

# Market Strategy

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## 2004 MARKET STRATEGY

### *Investment Theme #3: The China Boom*

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We have selected the China economic boom as our 3rd investment theme for 2004. Across the region today, we are seeing substantial investor interest in mainland Chinese companies listed on the New York, Hong Kong and Singapore exchanges.

It is not difficult to comprehend why the "China boom" theme was a favorite and recurring theme in Asian bourses throughout 2003. With an economy that has charged forward at an average rate of 7% per year in the last five years and that will probably grow 9.1% in 2003 despite SARS, this is hardly a surprise. China, it can be argued, has the world's most compelling growth story. And as it rises, China is shaking all kinds of markets all over, from driving up prices of commodities from copper to gas to sucking in billions of dollars of investments from foreign multi-national corporations.

Little wonder, then, that institutional investors all over the world are also clamoring for China stocks. The fact that Chinese shares have been shooting through the roof this year is another lure for foreign portfolio investors into China. The Bank of New York's China index, a composite for shares of 25 Chinese companies traded on New York exchanges as American depository receipts, has climbed 55% for the year, while the broader MSCI Golden Dragon Index has risen nearly 40%.

Across the causeway too, mainland China companies that are listed on the Singapore Exchange ("SGX"), including SESDAQ, are enjoying tremendous interest from investors there. And many of these shares have posted spectacular capital gains for investors in 2003.

We believe the "China boom" theme would continue to dominate in 2004. Unusually, this theme does not seem to have caught on with investors in the Kuala Lumpur Stock Exchange ("KLSE").

Why the lack of such interest on the KLSE? The most obvious answer is that there are no mainland Chinese companies listed on the KLSE. The Securities Commission's efforts to woo foreign-incorporated companies to list on the KLSE have thus far been fruitless.

There is also the misperception that there are no Malaysian companies with significant exposure in China. While there are Malaysian companies selling their goods and services to China, such as the export of palm oil products by Malaysian plantation companies, there are few Malaysian companies with manufacturing operations inside China itself and catering to the Chinese and export markets.

So where do all these leave for the Malaysian institutional investor, whom, because of exchange controls, are not allowed to invest in foreign markets without the prior approval of Bank Negara Malaysia. And even when allowed, the local institutional funds are not permitted to invest more than 5% of their total funds under management in overseas approved bourses.

But there is a way for local institutional fund managers to play the China boom, and that is to buy into Malaysian-owned and KLSE-listed companies that have significant manufacturing operations in greater China (i.e., including the two Special Administrative Regions of Hong Kong and Macau) and that are selling to the Chinese market (both domestic demand as well as to multi-national corporations based in China) and/or selling to multi-national corporations in places such as Japan, Korea, Taiwan and the United States of America.

But we are not talking about Malaysian companies that are merely exporting to China (otherwise we would have the whole gamut of plantation companies as "China plays") but rather, we are looking for Malaysian companies with substantial manufacturing operations in China that are contributing in a meaningful way to their bottom-lines. In the next few pages, we attempt to identify KLSE-listed companies with interests in China that are contributing to their respective bottom-lines. Malaysian companies where China is an integral part of their overall strategy are also included in our list.

That said, our list is by no means exhaustive, nor does it reflect our stock preferences. And while we are able to come out with more than 20 names, sadly, the majority do not have meaningful presence or operations in China, or that their exposure in China are still at a very nascent stage of earnings contribution.

Still, there are some stocks that stand out and which we believe are good or excellent proxies (including those with potential) to the Chinese market and booming economy. Investors looking primarily for Malaysian stocks with China exposure might want to consider the following stocks:

- 1) AKN Messaging Technologies Bhd
- 2) Kwantas Corporation Bhd
- 3) LBS Bina Group Bhd
- 4) Malaysian AE Models Holdings Bhd
- 5) OYL Industries Bhd, and
- 6) Transmile Group Bhd

Other Malaysian companies with significant interests in China but for which we have yet to initiate coverage but which are potentially interesting are:

- 1) Ire-Tex Corporation Bhd (soon-to-be-listed)
- 2) Lion Diversified Holdings Bhd, and
- 3) Salcon Bhd

Interestingly, companies involved in sewage and water treatment and/or distribution seem to have a penchant for expanding their reach into China. At least 4 water & sewage and water-related companies in Malaysia have to date entered into joint venture agreements with mainland Chinese partners to undertake sewage treatment and water production, treatment and distribution in various cities in China. These companies include:

- 1) PBA Holdings Bhd
- 2) PPB Group Bhd
- 3) Salcon Bhd, and
- 4) YLI Holdings Bhd

Company	Recommendation	Description of Operations in China (including Hong Kong & Macau)
<b>AKN Messaging Technologies</b>	<b>BUY</b>	Its venture into China would be via its soon-to-be-completed merger with Messaging Technologies (HK) ("MTech HK"), a Hong Kong company that offers similar services as AKN Messaging Technologies Bhd ("AKN MTech"). MTech HK has signed a MOU with Golden Bridge Network in Xiamen to launch a complete range of mobile content and applications in partnership with China's mobile network operators. The company is already negotiating joint venture agreements with China Mobile and China Unicom. MTech HK expects to roll out its service in 2Q 2004. China has some 250m mobile subscribers and this offers tremendous opportunities for MTech HK.
<b>APM Automotive Holdings</b>	<b>N.R.</b>	APM Automotive has a 60% subsidiary in China that is involved in the manufacture and sales of automotive seats, interior part and metal components. This subsidiary started operations in 2002 but has only just broke-even in 3Q03.
<b>Astro All Asia Networks</b>	<b>HOLD</b>	Its 100%-owned subsidiary, Celestial Pictures Ltd, recently signed an agreement with Galaxy Satellite Broadcasting Ltd of Hong Kong for distribution of its Celestial Movies Channel in Hong Kong beginning January 2004. In addition, Celestial also has video distribution agreements with distributors in Hong Kong and the People's Republic of China. However, earnings contribution from these distribution agreements is expected to be minimal.
<b>Eng Teknologi</b>	<b>HOLD</b>	Eng Teknologi has an office in Hong Kong and operates a factory in Dongguan, China. The China factory currently enjoys orders for over-mould actuators from Maxtor. Its Hong Kong/China operations contribute about 25% of group revenue.
<b>Globetronics Technology</b>	<b>HOLD</b>	Globetronics has just started a small semiconductor assembly and test outfit in Jiaxing, Zhejiang, China. The company is expected to shift some of its equipment from its Penang plant to China in the next six months. But contribution is not expected to be significant. On the contrary, it is likely to record small losses in its first year of operations.
<b>Ire-TeX Corporation</b>	<b>N.A.</b>	This polymer-based materials maker, which is en route to a listing on the 2nd Board, expects to further expand its China operations as well as penetrate India next year. The company now has 4 plants in Malaysia and 2 in China (in Xiamen and Suzhou). It plans to venture into Zhuhai, China and Bangalore, India in 2004. Its existing China operations currently contribute about 40% to group turnover.
<b>Kim Hin Industry</b>	<b>N.R.</b>	Kim Hin Industry is one of Malaysia's largest ceramic tile producer and distributor with factories in Kuching and Seremban in Malaysia and one in Jinshan County, Shanghai, China. Its China plant / subsidiary has a rated production capacity of 2m square meters (2 lines of 1m m <sup>2</sup> each) but is currently running at only 50% utilization. However, it plans to double the output at its China plant in 2004 with the additional products for exports to Australia, Canada, USA and Japan. Its 71.5%-owned Chinese subsidiary reported a net profit of RM1.9m or 6.4% of group net profit before minority interest in FYE12/02.

Company	Recommendation	Description of Operations in China (including Hong Kong & Macau)
Kwantas Corporation	BUY	Kwantas is building an edible oil refinery in China, which is due for completion in mid-04. The refinery in China will have a capacity of 250,000 tons per year and costs about RM15m to build. Given the fact that this refinery will be able to refine soybean oil as well as crude palm oil and that demand for vegetable oil in China is expected to remain strong, we anticipate this refinery to begin contributing to profits from FY05 onwards. Moreover, refining margins achieved in China is double that of Malaysia, given the cheaper operational costs. Kwantas estimates the investment return (ROI) on this refinery to be in the range of 30-35% p.a.
LBS Bina Group	BUY	LBS Bina has an option to buy a 60% stake in a property development joint venture in Zhuhai, China at only US\$1. The JV is already operating an F3 racing circuit and a 36-hole golf course. The jewel is the 300-acre piece of land held for development in Zhuhai given the strong economic growth and shortage of landed properties in that city. The property development project has a potential gross development value (GDV) of RMB3 - 4bn (about RM1.4 - 1.9bn). Land titles for the racing circuit and golf course have been transferred to the JV and LBS is working round the clock to secure the land title for the 300-acre land before exercising its option.
Lion Diversified Holdings	N.R.	The company proposed last September to acquire the Parkson Retail Group that involves the acquisition of the entire equity interests in a group of 6 companies incorporated in Singapore, 3 companies incorporated in Malaysia and 1 company incorporated in Hong Kong SAR, which are retail based companies in China and Malaysia for RM431.8m. Parkson Retail China operates a total of 36 outlets of which 33 are Parkson stores, 2 hypermarkets and 1 shopping center in various locations such as Beijing, Shanghai, Dalian, Xian, Wuxi and Sichuan. The Parkson Retail Group posted a net profit of RM37.6m in 2002.
Malayan Banking	BUY	Maybank is the only Malaysian-owned bank to have a full banking license in China. It has a branch in Shanghai but operations are still very small. Its Chinese loan assets represent only about 0.15% of the Maybank group's gross loans book.
Malaysian AE Models Holdings	BUY	The company has a plant in Suzhou, China that assembles modular conveyors and bulk handling conveyor systems. As at Dec 2003, MAE has an order book of RM110m of which RM30m are from China. In FYE5/03, the company saw revenue from China rise to 23% from just 5% in FY02. Management sees tremendous opportunities to supply material handling systems to China's logistics and food & beverage industries.
Oriental Holdings	SELL	The Group owns a subsidiary in China that is involved in plastic injection molding. Its operations in China currently contribute only about RM2m in pretax profits (or 0.8% of total PBT) to the group. But this quantum would increase with the group's planned expansion in China. They have just bought over a second plant in Suzhou and a piece of land in Wuxi, which they plan to use to build a third plant.

Company	Recommendation	Description of Operations in China (including Hong Kong & Macau)
OYL Industries	<b>BUY</b>	OYL Industries has two plants in China (Wuhan and Shenzhen) catering to the bustling domestic market. Due to rising demand, the company is in the process of building its third plant in Suzhou. Once this plant is completed by end 04, it will provide additional capacity to meet the strong domestic demand as well as to venture into other new Asian markets and expand its product range in the US and Europe markets. The new plant is expected to make a significant impact on the group's earnings in FYE6/05.
PBA Holdings	<b>N.R.</b>	Pinang Water Ltd ("PWL"), in which PBA Holdings Bhd has a 26% equity interest, signed its first Build, Operate and Transfer (BOT) agreement with the People's Government of Yichun City, Jiangxi Province, China on 13 July 2003 for the construction of a 100m liters a day (100,000 m <sup>3</sup> per day) water treatment plant ("Yuan He Water Treatment Plant"). PWL also signed a Sale of Water agreement to supply treated water to the Yichun Water Supply Company for a period of 29 years from the practical completion date of the project. However, earnings (in the form of share of profits of associates) from this joint venture is not expected to be significant for PBA Holdings.
PPB Group	<b>N.R.</b>	Last July, a consortium comprising Kerry Utilities Ltd ("KUL"), a 50%-owned subsidiary of PPB Group Bhd, won the bid for the RMB201m (RM92.3m) Lugouqiao Sewage Treatment Plant project in Fengtai District, Beijing, China. Pursuant to the award, the consortium, in which KUL holds 51% equity interest, will form a business association with Beijing Municipal Water Discharge (Group) Co Ltd ("BMWDG") to jointly fund the construction of the sewage treatment plant with a treatment capacity of 100,000 m <sup>3</sup> per day in preparation for Olympics 2008. The consortium will raise RMB84.7m (RM38.9m) for the project while BMWDG will fund the balance with loans from the World Bank. The Business Association will assume the operations and maintenance of the plant for a concession period of 20 years commencing July 2004. This project is expected to generate total revenue in excess of RMB1 billion (RM459m) over the concession period.
Salcon	<b>N.R.</b>	Salcon holds a 75% equity interest in Shandong Changle Salcon Water Supply Company ("SCSWS"). Salcon has to date invested US\$1.44m (RM5.5m) into SCSWS, whose principal activity is to acquire, construct, manage & operate the water production & distribution systems including the sale, billing and revenue collection of water in Changle County, Shandong Province, China for a concession period of 50 years.
SDKM Fibres, Wires & Cables	<b>N.R.</b>	The audiovisual and PC accessories company is currently outsourcing some of its products to a Guangdong-based company in which it has management control. Plans are afoot to set up an operating center in China that will lower inventory cost and shorten transportation time to its clients in Japan.
Sime Darby	<b>HOLD</b>	Sime Darby is in the heavy equipment and motor vehicle distribution business in China, where it holds the dealership for Caterpillar heavy equipment, and the BMW, Mini Cooper, Ford, Rolls-Royce and Mitsubishi franchise or dealerships for passenger cars. Its China operations contributed 2% to group pretax profit in FY03.

Company	Recommendation	Description of Operations in China (including Hong Kong & Macau)
Southern Steel	HOLD	The company has rolling mills in Xiamen, China that supplies steel rods and bars mainly to cater to the China market. Southern Steel does not manufacture billets in its China production plant, but rather, billets are purchased either from primary steel producers or imported. We understand that the operations are running at full capacity to cope with strong demand. In future, there may be further plans to expand its operations in China.
Thong Guan Industries	N.R.	The company has manufacturing operations in Suzhou, China, which is currently being expanded to include a second facility. The expansion will increase its total rated capacity in China to 18,000 metric tons of plastic film products per year. Commercial production of the second plant is slated to start in 1Q 2004. In addition, the company is in the midst of negotiations to start another facility in China in a joint venture with a Japanese company. This second facility will manufacture goods for the Japanese and South Korean markets.
Transmile Group	BUY	China currently contributes around 30% of Transmile Group Bhd ("Transmile")'s revenue and this percentage is expected to increase over the next few years. Transmile currently has 6 landing rights in China but has only utilized one, flying to Shenzhen 7x weekly from only 5x weekly in early-03. Transmile is expected to start flying the "Kuala Lumpur-Penang-Shanghai" round trip for a multi-national corporation, possibly in early-04 but would still have 4 unutilized landing rights in China. Furthermore, Transmile is also expected to sign a charter contract with Air Macau to fly the "Taipei-Macau-Shanghai" round trip sometime in 1Q 2004.
YLI Holdings	N.R.	YLI Holdings owns a 37% equity interest in Pinang Water Ltd ("PWL"), an associate company of PBA Holdings Bhd. [Please see further comments under PBA Holdings Bhd above].