

TAIWAN

Gemtek

26 November 2008

4906 TT **Outperform**

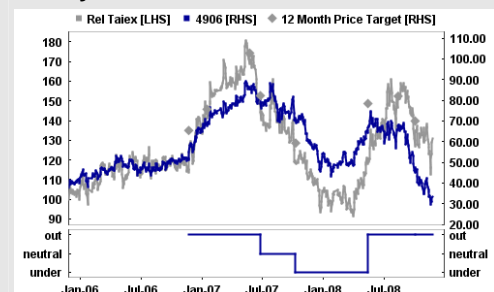
Stock price as of 24 Nov 08	NT\$	33.50
12-month target	NT\$	46.50
Upside/downside	%	+38.8
Valuation	NT\$	52.00
- DCF (WACC 10.0%)		

GICS sector	technology hardware & equipment		
Market cap	NT\$m	8,642	
30-day avg turnover	NT\$m	121.9	
Market cap	US\$m	259	
Number shares on issue	m	258.0	

Investment fundamentals

Year end 31 Dec		2007A	2008E	2009E	2010E
Total revenue	m	17,492	20,850	21,750	25,080
Reported profit	m	1,008	1,212	1,177	1,354
Profit bonus exp	m	669	1,212	1,177	1,354
Bon exp/rep prof	%	33.6	0.0	0.0	0.0
Adjusted profit	m	1,008	1,212	1,177	1,354
EPS rep	NT\$	4.21	4.88	4.65	5.35
EPS rep growth	%	8.3	15.7	-4.6	15.1
EPS bonus exp	NT\$	2.80	4.88	4.65	5.35
EPS bonus growth %	%	50.9	74.3	-4.6	15.1
PE rep	x	8.0	6.9	7.2	6.3
PE bonus exp	x	12.0	6.9	7.2	6.3
Total DPS	NT\$	2.88	3.02	3.20	3.40
Total div yield	%	8.6	9.0	9.6	10.1
ROA	%	8.8	10.4	10.6	11.8
ROE	%	13.7	15.3	14.1	15.2
EV/EBITDA	x	4.4	2.9	2.6	2.2
Net debt/equity	%	-32.1	-27.0	-30.8	-33.7
Price/book	x	1.1	1.0	1.0	0.9

4906 TT rel Taix performance, & rec history



Source: Datastream, Macquarie Research, November 2008 (all figures in NT\$ unless noted)

Analyst

Chialin Lu, CFA
886 2 2734 7526 chialin.lu@macquarie.com

Kylie Huang
886 2 2734 7528 kylie.huang@macquarie.com

Mixed outlook ahead

Event

- Gemtek hosted its regular semi-annual analyst meeting Tuesday afternoon, providing a business update and forward-looking guidance. From the company's comments, we learned that the retail demand for Wi-Fi devices is dropping faster than our prior expectation. We have therefore trimmed our earnings forecasts.
- However, we believe IP set-top box (STB) and WiMAX product lines will continue their secular growth in 2009, keeping Gemtek resilient throughout the economic downturn. We reaffirm our Outperform rating.

Impact

- Industry outlook update:** Gemtek generates around 43%, 31%, 15% and 11% of revenues from Wi-Fi module, retail Wi-Fi device (routers, access points), IP STB/IAD and WiMAX devices, respectively. Gemtek's CEO expects that retail Wi-Fi demand will remain very weak into 2009, along with the falling global economy. Wi-Fi module unit growth is expected to slow to single digits (vs 20%+ in prior years), in tandem with NB PC growth.
- However, on the positive side Gemtek's CEO expects global IP STB demand to see 30%+ growth, with more operators in developed countries bundling pay-TV service with existing fixed-line service. WiMAX is also a growing sector, with demand coming from the other end of the spectrum – operators from emerging countries (Eastern Europe, Latin America and the Middle East) are using WiMAX as a fixed-line telecom substitution.
- 4Q08 guidance:** Despite IPTV and WiMAX device shipments still seeing sequential growth, Gemtek expects 4Q08 sales to decline 10% QoQ, largely due to the sharp drop of Wi-Fi router orders from retail clients since early November. Wi-Fi module sales are expected to decline as well but at a milder degree (low-single digit), with NB PC clients placing orders more cautiously.
- 2009 guidance:** Looking into 2009, Gemtek expects revenues from its retail Wi-Fi devices to decline, but the other three product lines will likely see various degrees of growth (better growth for WiMAX and IP STB; mild growth for Wi-Fi module). All in all, Gemtek expects sales to see flat to single-digit growth in 2009. As for the margin trend, Gemtek guides for gross margin staying at the current level if not improving slightly, due to the better product mix.

Earnings revision

- We are lowering our 2008/2009/2010 EPS forecasts by 8%/27%/35%.

Price catalyst

- 12-month price target: NT\$46.50 based on a PER methodology.
- Catalyst: No near-term catalyst, but IP STB, WiMAX will drive long-term growth

Action and recommendation

- Following the earnings cut, we are trimming our TP from NT\$70 to NT\$46.5 (10x 2009E EPS). We maintain our Outperform rating. Despite slowing momentum, with the right products and right clientele (tier-one networking OEMs), we believe Gemtek is in a better position to grow in 2009 compared with other local networking peers.

Please refer to the important disclosures and analyst certification on inside back cover of this document, or on our website www.macquarie.com.au/research/disclosures.

Fig 1 Earnings revision

P/L Revision (NT\$ mn)	2007		2008E		2009E		Change (%)	
	New	Old	New	Old	New	2008F	2009F	
Net sales	17,492	22,425	20,850	26,003	21,750	-7.0	-16.4	
Gross profits	2,065	3,034	2,776	3,618	2,965	-8.5	-18.0	
Operating profit	1,085	1,621	1,358	1,980	1,443	-16.2	-27.1	
Pretax profit	1,289	1,648	1,527	2,925	2,388	-7.3	-18.4	
Net profit	1,008	1,310	1,212	1,606	1,177	-7.5	-26.8	
EPS	4.2	5.3	4.9	6.3	4.7	-7.5	-26.8	
Key ratio (%)								
Sale growth	6.5	28.2	19.2	16.0	4.3			
Gross margin	11.8	13.5	13.3	13.9	13.6			
Net margin	5.8	5.8	5.8	6.2	5.4			

Source: Macquarie Research, November 2008

Fig 2 Valuation comparison table

Company	Ticker	Price (lc) 25/11/08	MACQ Rating	Mkt cap (US\$ m)	EPS (lc)			PER (x)			EPS growth (%)		
					2007	2008E	2009E	2007	2008E	2009E	2007	2008E	2009E
Global peers													
Cisco	CSCO US	16.4	NR	96,023	1.2	1.4	1.5	13.6	11.7	10.7	33.0	15.5	9.2
Alcatel Lucent	ALU US	2.06	NR	4,774	1.6	0.0	0.3	1.3	103.0	7.8	na	-98.7	1,225.0
Foundry Networks	FDRY US	15.43	NR	2,307	0.6	0.7	0.7	28.1	22.7	20.6	103.7	23.6	10.0
Netgear	NTGR US	10.99	NR	388	1.3	1.2	1.2	8.3	8.9	9.0	7.3	-6.5	-1.3
3Com	COMS US	1.79	NR	727	-0.2	0.4	0.4	na	5.0	4.7	na	na	5.6
ZTE	763 HK	14.42	OP	3,861	0.9	1.3	2.4	15.5	11.2	5.9	63.3	38.6	88.7
Average					-	-	-	13.3	27.1	9.8	51.8	-5.5	222.9
Local peers													
D-Link	2332 TT	16.55	N	280	5.9	2.7	2.5	2.8	6.0	6.7	30.1	-53.7	-10.4
ZyXEL	2391 TT	14	NR	217	3.1	1.2	2.1	4.5	11.3	6.8	13.5	-60.4	66.7
Gemtek	4906 TT	33.5	OP	255	4.2	4.9	4.7	8.0	6.9	7.2	8.3	15.7	-4.6
Alpha Networks	3380 TT	13.85	OP	186	3.2	2.8	2.9	4.3	5.0	4.8	13.3	-13.6	3.5
USI	2350 TT	6.56	UP	212	1.8	1.4	1.1	3.7	4.6	6.2	8.8	-19.1	-25.5
Zinwell	2485 TT	22.05	OP	210	6.5	4.8	4.6	3.4	4.6	4.8	155.0	-26.3	-4.0
Average					-	-	-	4.4	6.4	6.1	38.2	(26.2)	4.3

Note: Data for Not rated companies are based on Bloomberg consensus estimates.

Source: Bloomberg, Macquarie Research, November 2008

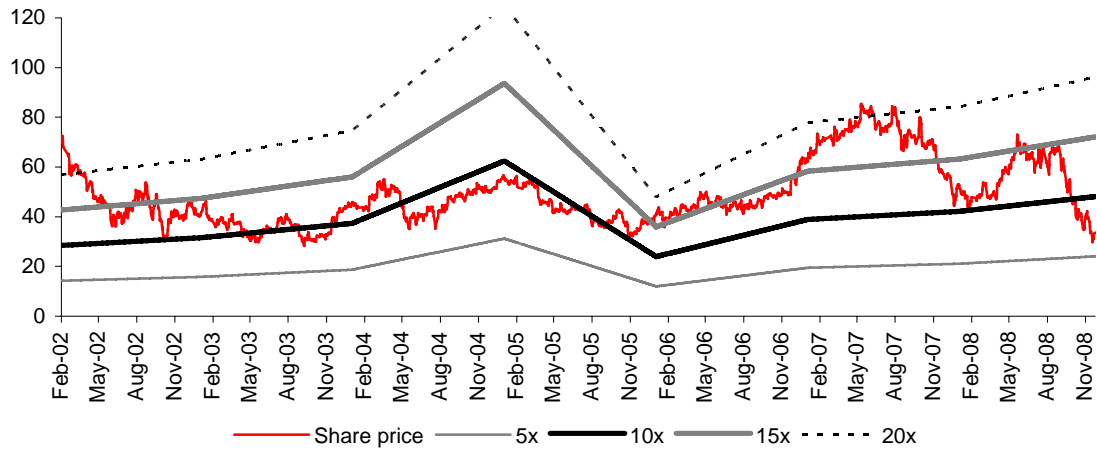
Fig 3 Valuation comparison table

Company	Ticker	ROE(%)			BVPS (lc)			PBR (x)			EV/EBIT DA (x)		
		2007	2008E	2009E	2007	2008E	2009E	2007	2008E	2009E	2007	2008E	2009E
Global peers													
Cisco	CSCO US	26.5	21.1	21.2	5.2	6.5	6.9	3.2	2.5	2.4	7.2	7.3	8.5
Alcatel Lucent	ALU US	na	na	na	6.9	28.2	25.6	0.3	0.1	0.1	3.2	2.7	2.3
Foundry Networks	FDRY US	8.1	4.9	na	7.1	7.3	na	2.2	2.1	na	9.3	16.9	13.6
Netgear	NTGR US	13.8	8.2	6.5	10.5	11.6	13.4	1.0	0.9	0.8	1.6	2.1	1.3
3Com	COMS US	-7.5	na	na	2.9	na	na	0.6	na	na	2.0	na	na
ZTE	763 HK	10.3	13.5	24.0	9.6	9.6	10.8	1.5	1.5	1.3	7.5	4.4	2.7
Average		10.2	11.9	17.2	-	-	-	1.5	1.4	1.2	5.1	6.7	5.7
Local peers													
D-Link	2332 TT	20.1	9.9	8.7	27.2	27.7	28.6	0.6	0.6	0.6	1.4	2.1	2.1
ZyXEL	2391 TT	15.5	6.1	8.9	21.0	21.6	22.9	0.7	0.6	0.6	1.4	2.2	1.5
Gemtek	4906 TT	13.7	15.3	14.1	31.5	32.2	33.9	1.1	1.0	1.0	4.4	2.9	2.6
Alpha Networks	3380 TT	18.1	14.9	14.8	18.7	18.7	20.3	0.7	0.7	0.7	1.5	1.6	1.2
USI	2350 TT	12.8	9.7	7.3	14.7	14.6	14.6	0.4	0.4	0.5	1.5	1.9	1.7
Zinwell	2485 TT	42.2	25.5	21.8	17.8	19.8	22.4	1.2	1.1	1.0	1.8	1.9	1.5
Average		20.4	13.6	12.6	-	-	-	0.8	0.8	0.7	2.0	2.1	1.8

Note: Data for Not rated companies are based on Bloomberg consensus estimates.

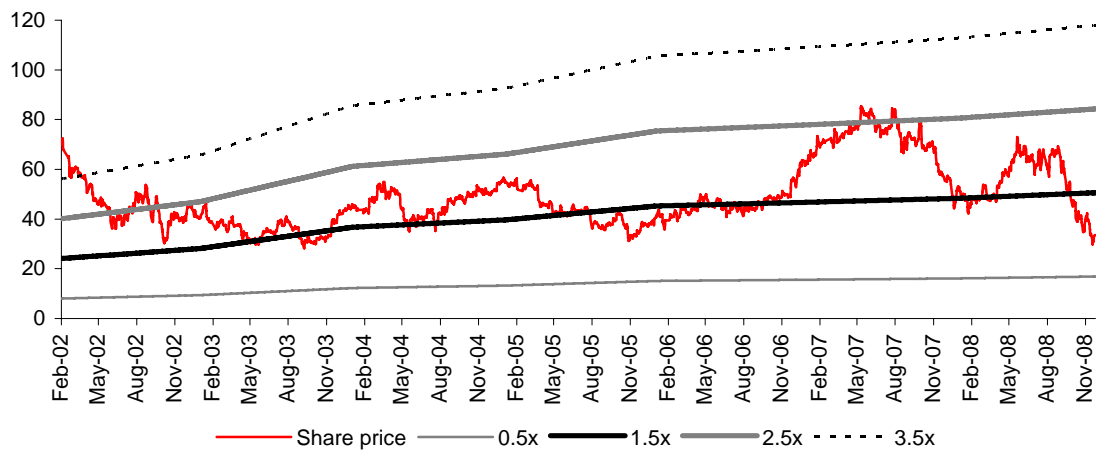
Source: Bloomberg, Macquarie Research, November 2008

Fig 4 Trailing PER band – annual



Source: Bloomberg, Macquarie Research, November 2008

Fig 5 P/BV Band – annual



Source: Bloomberg, Macquarie Research, November 2008

Gemtek (4906 TT, Outperform, Target price: NT\$46.50)

Quarterly Results		3Q/08A	4Q/08E	1Q/09E	2Q/09E	Profit & Loss		2007A	2008E	2009E	2010E
Revenue	m	5,718	5,114	4,880	5,099	Revenue	m	17,492	20,850	21,750	25,080
Gross Profit	m	766	691	660	694	Gross Profit	m	2,065	2,776	2,965	3,456
Operating Expenses	m	-370	-400	-337	-362	Operating Expenses	m	-979	-1,418	-1,523	-1,756
Operating Income	m	396	291	323	332	Operating Income	m	1,085	1,358	1,443	1,700
Net Non-operating income	m	126	-49	-2	4	Net Non-operating income	m	203	169	35	6
Pre-Tax Income	m	523	242	322	335	Pre-Tax Income	m	1,289	1,527	1,478	1,706
Tax Expense	m	-141	83	-62	-68	Tax Expense	m	-186	-290	-266	-307
Exceptionals	m	0	0	0	0	Exceptionals	m	0	0	0	0
Minority Interests	m	0	-25	0	0	Minority Interests	m	-94	-25	-35	-45
Reported Earnings	m	382	300	259	267	Reported Earnings	m	1,008	1,212	1,177	1,354
Reported Earnings (bonus exp)	m	382	300	259	267	Reported Earnings (bonus exp)	m	669	1,212	1,177	1,354
Bonus exp / Reported Earnings	%	0.0	0.0	0.0	0.0	Bonus exp / Reported Earnings	%	33.6	0.0	0.0	0.0
Adjusted Earnings	m	382	300	259	267	Adjusted Earnings	m	1,008	1,212	1,177	1,354
EBITDA	m	592	486	559	568	EBITDA	m	1,458	2,140	2,388	2,830
EPS (rep)	NT\$	1.54	1.21	1.02	1.06	EPS (rep)	NT\$	4.21	4.88	4.65	5.35
EPS pcp growth (rep)	%	21.3	198.5	65.2	-30.2	EPS growth (rep)	%	8.3	15.7	-4.6	15.1
EPS (rep bonus exp)	NT\$	1.54	1.21	1.02	1.06	EPS (rep bonus exp)	NT\$	2.80	4.88	4.65	5.35
EPS pcp growth (rep bonus exp)	%	82.8	349.7	65.2	-30.2	EPS growth (rep bonus exp)	%	50.9	74.3	-4.6	15.1
EPS (adj)	NT\$	1.54	1.21	1.02	1.06	EPS (adj)	NT\$	4.21	4.88	4.65	5.35
EPS pcp growth (adj)	%	21.3	198.5	65.2	-30.2	EPS growth (adj)	%	8.3	15.7	-4.6	15.1
Revenue pcp growth	%	25.1	22.3	15.6	-12.0	PE (rep)	x	8.0	6.9	7.2	6.3
Operating Income pcp growth	%	19.4	25.4	31.0	-21.8	PE (rep bonus adj)	x	12.0	6.9	7.2	6.3
Reported Earnings pcp growth	%	26.0	210.0	68.1	-29.0	PE (adj)	x	8.0	6.9	7.2	6.3
Gross Profit Margin	%	13.4	13.5	13.5	13.6	Total DPS	NT\$	2.88	3.02	3.20	3.40
Operating Income Margin	%	6.9	5.7	6.6	6.5	Total Div Yield	%	8.6	9.0	9.6	10.1
Reported Earnings Margin	%	6.7	5.9	5.3	5.2	Weighted Average Shares	m	239.3	248.6	253.0	253.0
EBITDA Margin	%	10.3	9.5	11.5	11.1	Period End Shares	m	245.5	253.0	253.0	253.0
Profit and Loss Ratios		2007A	2008E	2009E	2010E	Cashflow Analysis		2007A	2008E	2009E	2010E
Revenue Growth	%	6.5	19.2	4.3	15.3	Reported Earnings	m	1,008	1,212	1,177	1,354
Gross Profit Growth	%	7.9	34.4	6.8	16.5	Depreciation & Amortisation	m	372	782	945	1,130
Operating Income Growth	%	1.1	25.1	6.2	17.8	Chgs in Working Cap	m	977	-696	-98	-348
Reported Earnings Growth	%	17.1	20.2	-2.9	15.1	Other	m	95	37	30	30
EBITDA Growth	%	0.3	46.8	11.5	18.5	Operating Cashflow	m	2,452	1,335	2,053	2,166
Gross Profit Margin	%	11.8	13.3	13.6	13.8	Acquisitions	m	-170	-40	-40	-40
Operating Income Margin	%	6.2	6.5	6.6	6.8	Capex	m	-341	-733	-840	-900
Reported Earnings Margin	%	5.8	5.8	5.4	5.4	Asset Sales	m	0	0	0	0
EBITDA Margin	%	8.3	10.3	11.0	11.3	Other	m	22	55	-3	-3
Payout Ratio	%	68.3	62.0	68.8	63.5	Investing Cashflow	m	-490	-718	-883	-943
EV/EBITDA	x	4.4	2.9	2.6	2.2	Dividend (Ordinary)	m	-553	-706	-759	-810
EV/EBIT	x	6.0	4.7	4.4	3.7	Equity Raised	m	304	-84	-0	-0
Balance Sheet Ratios						Debt Movements	m	-686	169	-356	-107
ROE	%	13.7	15.3	14.1	15.2	Other	m	0	0	0	0
ROA	%	8.8	10.4	10.6	11.8	Financing Cashflow	m	-935	-620	-1,115	-917
ROIC	%	15.3	21.0	19.9	23.4	Net Chg in Cash/Debt	m	1,027	-3	55	306
Net Debt/Equity	%	-32.1	-27.0	-30.8	-33.7	Free Cashflow	m	2,111	602	1,213	1,266
Interest Cover	x	nmf	473.9	1,945.4	nmf	FCF per Share	NT\$	8.82	2.42	4.79	5.00
Price/Book	x	1.1	1.0	1.0	0.9	P/FCF	x	3.8	13.8	7.0	6.7
Book Value per Share	NT\$	31.5	32.2	34.0	36.3	Balance Sheet		2007A	2008E	2009E	2010E
						Cash	m	3,223	3,212	3,299	3,639
						Receivables	m	3,387	4,056	4,231	4,879
						Inventories	m	1,692	2,126	2,210	2,544
						Investments	m	0	0	0	0
						Fixed Assets	m	2,969	2,920	2,815	2,585
						Intangibles	m	0	0	0	0
						Other Assets	m	1,196	1,213	1,242	1,310
						Total Assets	m	12,467	13,527	13,797	14,957
						Payables	m	3,141	3,466	3,603	4,147
						Short Term Debt	m	0	20	13	11
						Long Term Debt	m	742	990	641	536
						Provisions	m	0	0	0	0
						Other Liabilities	m	855	907	946	1,090
						Total Liabilities	m	4,738	5,383	5,203	5,785
						Total S/H Equity	m	7,730	8,144	8,594	9,172
						Total Liab & S/H Funds	m	12,467	13,527	13,797	14,957

All figures in NT\$ unless noted.

Source: Macquarie Research, November 2008

Important disclosures:

Recommendation definitions	Volatility index definition*	Financial definitions
<p>Macquarie - Australia/New Zealand Outperform – return >5% in excess of benchmark return (>2.5% in excess for listed property trusts) Neutral – return within 5% of benchmark return (within 2.5% for listed property trusts) Underperform – return >5% below benchmark return (>2.5% below for listed property trusts)</p> <p>Macquarie – Asia/Europe Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie First South - South Africa Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie – Canada Outperform – return >5% in excess of benchmark return Neutral – return within 5% of benchmark return Underperform – return >5% below benchmark return</p> <p>Macquarie – USA Outperform (Buy) – return >5% in excess of benchmark return Neutral (Hold) – return within 5% of benchmark return Underperform (Sell) – return >5% below benchmark return</p> <p>Recommendations – 12 months</p> <p>Note: Quant recommendations may differ from Fundamental Analyst recommendations</p>	<p>This is calculated from the volatility of historic price movements.</p> <p>Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p>High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p>Medium – stock should be expected to move up or down at least 30–40% in a year.</p> <p>Low–medium – stock should be expected to move up or down at least 25–30% in a year.</p> <p>Low – stock should be expected to move up or down at least 15–25% in a year.</p> <p>* Applicable to Australian/NZ stocks only</p>	<p>All "Adjusted" data items have had the following adjustments made: Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests</p> <p>EPS = adjusted net profit / epowa* ROA = adjusted ebit / average total assets ROA Banks/Insurance = adjusted net profit / average total assets ROE = adjusted net profit / average shareholders funds Gross cashflow = adjusted net profit + depreciation *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>

Recommendation proportions – For quarter ending 30 September 2008

	AU/NZ	Asia	RSA	USA	CA	EUR
Outperform	43.17%	61.57%	63.08%	53.60%	71.54%	43.00%
Neutral	41.37%	16.43%	30.77%	37.60%	24.61%	48.00%
Underperform	15.47%	22.00%	6.15%	8.80%	3.85%	9.00%

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Asia Research

Head of Equity Research

Stephen O'Sullivan (852) 2823 3566

Automobiles/Auto Parts

Deepak Jain (India) (9122) 6653 3157
Kenneth Yap (Indonesia) (6221) 515 7343
Dan Lucas (Japan) (813) 3512 6050
Eunsook Kwak (Korea) (822) 3705 8644
Linda Huang (Taiwan) (8862) 2734 7521

Banks and Non-Bank Financials

Ismael Pili (Asia) (65) 6231 2840
Nick Lord (Asia, China, Hong Kong) (852) 2823 4774
Sarah Wu (China) (8621) 2412 9035
Seshadri Sen (India) (9122) 6653 3053
Ferry Wong (Indonesia) (6221) 515 7335
Chin Seng Tay (Malaysia, S'pore) (65) 6231 2837
Nadine Javellana (Philippines) (632) 857 0890
Matthew Smith (Taiwan) (8862) 2734 7514
Alastair Macdonald (Thailand) (662) 694 7741

Chemicals/Textiles

Scott Weaver (Taiwan) (8862) 2734 7512
Jal Irani (India) (9122) 6653 3040
Christina Lee (Korea) (822) 3705 8670
Sunaina Dhanuka (Malaysia) (603) 2059 8993

Conglomerates

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Leah Jiang (China) (8621) 2412 9020
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Ashwin Sanketh (Singapore) (65) 6231 2830

Consumer

Mohan Singh (Asia) (852) 3901 1111
Jessie Qian (China, Hong Kong) (852) 2823 3568
Charles Yan (China) (8621) 2412 9033
Unmesh Sharma (India) (9122) 6653 3042
Sarina Lesmina (Indonesia) (6221) 515 7339
Duane Sandberg (Japan) (813) 3512 7867
Toby Williams (Japan) (813) 3512 7392
Heather Kang (Korea) (822) 3705 8677
HongSuk Na (Korea) (822) 3705 8678
Edward Ong (Malaysia) (603) 2059 8982
Alex Pomento (Philippines) (632) 857 0899
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Robert Burghart (Japan) (813) 3512 7853
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Scott Weaver (Taiwan) (8862) 2734 7512

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Christopher Cintavey (Japan) (813) 3512 7432
Janet Lewis (Japan) (813) 3512 7475
Michael Na (Korea) (822) 2095 7222
Sunaina Dhanuka (Malaysia) (603) 2059 8993
David Gambrell (Thailand) (662) 694 7753

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Seshadri Sen (Asia, India) (9122) 6653 3053
Makarim Salman (Japan) (813) 3512 7421

Media

Jessie Qian (China, Hong Kong) (852) 2823 3568
Shubham Majumder (India) (9122) 6653 3049
Prem Jearajasingam (Malaysia) (603) 2059 8989
Alex Pomento (Philippines) (632) 857 0899

Oil and Gas

David Johnson (Asia, China) (852) 2823 4691
Scott Weaver (Taiwan) (8862) 2734 7512
Jal Irani (India) (9122) 6653 3040
Christina Lee (Korea) (822) 3705 8670
Edward Ong (Malaysia) (603) 2059 8982
Sunaina Dhanuka (Malaysia) (603) 2059 8993
Ashwin Sanketh (Singapore) (65) 6231 2830
Trevor Buchinski (Thailand) (662) 694 7728

Pharmaceuticals

Abhishek Singhal (India) (9122) 6653 3052
Naomi Kumagai (Japan) (813) 3512 7474
Christina Lee (Korea) (822) 3705 8670

Property

Matt Nacard (Asia) (852) 2823 4731
Eva Lee (China, Hong Kong) (852) 2823 3573
Chris Cheng (China, Hong Kong) (852) 2823 3581
Tata Goeyardi (Hong Kong) (852) 2823 4077
Unmesh Sharma (India) (9122) 6653 3042
Chang Han Joo (Japan) (813) 3512 7885
Hiroshi Okubo (Japan) (813) 3512 7433
Tuck Yin Soong (Singapore) (65) 6231 2838
Elaine Cheong (Singapore) (65) 6231 2839
Corinne Jian (Taiwan) (8862) 2734 7522
Patti Tomaitrichitr (Thailand) (662) 694 7727

Resources / Metals and Mining

Andrew Dale (Asia) (852) 2823 3587
YeeMan Chin (China) (852) 2823 3562
Rakesh Arora (India) (9122) 6653 3054
Adam Worthington (Indonesia) (6221) 515 7338
Polina Diyachkina (Japan) (813) 3512 7886
Christina Lee (Korea) (822) 3705 8670
Scott Weaver (Taiwan) (8862) 2734 7512

Technology

Warren Lau (Asia) (852) 2823 3592
Kishore Belai (India) (9122) 6653 3046
Damian Thong (Japan) (813) 3512 7877
David Gibson (Japan) (813) 3512 7880
George Chang (Japan) (813) 3512 7854
Yoshihiro Shimada (Japan) (813) 3512 7862
Yukihiro Goto (Japan) (813) 3512 5984
Do Hoon Lee (Korea) (822) 3705 8641
Michael Bang (Korea) (822) 3705 8659
Patrick Yau (Singapore) (65) 6231 2835
Andy Kung (Taiwan) (8862) 2734 7534
Chia-Lin Lu (Taiwan) (8862) 2734 7526
Daniel Chang (Taiwan) (8862) 2734 7516
James Chiu (Taiwan) (8862) 2734 7517
Nicholas Teo (Taiwan) (8862) 2734 7523

Telecoms

Tim Smart (Asia, China) (852) 2823 3565
Bin Liu (China) (852) 2249 3634
Shubham Majumder (India) (9122) 6653 3049
Kenneth Yap (Indonesia) (6221) 515 7343
Nathan Ramler (Japan) (813) 3512 7875
Prem Jearajasingam (Malaysia) (603) 2059 8989
Ramakrishna Maruvada (Philippines, Singapore, Thailand) (65) 6231 2842

Transport & Infrastructure

Anderson Chow (Asia, China) (852) 2823 4773
Jonathan Windham (Asia, China) (852) 2823 5417
Tim Bacchus (Asia, China) (852) 2823 3586
Wei Sim (China, Hong Kong) (852) 2823 3598
Eunsook Kwak (Korea) (822) 3705 8644
Sunaina Dhanuka (Malaysia) (603) 2059 8993

Utilities

Carol Cao (China, Hong Kong) (852) 2823 4075
Deepak Jain (India) (9122) 6653 3157
Adam Worthington (Indonesia) (6221) 515 7338
Kakutoshi Ohoi (Japan) (813) 3512 7296
Prem Jearajasingam (Malaysia) (603) 2059 8989
Alex Pomento (Philippines) (632) 857 0899

Commodities

Jim Lennon (4420) 7065 2014
Adam Rowley (4420) 7065 2013
Jonathan Butcher (4420) 7065 5938
Max Layton (4420) 7065 2000
Bonnie Liu (8621) 2412 9008
Henry Liu (8621) 2412 9005
Rakesh Arora (9122) 6653 3054

Data Services

Andrea Clohessy (Asia) (852) 2823 4076

Economics

Bill Belchere (Asia) (852) 2823 4636
Rajeev Malik (ASEAN, India) (65) 6231 2841
Richard Gibbs (Australia) (612) 8232 3935
Paul Cavey (China) (852) 2823 3570
Richard Jerram (Japan) (813) 3512 7855

Quantitative

Martin Emery (Asia) (852) 2823 3582
Viking Kwok (Asia) (852) 2823 4735
George Platt (Australia) (612) 8232 6539
Raelene de Souza (Australia) (612) 8232 8388
Tsumugi Akiba (Japan) (813) 3512 7560

Strategy/Country

Tim Rocks (Asia) (852) 2823 3585
Daniel McCormack (Asia) (852) 2823 4073
Desh Peramunetilleke (Asia) (852) 2823 3564
Mahesh Kedia (Asia) (852) 2823 3576
Michael Kurtz (China) (8621) 2412 9002
Seshadri Sen (India) (9122) 6653 3053
Ferry Wong (Indonesia) (6221) 515 7335
Chris Hunt (Japan) (813) 3512 7878
Peter Eadon-Clarke (Japan) (813) 3512 7850
Eugene Ha (Korea) (822) 3705 8643
Prem Jearajasingam (Malaysia) (603) 2059 8989
Edward Ong (Malaysia) (603) 2059 8982
Alex Pomento (Philippines) (632) 857 0899
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Daniel Chang (Taiwan) (8862) 2734 7516
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Michelle Paisley (China, Hong Kong) (852) 2823 3516
Ulrike Pollak-Tsutsumi (Frankfurt) (49) 69 7593 8747
Thomas Renz (Geneva) (41) 22 818 7712
Ajay Bhatia (India) (9122) 6653 3200
Stuart Smythe (India) (9122) 6653 3200
Chris Gray (Indonesia) (6221) 515 7304
K.Y. Nam (Korea) (822) 3705 8607
Lena Yong (Malaysia) (603) 2059 8888
Gino C Rojas (Philippines) (632) 857 0761
Greg Norton-Kidd (New York) (1 212) 231 2527
Luke Sullivan (New York) (1 212) 231 2507

Regional Heads of Sales cont'd

Scot Mackie (New York) (1 212) 231 2848
Sheila Schroeder (San Francisco) (1 415) 835 1235
Giles Heyring (Singapore) (65) 6231 2888
Mark Duncan (Taiwan) (8862) 2734 7510
Angus Kent (Thailand) (662) 694 7601
Michael Newman (Tokyo) (813) 3512 7920
Charles Nelson (UK/Europe) (44) 20 7065 2032
Rob Fabbro (UK/Europe) (44) 20 7065 2031

Sales Trading

Adam Zaki (North Asia) (852) 2823 3528
Mona Lee (Hong Kong) (852) 2823 3519
Stuart Goddard (Europe) (44) 20 7065 2033

Sales Trading cont'd

Brendan Rake (India) (9122) 6653 3204
Edward Robinson (London) (44) 20 7065 5883
Robert Risman (New York) (1 212) 231 2555
Isaac Huang (Taiwan) (8862) 2734 7582
Jon Omori (Tokyo) (813) 3512 7838

Alternative Strategies

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Futures - Tim Smith (852) 2823 4637
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