

JPM-pp1

Asia Pacific Equity Research

04 March 2015

# Xinyi Glass (868 HK)

## Overweight

Price: HK\$4.67

03 Mar 2015

Price Target: HK\$6.10

PT End Date: 31 Dec 2015

### Key notes from management meeting

Xinyi Glass (XYG) is one of the largest and most diversified glass producers in China. We hosted a FY14 post results investor meeting for the company on March 04, 2015. Here are some key notes:

#### Positive

- **Auto glass doing well.** Over 70% of XYG's auto glass sales is for export, with the majority in the North American market. Sales to North America overall rose 47% Y/Y in 2014, which was driven by a renewal of a supply contract to one of the largest auto glass brands in the US. The new supply contract stipulated a larger guaranteed volume from that customer. Management continues to expect strong growth as lower oil prices is leading to more driving (which correlates to broken windshields and replacement demand).
- **Float glass recovery slowly underway.** Since prices bottomed out in China in July 2014 (at about Rmb1,300 to Rmb1,400 per ton including VAT), prices recovered to about Rmb1,700 per ton including VAT in southern China (perhaps a little lower in other parts of China) by Jan 2015. One piece of positive news is that deliveries for January were better than management's expectations and better than last year. We note that this is a good sign as January is normally quite weak and strong deliveries show some improvement in the overall credit and construction environment. We expect prices will probably drop during slack season in Jan and early March, before recovering in April.

#### Concern

- **Low - E glass.** GPM was lower by 3% in 2014 (to a still respectable 35.3%) due to more customers demanding discounts due to the poor construction environment. Sales growth of 18% was also lower than management's expectations at the beginning of 2014. XYG is adding capacity by 36% in 2015 which is a little aggressive in our view, given the difficulties in 2015. However, management mentioned that all of the new capacity is located in new areas that XYG currently does not serve and is intended to capture market share in those areas from less efficient / lower quality peers. However, we note that this still adds significantly (maybe 7% or so) to overall supply of low - E glass in China.
- **New wind power business.** XYG announced in late 2014 that it is planning a new EPC business for wind power where the company builds wind farms for third parties. This would be a small business for XYG in the initial years but XYG plans to leverage its experience in grid connection and negotiations (from its solar farm operations) in order to succeed in developing wind farms.

#### Others

- **Expanding in Malaysia for strategic reasons.** The new construction of new lines (HK\$500m for XYG and HK\$500m for XY Solar) in Malaysia will be underway in 2015, with production sometime in 2016. The new plants should benefit from lower labour and gas costs, plus could have tax advantages exporting to Asean countries duty free and also exporting solar glass to the US and EU without incurring anti-dumping duties.

**Price, valuation and risks.** Our PT (Dec-15, DCF-derived) of HK\$6.10 implies a forward P/BV of 1.8x and fwd P/E of 10.9x (FY16E). The key downside risks to our PT are falling demand for construction glass that could result from a cooling property market in China, and further weakness in PV glass demand from Europe.

Please refer to our latest note, "[Xinyi Glass: Lowering PT to HK\\$6.1 - Demand bottoming out with some upside in lower](#)

[fuel costs](#)” dated Mar 02, 2015 for details.

## Investment Thesis

We believe that Xinyi is China's most diversified glass conglomerate. The defensive auto glass aftermarket business and the advanced low emission construction glass business continued to do well in 2013 with stable growth and steady margins. The key drivers for growth in the rest of this year is the recovery in margins for the float glass business, which was 9% for 2012 and 17% for 2013. In the past, we have seen peak margins for float glass hit 40% when the market is in short supply. We could see margins exceed our estimate in the peak season in 2014 (Aug to Nov) as demand should be strong and new supply slows to a trickle in 2014.

## Valuation

Our Dec-15 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 11.3%. 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	Rating	Share Price (HK\$)	Price Target (HK\$)
03-Feb-09	OW	1.00	2.25
04-Mar-10	OW	3.12	4.12
31-Mar-10	OW	3.54	5.50
02-Aug-10	OW	3.51	5.70
20-Sep-10	OW	4.76	6.80
09-Nov-10	OW	5.80	8.80
01-Mar-11	OW	6.35	9.00
20-Apr-11	OW	8.77	11.00
28-Nov-11	OW	4.15	6.00
09-Feb-12	N	5.39	5.10
27-Feb-12	N	4.52	4.60
07-May-12	N	5.07	5.50
01-Aug-12	OW	4.01	5.10
31-Dec-12	OW	4.71	5.90
28-Feb-13	OW	5.16	6.90
22-May-13	OW	6.30	8.00
23-Jul-13	OW	6.58	8.70
31-Jul-13	OW	7.13	10.00
04-Sep-13	OW	6.65	10.50
26-Sep-13	OW	7.01	10.90
25-Nov-13	OW	8.53	9.80
26-Feb-14	OW	6.56	10.00
20-Jun-14	OW	4.68	6.50
24-Jul-14	OW	4.76	5.70
15-Sep-14	OW	4.78	6.70
02-Mar-15	OW	4.55	6.10

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