

25 July 2018

Construction & Engineering

Infrastructure

Overweight (Maintained)

At a Turning Point

Stocks Covered: 5

Ratings (Buy/Neutral/Sell): 4 / 1 / 0

Last 12m Earnings Revision Trend:

Maintain **OVERWEIGHT** on sector with **Top Picks CCCC and CRG**. Infrastructure stocks rallied over the past two days, on positive monetary and fiscal policies implemented since 19 Jul. In 1H, completed FAI was up by only 5.96% YoY, due to tightening credit conditions in place since 2H17. In 2H18, we expect to see faster execution of PPP projects and revenue growth. Also, a sector revaluation – driven by easing policies – should benefit stocks with low P/E or P/BV. Companies with PPP focus may also see cash flows improve. With the policies announced, we can now look forward to efforts by the NDRC and MoF to speed up PPP project approvals, as well as shorter execution periods and easier bank loans.

Top Picks

CCCC (1800 HK) – BUY
CRG (390 HK) – BUY

Target Price

HKD11.70
HKD7.68

1H was relatively slow. Fundamentally, most infrastructure companies have sufficient new contracts in hand, but were facing tight liquidity conditions to execute projects in 1H. Fixed asset investments (FAI) completed increased in 1H by only 6% YoY, vs 10% and 8% in 2016 and 2015 – due to tightening liquidity and credit since 2H17, and government regulations on public-private partnerships (PPP).

In addition, the sector underwent a de-rating in 2H17 due to concerns over liquidity and credit tightening, as well as projects being cleared from the Ministry of Finance's (MoF) PPP pool, as part of China's effort to deleverage.

Easing signs. Both fiscal and monetary policies implemented since 19 Jul have shown positive signs:

- i. New asset management rules announced last weekend show that monetary policies support the infrastructure sector;
- ii. Medium-term lending facility (MLF) of CNY500bn will mostly be allocated to municipal bonds to support infrastructure development;
- iii. China State Council meeting raised a few points on fiscal policy to support the infrastructure sector;
- iv. *The People's Daily*, on 23 Jul reported that structural deleverage is progressing steadily, and the debt ratio is now under control. China is now at the stage of stabilising its debt, instead of deleveraging.

We believe the easing policies were triggered by the Chinese economy being under pressure from the trade war, and the Central Government is concerned about GDP growth of 6.5% for 2018F, while a total social financing increase of 6.8% YoY in June is unacceptable.

What is next? In tandem with the monetary policy, China's fiscal policy also supports the infrastructure sector. We expect the National Development and Reform Commission (NDRC) and MoF to speed up approval of PPP projects, as well as bank loans to be approved to speed up PPP execution.

Major beneficiaries and 2H winners. Companies with low P/BV and P/E, and were re-rated mainly in 1H stand to benefit (China Communications Construction (CCCC), CRCC, China Railway Group (CRG) and China State Construction (CSCI). Beneficiaries would also be PPP-focused SOEs (like CCCC and CSCI), as well as Central Government SOEs and sector leaders (CCCC, CRG and CRCC).

Sector Top Picks are CCCC and CRG. Currently, most infrastructure stocks are undervalued due the de-rating in 2H17. We believe upcoming progress should stem from NDRC and MoF support, which should help improve valuations.

Company Name	Rating	Price	Target	% Upside (Downside)	P/E (x) Dec-19F	P/B (x) Dec-19F	Yield (%) Dec-19F
China Communications Construction	BUY	HKD8.37	HKD11.70	39.8	5.3	0.5	4.1
China Railway	BUY	HKD6.74	HKD7.68	13.9	6.2	0.8	2.3
China Railway Construction	BUY	HKD9.39	HKD11.10	18.2	4.6	0.6	3.3
China State Construction	BUY	HKD9.17	HKD13.20	43.9	5.6	0.9	5.0
CRRC Corp	NEUTRAL	HKD6.44	HKD7.02	9.0	12.5	1.1	2.8

Source: Company data, RHB

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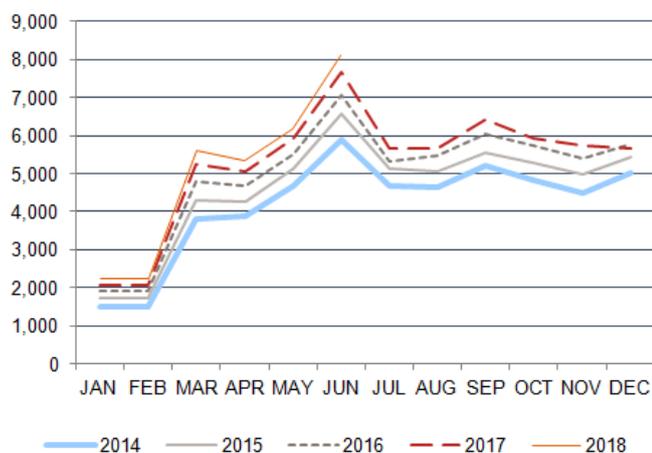


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Sector Re-Rating Ahead On Easing Policies

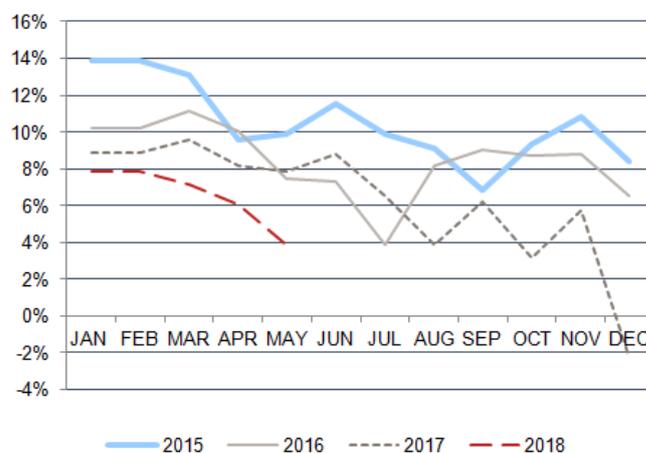
Slow infrastructure growth in 1H18 due to tightening credit

Figure 1: Monthly FAI completed (CNYbn)



Source: RHB, National Bureau of Statistics (NBS)

Figure 2: FAI growth YoY



Source: RHB, NBS

The sector de-rating in 2H17 was premised on policy changes, as China aimed to deleverage and gain greater control on PPP project approvals. PPP projects being flushed into the market since 2016 may have led to local government debt spiralling out of control. As such, FAI growth has slowed down since 2H17 (Figures 1 and 2).

Easing policies – four factors supporting infrastructure sector growth

- i. New asset management rules announced on 20 Jul state that publicly-offered asset management products (AMPs) can invest in certain non-standard credit assets (NSCA), in addition to bonds and equities and roll-over of existing products. The relaxation indirectly adds liquidity to the infrastructure sector, as a large amount of infrastructure funding comprises NSCA;
- ii. On 23 Jul, the People's Bank of China (PBOC) began to execute a 1-year MLF of CNY502bn, which will mostly be allocated to municipal bonds to support infrastructure development, due to the rating requirement;
- iii. The State Council met on 23 Jul, and mentioned a couple of points on fiscal policies to support infrastructure;
- iv. Premier Li Keqiang mentioned:
 - China will speed up the issue of a CNY1.35trn government special bond, of which only CNY363bn was issued so far;
 - China will satisfy reasonable demand on the financing front, which typically comprise infrastructure and construction fund-raising platforms;
 - There will be more positive fiscal policies to support economic growth and a CNY1.1trn tax cut.

On 23 Jul, *The People's Daily* reported that structural deleverage is progressing steadily. The debt ratio is now under control and China is now at the stage of stabilising debt levels, instead of deleveraging.

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CCCC – Benefiting from PPP growth in 2H18

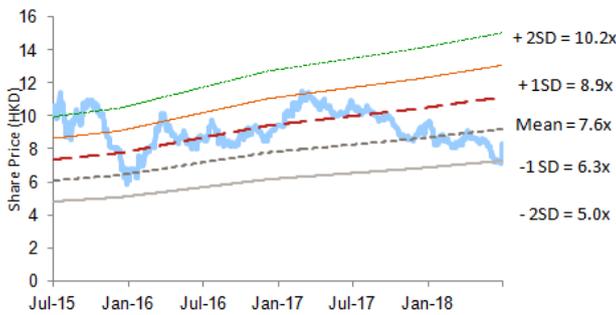
CCCC’s new contracts are growing fast, and 1Q18 new contracts are worth CNY179.3bn. We estimate 1H18 revenue and earnings growth should be around 13% and 9% YoY. Easing policies may boost the company’s 2H18 earnings growth, as it has relatively greater focus on PPPs. Also, One Belt One Road (OBOR) projects may continue to boost its growth.

The stock is trading at 1SD below its mean P/E and P/BV. Its valuation is still low at 6.1x P/E, and 1SD below the 3-year P/E and P/BV mean.

Maintain BUY and TP of HKD11.70, based on 8x P/E on 2018F earnings – in line with its 3-year average P/E. We believe this is justified, given the company’s position within the Government’s OBOR initiative and its undemanding valuations.

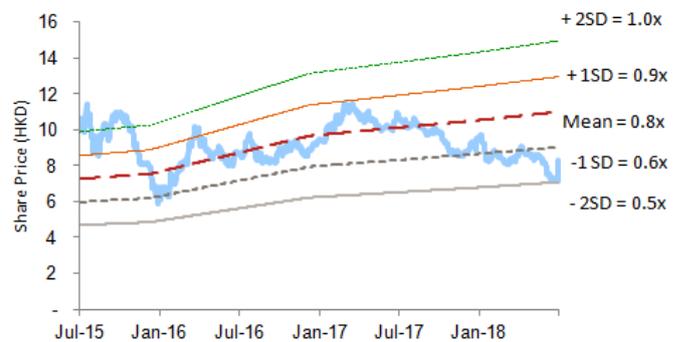
Key risks to our call include cutbacks in infrastructure investments, liquidity risks as working capital requirements increase, rising funding costs, and any inability to secure bank loans.

Figure 3: CCCC's 3-year forward P/E band



Source: Bloomberg, RHB

Figure 4: CCCC's 3-year forward P/BV band



Source: Bloomberg, RHB

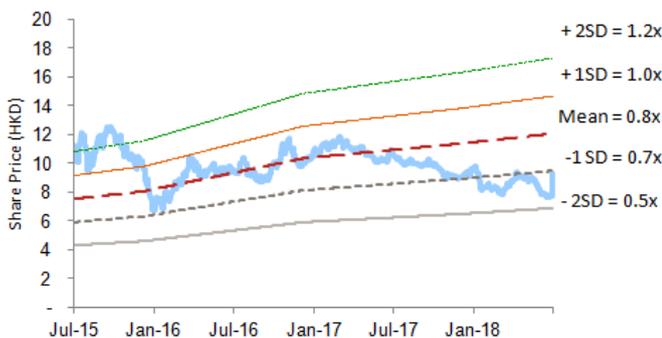
CRCC – Steady growth of new contracts in 1H

2Q new contracts grew 13.5% YoY to CNY329.2bn, driven by an OBOR project, ie Nigerian railway project worth CNY42.3bn in May. We estimate that 1H topline and bottomline grew by 10% YoY.

Maintain BUY and TP of HKD11.10, based on FY18F P/E of 6x, in line with its 3-year average P/E of 6x. We believe this is justified, given concerns over PPP risks and the tightening credit market – although these would be cushioned by strong new contracts and improving GPMs. Our TP is backed by our DCF valuation of HKD12.10.

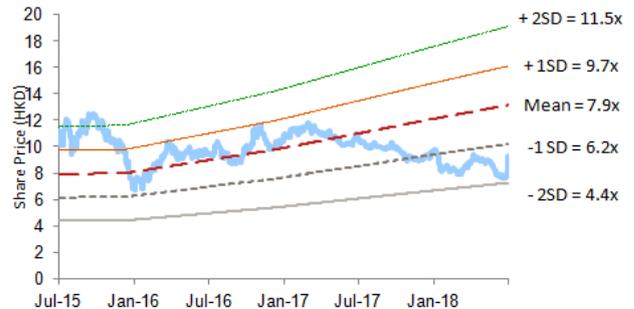
Key downside risks include an ongoing liquidity crunch where revenue growth may be limited due to the requirement of PPP projects, limited profit growth and railway accidents.

Figure 5: CRCC's 3-year forward P/BV band



Source: Bloomberg, RHB

Figure 6: CRCC's 3-year forward P/E band



Source: Bloomberg, RHB

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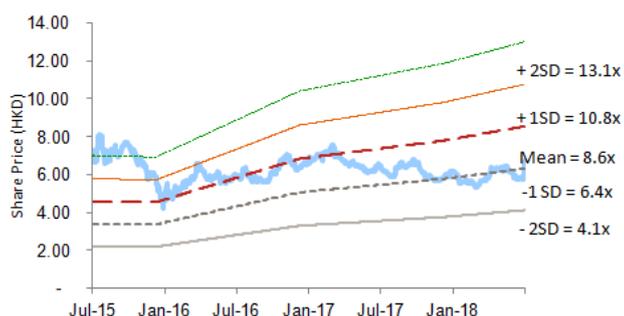
CRG – Continued stable earnings growth in 2018

Continued strong earnings growth. We expect GPM of 9.2% in 2018, driven by revenue mix improvements with a higher proportion of PPP and municipal projects, and fewer railway projects that generate lower margins. In 1H18, CRG's balance sheet and margins continued to improve, and we estimate c.11% and c.18% in topline and bottomline growth in 1H.

Maintain BUY with TP of HKD7.68 based on a 2018F P/E of 8x – below the global peer average, and 0.5SD below its 3-year average P/E. We believe the multiple is justified, given its transition into higher-margin infrastructure projects and its diversified businesses in mining and property. Our TP is backed by our DCF valuation of HKD7.30.

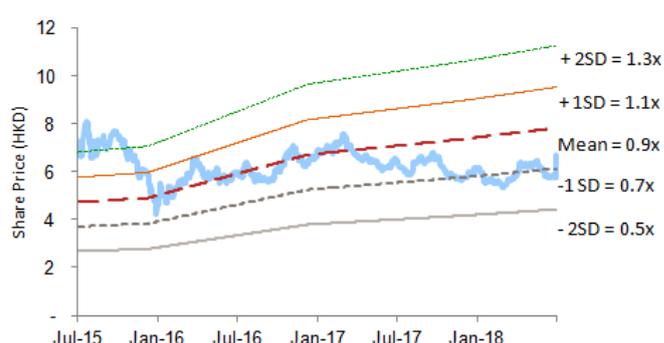
Key risks include the execution of PPP margins, unfavourable policies on the railway sector, and lower-than-expected new contract collection.

Figure 7: CRG's 3 year forward P/E band



Source: Bloomberg, RHB

Figure 8: CRG's 3 year forward P/BV band



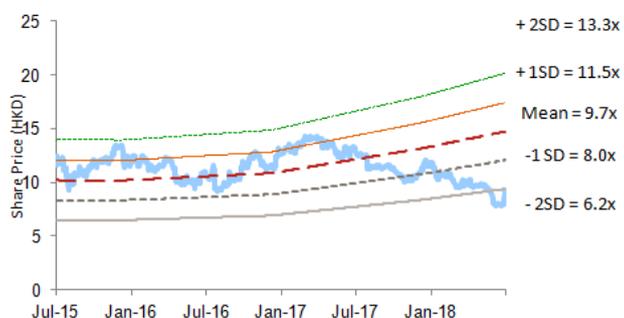
Source: Bloomberg, RHB

CSCI – Easing policies help to maintain earnings growth

The company has been conservative in terms of PPP project execution in 1H, but we think concerns over the gearing ratio control of 40% and insufficient liquidity may subside as easing policies may help PPP execution. We estimate CSCI may post 10-15% topline and bottomline growth, slower than before, as liquidity tightening impacts its 1H performance.

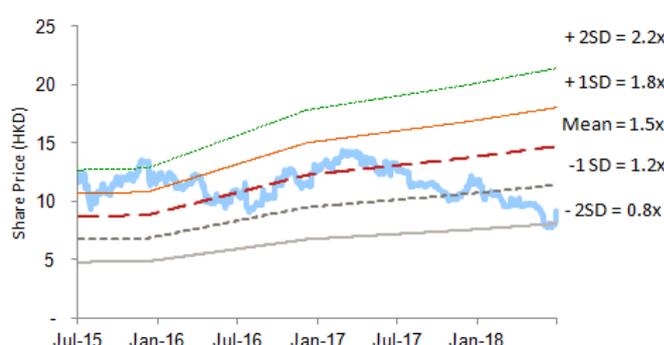
Maintain BUY and HKD13.20 TP. Our TP is based on FY18F recurring P/E of 10x or -0.5SD below the 5-year forward mean. This is also above the Bloomberg consensus peer average of 8x for its HK-listed peers. We believe this is justified, given CSCI's superior ROEs and margins. Risks to our call include an inability to securitise assets and a slower-than-expected China PPP market.

Figure 9: CSCI's 3-year forward P/E band



Source: Bloomberg, RHB

Figure 10: CSCI's 3-year forward P/BV band



Source: Bloomberg, RHB

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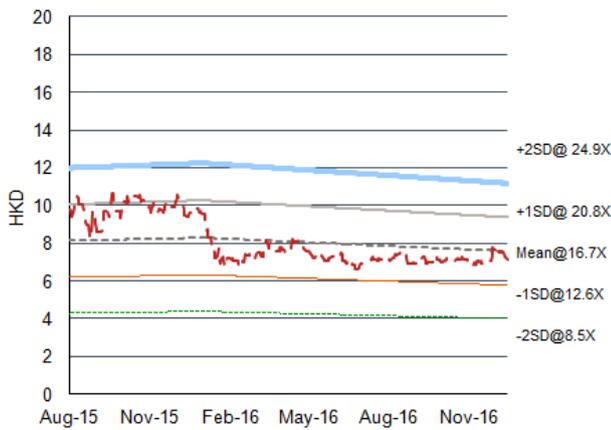
CRRC – Turning positive in 1H

Turning positive, but slowly. We believe that, going into 2H18, CRRC’s business may recover from the low base in 2H17. We forecast revenue and earnings growth of 10.8% and 9.3% YoY in 2018, with the relatively slower earnings growth reflecting the fast growth in the urban rail segment.

CRRC’s stable revenue growth should be driven by its strong CNY243.4bn backlog, with 28.23% YoY growth (especially multiple units (MUs) of CNY5.3bn, up 70.7% YoY), and urban rail projects totalling CNY138.3bn (+33.2% YoY).

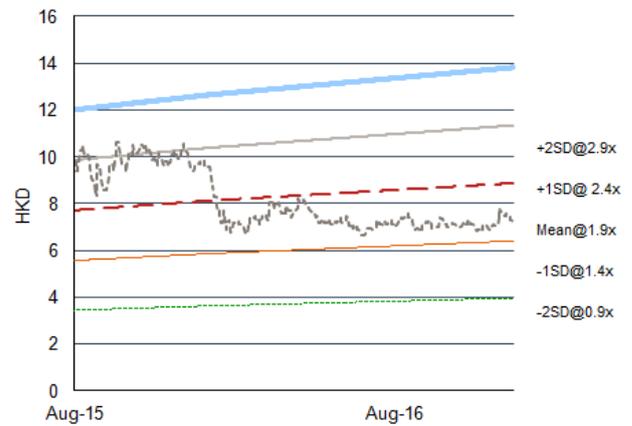
Maintain NEUTRAL and HKD7.02 TP. Our TP is based on FY18F P/E of 15x, or 0.5SD below the 5-year historical forward mean. Our corroborative DCF valuation is HKD6.30. Key upside risks to our recommendation include higher-than-expected MU orders from CRC. Key downside risks include softer-than-expected international businesses.

Figure 11: CRRC’s 3-year P/E



Source: RHB, Bloomberg

Figure 12: CRRC’s 3-year P/BV



Source: RHB, Bloomberg

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Figure 1311: Peer comparison I

Company	Ticker	Price	Mkt cap (US\$m)	3-mth avg t/o (US\$m)	PER Hist (x)	PER FY1 (x)	PER FY2 (x)	EPS FY1 YoY%	EPS FY2 YoY%	3-Yr EPS Cagr (%)	PEG (x)	Div yld Hist (%)	Div yld FY1 (%)	P/B Hist (x)	P/B FY1 (x)
CHINA RAIL GR-H	390 HK	6.74	19,623	13.8	8.5	7.5	6.4	14.0	17.3	19.8	0.3	2.0	2.1	0.9	0.8
CHINA RAIL CN-H	1186 HK	9.39	19,660	7.9	7.2	5.9	5.0	22.2	16.6	17.5	0.3	2.3	2.6	0.7	0.7
CHINA COM CONS-H	1800 HK	8.37	27,828	17.9	6.8	6.1	5.5	10.8	12.0	9.1	0.6	3.4	3.5	0.7	0.6
CHINA STATE CONS	3311 HK	9.17	5,901	7.8	8.2	6.8	5.6	21.1	21.5	16.2	0.3	3.8	4.3	1.2	1.1
HSI		31,276			12.9	12.2	11.1	5.5	10.4	8.9	1.4	3.4	3.3	1.4	1.4
CSI300		3,835			14.7	12.8	11.1	14.3	15.1	15.2	0.8	1.9	2.4	1.8	1.7
Sector avg (Infra)					13.3	11.7	9.6	23.1	16.3	(2.3)	1.7	2.4	2.5	1.4	1.2
HK listed railway & infrastructure construction															
CHINA MACHINER-H	1829 HK	4.09	2,151	1.6	8.7	6.4	6.1	34.9	6.1	12.9	0.5	6.0	5.7	0.9	0.8
Average					7.87	6.53	5.70	20.60	14.69	15.08	0.41	3.50	3.62	0.89	0.80
Subway construction and operator															
BII RAILWAY TRAN	1522 HK	0.56	150	0.0	31.1	N/A	N/A	N/A	N/A	N/A	N/A	1.8	N/A	0.5	N/A
BEIJING URBAN-H	1599 HK	3.69	634	0.3	8.2	6.1	5.0	34.1	22.4	35.5	0.2	3.3	4.5	1.1	1.1
Average					19.67	6.13	5.01	34.10	22.37	35.49	0.17	2.54	4.52	0.82	1.07
China listed railway & infrastructure construction															
CHINA RAILWAY-A	601390 CH	7.47	19,623	2.0	10.6	9.6	8.5	10.8	12.7	13.1	0.7	1.5	1.6	N/A	N/A
CHINA RAILWAY-A	601186 CH	10.18	19,660	22.3	8.8	7.6	6.6	16.0	15.1	14.6	0.5	1.8	2.1	1.0	0.8
CHINA COMMUNIC-A	601800 CH	13.41	27,828	11.9	10.4	9.9	8.8	4.1	12.6	9.5	1.1	1.8	1.9	1.3	1.1
CHINA STATE -A	601668 CH	5.94	36,578	76.8	7.8	6.7	5.4	16.3	22.8	17.6	0.4	2.6	3.2	1.2	1.0
CHINA RAILWAY-A	600528 CH	10.45	3,405	9.6	16.6	14.5	11.7	14.3	24.3	20.0	0.7	0.2	N/A	1.6	1.4
Average					10.82	9.66	8.21	12.30	17.51	14.98	0.68	1.58	2.20	1.25	1.11
Regional listed railway & infrastructure construction															
DAELIM INDUS CO	000210 KS	75,800	2,329	21.1	6.0	4.7	5.2	27.3	(10.7)	4.7	1.0	1.3	1.0	0.5	0.5
DAEWOO ENG & CON	047040 KS	5,560	2,040	18.4	8.8	5.3	5.2	66.0	2.4	19.1	0.3	N/A	0.0	1.1	0.9
GS ENGINEERING	006360 KS	46,600	3,175	42.2	N/A	6.8	8.0	N/A	(14.8)	(237.5)	N/A	0.6	0.7	1.1	1.0
HDC HOLDINGS CO	012630 KS	24,600	683	15.6	1.9	1.8	1.6	6.6	7.9	6.3	0.3	9.7	9.4	2.6	0.2
HYUNDAI ENG&CONS	000720 KS	53,900	5,298	251.8	29.8	11.6	10.3	157.7	12.6	45.6	0.3	0.9	1.0	1.0	0.9
SHIMIZU CORP	1803 JP	1,167	8,274	25.9	10.8	9.1	9.4	18.1	(2.9)	4.5	2.0	1.4	2.3	1.4	1.3
KAJIMA CORP	1812 JP	858	8,157	41.4	7.0	8.5	8.5	(17.5)	(0.2)	(7.4)	N/A	2.8	2.9	1.3	1.2
TAISEI CORP	1801 JP	6,140	12,396	49.7	10.9	12.7	11.9	(13.8)	6.9	(2.1)	N/A	2.0	2.1	2.1	1.9
Average					10.74	7.55	7.51	34.91	0.15	(20.85)	0.77	2.69	2.43	1.39	0.99
Global railway rolling stock & equipments															
CRRCLTD -H	1766 HK	6	32,989	15.4	15.2	13.3	12.8	14.0	4.1	2.6	5.0	2.9	3.3	1.3	1.2
ZHUZHOU CRRCLTD -H	3898 HK	44	6,607	13.9	17.8	15.3	13.4	16.4	14.3	15.4	1.0	1.3	1.3	2.5	2.3
CHINA AUTOMATION	569 HK	1	158	0.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.9	N/A
HOLLYSYS AUTOMAT	HOLI US	23	1,372	7.9	19.8	12.3	10.4	60.9	17.9	29.8	0.4	0.5	0.7	1.6	1.6
CRRCLTD -A	601766 CH	8	32,989	37.8	21.7	19.0	16.7	14.2	13.6	13.7	1.4	1.8	2.2	1.9	1.8
KAWASAKI HVY IND	7012 JP	3,265	4,905	32.1	18.9	11.6	10.3	62.4	12.8	26.6	0.4	1.8	2.4	1.2	1.1
NABTESCO CORP	6268 JP	3,365	3,786	27.7	16.5	15.4	15.4	6.9	0.4	5.6	2.7	2.2	2.3	2.4	2.3
MITSUBISHI HEAVY	7011 JP	4,112	12,473	48.0	19.6	17.4	12.6	12.5	38.3	20.4	0.9	2.9	3.1	0.8	0.8
BOMBARDIER INC-B	BBD/B CN	5	8,767	59.0	N/A	52.6	19.3	N/A	172.5	(206.6)	N/A	N/A	0.0	N/A	N/A
SIEMENS AG-REG	SIE GY	118	117,588	225.1	15.9	15.8	14.6	0.8	8.0	6.1	2.6	3.1	3.2	2.3	2.2
ALSTOM	ALO FP	38	9,958	24.6	17.8	19.1	18.1	(6.9)	5.5	1.0	19.5	0.9	1.3	2.1	2.4
Average					18.13	19.19	14.36	20.13	28.75	(8.55)	3.76	1.94	1.98	1.70	1.73

Note: Data as at 24 Jul 2018

Source: RHB, Bloomberg

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Figure 14: Peer comparison II

Company	Rev Hist (US\$m)	Rev FY1 (US\$m)	NP Hist (US\$m)	NP FY1 (US\$m)	Net gearing Hist (%)	Net gearing FY1 (%)	Unlev beta	Gross margin Hist (%)	Net margin Hist (%)	Net margin FY1 (%)	ROE Hist (%)	ROE FY1 (%)	Sh px 1-mth %	Sh px 3-mth %
CHINA RAIL GR-H	99,759	110,291	2,327	2,653	34	19	0.5	9.1	2.3	2.4	11.8	12.1	10.9	13.3
CHINA RAIL CN-H	98,630	108,260	2,326	2,792	(3)	(8)	0.6	9.2	2.4	2.6	11.4	12.2	14.1	6.7
CHINA COM CONS-H	66,634	72,828	2,572	2,849	64	64	0.6	13.1	3.9	3.9	10.4	10.4	2.8	(4.5)
CHINA STATE CONS	6,441	7,232	661	800	41	41	0.6	15.2	10.3	11.1	21.1	17.3	3.1	(7.2)
HSI											10.9	11.0	4.5	2.5
CSI300											12.6	13.1	1.6	(5.7)
Sector avg (Infra)	32,440	37,747	1,143	1,384	21.9	14.2	0.9	16.6	5	6	11.4	12.3	1.9	(0.2)
HK listed railway & infrastructure construction														
CHINA MACHINER-H	3,474	3,798	251	343	0	1	0.8	19.9	7.2	9.0	10.9	13.1	(1.1)	(3.7)
Average	54,988	60,482	1,627	1,887	27.20	23.45	0.63	13.32	5.21	5.80	13.14	13.05	5.96	0.93
Subway constuction and operator														
BII RAILWAY TRAN	72	N/A	5	N/A	0	N/A	0.8	20.1	6.8	N/A	1.8	N/A	(8.2)	(13.8)
BEIJING URBAN-H	1,023	1,314	73	106	0	48	0.9	19.3	7.1	8.1	13.7	16.5	2.2	1.4
Average	547	1,314	39	106	0.00	47.80	0.86	19.66	7	8	7.77	16.54	(2.99)	(6.24)
China listed railway & infrastructure construction														
CHINA RAILWAY-A	101,048	109,612	2,357	2,612	32	36	0.9	9.1	2.3	2.4	11.3	10.9	N/A	N/A
CHINA RAILWAY-A	99,179	109,264	2,356	2,744	36	10	1.1	8.6	2.4	2.5	12.2	11.9	18.5	2.9
CHINA COMMUNIC-A	67,495	75,581	3,072	3,193	63	84	0.9	13.1	4.6	4.2	11.9	11.7	10.1	0.6
CHINA STATE -A	152,581	172,085	4,833	5,481	35	N/A	1.2	9.3	3.2	3.2	17.1	15.2	2.4	(0.9)
CHINA RAILWAY-A	2,309	2,672	196	235	0	N/A	1.6	19.6	8.5	8.8	9.7	10.0	2.6	(5.8)
Average	84,522	93,843	2,563	2,853	32.95	43.28	1.14	11.95	4.19	4.22	12.45	11.93	8.39	(0.78)
Regional listed railway & infrastructure construction														
DAELIM INDUS CO	10,866	9,765	432	528	13	10	0.8	9.7	4.0	5.4	11.1	11.5	(5.3)	(10.3)
DAEWOO ENG & CON	10,365	9,433	228	381	46	37	1.0	7.1	2.2	4.0	8.3	18.4	(5.0)	(10.6)
GS ENGINEERING	10,288	10,760	(148)	456	36	22	N.A	6.9	(1.4)	4.2	3.4	15.4	0.0	22.1
HDC HOLDINGS CO	4,720	5,202	343	398	0	0	1.0	18.4	7.3	7.7	29.2	15.0	(20.6)	(29.4)
HYUNDAI ENG&CONS	14,876	15,144	178	461	0	0	0.9	10.5	1.2	3.0	4.5	8.0	(12.1)	4.3
SHIMIZU CORP	13,662	15,724	764	903	0	0	1.1	13.4	5.6	5.7	13.9	14.7	5.7	15.2
KAJIMA CORP	16,459	17,924	1,140	940	0	0	1.1	14.1	6.9	5.2	20.9	15.0	0.7	(14.6)
TAISEI CORP	14,255	14,709	1,140	960	0	0	0.9	16.8	8.0	6.5	20.5	15.9	1.8	8.5
Average	11,937	12,333	510	629	11.81	8.53	0.95	12.12	4.21	5.24	13.96	14.24	(4.34)	(1.85)
Global railway rolling stock & equipments														
CRRC CORP LTD -H	30,562	35,526	2,139	1,783	NA	NA	1	23.5	7.0	5.0	9.5	9.6	2.5	(2.7)
ZHUZHOU CRRC T-H	2,202	2,485	370	427	0	0	1	36.5	16.8	17.2	14.1	15.6	16.5	12.4
CHINA AUTOMATION	179	N/A	(31)	N/A	72	N/A	N.A	15.7	(17.0)	N/A	(16.2)	N/A	12.0	21.0
HOLLYSYS AUTOMAT	432	529	69	111	0	0	1	32.5	16.0	21.0	13.1	14.2	0.0	3.1
CRRC CORP LTD-A	30,375	33,443	1,584	1,802	0	0	1	22.1	5.2	5.4	9.1	10.1	8.4	(14.4)
KAWASAKI HVY IND	14,154	14,933	260	418	78	71	1	16.2	1.8	2.8	6.4	9.5	0.8	(11.8)
NABTESCO CORP	2,539	2,744	226	238	0	0	1	28.5	8.9	8.7	17.6	15.4	(0.4)	(16.7)
MITSUBISHI HEAVY	36,961	37,617	634	751	24	30	1	17.8	1.7	2.0	3.9	4.2	3.2	(3.6)
BOMBARDIER INC-B	16,218	17,059	(516)	190	N/A	(141)	N.A	12.0	(3.2)	1.1	N/A	(4.9)	(9.0)	19.2
SIEMENS AG-REG	71,061	71,757	5,173	5,210	53	47	1	30.1	7.3	7.3	16.8	13.9	1.8	11.4
ALSTOM	6,803	6,976	406	364	12	0	1	15.9	6.0	5.2	12.5	12.7	(2.9)	0.8
Average	19,226	22,307	938	1,130	26.56	0.73	0.87	22.80	4.59	7.57	8.66	10.03	3.00	1.69

Note: Data as at 24 Jul 2018

Source: RHB, Bloomberg

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