

Hong Leong Asia's diesel engine business grabs US investor attention

| BY JOAN NG |

Peter Delgado was feeling rather pleased with himself immediately after a conference call last week with Hong Leong Asia's CFO Philip Ting. During the hour-long call with individual and professional investors based in the US, Ting confirmed Delgado's bullish thesis on **China Yuchai International**, the New York-listed diesel engine maker controlled by Hong Leong Asia, and promised to do more in the future to communicate to US investors the progress that the company is making.

Less than two weeks before the conference call, Delgado had published a blog opining that China Yuchai's fast-growing diesel engine business, as well as the investments the company has made in Singapore-listed **Thakral Corp** and **HLG Enterprise** (formerly LKN-Primefield), are not fully reflected in the market value of its shares.

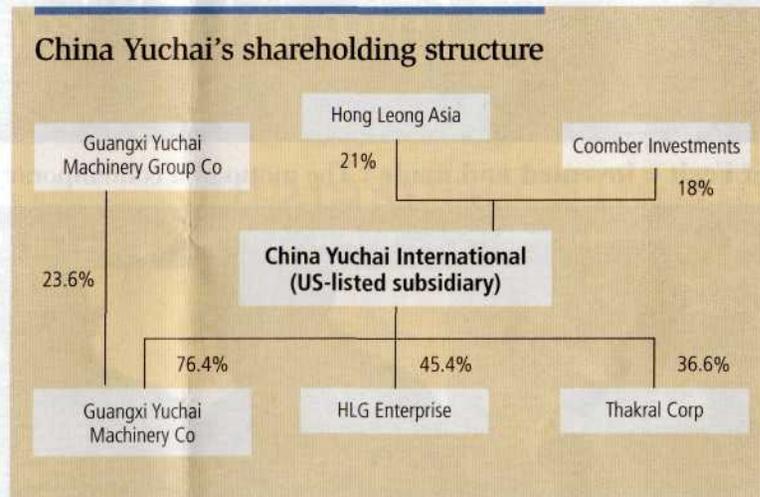
In strident language, Delgado, the principal of Threshold Capital, a tiny New Jersey-based investment advisory firm with less than US\$5 million (\$7.6 million) under man-

agement changes in China Yuchai's principal operating subsidiary in China, Guangxi Yuchai Machinery Co, while implementing cost-cutting programmes and improving the group's profitability.

"There have been very significant improvements in the way Guangxi Yuchai operates," Ting told investors. "And the new chairman and his management team have been very cooperative. I think this has resulted in increased profits and better control, which more than compensates the shareholders."

Indeed, riding the rapid expansion of China's highways and local government policies encouraging the use of diesel engines in vehicles made in the country, China Yuchai's diesel engine business is now growing faster than ever. Last year, the company sold 283,583 diesel engines, a 23.2% increase from the 230,228 units that were sold in 2005. And, net sales reached a record 6.9 million renminbi (\$1.4 million).

Ting said the company was in the midst of discussions with **Geely Holding Group**, one of China's leading automobile manufacturers, to produce diesel engines for passenger



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Weichai Power, another diesel engine manufacturer, trade at 22 times earnings in Hong Kong and 36 times in Shenzhen.

Little interest in Singapore

Ironically, just four years ago, investors in Hong Leong Asia were just as interested in China Yuchai's progress as Delgado is today. At the time, Hong Leong Asia's core building materials business was in a slump. And, China Yuchai — one of a handful of China-based businesses the compa-

New reorganisation plan

Still, with China Yuchai's improving fortunes, it might just be a matter of time before investors in Hong Leong Asia take notice once more. For starters, the market value of its stakes in Thakral and HLGE has doubled since they were acquired. Together, those two investments are now worth about \$304.55 million, or US\$200.68 million. That's almost half of China Yuchai's own market capitalisation of US\$446.84 million. The company's directors have indicated that they are willing to consider a sale of these investments should the right opportunities come along.

More importantly, the troublesome Wang was replaced in October 2005 by Yan Ping, another well-connected official in the city of Yulin, where Guangxi Yuchai Machinery's primary manufacturing facilities are located. By all accounts, Yan has been rather successful in implementing corporate governance practices and building a reputable brand name for the company. And, it's showing up in the form of improving financial numbers. China Yuchai's FY2006 net profit more than tripled to 199.4 million renminbi. Yan has also developed an "excel-

agement, noted that Hong Leong Asia holds a golden share in China Yuchai, which gives it outright control of the board despite only owning 21% of the company's shares; and that the group's executives do far less to engage investors in China Yuchai than shareholders of Hong Leong Asia.

During the conference call, Ting insisted that the interests of Hong Leong Asia were fully aligned with minority shareholders of China Yuchai, and that its control of the board via its golden share had benefited investors equally. Among other things, Hong Leong Asia had used board control to

cars. "This is a very significant event for us because, in the past, Yuchai supplied only diesel engines for commercial trucks and buses and minivans in China," he said. "To move into the passenger market is a major milestone for us."

Ting also confirmed reports in China-based newspapers that China Yuchai is working on a deal to supply diesel engines to a large Russian vehicle maker. "We just started very initial, preliminary, discussions with this Russian company about the potential of us supplying diesel engines for their truck chassis in China," he said. "This is a way that we can ex-

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port our product not just in domestic China but overseas as well." A similar export agreement is also in the works with a company based in the Middle East.

Against the backdrop of these developments, Ting said he was confident that China Yuchai's growth in 2Q2007 would be in line with that of the industry. "The fundamentals of our diesel engine business remain good and strong, in line with the growth in demand of new trucks and buses, which [according to] government statistics grew 14% to 16% in 1Q2007," he said. Based on input from Yuchai's salespeople, Ting said growth in 2Q should be in line with that in 1Q.

While much of the information that Ting disclosed during the conference call had already been reported in piecemeal fashion in China and in the US, investors who participated in the conference call seemed reassured to hear it all directly from a senior Hong Leong Asia executive. "I think we learned a number of very compelling things," Delgado tells *The Edge Singapore* in an email following the call.

If Hong Leong Asia keeps up the practice of engaging US investors, it could just be a matter of time before shares in China Yuchai climb higher. Delgado believes that shares in China Yuchai, which currently trade at 17 times earnings, deserve higher valuations. For instance, shares in

ny acquired to revive its fortunes — looked like its best hope.

In fact, in 2003, shares in China Yuchai traded as high as US\$36.45, more than three times their current level. In 2004, however, it emerged that Wang Jianming, the politically connected chairman of Guangxi Yuchai Machinery at that time, had diverted company funds to an unauthorized loan and was attempting to wrest control of the business. In the process, China Yuchai's net profit collapsed by 85.7% to 68.5 million renminbi in FY2005 and its share price sank to under US\$10.

In April 2005, the board of China Yuchai agreed to a reorganisation plan that would have seen Guangxi Yuchai Machinery spun off and listed as a separate company. Around that time, China Yuchai bought a 36.6% stake in electronics distributor Thakral Corp and a 45.4% stake in property developer HLG Enterprise (HLGE) to diversify its interests. That has left it saddled with 1.65 billion renminbi in borrowings, reflecting a net debt-to-equity ratio of 31.7%, as at the end of last year.

In the meantime, Hong Leong Asia's building materials business has staged a thumping recovery on the back of a massive infrastructure building and property development boom in Singapore. In June, the company announced that it had been appointed a key supplier of concrete to **Marina Bay Sands'** integrated resort project. The result is that investors in Hong Leong Asia seem to care little now about developments at its diesel engine arm. Citigroup analyst Lim Jit Soon says that until more concrete developments are announced, there's little reason for investors to be bothered with any reorganisation.

lent" working relationship with China Yuchai's board of directors, says Teo Tong Kooi, CEO of Hong Leong Asia and a director and president of China Yuchai.

With things working out so well now, the reorganisation agreement that China Yuchai signed is being reconsidered. In an announcement earlier this month, China Yuchai said the parties to the deal — which include **Coomber Investments**, a company that owns 18% of China Yuchai, and a Chinese state-owned company that holds 23.6% of Guangxi Yuchai Machinery — are working on a deal that "benefits and interests each party".

Instead of a spin-off, the new reorganisation will more likely involve a change in Guangxi Yuchai Machinery's complicated ownership structure, which could help improve the market value of China Yuchai's shares. Such a reorganisation could signal the start of a new relationship among all parties, which is generally a positive thing, says one analyst.

One possibility that would certainly be welcomed by investors is a seat for Yan on China Yuchai's board of directors. "He has built an exceptional reputation for himself and has so far been doing all the right things," says Delgado, who would certainly like to see Yan take a more active role in China Yuchai's management. Electing Yan to the board would put him in a position to make public statements on behalf of the company in the US about the progress of its diesel engine business and ensure that US investors are kept fully abreast of its business deals and growth initiatives. Even if shareholders in Hong Leong Asia aren't too concerned about that right now, such a move would probably be in their interest too. **E**



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