

## Chip Eng Seng Corporation Ltd -

*Transformed into a high-end & mid-tier residential developer*

27 Sep 2006

**Recommendation** BUY

Bloomberg Code CHIP SP

Share Price S\$0.22

Target Price S\$0.30

Upside Potential 36.4%

### Report Type

Initiating Coverage

### Company website

[www.chipengseng.com.sg](http://www.chipengseng.com.sg)

### Stock data

Sector : Property & Construction

Share Cap : 606.8m shares

Market Cap: S\$133.5m

Major Shareholders:

Lim family 56.9%

Free float (%) : 43.0%

### Analyst

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MICA (P) 073/01/2006

### Investment Highlights

- **A high-end and mid-tier property play.** Chip Eng Seng (CES) is a play on the high-end and mid-tier property markets. It has a portfolio of four land parcels comprising of three sites in the prime districts of 9, 10 and 11, at Grange Road (jointly with Citadel Equity Fund), Peck Hay Road (jointly with Lehman Brothers Real Estate Partners II) and Balmoral Road, and one site at West Coast Road, for mid-tier residential development.
- **Relatively cheap land bank.** Management had the foresight to move into high-end and mid-tier property markets early and benefited from inexpensive land bank. Jointly with Keppel Land, CES acquired a prime residential site at Devonshire Road in June 2004, when high-end housing market was soft. Launched in mid 2006, this project, Ritz Residences was well received with sales to-date of close to 70% and yielded attractive profit margin of about 40%. Management was swift to acquire more land parcels when the high-end housing market was turning around. Over the past two years, CES has built up four additional land parcels, as mentioned earlier. At current selling prices, developments at Balmoral Road and Peck Hay Road, where the sites were acquired in 2005 and 1H2006 respectively, are expected to fetch profit margin of more than 25% while the development at Grange Road is expected to yield a profit margin of at least 15%.
- **Higher ROE than most property developers.** CES has a unique structure whereby it is involved in the construction of the private property development in which it has an equity stake in. On this account, CES receives an additional level of construction revenue and profit for each development project. As a result, CES offers higher ROE, estimated at about 18% (FY06), than most local property developers.
- **Build up expertise in construction of private housing for additional avenue of growth.** CES is a well-established name in the construction market for public housing. Its venture into the construction of jointly-owned private housing projects will enable the Group to tap into the building methodology and project management expertise of established private developers such as NTUC Choice Homes and Keppel Land. This will serve as an important reference for the Group's future tender for construction work in the private housing segment.
- **Relatively high dividend yield for a developer.** In view of strong profitability, CES is expected to offer dividend per share of at least 1.0cts, similar to that of FY2005, providing an attractive dividend yield of at least 4.4%.
- **Financially healthy.** CES' net gearing is healthy at about 0.6x (FY06). Taking into account further borrowing requirements for its future property developments, net gearing is expected to be maintained at below 1.0x.
- **Valuation and Recommendation.** We are of the view that there is further capital upside, of about 10% to 15%, in the high-end and mid-tier home markets over the next 12 months. Accordingly, we value CES at RNAV per share of S\$0.40 (please refer to Sensitivity Table on Page 3). As smaller developers generally trade at a discount to RNAV, we apply a conservative 25% discount to RNAV of CES. CES has a target price of S\$0.30, providing an upside of at least 36%. BUY.

## Valuation

We valued the investment properties and development properties in Singapore and arrived at a surplus of S\$1.6m and S\$108.5m respectively. Overseas, CES has two small properties - a 60% stake in about 4,700 sqft of office space in Pulteney Street, Adelaide and a small 23-unit residential project in North Glenelg, Adelaide. These projects are currently rented out in view of the weak property market in Adelaide. These projects have been valued by independent valuers and the surplus over book value is immaterial. We took a conservative approach and have not attributed a valuation surplus to these projects in our valuation.

For the construction business, we applied market PE of about 5x to the construction earnings for FY07 and arrived at S\$23.4m or about 3.9cts per share. The base case RNAV per share is S\$0.35.

### RNAV Table (Base Case)

Properties	NLA (sf)	Stake	Valuations	
			(S\$psf)	Valuation (\$'000)
CES Bldg, 69 Ubi Crescent	67,027	100%	209	14,000
6,6A,6B Perak Rd	5,813	100%	327	1,900
86/A/B Tanjong Pagar Rd	4,564	100%	416	1,900
161 Geylang Rd	7,772	100%	373	2,900
115, 117, 119 Geylang Rd	9,688	100%	382	3,700
				24,400
Book value of investment property as at 31 Dec 2005				22,806
Surplus/(Deficit)				1,594
Development Properties	<b>GFA (sf)</b>			
Grandeur 8	766,000			456
ShanghaiOne	48,222			7,745
Riviera Residences	174,806			8,938
Ritz Residences	223,028			36,748
21 Balmoral Road site	43,112			17,797
21 Peck Hay Road site	156,644			22,771
West Coast Road site (former Westpeak Condo)	654,841			6,356
Grange Road site (former Grange Tower)	164,302			7,693
Surplus from development properties				108,504
Construction business				
5x FY07 earnings				23,400
Book value as at 31 Dec 2005				79,280
RNAV				212,778
No. of shares				606,789
RNAV per share (S\$)				<b>0.35</b>

Source: Westcomb Securities

## Sensitivity Analysis

We have valued CES' property development projects in Singapore based on the prevalent selling prices. However, we are of the view that there is further capital upside, of about 10% to 15%, in the high-end and mid-tier home markets over the next 12 months. To take into account this capital upside, we have included a sensitivity table that shows the impact of an upward adjustment in the selling prices of CES' new launches on RNAV per share.

### Sensitivity Table

Sensitivity Table	
Adjustment on average selling prices of new launches	Impact on RNAV per share (S\$)
Base case	0.35
+5%	0.37
+10%	0.39
+15%	0.41
+20%	0.43

Source : Westcomb Securities

## Promising Residential Property Outlook

**Strong interests from foreign buyers.** The high-end property market continued to shine in 2Q2006, driven by foreign buyers (including permanent residents). Currently, foreigners account for about 23% of all property transactions and about 50% to 60% of luxury home transactions. The introduction of new boutique developments and high profile launches over the past few years – waterfront condominiums and bungalows at Sentosa Cove and high-rise city condominium facing Marina Bay – has raised the investment appeal of Singapore property among foreigners.

The Singapore government's decision to have two integrated resorts with casino has also placed Singapore on the international radar scene. Political stability and Singapore government's open policy to receiving foreigners has continued to attract foreign investments. All these factors coupled with the fact that the rise in property prices of Singapore is comparatively less than those in major cities such as London, Hong Kong and Shanghai, etc, will continue to draw foreign demand and lend support to growth in high-end home prices.

**Enbloc sales will tighten supply.** Strong collective sales activities in the high-end districts over the past one-and-a-half years will bring about shortage in high-end homes in the next one to two years as construction activities begin on these sites. Unlike the collective sales in the 1990s where redevelopments could benefit from enhancements in gross floor area (GFA) over previous properties, new redevelopments are largely "old-for-new replacements", with only slightly more GFA than the existing properties. Also, an increasing number of old high-end homes under en-bloc sale for redevelopment will also result in shortage of good size condominiums (of 2,000 sqft or more) in the prime areas. This shortage is likely to persist over at least the next 12 to 18 months and will continue to lend support for growth in rentals and prices of high-end homes over the next 12 months.

**Supply tightness in high-end homes has spill-over effects on mid-tier homes.** Faced with shortage of high-end homes for rental, expatriates have moved to the "outer-prime" mid-tier areas such as Newton, Novena, Tanjong Rhu, East Coast, and West Coast areas, and as a result led to rising rental prices in these areas. Although price of high-end homes have surged by about 30% from 2004, prices of mid-tiers homes have only risen about 12% to 15% over the same period. With a

wide price differential between the high-end and mid-tier housing markets, improving occupancy and rental yields in the mid tier housing markets as well as strengthening demand from locals, we believe prices of mid-tier homes will also see upside in capital values over the next 12 -18 months.

## Prospects

### Property Development

CES began as an ad-hoc property developer of small projects and made its first foray into large scale property development in 2000. Its first major project, Bishan Loft, was jointly developed with NTUC Choice Homes (NCH). Subsequent to Bishan Loft, CES also jointly-developed two other projects, Grandeur 8 and Riviera Residences, with NCH and in the process, learned the ropes of private property development. Since then, CES has taken on high-end projects on its own or with other local or foreign joint-venture (JV) partners.

**Opportunistic in landbanking.** Under the leadership of the managing director of the property arm, CES was opportunistic in building up its land bank portfolio when the property market was soft. In 2002 and 2004, CES acquired prime residential land sites in Shanghai Road and, jointly with Keppel Land, Devonshire Road, respectively. Taking a view that the price of high-end property market will continue to improve and the buoyant high-end property market will spill-over to the mid-tier home segment in the next 12 months, CES continued to acquire land parcels in the high-end as well as the mid-tier homes segments.

Without further acquisition of land, the existing land bank will bring about earnings growth to CES through FY2009/FY2010.

### Projects under Development

Projects under Development							
Project & Location	Stake	JV partners	Tenure	Segment	Types of Development	Ave SP (\$ psf)	Breakeven (\$ psf)
Riviera Residences Upp East Coast Road	40%	NTUC Choice Homes	Freehold	Mid-tier	138 condo units	625	473
Ritz Residences Devonshire Road	40%	Keppel Land	Freehold	High-end	157 condo units	1,300	767
ShanghaiOne Shanghai Road	100%	NA	Freehold	Upper-mid	52 condo units	830	625

Source : Westcomb Securities

### Projects to be Launched

Land Bank								
Location	Stake	JV Partner	Tenure	Segment	Type of Development	Launch	Ave SP (\$ psf)	Breakeven (\$ psf)
Balmoral Road	100%	NA	FH	High-end	35 condo units	November 2006	1,350	776
Peck Hay Road	50%	Lehman Bro. Real Est.	FH	High-end	70 condo units	1H 2007	1,500	1,094
West Coast Road	Assume 25%	Not determined yet	FH	Mid-tier	Est. 650 units	2H 2007	630	568
Grange Road	25%	Citadel Equity Fund	FH	High-end	80 condo units	2H 2007	1,750	1,464

Source : Westcomb Securities

### Investment Property

CES owns a portfolio of five investment properties in Singapore, comprising one light industrial building and shophouses in various parts of Singapore. The properties provide CES with a stable rental income of about S\$1.5m per annum and steady cash flow.

In Australia, CES owns 23 units of oceanfront-facing apartments in Glenelg, Adelaide. The development was completed in early 2006 and will be leased out pending a recovery in the residential property market. Through a 60%-owned

subsidiary, CES also rents out about 4,700 sqft of office space in a commercial building at Pulteney Street, Adelaide. Again, the commercial space will be sold pending a recovery in the commercial property market. Rental contribution from Australia is not material.

### **Construction**

CES is a leading construction company with prudent and experienced management. The Group remained profitable during periods of construction downturn in the late 1990s and early 2000s. The construction arm has undertaken both public and private construction projects. Most of the public projects are obtained from the Housing and Development Board (HDB) while the private projects are largely CES' private residential property developments.

To-date, it has approximately S\$357m worth of contracts on hand that will take the Group through to FY2009. The most prominent of which is a S\$279m contract awarded by HDB to build The Pinnacle@Duxton, Singapore's tallest public housing project, which will be completed in 2009.

Optimism in the housing market, particularly high-end private residential homes, has resulted in high construction activities in Singapore. Supply tightness in the construction industry has brought about margin expansion for both public and private projects. CES' construction margin is estimated at about 5% currently, compared to about 2.5%-3.5% in early 2000. In the medium term, we expect construction margins to remain firm in the light of housing boom and the development of integrated resorts at the Marina area and Sentosa Island.

## Financial Performance

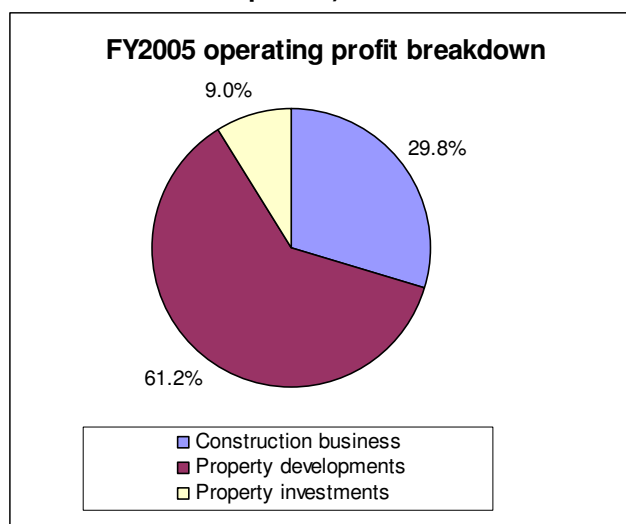
In FY2005, revenue declined 29.6% to S\$99.8m was due to timing difference in revenue recognition of projects. There were a few projects completed in 2004, which resulted in higher revenue recognition in FY2004. In FY2005, property development revenue came from residual revenue from OneFort condominium and initial revenue recognition of wholly-owned ShanghaiOne, off River Valley Road, which was at the preliminary stages of construction.

Despite the lower revenue, net profit improved 8.0% to S\$11.3m. The growth came from recognition of more profits from joint property development projects undertaken through associated companies. These joint projects are Grandeur 8, which was completed in FY2005 and Riviera Residences, which provided initial contributions to CES.

Construction revenue and profit was lower due to fewer on-going projects in FY2005 and the lack of revenue and profit recognition from The Pinnacle@Duxton which was at early stages of construction.

Contribution from investment property was small but provided CES with stable rental income and steady cashflow.

### FY2005 Operating Profit Breakdown (including property development profits from associate companies)



Source : Westcomb Securities

## Risk Factors

**Inability to find a JV partner for West Coast Road project.** In April 2006, CES paid S\$206.1m for a 311,829 sqft land parcel at West Coast Road for residential development. In dollar value and land size, this is the largest acquisition CES has made to-date. Based on the current financial strength, CES is unlikely to undertake the project on its own and will need a JV partner to jointly develop the project with. The en-bloc deal is likely to be finalised only in around April 2007 and CES still has more than six months to source for a JV partner. Should CES fail to find a JV partner by April 2007, the Group's financial health may severely deteriorate, with high gearing.

## Financial Ratios

Financial Ratios					
Year end : 31 Dec	2003	2004	2005	2006F	2007F
<b>Per Share Data</b>					
Revenue per share (cts)	31.4	24.8	16.4	19.7	26.4
EPS (cts)	1.7	1.8	1.9	2.5	7.0
EPS growth (%)	109.2%	9.1%	1.8%	36.2%	176.3%
NTA per share (cts)	12.0	13.2	13.1	15.3	21.3
Dividend per share (cts)	2.0	1.5	1.0	1.0	1.0
Share Base (m sh)	508,074	571,886	606,788	606,789	606,789
<b>Valuation</b>					
P/revenue (x)	0.7	0.9	1.3	1.1	0.8
PER (x)	13.2	12.1	11.8	8.7	3.1
P/NTA (x)	1.8	1.7	1.7	1.4	1.0
PEG (x)	0.1	1.3	6.6	0.2	0.0
Net gearing (x)	0.5	0.5	0.3	0.7	0.7
Return on Equity (%)	14.7%	15.3%	14.6%	17.9%	38.3%
Dividend Yield (%)	9.1%	6.8%	4.5%	4.5%	4.5%
<b>Growth Rates (%)</b>					
Revenue	-9.2%	-11.3%	-29.6%	19.5%	34.2%
Operating Profit	107.5%	-19.7%	-26.0%	6.1%	133.7%
Net Profit	114.5%	22.9%	8.0%	36.2%	176.3%
<b>Margins (%)</b>					
Operating margin	6.2%	5.6%	5.9%	5.2%	9.1%
Net margin	5.3%	7.4%	11.3%	12.9%	26.5%

## Earnings Forecast

Profit & Loss (\$S'000)					
Year end : 31 Dec	2003	2004	2005	2006F	2007F
<b>Revenue</b>	159,770	141,768	99,799	119,280	160,022
<b>Cost of Sales</b>	(145,837)	(130,077)	(89,207)	(107,353)	(137,741)
<b>Gross Profit</b>	13,933	11,691	10,592	11,927	22,280
<b>Operating Expenses</b>	(4,013)	(3,726)	(4,694)	(5,668)	(7,649)
Admin Expenses	(3,561)	(3,187)	(4,495)	(5,372)	(7,207)
Selling Expenses	(869)	(805)	(344)	(411)	(552)
Other Expenses	417	266	145	116	110
<b>Operating Profit</b>	9,920	7,965	5,898	6,260	14,632
Net interest	(172)	(73)	451	(1,377)	(1,996)
Share from Associate	2,728	3,667	6,328	12,389	35,091
Exceptional items	(1,143)	184	-	-	-
<b>Pre-tax Profit</b>	11,333	11,743	12,677	17,272	47,727
Income tax	(2,729)	(1,303)	(1,284)	(1,900)	(5,250)
Minority interest	(106)	-	(116)	(14)	(38)
<b>Net Profit</b>	8,498	10,440	11,277	15,358	42,439
<b>EPS (Scts)</b>	1.7	1.8	1.9	2.5	7.0
<b>EPS Growth (%)</b>	109.2%	9.1%	1.8%	36.2%	176.3%

## Balance Sheet

Balance Sheet (S\$'000)					
Year end : 31 Dec	2003	2004	2005	2006F	2007F
<b>Non-current assets</b>					
Fixed Assets, Net	1,687	1,282	770	1,170	1,401
Associated companies	9,125	12,795	15,488	20,004	38,323
Investment properties	23,961	22,806	22,806	22,806	22,806
Other non-current assets	729	26,973	45,696	37,639	77,691
<b>Total non-current assets</b>	<b>35,502</b>	<b>63,856</b>	<b>84,760</b>	<b>81,619</b>	<b>140,221</b>
<b>Current assets</b>					
Cash	3,205	13,429	2,957	2,400	4,772
Trade Receivables	30,943	29,885	24,111	30,392	41,588
Completed properties held for sale	11,310	2,759	606	20,184	20,184
Development properties	48,437	82,073	45,622	70,960	79,670
Other current assets	38,872	11,267	13,309	18,755	25,599
<b>Total current assets</b>	<b>132,767</b>	<b>139,413</b>	<b>86,605</b>	<b>142,691</b>	<b>171,813</b>
<b>Total assets</b>	<b>168,269</b>	<b>203,269</b>	<b>171,365</b>	<b>224,310</b>	<b>312,034</b>
<b>Current Liabilities</b>					
Trade Creditors	59,058	52,922	52,717	61,765	79,248
Bank borrowings, secured	5,568	38,327	18,557	33,395	21,595
Other current liabilities	17,564	24,710	8,661	4,945	5,455
<b>Total current liabilities</b>	<b>82,190</b>	<b>115,959</b>	<b>79,935</b>	<b>100,104</b>	<b>106,299</b>
<b>Non-current liability</b>					
Bank borrowings, unsecured	24,704	11,500	11,800	31,253	36,375
Other non-current liability	157	136	128	128	40,128
<b>Total non-current liability</b>	<b>24,861</b>	<b>11,636</b>	<b>11,928</b>	<b>31,381</b>	<b>76,503</b>
<b>Shareholders funds</b>	<b>61,218</b>	<b>75,674</b>	<b>79,502</b>	<b>92,824</b>	<b>129,233</b>

**Cash Flow**

<b>Cash flow Statement (S\$'000)</b>					
<b>Year end : 31 Dec</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006F</b>	<b>2007F</b>
<b>Cash flow from Operating Activities</b>					
Pretax profit	11,333	11,743	12,677	17,272	47,727
Adjustments:					
Depreciation & amortization	1,179	776	630	600	568
Share of profit of associated companies	(2,728)	(3,667)	(6,328)	(12,389)	(35,091)
Interest Expense	220	133	145	2,909	4,409
Interest Income	(48)	(60)	(596)	(44)	(43)
Others	1,400	207	204	40	53
<b>Operating profit before working capital changes</b>	<b>11,356</b>	<b>9,132</b>	<b>6,732</b>	<b>8,388</b>	<b>17,623</b>
<b>Changes in working capital</b>	<b>(16,910)</b>	<b>(20,195)</b>	<b>5,526</b>	<b>(38,045)</b>	<b>(46,931)</b>
Tax Paid	(5,283)	(3,200)	(359)	(1,900)	(5,250)
<b>Net Cash generated from operations</b>	<b>(10,837)</b>	<b>(14,263)</b>	<b>11,899</b>	<b>(31,557)</b>	<b>(34,558)</b>
<b>Cash flow from Investing Activities</b>					
Interest Received	48	60	596	44	43
Capex	(116)	(402)	(118)	(1,000)	(800)
Investment in associated companies	(650)	(40)	(400)	(4,516)	(18,319)
Others	603	1,425	4,055	41	78
<b>Net Cash generated from investing</b>	<b>(115)</b>	<b>1,043</b>	<b>4,133</b>	<b>(5,431)</b>	<b>(18,999)</b>
<b>Cash flow from Financing Activities</b>					
Loans, Net	3,831	0	0	45,409	26,405
Repayment of other borrowings, net	0	19,555	(19,072)	0	0
Dividend Paid	(2,871)	(9,709)	(7,281)	(6,068)	(6,068)
Interest Paid	(220)	(133)	(145)	(2,909)	(4,409)
Others	227	10,313	3,418	0	40,000
<b>Net Cash generated from financing activities</b>	<b>967</b>	<b>20,026</b>	<b>(23,080)</b>	<b>36,432</b>	<b>55,929</b>
<b>Net change in cash or cash equivalent</b>	<b>(9,985)</b>	<b>6,806</b>	<b>(7,048)</b>	<b>(557)</b>	<b>2,371</b>
Cash balance at the beginning of the year	13,174	3,205	10,011	2,957	2,400
Foreign exchange & other adjustments	16	3,418	(6)	0	0
<b>Cash balance at the end of the year</b>	<b>3,205</b>	<b>13,429</b>	<b>2,957</b>	<b>2,400</b>	<b>4,772</b>

**What it does**

Chip Eng Seng Corporation Ltd (CES) is one of the leading construction companies in Singapore. The scope of business includes construction, property development and property investment. CES is listed on the main board of the Singapore Exchange (SGX).

The construction arm, Chip Eng Seng Contractors (1988) Pte Ltd, is a BCA A1 general building contractor eligible for public project tenders of unlimited value. Leveraging on the Group's competencies in building methodology and project management, the Group diversified into property development in 2000 to broaden the Group's scope and earnings.

CES operates the property development and property investment businesses under CEL Development Pte Ltd. It has since undertaken development projects largely in Singapore and, to a lesser extent, in Australia either on its own or with JV partners.

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Trading Buy	: + 10% to + 15% range over the next 3 months
Hold	: +/- 15% range over the next 12 months
Trading Sell	: - 10% to - 15% range over the next 3 months
Sell	: >15% downside over the next 12 months

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