

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

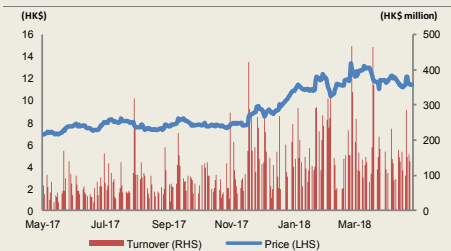
China Construction Sector - Building Materials

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%)

Mark Po, CFA — Senior Analyst

(852) 3698-6318

markpo@chinastock.com.hk

Wong Chi Man, CFA — Head of Research

(852) 3698-6317

cmwong@chinastock.com.hk

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

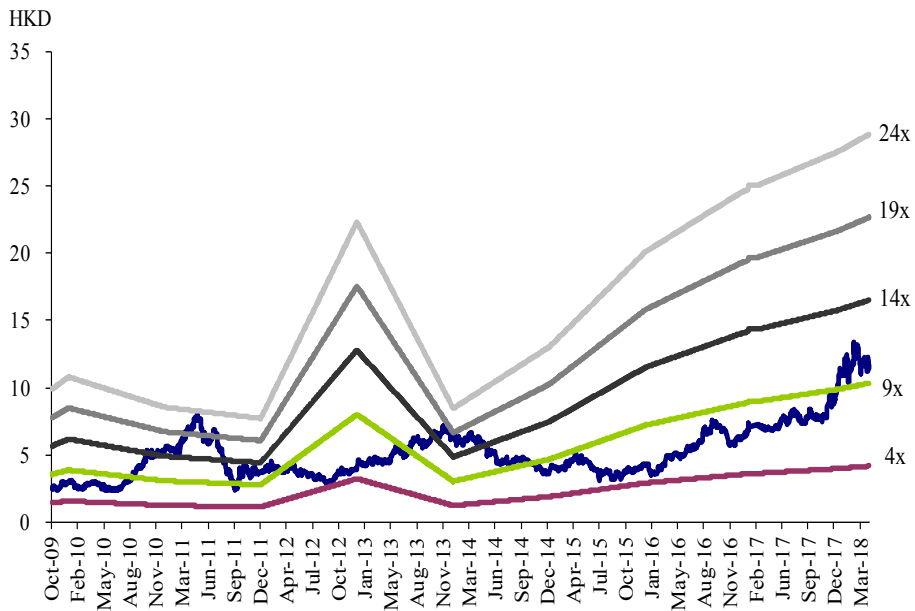
Figure 3: Earnings projection

Income Statement (HKDm)						Cash Flow Statement (HKDm)					
	FY2015	FY2016	FY2017	FY2018F	FY2019F		FY2015	FY2016	FY2017	FY2018F	FY2019F
Revenue	11,460	12,848	14,728	16,544	19,220	Net Income	1,796	2,712	3,431	3,652	4,206
Growth yoy%	5.5%	12.1%	14.6%	12.3%	16.2%	Depreciation & Amort.	766	808	883	1,003	1,123
Gross Profit	3,133	4,659	5,444	6,235	7,191	Change in Working Capital	456	40	(869)	(299)	(451)
Growth yoy%	14.6%	48.7%	16.8%	14.5%	15.3%	Cash from Ops.	3,018	3,560	3,445	4,356	4,877
Selling General & Admin Exp.	(1,615)	(1,822)	(2,045)	(2,297)	(2,669)	Capital Expenditure	(1,967)	(1,853)	(2,500)	(2,500)	(2,500)
Others Operating Expenses/Items	215	342	377	339	393	Sale of Property, Plant, and Equipment	-	-	-	-	-
Operating Income	1,733	3,179	3,777	4,277	4,916	Change in Investing Activities	40	51	55	55	41
Growth yoy%	n.a.	83%	19%	13%	15%	Cash from Investing	(1,927)	(1,802)	(2,445)	(2,445)	(2,459)
Interest Expense	(50.2)	(76.8)	(96.6)	(96.6)	(110.3)	Net increase in bank borrowings	16	1,646	792	0	0
Interest and Invest. Income						Issuance of Common Stock	0	0	0	0	0
Income/(Loss) from Affiliates	317.3	562.6	699.7	849.6	944.0	Common Dividends Paid	(1,043)	(1,552)	(1,905)	(2,224)	(2,544)
Other Non-Operating Inc. (Exp.)	0	0	0	0	0	Special Dividend Paid	-	-	-	-	-
Impairment of Goodwill	0	0	0	0	0	Other Financing Activities	0	(400)	0	0	0
Gain (Loss) On Sale Of Invest.	379	159	317	237	276	Cash from Financing	(1,027)	(306)	(1,113)	(2,224)	(2,544)
Gain (Loss) On Sale Of Assets						Net Change in Cash	64	1,451	(113)	(313)	(125)
Income Tax Expense	(266)	(607)	(682)	(765)	(875)						
Minority Int. in Earnings	(0)	(3)	(0)	4	4						
Net Income	2,113	3,213	4,014	4,505	5,153						
Growth yoy%	54.9%	52.1%	24.9%	12.2%	14.4%						

Balance Sheet (HKDm)						Ratios					
	FY2015	FY2016	FY2017	FY2018F	FY2019F		FY2015	FY2016	FY2017	FY2018F	FY2019F
ASSETS						Profitability					
Cash And Equivalents	1,298	2,763	3,049	2,283	2,157	Return on Assets %	10.0%	14.1%	14.8%	14.3%	15.1%
Receivables	2,381	2,377	3,072	3,411	3,980	Return on Capital %	7.9%	13.0%	13.0%	12.7%	13.5%
Inventory	1,223	1,321	1,698	1,885	2,200	Return on Equity %	16.9%	24.8%	25.6%	23.3%	23.9%
Other Current Assets	93	76	107	107	107	Margin Analysis					
Total Current Assets	4,995	6,537	7,926	7,687	8,445	Gross Margin %	27.3%	36.3%	37.0%	37.7%	37.4%
Net Property, Plant & Equipment	13,177	12,952	16,356	18,377	19,757	SG&A Margin %	14.1%	14.2%	13.9%	13.9%	13.9%
Long-term Investments	-	-	-	-	-	EBIT Margin %	15.1%	24.7%	25.6%	25.8%	25.6%
Other Intangibles	-	-	-	-	-	EBITDA Margin %	21.8%	31.0%	31.6%	31.9%	31.4%
Deferred Tax Assets, LT	-	-	-	-	-	Net Income Margin %	18.4%	25.0%	27.3%	27.2%	26.8%
Other Long-Term Assets	3,249	4,534	6,017	6,663	7,390	Asset Turnover					
Goodwill	-	-	-	-	-	Total Asset Turnover	0.5x	0.5x	0.5x	0.5x	0.5x
Accounts Receivable Long-Term	-	-	-	-	-	Fixed Asset Turnover	0.7x	0.7x	0.7x	0.7x	0.7x
Total Long Term Assets	16,426	17,486	22,373	25,040	27,147	Accounts Receivable Turnover	4.7x	5.4x	5.4x	5.1x	5.2x
Total Assets	21,422	24,022	30,299	32,726	35,592	Inventory Turnover	9.4x	9.7x	8.7x	8.8x	8.7x
LIABILITIES & EQUITY						Liquidity					
Accounts Payable	2,112	2,297	2,554	2,836	3,309	Current Ratio	1.0x	1.1x	1.5x	1.4x	1.4x
Accrued Exp.	-	-	-	-	-	Quick Ratio	0.7x	0.9x	1.2x	1.0x	1.0x
Short-term Borrowings	2,514	3,165	2,068	2,068	2,068	Avg. Days Sales Out.	75.8	67.5	76.1	75.3	75.6
Curr. Port. of LT Debt	-	-	-	-	-	Avg. Days Inventory Out.	38.9	37.5	42.1	41.6	41.8
Curr. Income Taxes Payable	-	-	-	-	-	Avg. Days Payable Out.	89.6	98.3	95.4	95.4	93.2
Unearned Revenue, Current	-	-	-	-	-	Avg. Cash Conversion Cycle	62.2	61.1	79.6	79.4	79.5
Other Current Liabilities	333	538	535	535	535	Net Debt to Equity	37%	37%	30%	30%	28%
Total Current Liabilities	4,959	6,000	5,157	5,439	5,912	Growth Over Prior Year					
Long-Term Debt	3,514	4,509	6,399	6,399	6,399	Total Revenue	5.5%	12.1%	14.6%	12.3%	16.2%
Def. Tax Liability, Non-Curr.	159	218	335	335	335	Net Income	54.9%	52.1%	24.9%	12.2%	14.4%
Other Non-Current Liabilities	63	48	108	108	108	Payout Ratio %	49.4%	48.3%	47.5%	49.4%	49.4%
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						

Sources: Company, CGIS Research

Figure 4: XYG's PER trend



Sources: Bloomberg, CGIS Research estimates

Disclaimer

This research report is not directed at, or intended for distribution to or used by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution, publication, availability or use would be contrary to applicable law or regulation or which would subject China Galaxy International Securities (Hong Kong) Co., Limited ("Galaxy International Securities") and/or its group companies to any registration or licensing requirement within such jurisdiction.

This report (including any information attached) is issued by Galaxy International Securities, one of the subsidiaries of the China Galaxy International Financial Holdings Limited, to the institutional clients from the information sources believed to be reliable, but no representation or warranty (expressly or implied) is made as to their accuracy, correctness and/or completeness.

This report shall not be construed as an offer, invitation or solicitation to buy or sell any securities of the company(ies) referred to herein. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. The recipient of this report should understand and comprehend the investment objectives and its related risks, and where necessary consult their own independent financial advisers prior to any investment decision.

Where any part of the information, opinions or estimates contained herein reflects the personal views and opinions of the analyst who prepared this report, such views and opinions may not correspond to the published views or investment decisions of China Galaxy International Financial Holdings Limited and any of its subsidiaries ("China Galaxy International"), directors, officers, agents and employees ("the Relevant Parties").

All opinions and estimates reflect the judgment of the analyst on the date of this report and are subject to change without notice. China Galaxy International and/or the Relevant Parties hereby disclaim any of their liabilities arising from the inaccuracy, incorrectness and incompleteness of this report and its attachment/s and/or any action or omission made in reliance thereof. Accordingly, this report must be read in conjunction with this disclaimer.

Disclosure of Interests

China Galaxy Securities Co., Ltd. (6881.HK; 601881.CH) is the direct and/or indirect holding company of the group of companies under China Galaxy International.

China Galaxy International may have financial interests in relation to the subjected company(ies) the securities in respect of which are reviewed in this report, and such interests aggregate to an amount may equal to or more than 1 % of the subjected company(ies)' market capitalization.

One or more directors, officers and/or employees of China Galaxy International may be a director or officer of the securities of the company(ies) mentioned in this report.

China Galaxy International and the Relevant Parties may, to the extent permitted by law, from time to time participate or invest in financing transactions with the securities of the company(ies) mentioned in this report, perform services for or solicit business from such company(ies), and/or have a position or holding, or other material interest, or effect transactions, in such securities or options thereon, or other investments related thereto.

China Galaxy International may have served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the last 12 months, significant advice or investment services in relation to the investment concerned or a related investment or investment banking services to the company(ies) mentioned in this report.

Furthermore, China Galaxy International may have received compensation for investment banking services from the company(ies) mentioned in this report within the preceding 12 months and may currently seeking investment banking mandate from the subject company(ies).

Analyst Certification

The analyst who is primarily responsible for the content of this report, in whole or in part, certifies that with respect to the securities or issuer covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject, securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by the analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the securities covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the securities covered in this research report three business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong-listed companies covered in this report; and (4) have any financial interests in the Hong Kong-listed companies covered in this report.

Explanation on Equity Ratings

BUY : share price will increase by >20% within 12 months in absolute terms

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

Copyright Reserved

No part of this material may be reproduced or redistributed without the prior written consent of China Galaxy International Securities (Hong Kong) Co., Limited.

China Galaxy International Securities (Hong Kong) Co. Limited, CE No.AXM459

20/F, Wing On Centre, 111 Connaught Road Central, Sheung Wan, Hong Kong. General line: 3698-6888.