# **China Insurance Sector**

# The Long-awaited Auto Pricing Deregulation

# Further deregulation to weigh on P&C insurers

Last Friday (9 Jun), CIRC announced the details of the second-round auto pricing deregulation, which allows insurers to offer products at maximum 14% lower prices. The reform should have been expected by investors given it has been widely reported by local media this year, and will weigh on P&C insurers' top-line growth and combined ratios. Two PICC names remain our least preferred given their highest P&C exposure. We suggest staying with lifers, and Ping An/CPIC are our top picks.

# New rules would lead to 6% lower premium rates

The new rules further relax the floor of underwriting and channel factors, which allow insurers to offer products at maximum 14% lower prices (Fig. 4). We understand that ~80% of policies are currently priced at maximum discounts (i.e. both factors set at 0.85x). If we assume 50% of them are priced at the new floors, premium rates could fall by ~6%. We expect the new rules and high-base effect in 2H16 (due to front-loaded new car sales) to weigh on P&C insurers' auto premium growth: we maintain our mid-single-digit growth forecast for PICC/Ping An, and low-single-digit for CPIC/CTIH in 2017E (Fig. 6).

# Competition will persist despite more supervision

While CIRC expects the sector's loss ratio to rise by 3.6ppts post-reform, it tightens supervision on insurers' combined ratios and other operational metrics to prevent further pricing competition. We understand that CIRC's intension is to force insurers to lower expense ratios, which rapidly deteriorated after the first-round reform. However, the new measures may not be enough to suppress competition as: 1) P&C insurers still have strong capital positions to compete; and 2) they may sacrifice margins to sustain top-line growth amid slower new car sales. As such, we keep our view unchanged on further deterioration in combined ratios (Fig. 2).

# Prefer lifers over P&C players

Two PICC names remain our least preferred in the sector given their highest P&C exposure. We maintain SELL on PICC P&C due to concerns about auto combined ratios and top-line growth amid the new pricing rules and slower new car sales. However, CIRC's <u>tougher regulations</u> would eventually spill over to the auto insurance market resulting in a clamp down on irrational pricing, which would be a positive risk factor.

We suggest investors stay with lifers. Ping An/CPIC remain our sector top picks given their strong VNB growth and earnings quality. We see CPIC's laggard share performance YTD as unjustified.

[Unchanged]

🚯 Kim Eng

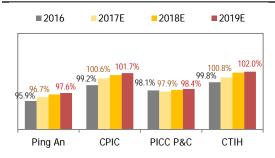
#### Analyst

Ning Ma, CFA (852) 2268 0672 ningma@kimeng.com.hk

	2016 market share	Change in floor pricing
Region A	76%	-12%
Region B	17%	-22%
Henan	4%	-17%
Shenzhen	3%	-13%
Overall	100%	-14%

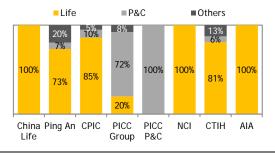
Source: CIRC, Maybank Kim Eng. \*Fig. 4 for details

#### Fig 2: P&C combined ratios



Source: Company data, Maybank Kim Eng

Fig 3: TP valuation composition

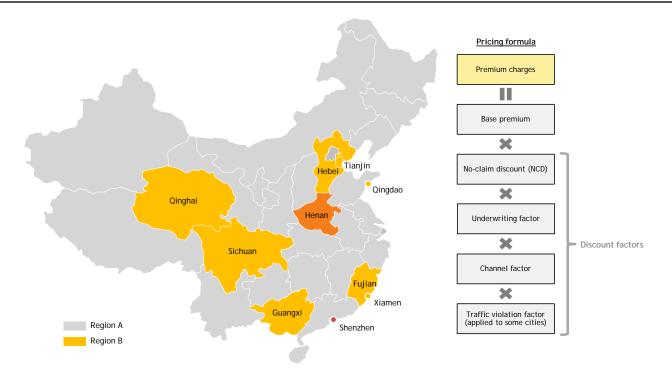


Source: Maybank Kim Eng

				Last		PB (x)		P/EV (x)			EV growth#			VNB (x)			VNB growth#			
Name	Ticker	Rating	TP	price	Upside	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E
China Life	2628 HK	HOLD	26.50	25.45	4%	2.18	2.09	1.96	0.99	0.87	0.74	7%	16%	17%	(0.2)	(1.7)	(3.3)	57%	20%	18%
Ping An	2318 HK	BUY	57.00	52.05	10%	2.22	2.00	1.75	1.34	1.15	0.96	25%	19%	19%	4.2	1.7	(0.4)	49%	27%	23%
CPIC	2601 HK	BUY	38.50	31.10	24%	1.92	1.86	1.59	1.03	0.91	0.72	13%	16%	16%	0.3	(1.1)	(3.3)	57%	24%	21%
PICC Group	1339 HK	HOLD	3.30	3.30	0%	1.01	0.99	0.90	0.89	0.86	0.77	10%	15%	14%	(4.7)	(4.4)	(7.8)	47%	14%	15%
PICC P&C	2328 HK	SELL	11.00	12.78	-14%	1.42	1.28	1.14	na	na	na	na	na	na	na	na	na	n/a	na	na
NCI	1336 HK	BUY	46.50	42.30	10%	2.00	1.89	1.73	0.91	0.78	0.66	17%	19%	19%	(1.1)	(2.7)	(4.2)	30%	22%	18%
СТІН	966 HK	BUY	25.00	20.35	23%	1.42	1.32	1.19	0.71	0.64	0.55	9%	12%	15%	(3.2)	(3.8)	(4.5)	50%	21%	20%
AIA Group	1299 HK	BUY	61.00	56.30	8%	2.50	2.30	2.12	2.08	1.85	1.65	10%	12%	12%	16.5	12.4	8.9	25%	18%	19%
Source: Company data, Bloomberg, Maybank Kim Eng. #FY16 EV/VNB growth for Chinese insurers are underlying growth ex. C-ROSS impact and EV assumption changes																				

#### 🛞 Kim Eng

#### Fig 4: P&C insurers could offer auto insurance products at maximum 14% lower prices Summary of second-round commercial auto pricing deregulation



	2016 market share*	No-claim discount** (A)	Underwriting factor (B)	Channel factor (C)	Overall pricing*** (A x B x C)	Change in floor pricing
Region A	76%	0.60-2.00	0.85-1.15	Old: 0.85-1.15 New: 0.75-1.15	Old: 0.43-2.65 New: 0.38-2.65	-12%
Region B	17%	0.60-2.00	Old: 0.85-1.15 New: 0.75-1.15	Old: 0.85-1.15 New: 0.75-1.15	Old: 0.43-2.65 New: 0.34-2.65	-22%
Henan	4%	0.60-2.00	Old: 0.85-1.15 New: 0.80-1.15	Old: 0.85-1.15 New: 0.75-1.15	Old: 0.43-2.65 New: 0.36-2.65	-17%
Shenzhen	3%	0.60-2.00	Old: 0.75-1.15 New: 0.70-1.25	Old: 0.75-1.15 New: 0.70-1.25	Old: 0.34-2.65 New: 0.29-3.13	-13%
Overall	100%					-14%

Additional requirements:

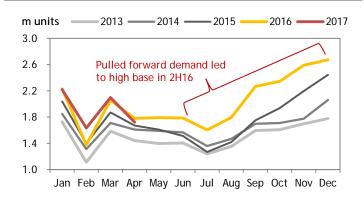
Insurers need to submit their targets on combined ratio, expense ratio and net loss reserve ratio (both nationwide and regional levels) when they apply for approval of premium rates.
 Insurers should adjust and re-submit their premium rates for approval when their actual operation results significantly deviate from targets. Significant deviation occurs when the

difference between actual ratio and treated when the average actual change in the past three years. Besides, insurer's market influence and historical results will also be considered.

Non-compliant products will face sales suspension and premium rate adjustments. For serious violation of regulations, CIRC could suspend insurers from launching new products.

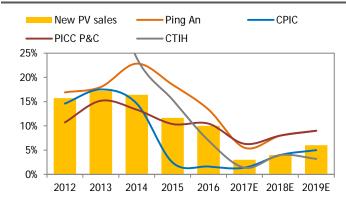
Source: CIRC, Maybank Kim Eng. \*Based on P&C GWP; \*\*Xiamen and Beijing use wider NCD of 0.40-3.00; \*\*\*Excl. traffic violation factor in calculation for simplicity.



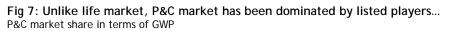


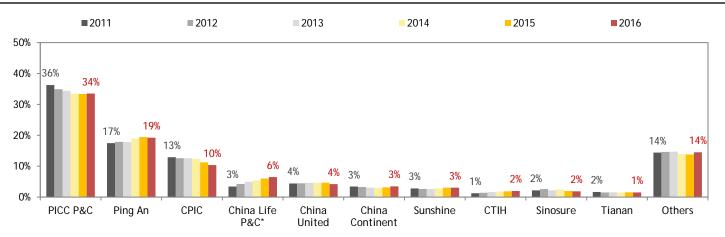
Source: CAAM, Maybank Kim Eng

# Fig 6: We expect mid-single-digit auto premium growth for PICC/Ping An in 2017E, and low-single-digit for CPIC/CTIH Auto GWP vs new passenger vehicle sales growth in 2012-19E

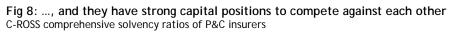


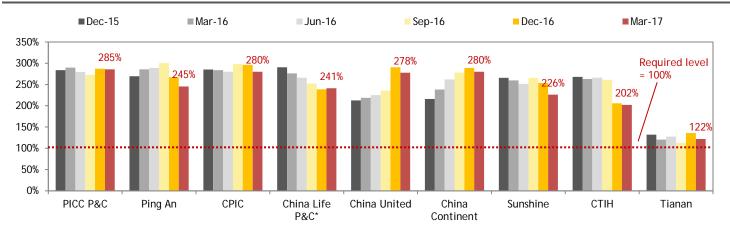
Source: Company data, CAAM, Maybank Kim Eng





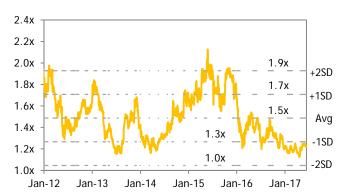
Source: CIRC, Maybank Kim Eng. \*40% owned by China Life



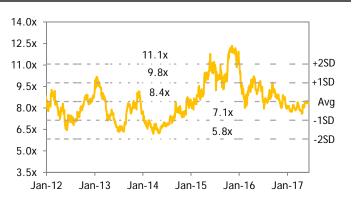


Source: Company data, Maybank Kim Eng. \*40% owned by China Life





#### Fig 10: PICC P&C - 12-month forward P/E



Source: Bloomberg, Company data, Maybank Kim Eng

Source: Bloomberg, Company data, Maybank Kim Eng

# Appendix: Recent research reports

# Fig 11: Recent research reports on HK/China insurance sector

Date	Report title
2 Jun 17	China Insurers: Sailing Through a Policy Year
1 Jun 17	AIA (1299 HK): Growing Broker Channel to Avoid Slowdown in HK VNB
18 May 17	China Insurers: Further Tightening in Savings Products
17 May 17	PICC Grp (1339 HK): Listing in the Home Market
5 May 17	China Insurers: Strong Agency Sales to Support 2017 VNB Growth
28 Apr 17	China Life (2628 HK): Business in Better Shape But Quality Risks Remain
28 Apr 17	Ping An (2318 HK): Impressive VNB Growth Sustained into 1Q17
27 Apr 17	AIA (1299 HK): Big VNB Surprise to Shift Focus to China Growth; U/G to BUY
24 Apr 17	China Insurers: Lifers' Fundamentals Remain Intact Despite Policy Overhangs
21 Apr 17	AIA (1299 HK): Divergent Views Could Persist, But Risks Have Decreased YTD
30 Mar 17	CPIC (2601 HK): 2016 Results - Strong VNB and Better P&C Profitability
30 Mar 17	NCI (1336 HK): More Visible Progress in 2H16 But Concerns Remain
27 Mar 17	AIA (1299 HK): HK Regulator Discontinued Disclosure on Offshore Sales
27 Mar 17	PICC Grp (1339 HK): 2016 Results - VNB Beat, But Life Quality & P&C Did Not
27 Mar 17	PICC P&C (2328 HK): Weak Underwriting Results Offset by Huaxia Bank Gains
24 Mar 17	China Life (2628 HK): 2016 Results - Strong VNB But Concerns on Assumptions
24 Mar 17	CTIH (966 HK): 2016 Results - Exceptional VNB Growth and First-time Dividend
23 Mar 17	Ping An (2318 HK): Expect Share Price to Catch Up Post Strong 2016 Results
17 Mar 17	Ping An (2318 HK): Bank 2016 Results - Kitchen Sinking For New Leadership
28 Feb 17	AIA (1299 HK): Regulatory Risks Remain Despite Better 1017 Visibility
8 Feb 17	AIA (1299 HK): Low Near-term VNB Visibility Caps Valuation Upside
26 Jan 17	China Life (2628 HK): Profit Warning Indicates Better 4Q16 Net Profit
25 Jan 17	China Insurers: Putting the Brakes on Aggressive Stock Investments
25 Jan 17	NCI (1336 HK): Waiting for Fundamentals to Catch Up
23 Jan 17	China Insurers: Marketing Feedback: Strong Interests in Lifers
16 Jan 17	China Insurers: More Regulated Life Markets Favors Listed Players
12 Jan 17	China Insurers: PICC Group's Vice Chairman under Investigation
5 Jan 17	AIA (1299 HK): Onshore Banks Refuse to Accept Cheques by HK Insurers
2 Jan 17	China Insurers: Initiation - Bridging the Quality Gap
2 Jan 17	AIA (1299 HK): Capital Control Fears Persist

Source: Maybank Kim Eng

#### REGIONAL

Sadiq CURRIMBHOY Regional Head, Research & Economics (65) 6231 5836 sadiq@maybank-ke.com.sg WONG Chew Hann, CA

Regional Head of Institutional Research (603) 2297 8686 wchewh@maybank-ib.com ONG Seng Yeow Regional Head of Retail Research

(65) 6231 5839 ongsengyeow@maybank-ke.com.sg TAN Sin Mui

Director of Research (65) 6231 5849 sinmui@kimeng.com.hk

#### ECONOMICS

Suhaimi ILIAS Chief Economist Malaysia | Philippines (603) 2297 8682 suhaimi\_Ilias@maybank-lb.com CHUA Hak Bin Regional Thematic Macroeconomist (65) 6231 5830 chuahb@maybank-ke.com.sg LEE Ju Ye Singapore (65) 6231 5844 leejuye@maybank-ke.com.sg Tim LEELAHAPHAN Thailand (66) 2658 6300 ext 1420 tim.l@maybank-ke.co.th Saktiandi SUPAAT

Head, FX Research (65) 6320 1379 saktiandi@maybank.com.sg

#### STRATEGY

Sadiq CURRIMBHOY Global Strategist (65) 6231 5836 sadiq@maybank-ke.com.sg Willie CHAN Hong Kong / Regional

(852) 2268 0631 williechan@kimeng.com.hk

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

Desmond CH'NG, ACA (603) 2297 8680 desmond.chng@maybank-ib.com • Banking & Finance

LIAW Thong Jung (603) 2297 8688 Ijliaw@maybank-ib.com • Oil & Gas Services- Regional ONG Chee Ting, CA (603) 2297 8678 ct.ong@maybank-ib.com • Plantations - Regional

Mohshin AZIZ (603) 2297 8692 mohshin.aziz@maybank-ib.com • Aviation - Regional • Petrochem

YIN Shao Yang, CPA (603) 2297 8916 samuel.y@maybank-ib.com • Gaming - Regional • Media TAN Chi Wei CFA

TAN Chi Wei, CFA (603) 2297 8690 chiwei.t@maybank-ib.com • Power • Telcos WONG Wei Sum, CFA

(603) 2297 8679 weisum@maybank-ib.com • Property

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

(603) 2297 8612 ivan.yap@maybank-ib.com • Automotive • Semiconductor • Technology

Kevin WONG (603) 2082 6824 kevin.wong@maybank-ib.com • REITs • Consumer Discretionary LIFW Wei Han

(603) 2297 8676 weihan.l@maybank-ib.com • Consumer Staples

TEE Sze Chiah Head of Retail Research (603) 2082 6858 szechiah. t@maybank-ib.com Nik Ihsan Raja Abdullah, MSTA, CFTe (603) 2297 8694 nikmohdihsan. ra@maybank-ib.com

Chartist

HONG KONG / CHINA Howard WONG Head of Research (852) 2268 0648 howardwong@kimeng.com.hk

Strategy
 Oil & Gas - Regional
Benjamin HO
(852) 2268 0632 benjaminho@kimeng.com.hk

• Consumer & Auto Christopher WONG

(852)2268 0652 christopherwong@kimeng.com.hk • HK & China Properties Jacqueline KO, CFA

(852) 2268 0633 jacquelineko@kimeng.com.hk • Consumer Staples & Durables

Ka Leong LO, CFA (852) 2268 0630 kllo@kimeng.com.hk • Consumer Discretionary & Auto

Mitchell KIM (852) 2268 0634 mitchellkim@kimeng.com.hk • Internet & Telcos

Ning MA, CFA (852) 2268 0672 ningma@kimeng.com.hk • Insurance

Ricky NG, CFA (852) 2268 0689 rickyng@kimeng.com.hk • Regional Renewables • HK & China Properties

Sonija LI, CFA, FRM (852) 2268 0641 sonijali@kimeng.com.hk • Gaming

Stefan CHANG, CFA (852) 2268 0675 stefanchang@kimeng.com.hk • Technology - Regional

Tony Ren, MBA, CFA (852) 2268 0640 tonyren@kimeng.com.hk • Healthcare & Pharmaceutical

INDIA

Jigar SHAH Head of Research (91) 22 6623 2632 jigar@maybank-ke.co.in • Strategy • Oil & Gas • Automobile • Cement Vishal MODI

(91) 22 6623 2607 vishal@maybank-ke.co.in • Banking & Financials

Neerav DALAL (91) 22 6623 2606 neerav@maybank-ke.co.in • Software Technology • Telcos

Vishal PERIWAL (91) 22 6623 2605 vishalperiwa@maybank-ke.co.in • Infrastructure

#### SINGAPORE

Neel SINHA Head of Research (65) 6231 5838 neelsinha@maybank-ke.com.sg • Strategy

• SMID Caps - Regional Gregory YAP (65) 6231 5848 gyap@maybank-ke.com.sg

SMID Caps
 Technology & Manufacturing • Telcos

CHUA Su Tye (65) 6231 5842 chuasutye@maybank-ke.com.sg • REITs

Derrick HENG, CFA (65) 6231 5843 derrickheng@maybank-ke.com.sg • Transport • Property • REITs (Office)

John CHEONG, CFA (65) 6231 5845 johncheong@maybank-ke.com.sg • Small & Mid Caps • Healthcare

NG Li Hiang (65) 6231 5840 nglihiang@maybank-ke.com.sg • Banks

#### INDONESIA

Isnaputra ISKANDAR Head of Research (62) 21 8066 8680 isnaputra.iskandar@maybank-ke.co.id • Strategy • Metals & Mining • Cement

Rahmi MARINA (62) 21 8066 8689 rahmi.marina@maybank-ke.co.id • Banking & Finance

Aurellia SETIABUDI (62) 21 8066 8691 aurellia.setiabudi@maybank-ke.co.id • Property

Pandu ANUGRAH (62) 21 8066 8688 pandu.anugrah@maybank-ke.co.id • Infra • Construction • Transport• Telcos

Janni ASMAN (62) 21 8066 8687 janni.asman@maybank-ke.co.id • Cigarette • Healthcare • Retail

Adhi TASMIN (62) 21 8066 8694 adhi.tasmin@maybank-ke.co.id • Plantations

PHILIPPINES Lovell SARREAL (63) 2 849 8841 lovell\_sarreal@maybank-atrke.com • Consumer • Media • Cement

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

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

#### THAILAND

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

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

Yupapan POLPORNPRASERT (66) 2658 6300 ext 1395 yupapan.p@maybank-ke.co.th • Oil & Gas

Tanawat RUENBANTERNG (66) 2658 6300 ext 1394 Tanawat.R@maybank-ke.co.th • Banks & Diversified Financials

Vorapoj HONGPINYO (66) 2658 6300 ext 1392 Vorapoj.h@maybank-ke.co.th • Real Estate & Contractors

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

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

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

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

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

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

#### VIETNAM

LE Hong Lien, ACCA Head of Institutional Research (84) 8 44 555 888 x 8181 lien.le@maybank-kimeng.com.vn • Strategy • Consumer • Diversified

THAI Quang Trung, CFA, Deputy Head, Institutional Research (84) 8 44 555 888 x 8180 trung, thai@maybank-kimeng.com.vn • Real Estate • Construction • Materials

LE Nguyen Nhat Chuyen (84) 8 44 555 888 x 8082 chuyen.le@maybank-kimeng.com.vn • Oil & Gas

NGUYEN Thach Lam (84) 8 44 555 888 x 8085 thachlam.nguyen@maybank-kimeng.com.vn • Utilities

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

TRUONG Quang Binh, Deputy Head, Retail Research (84) 44 555 888 x 8087 binh.truong@maybank-kimeng.com.vn Rubber Plantation • Tyres and Tubes • Oil & Gas

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

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

NGUYEN Thanh Lam (84) 4 44 555 888 x 8086 thanhlam.nguyen@maybank-kimeng.com.vn • Technical Analysis

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#### 👩 Malaysia

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

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

#### Philippines

Maybank ATR Kim Eng Securities Inc. 17/F, Tower One & Exchange Plaza Ayala Triangle, Ayala Avenue Makati City, Philippines 1200

Tel: (63) 2 849 8888 Fax: (63) 2 848 5738

#### 👩 South Asia Sales Trading

Kevin Foy Regional Head Sales Trading kevinfoy@maybank-ke.com.sg Tel: (65) 6636-3620 US Toll Free: 1-866-406-7447

Malaysia Joann Lim joann.lim@maybank-ib.com Tel: (603) 2717 5166

Indonesia Harianto Liong harianto.liong@maybank-ke.co.id Tel: (62) 21 2557 1177

New York Andrew Dacey adacey@maybank-keusa.com Tel: (212) 688 2956

Vietnam Patrick Mitchell patrick.mitchell@maybank-kimeng.com.vn Tel: (84)-8-44-555-888 x8080

# 📀 Singapore

Maybank Kim Eng Securities Pte Ltd Maybank Kim Eng Research Pte Ltd 50 North Canal Road Singapore 059304

Tel: (65) 6336 9090

#### 👩 Hong Kong

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

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

#### 👩 Thailand

Maybank Kim Eng Securities (Thailand) Public Company Limited 999/9 The Offices at Central World, 20<sup>th</sup> - 21<sup>st</sup> Floor, Rama 1 Road Pathumwan, Bangkok 10330, Thailand

Tel: (66) 2 658 6817 (sales) Tel: (66) 2 658 6801 (research)

#### 🔊 North Asia Sales Trading

Andrew Lee andrewlee@kimeng.com.hk Tel: (852) 2268 0283 US Toll Free: 1 877 837 7635

Thailand Tanasak Krishnasreni Tanasak.K@maybank-ke.co.th Tel: (66)2 658 6820

London Scott Kinnear-Nock SKinnear-nock@maybank-ke.co.uk Tel: (44) 207-332-0221

India Manish Modi manish@maybank-ke.co.in Tel: (91)-22-6623-2601

Philippines Keith Roy keith\_roy@maybank-atrke.com Tel: (63) 2 848-5288

#### 🐔 London

Maybank Kim Eng Securities (London) Ltd PNB House 77 Queen Victoria Street London EC4V 4AY, UK

Tel: (44) 20 7332 0221 Fax: (44) 20 7332 0302

# 👩 Indonesia

PT Maybank Kim Eng Securities Sentral Senayan III, 22<sup>nd</sup> Floor JI. Asia Afrika No. 8 Gelora Bung Karno, Senayan Jakarta 10270, Indonesia

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

# 👩 Vietnam

Maybank Kim Eng Securities Limited 4A-15+16 Floor Vincom Center Dong Khoi, 72 Le Thanh Ton St. District 1 Ho Chi Minh City, Vietnam

Tel : (84) 844 555 888 Fax : (84) 8 38 271 030

#### 👩 New York

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

Tel: (212) 688 8886 Fax: (212) 688 3500

# 👩 India

<

Kim Eng Securities India Pvt Ltd 2nd Floor, The International, 16, Maharishi Karve Road, Churchgate Station, Mumbai City - 400 020, India

Tel: (91) 22 6623 2600 Fax: (91) 22 6623 2604

#### Saudi Arabia

In association with Anfaal Capital Villa 47, Tujjar Jeddah Prince Mohammed bin Abdulaziz Street P.O. Box 126575 Jeddah 21352

Tel: (966) 2 6068686 Fax: (966) 26068787

www.maybank-ke.com | www.maybank-keresearch.com