

# Prime Beneficiary of Tight Float Glass Supply; 6% div yield attractive

Reiterate Rating: BUY | PO: 12.50 HKD | Price: 10.86 HKD

Equity | 08 January 2018

## Higher float glass px in 2018 on tighter supply

Since Nov 17, glass [supply has tightened on the back of closures of 12 lines in Shahe](#) (5% of China's total). We expect an additional 5-10% of China's capacity may not get the Pollutant Emission Permit (PEP) and would have to close down, facilitated by the government's push for coal/heavy oil based capacities to switch to gas-based. Float glass prices rallied to a 7-year high of Rmb 2200/t (inc. VAT) in Pearl River Delta. Given the tight supply and low inventory, we expect glass px to remain strong in 2018E. Soda ash price has also corrected Rmb 300/t from Nov 17's peak given reduced demand from glass capacity closure. We estimate each RMB100/t drop in soda ash price would result in RMB20/t drop in float glass unit cost and impact 2018E EPS by +2.2%. We see 2018 as a big year for [cold repair \(~10% of capacity could undergo 6-12 months maintenance\)](#), resulting in tighter supply, while XYG itself would only have 2 lines (800t/d on ave. or 5%) under repair in 2018. We raise our 18-19E EPS by 10-13% as we raise float glass ASP by 5-10%, and along with a change in BofAML's valuation of Xinyi Solar, we increase our PO by 25% to HK\$12.5. Reiterate Buy as XYG is a key beneficiary of glass industry consolidation, has good leverage to float glass recovery, with attractive valuation of 8.7x 18E P/E, 31% ROE, & 6% div yield.

## Good float glass demand in 18E, hiked property glass px

We are optimistic on property glass demand as it has an 18-24 months lag time vs property GFA sold – which only peaked in 1Q17 (and 11M17 +7%), while the use of more glass per GFA due to increased use of double/ triple-glazed windows and glass decoration should partly offset any slowdown. XYG just hiked architecture glass ASP in 4Q17 on tight supply, so this should be reflected in 2018's profit.

## Strong cashflow to fund expansion overseas and dividend

We expect XYG's float glass capacity to grow by 50% by 20E, led by growth overseas in Malaysia/ Canada. ASP in Malaysia is c.Rmb 1500/t (ex. VAT) yet gas cost (40% of cogs) is 10% lower than China and soda ash (25% of cogs) is 20% cheaper, thus GP margin is higher than China. Given the ASEAN free trade zone and no anti-dumping from India, Korea, Malaysia's capacity is targeted for exporting into these new/ growing markets.

### Estimates (Dec)

(HK\$)	2015A	2016A	2017E	2018E	2019E
Net Income (Adjusted - mn)	2,141	3,242	3,761	4,992	6,142
EPS	0.524	0.805	0.940	1.25	1.54
EPS Change (YoY)	55.1%	53.5%	16.9%	32.7%	23.0%
Dividend / Share	0.263	0.418	0.470	0.624	0.768
Free Cash Flow / Share	0.136	0.572	0.388	0.579	0.882

### Valuation (Dec)

	2015A	2016A	2017E	2018E	2019E
P/E	20.71x	13.50x	11.55x	8.70x	7.07x
Dividend Yield	2.42%	3.85%	4.33%	5.75%	7.07%
EV / EBITDA*	16.95x	11.67x	10.18x	7.72x	6.31x
Free Cash Flow Yield*	1.22%	5.09%	3.56%	5.31%	8.09%

\* For full definitions of [method](#) measures, see page 9.

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Refer to important disclosures on page 10 to 12. Analyst Certification on page 7. Price Objective Basis/Risk on page 7.

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Timestamp: 07 January 2018 03:00PM EST

### Key Changes

(HK\$)	Previous	Current
Price Obj.	10.00	12.50
2017E EPS	0.95	0.94
2018E EPS	1.13	1.25
2019E EPS	1.36	1.54
2017E EBITDA (m)	4,802.2	4,770.7
2018E EBITDA (m)	5,736.7	6,289.3
2019E EBITDA (m)	6,855.5	7,693.3

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### Stock Data

Price	10.86 HKD
Price Objective	12.50 HKD
Date Established	8-Jan-2018
Investment Opinion	C-17
52-Week Range	5.99 HKD-11.16 HKD
Mrkt Val / Shares Out (mn)	5,580 USD / 4,016.3
Market Value (mn)	43,617 HKD
Average Daily Value (mn)	25.56 USD
Free Float	45.8%
BofAML Ticker / Exchange	XYIGF / HKG
Bloomberg / Reuters	868 HK / 0868.HK
ROE (2017E)	26.6%
Net Dbt to Eqty (Dec-2016A)	37.1%

Key Income Statement Data (Dec)	2015A	2016A	2017E	2018E	2019E
<b>(HK\$ Millions)</b>					
Sales	11,460	12,848	14,748	17,464	20,736
Gross Profit	3,133	4,659	5,335	6,976	8,531
Sell General & Admin Expense	(1,615)	(1,822)	(2,050)	(2,445)	(2,903)
Operating Profit	2,113	3,338	3,860	5,212	6,436
Net Interest & Other Income	(50)	(77)	(30)	(8)	31
Associates	317	563	645	736	841
Prelax Income	2,380	3,823	4,475	5,939	7,308
Tax (expense) / Benefit	(266)	(607)	(711)	(943)	(1,161)
Net Income (Adjusted)	2,141	3,242	3,761	4,992	6,142
Average Fully Diluted Shares Outstanding	4,031	3,993	3,999	3,999	3,999
<b>Key Cash Flow Statement Data</b>					
Net Income	2,113	3,213	3,761	4,992	6,142
Depreciation & Amortization	753	822	911	1,078	1,257
Change in Working Capital	259	327	(151)	(266)	(345)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(488)	(798)	33	12	(26)
Cash Flow from Operations	2,637	3,565	4,554	5,815	7,029
Capital Expenditure	(2,105)	(1,346)	(3,000)	(3,500)	(3,500)
(Acquisition) / Disposal of Investments	317	(44)	(55)	(59)	(62)
Other Cash Inflow / (Outflow)	267	(889)	69	71	105
Cash Flow from Investing	(1,520)	(2,280)	(2,986)	(3,488)	(3,457)
Shares Issue / (Repurchase)	(607)	(1,467)	0	0	0
Cost of Dividends Paid	(902)	(608)	(1,387)	(895)	0
Cash Flow from Financing	(625)	225	(1,486)	(974)	(74)
Free Cash Flow	532	2,219	1,554	2,315	3,529
Net Debt	4,730	4,911	4,830	3,477	(21)
Change in Net Debt	(451)	181	(81)	(1,354)	(3,498)
<b>Key Balance Sheet Data</b>					
Property, Plant & Equipment	11,971	11,831	13,429	14,255	13,429
Other Non-Current Assets	4,455	5,655	5,708	5,763	5,822
Trade Receivables	2,381	2,377	2,698	3,150	3,735
Cash & Equivalents	1,298	2,763	2,844	4,198	7,696
Other Current Assets	1,316	1,396	1,537	1,788	2,113
Total Assets	21,422	24,022	26,216	29,153	32,795
Long-Term Debt	3,514	4,509	4,509	4,509	4,509
Other Non-Current Liabilities	223	266	266	266	266
Short-Term Debt	2,514	3,165	3,165	3,165	3,165
Other Current Liabilities	2,445	2,835	3,145	3,582	4,147
Total Liabilities	8,696	10,775	11,086	11,522	12,088
Total Equity	12,726	13,247	15,131	17,631	20,707
Total Equity & Liabilities	21,422	24,022	26,217	29,153	32,795
<b>iQmethod<sup>SM</sup> - Bus Performance*</b>					
Return On Capital Employed	10.1%	14.2%	14.9%	18.3%	20.3%
Return On Equity	17.1%	25.0%	26.6%	30.6%	32.2%
Operating Margin	18.4%	26.0%	26.2%	29.8%	31.0%
EBITDA Margin	25.0%	32.4%	32.3%	36.0%	37.1%
<b>iQmethod<sup>SM</sup> - Quality of Earnings*</b>					
Cash Realization Ratio	1.2x	1.1x	1.2x	1.2x	1.1x
Asset Replacement Ratio	2.8x	1.6x	3.3x	3.2x	2.8x
Tax Rate (Reported)	11.2%	15.9%	15.9%	15.9%	15.9%
Net Debt-to-Equity Ratio	37.2%	37.1%	31.9%	19.7%	-0.1%
Interest Cover	23.4x	26.1x	38.8x	NM	NM
<b>Key Metrics</b>					

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 9.

## Company Sector

Building Materials

## Company Description

Xinyi Glass (XYG) is the largest float glass manufacturer in China with c.5mnt of capacity as at 2016. It produces and distributes automobile glass, energy saving construction glass and other glass products. It is the largest automobile glass exporter in China in the aftermarket sector (20% global market share) and one of the leaders in architectural low-emission (low-E) glass in China. XYG has c.29.5% stake in Xinyi Solar Holdings (968 HK), which is the largest solar-glass manufacturer in China

## Investment Rationale

We like Xinyi Glass shares given our positive view on the float glass industry, its focus on higher value-add products (>30% of total), healthy balance sheet (30% net gearing), and 20-30% 2017-20E earnings growth, driven by overseas capacity expansion.

## Stock Data

Price to Book Value 2.9x

## Exhibit 1: Xinyi Glass – Changes to Key Metrics

### Key metrics summary - Xinyi Glass

	<b>New</b>	<b>Old</b>	<b>Chg%</b>
Rating	BUY	BUY	-
Price Objective (HK\$)	HK\$ 12.5	HK\$ 10.0	25%
Current Price (HK\$)	HK\$ 10.9		
Upside to PO:	14%		

Key Changes	2016	2017E			2018E			2019E		
	Actual	New	Old	Chg%	New	Old	Chg%	New	Old	Chg%
<b>Key Drivers</b>										
<b>Float Glass</b>										
Revenue	6,510	7,974	8,242	-3%	9,873	10,317	-4%	12,283	12,099	2%
COGS	4,719	5,528	5,761	-4%	6,185	7,117	-13%	7,486	8,124	-8%
Gross Profit	1,791	2,446	2,481	-1%	3,688	3,199	15%	4,797	3,975	21%
GP Margin %	28%	31%	30%	2%	37%	31%	20%	39%	33%	19%
<b>Auto Glass</b>										
Revenue	4,097	4,568	4,568	0%	5,038	5,038	0%	5,559	5,559	0%
COGS	2,184	2,410	2,422	0%	2,304	2,343	-2%	2,680	2,719	-1%
Gross Profit	1,913	2,157	2,146	1%	2,734	2,695	1%	2,879	2,840	1%
GP Margin %	47%	47%	47%	1%	54%	53%	1%	52%	51%	1%
<b>Architectural Glass</b>										
Revenue	2,677	3,024	3,024	0%	3,415	3,415	0%	3,881	3,881	0%
COGS	1,701	1,892	1,901	0%	2,096	2,110	-1%	2,348	2,378	-1%
Gross Profit	976	1,131	1,123	1%	1,319	1,305	1%	1,533	1,503	2%
GP Margin %	36%	37%	37%	1%	39%	38%	1%	39%	39%	2%
<b>Key Financials (HK\$mn)</b>										
Sales	12,848	14,748	15,016	-2%	17,464	17,908	-2%	20,736	20,552	1%
Gross Profit	4,659	5,335	5,393	-1%	6,976	6,468	8%	8,531	7,674	11%
EBIT	3,338	3,860	3,892	-1%	5,212	4,659	12%	6,436	5,598	15%
EBITDA	4,160	4,771	4,802	-1%	8,718	7,759	12%	7,693	6,855	12%
NPAT	3,242	3,761	3,787	-1%	4,992	4,528	10%	6,142	5,428	13%
EPS (HK\$/sh)	0.83	0.94	0.95	-1%	1.25	1.13	10%	1.54	1.36	13%

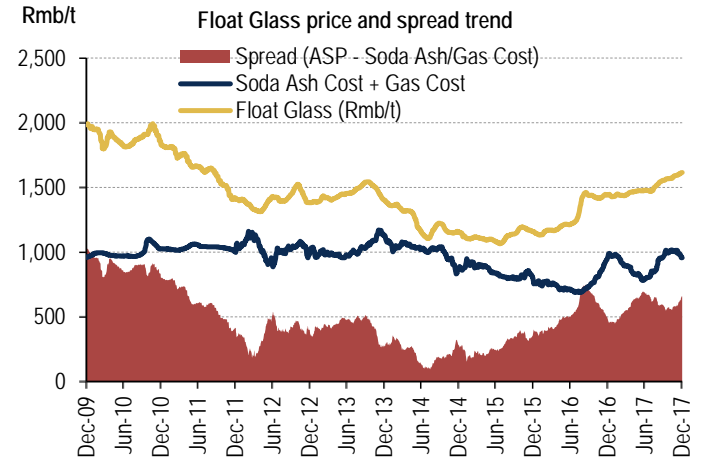
Source: Company data, Bloomberg, BofA Merrill Lynch Global Research estimates

**Chart 1: 12 lines closed, cutting 37%/5% of Shahe/China's capacity**

Float Glass Line	Capacity (t/d)	Shutown date
Shahe Great Wall Line 4	500	6-Nov
Shahe Great Wall Line 6	700	15-Nov
Shahe Safe Glass Line 5	500	15-Nov
Shahe Safe Glass Line 6	700	4-Nov
DeJin Glass Line 3	800	7-Nov
DeJin Glass Line 4	800	15-Nov
Shahe JiHengYuan	600	15-Nov
ChangHong Glass Line 1	600	15-Nov
ChangHong Glass Line 2	600	15-Nov
Xinli Glass Line 2	650	2-Dec
Xinli Glass Line 3	700	2-Dec
Xinli Glass Line 4	700	2-Dec
<b>Total</b>	<b>7,850</b>	
<b>% of Shahe effective capacity</b>	<b>37.4%</b>	
<b>% of China's effective capacity</b>	<b>4.9%</b>	

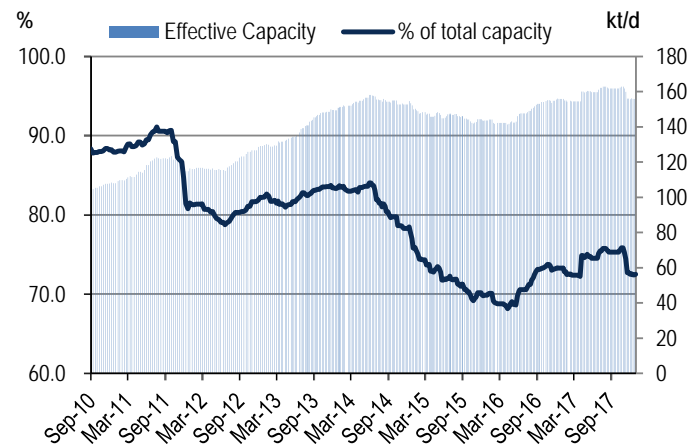
Source: Glassinfo, WIND, Bloomberg, BofA Merrill Lynch Global Research estimates

**Chart 2: More upside to float glass price/ margin ahead on supply tightness**



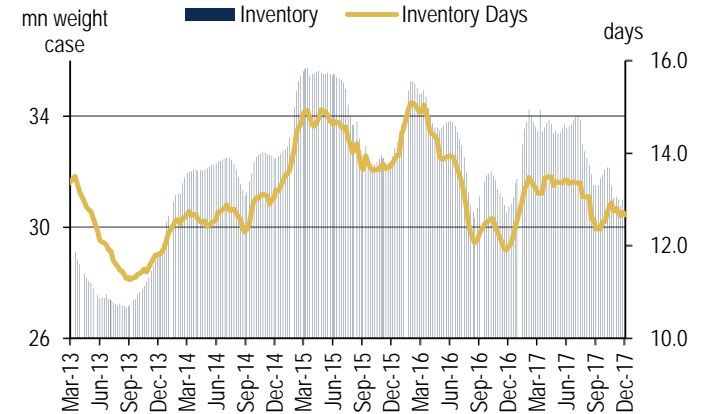
Source: Glassinfo, WIND, Bloomberg, BofA Merrill Lynch Global Research estimates

**Chart 3: % of effective capacity significantly dipped to 72.5%, means tighter supply and more price hikes ahead**



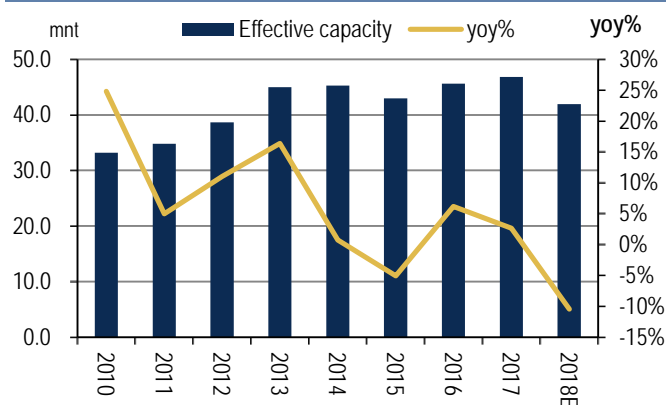
Source: Glassinfo, WIND, Bloomberg, BofA Merrill Lynch Global Research estimates

**Chart 4: Industry inventory days at a relatively low 12.7 days**



Source: Glassinfo, WIND, Bloomberg, BofA Merrill Lynch Global Research estimates

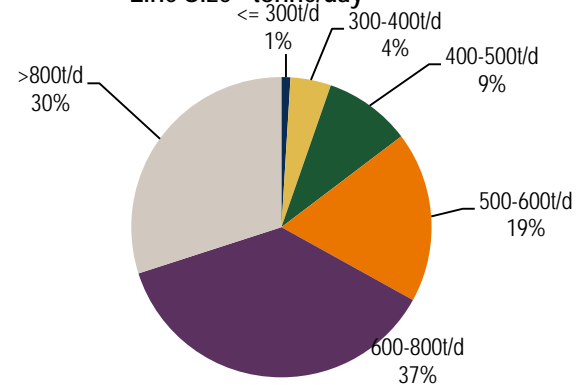
**Chart 5: We expect a drop in effective capacity in 2018 given restriction on new supply add, environmental closures and cold-repair cycle**



Source: Glassinfo, WIND, Bloomberg, BofA Merrill Lynch Global Research estimates

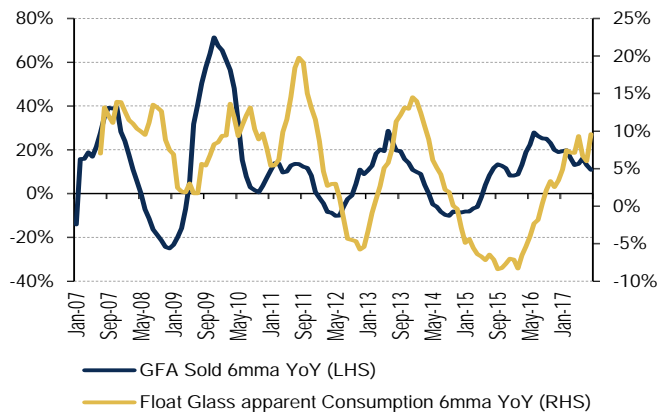
**Chart 6: We expect small lines (<400t/d) and non-gas-based lines (~55%) to be phased out in the future given tighter requirement for energy efficiency and environmental standards**

**China Float Glass Capacity Breakdown by Line Size - tonne/day**



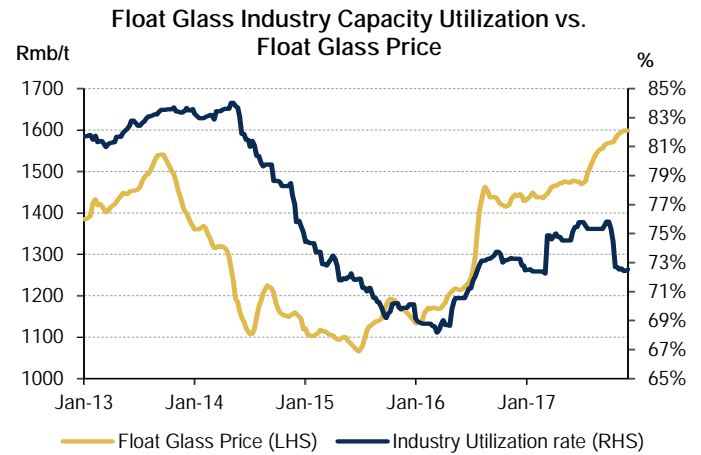
Source: Glassinfo, WIND, Bloomberg, BofA Merrill Lynch Global Research estimates

**Chart 7: We see 18-24 months delay of glass demand vs. property GFA sold – as GFA sales is still growing we expect 18E glass demand likely to remain healthy with stable growth from auto demand**



Source: Glassinfo, WIND, Bloomberg, BofA Merrill Lynch Global Research estimates

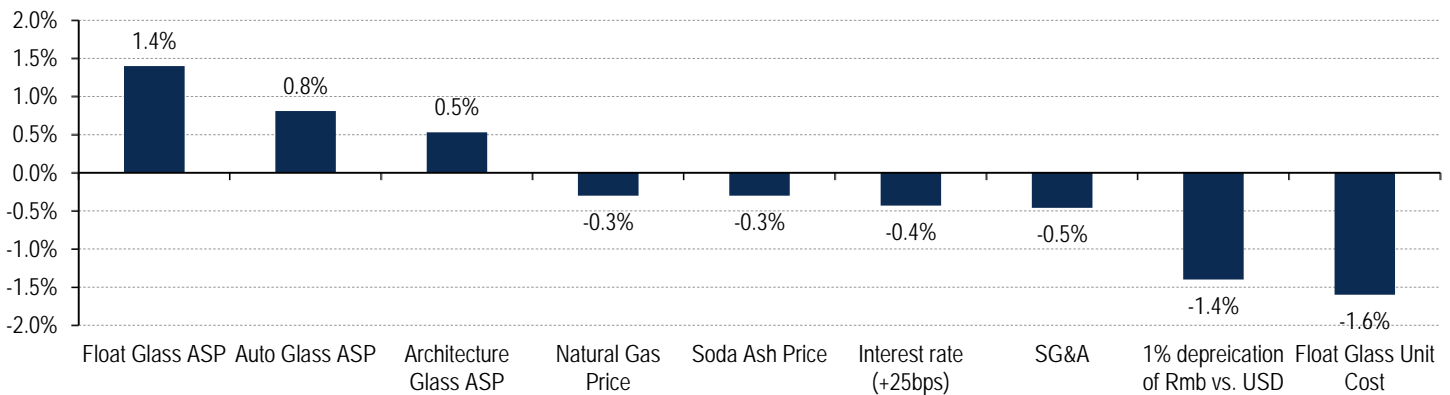
**Chart 8: Utilization improvement usually supports float glass prices**



Source: Glassinfo, WIND, Bloomberg, BofA Merrill Lynch Global Research estimates

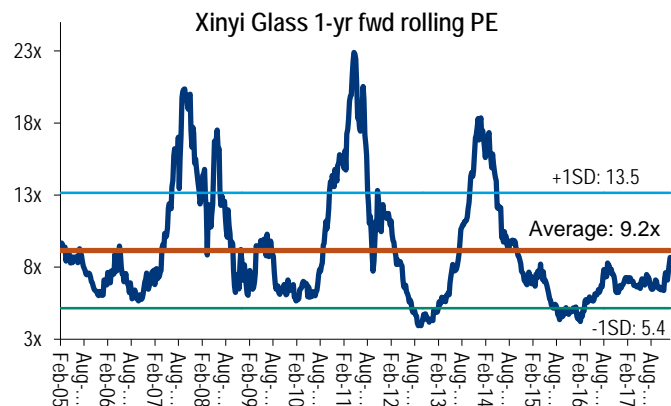
**Chart 9: Xinyi Glass - 2018E EPS sensitivity analysis (2018E EPS change on 1% increase of the following factors)**

Xinyi Glass - Sensitivity Analysis: impact of 1% increase in the following to 2018E EPS



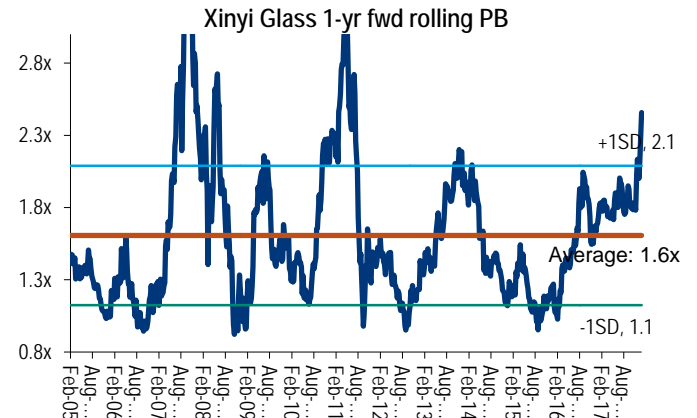
Source: Company data, BofA Merrill Lynch Global Research estimates.

**Chart 10: Xinyi Glass – one-year forward rolling P/E**



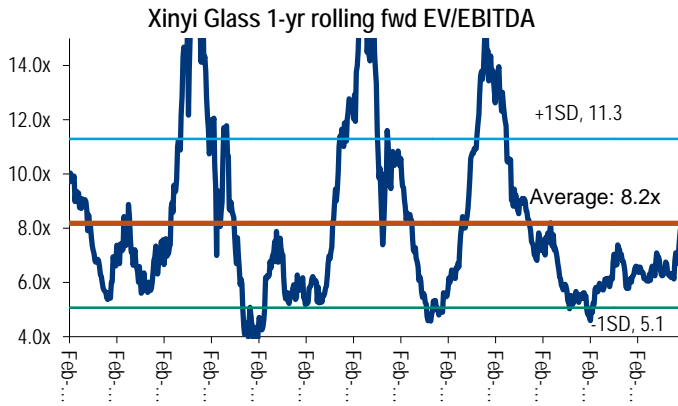
Source: Bloomberg, Company data, BofA Merrill Lynch Global Research estimates

**Chart 11: Xinyi Glass – one-year forward rolling P/B**



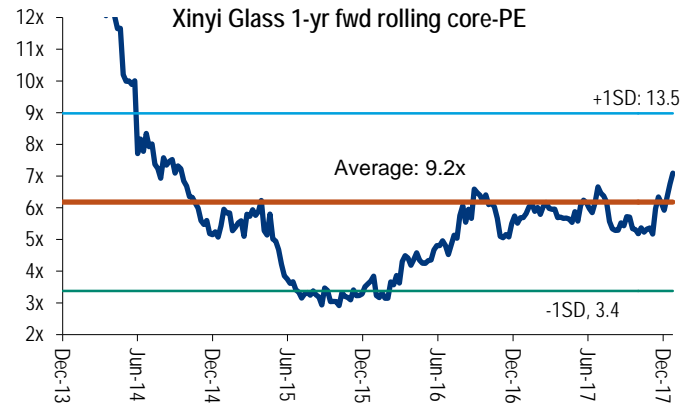
Source: Bloomberg, Company data, BofA Merrill Lynch Global Research estimates

**Chart 12: Xinyi Glass – one-year forward rolling EV/EBITDA**



Source: Bloomberg, Company data, BofA Merrill Lynch Global Research estimates

**Chart 13: Xinyi Glass – one-year forward rolling core P/E (taking away attributable income and market cap of XYS)**



Source: Bloomberg, Company data, BofA Merrill Lynch Global Research estimates

## Price objective basis & risk

### Xinyi Glass (XYIGF)

Our PO of HK\$12.5 is based on a SOTP (sum-of-the-parts) approach and uses (1) 10x one-year forward P/E multiple for XYG's core operations, similar to its historical mid-range of 8-11x, and (2) attributable interest of market cap of Xinyi Solar, based on BofAML's Xinyi Solar valuation. We apply a 15% conglomerate discount to arrive at our PO of HK\$12.5/sh, implying 8.1x 2018E P/E, within the historical mid-range of 8-11x.

Downside risks: 1) weaker-than-expected property demand, 2) more-than-expected industry capacity addition, 3) delay in overseas expansion, 4) large hike in soda ash/gas price, 5) large currency fluctuations, 6) equity dilution

Upside risks: 1) better-than-expected demand, 2) more-than-expected industry capacity closure/cold repairs, 3) lower-than-expected gas/ soda ash prices, 4) higher-than-expected ASP

## Analyst Certification

I, David Ching, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

**APR - Metals, Mining & Steel Coverage Cluster**

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Angang Steel	ANGGF	347 HK	Matty Zhao
	Anhui Conch	AHCHF	914 HK	Matty Zhao
	Anhui Conch -A	AHCAF	600585 CH	Matty Zhao
	Banpu Pcl	XBUPF	BANPU TB	Komsun Suksumrun
	Baosteel	BAOSF	600019 CH	Matty Zhao
	BBMG	BBMGF	2009 HK	Matty Zhao
	BBMG -A	XMRHF	601992 CH	Matty Zhao
	China Coal	CCOZF	1898 HK	Matty Zhao
	China Shenhua	CUAEF	1088 HK	Matty Zhao
	Conch Venture	XIUSF	586 HK	David Ching, CFA
	CR Cement	CJRCF	1313 HK	Matty Zhao
	Eagle Cement Corporation	XEESF	EAGLE PM	Caroline Vergara, CFA
	Hindalco	HNDFF	HNDL IN	Anuj Singla
	Hindustan Zinc	XWVDF	HZ IN	Anuj Singla
	Hyundai Steel	XHDUF	004020 KS	Andy Euisup Lee, CFA
	Jiangxi Copper	JIAXF	358 HK	Hefei Deng
	Jidong Cement	XDXOF	000401 CH	David Ching, CFA
	JSW Steel	XWWDF	JSTL IN	Anuj Singla
	Lee & Man Paper	LMPMF	2314 HK	Matty Zhao
	Nine Dragons Paper	NDGPF	2689 HK	Matty Zhao
	POSCO	PKXFF	005490 KS	Andy Euisup Lee, CFA
	POSCO -A	PKX	PKX US	Andy Euisup Lee, CFA
	Tata Steel	XTLLF	TATA IN	Anuj Singla
	Xinyi Glass	XYIGF	868 HK	David Ching, CFA
	Zijin Mining	ZIJMF	2899 HK	Hefei Deng
<b>NEUTRAL</b>				
	Angang Steel -A	AGGSF	000898 CH	Matty Zhao
	Chalco	ALMMF	2600 HK	Hefei Deng
	China Coal	XAWLF	601898 CH	Matty Zhao
	CNBM	CBUMF	3323 HK	Matty Zhao
	Jiangxi Copper	JGXCF	600362 CH	Hefei Deng
	NMDC	XWDDF	NMDC IN	Anuj Singla
	Semirara Mining Corporation	SRCCF	SCC PM	Ping Javier, CFA
	Siam Cement	SCVQF	SCC TB	Jiraporn Linmaneechote
	Siam Cement -F	SCVPF	SCC/F TB	Jiraporn Linmaneechote
	Yanzhou Coal	YZCHF	1171 HK	Matty Zhao
	Zijin Mining	XZNMF	601899 CH	Hefei Deng
<b>UNDERPERFORM</b>				
	Atlas Consolidated Mining	ATMZF	AT PM	Philip Albert Felix
	CEMEX Holdings Philippines, Inc.	XCHXF	CHP PM	Caroline Vergara, CFA
	Chalco -A	XAMTF	601600 CH	Hefei Deng
	Indocement	PITPF	INTP IJ	Andi Hadiwidjojo
	Maanshan Iron & Steel	MAANF	323 HK	Matty Zhao
	Maanshan Iron & Steel -A	MISIF	600808 CH	Matty Zhao
	Nickel Asia Corporation	XXUYF	NIKL PM	Philip Albert Felix
	SAIL	SLAUF	SAIL IN	Anuj Singla
	Semen Indonesia	PSGTF	SMGR IJ	Andi Hadiwidjojo
	Yanzhou Coal	YZCIF	600188 CH	Matty Zhao
<b>RVW</b>				
	China Hongqiao	CHHOF	1378 HK	Hefei Deng
	China Shenhua	XCUAF	601088 CH	Matty Zhao



**iQ<sup>method</sup> SM Measures Definitions**

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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### XYIGF Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of December 31, 2017 or such later date as indicated.

### Equity Investment Rating Distribution: Building Group (as of 31 Dec 2017)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	39	45.88%	Buy	21	53.85%
Hold	19	22.35%	Hold	11	57.89%
Sell	27	31.76%	Sell	12	44.44%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2017)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1561	52.31%	Buy	975	62.46%
Hold	646	21.65%	Hold	406	62.85%
Sell	777	26.04%	Sell	372	47.88%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

\* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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