

Xinyi Glass [0868.HK]

Key takeaways from plant visit

We joined the plant visits organized by both Xinyi Glass (XYG) and Xinyi Solar (XYS) last week. During the discussion, management of both Companies reiterated their positive views on the outlook. XYG management mentioned that there is no major reason for the float glass price to come down, given the more favourable supply/demand dynamics. XYG has shipped float glass from its Malaysian plant (small volume at this stage) to China given the tight supply/demand situation. XYG management further elaborated that the overseas expansion will have a positive impact on the Company's overall profitability; the details of the expansion are likely to be released by end of this year. Management also highlighted that growth in auto glass products, which had declined YoY in 1H 2017, reported YoY growth in Q3 2017 and that sales of auto glass products will pick up in 2H 2017. The increase in average selling prices (ASP) has more than offset the impact of the increase in costs, especially for soda ash. Regarding XYS, demand for solar glass remains strong, and XYS is considering another ASP hike in near term after a hike in Q3 2017. The HoH increase in sales volume and better pricing of solar glass will offset the impact of lack of booking of EPC revenue in 2H 2017 vs. 1H 2017. XYS's operating performance is unlikely to see a major HoH decline in 2H 2017. XYS management also highlighted that the Chinese government is more active in paying back subsidies, which we believe will ease market concerns. We believe the float glass industry in China will see more favourable supply/demand dynamics, as the cold repairing cycle is likely to start in 2018, which will reduce production capacity, as will potential industry consolidation triggered by other glass manufacturers, which is positive for XYG. The improvement in sentiment on XYS is also positive for XYG, which is now trading at a 8.5x 2017 PER and an estimated yield of 5.8%. With its undemanding valuation, we maintain our BUY call, with a target price of HK\$10.13 (based on a 11x 2017E PER, lower than its historical average and the average of its listed peers).

Investment Highlights

- Addressing concerns.** During the discussion, XYG management addressed concerns of the market. Soda ash prices have increased substantially since early Sep 2017, up from RMB1,800 per tonne in Q2 to RMB2,400–2,450 per tonne recently. According to XYG management, the jump in the soda ash price in China was due to capacity shut down, given increasing environmental protection controls. XYG secured a supply of soda ash at lower cost from overseas suppliers, which will help protect the Company's profitability in the face of an increase in the soda ash price in the China market. The increase in the float glass price has more than offset the impact of the increase in soda ash price. The potential increase in the natural gas price in the winter season is expected to have a limited impact on XYG's profitability, given last year's experience. XYG management shares our view that there is no major reason for a sharp fall in the float glass price in the near term. XYG management is confident that the growth in auto glass products will pick up in 2H 2017 vs. a YoY decline in 2H 2017 and that Q3 2017 top-line growth is on track. XYG has shipped float glass products from its Malaysian plant to China given the tight supply situation.
- Overseas expansion is positive.** Regarding overseas expansion, XYG is likely to focus on countries such as Malaysia and Canada, where we think the risks are more controllable, so investors should have less concern. XYG is finalizing the details of its overseas expansion and is likely to announce them by the end of 2017. If the project in Canada is finalized, XYG will serve both the Canada and US markets. XYG will also install construction glass production facilities to cope with end demand. Management highlighted that the project in Canada is likely to offer higher profitability, given lower competition and lower energy costs. The overseas expansion should have a positive effect on XYG's overall probability. Concern about XYG's overseas expansion is somewhat overdone, in our view.
- Non-float glass operations to pick up in 2H 2017.** XYG's automobile glass division is expected to pick up in 2H 2017, as the impact of the spin-off of Xinyi HK [8328.HK] and the anti-dumping case in Brazil has faded. According to XYG management, the Company's sales of automobile glass resumed growth in Q3 2017. Management highlighted that the Chinese government is cleaning up the subsidy issue. XYS is close to getting the subsidies for the 6th batch of solar energy subsidies, which is estimated at about RMB200m. XYS is submitting the details for the 7th batch of subsidies. Demand for solar glass remains strong and management believes 2H 2017 results, with a high contribution from its EPC business will be supported by a 20% HoH increase in capacity and better pricing. The ASP hike in solar glass will boost market sentiment on XYS, which is also indirectly positive for XYG.

Key Financials (in HKDm)	2014	2015	2016	2017E	2018E
Revenue	10,861.1	11,460.3	12,848.4	14,346.4	16,008.0
Change (YoY %)	9.3	5.5	12.1	11.7	11.6
Gross Profit	2,733.4	3,132.7	4,659.3	5,191.2	5,742.9
Gross Margin %	25.2	27.3	36.3	36.2	35.9
Net Profit	1,364.3	2,113.1	3,213.4	3,606.3	4,031.0
Net Margin %	12.6	18.4	25.0	25.1	25.2
EPS (Basic)	0.35	0.54	0.83	0.90	1.01
Change (YoY %)	(61.3)	54.9	54.2	8.9	11.8
DPS	\$0.150	\$0.265	\$0.400	\$0.445	\$0.497
ROE (%)	11.1	16.9	24.8	25.7	25.4
Dividend Yield (%)	1.96	3.46	5.22	5.80	6.49
PER (x)	22.1	14.3	9.3	8.5	7.6
PBR (x)	2.4	2.4	2.3	2.1	1.8
FCF Yield (%)	-0.61%	3.48%	5.73%	3.22%	7.64%
Capex (m)	(1,729.0)	(1,967.0)	(1,853.0)	(2,500.0)	(1,501.0)
Free cash flow per share	(0.0)	0.3	0.4	0.2	0.6
Net Gearing (%)	42.0	37.2	37.3	38.3	31.7

Source: Bloomberg, CGIS Research

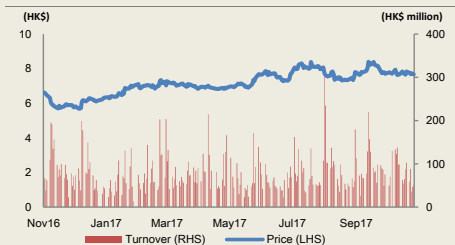
China Construction Sector - Building Materials

BUY

Close: HK\$7.67 (Oct 27, 2017)

Target Price: HK\$10.13 (+32.0%)

Share Price Performance



Source: Bloomberg, CGIS Research

Market Cap	US\$3,930m
Shares Outstanding	3,939m
Auditor	Pricewaterhouse-Coopers
Free Float	46.3%
52W range	HK\$5.69-8.40
3M average daily T/O	US\$11.7m
Major Shareholder	Mr Lee Yin Yee (20.3%)

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Figure 1: Assumptions for XYG

	2012	2013	2014	2015	2016	2017F	2018F
Turnover (HKDm)							
Automobile glass	3,077.8	3,287.2	3,593.2	3,786.6	3,748.4	3,975.9	4,189.7
Construction glass	1,574.6	2,154.5	2,555.5	2,651.5	2,590.2	2,509.9	2,739.3
Float glass	3,780.6	4,494.3	4,712.4	5,022.2	6,509.8	7,860.6	9,079.0
Total	8,433.0	9,936.1	10,861.1	11,460.3	12,848.4	14,346.4	16,008.0
YoY Change (%)							
Automobile glass		6.8	9.3	5.4	(1.0)	6.1	5.4
Construction glass		36.8	18.6	3.8	(2.3)	(3.1)	9.1
Float glass		18.9	4.9	6.6	29.6	20.8	15.5
Total		17.8	9.3	5.5	12.1	11.7	11.6
Volume							
Automobile (piece)		12,110.0	12,889.0	13,582.8	13,582.8	14,262.0	14,975.1
Construction(sqm)		16,363.0	19,380.0	20,107.5	21,716.1	20,630.3	22,074.4
Float glass (tonne)		2,927.0	3,510.0	3,856.8	4,435.3	4,657.0	5,122.7
YoY Change (%)							
Automobile (piece)			6.4	5.4	0	5.0	5.0
Construction(sqm)			18.4	3.8	8.0	(5.0)	7.0
Float glass (tonne)			19.9	9.9	15.0	5.0	10.0
ASP							
Automobile (HKD/piece)		271.4	278.8	278.8	276.0	278.8	279.8
Construction (HKD per sqm)		131.7	131.9	131.9	119.3	121.7	124.1
Float glass (HKD per tone)		1,535.5	1,342.6	1,302.2	1,467.7	1,687.9	1,772.3
YoY Change (%)							
Automobile (HKD/piece)			2.7	0.0	(1.0)	1.0	0.4
Construction (HKD per sqm)			0.1	0	(9.5)	2.0	2.0
Float glass (HKD per tone)			(12.6)	(3.0)	12.7	15.0	5.0
Gross margin (%)							
Automobile glass	42.8	43.3	41.8	44.3	49.0	48.0	48.0
Construction glass	37.2	39.9	35.3	33.9	39.9	37.5	37.5
Float glass	8.6	19.0	7.0	11.1	27.5	29.8	29.8
Blended	26.4	31.6	25.2	27.3	36.3	36.2	35.9
Net margin (%)	14.1	35.4	12.6	18.4	25.0	25.1	25.2
Cost (HKDm)							
S,G&A	(1,056.7)	(1,250.9)	(1,638.0)	(1,614.5)	(1,822.4)	(2,034.9)	(2,270.5)
Financial Expenses	(57.3)	(59.7)	(38.1)	(50.2)	(76.8)	(92.2)	(106.8)
YoY Change (%)							
S,G&A		18.4	30.9	(1.4)	12.9	11.7	11.6
Financial Expenses		4.2	(36.2)	32.0	53.0	20.0	15.9
CAPEX (HKDm)	1,435.3	3,752.3	1,729.0	1,967.0	1,853.0	2,500.0	1,501.0
Net Gearing (%)	35.8	33.6	42.0	37.2	37.3	38.3	31.7

Source: Company, CGIS Research

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- SELL : share price will decrease by >20% within 12 months in absolute terms
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