

Equity Research | China | Glass

7 October 2016

Margin expansion likely to continue

- We initiate coverage on Xinyi Glass (“XYG”) with a BUY rating and target price of HKD8.0, pegging on 10x 2016E PER.
- XYG is likely to maintain solid sales growth in 2H16 driven by the pent-up orders, along with improving margins on lower energy prices and rising prices.
- Trading at 2016E 8.6x PER, we see ample room for re-rating of XYG’s valuation with potential catalyst including the launch of phase II float glass project in Malaysia, M&As and a hike in dividend.

Beneficiary of pent-up domestic demand and de-capacity. We believe XYG would benefit from the domestic consumption demand growth for its high quality float glass products. The substantial GFA under construction would serve as pent-up orders for future delivery of construction glasses. On the supply-side, we believe the continued industry consolidation would benefit the larger players such as XYG, with the smaller producers subsequently gradually exit the industry.

Solid volume growth and margin expansion sustainable in 2H16. XYG benefited from the downward adjustment of city gate prices for natural gas, which can account for up to 40% of its float glass cost component, and this has been reflected in its 1H16 results. With the potential of further revising down the prices, the recent upsurge in float glass prices would become a major catalyst driving expansion of its margins next year. Meanwhile, in light of completion of relocation of its auto glass capacity, we foresee solid sales growth of all three of its business segments, i.e. float, Low-E and auto glass, in the coming year.

Strong balance sheet provides leeway for potential M&As or dividend. Apart from having started to ramp up its float glass capacity in Malaysia in 4Q16, XYG would have also maintained a low capex budget for the coming two years. We foresee its NDE ratio to remain healthy at the current levels going forward. Considering the significant improvement in its operating cashflow this year, we believe the management would able to start to look at inorganic growth, or even further raise its payout ratio.

Initiate coverage with BUY, re-rating catalysts ahead. XYG is trading at merely 1.9x 2016E PBR and 8.6x 2016E PER, which is below the mean level and at the lower end of the historical range during 2011 and 2016 respectively. Given its earnings growth prospects, underpinned by the continuous expansion in its construction glass margin which is on track to return to the record high levels of 2013 with dividend yield estimated at 5.6% for 2016E, we believe there is ample room for re-rating of its valuation. We initiate coverage on XYG with a Buy rating and set our target price at HKD8.0, representing 10.0x 2016E PER (or 11.5x 2016E ex-Xinyi Solar PER).

Xinyi Glass (868 HK)

Buy

(initiation)

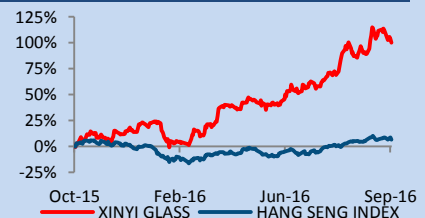
Price Target	HK\$8.0
(Revision)	(Nil)
(upside)	(12.7%)

EPS	2016E	2017E
revision	(+/-%)	(+/-%)

Close price	HKD7.10
Market cap.	HKD27,600 mn
Free float	42.76%
52-week range	HKD3.25 – 7.73
3-mth ave. T/O	HKD91.28 mn

Price as of 6 October 2016

Stock rel HSI performance (%)



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What is different from other supply-side reform stories?

Compared to other overcapacity industries, the glass industry in China is highly fragmented and dominated by a large number of private enterprises. In May 2016, the State Council issued a guideline to optimise the industrial structure of China's building materials sector. The guideline mandated further cutting the industrial capacity of cement and glass by 2020, with the aim of the top 10 cement and glass manufacturing enterprises constituting 60% of market share. Meanwhile, on the demand side, the government's promotion of energy-saving building materials will continue to boost demand for double-glazing low-E glasses. More importantly, it would benefit as NDRC to reduce natural gas prices to mitigate energy costs effective from last Nov.

Where is the catalyst and risk?

Property construction investment rebound has been the major consumption growth driver for the materials sector YTD. Market has concerns about the recent reversal of certain property market stimulate policies. We believe consumption growth of construction glass would probably slow down, but would remain considerably high as compared to last year. Considering construction glass is usually consumed in the later stage of the construction cycle, based on the total gross floor area under construction of 7.0bn m² as of end-June, glass demand would still be well-boldded into next year. Besides, we believe margin expansion driver would shift from cost savings during interims towards surging selling prices from 2H16 onwards. Float glass in terms gross profit contribution increased to 29% of total gross profit during 1H16, up from merely 13% in 1H15. We see room for further improvement in gross profit margins of float glass from the current levels towards an all-time high of 35% in 2010.

1H16 results review

XYG's turnover grew by 11% YoY to HKD5.885bn in 1H16, mainly driven by the strong growth of the float glass business due to the improving domestic property market amid a better product mix, as well as steady growth of the automobile glass business. Gross profit increased by 45% YoY to HKD2.041bn whilst gross profit margin grew to 35%, thanks to lower material costs, energy costs and enhanced production efficiency. Lower float glass production cost had also led to improvement in the gross profit margins of the automobile glass and construction glass businesses. Accordingly, net profit surged 45% to HKD1.369bn with net profit margin rising to 23%, primarily driven by strong float glass growth, widening margins and substantial increase in profit contribution from Xinyi Solar (968 HK).

Construction glass

XYG is China's largest supplier of high-quality float glass and a leading Low-E glass manufacturer in China. According to the Energy Development Strategy Action Plan (2014-2020), 50% of new buildings developed in cities and towns will meet green building codes by 2020. An Action Plan was issued by the government in September 2015 with the goal of green building materials to account for 20% of the industry's total revenue in 2018. The contribution of construction glass businesses accounted for 23% of the company's total gross profit in 1H16, down from 27% in 1H15.

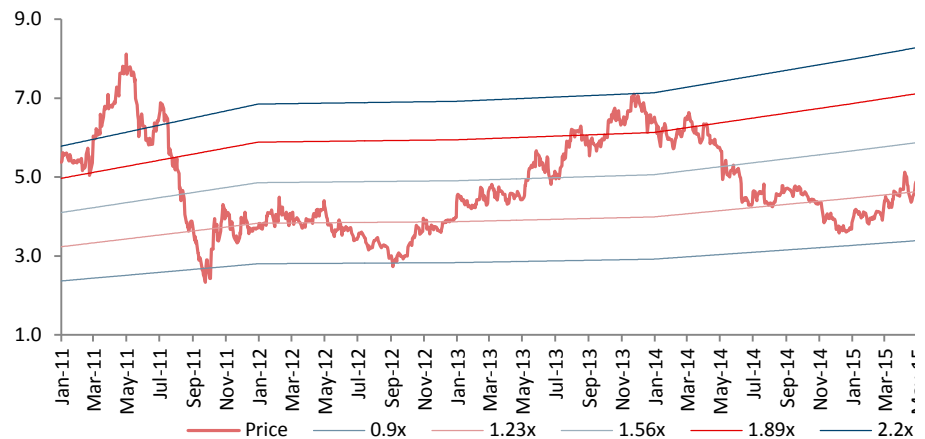
Automobile glass

XYG is also China's largest exporter of automobile glass in the aftermarket sector. Management remains optimistic about increasing its market share in the automobile glass aftermarket and alliances with auto insurance companies. XYG had spun off its Xinyi Automobile Glass Hong Kong Enterprises Limited (8328 HK) for a separate listing on the GEM board on 11 July 2016. In 1H16, despite segment contribution to total gross profit shrank to 47% from 59% in 1H15, mainly due to a slower pace of growth relative to float glass and construction glass, segment margin came in at a record high of 48.7%.

Valuation

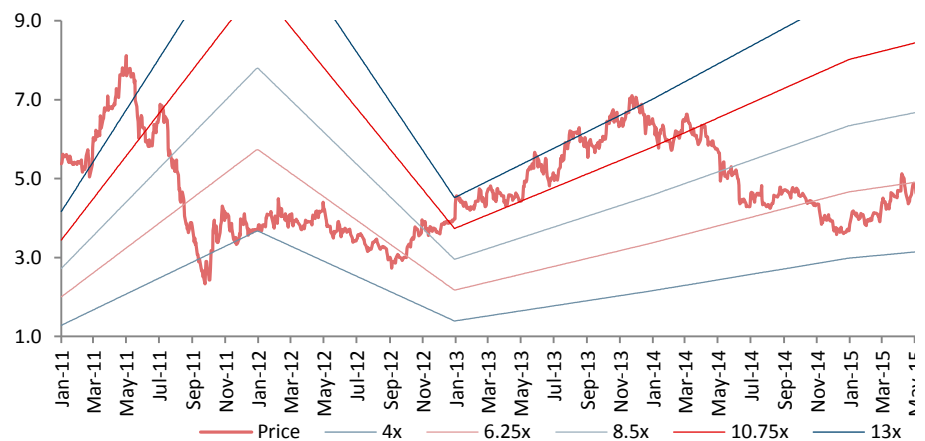
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Figure 1: PBR Band



Source: Bloomberg, CSCI Research estimates

Figure 2: PER Band



Source: Bloomberg, CSCI Research estimates

Figure 3: Peer Comparison

Company	Ticker	Close Ccy (Local\$)	Mkt cap (US\$b)	PER (x)		EPS Growth (%)		PBR (x)		ROE (%)		EV/EBITDA (x)		Yield (%)	Net debt / Equity (%)	
				2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E			
Glass																
Fuyao Glass	3606 HK	HKD	22.8	6.5	8.1	16.9	13.4	3.2	3.0	17.3	18.2	9.3	8.0	3.4	2.2	
Xinyi Glass	868 HK	HKD	7.1	3.6	8.6	7.8	52.8	11.3	1.9	1.7	22.5	22.2	7.4	6.3	5.6	32.8
Luoyang Glass	108 HK	HKD	5.9	1.3	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	
Xinyi Solar	968 HK	HKD	2.9	2.5	9.9	7.7	56.6	28.0	2.6	2.1	29.9	31.4	8.1	6.1	4.3	45.6
Flat Glass	6865 HK	HKD	1.7	0.4	5.9	5.5	N/A	6.9	0.9	0.9	11.1	17.0	N/A	N/A	N/A	N/A
Xinyi Automobile Glass	8328 HK	HKD	1.6	0.1	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	
China Glass	3300 HK	HKD	1.1	0.3	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	
Average				2.1	10.9	9.5	41.2	14.9	2.1	1.9	22.2	22.2	8.3	6.8	4.4	26.9

Source: Bloomberg, CSCI Research estimates

Key assumptions

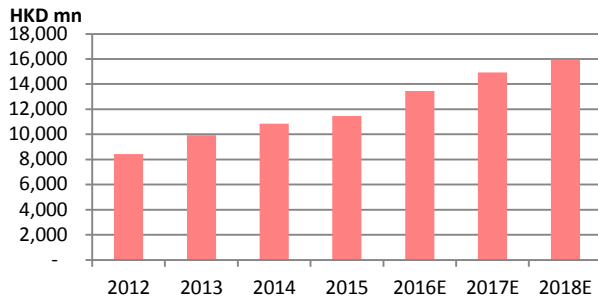
Figure 4: Xinyi Glass' key assumptions

Turnover	Unit	2014	2015	2016E	2017E	2018E
Float glass	HKD mn	4,712	5,022	5,770	6,696	7,165
Automobile glass	HKD mn	3,593	3,787	3,951	3,991	4,110
Construction glass	HKD mn	2,556	2,651	3,600	4,087	4,495
Total	HKD mn	10,861	11,460	13,321	14,773	15,770
% Split						
Float glass	%	43.4%	43.8%	43.3%	45.3%	45.4%
Automobile glass	%	33.1%	33.0%	29.7%	27.0%	26.1%
Construction glass	%	23.5%	23.1%	27.0%	27.7%	28.5%
Total	%	100.0%	100.0%	100.0%	100.0%	100.0%
Sales volume						
Float glass	tons	3,500	3,700	4,251	4,933	5,278
Automobile glass	piece	12,900	13,800	14,400	14,544	14,980
Construction glass	sqm	19,300	21,800	29,600	33,600	36,960
YoY Change						
Float glass	%	4.1%	5.7%	14.9%	16.0%	7.0%
Automobile glass	%	14.1%	7.0%	4.3%	1.0%	3.0%
Construction glass	%	30.4%	13.0%	35.8%	13.5%	10.0%
Unit price						
Float glass	HKD/ton	1,346	1,357	1,357	1,357	1,357
Automobile glass	HKD/piece	279	274	274	274	274
Construction glass	HKD/sqm	132	122	122	122	122
YoY Change						
Float glass	%	0.7%	0.8%	0.0%	0.0%	0.0%
Automobile glass	%	-4.2%	-1.5%	0.0%	0.0%	0.0%
Construction glass	%	-9.0%	-8.1%	0.0%	0.0%	0.0%
Gross profit						
Float glass	HKD mn	329	556	1,443	1,674	1,791
Automobile glass	HKD mn	1,502	1,679	1,924	1,955	2,014
Construction glass	HKD mn	902	898	1,404	1,635	1,798
Total	HKD mn	2,733	3,133	4,771	5,264	5,603
YoY Change						
Float glass	%	-61.4%	68.7%	159.6%	16.0%	7.0%
Automobile glass	%	5.5%	11.8%	14.6%	1.6%	3.0%
Construction glass	%	5.0%	-0.5%	56.4%	16.4%	10.0%
Total	%	-12.9%	14.6%	52.3%	10.3%	6.4%
GPM						
Float glass	%	7.0%	11.1%	25.0%	25.0%	25.0%
Automobile glass	%	41.8%	44.3%	48.7%	49.0%	49.0%
Construction glass	%	35.3%	33.9%	39.0%	40.0%	40.0%
Blended	%	25.2%	27.3%	35.8%	35.6%	35.5%

Source: Company, CSCI Research estimates

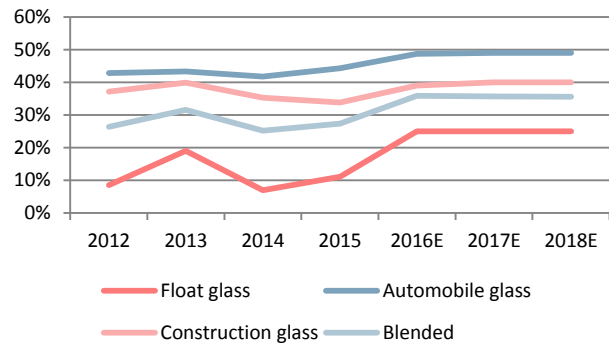
Focus Charts

Figure 5: Revenue



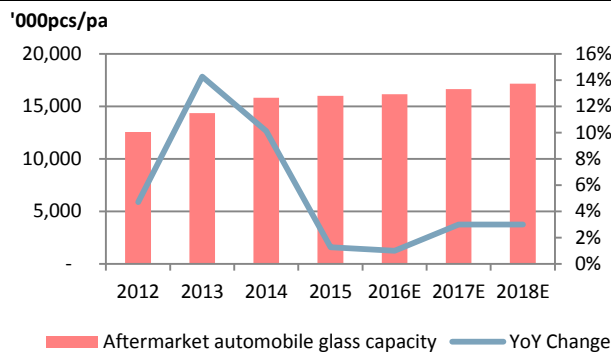
Source: Company, CSCI Research estimates

Figure 6: Gross Profit Margin



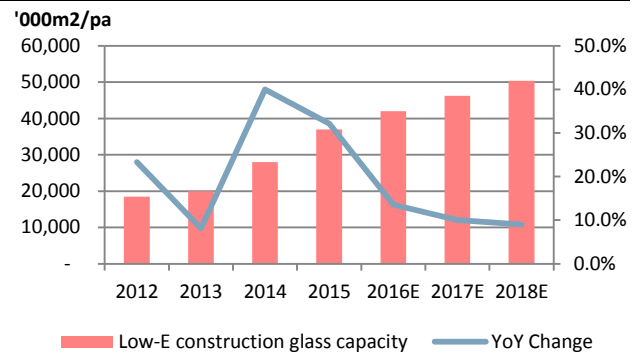
Source: Company, CSCI Research estimates

Figure 7: Aftermarket Automobile Glass Capacity



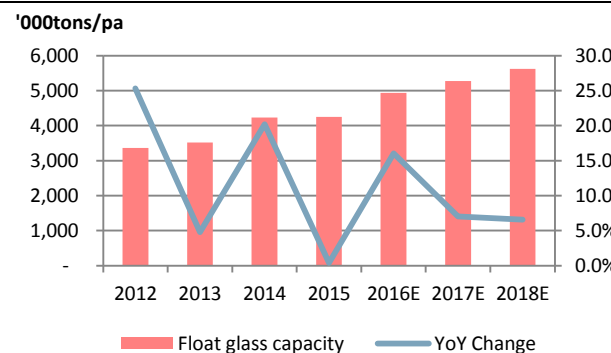
Source: Company, CSCI Research estimates

Figure 8: Low-E Construction Glass Capacity



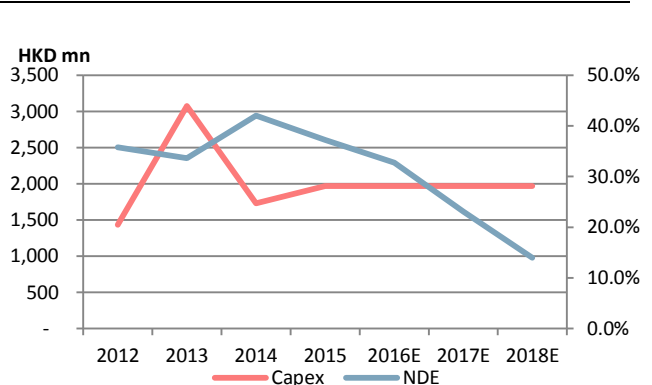
Source: Company, CSCI Research estimates

Figure 9: Float Glass Capacity



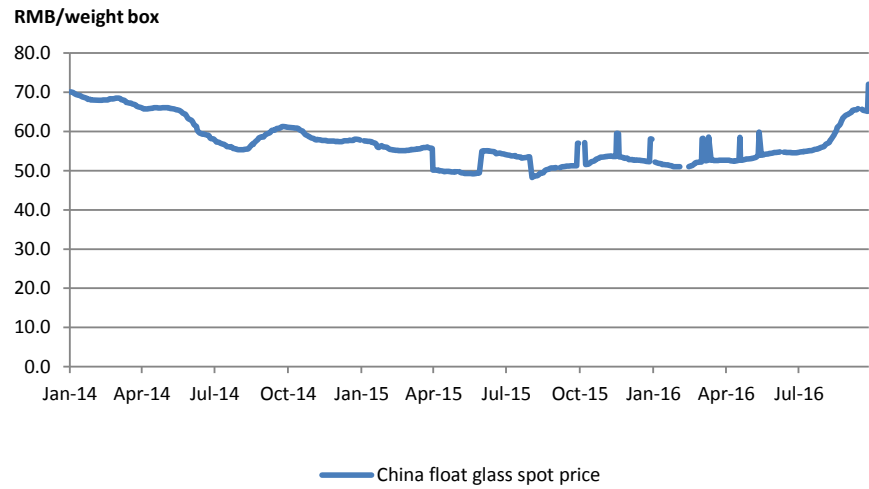
Source: Company, CSCI Research estimates

Figure 10: Capex and NDE Ratio



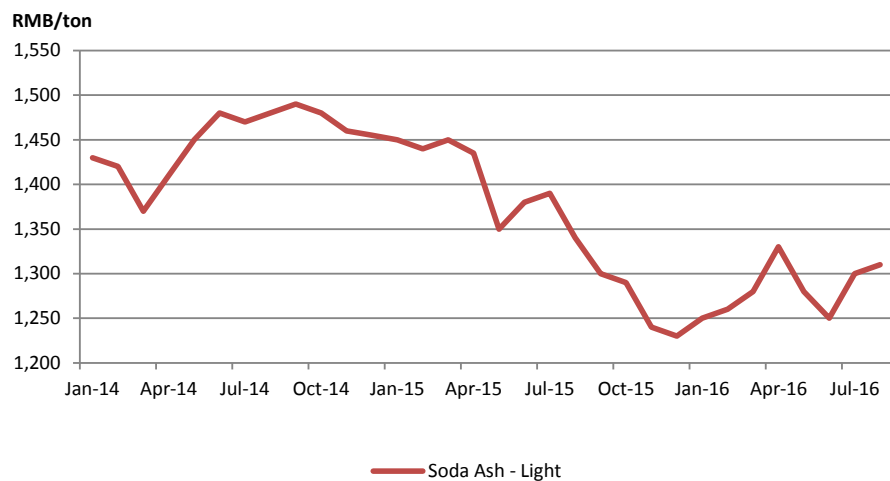
Source: Company, CSCI Research estimates

Figure 11: China Float Glass Price



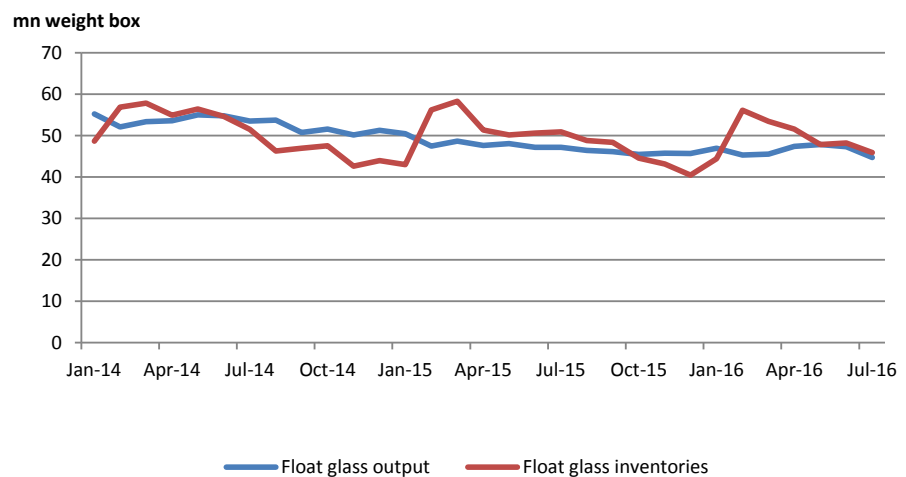
Source: CSCI Research

Figure 12: Domestic Soda Ash Price



Source: CSCI Research

Figure 13: China Float Glass Output and Inventories



Source: CSCI Research

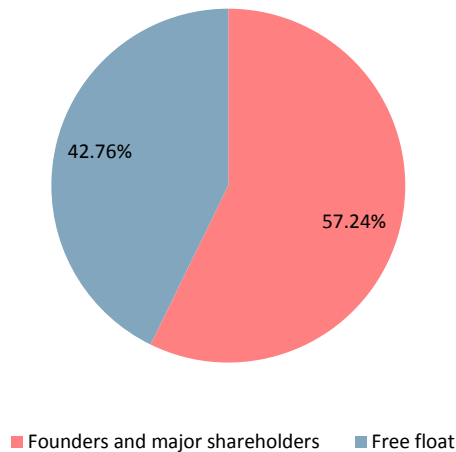
Milestones

Figure 14: Xinyi Glass' milestones

1989	Found in Hong Kong Started automobile glass business
1998	Started construction glass business
2005	Listed on the main board of HKEx Started low-emission coated glass business
2006	Vertically integration into upstream float glass production
2008	Started business of solar glass, which is used in solar power systems, in Jan 2008
2013	The first ultra-thin electronic glass production line started the trial run in May 2013 Spun-off its solar unit Xinyi Solar Holdings Limited (968 HK) for separate listing by way of introduction on the main board of HKEx on 12 December 2013
2014	Signed a wind farm project investment framework agreement with The People's Government of Jinzhai County of Lu'An City of Anhui Province in October 2014 to start development in wind power industry Entered into a land acquisition agreement with Perbadanan Kemajuan Negeri Melaka to acquire a land parcel for the construction of a glass production plant in Malacca, Malaysia in Novemeber 2014
2016	Spun-off its Xinyi Automobile Glass Hong Kong Enterprises Limited (8328 HK) for separate listing on the GEM of HKEx on 11 July 2016

Source: Company

Figure 15: Shareholding structure



Source: Company

Management

Figure 16: Xinyi Glass' management team

Name	Position	Age	Experience
Datuk Lee Yin Yee, B.B.S.	Chairman & Founder	63	Mr. Lee has 25 years' experience in the automobile glass industry. Prior to establishing the Group, Mr. Lee was involved in the trading of automobile parts. He is a national committee member of the Twelfth Chinese People's Political Consultative Conference. Mr. Lee is the chairman and non-executive Director of Xinyi Solar. Mr. Lee is responsible for the Group's business strategy.
Lau Sik Yuen	Chief Financial Officer	49	Mr. Lau is the Group company secretary, chief financial officer and qualified accountant. Prior to joining the Group in 2003, Mr. Lau had over 13 years' experience in auditing and financial accounting industry. Mr. Lau is responsible for the Group's financial, management and cost accounting, taxation, treasury and investor relations strategy and operation. Mr. Lau had worked for PricewaterhouseCoopers for over five years. Mr. Lau is a fellow member of the Hong Kong Institute of Certified Public Accountants and a member of the American Institute of Certified Public Accountants.
Tung Ching Bor	Executive Director	53	Mr. Tung had over 14 years' experience in automobile parts purchase. Mr. TUNG Ching Bor is the brother-in-law of Datuk LEE Yin Yee, B.B.S., brother of Mr. TUNG Ching Sai, and uncle of Mr. LEE Shing Kan, He is the vice-chairman and chief purchasing officer, responsible for managing our daily operations and overseeing our purchasing functions.
Tung Ching Sai	Executive Director	50	Mr. Tung has been joining for 25 years since inception in 1988. Mr. TUNG is the vice chairman and executive Director of Xinyi Solar. Mr. TUNG is executive Director and chief executive officer. He is responsible for overseeing our daily operations.
Lee Shing Kan	Executive Director	36	Mr. Lee is our executive Director and is responsible for overseeing the overseas automobile glass operation and the general manager of Xinyi Automobile Glass (Shenzhen) Company Limited. Mr. Lee is the son of Datuk Lee Yin Yee, nephew of Mr. Tung Ching Bor and Mr. Tung Ching Sai. Mr. LEE Shing Kan was appointed as the executive Director in 2008.

Source: Company

Financials

Figure 17: Xinyi Glass

Income statement (HKD mn)						Cash flow statement (HKD mn)					
Year end: Jun	2014	2015	2016E	2017E	2018E	Year end: Jun	2014	2015	2016E	2017E	2018E
Revenue	10,861	11,460	13,321	14,773	15,770	EBIT	1,631	2,430	3,713	4,290	4,604
COGS	(8,128)	(8,328)	(8,551)	(9,509)	(10,167)	Depreciation & amortisation	644	795	684	724	763
Gross profit	2,733	3,133	4,771	5,264	5,603	Net interest	38	50	76	62	37
Selling expenses	(608)	(680)	(790)	(876)	(935)	Taxes paid	(228)	(266)	(407)	(634)	(685)
General and administrative	(1,030)	(935)	(1,087)	(1,205)	(1,287)	Changes in working capital	(202)	375	(624)	(228)	(157)
Other opex	178	215	226	506	540	Others	(428)	(1,667)	(779)	(374)	(184)
EBITDA	2,276	3,225	4,396	5,014	5,367	Cash flow from operations	1,455	1,717	2,662	3,839	4,378
Depreciation & Amortization	(644)	(795)	(684)	(724)	(763)	Capex	(1,691)	(1,834)	(1,700)	(1,500)	(1,500)
EBIT	1,631	2,430	3,713	4,290	4,604	Acquisitions	(105)	(130)	-	-	-
Interest income	43	22	32	50	80	Disposals	116	292	-	-	-
Interest expense	(82)	(72)	(107)	(112)	(117)	Others	1,609	1,048	627	250	110
JVs and associates	138	317	593	601	682	Cash flow from investing	(72)	(625)	(1,073)	(1,250)	(1,390)
Others	220	379	-	-	-	Dividends	(902)	(608)	(1,573)	(1,750)	(1,890)
Pretax profit	1,593	2,380	3,637	4,228	4,567	Issue of shares	-	-	-	-	-
Taxation	(228)	(266)	(407)	(634)	(685)	Change in debt	1,003	(18)	500	500	500
Minority interests	(1)	(0)	(1)	(1)	(1)	Others	(173)	1	0	0	0
Net profit	1,364	2,113	3,229	3,593	3,881	Cash flow from financing	(72)	(625)	(1,073)	(1,250)	(1,390)
Net profit (adjusted)	1,364	2,113	3,229	3,593	3,881	Change in cash	1,311	467	517	1,340	1,598
Basic EPS (RMB)	0.35	0.54	0.82	0.92	0.99	Free cash flow	(236)	(117)	962	2,339	2,878
Diluted EPS (RMB)	0.35	0.54	0.82	0.92	0.99						
DPS (RMB)	0.15	0.26	0.40	0.45	0.48						
Balance sheet (HKD mn)						Key ratios					
Year end: Jun	2014	2015	2016E	2017E	2018E	Year end: Jun	2014	2015	2016E	2017E	2018E
Cash	831	1,298	1,815	3,155	4,753	Operating ratios					
Short term investments	-	-	-	-	-	Gross margin	25.2	27.3	35.8	35.6	35.5
Accounts receivables	2,487	2,381	2,829	3,138	3,350	EBITDA margin (%)	21.0	28.1	33.0	33.9	34.0
Inventory	1,478	1,223	1,387	1,542	1,649	Effective tax rate (%)	14.3	11.2	11.2	15.0	15.0
Other current assets	9	93	93	93	93	Revenue growth (%)	(60.0)	5.5	16.2	10.9	6.7
Total current assets	4,805	4,995	6,124	7,928	9,845	Net income growth (%)	(4.0)	55.0	52.8	11.3	8.0
PP&E	11,293	11,971	12,987	13,763	14,500	EPS growth adj (%)	14.2	54.9	52.8	11.3	8.0
Intangible Assets	79	75	75	75	75	DPS growth (%)	114.3	74.9	52.8	11.3	8.0
Total investments	2,793	2,972	2,972	2,972	2,972	Efficiency ratios					
Other long term assets	2,064	1,408	1,408	1,408	1,408	ROE (%)	11.1	16.6	22.5	22.2	21.3
Total long term assets	16,229	16,426	17,443	18,218	18,955	ROCE (%)	10.1	14.8	20.2	20.9	20.2
TOTAL ASSETS	21,034	21,422	23,567	26,146	28,800	Asset turnover (x)	0.5	0.5	0.6	0.6	0.5
Short term debt	2,529	2,514	2,723	2,931	3,140	Op cash / EBIT (x)	0.9	0.7	0.7	0.9	1.0
Accounts payables	1,978	2,112	2,100	2,336	2,497	Depreciation / CAPEX (x)	0.4	0.4	0.4	0.5	0.5
Other current liabilities	294	333	333	333	333	Accounts receivable days	79.7	77.5	77.5	73.7	75.1
Total current liabilities	4,801	4,959	5,155	5,599	5,969	Accounts payable days	83.6	89.6	89.9	85.1	86.7
Long term debt	3,483	3,514	3,806	4,097	4,389	Leverage ratios					
Deferred tax	159	159	159	159	159	Net gearing (%)	42.0	37.2	32.8	23.9	15.2
Bonds payable	-	-	-	-	-	Net debt / EBITDA (x)	2.3	1.5	1.1	0.8	0.5
Other long term liabilities	255	63	63	63	63	Interest cover (x)	42.9	48.4	48.9	69.4	125.0
Total long term liabilities	3,898	3,737	4,028	4,320	4,611	Current ratio (x)	1.0	1.0	1.2	1.4	1.6
TOTAL LIABILITIES	8,699	8,696	9,184	9,919	10,581	Valuation					
Shareholders' funds	12,333	12,718	14,375	16,218	18,209	PER (x)	20.4	13.2	8.6	7.8	7.2
Minority Interests	2	7	8	9	10	EV/EBITDA (x)	14.7	10.2	7.4	6.3	5.7
TOTAL LIAB AND EQUITY	21,034	21,422	23,567	26,146	28,800	PBR (x)	2.3	2.2	1.9	1.7	1.5
Net cash / (debt)	(5,181)	(4,730)	(4,713)	(3,873)	(2,775)	Dividend yield (x)	2.1	3.7	5.6	6.3	6.8

Source: Company, CSCI Research estimates



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Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	12-month absolute total return: $\geq 10\%$
Hold	12-month absolute total return: $> -10\%$ but $< 10\%$
Sell	12-month absolute total return: $\leq -10\%$

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