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CYD - Q1 2013 China Yuchai International Limited Earnings Conference Call

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**Benny Goh** *China Yuchai International Ltd - President*

**Kok Ho Leong** *China Yuchai International Ltd - CFO*

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**Joel Tiss** *Bank of Montreal - Analyst*

**Jonathan Brodsky** *Advisory Research - Analyst*

**Mohit Khanna** *Value Investment Principals - Analyst*

## PRESENTATION

### Operator

I would like now to turn the conference over to Kevin Theiss. Please go ahead, sir.

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### Kevin Theiss - *Grayling - IR*

Thank you for joining us today and welcome to China Yuchai International Limited's first quarter 2013 conference call and webcast. My name is Kevin Theiss and I am with Grayling, China Yuchai's US Investor Relations advisor. Joining us today are Mr. Benny H. Goh and Mr. Kok Ho Leong, President, and Chief Financial Officer of CYI, respectively.

Before we begin, I will remind all listeners that throughout this call, we may make statements that may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words "believe", "expect", "anticipate", "project", "targets", "optimistic", "intend", "aim", "will", or similar expressions are intended to identify forward-looking statements. All statements other than statements of historical fact are statements that may be deemed forward-looking statements. These forward-looking statements are based on current expectations or beliefs, including, but not limited to, statements concerning the Company's operations, financial performance and condition. The Company cautions that these statements by their nature involve risks and uncertainties, and actual results may differ materially depending on a variety of important factors, including those discussed in the Company's reports filed with the Securities and Exchange Commission from time to time. The Company specifically disclaims any obligation to maintain or update the forward-looking information, whether of the nature contained in this release and conference call or otherwise, in the future.

Mr. Goh will provide a brief overview and summary and then Mr. Leong will review the financial results for the first quarter of 2013. Thereafter, we will conduct a question and answer session. For the purposes of today's call, the financial results are unaudited and they will be presented in RMB and US dollars.

Mr. Goh, please start your presentation.

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### Benny Goh - *China Yuchai International Ltd - President*

Thank you, Kevin. We are pleased to report that we regained our revenue growth in the first quarter ended March 31, 2013, as revenues increased by 4.4% to RMB3.84b (US\$613.1m). Our engine sales during the first quarter of 2013 were 130,744 units compared with 131,697 units sold in the same quarter a year ago, which compares favorably against the industry decline of 6.8% in sales of diesel-powered commercial vehicles in the first quarter of 2013, as reported by the China Association of Automobile Manufacturers. Net earnings attributable to China Yuchai's shareholders increased to RMB173.5m (US\$27.7m), or earnings per share of RMB4.66 (US\$0.74), from net earnings of RMB167.9m, or earnings per share of RMB4.5 in the first quarter of 2012.



Our average sales price has increased approximately 11% between 2009 and 2012. In the first quarter of 2013, our average sales price rose 5.1% to RMB29,327 compared with the first quarter of 2012. The increase in ASP is the result of our product strategy of providing high-quality, high-performance engines with superior parts and after-sales service.

We continue to dominate the bus market in China. The bus market in China has grown by 43.3% between 2009 and 2012 rising from 354,054 units in 2009 to 507,403 units in 2012 according to the China Association of Automobile Manufacturers. In the first quarter of 2013, total bus unit sales in China increased by 6.3% to 116,338 from 109,421 in the first quarter last year. As the leading supplier of engines to the bus market, this growth trend is to our benefit.

Many local bus markets in China are ideal for our natural gas engines as school and municipal transit buses travel locally allowing easy refueling. Our main operating subsidiary, Guangxi Yuchai Machinery Company Limited ("GYMCL"), recently sold 298 units of its YC6J gas and electric hybrid engines to the Baoding Bus Company in Hebei Province. The hybrid YC6J medium-duty National IV- and V-compliant engine utilizes battery-operated motors to significantly reduce fuel consumption and emissions. We are maintaining our leading position in the Chinese automotive market with new, advanced natural gas, hybrid and diesel engines such as the YC6-K, YC6MK, and YC6J that meet or exceed the performance, quality and durability requirements of a wide range of bus models, combined with our superior service and training.

We offer customers diesel, hybrid and natural gas engines for our traditional truck, bus and agricultural markets, and new high horsepower diesel and natural gas engines to further penetrate the construction, mining, marine, and power generation markets.

Our product diversity allows us to react to changing sales opportunities. Our light-duty engine unit sales increased in the first quarter of 2013 primarily because the Chinese agriculture segment demanded more engines. Our heavy-duty unit sales rose in the first quarter of 2013 compared with a 17.4% industry sales decline in total sales of heavy-duty truck and large bus vehicles using diesel engines in the first quarter of 2013. Our sales increase in the heavy-duty sector reflected higher sales from existing customers as well as orders from new OEM customers.

In the first quarter of 2013 we increased R&D spending by 15.8% to RMB94.9m (US\$15.1m). We have been the domestic leader in emissions technology for a number of years and our new products continue to provide advanced engines to capture market share. For example, the National IV emission standard for diesel engines is to be implemented throughout China on July 1, 2013, but we had already in 2007, supplied engines compliant with the National IV and V emission standards to Beijing Public Transportation Holdings. We are again ahead of the curve with domestic engines capable of meeting the National IV and V emission standards.

Additionally, our new high horsepower diesel and natural gas engines are designed to penetrate the promising marine, power generation, mining and construction markets with heavy-duty engines much larger than we offer in the truck and bus markets. Both the YC6T and 40-liter YC6C model target the marine propulsion, power generators, construction and mining trucks markets. The YC6CL is a 54-liter version of the YC6C engine and is expected to be launched this year. The new YC6MJ model is an upgrade over the YC6M engine at 11.7 liters for use in mining, marine and power generation applications. The YC12VT is a 12-cylinder, 33-liter version of the YC6T engine for use in the power generator, marine and industrial markets, and it is expected to be launched next year in 2014. Finally, the YC4S engine is a new platform at 3.8 liters for use in highway vehicles and industrial engines.

In 2013, 12 new engines were introduced and are expected to be launched, of which seven are National V-compliant natural gas engines and five are National IV-compliant diesel engines with two targeting the trucking industry. These 12 engines will provide our customers with new capabilities as we seek to capture additional market share.

Let me now provide an update of our joint ventures.

As the trend is for more sales in the light-duty vehicle space, testing continues on the new 4D20 diesel engine for use in passenger cars and light-duty vehicles at our joint venture with Geely located in Jining, Shandong Province. Tests on the second-generation prototype engine are expected to be completed during the summer of 2013.



The long-term outlook for heavy-duty engines remains attractive. Our CIMC-Chery joint venture is building a suite of diesel and natural gas engines based on the next-generation YC6K engine design. The YC6K engine offers customers strong performance with low emissions. Larger and more powerful engines based on the YC6-K design, in the 10-, 12- and 13-liter size, are being built to address the needs of heavier and larger vehicles. These engines complement our existing portfolio of 6L, 6M, 6G and 6MK heavy-duty engines as our goal is to become one of the largest producers of heavy-duty engines in China.

Our "green" remanufacturing joint venture with Caterpillar has begun full operations at its permanent facility in the Suzhou Industrial Park. The remanufacturing of engines saves raw materials and reduces production waste compared with manufacturing a new engine. Our remanufacturing joint venture will leverage our network of over 3,000 service stations, the largest service network in China, to enable us to extend our reach as wide as possible.

We continue to produce positive operating cash flow to support our investment in new products, research and development, and manufacturing capabilities. During the first quarter of 2013, we generated net cash flows from operating activities of RMB287.8m (US\$45.9m), and invested RMB150.5m (US\$24.0m) in property, plant and equipment. In 2012 last year, we generated net cash flows from operating activities of RMB1.51b (US\$241.1m), and invested RMB643.5m (US\$102.6m), in property, plant and equipment. As we generate cash from our operations, we believe in continually investing in and growing the business.

Also, our new natural gas engine production facility is expected to be completed in the second half of 2013. In 2012, as a leader in natural gas engines, we sold approximately 20,000 natural gas engines, up from 13,000 in 2011. The combination of new natural gas engines and expanded production is expected to generate significant growth over the next few years.

Based on our number of unit sales, we continue to be the leader in the commercial engine business in the first quarter of 2013. With our new and existing portfolio of engines, we are now better positioned to defend our dominant market share in the bus market, capture market share in the truck market when it rebounds, and become a leading supplier to the off-road markets as well. We believe our diversification strategy, combined with superior R&D and service, provides us with a strong competitive advantage.

With that, let me now turn the call over to Kok Ho Leong, our CFO, to provide more details on our financial results.

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**Kok Ho Leong - China Yuchai International Ltd - CFO**

Thank you Benny. Let me first walk you through our unaudited first quarter 2013 financial results and then we can begin the Q&A session.

Net revenue for the first quarter of 2013 was RMB3.84b (US\$613.1m), compared with RMB3.68b in the first quarter of 2012. The increase in net sales was RMB161.7m, or 4.4% as compared with the same period in 2012. GYMCL's engine sales during the first quarter of 2013 was 130,744 units compared with 131,697 units in the same quarter a year ago, representing a decrease of 953 units or 0.7%. Gross profit was RMB777.3m (US\$124m), compared with RMB779.4m in the first quarter of 2012. Gross margin decreased to 20.2% in the first quarter of 2013 as compared with 21.2% a year ago. In the first quarter of 2013, the lower gross profit and margin were mainly attributable to the shift in sales mix to more light-duty engine sales.

Other income was RMB20.9m (US\$3.3m), a decrease of RMB5.1m from RMB26.0m in the first quarter of 2012. The decrease was mainly due to foreign exchange revaluation losses in this quarter as compared with foreign exchange gains in the first quarter of 2012.

Research and development ("R&D") expenses were RMB94.9m (US\$15.1m), compared with RMB81.9m in the first quarter of 2012, an increase of 15.8%. As a percentage of net revenue, R&D spending rose to 2.5% compared with 2.2% in the first quarter of 2012. The increase in R&D expenses was mainly due to the development of new engines as well as continued initiatives to improve engine quality.

Selling, general and administrative ("SG&A") expenses were RMB364.4m (US\$58.1m), down from RMB376.4m in the first quarter of 2012, a decrease of RMB12m or 3.2%. SG&A expenses represented 9.5% of first quarter 2013 net revenue compared with 10.2% in the same quarter a year ago.



Operating profit declined to RMB338.9m (US\$54.1m), from RMB347.2m in the first quarter of 2012, mainly due to lower gross profit and higher R&D expenses, partially offset by reduced SG&A expenses. The operating margin was 8.8% compared with 9.4% in the first quarter of 2012.

Finance costs declined to RMB34.2m (US\$5.5m) from RMB75.4m in the first quarter of 2012, a decrease of RMB41.2m or 54.6%. The decrease was due to less bills discounting and lower interest costs related to RMB1.0b of short-term financing bonds ("STFBs") outstanding at a lower interest rate in the first quarter of 2013, compared with outstanding STFBs totaling RMB1.39b issued at higher interest rates in the first quarter of 2012.

The share of joint ventures was a loss of RMB15.8m (US\$2.5m), compared with a loss of RMB16.7m in the first quarter of 2012.

In the first quarter of 2013, total net profit attributable to China Yuchai's shareholders was RMB173.5m (US\$27.7m), or earnings per share of RMB4.66 (US\$0.74), compared with RMB167.9m, or earnings per share of RMB4.5 in the same quarter in 2012.

Let me now go to the balance sheet highlights at March 31, 2013. Cash and bank balances were RMB3.27b (US\$521.3m), compared with RMB3.16b at the end of 2012.

Short and long-term borrowings were RMB2.44b (US\$388.8m), compared with RMB2.45b at the end of 2012.

Net inventory was RMB2.36b (US\$377.2m), compared with RMB2.01b at the end of 2012.

With that, operator, we are ready to begin the Q & A session.

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## QUESTIONS AND ANSWERS

### Operator

Thank you. We will now begin the question and answer session. (Operator Instructions).

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### Benny Goh - China Yuchai International Ltd - President

Okay, while we're waiting for the first questions, we've got some questions online. The first question here is asking about our Jining joint venture passenger vehicle engines. The question reads, when do you expect to begin deliveries of the 4D20 engines to Geely? And also, is the JV with Geely going to produce engines of various sizes, 1 liter, 1.5 liters, 2.0 liters and 2.2 liters?

The answer here is this. Right now we are currently in our second prototype and we expect to complete the trial runs in the fourth quarter of this year, so we will be begin production, ramping up production at the beginning of 2014.

As to the question of whether we have the requisite different sizes, currently we our main engine is 2.0 liters and it can be upgraded to 2.2. liters and we do have the 4W engine which is 1.2 liters and also 1.4 liters as well.

Operator, are there any questions from the phones?

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### Operator

(Operator Instructions).



**Benny Goh** - *China Yuchai International Ltd - President*

Okay, there's a question about export markets which asks about, what are the engines being sold to the (inaudible) export market in Vietnam and Peru?

For the Vietnam market we are selling primarily buses and trucks, this is also in conjunction with our OEM customers as well, whereas in Peru we are going into the bus as our main export product over there.

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**Operator**

Thank you. Our first question comes from the line of Joel Tiss from Bank of Montreal. Please go ahead.

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**Joel Tiss** - *Bank of Montreal - Analyst*

Hi, how are you?

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**Benny Goh** - *China Yuchai International Ltd - President*

Hi, good morning.

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**Joel Tiss** - *Bank of Montreal - Analyst*

I wondered if, just two areas I wanted to ask about. Can you talk a little bit about the outlook for the off-highway market, growth rates for 2013 and 2014 and any update you can give us on where the industry inventory levels are?

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**Benny Goh** - *China Yuchai International Ltd - President*

Okay. The off-highway market has obviously been going through a very difficult time last year and that continued to persist up to this quarter. In fact, we are seeing that as a very tough time. You can see that a lot of the construction -- off-road engines are really piling up in the supply chain as well.

As for 2013, the general optimism was that a change of government would have stimulated some projects and that will create this demand for off-road. Unfortunately, that has not taken place yet and we are all hoping that things will start to pan out towards the second half of the year. But, again, we are all very cautious about this whole development.

For 2014, we believe that there will be a much better outlook as things will be much clearer by that time.

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**Joel Tiss** - *Bank of Montreal - Analyst*

Thank you.

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**Operator**

Our next question comes from the line of Jonathan Brodsky from Advisory Research. Please go ahead.

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**Jonathan Brodsky** - *Advisory Research - Analyst*

Good evening, guys, how are you?

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**Benny Goh** - *China Yuchai International Ltd - President*

Hi, good evening, how are you?

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**Jonathan Brodsky** - *Advisory Research - Analyst*

Okay, thank you. Coming back to the balance sheet, can you talk a little bit about the receivables? They've been stubbornly high now for quite some time. Can you give us outlook on that? Are you seeing any issues with collections, timeframe, whether or not you're going to move towards factoring as interest rates go up? I'm just wondering what your perspective is on that. Then I have a follow-up question after that.

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**Kok Ho Leong** - *China Yuchai International Ltd - CFO*

Just to refresh numbers, the trade and bills receivable was RMB7.2b compared to December, RMB6.6b. If you look at this line item, they consist of two items; one is the open account, which is the account receivables and the other one is actually bills receivables. And our balances are RMB7.2b, a large part of it, and I would say a substantial part of it is actually bills receivables. These are bank-backed instruments that we can use for discounting.

So if you say our trades and bills receivables why is it so high? One of the reasons is we will not discount any bills. We will discount when we need the funds and also when the interest rate is acceptable.

So, if you look at our cash balances, we still remain at a very healthy level at RMB3.3b as compared to the year-end of RMB3.2b. And that's the reason why you see we did not discount for these bills receivables. So I can say with confidence our ageing in the receivables are very healthy. By comparison those that are in the long overdue are very small amounts.

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**Benny Goh** - *China Yuchai International Ltd - President*

So if I can just add some color to what Kok Ho has just said. If you look at the pure accounts receivables, those that are beyond three months are actually less than 10%, so this is a highly, a very commendable effort by the team over there. So what we are seeing here is that all our accounts receivables are all collectable within three months.

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**Jonathan Brodsky** - *Advisory Research - Analyst*

As a follow-up, I have two follow-up questions. One is, in looking at the increase in inventories, that's the first time I think we've seen an uptick in inventories in a couple of quarters. Is that a good indication on where you think things are going over the next few months?

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**Benny Goh** - *China Yuchai International Ltd - President*

Yes, that's right, in fact we are seeing some pull from the OEM customers and that's why we are stocking up some of our inventories. But by and large, our inventories are in the whole system, they're not actually more than 30 days, so the uptick is still relatively small.

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**Jonathan Brodsky** - *Advisory Research - Analyst*

And finally, as it relates to the high-end engines, I heard some talk about some of the European players coming into the market with very, very high-end quality engines. Can you talk about that in terms of competitiveness and what you're seeing?

**Benny Goh** - *China Yuchai International Ltd - President*

I think by and large, the foreign players see China as a very attractive market and it's no secret that they have always wanted to enter this very highly lucrative market. But given the current situation today, as you can see, there is obviously overcapacity and the demand for high-end engines is still relatively low. It will be a bit of a challenge for these guys to come in immediately. I would see them as probably trying to do some sort of partnership with a local player, if anything.

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**Jonathan Brodsky** - *Advisory Research - Analyst*

Thank you very much.

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**Benny Goh** - *China Yuchai International Ltd - President*

You're welcome.

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**Operator**

Thank you. Our next question comes from the line of Mohit Khanna from Value Investment Principals. Please go ahead.

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**Benny Goh** - *China Yuchai International Ltd - President*

Hi, Mohit.

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**Kok Ho Leong** - *China Yuchai International Ltd - CFO*

Morning.

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**Mohit Khanna** - *Value Investment Principals - Analyst*

Hi guys, morning. I had a question regarding the natural gas engines. Are you guys seeing more traction in other cities going forward and what are the real margins on heavy duty natural gas engines as compared to the diesel engines?

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**Benny Goh** - *China Yuchai International Ltd - President*

Well, natural gas engines to us presents the major attraction for the whole suite of business that we have. We see a great demand, especially in the buses and also in the heavy-duty segment. And by and large, our natural gas engines today are commanding the premium margins that we command today and it has actually helped us a lot in our average selling price.

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**Mohit Khanna** - *Value Investment Principals - Analyst*

Right, right. Can you give a mix of approximately how many natural gas engines have you guys sold in this current quarter?

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**Kok Ho Leong** - *China Yuchai International Ltd - CFO*

This quarter we sold 6,000 of our natural gas engines which is actually almost 50% higher than last year in the same timeframe.

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**Mohit Khanna** - *Value Investment Principals - Analyst*

Right, right. Thank you, thank you so much, guys.

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**Benny Goh** - *China Yuchai International Ltd - President*

You're welcome.

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**Operator**

(Operator Instructions). Our next question comes from the line of Joel Tiss from Bank of Montreal. Please go ahead.

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**Joel Tiss** - *Bank of Montreal - Analyst*

Hi, I just wanted to ask one follow-up. Can you talk about the enforcement of the emission standards starting in July? Do you think that's something that's going to be enforced or is it going to be very difficult for the government to enforce those new emissions standards?

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**Benny Goh** - *China Yuchai International Ltd - President*

Yes, in fact, there's quite a lot of speculation whether this is going to be, or shifted or not. Now the whole National IV regulation is stimulated by two major departments in the government. One is the EPA and the other is by the Ministry of Industrial Information Technology. Now, quite obviously, from the environmental angle this is a very important initiative and the first of July will be definitely a go ahead.

Now, what has caused an impact is that the diesel availability within the whole market is still not all the way through and so what we are anticipating is that the enforcement of the National IV may not be total across the whole of China. So what I mean is that, basically in the Tier 1 and Tier 2 cities it will be strictly enforced, but for the other parts of China, that may be less regulated. So we expect probably around a six-month timeframe before total enforcement is put in place.

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**Joel Tiss** - *Bank of Montreal - Analyst*

Great. Thank you.

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**Benny Goh** - *China Yuchai International Ltd - President*

You're welcome.

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**Kok Ho Leong** - *China Yuchai International Ltd - CFO*

Okay, there's a question from Neil. The question reads, when will the dividend be announced?

Okay, as of to date we have not make any announcement. As usual, when it's formal, we will make the announcement. If you look at our 20-F, we did mention that our main operating company, that is GYMCL, the factory in Guangxi, they have approved the dividend from our operating entity to us. That's as much I can update to you at the moment.

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**Benny Goh** - *China Yuchai International Ltd - President*

There's a question here that asks about how many marine engines were sold in the first quarter?

The marine engines we sold in the first quarter is about 1,500 this time around. Actually, last year we saw a huge demand for marine engines and this year we continue to see the same trend.

Operator, any more questions from the phone?

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**Operator**

We have now reached the end of our Q&A session and I will turn the call back over to Mr. Goh.

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**Benny Goh** - *China Yuchai International Ltd - President*

Okay. Thank you all for participating in our first quarter 2013 conference call, and we look forward to speaking with you again. Good-bye.

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**Operator**

Thank you. Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may all disconnect.

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