

# Singapore Company Focus

## Sembcorp Industries

Bloomberg: SCI SP | Reuters: SCIL.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

30 Oct 2015

### BUY

Last Traded Price: S\$3.58 (STI : 3,001.51)  
Price Target : S\$4.20 (17% upside) (Prev S\$4.00)

Reason for Report : 3Q15 results

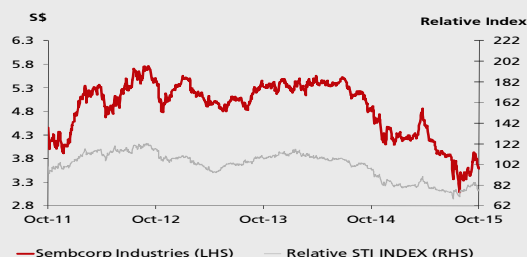
Potential Catalyst: Ramp up of India power plant

Where we differ: In line

#### Analyst

Pei Hwa Ho +65 6682 3714 peihwa@db.com

#### Price Relative



#### Forecasts and Valuation

FY Dec (\$m)	2014A	2015F	2016F	2017F
Revenue	10,895	9,263	9,618	9,999
EBITDA	1,612	1,388	1,437	1,495
Pre-tax Profit	1,246	1,386	1,013	1,051
Net Profit	801	1,013	661	691
Net Pft (Pre Ex.)	801	608	661	691
EPS (S cts)	44.9	56.7	37.0	38.7
EPS Pre Ex. (S cts)	44.9	34.1	37.0	38.7
EPS Gth (%)	(2)	26	(35)	5
EPS Gth Pre Ex (%)	(2)	(24)	9	5
Diluted EPS (S cts)	44.5	56.3	36.7	38.4
Net DPS (S cts)	16.0	17.0	13.0	13.6
BV Per Share (S cts)	315	355	375	401
PE (X)	8.0	6.3	9.7	9.2
PE Pre Ex. (X)	8.0	10.5	9.7	9.2
P/Cash Flow (X)	nm	2.8	6.2	4.4
EV/EBITDA (X)	6.9	7.3	7.3	7.0
Net Div Yield (%)	4.5	4.8	3.6	3.8
P/Book Value (X)	1.1	1.0	1.0	0.9
Net Debt/Equity (X)	0.4	0.2	0.3	0.2
ROAE (%)	14.8	16.9	10.1	10.0
Earnings Rev (%)		37	(8)	-
Consensus EPS (S cts):		36.7	38.3	38.9
Other Broker Recs:		B: 9	S: 1	H: 8

ICB Industry : Oil & Gas

ICB Sector: Oil Equipment; Services & Dist

Principal Business: Focus on Integrated Utilities and Energy, Marine Engineering, Environmental Engineering, Logistics & Engineering & Construction Services.

Source of all data: Company, DBS Bank, Bloomberg Finance L.P

### Dragged by Marine

- 3Q15 hit by disappointing Marine earnings
- Excluding provisions, Utilities was better
- Better marine earnings and ramp up in India power plant should drive sequential recovery
- Reiterate BUY; TP S\$4.20

**3Q15 dragged by Marine.** SCI's PATMI slid 38% y-o-y and 45% q-o-q to S\$122.3m in 3Q15, with the blame largely on the 70% plunge in Marine (Sembcorp Marine) earnings. Utilities segment was affected by a S\$16m bad debt provision and widening losses from TPCIL of S\$12m (vs S\$9m in 2Q15), partially offset by S\$18m gain on disposal of Zhumadian China Water. It is noteworthy that power spreads registered a small spike of 15-20% in 3Q15 on the back of maintenance shutdown by some power plants. But, this is expected to normalise to 1H levels from 4Q15.

**More upside ahead.** Management remains hopeful to achieve its guidance of breakeven for its first Indian power plant – TPCIL – this year, implying c. S\$20m profit in 4Q15. While this appears to be an ambitious target, the bottomline is that TPCIL is turning around and will contribute to profit in 4Q15. The Marine segment should also see earnings recovery in the absence of one-off items. In addition, SCI expects to conclude the divestment of its entire 40% stake in an Australian waste management company - SembSita Pacific Pte Ltd (SembSita) - to JV partner Suez Environment Asia by the end of the year, booking a sizeable gain of S\$350m.

**Potential uplift to DPS.** We have cut our FY15/16F recurring PATMI by 11%/8% to reflect SMM's earnings revision and loss of income post divestment of SembSita from FY16 onwards (c. S\$30m p.a.). Our target price for SCI is raised marginally to S\$4.20 after rolling over our valuation to FY16, partially offset by a downgrade in SMM's TP (from S\$2.48 to S\$2.32). We continue to like SCI for its regional expansion in its utilities business. Valuation is undemanding at below GFC trough. We have lifted our DPS expectations from 13 Scts to 17 Scts in anticipation of the successful divestment of SembSita by end of 2015, assuming a 30% payout ratio. There could be an increase of 3 Scts to DPS if the payout ratio is maintained at 35%, raising its dividend yield from c.5% to 6%.

#### At A Glance

Issued Capital (m shrs)	1,786
Mkt. Cap (S\$m/US\$m)	6,393 / 4,558
Major Shareholders	
Temasek Holdings Pte Ltd (%)	49.5
Mondrian Investment (%)	5.0
Free Float (%)	45.5
3m Avg. Daily Val (US\$m)	14.7

## INVESTMENT THESIS

Profile	Rationale
<p>Sembcorp Industries (SCI) is a trusted provider of essential energy and water solutions to both industrial and municipal customers. It has facilities with 5,900 megawatts of gross power capacity and over eight million cubic metres of water per day in operation and under development. It is also a world leader in marine and offshore engineering (via Sembcorp Marine) as well as an established brand name in urban development (comprising industrial parks as well as business, commercial and residential space) in Vietnam, China and Indonesia.</p>	<p><b>India growth to mitigate weakness in Singapore.</b> SCI's share price has corrected c.25% since end-April following its disappointing 1Q15 results and uninspiring outlook guidance. While the Singapore power business remains under pressure, we expect the ramp-up in its power plants in India to drive sequential improvement.</p> <p><b>India - a new growth engine.</b> The first unit of TPCIL's power plant in India, operational since April, incurred S\$9m startup losses in 2Q15 and further 12m in 3Q15 following the commencement of a second unit in mid-Sept. The plant is likely to break even this year and contribute to SCI's bottom line from 2016 onwards with better economies of scale after the second unit's ramp-up. This would mitigate earnings decline from Singapore power plants. Elsewhere, other overseas utility businesses are expected to be stable this year.</p> <p><b>Potential upside to DPS.</b> We have lifted our DPS expectations from 13 Scts to 17 Scts in anticipation of the successful divestment of SembSita by end of 2015, assuming a 30% payout ratio. There could be an increase of 3 Scts to DPS if payout ratio maintain at 35%, raising its dividend yield from 5% to 6%.</p>
Valuation	Risks
<p>Given its diverse earnings stream and various listed assets, we derive our fair value on SCI based on the sum of its different parts, which include market valuations of its stakes in listed companies Sembcorp Marine (SGX-listed, 60.6% stake), Gallant Venture (SGX-listed, 11.96% stake) and Salalah (Muscat stock exchange, 40% stake) and earnings from utilities and urban development. For its holding company position, we have applied a 10% conglomerate discount to the reappraised net asset value (RNAV). Our TP is adjusted slightly to S\$4.20 as we roll over the valuation to FY16, partially offset by downgrade in SMM's TP.</p>	<p><b>Increasing competition in the Singapore power market.</b> Total power generation supply in Singapore rose 9.3% y-o-y in 2014, marking the biggest y-o-y jump since the electricity market started. 2015 may herald a similar growth in supply, depressing prices further and hurting SCI's bottom line.</p> <p><b>Execution of Indian power plants.</b> The availability of coal supply and power purchase agreements for SCI's power plants in India have been of a concern. The first unit is up and running on a 500-MW purchase agreement and operating on both domestic and imported coal. Execution risk remains for the second unit, which was completed in Sept but has yet to win a purchase agreement.</p>

Source: DBS Bank

## Results Highlights

While revenue was flat q-o-q, at S\$2.39bn, PATMI registered steep declines of 38% y-o-y and 45% q-o-q to S\$122.3m in 3Q15.

**Marine earnings shock.** SCI's 61%-owned Marine subsidiary - Sembcorp Marine's earnings plunged by more than 70% in 3Q15 to a dismal S\$32m (approx. S\$20m attributable to SCI), blamed on profit reversals for five deferred jackups, share of associate losses from Cosco and mark-to-market adjustments for Cosco shares, which we estimated to total over S\$100m.

**Utilities would have been better.** Utilities segment saw marginal sequential improvement to S\$90.3m after stripping out the S\$54.7m gain from disposal of UK asset Bournemouth Water Investment in 2Q15. Singapore utilities, with PATMI of S\$30.6m, would have posted a 28% q-o-q growth if not for a S\$16m provision on bad debts. While management expects customers to eventually clear the payments, this is a prudent measure in line with its accounting policy for receivables greater than 6-months. There could be further provisions of a similar amount in 4Q15 if the customer continues to delay payment. There was a temporary surge in power spreads by 15-20% in 3Q15 due to

the maintenance shutdown of some power plants in Singapore, which have come back online in 4Q. Management guides for power spread in 4Q to revert to 1H levels.

**TPCIL plants still incurring ramp-up losses, but expected to breakeven for the year.** The first Thermal Powertech Corporation India Limited (TPCIL) plant continues to incur losses -S\$12.3m in 3Q15 (vs S\$9m in 2Q15) - due to higher upfront interest and depreciation charges, as well as higher costs related to usage of common facilities meant to be shared with the second unit that has also come onstream in mid-Sept. Management expects the TPCIL plant to breakeven for the full year with the ramp up of both units in 4Q15.

**Urban Development: land sales are patchy.** Land sales up 7% in 9M15 to 103 hectares, but profits were down 40% due to lumpy revenue recognition and lower margin mix. A lower proportion of higher-margin residential land sales, at least partially due to lower allocation of land sales quotas by the Nanjing government this year, and lumpy revenue recognition are driving the 40% decline in earnings from the segment. Management is guiding for a better FY16 as land quota is expected to increase next year.

## Profit segmental breakdown

PATMI (S\$m)	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	YoY Chg	QoQ Chg
Utilities	91.6	92.8	114.1	109.5	74.5	141.5*	90.2	-21%	-36%
Marine	74.3	79.8	80.0	105.9	64.7	66.7	19.7	-75%	-71%
Industrial Parks	19.5	4.8	4.9	15.1	1.1	11.9	4.6	-7%	-62%
Other Business & Corporate	(0.6)	1.6	(2.4)	10.2	1.9	3.6	7.8	-425%	117%
<b>Total</b>	<b>184.8</b>	<b>179.0</b>	<b>196.6</b>	<b>240.7</b>	<b>142.2</b>	<b>223.6</b>	<b>122.3</b>	<b>-38%</b>	<b>-45%</b>

\*Utilities PATMI in 2Q15 includes S\$54.7m Bournemouth Water Investment.

## Utilities geographical breakdown

PATMI (S\$ m)	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	YoY Chg	QoQ Chg
Singapore	52.8	46.7	61.3	56.5	30.9	36.4	30.6	-50%	-16%
China	17.2	17.2	14.2	22.4	19.9	25.1	20.1	42%	-20%
Rest of Asia	12.2	13.2	20	18.3	12.1	8.5	12.3	-39%	45%
Middle East & Africa	7	13.5	9.7	11.5	8.7	13.9	13.8	42%	-1%
UK	3.8	5.9	9.3	4.6	5.3	10.1	7.6	-18%	-25%
The Americas	2.2	1.9	2.7	4.5	4.1	3.0	2.9	7%	-3%
corporate	-3.6	-5.6	-3.1	-8.3	-6.5	-10.2	3.0	nm	nm
<b>Total</b>	<b>91.6</b>	<b>92.8</b>	<b>114.1</b>	<b>109.5</b>	<b>74.5</b>	<b>86.8*</b>	<b>90.3</b>	<b>-21%</b>	<b>4%</b>

\*Utilities PATMI in 2Q15 excludes S\$54.7m Bournemouth Water Investment.

Source: Company, DBS Bank

## DBS Sum-of-parts valuation methodology

	Value (S\$ m)	Basis	S\$ / share	Comments
Sembcorp Marine	2,938	Fair value for Sembcorp Marine	2.32	DBS' TP Most of the industrial park business (which is in Batam) is held in this listcos.
Gallant Ventures	69	Share price	0.24	
Salalah	298	40% stake	7.80	
	<b>3,305</b>			
Less: book value of listed companies	(2,035)			
<b>Surplus from listed companies</b>	1,270			
Utilities (Surplus)	961	Based on 12x FY16 PE, less book value		
Urban Development	(245)	Based on 12x FY16 PE, less book value		
<b>Net Surplus</b>	<b>1,987</b>			
Book value as of end FY14	6,344			
RNAV	8,330			
<b>RNAV per share (S\$)</b>	<b>4.63</b>			
<b>Fair value (S\$)</b>	<b>4.20</b>	10% conglomerate discount		
Implied FY15 PE (x)	11.3			

Source: DBS Bank estimates

### Key Assumptions

FY Dec	2013A	2014A	2015F	2016F	2017F
Marine contract wins	4,193	4,192	2,800	2,500	2,500

### Segmental Breakdown

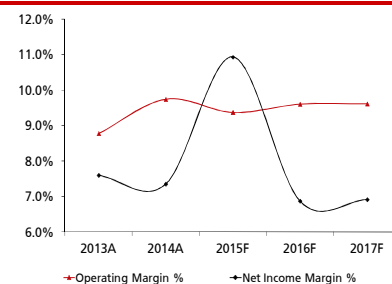
FY Dec	2013A	2014A	2015F	2016F	2017F
<b>Revenues (\$m)</b>					
Utilities	5,138	4,850	4,460	4,819	4,923
Marine	5,526	5,831	4,630	4,657	4,960
Industrial Parks	12.5	6.54	6.58	8.61	10.3
Other Businesses and	122	208	166	133	106
<b>Total</b>	<b>10,798</b>	<b>10,895</b>	<b>9,263</b>	<b>9,618</b>	<b>9,999</b>
<b>Net Profit before EI</b>					
Utilities	450	408	351	395	422
Marine	337	340	214	253	270
Industrial Parks	50.2	44.3	44.8	45.2	45.7
Other Businesses and	(16.6)	8.78	0.88	1.05	1.26
<b>Total</b>	<b>820</b>	<b>801</b>	<b>611</b>	<b>694</b>	<b>739</b>
<b>Net Margin before EI</b>					
Utilities	8.8	8.4	7.9	8.2	8.6
Marine	6.1	5.8	4.6	5.4	5.4
Industrial Parks	401.4	678.1	680.2	525.4	442.2
Other Businesses and	(13.6)	4.2	0.5	0.8	1.2
<b>Total</b>	<b>7.6</b>	<b>7.4</b>	<b>6.6</b>	<b>7.2</b>	<b>7.4</b>

### Income Statement (\$m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Revenue	10,798	10,895	9,263	9,618	9,999
Cost of Goods Sold	(9,510)	(9,480)	(8,099)	(8,367)	(8,698)
<b>Gross Profit</b>	<b>1,287</b>	<b>1,415</b>	<b>1,164</b>	<b>1,251</b>	<b>1,302</b>
Other Opng (Exp)/Inc	(339)	(352)	(296)	(327)	(340)
<b>Operating Profit</b>	<b>948</b>	<b>1,062</b>	<b>868</b>	<b>924</b>	<b>962</b>
Other Non Opg (Exp)/Inc	212	76.7	38.8	38.8	38.8
Associates & JV Inc	155	158	150	126	128
Net Interest (Exp)/Inc	(101)	(50.7)	(76.0)	(76.9)	(80.0)
Exceptional Gain/(Loss)	0.0	0.0	405	0.0	0.0
<b>Pre-tax Profit</b>	<b>1,214</b>	<b>1,246</b>	<b>1,386</b>	<b>1,013</b>	<b>1,051</b>
Tax	(117)	(162)	(223)	(186)	(193)
Minority Interest	(277)	(283)	(150)	(164)	(164)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>820</b>	<b>801</b>	<b>1,013</b>	<b>661</b>	<b>691</b>
Net Profit before Except.	820	801	608	661	691
EBITDA	1,619	1,612	1,388	1,437	1,495
<b>Growth</b>					
Revenue Gth (%)	6.0	0.9	(15.0)	3.8	4.0
EBITDA Gth (%)	4.6	(0.4)	(13.9)	3.5	4.1
Opg Profit Gth (%)	(10.5)	12.0	(18.3)	6.4	4.1
Net Profit Gth (Pre-ex) (%)	8.9	(2.4)	(24.1)	8.6	4.6
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	11.9	13.0	12.6	13.0	13.0
Opg Profit Margin (%)	8.8	9.7	9.4	9.6	9.6
Net Profit Margin (%)	7.6	7.4	10.9	6.9	6.9
ROAE (%)	16.9	14.8	16.9	10.1	10.0
ROA (%)	6.2	5.2	5.9	3.7	3.7
ROCE (%)	9.5	8.3	5.5	5.4	5.4
Div Payout Ratio (%)	37.0	35.7	30.0	35.0	35.0
Net Interest Cover (x)	9.4	21.0	11.4	12.0	12.0

Source: Company, DBS Bank

### Margins Trend



**Quarterly / Interim Income Statement (\$m)**

FY Dec	3Q2014	4Q2014	1Q2015	2Q2015	3Q2015
Revenue	3,069	2,664	2,338	2,388	2,399
Cost of Goods Sold	(2,725)	(2,241)	(2,050)	(2,035)	(2,110)
<b>Gross Profit</b>	<b>345</b>	<b>424</b>	<b>289</b>	<b>353</b>	<b>290</b>
Other Oper. (Exp)/Inc	(47.4)	(63.3)	(74.9)	(102)	(104)
<b>Operating Profit</b>	<b>297</b>	<b>360</b>	<b>214</b>	<b>251</b>	<b>186</b>
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	25.3	35.4	40.0	58.5	21.2
Net Interest (Exp)/Inc	(7.6)	(37.0)	(25.5)	(50.1)	(57.0)
Exceptional Gain/(Loss)	0.0	0.0	0.0	54.5	0.0
<b>Pre-tax Profit</b>	<b>315</b>	<b>359</b>	<b>228</b>	<b>314</b>	<b>150</b>
Tax	(52.4)	(25.6)	(40.5)	(41.1)	(10.9)
Minority Interest	(65.8)	(92.1)	(45.5)	(49.6)	(17.0)
<b>Net Profit</b>	<b>197</b>	<b>241</b>	<b>142</b>	<b>224</b>	<b>122</b>
Net profit bef Except.	197	241	142	169	122
EBITDA	322	396	254	310	207

**Growth**

Revenue Gth (%)	21.1	(13.2)	(12.2)	2.1	0.5
EBITDA Gth (%)	8.2	22.7	(35.9)	22.3	(33.2)
Opg Profit Gth (%)	17.0	21.2	(40.7)	17.6	(26.0)
Net Profit Gth (Pre-ex) (%)	9.8	22.6	(41.0)	18.9	(27.7)

**Margins**

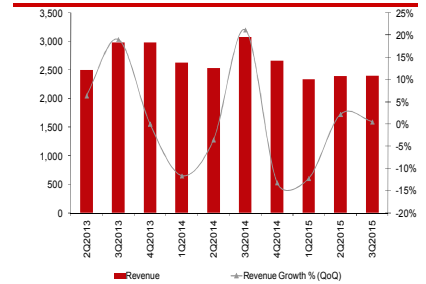
Gross Margins (%)	11.2	15.9	12.3	14.8	12.1
Opg Profit Margins (%)	9.7	13.5	9.1	10.5	7.8
Net Profit Margins (%)	6.4	9.0	6.1	9.4	5.1

**Balance Sheet (\$m)**

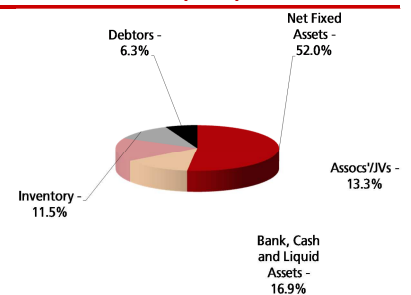
FY Dec	2013A	2014A	2015F	2016F	2017F
Net Fixed Assets	5,127	7,725	8,395	9,048	9,682
Invt in Associates & JVs	1,852	2,074	2,155	2,210	2,267
Other LT Assets	1,086	1,246	1,246	1,246	1,246
Cash & ST Invt	2,257	1,663	2,724	2,514	2,802
Inventory	2,241	3,205	1,853	1,924	1,667
Debtors	1,140	1,200	1,021	1,060	1,102
Other Current Assets	52.8	63.8	63.8	63.8	63.8
<b>Total Assets</b>	<b>13,754</b>	<b>17,176</b>	<b>17,454</b>	<b>18,061</b>	<b>18,825</b>
ST Debt	414	1,086	1,086	1,086	1,086
Creditor	2,692	2,745	2,334	2,424	2,520
Other Current Liab	1,796	1,526	1,337	1,334	1,377
LT Debt	1,485	3,649	3,649	3,649	3,649
Other LT Liabilities	837	938	938	938	938
Shareholder's Equity	5,230	5,616	6,344	6,701	7,161
Minority Interests	1,300	1,616	1,766	1,930	2,095
<b>Total Cap. &amp; Liab.</b>	<b>13,754</b>	<b>17,176</b>	<b>17,454</b>	<b>18,061</b>	<b>18,825</b>
Non-Cash Wkg. Capital	(1,054)	198	(735)	(711)	(1,064)
Net Cash/(Debt)	358	(3,071)	(2,010)	(2,220)	(1,933)
Debtors Turn (avg days)	39.1	39.2	43.8	39.5	39.4
Creditors Turn (avg days)	109.5	108.3	119.3	108.3	108.3
Inventory Turn (avg days)	81.8	108.4	118.8	85.9	78.6
Asset Turnover (x)	0.8	0.7	0.5	0.5	0.5
Current Ratio (x)	1.2	1.1	1.2	1.1	1.1
Quick Ratio (x)	0.7	0.5	0.8	0.7	0.8
Net Debt/Equity (X)	CASH	0.4	0.2	0.3	0.2
Net Debt/Equity ex MI (X)	CASH	0.5	0.3	0.3	0.3
Capex to Debt (%)	61.3	27.4	21.1	21.1	21.1
Z-Score (X)	2.2	1.7	1.7	1.7	1.7

Source: Company, DBS Bank

**Revenue Trend**



**Asset Breakdown (2015)**

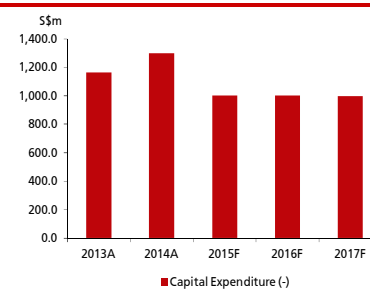


### Cash Flow Statement (\$m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Pre-Tax Profit	1,214	1,246	1,386	1,012	1,049
Dep. & Amort.	303	315	331	347	365
Tax Paid	(125)	(119)	(258)	(223)	(186)
Assoc. & JV Inc/(loss)	(155)	(158)	(150)	(126)	(128)
Chg in Wkg.Cap.	141	(1,414)	967	12.9	347
Other Operating CF	92.0	72.9	0.0	0.0	0.0
<b>Net Operating CF</b>	<b>1,470</b>	<b>(57.4)</b>	<b>2,275</b>	<b>1,023</b>	<b>1,447</b>
Capital Exp.(net)	(1,164)	(1,298)	(1,000)	(1,000)	(999)
Other Invts.(net)	16.1	4.30	0.0	0.0	0.0
Invts in Assoc. & JV	(284)	(280)	0.0	0.0	0.0
Div from Assoc & JV	94.7	122	70.0	70.0	71.0
Other Investing CF	(21.0)	10.9	0.0	0.0	0.0
<b>Net Investing CF</b>	<b>(1,358)</b>	<b>(1,441)</b>	<b>(930)</b>	<b>(930)</b>	<b>(928)</b>
Div Paid	(413)	(539)	(286)	(304)	(231)
Chg in Gross Debt	393	393	0.0	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	81.9	1,049	0.0	0.0	0.0
<b>Net Financing CF</b>	<b>61.8</b>	<b>903</b>	<b>(286)</b>	<b>(304)</b>	<b>(231)</b>
Currency Adjustments	22.1	1.78	0.0	0.0	0.0
Chg in Cash	196	(594)	1,060	(211)	287
Opg CFPS (\$ cts)	73.9	76.1	73.3	56.6	61.6
Free CFPS (\$ cts)	17.0	(76.0)	71.4	1.28	25.1

Source: Company, DBS Bank

### Capital Expenditure



### Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date	Closing Price	Target Price	Rating
1:	07 Nov 14	4.54	5.40	BUY
2:	04 Dec 14	4.21	4.70	BUY
3:	05 Dec 14	4.21	4.70	BUY
4:	18 Feb 15	4.24	4.80	BUY
5:	08 May 15	4.37	4.30	HOLD
6:	10 Aug 15	3.72	4.10	BUY
7:	31 Aug 15	3.42	4.00	BUY
8:	18 Sep 15	3.50	4.00	BUY
9:	23 Sep 15	3.53	4.00	BUY

Source: DBS Bank

DBS Bank recommendations are based on Absolute Total Return\* Rating system, defined as follows:

**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return i.e. > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

*Share price appreciation + dividends*

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**DBS Bank Ltd.**  
12 Marina Boulevard, Marina Bay Financial Centre Tower 3  
Singapore 018982  
Tel. 65-6878 8888  
Company Regn. No. 196800306E