

Xinyi Glass (868 HK)

Overweight

Price: HK\$6.18

13 Dec 2016

Profit alert - net profit growth of 40-55% for 2016

Price Target: HK\$9.30

PT End Date: 31 Dec 2017

Xinyi Glass (XYG) is one of China's largest and most diversified glass producers. The company announced on 13 Dec (after trading) that it expects net profit to rise 40-55% for 2016 YY.

- **In line with expectations.** We estimate that NP could increase 47% YY for 2016 to HK\$3.1bn which is in the middle of the range of the 40-55% increase expected by XYG management. Our 2016 EPS estimate is also in line with consensus (Bloomberg).
- **Impressive increase.** The increase in profit is driven by rising margins and sales volume for float glass and a higher contribution from solar subsidiary Xinyi Solar. The increase is even more impressive given that there was ~HK\$370m in gains in 2015 and we don't estimate any for 2016.
- **May be a relief.** While the profit alert is in line with our expectations (and consensus) we note that many estimates were made in the Aug/Sep period (after the interims) and the shares of XYG have underperformed the HSCEI by ~15% over this period on concerns that weakening demand and higher natural gas prices may impact 2H16 profits. This profit alert should alleviate some of those concerns.

Investment Thesis

We believe Xinyi is China's most diversified glass conglomerate. The defensive auto glass aftermarket business and the advanced low emission construction glass business continue to do well with stable growth and steady margins. The key driver for growth in the rest of this year is the recovery in margins for the float glass business. In the past, we have seen peak margins for float glass hit 40% when the market is in short supply. We could see margins recover when demand improves as new supply has slowed to a trickle since the beginning of 2014.

Valuation

Our Dec-17 PT is based on a DCF valuation that assumes a market risk premium of 6.0% and a risk-free rate of 4.2% (yield on 10-year government notes in China). We have assumed a beta of 1.3 (Bloomberg Beta is 1.3). Accordingly, WACC is assumed at 11.4%. We have estimated free cash flow for XYG until 2020 and assume a terminal growth rate of 3.0%. The terminal growth is based on the annual growth rate expected in 2020 (the final year of the estimate period) subject to a minimum of 3% and a maximum of 6%, depending on the nature of the industry and the level of maturity in China.

Risks to Rating and Price Target

The key downside risks to our OW rating and PT are falling demand for construction glass that may result from a cooling property market in China and further weakness in PV glass demand from Europe.

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Date	Ratin	Share	Price
	g	Price	Target
		(HK\$)	(HK\$)
03-Feb-0	OW	0.98	2.25
9			
04-Mar-1	OW	3.16	4.12
0			
31-Mar-1	OW	3.54	5.50
0			
02-Aug-1	OW	3.51	5.70
0			
20-Sep-1	OW	4.89	6.80
0			
09-Nov-1	OW	5.84	8.80
0			
01-Mar-1	OW	6.13	9.00
1			
20-Apr-1	OW	8.77	11.00
1			
28-Nov-1	OW	4.03	6.00
1			
09-Feb-1	N	5.01	5.10
2			
27-Feb-1	N	4.80	4.60
2			
07-May-1	N	5.07	5.50
2			
01-Aug-1	OW	4.01	5.10
2			
31-Dec-1	OW	4.78	5.90
2			
28-Feb-1	OW	5.16	6.90
3			
22-May-1	OW	6.30	8.00
3			

23-Jul-13	OW	6.58	8.70
31-Jul-13	OW	7.13	10.00
04-Sep-1	OW	6.65	10.50
3			
26-Sep-1	OW	7.01	10.90
3			
25-Nov-1	OW	8.33	9.80
3			
26-Feb-1	OW	6.56	10.00
4			
20-Jun-1	OW	4.76	6.50
4			
24-Jul-14	OW	4.76	5.70
15-Sep-1	OW	4.92	6.70
4			
02-Mar-1	OW	4.15	6.10
5			
28-Jul-15	OW	3.89	5.50
10-Sep-1	OW	3.95	5.20
5			
15-Oct-1	OW	3.97	6.00
5			
17-Jun-1	OW	5.67	7.00
6			
02-Aug-1	OW	6.40	8.20
6			
07-Sep-1	OW	7.26	9.30
6			

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