

Xinyi Solar (968 HK)

Buy (upgraded)

Target price: HK\$3.05



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Results slightly beat; maintain Buy

2014 results beat by 2% Xinyi Solar (XYS) announced 2014 net profit jumped 62% YoY to HK\$493m, ~2% higher than our estimate and market consensus, mainly due to: 1) better-than-expected operating cost control; 2) lower-than-expected financing costs; 3) a lower-than-expected effective tax rate of 14% (our estimate: 18%); 4) higher-than-expected other income stemming from government grant and sales of scrap materials. However, gross margin came in at 31.6%, below our expected 35.2%, mainly due to a smaller-than-expected contribution from its solar farm segment and lower-than-expected gross margin from sales of raw glass and processed glass on a lower ASP and higher natural gas cost.

Natural gas cost reduction a positive catalyst We view the recent cut in natural gas prices as a positive catalyst for XYS in 2015 as natural gas costs account for >30% of COGS in the solar glass segment (our estimate). Management is conservatively positive on the potential for cost reduction in its solar glass segment. We expect the effect of lower natural gas costs as well as economies of scale after the full commencement of its new production line to be fully reflected in 2H15. We believe gross margin in its solar glass segment will improve from 30.9% to 33.5% in 2015.

Target to reach solar farm capacity of 1GW in 2015 maintained Management reiterated its target of reaching total solar capacity of 1GW in 2015, with self-owned projects of 73MW inclusive. Capex guidance was HK\$4.0bn vs our estimate of HK\$4.6bn. We expect total solar segment revenue to reach HK\$1.7bn, of which HK\$1bn revenue will come from EPC contracts. We expect the contribution from the company's solar segment to reach 34%/40% of gross profit in 2015/16 respectively.

Maintain Buy We lift our 2015/16 net profit forecasts by 25.5%/18.1% to HK\$1.0bn/1.3bn, as: 1) we expect better GPM from its solar glass segment; 2) we see higher utilization hours and installation progress in its solar farm segment; 3) we predict a lower effective tax rate. We raise our DCF-based target price from HK\$2.98 to HK\$3.05, and maintain our Buy rating. We see the recently announced cut in natural gas prices as a one-off re-rating factor for XYS. Medium term positive catalysts include an ASP rebound for solar glass and smooth progress at new solar farms.

Downside risks 1) slower-than-expected installation progress at its solar farm projects; 2) lower-than-expected ASP for raw glass and processed glass; 3) possible share placement to finance solar farm development.

Stock performance



Source: Bloomberg

Key data

Feb 27 close (HK\$)	2.30
Shares in issue (m)	6,080
Major shareholder	Mgmt. (35.5%)
Market cap (HK\$ bn)	14.0
3M avg. vol. (m)	2.1
52W high/low (HK\$)	2.95 / 1.75

Source: Bloomberg

Stock valuation

	Turnover (HK\$ m)	Net profit (HK\$ m)	EPS (HK\$)	EPS YoY (%)	P/E	BPS (HK\$)	P/B	ROE (%)
2013	1,968	304	0.053	55	43.2	0.405	5.7	13.1
2014	2,410	493	0.081	52	28.4	0.544	4.2	14.9
2015E	5,176	1,010	0.166	105	13.8	0.655	3.5	25.4
2016E	6,218	1,282	0.211	27	10.9	0.778	3.0	27.1
2017E	7,850	1,550	0.255	21	9.0	0.923	2.5	27.6

Sources: Company data, GF Securities (HK)

Note: Calculated based on diluted shares.

Table 1: 2014 results - comparison between our estimates and actual figures

(Yr-end Dec) (HK\$m)	1H14A	2H14E	2H14A	Deviation	2013	2014E	2014A	Deviation
Revenue	994	1,402	1,416	1.0%	1,968	2,397	2,410	0.6%
Cost of sales	(659)	(894)	(990)	10.7%	(1,375)	(1,553)	(1,649)	6.2%
Gross profit	335	508	426	-16.2%	592	843	761	-9.7%
Gross margin	33.7%	36.2%	30.1%		30.1%	35.2%	31.6%	
Other income	26	35	62	78.1%	63	60	87	45.0%
Other gains/(losses), net	(9)	0	(4)	NA	0	(9)	(13)	42.2%
Selling and marketing expenses	(44)	(71)	(55)	-23.2%	(124)	(115)	(98)	-14.4%
Administrative expenses	(71)	(108)	(89)	-17.0%	(162)	(178)	(160)	-10.3%
Operating profit	237	364	340	-6.6%	369	601	577	-4.0%
EBIT margin	23.8%	25.9%	24.0%		18.7%	25.1%	23.9%	
Finance income	3	1	(1)	-144.9%	2	4	2	-41.0%
Finance expense	(1)	(12)	(7)	-43.6%		(13)	(7)	-41.6%
Profit before income tax	239	353	332	-5.8%	370	592	572	-3.4%
Income tax expense	(39)	(67)	(40)	-41.3%	(67)	(107)	(79)	-26.1%
Tax rate	-16%	-19%	-12%		-18%	-18%	-14%	
Net profit	200	285	293	2.6%	304	485	493	1.6%
Net margin	20.1%	20.3%	20.7%		15.4%	20.3%	20.5%	

Sources: Company data, GF Securities (HK)

Table 2: DCF valuation

DCF Valuation (HK\$ m)	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Year		1	2	3	4	5	6	7	8	9	10
Free cash flow calculation											
Cash from operations	1,001	1,462	1,808	2,230	2,515	2,874	3,244	3,578	3,859	4,068	4,291
Less: Capex	(2,622)	(4,606)	(3,044)	(1,976)	(1,945)	(1,945)	(1,692)	(1,556)	(1,556)	(1,556)	(1,556)
Free cash flow	(1,621)	(3,145)	(1,236)	254	569	928	1,552	2,022	2,302	2,512	2,735
Discounted free cash flow	(2,903)	(1,053)	200	413	622	960	1,154	1,213	1,221	1,221	1,228

Terminal growth rate

2.0%

Sum of PV of discounted FCF

3,055

Terminal value

19,748

Less: Net debt (2015E)

(4,235)

Equity value (HK\$ m)

18,568

Total no. of shares

6,080

NPV per share (HKD)

3.05

WACC Derivation

Risk free rate	2.0%
Market risk premium	12%
Beta	0.7
Cost of equity	10.4%
Pre-tax Cost of debt	4.1%
Effective tax rate	14%
After-tax cost of debt	3.54%
Estimated debt-to-capital ratio	30%
WACC	8.3%

Sources: Company data, GF Securities (HK)

Figure 3: Financial statements

Income Statement						Balance Sheet					
Year end Dec (HK\$ m)	2013	2014	2015E	2016E	2017E	Year end Dec (HK\$ m)	2013	2014	2015E	2016E	2017E
Ultra-clear PV raw glass	562	237	293	293	453	Cash and cash equivalents	279	543	765	493	580
Ultra-clear PV processed glass	1,405	2,142	3,224	3,733	4,827	Inventories	91	299	616	722	912
Other glass	1	0	0	0	0	Trade and other receivables	705	760	1,573	1,890	2,386
Solar projects	0	31	1,660	2,193	2,571	Other current assets	0	0	0	0	0
Turnover	1,968	2,410	5,176	6,218	7,850	Total current assets	1,075	1,602	2,954	3,105	3,878
YoY (%)	28.3	22.5	114.8	20.1	26.2	Property, plant & equipment	1,368	3,685	7,949	10,525	11,954
Ultra-clear PV raw glass	104	26	35	35	54	Land use right	189	180	181	177	173
Ultra-clear PV processed glass	489	708	1,144	1,306	1,689	Prepayments	54	295	295	295	295
Other glass	(0)	0	0	0	0	Other non-current assets	1	1	1	1	1
Solar projects	0	27	604	899	1,081	Total non-current assets	1,612	4,162	8,426	10,998	12,424
Gross profit	592	761	1,783	2,240	2,825	Total assets	2,687	5,764	11,380	14,103	16,302
YoY (%)	124.2	28.5	134.4	25.6	26.1	Short-term borrowings	0	143	1,500	2,000	2,000
Other income	63	87	86	86	86	Trade and other payables	350	1,121	2,306	2,704	3,415
Other gains/(losses), net	0	(13)	0	0	0	Other current liabilities	17	28	81	160	264
Selling and marketing expenses	(124)	(98)	(176)	(201)	(321)	Total current liabilities	367	1,291	3,887	4,864	5,679
Administrative expenses	(162)	(160)	(303)	(354)	(457)	Long-term borrowings	0	1,157	3,500	4,500	5,000
Operating profit	369	577	1,391	1,771	2,133	Other non-current liabilities	10	10	10	10	10
YoY (%)	24.7	68.9	47.4	33.7	45.1	Total non-current liabilities	10	1,167	3,510	4,510	5,010
Net finance income/(expenses)	2	(5)	(203)	(263)	(288)	Total liabilities	377	2,458	7,397	9,374	10,689
Pre-tax profit	370	572	1,188	1,509	1,846	Share capital & reserves	1,809	2,387	2,387	2,387	2,387
YoY (%)	157.7	54.3	107.8	27.0	22.4	Other reserves	502	919	1,596	2,342	3,226
Income tax expense	(67)	(79)	(178)	(226)	(295)	Equity attri. to shareholders	2,310	3,306	3,983	4,729	5,613
Net profit	304	493	1,010	1,282	1,550						
YoY (%)	153.5	62.3	104.9	27.0	20.9						

Cash Flow Statement						Financial Ratio					
Year end Dec (HK\$ m)	2013	2014E	2015E	2016E	2017E	2013	2014E	2015E	2016E	2017E	
Pre-tax profit	370	572	1,188	1,509	1,846	Gross margin (%)	30.1	31.6	34.5	36.0	36.0
Tax paid	(44)	(67)	(125)	(147)	(192)	EBIT margin (%)	18.7	23.9	26.9	28.5	27.2
Dep'n and amortization	100	91	347	472	550	Net margin (%)	15.4	20.5	19.5	20.6	19.8
Change in working capital	224	507	56	(25)	26	ROA (%)	11.3	8.6	8.9	9.1	9.5
Others	3	(102)	(5)	0	0	ROE (%)	13.1	14.9	25.4	27.1	27.6
Cash from operations	654	1,001	1,462	1,808	2,230	Net gearing (%)	NC	0.2	106.3	127.0	114.4
Capital expenditure	(240)	(2,381)	(4,606)	(3,044)	(1,976)	Interest coverage (x)	(210.8)	113.5	6.9	6.7	7.4
Others	115	(241)	0	0	0	Current ratio	2.9	1.2	0.8	0.6	0.7
Cash from investing	(125)	(2,622)	(4,606)	(3,044)	(1,976)						
Proceed from share issuance	0	778	0	0	0						
Change in borrowings	0	1,300	3,700	1,500	500						
Dividend paid	0	(194)	(333)	(536)	(666)						
Others	(305)	0	0	0	0						
Cash from financing	(305)	1,884	3,367	964	(166)						
FX change	1	0	0	0	0						
Net change in cash	225	264	223	(273)	88						

Sources: Company data, GF Securities (HK)

Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

Company ratings

Buy	Stock expected to outperform benchmark by more than 15%
Accumulate	Stock expected to outperform benchmark by more than 5% but not more than 15%
Hold	Expected stock relative performance ranges between -5% and 5%
Underperform	Stock expected to underperform benchmark by more than 5%

Sector ratings

Positive	Sector expected to outperform benchmark by more than 10%
Neutral	Expected sector relative performance ranges between -10% and 10%
Cautious	Sector expected to underperform benchmark by more than 10%

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