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5 May 2017

China Materials

Reuters 0868.HK
Bloomberg 868 HK

Priced on 4 May 2017

HS CEI @ 10,088.0

12M hi/lo HK\$7.53/4.74

12M price target HK\$8.35
±% potential +20%

Shares in issue 3,891.8m
Free float (est.) 43.9%

Market cap US\$3,495m

3M average daily volume
HK\$83.1m (US\$10.7m)

Foreign s'holding 52.0%

Major shareholders

Lee Yin Yee 22.0%
Tung Ching Sai 9.8%

Stock performance (%)

	1M	3M	12M
Absolute	0.1	1.5	37.8
Relative	2.4	(2.6)	18.8
Abs (US\$)	0.0	1.1	37.5



Source: Bloomberg

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In-line operation

Stable float demand/supply with lower cost helps

Having entered the first "small" peak season of the year, we see stable float-glass demand/supply amid a satisfactory property market and no capacity growth, in line with our expectation. Meanwhile, the recent cost decline (soda ash and natural gas) will help XYG's margin outlook despite some drag in 1Q17. We also see limited impact from the recent convertible bond (CB) conversion. With the overall operation running on track and undemanding valuation of 7.5x 17CL PE/6.5% 17CL dividend yield, we stay positive on XYG with fine-tuned earnings forecasts but an unchanged BUY rating and HK\$8.35 TP.

Stable float-glass demand/supply retained

Float glass prices rebound slightly after a retreat in the slack 1Q. Indeed, the property market has been stable YTD despite tightening controls, with new GFA starts maintaining steady growth. Given the delayed impact on glass demand, we maintain our expectation of a fairly stable demand outlook in 2017. Besides, market operating float glass capacity has been flat vs the end-2016 level, suggesting a stable supply environment as well. Construction glass also logged better shipments YTD on a YoY basis with better prices, extending the gradual improvement trend from 2H16.

Easing cost pressure

The soda ash price (about 15-20% of float glass cost) has retreated about 30% from the winter peak, with the current level on par with the average 2016 level already. Besides, the 10% winter natural-gas price hike has been removed. The higher costs in 1Q17 should have dragged margins and thus we lowered our 2017 auto/construction glass GPM accordingly, though the easing cost pressure should help improve margin performance going forward.

CB exercise

A CB bondholder recently exercised HK\$545m of the principal amount just before maturity, or about 88% the outstanding amount of the CB of late. This is equivalent to about 2.49% of the new share issue, but the impact is already in our forecast.

Maintain BUY with unchanged TP

We fine-tuned our earnings forecasts with higher float/construction glass sales (mainly on ASP), offset by slightly lower GPMs for auto/construction glass amid higher costs in 1Q17, plus our recent cut in XYG's forecasts. Our TP is unchanged at HK\$8.35, which is based on a blended PE/PB approach.

Financials

Year to 31 December	15A	16A	17CL	18CL	19CL
Revenue (HK\$m)	11,460	12,848	14,278	15,228	15,990
Rev forecast change (%)	-	-	3.9	4.4	5.2
Adjusted net profit (HK\$m)	1,734	3,055	3,733	4,192	4,660
NP forecast change (%)	-	-	(0.7)	0.3	2.0
Adjusted EPS (HK¢)	43.0	76.5	93.4	105.1	116.8
CL/consensus (9) (EPS%)	-	-	104	107	107
Adj EPS growth (% YoY)	51.7	77.8	22.1	12.4	11.2
Adjusted PE (x)	16.2	9.1	7.5	6.6	6.0
Dividend yield (%)	3.8	5.7	6.5	7.3	8.1
ROE (%)	16.9	24.8	26.4	25.9	25.2
Net debt/equity (%)	37.2	37.0	34.3	21.0	8.7

Source: CLSA

Steady demand growth and stable capacity to support float glass prices to stay high

Construction glass also logged some improvement on YoY basis

Soda ash and natural gas prices retreated from high level in 1Q17

Float glass prices picked up slightly after end of slack season

Stable float-glass demand/supply retained

The float-glass market has entered into the first “small” peak season of the year, with improving market demand to drive a slight c.2% rebound in float glass prices after some retreat in the slack 1Q. Indeed, the property market has been stable YTD despite tightening controls. New GFA starts accelerated to 13.1% YoY in March (vs 10.4% in 2M17) with property inventory continued to improve, and tight supply in tier-1/2 cities will continue to support property investment. Given the delayed impact on glass demand, we maintain our expectation of a fairly stable demand outlook in 2017.

Besides, market operating float glass capacity has been flat vs the end-2016 level, suggesting a stable supply environment as well. The impact of capacity increase from new starts/the restart of previously suspended production lines is offset by those newly entered into overhaul.

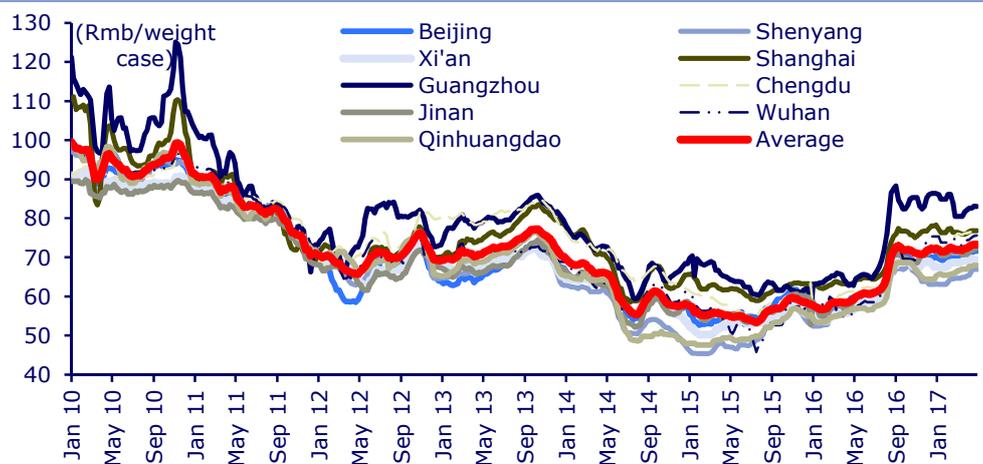
On the other hand, construction glass also logged better shipments YTD on a YoY basis, with prices being stable after some hike in 2H16, ie, extending the gradual improvement trend from 2H16 amid better property construction activities.

Easing cost pressure

The soda ash price (about 15-20% of float glass cost) has retreated about 30% from the winter peak, with the current level on par with the average 2016 level already. Besides, the 10% winter natural-gas price hike has been removed (fuel is about 30-35% of cost). Meanwhile, the higher costs in 1Q17 should have dragged margins and thus we lowered our 2017 auto/construction glass GPMs accordingly. Nonetheless, we believe the easing cost pressure should help improve margin performance going forward, even though the soda ash price is volatile and could be affected by supply distortion (eg, maintenance/pollution-control-driven shutdown). A 1% increase in fuel cost/soda ash cost will lower our 2017 core profit forecasts by about 0.6%/0.4% respectively.

Figure 1

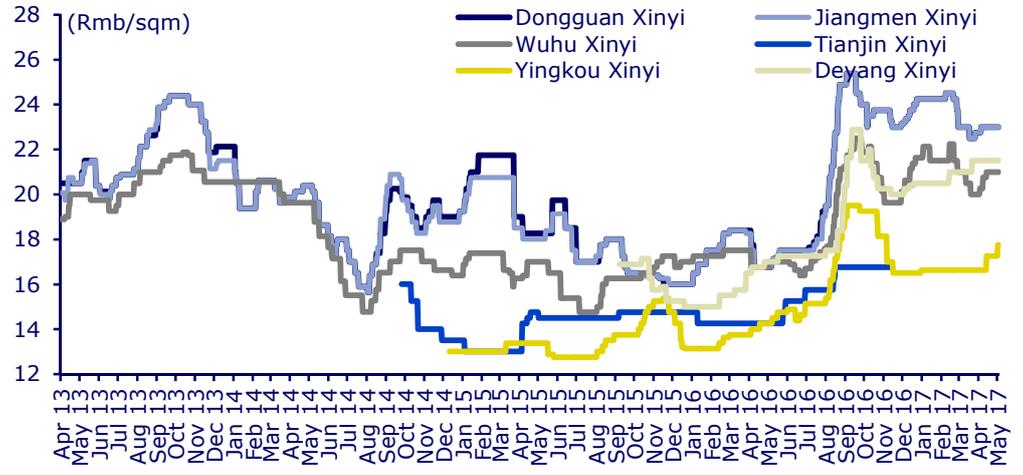
Float glass prices in various regional markets across China



Source: WIND, CLSA

Figure 2

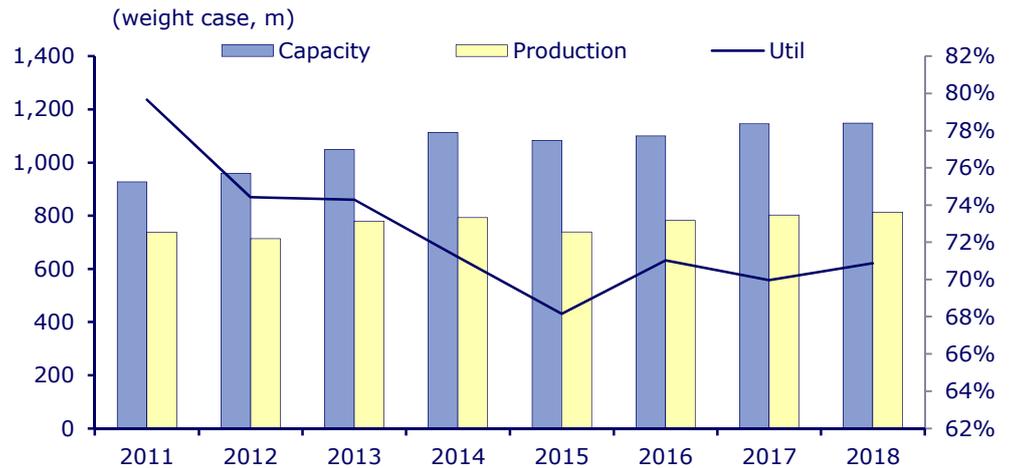
XYG's float glass product price quotes (5mm clear glass)



Source: SCI99.com, CLSA

Figure 3

Float glass demand/supply dynamics

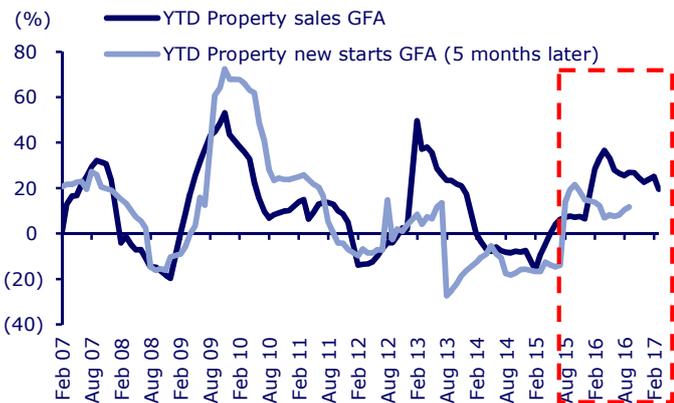


Source: CLSA

We expect fairly stable demand/supply dynamics in 2017

Figure 4

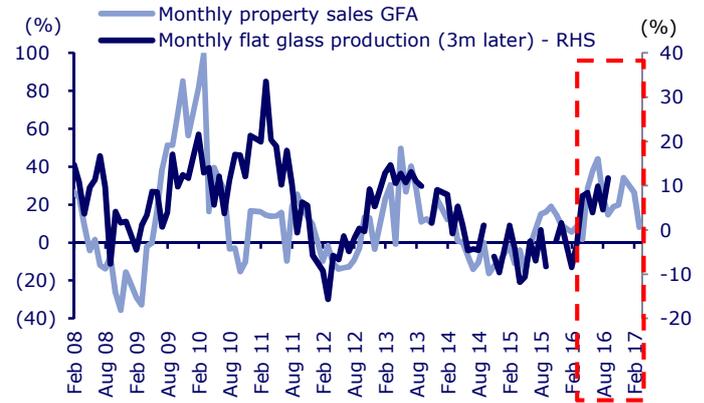
YTD Property sales/new starts started to slow but not yet massively



Source: NBS, CLSA

Figure 5

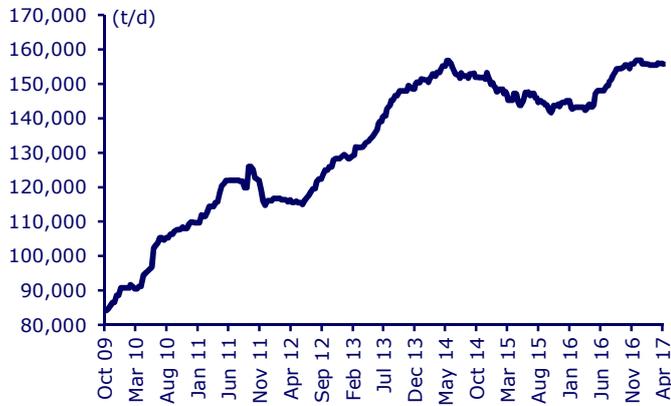
Glass demand lags behind property sales



Source: NBS, CLSA

Figure 6

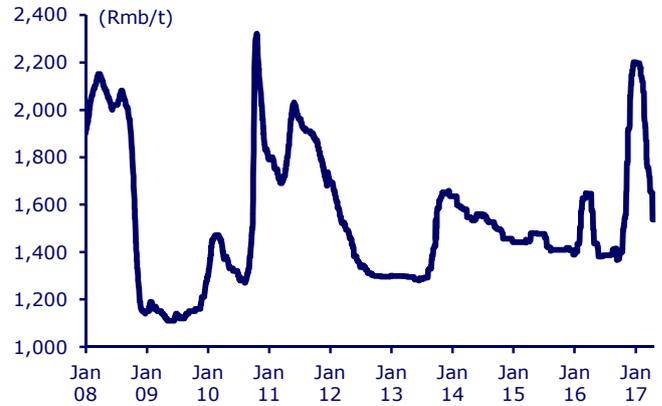
Float glass capacity under operation in China (including lines just ignited and ultra-clear lines)



Source: WIND, CLSA

Figure 7

Domestic soda ash prices



Source: WIND, CLSA

CB holder to exercise most of the CB

The CB exercise

XYG announced that the holder of its CB requested to convert HK\$531m of the CB yesterday. Together with the exercise of 2 x HK\$7m CB last week, the bondholder exercised CB of principal amount of HK\$545m.

The company issued this zero coupon CB to Och-Ziff in 2012 with a principal value of HK\$776m, maturing on 10 May 2017 with an exercise price of HK\$5.61 (after subsequent adjustment). Despite the zero coupon, XYG will redeem the CB at 121.95% of its principal amount on the maturity date. With a buyback of HK\$156m in August 2014 and the recent conversion, the total outstanding amount of the CB is HK\$75m.

Limited impact on our model

The CB conversion would result in the issue of totally 97,147,948 new shares, or 2.49% of the original outstanding share capital. We have already factored in the impact of the dilution from the CB exercise in our model.

By applying the 21.95% guaranteed return upon redemption to the exercise price of HK\$5.61, the theoretical breakeven point between redemption and conversion is HK\$6.84, and the current share price suggests it is slightly better-off to convert than to wait for redemption. Meanwhile, the conversion of CB immediately before maturity by sacrificing the 21.95% guaranteed return upon redemption, and no conversions were made even when share prices were at higher level previously, could suggest the bondholder is positive on the share price outlook of the company.

Figure 8

Earnings revisions

	17CL			18CL		
	New	Old	Change	New	Old	Change
Revenue (HK\$ m)	14,278	13,744	3.9%	15,228	14,581	4.4%
- Automobile glass products	3,806	3,794	0.3%	3,879	3,827	1.4%
- Construction glass	2,638	2,435	8.4%	2,722	2,398	13.5%
- Float glass (inc. electronic glass)	7,815	7,304	7.0%	8,552	8,005	6.8%
- Wind farm	19	210	-91.1%	75	350	-78.7%
Gross profit margin	38.0%	39.0%	-0.9 ppt	38.9%	39.6%	-0.7 ppt
- Automobile glass products	50.2%	52.4%	-2.2 ppt	51.2%	52.0%	-0.8 ppt
- Construction glass	39.4%	39.6%	-0.3 ppt	38.8%	38.6%	0.3 ppt
- Float glass (inc. electronic glass)	31.6%	30.9%	0.7 ppt	33.2%	32.6%	0.5 ppt
- Wind farm	70.3%	70.3%	0.0 ppt	70.3%	70.3%	0.0 ppt
Core profit (HK\$ m)	3,733	3,758	-0.7%	4,192	4,181	0.3%

Source: CLSA

Figure 9

Valuation of Xinyi Glass**PE basis**

Average 17-18CL EPS (HK\$)	1.05
Target multiple (x)	9.0
Fair value (HK\$)	9.50

PB basis

Average 16-17CL BVPS (HK\$)	3.78
Target multiple (x)	1.9
Fair value (HK\$)	7.20

Average (HK\$)

Implied 17/18CL PE	8.9x/7.9x
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Source: CLSA

Figure 10

Valuation of Xinyi Glass's non-solar business

HK\$m	FY17CL	FY18CL
Net profit of Xinyi Glass	3,733	4,192
Less: after-tax share of profits of Xinyi Solar	(590)	(643)
Non-solar profit	(a) 3,143	3,550
Current market cap of Xinyi Glass	(b) 27,810	27,810
Current market cap of Xinyi Solar	(c) 17,965	17,965
M'cap of Xinyi Glass's non-solar business	(d) = (b) - 29.5%*(c)	22,505
PE of Xinyi Glass's non-solar business	(e) = (d)/(a)	7.2
		6.3

Source: CLSA

Our TP is based on a blended PE and PB approach

Current market-cap implies 7.2x/6.3x its non-solar businesses earnings in 17/18CL

Figure 11

Xinyi Glass 12m fwd PE chart

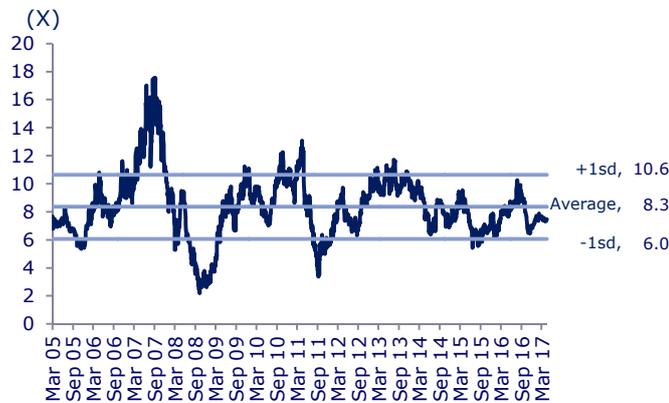
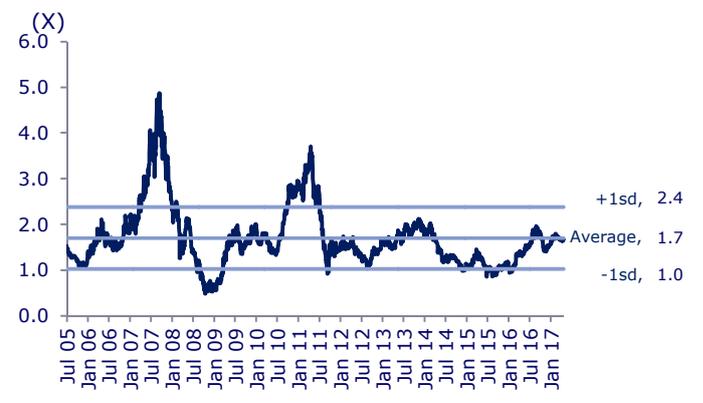


Figure 12

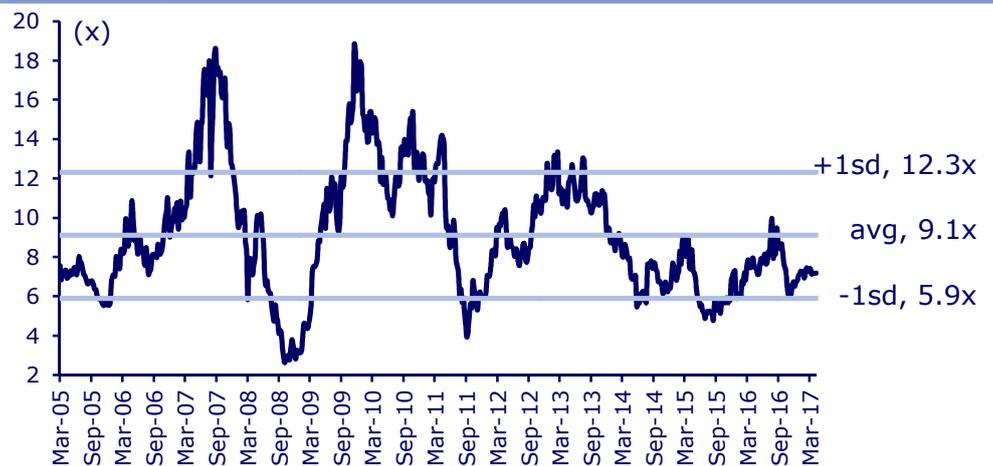
Xinyi Glass 12m fwd PB chart



Source: CLSA, Datastream

Figure 13

12m fwd PE chart – Xinyi Glass after stripping out Xinyi Solar at market price (since Dec-13)



Source: CLSA, Datastream

Figure 14

Valuation comp – Xinyi Glass

Stock	Ticker	Price (local)	Mkt Cap (USD,m)	ADTV (USD,m)	CLSA			12m forward valuations					EPS Cagr FY1-FY3	PEG	Gearing (%)	Performance (%)			
					Rec	Target	Upside	PE	PB	Yield	EV/Ebitda	ROE				1m	3m	6m	12m
Xinyi Glass	868 HK	6.97	3,495	10.7	BUY	8.35	20%	7.2	1.8	6.8	6.4	26.2	11.8	0.6	37	0	1	8	46
Fuyao Glass - H	3606 HK	27.55	8,221	5.1				16.5	3.0	3.6	9.6	18.5	9.3	1.8	0	4	21	21	57
China Glass	3300 HK	0.85	198	0.1											47	(4)	5	(8)	(14)
Luoyang Glass	1108 HK	5.06	1,010	1.8											106	(9)	(5)	(4)	0
CSG Holding	000012 CH	10.02	2,443	39.9				17.8							73	(8)	(12)	(14)	(12)
Fuyao Glass - A	600660 CH	22.14	8,221	51.0				15.2	2.7	3.9	9.7	18.5	11.9	1.3	0	(2)	19	26	54
Yaohua Pilkington	600819 CH	7.12	902	17.2											48	(14)	(13)	(8)	4
Shandong Jinjing	600586 CH	4.97	1,052	18.4											57	(1)	9	7	9
AVIC Sanxin	002163 CH	8.21	957	37.3											287	(19)	(12)	1	9
Xiuqiang Glasswork	300160 CH	9.10	789	27.9				25.3	3.3	0.6	14.9	14.2	16.5	1.5		(24)	(23)	(23)	(43)
Changzhou Almaden	002623 CH	28.63	664	14.1				35.2							39	(28)	(21)	(46)	(13)
Zhuzhou Kibing	601636 CH	4.39	1,658	25.0				11.5	1.5		6.7	14.3	19.4	0.6	56	(1)	3	16	25
Taiwan Glass	1802 TT	15.80	1,524	3.8											44	(9)	16	21	20
Asahi Glass	5201 JP	992.00	10,427	39.4	O-PF	1,025.00	3%	17.6	1.1	2.1	4.9	6.0	1.9	9.1	25	12	20	43	62
Nippon Sheet Glass	5202 JP	905.00	724	11.7				9.6	0.6	0.6	6.8	9.8	43.2	0.2	333	15	12	13	9
Central Glass	4044 JP	491.00	935	3.9				9.9	0.6	2.2	5.5	5.5	7.0	1.4	23	7	(4)	22	(17)
Hankuk Glass Industries	002000 KS	26,150.00	232	0.0											(21)	(4)	(2)	(1)	(5)
Cie de St-Gobain	SGO FP	51.02	30,980	80.4				16.9	1.4	2.6	7.7	8.4	12.2	1.4	29	7	11	31	33
PPG Industries Inc	PPG US	109.20	28,027	175.5				16.9	5.1	1.5	11.3	33.8	9.9	1.7	52	4	8	18	1
Turkiye Sise	SISE TI	4.42	2,549	4.6				11.2	1.0	3.0	6.5	9.8	8.9	1.3	13	8	9	43	32
Trakya Cam Sanayii	TRKCM TI	3.56	931	1.8				10.1	0.9	4.9	7.6	8.9	12.0	0.8	32	10	14	42	89
Corning	GLW US	28.76	26,466	172.8				16.3	1.6	2.2	8.5	9.7	7.2	2.3	(8)	7	8	28	57
Average								15.8	1.9	2.8	8.2	14.1	13.2	1.8	60.6				

Source: Bloomberg, CLSA

Valuation details

We value XYG using a blended PE and PB approach. We apply a target multiple of 9x to 18CL EPS and a target multiple of 1.9x to 17CL BVPS, in line with the historical averages.

Investment risks

Key risks include: 1) Weakening of the property market or even the auto market. Demand for float glass and construction glass is highly dependent on the property market. Besides, despite being a stable business, the auto glass segment is correlated to the global number of vehicles in use, and any significant slowdown in the global auto industry may also affect the segment's performance. 2) Further tightening of credit. Tightening of credit also affects developers' cash flows and progress in construction of property projects. 3) Incremental production costs. A significant surge in natural gas, international crude oil prices and other raw material costs may affect XYG's gross margin if it cannot pass on incremental costs by raising ASP. 4) More capacity additions in the market.

Summary financials

Year to 31 December	2015A	2016A	2017CL	2018CL	2019CL
Summary P&L forecast (HK\$m)					
Revenue	11,460	12,848	14,278	15,228	15,990
Op Ebitda	2,313	3,664	4,378	4,951	5,429
Op Ebit	1,518	2,837	3,471	3,944	4,346
Interest income	40	51	49	29	31
Interest expense	(90)	(128)	(96)	(80)	(53)
Other items	912	1,063	962	1,036	1,149
Profit before tax	2,380	3,823	4,386	4,929	5,473
Taxation	(266)	(607)	(650)	(733)	(810)
Minorities/Pref divs	0	(3)	(3)	(3)	(3)
Net profit	2,113	3,213	3,733	4,192	4,661
Summary cashflow forecast (HK\$m)					
Operating profit	1,518	2,837	3,471	3,944	4,346
Operating adjustments	-	-	-	-	-
Depreciation/amortisation	795	827	906	1,008	1,083
Working capital changes	(207)	(426)	(186)	(104)	(83)
Net interest/taxes/other	(421)	(784)	(747)	(814)	(862)
Net operating cashflow	1,685	2,453	3,445	4,033	4,484
Capital expenditure	(1,967)	(1,853)	(2,500)	(1,500)	(1,500)
Free cashflow	(282)	600	945	2,533	2,984
Acq/inv/disposals	-	-	-	-	-
Int, invt & associate div	951	1,112	1,008	1,062	1,177
Net investing cashflow	(1,016)	(741)	(1,492)	(438)	(323)
Increase in loans	16	1,646	(1,328)	(1,493)	(1,848)
Dividends	(1,029)	(1,622)	(1,804)	(2,027)	(2,253)
Net equity raised/other	812	(267)	(446)	-	-
Net financing cashflow	(202)	(244)	(3,579)	(3,520)	(4,101)
Incr/(decr) in net cash	468	1,468	(1,626)	76	61
Exch rate movements	-	-	-	-	-
Opening cash	832	1,300	2,768	1,142	1,218
Closing cash	1,300	2,768	1,142	1,218	1,279
Summary balance sheet forecast (HK\$m)					
Cash & equivalents	1,300	2,768	1,142	1,218	1,279
Debtors	1,136	1,036	1,207	1,287	1,352
Inventories	1,223	1,321	1,371	1,431	1,477
Other current assets	1,337	1,412	1,858	1,858	1,858
Fixed assets	11,971	11,831	13,453	13,974	14,419
Intangible assets	1,281	1,193	1,164	1,135	1,108
Other term assets	3,174	4,462	4,462	4,462	4,462
Total assets	21,422	24,022	24,657	25,366	25,954
Short-term debt	2,514	3,165	2,618	2,002	1,240
Creditors	740	789	824	861	888
Other current liabs	1,705	2,046	2,046	2,046	2,046
Long-term debt/CBs	3,514	4,509	3,729	2,852	1,766
Provisions/other LT liabs	223	266	266	266	266
Minorities/other equity	7	66	66	66	66
Shareholder funds	12,718	13,181	15,109	17,275	19,683
Total liabs & equity	21,422	24,022	24,657	25,366	25,954
Ratio analysis					
Revenue growth (% YoY)	5.5	12.1	11.1	6.7	5.0
Ebitda growth (% YoY)	33.0	58.4	19.5	13.1	9.7
Ebitda margin (%)	20.2	28.5	30.7	32.5	34.0
Net profit margin (%)	18.4	25.0	26.1	27.5	29.2
Dividend payout (%)	50.5	49.7	48.4	48.4	48.3
Effective tax rate (%)	11.2	15.9	14.8	14.9	14.8
Ebitda/net int exp (x)	46.1	47.7	92.2	97.8	252.8
Net debt/equity (%)	37.2	37.0	34.3	21.0	8.7
ROE (%)	16.9	24.8	26.4	25.9	25.2
ROIC (%)	8.7	15.7	18.2	19.0	20.3
EVA@/IC (%)	(2.9)	4.1	6.6	7.4	8.7

Source: CLSA

Improving margins and higher associates profit to drive earnings growth

Capex mainly on Malaysia investments

Balance sheet still healthy

Improving ROE

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Companies mentioned

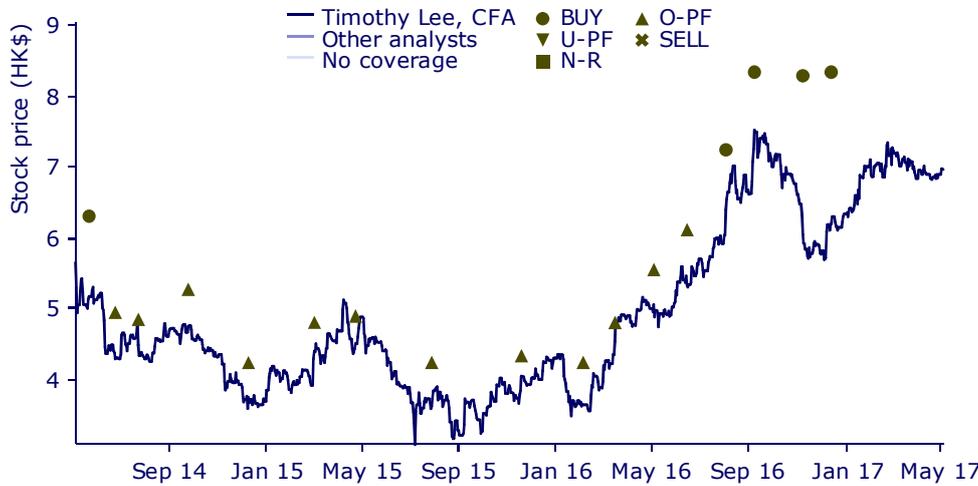
Xinyi Glass (868 HK - HK\$6.97 - BUY)
Asahi Glass (5201 JP - ¥992 - OUTPERFORM)
AVIC Sanxin (N-R)
Central Glass (N-R)
Changzhou Almaden (N-R)
China Glass (N-R)
Cie de St-Gobain (N-R)
Corning (N-R)
CSG - A (N-R)
Fuyao Glass - A (N-R)
Fuyao Glass (N-R)
Hankuk Glass Industries (N-R)
Jinjing (N-R)
Kibing (N-R)
Luoyang Glass (N-R)
NSG (N-R)
Och-Ziff (N-R)
PPG (N-R)
Sise Cam (N-R)
SYP Glass - A (N-R)
Taiwan Glass (N-R)
Trakya Cam Sanayii (N-R)
Xinyi Solar (968 HK - HK\$2.42 - BUY)
Xiuqiang Glasswork (N-R)

Analyst certification

The analyst(s) of this report hereby certify that the views expressed in this research report accurately reflect my/our own personal views about the securities and/or the issuers and that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in this research report.

Important disclosures

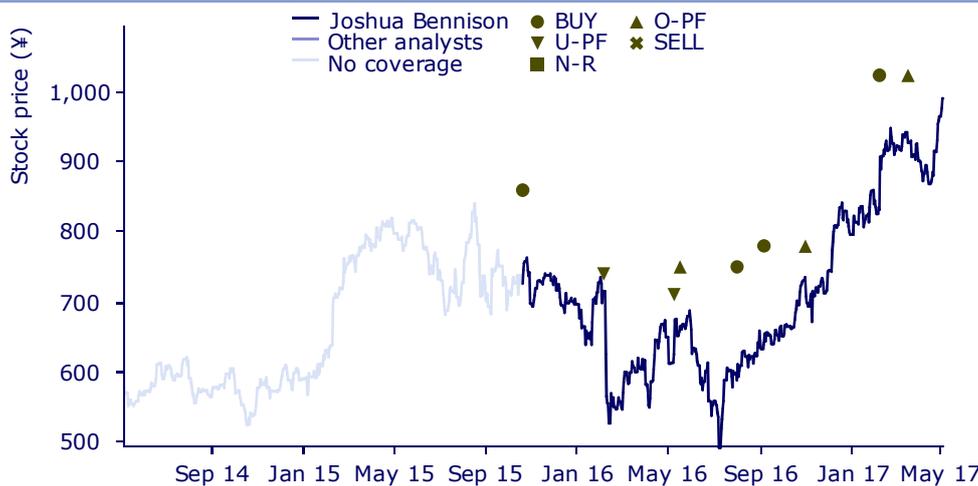
Recommendation history of Xinyi Glass Holdings Ltd 868 HK



Date	Rec	Target	Date	Rec	Target
14 Dec 2016	BUY	8.35	29 Jul 2015	O-PF	4.24*
08 Nov 2016	BUY	8.30	24 Apr 2015	O-PF	4.90*
08 Sep 2016	BUY	8.35	03 Mar 2015	O-PF	4.81*
03 Aug 2016	BUY	7.25	10 Dec 2014	O-PF	4.23*
15 Jun 2016	O-PF	6.12*	25 Sep 2014	O-PF	5.28*
04 May 2016	O-PF	5.56*	24 Jul 2014	O-PF	4.85*
16 Mar 2016	O-PF	4.80*	25 Jun 2014	O-PF	4.95*
05 Feb 2016	O-PF	4.24*	23 May 2014	BUY	6.31*
19 Nov 2015	O-PF	4.33*			

Source: CLSA; * Adjusted for corporate action

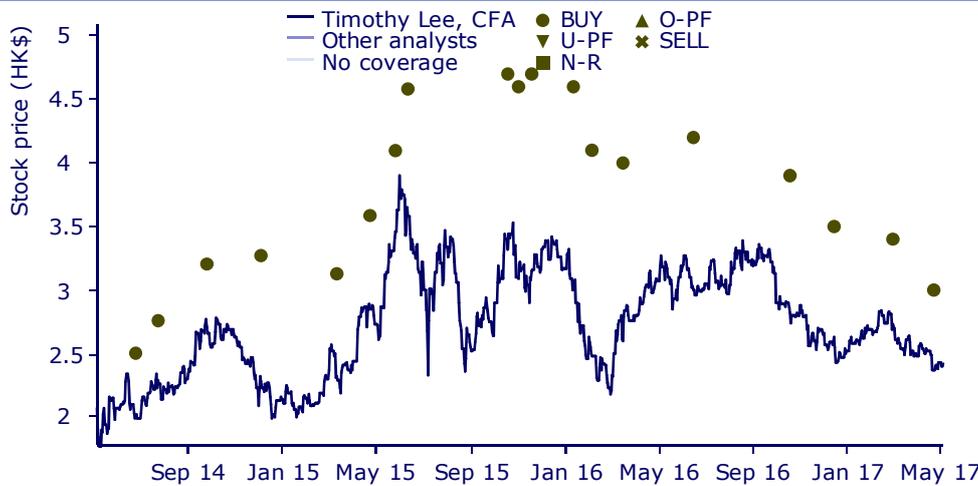
Recommendation history of Asahi Glass Co Ltd 5201 JP



Date	Rec	Target	Date	Rec	Target
17 Mar 2017	O-PF	1,025.00	17 May 2016	O-PF	750.00
07 Feb 2017	BUY	1,025.00	09 May 2016	U-PF	710.00
31 Oct 2016	O-PF	780.00	05 Feb 2016	U-PF	740.00
06 Sep 2016	BUY	780.00	20 Oct 2015	BUY	860.00
01 Aug 2016	BUY	750.00			

Source: CLSA

Recommendation history of Xinyi Solar Holdings Ltd 968 HK



Date	Rec	Target	Date	Rec	Target
22 Apr 2017	BUY	3.00	19 Oct 2015	BUY	4.70
28 Feb 2017	BUY	3.40	12 Jun 2015	BUY	4.58
14 Dec 2016	BUY	3.50	27 May 2015	BUY	4.10
18 Oct 2016	BUY	3.90	24 Apr 2015	BUY	3.59
15 Jun 2016	BUY	4.20	12 Mar 2015	BUY	3.13
16 Mar 2016	BUY	4.00	04 Dec 2014	BUY	3.27
05 Feb 2016	BUY	4.10	25 Sep 2014	BUY	3.20
12 Jan 2016	BUY	4.60	24 Jul 2014	BUY	2.76
19 Nov 2015	BUY	4.70	25 Jun 2014	BUY	2.50
02 Nov 2015	BUY	4.60			

Source: CLSA

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