

COMPANY NOTE

Target | Estimate Change

China | Industrials | Basic Materials

12 June 2017

Jefferies

Xinyi Glass (868 HK) Higher Volume + Higher Margin

Key Takeaway

XYG's share price has been moving inline with glass margin spread but has yet to price in volume growth from Malaysia and the supply side improvement in China, in our view. We believe it is still early to worry about domestic demand given the lag time between glass demand and construction new start. Shares of XYG are now trading at 7x forward PE with 6% dividend yield, attractively valued.

A bargain for an industry leader. XYG's share price has been moving inline with glass margin spread (Chart 1) in the past three years, but we believe it hasn't priced in the volume growth driven by new capacity in Malaysia as well as the structural supply side improvement in China. Shares of XYG are trading at 7x forward PE with 6% div. yield, attractively valued.

New capacity in Malaysia: The new plant in Malaysia has been running at full capacity since April, and should lead to 5% incremental growth in sales volume of float glass this year, in our view. Sales from Malaysia could yield higher margin due to lower cost, but capacity in Malaysia is still small compared to the overall capacity, thus, margin upside is minimal for now. The company has started building two more lines of float glass capacity in Malaysia (equivalent to ~10% of current capacity), and expect to start production by 2H18, and should lead to further volume growth and margin upside going forward.

Still early to worry about demand: Glass prices have pretty much flat YTD, thanks to stable demand and supply side discipline among the glassmakers. Although we are cautious on property demand next year due to increasing tightening policies in the property and banking sector, we are confident on glass demand and pricing for 2018 given that glass demand typically has a year lag time vs. construction new start.

Over concern on cost: We think winter peak season price hike of natural gas will be a norm going forward but we expect natural gas cost to be flat yoy given the weak oil price outlook. The large price hike of soda ash due to environmental policy was a one-off, in our view. We forecast FY17 average gross margin of float glass to be 2H last year.

Valuation/Risks

We maintain Buy and raise PT from HK\$8.6 to HK\$9.3 based on SOTP, valuing its glass business (float/auto/construction glass) at 10x 2018E earnings and Xinyi Solar at current market price. Our PT HK\$9.3 implies 9x 2018E P/E and 2.1x 2018E P/B, in-line with the historical average.

HKD	Prev.	2016A	Prev.	2017E	Prev.	2018E	Prev.	2019E
Rev. (MM)	--	12,848.0	14,194.0	14,405.0	14,711.0	14,877.0	--	15,282.0
Operating Profit (MM)	--	2,837.0	2,981.0	3,313.0	3,196.0	3,631.0	--	3,723.0
Net Profit	--	3,213.0	3,399.0	3,672.0	3,649.0	4,011.0	--	4,129.0
ROE	--	24.4%	22.6%	24.0%	21.4%	22.9%	--	20.9%
DPS	--	0.40	0.42	0.46	0.45	0.50	--	0.51
Cons. EPS	--	--	0.92	0.93	0.99	1.01	--	1.03
EPS								
FY Dec	--	0.83	0.88	0.95	0.94	1.03	--	1.06
FY P/E	--	9.3x		8.1x		7.4x	--	7.2x

BUY

Price target HK\$9.30
(from HK\$8.60)
Price HK\$7.67^

Bloomberg: 868 HK
Reuters: 868.HK

Financial Summary

Net Debt (MM): HK\$4,911.0

Market Data

52 Week Range: HK\$7.95 - HK\$4.95

Total Entprs. Value (MM): HK\$34,991.2

Market Cap. (MM): HK\$30,080.2

Shares Out. (MM): 3,921.8

Float (MM): 1,850.4

Avg. Daily Vol.: 10,747,560

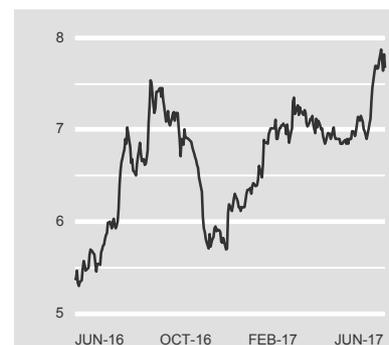
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Price Performance



^Prior trading day's closing price unless otherwise noted.

Scenarios

Target Investment Thesis

- Float glass capacity to reach 5.4mt by YE2018
- Float glass ASP to increase by 13% and stay flat in 2017 and 2018
- Gross margin expanded to ~37% for FY17
- Target price: HK\$9.3 based on SOTP valuation methodology, valuing its glass business at 10x 2018 PE and Xinyi Solar stake at current market price

Upside Scenario

- Float glass capacity to ramp up faster than expected
- Float glass ASP to increase by 16% and 5% in 2017 and 2018
- Gross margin expanded to >37% for FY16
- Target price: HK\$11.0 based on SOTP valuation methodology, valuing its glass business at 12x 2018 PE and Xinyi Solar stake at current market price

Downside Scenario

- Float glass capacity to ramp up slower than expected
- Float glass ASP to increase by 8% in 2017 and stars to decline 2018
- Gross margin contracted to <37% for FY16
- Target price: HK\$7.6 based on SOTP valuation methodology, valuing its glass business at 8x 2018 PE and Xinyi Solar stake at current market price

Long Term Analysis

1 Year Forward PE



Source: Bloomberg, Jefferies estimates

Financial Model Drivers

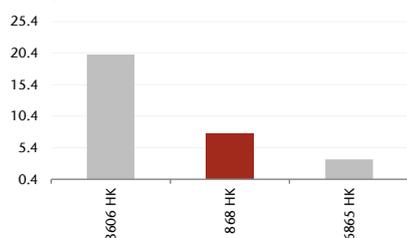
Earnings CAGR (FY16-19E)	9%
Revenue CAGR (FY16-19E)	6%
EBIT CAGR (FY16-19E)	9%

Other Considerations

- Soda ash price hike due to environmental regulation
- Policy to lower natural gas cost
- Property curbing measures that could negatively impact demand

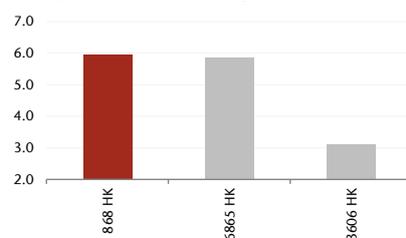
Peer Group

Group 2018 P/E



Source: Bloomberg, Jefferies estimates

Group 2017 Dividend yield (%)



Source: Bloomberg, Jefferies estimates

Ratings / Price Target

Ticker	Rec.	PT
868 HK	Buy	HK\$9.30
3606 HK	Buy	HK\$24.0
6865 HK	NC	NC

Catalysts

- Capacity closure and restriction to build new capacity
- Float glass price rise during peak season in end of 3Q

Company Description

Xinyi Glass is engaged in the production and sales of a wide range of glass products, including automobile glass, energy saving construction glass, high quality float glass and other glass products. Its customers include companies in the business of automobile glass manufacturing, wholesale and distribution, curtain wall engineering and installing, construction and furniture glass manufacturing, and float glass wholesale and distribution. As of YE15, the company has ~5mt of float glass capacity.

Changes in estimates

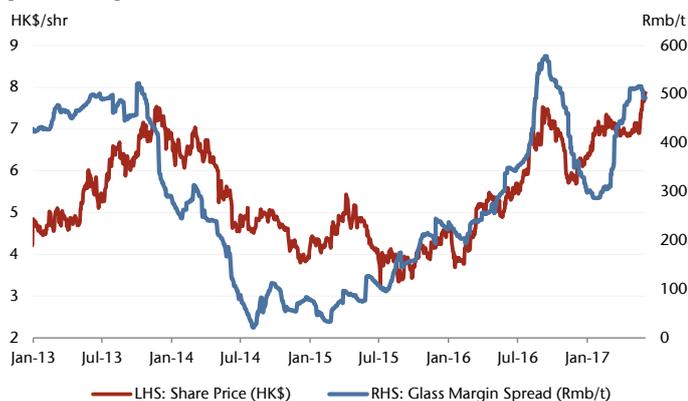
We revised up our volume and gross margins to incorporate current glass margin spread and the new Malaysia capacity. We revise up our FY17/18 earnings estimates by about 8%/10%, as we price in higher volume and GP/t of the float glass business.

Table 1: Changes in estimates

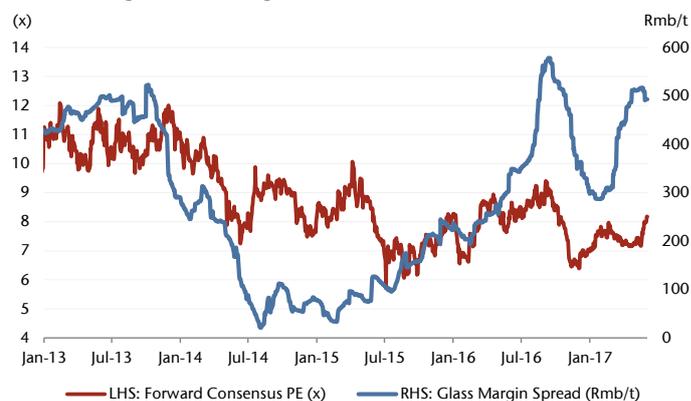
		Old		New		Changes	
		2017E	2018E	2017E	2018E	2017E	2018E
Revenue	HK\$ m	14,194	14,711	14,405	14,877	1.5%	1.1%
Gross profit	HK\$ m	4,994	5,283	5,357	5,741	7.3%	8.7%
Operating profit	HK\$ m	2,981	3,196	3,313	3,631	11.2%	13.6%
NPAT	HK\$ m	3,399	3,649	3,672	4,011	8.1%	9.9%
Diluted EPS	HK\$	0.86	0.92	0.93	1.01	8.0%	9.8%

Source: Company data, Jefferies estimate

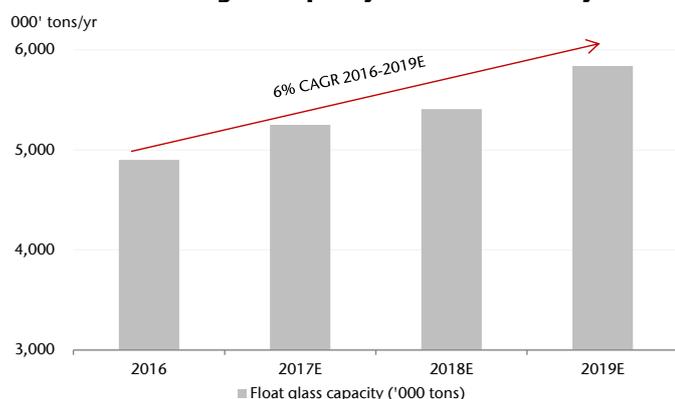
Shares are undervalued. YYG's share price has been moving closely with glass margin (Chart 1) in the past three years, but has not priced in the volume growth driven by the new Malaysia capacity as well as the structural supply side improvement in the domestic market, in our view. Shares of XYG are now trading at 7x forward PE with 6% dividend yield, attractively valued.

Chart 1: XYG's share price moved closely with glass margin spread improvement

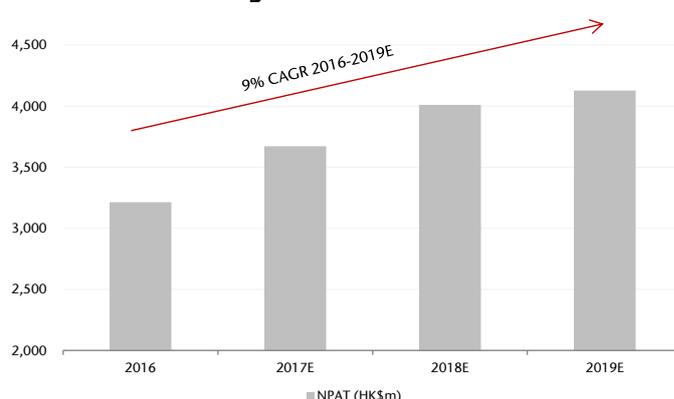
Source: Wind, Bloomberg, Jefferies Estimate

Chart 2: but has not priced in the increase in sales volume/higher earnings

Source: Wind, Bloomberg, Jefferies Estimate

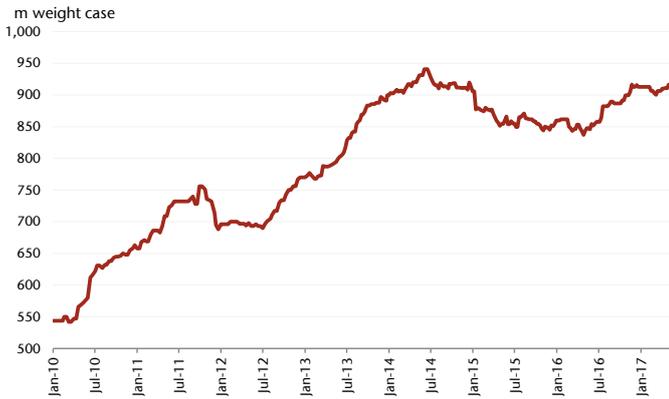
Chart 3: New float glass capacity comes from Malaysia

Source: Company data, Jefferies Estimate

Chart 4: XYG's earnings to record 9% CAGR in 2016-19E

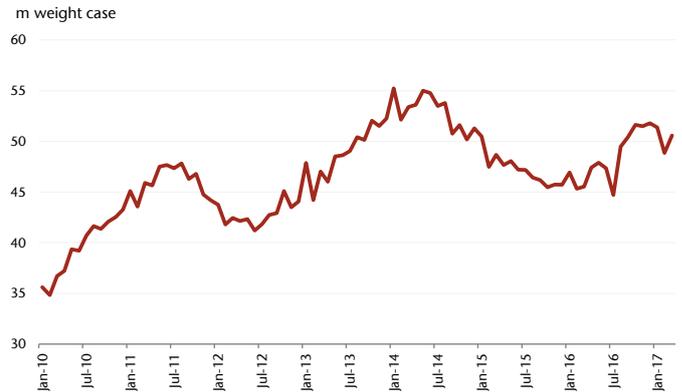
Source: Company data, Jefferies Estimate

Chart 5: Capacity in operation has gone up with ASP in 2H16 and stayed flat YTD



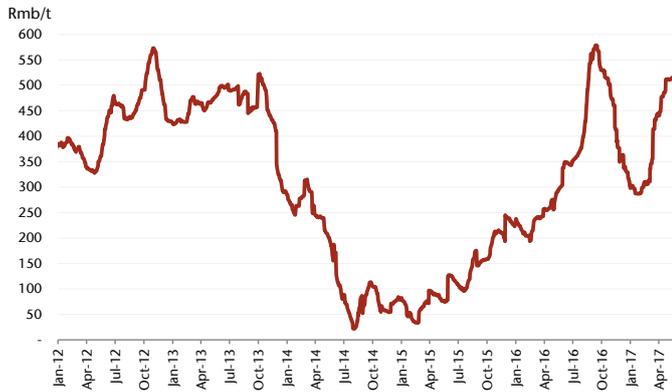
Source: Wind, Jefferies

Chart 6: Monthly float glass production remain strong post CNY



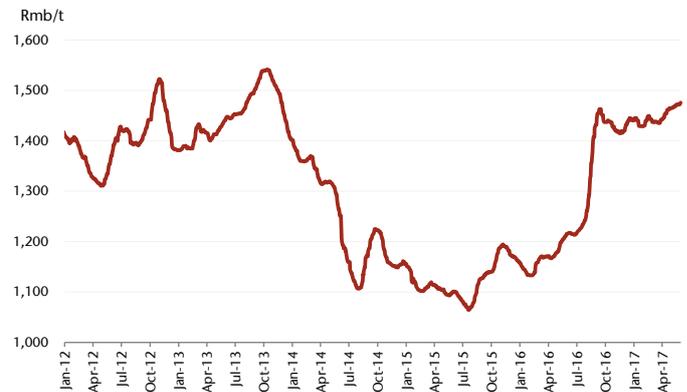
Source: Wind, Bloomberg, Jefferies Estimate

Chart 7: Margin spread (ASP minus soda ash and natural gas cost)



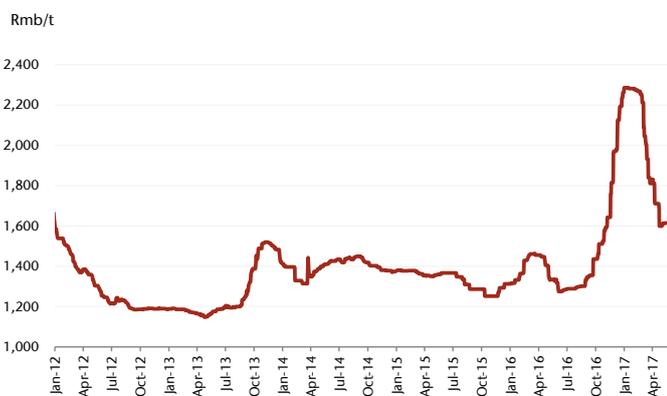
Source: Wind, Jefferies

Chart 8: National average glass price has stayed flat YTD



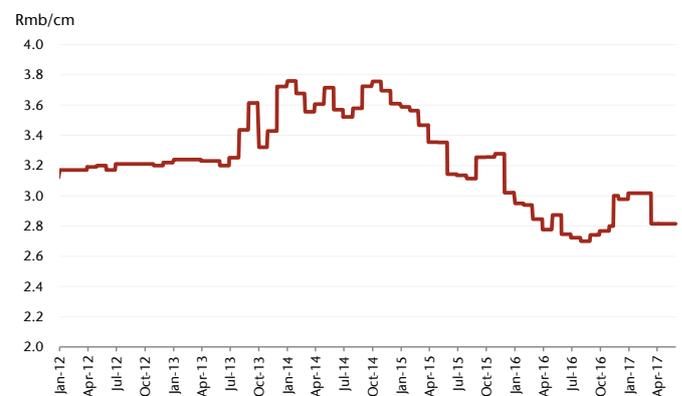
Source: Wind, Bloomberg, Jefferies Estimate

Chart 9: Soda ash price: huge price hike was a one off, in our view



Source: Wind, Jefferies

Chart 10: Natural gas price: peak season price hike of natural gas like last year will be a norm going forward



Source: Wind, Bloomberg, Jefferies Estimate

PT of HK\$8.6

We value Xinyi Glass based on SOTP valuation methodology, valuing its glass business (float/auto/construction glass) at 10x 2018E earnings and Xinyi Solar at the current market price. Our PT of HK\$9.3 implies 9x 2018E P/E and 2.1x 2018E P/B, in-line with the historical average.

Chart 11: Xinyi Glass Valuation

Xinyi Glass	
Float/Auto/Construction Glass Business	
NPAT (2018E)	3,330
x Target multiple	10
Market Value (HK\$ m)	33,298
÷ Shares outstanding (m)	3,882
Share price (HK\$/share)	8.58
Xinyi Solar (968 HK)	
Current Share Price (HK\$)	2.39
XYG's shareholdings	30%
Market value of Xinyi Solar's holdings	0.71
Target Price	9.28
Rounded to HK\$0.10/share	9.30
Latest price	7.67
Upside	21%

Source: Jefferies estimates

Risks

Key risks to our estimates and PT: Liquidity tightening policy, which could negatively impact new floor spaces started and construction demand; collapse in float glass prices due to more than expected new capacity in operation and slowdown in demand growth; intensifying competition of high quality float glass product; additional expenses due to overseas capacity expansion; trade disputes and currency fluctuations.

Table 2: Valuation comparison

Company	Ticker	Mkt cap (US\$ bn)	Price (local)	Target (local)	Rec.	Upside to target	P/E (x)		P/B (x)		EV*/EBITDA (x)		ROE (%)		Div Yield (%)	
							2017E	2018E	2017E	2018E	2017E	2018E	2017E	2018E	2017E	2018E
Glass - H																
Fuyao Glass	3606 HK	9.7	31.50	24.00	Buy	-24%	22.4	20.2	3.8	3.5	11.1	9.9	16.8	17.5	3.1	3.5
Consensus							19.3	17.1	3.5	3.2	11.7	10.1	18.4	18.5	3.1	3.5
Xinyi Glass	868 HK	3.9	7.67	9.30	Buy	21%	8.3	7.6	1.9	1.7	7.5	6.8	24.0	22.9	6.0	6.5
Consensus							8.3	7.6	1.9	1.7	7.9	7.3	24.7	23.2	5.8	6.4
Flat Glass	6865 HK	0.3	1.51		NC		4.2	3.6	nmf	nmf	2.3	1.8	18.7	23.2	5.9	7.2
Average							11.6	10.4	2.9	2.6	7.0	6.2	19.8	21.2	5.0	5.7
Glass - A																
Fuyao Glass - A	600660 CH	9.7	26.10		NC		18.7	16.3	3.3	3.0	11.8	10.1	18.5	18.6	3.2	3.6
CSG Holdings	000012 CH	2.3	9.23		NC		17.6	14.0	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf
Zhuzhou Kibing Group	601636 CH	1.7	4.29		NC		11.5	9.8	1.5	1.3	7.0	6.3	14.3	14.3	nmf	nmf
Jinjing Group	600586 CH	1.0	4.53		NC		9.2	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf	nmf
Average							14.3	13.3	2.4	2.2	9.4	8.2	16.4	16.5	3.2	3.6

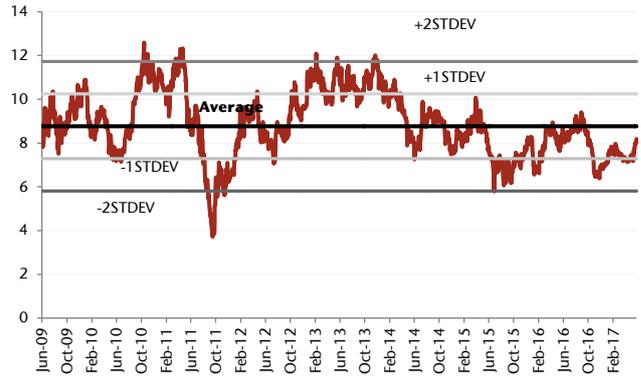
Source: Company data, Jefferies estimates, NC data from Bloomberg,

Chart 12: Xinyi Glass Historical PE Chart



Source: Bloomberg, Jefferies

Chart 13: Xinyi Glass Historical PE Chart



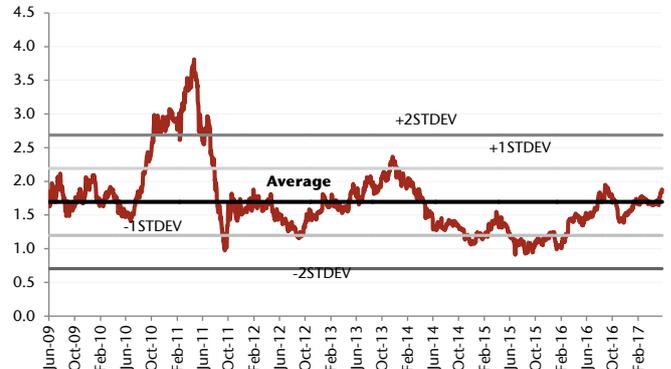
Source: Bloomberg, Jefferies

Chart 14: Xinyi Glass Historical PB Chart



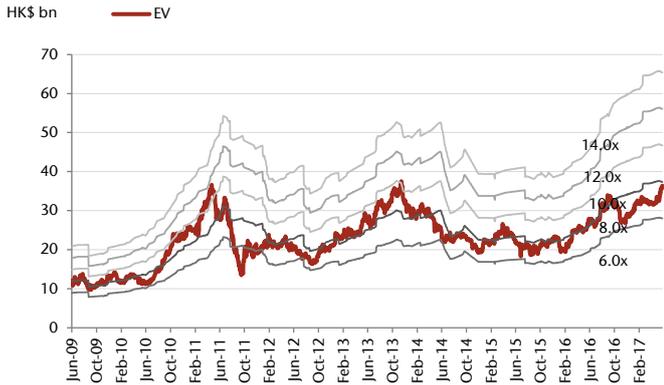
Source: Bloomberg, Jefferies

Chart 15: Xinyi Glass Historical PB Chart



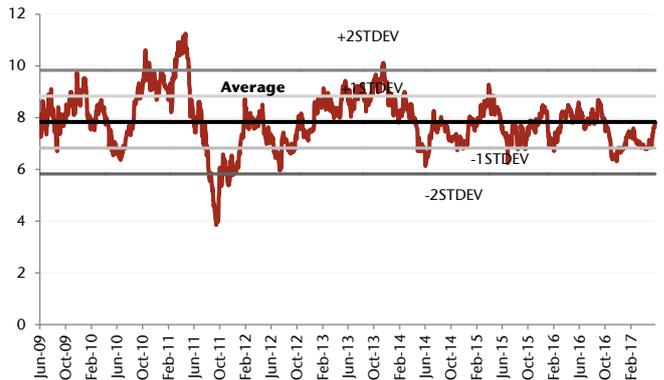
Source: Bloomberg, Jefferies

Chart 16: Xinyi Glass Historical EV/EBITDA Chart



Source: Bloomberg, Jefferies

Chart 17: Xinyi Glass Historical EV/EBITDA Chart



Source: Bloomberg, Jefferies

Table 3: Xinyi Glass Financials Summary

Income statement					Cash flow				
HK\$ m	2016	2017E	2018E	2019E	HK\$ m	2016	2017E	2018E	2019E
Revenue	12,848	14,405	14,877	15,282	Profit before tax	3,823	4,362	4,772	4,904
COGS	-8,189	-9,048	-9,136	-9,391	D&A	824	816	932	972
Gross profit	4,659	5,357	5,741	5,891	Change in working cap.	46	-186	-77	-44
Operating expenses	-1,822	-2,043	-2,110	-2,168	Other	-1,542	-693	-758	-779
Operating profit	2,837	3,313	3,631	3,723	CF from operations	3,151	4,300	4,870	5,052
Other gains - net	552	569	611	662	Capex	-1,853	-2,500	-1,500	-1,000
Share of results of assoc. & JCE's	563	619	681	681	Acquisitions and others	0	0	0	0
Finance costs	-128	-139	-150	-162	CF from investing	-1,853	-2,500	-1,500	-1,000
Pre-tax profit	3,823	4,362	4,772	4,904	Equity raised/ (repaid)	-1,467	0	0	0
Tax	-607	-693	-758	-779	Debt raised/ (repaid)	1,646	681	681	681
Profit	3,216	3,669	4,014	4,125	Dividends, interest and others	-981	-1,553	-1,775	-1,941
Minority interest	-3	3	-3	4	CF from financing	-802	-871	-1,093	-1,260
Net profit	3,213	3,672	4,011	4,129	Net cash flow	496	929	2,276	2,792
Basic EPS (Rmb)	0.83	0.95	1.03	1.06	Exchange gain	0	0	0	0
Diluted EPS (Rmb)	0.81	0.93	1.01	1.04	Cash at end of year	2,763	3,692	5,968	8,760
Balance sheet					Ratio & financial metrics analysis				
HK\$ m	2016	2017E	2018E	2019E		2016	2017E	2018E	2019E
Cash	2,763	3,692	5,968	8,760	Revenue Growth	12.1%	12.1%	3.3%	2.7%
Inventories	1,321	1,459	1,473	1,514	EBIT Growth	86.9%	16.8%	9.6%	2.5%
Receivables	2,377	2,665	2,752	2,827	EPS Growth	53.6%	14.3%	9.2%	2.9%
Other current assets	76	76	76	76	EBIT Margin	22.1%	23.0%	24.4%	24.4%
Fix assets	11,831	13,514	14,082	14,110	Net Profit Margin	25.0%	25.5%	27.0%	27.0%
Others assets	5,655	5,655	5,655	5,655	Payout Ratio	48.3%	48.3%	48.3%	48.3%
Total assets	24,022	27,061	30,007	32,943	Valuation metrics				
ST debt	3,165	3,817	4,468	5,119	PER (x)	9.3	8.1	7.4	7.4
Other current liabilities	2,835	3,076	3,101	3,172	EV/EBITDA (x)	9.6	8.4	7.3	6.6
LT debt	4,509	4,539	4,569	4,599	Price to Book (x)	2.3	1.9	1.7	1.5
Other LT liabilities	266	266	266	266	Balance Sheet Ratios				
Total liabilities	10,775	11,698	12,404	13,157	ROE	24.4%	24.0%	22.9%	20.9%
Shareholder's equity	13,181	15,301	17,536	19,727	ROCE	13.2%	14.0%	14.8%	15.1%
Minority interests	66	63	66	63	Net debt to Equity	37.1%	30.4%	17.4%	4.8%
Total liability & equity	24,022	27,061	30,007	32,947	Interest coverage (x)	28.7	29.7	30.4	29.0
					Book value per share	3.4	3.9	4.5	5.1

Source: Company data, Jefferies estimates

Company Description

Xinyi Glass is engaged in the production and sales of a wide range of glass products, including automobile glass, energy saving construction glass, high quality float glass and other glass products. Its customers include companies in the business of automobile glass manufacturing, wholesale and distribution, curtain wall engineering and installing, construction and furniture glass manufacturing, and float glass wholesale and distribution. As of YE15, the company has ~5mt of float glass capacity.

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Investment Recommendation Record

(Article 3(1)e and Article 7 of MAR)

Recommendation Published , 13:56 ET. June 11, 2017
Recommendation Distributed , 14:15 ET. June 11, 2017

Explanation of Jefferies Ratings

Buy - Describes securities that we expect to provide a total return (price appreciation plus yield) of 15% or more within a 12-month period.

Hold - Describes securities that we expect to provide a total return (price appreciation plus yield) of plus 15% or minus 10% within a 12-month period.

Underperform - Describes securities that we expect to provide a total return (price appreciation plus yield) of minus 10% or less within a 12-month period.

The expected total return (price appreciation plus yield) for Buy rated securities with an average security price consistently below \$10 is 20% or more within a 12-month period as these companies are typically more volatile than the overall stock market. For Hold rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is plus or minus 20% within a 12-month period. For Underperform rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is minus 20% or less within a 12-month period.

NR - The investment rating and price target have been temporarily suspended. Such suspensions are in compliance with applicable regulations and/or Jefferies policies.

CS - Coverage Suspended. Jefferies has suspended coverage of this company.

NC - Not covered. Jefferies does not cover this company.

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Monitor - Describes securities whose company fundamentals and financials are being monitored, and for which no financial projections or opinions on the investment merits of the company are provided.

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Risks which may impede the achievement of our Price Target

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Other Companies Mentioned in This Report

- Fuyao Glass Industry Group Co., Ltd. (3606 HK: HK\$31.50, BUY)
- Xinyi Glass Holdings Limited (868 HK: HK\$7.67, BUY)

Rating and Price Target History for: Xinyi Glass Holdings Limited (868 HK) as of 06-08-2017

09/21/16
I:B:HKD8.6



Rating and Price Target History for: Fuyao Glass Industry Group Co., Ltd. (3606 HK) as of 06-08-2017

09/21/16
I:B:HKD24



Notes: Each box in the Rating and Price Target History chart above represents actions over the past three years in which an analyst initiated on a company, made a change to a rating or price target of a company or discontinued coverage of a company.

Legend:

I: Initiating Coverage

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

868 HK

Target | Estimate Change

12 June 2017

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Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY	1093	50.00%	336	30.74%
HOLD	926	42.36%	181	19.55%
UNDERPERFORM	167	7.64%	13	7.78%

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