, coupled with attractive valuations.	Inari Amertron & MPI

Source: AmInvestment Bank

EXHIBIT 12: NEUTRAL SECTORS

Sector	Rationale	BUYs
Construction	Greater earnings visibility as more mega projects are rolled out. However, we expect thinner margins due to rising operating costs from major supply distruption and market dislocations.	WCT
Consumer	While the demand and supply recovery remains intact as wider economic activities pick up, rising commodity and energy prices pose downside risk to the sector's earnings.	Berjaya Food & Mr DIY
EMS	Labour shortages continue to be bottleneck for growing capacity.	VS Industry
Glove	Negative stagflationary impact on margins as cost increases are unlikely to be fully passed on to consumers amid declining average selling prices.	N/A
Healthcare	IHH trades at unexciting PE valuations and dividend yields even though the impact of stagflation could be muted given demographic concentration on the mid-to-high income group.	Apex Healthcare
Insurance	Higher interest rates moving forward is likely to result in fair value losses on insurance companies' securities portfolio. Also, there remain uncertainties surrounding the day 1 impact of FRS 17 while claims are expected to trend higher in 2022 from the normalisation of motor and medical claims. The impending phase 2 detariffication is expected to exert pressure on the pricing of fire/general insurers.	Allianz
Property	We expect softer property sales amid the expiry of Home Ownership Campaign and heightened building material costs as a result of prolonged supply chain disruptions. The developers could scale back new launches should construction costs continue to rise.	Sunway
REITs	Declining DPU yield spread against 10-year Malaysian Government Securities (MGS) with interest rates on the uptrend resuting in softer sentiments for yield players. Under stagflationary pressures, we expect lower discretionary spending by consumers.	Sunway REIT
Telecommunications	Higher opex from Digital Nasional's fixed 5G annual wholesale capacity charge on celcos could more than offset escalated data demand and easing competition from the consolidation of 2 major cellular operators amid a stagflationary outlook which could depress subscriber affordability.	Telekom Malaysia

Source: AmInvestment Bank

EXHIBIT 13: TOP DIVIDEND PICKS

Company	Sector	Current Share price	DPS (sen)	Yield 2022 (%)
Malakoff	Power	0.64	5.0	7.8
Astro Malaysia	Media	0.90	6.8	7.5
Globetronics	Tech	1.11	9.0	8.1
Lagenda Properties	Property	1.23	9.4	7.6
YTL Hospitality REIT	REIT	0.94	6.2	6.6
Malayan Banking	Financial Services	8.58	55.9	6.5
RHB Bank	Financial Services	5.65	34.7	6.1
Mah Sing Group	Property	0.60	3.5	5.8
Bermaz	Auto	1.70	9.9	5.6
Pavilion REIT	REIT	1.31	7.1	5.5
Allianz Malaysia	Financial Services	12.88	64.3	5.0

Source: AmInvestment Bank

EXHIBIT 14: TOP BUY CALLS

Company	Sector	Market Cap RMmil	Share price RM/share	Fair value RM/share	Upside %	Rationale
Maybank	Banking	102,630	8.58	10.30	20.0	Expected improvement in core operating income with the interest rate uptrend benefitting underlying NIMs and lower provisions for loan losses with the tapering of new applications for RA in Malaysia while that for overseas operations are stabilising.
CIMB	Banking	51,108	5.09	6.60	29.7	Undemanding valuation trading at 0.8x FY23 P/BV, potential ROE uplift from impairment of goodwill and intangible assets coupled with the group's initiatives on cost take-out to trim opex.
Tenaga Nasional	Power	51,760	7.96	12.00	50.8	Undemanding FY23F PE of 9x while rate of return of 7.3% is protected under RP3 guidelines.
RHB Bank	Banking	23,697	5.65	7.40	31.0	Strong capital position with a CET1 ratio of 16.8% as well as attractive FY23F P/BV valuation at 0.8x.
Berjaya Food	Consumer	1,566	3.79	5.05	33.2	Leveraging on Starbuck's strong brand equity, the company is relatively in a better position to compete in retaining consumer's share of wallet under the current inflationary environment compared to its peers.
Telekom Malaysia	Telco	18,830	5.13	7.08	38.0	Strong earnings growth underpinned by rapid fibre subscriber growth on a nationwide network, rising wholesale revenue from 5G deployment and levelisation of playing field against established players together with improving cost management.
Inari Amertron	Technology	9,490	2.60	3.72	43.1	Proxy to the rapid growth of 5G telecommunication technology through its radio frequency business, which is set to benefit from the expected increase in demand for 5G smartphones.
Sunway	Property	8,190	1.63	2.27	39.3	Strong brand recognition established by its highly successful landmark developments and expanding healthcare business, supported by substantive unbilled sales and outstanding order book.
Malaysian Pacific Industries	Technology	6,890	28.00	45.16	61.3	Core strength in investing in the right technology at the opportune time, and is set to benefit from early investment to produce silicon carbide and gallium nitride power products.
Astro	Media	5,136	0.90	1.33	47.8	Strength in vernacular content & high household penetration rate of 72%, attractive dividend yield of 6%, impresisve aggregation of streaming services, and offering of internet services.
Sunway REIT	REIT	4,966	1.47	1.76	19.7	Diversified investment portfolio which encompasses retail malls, hotels, offices, a university, and hospitals that spread across Malaysia. Strong occupancy rates which have exceeded 90% in retail assets. Stable rental income generated from the services and industrial segments.
Bermaz Auto	Auto	2,025	1.70	2.25	32.4	The group's constant product updates bode well as it would translate to a more consistent and predictable sales flow. Meanwhile, the ventures in Kia and Peugeot distributorships help to extend the company's future growth runway. The high order backlogs of about 9,000 units will provide the company with sales visibility in the next 7-8 months.
Dialog Group	Oil & Gas	12,139	2.01	3.66	82.1	Improving sector recovery on bullish crude oil prices poised to spur recurring services growth and the group's strategic Pengerang developments.

Source: AmInvestment Bank

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