

Analyst: Vincent Leung

Main-Board H-share Listing - Research

潍柴動力股份有限公司
Weichai Power Co., Ltd. [Stock Code: 2338]
Sponsor, Bookrunner, Joint Global Coordinator and Lead Manager : CITIC Capital Markets Limited

Joint Global Coordinator and Lead Manager : CLSA Limited

Sector : Machinery

Business : Manufacture and sale of heavy-duty diesel engines in the PRC

Total share offer: <u>110,000,000</u> shares (34.92% of the enlarged share capital) IPO: 11,000,000 shares (10%) Placement: 99,000,000 shares (90%) Greenshoe: 16,500,000 shares	<u>Business of Weichai Power</u> Weichai Power is principally engaged in the manufacture and sale of high-speed, high-power diesel engines, primarily for domestic use in heavy-duty trucks and wheel-loaders. The sales of heavy-duty vehicle engines and construction-machine engines accounted for 54.9% and 38.8% respectively of the Company's turnover in 2003. Products of the Company are: - WD615 Engines: water-cooled, linear, 6-cylinder, turbo-charging, high-speed diesel engines; generating 110kW-266kW of output; Euro II Standards - WD618 Engines: a new series of diesel engines developed based on the WD615 series; having all major features of WD615 Engines; generating 265kW-323kW of output; Euro II Standards The Company manufactures 4 series of WD615 Engines, namely vehicle engines (for heavy-duty vehicles and coaches) construction-machine engines, vessel engines and power-generator engines. Currently, the Company and Hangzhou Auto Engine Factory are the only 2 engine producers using the WD615 Engine technology. The Company's 2 production lines are located in Chongqing (for WD615 Engines) and Weifang (for both WD615 and WD618 Engines), Shandong province. It produced approximately 80,400 diesel engines in 2003.
Price: HK\$8.30 – HK\$10.80 per share H-share Market Cap. : HK\$913 million – HK\$1,188 million Historical 2003 P/E: 10x – 13x (fully diluted) Adjusted NTA per share: HK\$3.14 – HK\$3.91 Staffing: 5,162	
Book opens: 18 th February, 2004 Book closes: 2 nd March, 2004 IPO commences: 26 th February, 2004 IPO closes: 2 nd March, 2004 Receiving bank: HSBC Share registrar: Computershare Hong Kong Investor Services Limited Listing date: 11 th March, 2004	

Major Shareholder after Listing
(Assuming the over-allotment option is not exercised)

China National Heavy Duty Truck Group Co. Ltd. (a state-owned enterprise)	25.01%
*Peterson Holdings Company Limited	7.46%
Shenzhen Chuangxin Investment Group Company Limited	6.83%
Fujian Longyan Construction Machinery (Group) Company Limited	6.83%
Weifang Investment Company (a state-owned enterprise)	6.22%
*IVM Technical Consultants Wien Gesellschaft m.b.H. (indirectly owned by Julius G. Kiss, a non-executive director of the Company)	3.41%
Shandong Enterprise Trust Operation Company Limited	3.17%
Guangxi Liugong Group Company Limited (a state-owned enterprise)	1.45%
Mr. TAN Xuguang (aged 43; chairman and an executive director of the Company)	1.36%
Mr. XU Xinyu (aged 40; an executive director and general manager of the Company)	0.32%
Mr. SUN Shaojun (aged 38; an executive director and deputy general manager of the Company)	0.32%
Mr. ZHANG Quan (aged 40; an executive director and deputy general manager of the Company)	0.32%
20 other senior executives of the Company	2.38%
	<u>65.08%</u>

*None of the shares held by Peterson and IVM, which are defined as foreign shares, may be transferred until 22nd December 2005.

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$888 million.

(Assuming the over-allotment option is not exercised and an issue price of HK\$9.55 per share, being the midpoint of the indicative price range of HK\$8.30-HK\$10.80)

	RMB million
To modify the Company's existing production line and establish an additional production line for the WD615 and WD618 Engines	500
To fund the development, jointly with AVL, of the Company's WD615 and WD618 Euro III Engines, which are yet to be developed by the Company	80
To further develop the Company's existing sales and service network, consolidate its image and standard, as well as implement computer networking between its services centres, licensed service centres and sales department	80
To establish the Company's enterprise-resources-planning and production-data-management systems.	54
To serve as the Company's general working capital	Balance

Financial Highlights

	Year ended 31st December		
	2003	2002	2001
	RMB '000	RMB '000	RMB '000
Turnover (by product applications)			
<i>Heavy-duty vehicles</i>	1,951,520	1,024,066	423,370
<i>Construction machines</i>	1,380,644	716,400	355,553
<i>Vessels</i>	56,194	59,633	32,485
<i>Coaches</i>	42,172	1,189	-
<i>Power generators</i>	25,126	15,235	17,976
<i>Others</i>	<u>100,014</u>	<u>63,845</u>	<u>27,197</u>
	<u>3,555,670</u>	<u>1,880,368</u>	<u>856,581</u>
Operating profit	<u>485,918</u>	<u>234,377</u>	<u>92,798</u>
Net profit	<u>277,468</u>	<u>167,545</u>	<u>78,512</u>
Dividend	20,439	-	-
EPS – basic	<u>RMB1.29</u>	<u>RMB2.01</u>	<u>RMB0.98</u>

**Sales volume by product categories:**

	Year ended 31 st December					
	2003		2002		2001	
	<u>Units</u>	<u>%</u>	<u>Units</u>	<u>%</u>	<u>Units</u>	<u>%</u>
Heavy-duty vehicle engines	40,286	50.1	22,955	53.2	9,886	50.3
Construction machine engines	37,945	47.1	18,772	43.5	8,783	44.7
Vessels	1,094	1.4	1,188	2.7	668	3.4
Coaches	671	0.8	18	-	-	-
Power generators	487	0.6	256	0.6	294	1.5
Others	-	-	-	-	28	0.1
	<u>80,483</u>	<u>100.0</u>	<u>43,189</u>	<u>100.0</u>	<u>19,659</u>	<u>100.0</u>

Strengths

- ✓ The Company posted a CAGR of 88% for its net profit during 2001-2003, on a 104% CAGR for its turnover. During the period, the group's market share in new heavy-duty vehicle engines in the PRC with a load capacity of 15 tonnes (or above) rose to 71.3% in 2003. Moreover, its market share of the new wheel-loader engines (a type of construction-machine engine) with a load capacity of 5 tonnes or above increased to 73%. With its leading positions in the market, the Company should be able to capture the robust demand for high-speed, heavy-duty diesel engines amid the strong fixed-asset investment in the PRC.
- ✓ The Company's financial position has been improved drastically. Its net gearing ratio declined from 159.3% as at the end of 2001 to 7.2% as at the end of 2002, while it had net cash of RMB186.5 million as at the end of 2003. This is mainly attributable to the Company's adoption of a new policy of using bills to settle suppliers' invoices in 2003, which has improved its cash position but caused creditor turnover days to deteriorate from 80.1 days in 2002 to 200.1 days in 2003.
- ✓ The Company has an established and renowned customer base. Its major customers in the heavy-duty vehicle industry include the China Heavy Duty Truck Group*, Shaanxi Zhongqi, Chongqing Hongyan and Beiqi Futian, while those in the construction-machine industry include Guangxi Liugong*, Fujian Longyan* and Shandong Lingong. (*connected parties of the Company)
- ✓ The Company has a large network of 37 service centres and 480 licensed service centres (not owned by Weichai Power but are paid by the Company based on the services provided to its clients).
- ✓ Entry barriers for the diesel-engine industry are high due to high R&D investment and high switching cost for heavy-duty-truck and construction-machine manufacturers. Imported engines are not competitive in the PRC as the prices are high and after-sales-service coverage is limited.
- ✓ Shares of Weichai Power being offered are priced at a historical FY2003 P/E of 10x-13x on a fully-diluted basis. While there is no direct comparison available in the local market, valuation of Weichai Power looks reasonable when compared with its US-listed peer China Yuchai International. China Yuchai, which has a controlling interest in Guangxi Yuchai Machinery (a medium-duty diesel-engine maker in the PRC), is trading at an estimated FY2003 P/E of 14.9x.

Weaknesses

- × The Company depends heavily on shareholders and affiliates for orders. Orders from related customers/shareholders accounted for RMB1.3 billion or 36.9% of its total turnover in 2003, while the Company expects to receive orders from these parties of not exceeding RMB1.6 billion in 2004 and RMB2.13 billion in 2005.
- × Raw materials and parts purchases accounts for over 90% of the Company's cost of sales. Fluctuation in steel prices, which has been on an uptrend, does create uncertainty to the profitability of the Company although its gross margins have been stable at 22%-24% during 2001-2003 due to its economies of scale.

Recommendation: Subscribe