Xinyi Glass Holdings (868 HK)

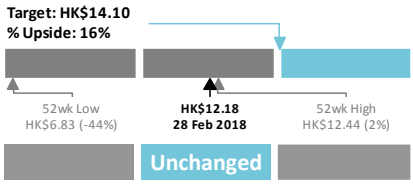
Member of key HTI Themes: Capex/New Projects, Government Policy, Productivity

Target Price	HK$14.10
Current Price	HK$12.18
% Upside	16%

Expecting Better GPM for Float Glass Division in FY18

Automobiles & Components
Hong Kong
28 Feb 2018

BUY



Basic Share Information

Market cap	HK$48.94b / US$6.25b
Daily traded value (3mth)	US$19.44m
Shares outstanding	3,882m
Free float	55%
Net debt-to-equity	31.2%
1 yr high	HK$12.44
1 yr low	HK$6.83
Major shareholding	21.6%
Last HTI contact w/ Co	26 Feb 18

Price/Volume

Source: Bloomberg

	1mth	3mth	12mth
Absolute	0%	35.5%	73%
Absolute USD	-0.1%	35.1%	71.6%
Relative to HSI	5.7%	30.2%	41.3%

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Management Remains Upbeat on FY18 Outlook

Summary: We expect Xinyi Glass Holdings' (XYG) GPM to improve in FY18 due to rising profitability at its float-glass division. According to glass.org.cn, Hebei's Shahe city has shut down nine float-glass production lines as they lacked environmental permits. Total capacity involved was about 1.74mn tonnes, about 2.6% of total float-glass capacity in China. We believe that float-glass demand is likely to remain solid in 2018 as property sales in China remained strong in 2017. Glass windows are typically installed 12 months after property sales, so this should translate into stable demand in 2018. With no new production lines in China and some production lines being shut down, we expect float-glass prices to rise further in 2018. We revise up our EPS forecasts by 5.4% for FY18 and 19.1% for FY19 to factor in a rising GPM in FY18 and XYG's capacity-expansion plans.

Target Price and Catalyst: We raise our target price from HK$9.30 to HK$14.10, based on 12x the average of our EPS forecasts of HK$1.10 for FY18 and HK$1.24 for FY19. Major catalysts for the share price include float glass prices rising in August–September 2018 when the peak season starts, and the interim results announcement scheduled for August 2018. Any news related to the government shutting down float-glass production capacity should also be positive for the share price.

Earnings: We revise up our EPS forecasts by 5.4% for FY18 and 19.1% for FY19. For FY18, the earnings revision mainly reflects our optimism about rising float-glass prices this year and an improving GPM. We expect the average selling price to increase by 12% in FY18. For FY19, our revision mainly reflects the contribution of two new float-glass production lines in Malaysia, which are set to begin operations in H2 FY18 and start contributing to NP in FY19. We introduce our FY20 forecasts in this report.

Valuation: We value the stock at 12x forward PER, previously 9x or the average of its historical trading range. XYG has enjoyed peak-cycle margins at its float-glass division for more than 18 months. We believe that it is a beneficiary of industry consolidation and strengthening pricing power and hence deserves a higher valuation multiple. A-share peer Zhuzhou Kibing Group (601636 CH), for which we have a BUY rating and target price of Rmb6.50, trades at 15.6x FY17 PER on Bloomberg-consensus estimates compared with XYG's 12.0x. The main risk to our rating and the attainment of our target price is a slowdown in property sales in China, which would likely have a negative impact on float-glass prices. In addition all XYG's production lines use natural gas, so any increases in natural-gas prices would be negative for the company.

	Dec-16A	Dec-17A	Dec-18E	Dec-19E	Dec-20E	Trend
Total turnover (HK$m)	12,848	14,728	16,140	18,831	21,665	
Operating profit (HK$m)	3,338	4,093	4,453	5,340	6,149	
Pre-tax profit (HK$m)	3,823	4,696	5,191	6,102	6,931	
Net income to ord equity (HK$m)	3,213	4,014	4,407	5,001	5,542	
Net profit growth	52.1%	24.9%	9.8%	13.5%	10.8%	
P/E (x)	14.71	12.04	11.11	9.79	8.84	
Adj EV/EBITDA (x)	9.39	8.43	7.63	6.29	5.35	
P/B (x)	3.59	3.01	2.65	2.31	2.02	
ROE	24.8%	27.4%	25.5%	25.2%	24.4%	
Dividend yield	3.3%	4.0%	4.3%	4.9%	5.4%	
EPS HTI old (HK$)	0.83	0.90	1.04	1.04	-	
EPS HTI New (HK$)	0.83	1.01	1.10	1.24	1.38	
Consensus EPS (HK$)	0.80	0.94	1.10	1.20	0.70	
HTI EPS vs Consensus	3.2%	7.8%	(0.4%)	3.5%	96.9%	

Source: Company data, Bloomberg, HTI estimates

Click here to download the working model

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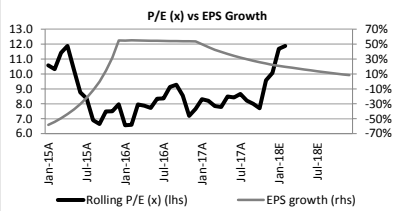
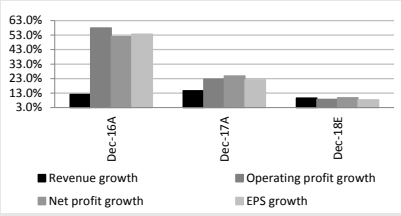
Valuation



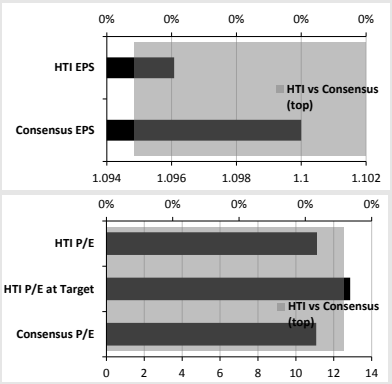
Source: Company data, Bloomberg, HTI estimates

Earnings Trends



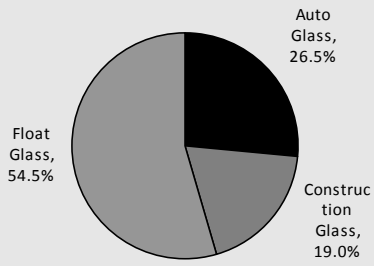
Source: Company data, Bloomberg, HTI estimates

Earnings: HTI vs Consensus



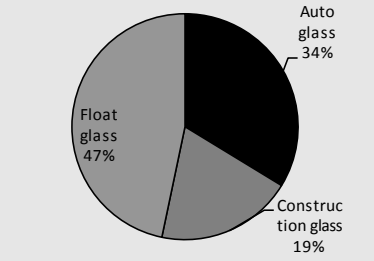
Source: Company data, Bloomberg, HTI estimates

FY17 Sales Breakdown



Source: Company data

FY17 GP Breakdown



Source: Company data

Investment Thesis

BUY

➤ According to Wind statistics, the average float-glass spot price on 27 February 2018 was up by 12% YoY and soda ash, XYG's major cost, was about Rmb1,743 per tonne, down by 22.7% YoY.

➤ The rise in float-glass price was mainly due to capacity shutdowns in Shahe city, Hebei province. Given the increase in average selling price and fall in production cost, we believe that XYG's GPM is likely to expand in FY18.

➤ We expect float glass demand to remain stable over the medium term as strong property sales are usually favorable for future glass demand. Glass installation is usually the last stage of property construction, so strong property sales in 2017 are likely to translate into solid float-glass demand 12–18 months later.

➤ We continue to see XYG as a champion in China's float-glass industry. Industry consolidation is likely in our view to benefit market leaders such as XYG. All its production lines use natural gas as the major energy source, which is in line with the government's policy of enforcing strict environmental-emissions standards.

Company Snapshot

Click here for relevant SCNet visits: China Glass Holdings (3300 HK).

XYG is one of the largest glass manufacturers in China. It has three major business lines, auto glass, construction glass and float glass. For auto glass, it is the largest supplier of auto-replacement glass globally, with a market share of around 20%. For construction glass, the company is the second largest supplier of low-emissivity glass in China. For float glass, it is the largest float-glass manufacturer in China, with 5.4mn tons of annual melting capacity and production lines in Guangdong, Anhui, Tianjin, Liaoning, and Sichuan.

XYG has a 29.5% equity interest in associate company Xinyi Solar Holdings (968 HK), which is the largest solar-glass manufacturer in China.

Key Investment Metrics

Revenue Growth

Revenue rose by 14.6% YoY to HK$14.7bn in FY17, driven by growth in all three divisions. Auto glass revenue was up 4.3% YoY, construction glass by 8.1% YoY, and float glass by 23.2% YoY.

Profit Margins

The FY17 GPM rose by 0.7ppt YoY to 37%, mainly driven by improving margins in the float-glass division.

Shareholder Returns

ROE reached 27.4% in FY17.

Balance Sheet Risks

High | Medium | **Low**

We expect net gearing to fall to 24.9% at the end of FY18.

Barriers to Entry

Glass manufacturing is energy intensive and regulated heavily in China, where it is difficult to get a permit to build new float-glass production lines. Nonetheless, industry utilization is only about 71% and some companies could restart operations should market conditions improve. In auto-glass manufacturing, XYG and Fuyao Glass Industry Group (3606 HK) have a combined market share of about 70% in China.

International Exposure/Breakdown

High | **Medium** | Low

XYG generates 30% of its revenue from overseas sales, as most of its auto glass is for export. Its float glass and construction glass are mainly sold in China. Export revenue is denominated in USD, which helps hedge the company's HKD loan exposure and partly offsets its risk from CNY depreciation.

FX Exposure

High | Medium | **Low**

The balance sheet is denominated in HKD, as are most of XYG's bank borrowings. The main forex risk is CNY depreciation against the HKD and USD, as 70% of sales are domestic. The mismatch of HKD loans and CNY sales on the balance sheet is mitigated in part by exports, which contribute 30% of sales and are denominated in USD.

Corporate Governance

Major shareholders have frequently bought back the company's shares when the share price has dropped to low levels. The dividend-payout ratio has also been consistent. There have been no instances of share placements at large discounts.