

Xinyi Glass [0868.HK]

Overseas expansion on track. Short-term ASP retreat not a concern. Maintain BUY

We joined the Melaka plant visits organized by Xinyi Glass (XYG) and Xinyi Solar (XYS) last week. During the discussion, management of both Companies provided updates on the current status of the expansion plan for the Melaka plants. The expansion of the Malaysia production base is on track, with two new production lines coming on stream in 2018, and the profitability of the operation in Malaysia is higher than that of the China operation. XYG management mentioned that the float glass market softened somewhat in Apr 2018 after a stronger-than-expected low season around Chinese New Year (CNY). Some float glass companies have delayed the cold repairing of their production lines, given the good market environment, which may make the industry capacity contraction in 2018 lower than we expected. In the near term, XYG may underperform other commodities names, which are seeing upward movement in ASPs. Despite a softening in float glass prices recently, we maintain our positive view on XYG, as we still hold the view that the float glass industry in China will see more favourable supply/demand dynamics, given (a) the likelihood of the cold repairing cycle starting in 2018 (though some has been delayed), which will reduce production capacity, and (b) potential industry consolidation triggered by other glass manufacturers, which would be positive for XYG. XYG is now trading at a 10.1x 2018 PER and an estimated yield of 4.9%. With its undemanding valuation, we maintain our BUY call with a target price of HK\$14.76 (based on a 13x 2018E PER, lower than its historical average and the average of its listed peers).

Investment Highlights

Overseas expansion on track. XYG's Melaka production plant serves mainly Asian countries, such as Vietnam, Taiwan, Korean and other ASEAN countries. The expansion of phase II and III of the Melaka plant is on track. Regarding the phase II expansion, XYG will have one production line with capacity of 800 tonnes per day line commence trial production by Jun 2018 and one production line with capacity of 1,200 tonnes per day in Q3 2018. The initial infrastructure work of the phase III expansion started, and construction of the plant is expected to start in 2019. Based on the current plan, the Malaysia operations will have capacity of over 5,000 tonnes per day, which will be about 20% of XYG's total capacity in 2020. According to management, the Malaysia production plants are expected to produce higher margins than the production plants in China, given: (a) lower energy costs, (b) lower labour costs, especially since production efficiency has been improving, and (c) manageable transportation costs. The increasing contribution from the Melaka production plant will have a positive impact on XYG's profitability. Given the increasing production scale, it is not surprising that XYG is likely to have its own pier going forward, which may further reduce transportation costs. XYG is also in negotiation with a natural gas supplier for a further price discount for bulk purchases, which will lower energy costs further.

Softening of float glass prices in China. After a stronger-than-expected low season around CNY, float glass prices softened in Apr 2018 and will most likely remain soft in May 2018. The possible reasons for the softer float glass prices are (a) aggressive pricing in Q1 2018, (b) a delay in the cold repairing process by some glass manufacturers, and (c) the possibility of downstream customers waiting for a better pricing environment. We maintain the view that XYG will report solid 1H 2018 results, given the YoY improvement in float glass prices in 2018 and improvement in the auto glass and architectural glass segments. The market may also have concerns about a rebound in soda ash prices. However, we hold the view that firm raw material prices should support float glass prices, as there is limited new supply. The profitability of the automobile and architectural glass segments is expected to rebound, given higher sales growth.

Spin-off of Xinyi Energy on track. The new policy on distributed solar energy projects may have a negative impact on demand for solar glass in China in 2H 2018 or 2019, depending on the timing of the release. XYS management reiterated that the adoption of bifacial solar panels has created growth opportunities for XYS. Bifacial mono-silicon solar panels have cost advantages over other types of solar panels, so bifacial panels are expected to continue to gain market share and drive demand for solar glass. The spin-off of Xinyi Energy is on track, but the timing remains uncertain.

Key Financials (in HKDm)	2015	2016	2017	2018E	2019E
Revenue	11,460.3	12,848.4	14,727.5	16,544.3	19,219.9
Change (YoY %)	5.6	12.1	14.6	12.3	16.2
Gross Profit	3,132.7	4,669.3	5,444.1	6,235.3	7,191.2
Gross Margin %	27.3	36.3	37.0	37.7	37.4
Net Profit	2,113.1	3,213.4	4,013.8	4,505.4	5,153.5
Net Margin %	18.4	25.0	27.3	27.2	26.8
EPS (Basic)	0.54	0.83	1.01	1.14	1.30
Change (YoY %)	54.9	54.2	22.1	12.2	14.4
DPS	\$0.265	\$0.400	\$0.480	\$0.560	\$0.641
ROE (%)	16.9	24.8	25.6	23.3	23.9
Dividend Yield (%)	2.32	3.50	4.20	4.90	5.60
PER (x)	21.3	13.8	11.3	10.1	8.8
PBR (x)	3.6	3.4	2.5	2.2	2.0
FCF Yield (%)	2.33%	3.84%	2.08%	4.09%	5.24%
Capex (m)	(1,967.0)	(1,853.0)	(2,500.0)	(2,500.0)	(2,500.0)
Free cash flow per share	0.3	0.4	0.2	0.5	0.6
Net Gearing (%)	37.2	37.3	29.7	30.3	27.7

Source: Bloomberg, CGIS Research

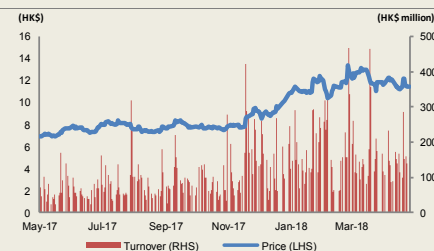
China Construction Sector - Building Materials

BUY

Close: HK\$11.44 (Apr 30, 2018)

Target Price: HK\$14.76 (+29.0%)

Share Price Performance



Sources: Bloomberg, CGIS Research

Market Cap	US\$5,858m
Shares Outstanding	3,999m
Auditor	Pricewaterhouse-
Free Float	45.6%
52W range	HK\$6.90-13.40
3M average daily T/O	US\$23.0m
Major Shareholder	Mr Lee Yin Yee (20.3%)

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Figure 1: Results highlights

Results Highlights (HKD m)	1H 2014	2H 2014	1H 2015	2H 2015	1H 2016	2H 2016	1H 2017	2H 2017
Revenue	5,034	5,827	5,283	6,177	5,885	6,963	6,677	8,051
Cost of sales and services	-3,697	-4,430	-3,873	-4,455	-3,844	-4,346	-4,248	-5,036
Gross profit	1,337	1,397	1,410	1,723	2,041	2,618	2,429	3,015
Other income and other gains and losses	247	152	287	307	147	547	96	598
Distribution and selling expenses	-268	-340	-312	-367	-351	-269	-334	-341
Administrative expenses	-472	-558	-441	-494	-533	-669	-586	-784
Finance costs	-25	-14	-26	-24	-44	-52	-50	-47
JV & Associates	57	80	161	157	312	250	368	332
Profit before tax	876	716	1,079	1,301	1,572	2,425	1,923	2,773
Income tax expense	-114	-114	-138	-128	-202	-405	-285	-397
MI	-0	-0	-2	1	-0	-2	-2	2
Profit for the period	762	602	939	1,174	1,369	2,018	1,636	2,378
Gross margin (%)	26.6	24.0	26.7	27.9	34.7	37.6	36.4	37.4
Operating margin (%)	17.9	12.5	20.9	21.4	27.5	35.6	29.6	35.0
Net Margin (%)	15.1	10.3	17.8	19.0	23.3	29.0	24.5	29.5
Turnover by products (HKDm)								
Automobile glass	1,781	1,813	1,897	1,890	1,990	1,758	1,871	2,039
Construction glass	1,079	1,477	1,206	1,445	1,220	1,370	1,186	1,614
Float glass	2,175	2,538	2,180	2,843	2,675	3,835	3,619	4,398
Gross margin by products (%)								
Automobile glass	42.1	41.5	44.1	44.6	48.7	49.3	47.8	46.2
Construction glass	37.0	34.1	31.7	35.6	39.0	40.6	37.5	38.4
Float glass	8.6	5.6	8.7	12.9	22.3	31.2	30.1	33.0

Source: Company, CGIS Research

Figure 2: Key assumptions for XYG

	2012	2013	2014	2015	2016	2017	2018F	2019F
Turnover (HKDm)								
Automobile glass	3,077.8	3,287.2	3,593.2	3,786.6	3,748.4	3,910.0	4,050.0	4,374.0
Construction glass	1,574.6	2,154.5	2,555.5	2,651.5	2,590.2	2,800.6	3,146.5	3,535.1
Float glass	3,780.6	4,494.3	4,712.4	5,022.2	6,509.8	8,016.9	9,347.7	11,310.7
Total	8,433.0	9,936.1	10,861.1	11,460.3	12,848.4	14,727.5	16,544.3	19,219.9
YoY Change (%)								
Automobile glass		6.8	9.3	5.4	(1.0)	4.3	3.6	8.0
Construction glass		36.8	18.6	3.8	(2.3)	8.1	12.4	12.4
Float glass		18.9	4.9	6.6	29.6	23.2	16.6	21.0
Total		17.8	9.3	5.5	12.1	14.6	12.3	16.2
Volume								
Automobile (piece)		12,110.0	12,889.0	13,582.8	13,582.8	13,786.6	14,475.9	15,634.0
Construction (sqm)		16,363.0	19,380.0	20,107.5	21,716.1	20,630.3	22,074.4	23,619.6
Float glass (tonne)		2,927.0	3,510.0	3,856.8	4,435.3	4,790.1	5,077.5	5,585.2
YoY Change (%)								
Automobile (piece)			6.4	5.4	0	1.5	5.0	8.0
Construction (sqm)			18.4	3.8	8.0	(5.0)	7.0	7.0
Float glass (tonne)			19.9	9.9	15.0	8.0	6.0	10.0
ASP								
Automobile (HKD/piece)		271.4	278.8	278.8	276.0	278.8	279.8	279.8
Construction (HKD per sqm)		131.7	131.9	131.9	119.3	135.8	142.5	149.7
Float glass (HKD per tone)		1,535.5	1,342.6	1,302.2	1,467.7	1,673.6	1,841.0	2,025.1
YoY Change (%)								
Automobile (HKD/piece)			2.7	0.0	(1.0)	1.0	0.4	0
Construction (HKD per sqm)			0.1	0	(9.5)	13.8	5.0	5.0
Float glass (HKD per tone)			(12.6)	(3.0)	12.7	14.0	10.0	10.0
Gross margin (%)								
Automobile glass	42.8	43.3	41.8	44.3	49.0	46.9	46.9	46.9
Construction glass	37.2	39.9	35.3	33.9	39.9	38.0	39.0	39.0
Float glass	8.6	19.0	7.0	11.1	27.5	31.7	33.2	33.2
Blended	26.4	31.6	25.2	27.3	36.3	37.0	37.7	37.4
Net margin (%)	14.1	35.4	12.6	18.4	25.0	27.3	27.2	26.8
Cost (HKDm)								
S,G&A	(1,056.7)	(1,250.9)	(1,638.0)	(1,614.5)	(1,822.4)	(2,045.1)	(2,297.4)	(2,668.9)
Financial Expenses	(57.3)	(59.7)	(38.1)	(50.2)	(76.8)	(96.6)	(96.6)	(110.3)
YoY Change (%)								
S,G&A		18.4	30.9	(1.4)	12.9	12.2	12.3	16.2
Financial Expenses		4.2	(36.2)	32.0	53.0	25.7	0	14.2
CAPEX (HKDm)	1,435.3	3,752.3	1,729.0	1,967.0	1,853.0	2,500.0	2,500.0	2,500.0
Net Gearing (%)	35.8	33.6	42.0	37.2	37.3	29.7	30.3	27.7

Source: Company, CGIS Research

Figure 3: Earnings projection

Income Statement (HKDm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
Revenue	11,460	12,848	14,728	16,544	19,220
Growth yoy%	5.5%	12.1%	14.6%	12.3%	16.2%
Gross Profit	3,133	4,659	5,444	6,235	7,191
Growth yoy%	14.6%	48.7%	16.8%	14.5%	15.3%
Selling General & Admin Exp.	(1,615)	(1,822)	(2,045)	(2,297)	(2,669)
Others Operating Expenses/Items	215	342	377	339	393
Operating Income	1,733	3,179	3,777	4,277	4,916
Growth yoy%	n.a.	83%	19%	13%	15%
Interest Expense	(50.2)	(76.8)	(96.6)	(96.6)	(110.3)
Interest and Invest. Income					
Income/(Loss) from Affiliates	317.3	562.6	699.7	849.6	944.0
Other Non-Operating Inc. (Exp.)	0	0	0	0	0
Impairment of Goodwill	0	0	0	0	0
Gain (Loss) On Sale Of Invest.	379	159	317	237	276
Gain (Loss) On Sale Of Assets					
Income Tax Expense	(266)	(607)	(682)	(765)	(875)
Minority Int. in Earnings	(0)	(3)	(0)	4	4
Net Income	2113	3213	4014	4505	5153
Growth yoy%	54.9%	52.1%	24.9%	12.2%	14.4%

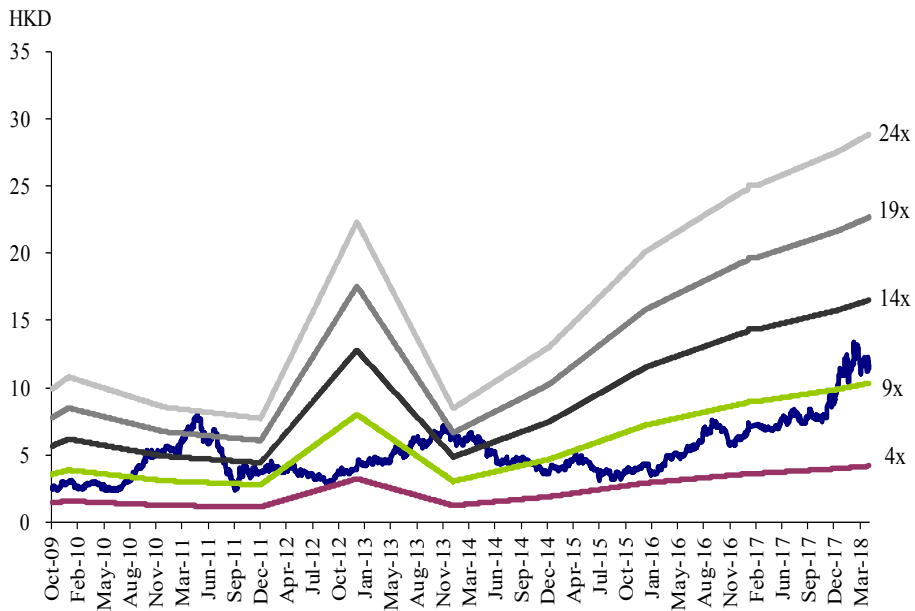
Cash Flow Statement (HKDm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
Net Income	1,796	2,712	3,431	3,652	4,206
Depreciation & Amort.	766	808	883	1,003	1,123
Change in Working Capital	456	40	(869)	(299)	(451)
Cash from Ops.	3,018	3,560	3,445	4,356	4,877
Capital Expenditure	(1,967)	(1,853)	(2,500)	(2,500)	(2,500)
Sale of Property, Plant, and Equipment	-	-	-	-	-
Change in Investing Activities	40	51	55	55	41
Cash from Investing	(1,927)	(1,802)	(2,445)	(2,445)	(2,459)
Net increase in bank borrowings	16	1,646	792	0	0
Issuance of Common Stock	0	0	0	0	0
Common Dividends Paid	(1,043)	(1,552)	(1,905)	(2,224)	(2,544)
Special Dividend Paid	-	-	-	-	-
Other Financing Activities	0	(400)	0	0	0
Cash from Financing	(1,027)	(306)	(1,113)	(2,224)	(2,544)
Net Change in Cash	64	1,451	(113)	(313)	(125)

Balance Sheet (HKDm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
ASSETS					
Cash And Equivalents	1,298	2,763	3,049	2,283	2,157
Receivables	2,381	2,377	3,072	3,411	3,980
Inventory	1,223	1,321	1,698	1,885	2,200
Other Current Assets	93	76	107	107	107
Total Current Assets	4,995	6,537	7,926	7,687	8,445
Net Property, Plant & Equipment	13,177	12,952	16,356	18,377	19,757
Long-term Investments	-	-	-	-	-
Other Intangibles	-	-	-	-	-
Deferred Tax Assets, LT	-	-	-	-	-
Other Long-Term Assets	3,249	4,534	6,017	6,663	7,390
Goodwill	-	-	-	-	-
Accounts Receivable Long-Term	-	-	-	-	-
Total Long Term Assets	16,426	17,486	22,373	25,040	27,147
Total Assets	21,422	24,022	30,299	32,726	35,592
LIABILITIES & EQUITY					
Accounts Payable	2,112	2,297	2,554	2,836	3,309
Accrued Exp.	-	-	-	-	-
Short-term Borrowings	2,514	3,165	2,068	2,068	2,068
Curr. Port. of LT Debt	-	-	-	-	-
Curr. Income Taxes Payable	-	-	-	-	-
Unearned Revenue, Current	-	-	-	-	-
Other Current Liabilities	333	538	535	535	535
Total Current Liabilities	4,959	6,000	5,157	5,439	5,912
Long-Term Debt	3,514	4,509	6,399	6,399	6,399
Def. Tax Liability, Non-Curr.	159	218	335	335	335
Other Non-Current Liabilities	63	48	108	108	108
Total Liabilities	8,696	10,775	11,999	12,281	12,754
Common Stock	4,277	1,719	2,557	4,839	7,449
Additional Paid In Capital	-	-	-	-	-
Retained Earnings	8,442	11,462	15,680	15,542	15,328
Treasury Stock	-	-	-	-	-
Comprehensive Inc. and Other	-	-	-	-	-
Minority Interest	7.2	66.0	69.0	65.2	61.4
Total Equity	12,726	13,247	18,306	20,446	22,838
Total Liabilities And Equity	21,422	24,022	30,305	32,727	35,592

Ratios	FY2015	FY2016	FY2017	FY2018F	FY2019F
Profitability					
Return on Assets %	10.0%	14.1%	14.8%	14.3%	15.1%
Return on Capital %	7.9%	13.0%	13.0%	12.7%	13.5%
Return on Equity %	16.9%	24.8%	25.6%	23.3%	23.9%
Margin Analysis					
Gross Margin %	27.3%	36.3%	37.0%	37.7%	37.4%
SG&A Margin %	14.1%	14.2%	13.9%	13.9%	13.9%
EBIT Margin %	15.1%	24.7%	25.6%	25.8%	25.6%
EBITDA Margin %	21.8%	31.0%	31.6%	31.9%	31.4%
Net Income Margin %	18.4%	25.0%	27.3%	27.2%	26.8%
Asset Turnover					
Total Asset Turnover	0.5x	0.5x	0.5x	0.5x	0.5x
Fixed Asset Turnover	0.7x	0.7x	0.7x	0.7x	0.7x
Accounts Receivable Turnover	4.7x	5.4x	5.4x	5.1x	5.2x
Inventory Turnover	9.4x	9.7x	8.7x	8.8x	8.7x
Liquidity					
Current Ratio	1.0x	1.1x	1.5x	1.4x	1.4x
Quick Ratio	0.7x	0.9x	1.2x	1.0x	1.0x
Avg. Days Sales Out.	75.8	67.5	76.1	75.3	75.6
Avg. Days Inventory Out.	38.9	37.5	42.1	41.6	41.8
Avg. Days Payable Out.	89.6	98.3	95.4	95.4	93.2
Avg. Cash Conversion Cycle	62.2	61.1	79.6	79.4	79.5
Net Debt to Equity	37%	37%	30%	30%	28%
Growth Over Prior Year					
Total Revenue	5.5%	12.1%	14.6%	12.3%	16.2%
Net Income	54.9%	52.1%	24.9%	12.2%	14.4%
Payout Ratio %	49.4%	48.3%	47.5%	49.4%	49.4%

Sources: Company, CGIS Research

Figure 4: XYG's PER trend



Sources: Bloomberg, CGIS Research estimates

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

HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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