

Xinyi Glass

Lifting PT to HK\$12 - Winner from trend of lower energy costs

Xinyi Glass (XYG) is one of China's largest and most diversified glass producers. We expect some benefits from lower cost of natural gas (after Sept 1) in an environment of strong pricing power for float glass. We lift our Dec 18 PT to HK\$12.0.

- Lower cost of gas should lift margins.** Natural gas was lowered by Rmb0.10 per cubic meter by the major oil companies to city gas distribution companies on 1 Sept. While the price that XYG pays is negotiated with the large oil and gas companies (mainly Petro China) directly and may not change by the same amount as city gas companies, they normally get a similar change. Since natural gas is approx. 40% of the cost of production of float glass and 20% of the cost of production of auto glass and construction glass, we expect the cost savings to result in some reduction in selling prices but some upward pressure on margins. In particular, float glass prices are at very high levels now and indicate a market shortage in many regions. This means XYG should be able to keep some of the gas savings and this should be reflected in higher GPM. We note that more than half of the float glass producers are using oil or coal based heating and they will not be able to benefit from the lower cost of gas.
- Minor increase in profits and PT.** We lower sales and profits by 1% in 2017 and 2018 to reflect lower selling price of glass products following a drop in the cost of natural gas – a key cost ingredient. We therefore increase GPM by 0.8% in 2017 and 1% in FY18 to reflect the benefits of lower natural gas cost and also relatively strong pricing power of XYG for glass products over this period. We also push our earnings estimate from FY20 to FY25 and adjust down our terminal multiple (3% at FY20 to 2% at FY25). Accordingly, we lift our DCF-based Dec 18 PT to \$12 (prev. \$11) to factor in upward net profit revisions as well as a longer estimates horizon.
- Our New Dec 18 PT implies a 8.9x CY19 PE. The.** The key downside risks 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.

Xinyi Glass (Reuters: 0868.HK, Bloomberg: 868 HK)

| HK\$ in mn, year-end Dec | FY15A | FY16A | FY17E | FY18E | FY19E |
|--------------------------|--------|--------|--------|--------|--------|
| Revenue (HK\$ mn) | 11,460 | 12,848 | 15,177 | 17,721 | 20,021 |
| Net Profit (HK\$ mn) | 2,113 | 3,216 | 4,244 | 4,859 | 5,414 |
| EPS (HK\$) | 0.54 | 0.80 | 1.06 | 1.21 | 1.35 |
| DPS (HK\$) | 0.27 | 0.40 | 0.53 | 0.61 | 0.68 |
| Revenue growth (%) | 5.5% | 12.1% | 18.1% | 16.8% | 13.0% |
| EPS growth (%) | 54.8% | 48.8% | 32.0% | 14.5% | 11.4% |
| ROCE | 8.3% | 13.5% | 15.2% | 15.5% | 16.0% |
| ROE | 16.9% | 24.8% | 28.3% | 27.0% | 26.3% |
| P/E (x) | 14.2 | 9.5 | 7.2 | 6.3 | 5.7 |
| P/BV (x) | 2.4 | 2.3 | 1.8 | 1.6 | 1.4 |
| EV/EBITDA (x) | 13.7 | 8.7 | 7.3 | 6.4 | 5.7 |
| Dividend Yield | 3.5% | 5.2% | 6.9% | 7.9% | 8.8% |

Source: Company data, Bloomberg, J.P. Morgan estimates.

Overweight

0868.HK, 868 HK

Price: HK\$7.65

▲ **Price Target: HK\$12.00**
 Previous: HK\$11.00

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Price Performance



See page 11 for analyst certification and important disclosures, including non-US analyst disclosures.

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| Key catalysts for the stock price: | Upside risks to our view: | Downside risks to our view: |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> Price of float glass improving after the slack 1Q season More information on new electric (LCD) glass business to indicate sales and profit contribution Finalization of new downstream solar projects | <ul style="list-style-type: none"> A rise in float glass price higher than our expectations driven by strong construction demand New customers for the electric glass business is of a better quality than what we expect Faster completion of new electric glass lines to boost sales | <ul style="list-style-type: none"> Further weakness in PV glass demand from Europe Falling demand for construction and float glass that may result from a cooling property market in China |

| Key financial metrics | FY16 | FY17E | FY18E | FY19E |
|-----------------------------|--------|--------|--------|--------|
| Revenues (LC) | 12,848 | 15,177 | 17,721 | 20,021 |
| Revenue growth (%) | 12.1% | 18.1% | 16.8% | 13.0% |
| EBITDA (LC) | 3,991 | 4,916 | 5,624 | 6,343 |
| EBITDA margin (%) | 31.1% | 32.4% | 31.7% | 31.7% |
| Tax rate (%) | 16% | 14% | 13% | 13% |
| Net profit (LC) | 3,216 | 4,244 | 4,859 | 5,414 |
| EPS (LC) | 0.80 | 1.06 | 1.21 | 1.35 |
| EPS growth (%) | 48.8% | 32.0% | 14.5% | 11.4% |
| DPS (LC) | 0.40 | 0.53 | 0.61 | 0.68 |
| BVPS (LC) | 3.29 | 4.19 | 4.80 | 5.47 |
| Operating cash flow (LC mn) | 3,739 | 3,995 | 4,611 | 5,360 |
| Free cash flow (LC mn) | 665 | 565 | 1,747 | 2,401 |
| Interest cover (x) | 52 | 348 | 102 | 97 |
| Net margin (%) | 25.0% | 28.0% | 27.4% | 27.0% |
| Sales/assets (X) | 0.57 | 0.58 | 0.59 | 0.60 |
| Debt/equity (%) | 57.9% | 45.6% | 39.8% | 34.9% |
| Net debt/equity (%) | 37.1% | 35.0% | 32.0% | 27.6% |
| ROE (%) | 25% | 28% | 27% | 26% |

| Key model assumptions | FY16E | FY17E | FY18E | FY19E |
|----------------------------------|-------|-------|-------|-------|
| Auto glass capacity (m) | 17.4 | 17.8 | 18.1 | 19.0 |
| Float glass capacity (mn tonnes) | 5.9 | 6.5 | 6.7 | 7.4 |
| Float glass price (HK\$/ton) | 1,573 | 1,856 | 2,041 | 2,041 |

Source: Company and J.P. Morgan estimates.

| Sensitivity analysis | EBITDA | | EPS | |
|-----------------------------|--------|-------|-------|-------|
| Sensitivity to | FY17E | FY18E | FY17E | FY18E |
| 5% chg in float glass price | 9% | 9% | 7% | 7% |
| 5% chg in fuel cost | -2% | -2% | -2% | -2% |
| 5% chg in wage | -3% | -2% | -2% | -2% |
| 1% chg in GM | 4% | 4% | 3% | 3% |

Source: J.P. Morgan estimates.

Peer valuation comparison

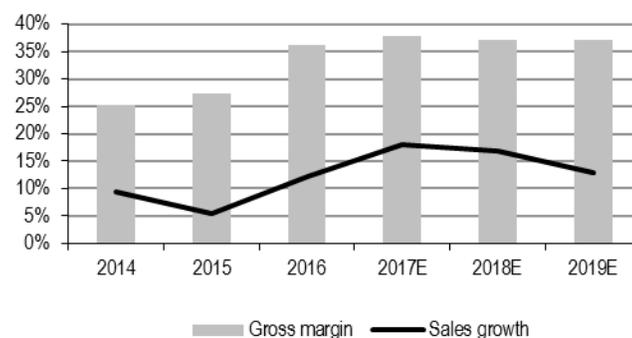
| Company Name | Code | Price (TP) | MCAP US\$MM | Vol US\$mn | 3M Chg | P/E 17e (x) | PE 18e (x) | ROE (%) | P/B (x) | Yld (%) |
|-------------------------|---------------|------------|----------------|-------------|------------|-------------|------------|-------------|------------|------------|
| CHINA STATE CONS | 3311 HK | 11.4 | 6,548.1 | 17.2 | (13.5) | 8.4 | 7.3 | 22.0 | 1.4 | 2.9 |
| ND PAPER | 2689 HK | 13.4 | 7,992.3 | 24.6 | 38.7 | 11.1 | 9.7 | 16.7 | 1.4 | 0.7 |
| LM PAPER | 2314 HK | 9.3 | 5,362.1 | 12.6 | 35.6 | 9.7 | 8.3 | 13.4 | 1.9 | 2.2 |
| XINYI GLASS HOLD | 868 HK | 7.6 | 3,911.1 | 11.4 | 5.0 | 7.2 | 6.3 | 24.8 | 1.6 | 5.2 |
| HAITIAN | 1882 HK | 22.5 | 4,593.6 | 5.0 | 19.8 | 15.1 | 12.9 | 18.1 | 2.5 | 2.0 |
| KINGBOARD CHEM | 148 HK | 42.5 | 5,654.0 | 11.2 | 51.6 | 8.0 | 6.7 | 13.5 | 0.9 | 3.1 |
| CHINA LESSO | 2128 HK | 5.5 | 2,183.6 | 2.9 | (6.2) | 6.2 | 5.9 | 18.3 | 1.0 | 3.3 |
| KB LAM | 1888 HK | 13.2 | 5,198.2 | 13.1 | 47.0 | 9.2 | 8.8 | 31.5 | 2.0 | 8.5 |
| Average | | | | | | 9.0 | 8.0 | 18.3 | 1.5 | 4.3 |

Source: Company data, Bloomberg, J.P. Morgan estimates. Share prices are as of intraday price of 5 Sep 2017

Valuation and price target basis

Our PT is derived on a DCF based valuation with a WACC of 11.4% and a terminal growth rate of 2%

Sales growth and GPM trends



Source: Bloomberg, Company and J.P. Morgan estimates.

JPM vs. consensus, change in estimates

| EPS (LC) | FY17E | FY18E |
|-----------|-------|-------|
| JPM old | 1.04 | 1.17 |
| JPM new | 1.06 | 1.21 |
| % chg | 2% | 3% |
| Consensus | 0.93 | 1.03 |

Source: Bloomberg, J.P. Morgan estimates.

Minor adjustment to 2018 sales and profits

We lower sales and profits by 1% in 2017 and 2018 to reflect lower selling price of glass products following a drop in the cost of natural gas – a key cost ingredient. Natural gas was lowered by Rmb0.10 per cubic meter to city gas companies on 1 Sept. While the price that XYG pays is negotiated with the large oil and gas companies (mainly Petro China) directly and may not change by the same amount as city gas companies, they normally get a similar price change. Since natural gas is approx. 40% of the cost of production of float glass and 20% of the cost of production of auto glass and construction glass, we expect the cost savings to result in some reduction in selling prices but some upward pressure on margins. We therefore increase GPM by 0.8% in 2017 and 1% in FY18 to reflect the benefits of lower natural gas cost and also relatively strong pricing power of XYG for glass products over this period.

We have also pushed our earnings estimate from FY20 to FY25 and adjusted down our terminal multiple (3% at FY20 to 2% at FY25). Accordingly, we lift our DCF based Dec 18 PT to \$12 (prev. \$11) to factor in upward net profit revisions as well as a longer estimates horizon.

Table 1: Earnings Revisions

| Year to Dec (HKDm) | New | | Old | | Change | |
|-----------------------|--------|--------|--------|--------|--------|-------|
| | FY17E | FY18E | FY17E | FY18E | FY17E | FY18E |
| Turnover | 15,177 | 17,721 | 15,326 | 17,890 | -1.0% | -0.9% |
| Gross profit | 5,743 | 6,560 | 5,682 | 6,435 | 1.1% | 1.9% |
| EBIT | 3,994 | 4,573 | 3,913 | 4,425 | 2.1% | 3.3% |
| Net profit | 4,244 | 4,859 | 4,160 | 4,702 | 2.0% | 3.3% |
| EPS (HKD) | 1.06 | 1.21 | 1.04 | 1.17 | 2.0% | 3.3% |
| Assumptions | | | | | | |
| Gross margin | 37.8% | 37.0% | 37.1% | 36.0% | 0.8% | 1.0% |

Source: J.P. Morgan estimates

Highlights from the 1H investor meetings

Management positive on float glass demand. Management remains positive on the sustainability of float glass demand as well as the current healthy margins. Overall construction is rising and the use of double glaze glass for residential and construction (in order to save energy) should boost demand for many years. XYG also mentioned that the quality and price premium of XYG's float glass allows the company to make superior margins while smaller and technically less sophisticated glass makers make significantly lower margins and have little incentive to expand. While new licenses for float glass facilities is increasingly difficult to obtain in the denser, richer parts of Coastal China XYG will still try to expand in order to capture market share and increase profits longer term.

More aggressive float glass expansion. XYG is now planning up to 50% expansion in its float glass capacity from the end of 2017 to the end of 2020. This annualized increase of 14-15% is more aggressive than the average 8-9% CAGR from 2015 to 2016. They did not disclose the exact location of the new expansion (up to 8 new lines) but we expect three-quarters to be in China and the rest in Malaysia and SE Asia. It is also uncertain how XYG will be able to obtain new licenses and land for expansion and we look forward to more details in the ultimate location for such expansion to see if it will trigger any oversupply or price declines.

Expansion in Malaysia going well. The company commenced its first float glass and first solar glass lines in Malaysia in late 2016 / early 2017. Management is satisfied with the performance of these lines and mentioned that the production cost is currently cheaper in Malaysia. Management has also planning to add new float and solar production lines in Malaysia over the coming years.

- **Auto glass is still weaker than expected.** We have seen a 6% y/Y drop in 1H17 auto glass sales as depreciation of many export currencies against the HK\$ dragged on sales. In addition, auto glass sales were weak in 2016 due to 3 main factors: a) Largest customer PGW in the US had an ownership change mid-2016 and the change in management disrupted purchases from XYG; b) a new anti-dumping duty from Brazil resulted in a drop in sales to that country (<3% of auto glass sales); c) rising USD resulted in many emerging markets customers buying less. We see these factors being less negative in 2H17 and expect a return to growth driven by global demand for low cost windshields
- **Construction glass hampered by FX.** Sales of construction glass were down 2.7% Y/Y in 1H17 after a 3% drop in sales in 2016. Sales would have been up low single digits in Rmb terms. We look for a seasonally better 2H17 to help achieve a flat 2017 y/y sale growth.

Valuation and share price analysis

DCF valuation

Our Dec-18 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 11.4%. We have estimated free cash flow for XYG until 2025 and assume a terminal growth rate of 2%. The terminal growth is based on the annual growth rate expected in 2025 (the final year of the estimate period) subject to a minimum of 2% and a maximum of 6% depending on the nature of the industry and the level of maturity in China.

We also analyzed the DCF price sensitivity to WACC, and the terminal multiple.

Table 2: XYG – base-case DCF analysis

| HK\$ in millions, year-end Dec | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E | 2024E | Terminal |
|----------------------------------------|---------------|-------------------------------|------------|--------------|-----------------|--------------|--------------|--------------|
| Cash flow estimates | | | | | | | | |
| Sales | 9,936 | 10,861 | 11,460 | 12,848 | 15,265 | 18,056 | 20,384 | 23,682 |
| EBIT | 2,212 | 1,274 | 1,733 | 3,178 | 3,903 | 4,473 | 5,164 | 6,087 |
| NOPAT | 2,229 | 1,092 | 1,540 | 3,243 | 4,039 | 4,740 | 5,427 | 6,204 |
| Capex, net | (2,913) | (1,715) | (1,914) | (1,853) | (2,040) | (2,866) | (2,670) | (2,399) |
| Depreciation | 639 | 644 | 795 | 812 | 885 | 985 | 1,099 | 1,190 |
| Change in working capital | 129 | 60 | 539 | 13 | (328) | (360) | (259) | (553) |
| Free operating CF (FoCF) | 84 | 82 | 959 | 2,217 | 2,558 | 2,502 | 3,601 | 4,448 |
| DCF Parameters | | | | | | | | |
| Liabilities as a % of EV | 10% | Assumptions | | | Terminal growth | | | |
| WACC | 11.4% | Risk-free rate | | | 2.0% | | | |
| Enterprise NPV (10-16E) | 53,679 | Market risk | | | 4.2% | | | |
| + Net cash (debt), 14E | (6,159) | Beta | | | 6.0% | | | |
| - Minorities (Market value) | (8) | Cost of debt | | | 1.30 | | | |
| +/- Other items | 0 | Implied exit P/E multiple (x) | | | 7x | | | |
| = Equity value | 47,511 | | | | | | | |
| / Number of shares | 3,915 | | | | | | | |
| = Equity value per share (HK\$) | 12.0 | | | | | | | |

Source: Company data, J.P. Morgan estimates

Table 3: XYG – Sensitivity analysis

| | | Terminal growth rate | | | | | | |
|------|-------|----------------------|------|------|------|------|------|------|
| | | 0.5% | 1% | 1.5% | 2.0% | 2.5% | 3.0% | 3.5% |
| WACC | 9.8% | 13.4 | 13.9 | 14.6 | 15.3 | 16.1 | 17.1 | 18.2 |
| | 10.3% | 12.5 | 13 | 13.5 | 14.2 | 14.9 | 15.7 | 16.6 |
| | 10.8% | 11.7 | 12.1 | 12.6 | 13.2 | 13.8 | 14.5 | 15.3 |
| | 11.3% | 11 | 11.4 | 11.8 | 12.3 | 12.8 | 13.4 | 14.1 |
| | 11.8% | 10.4 | 10.7 | 11.1 | 11.5 | 12 | 12.5 | 13 |
| | 12.3% | 9.8 | 10.1 | 10.4 | 10.8 | 11.2 | 11.6 | 12.1 |
| | 12.8% | 9.2 | 9.5 | 9.8 | 10.1 | 10.5 | 10.9 | 11.3 |

Source: J.P. Morgan estimates.

Table 4: XYG – Revenue mix

| HK\$ MM, year-end 31Dec | 2015 | 2016 | 2017E | 2018E | 2019E |
|-------------------------|---------------|---------------|---------------|---------------|---------------|
| Automobile glass | 3,786 | 3,748 | 3,555 | 3,862 | 4,068 |
| YoY | 5.4% | -1.0% | -5.1% | 8.6% | 5.3% |
| % of total | 33.0% | 29.2% | 23.6% | 22.1% | 20.7% |
| Construction glass | 2,652 | 2,590 | 2,702 | 3,124 | 3,322 |
| YoY | 3.8% | -2.3% | 4.3% | 15.6% | 6.3% |
| % of total | 23.1% | 20.2% | 18.0% | 17.9% | 16.9% |
| Float glass | 4,671 | 6,010 | 7,857 | 8,918 | 9,880 |
| YoY | 9.4% | 28.7% | 30.7% | 13.5% | 10.8% |
| % of total | 40.8% | 46.9% | 52.3% | 51.1% | 50.4% |
| PV glass | 0 | 0 | 0 | 0 | 0 |
| YoY | 40.8% | 46.9% | 52.3% | 51.1% | 50.4% |
| % of total | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Electronic glass | 351 | 475 | 919 | 1536 | 2337 |
| YoY | -20.8% | 35.3% | 93.4% | 67.2% | 52.2% |
| % of total | 3.1% | 3.7% | 6.1% | 8.8% | 11.9% |
| Total revenue | 11,460 | 12,824 | 15,034 | 17,440 | 19,608 |

Source: Company data, J.P. Morgan estimates

Table 5: XYG – P&L statement

| Year-end 31Dec (HK\$MM) | 2015 | 2016 | 2017E | 2018E | 2019E |
|-----------------------------|---------------|---------------|---------------|---------------|---------------|
| Total Revenues | 11,460 | 12,848 | 15,177 | 17,721 | 20,021 |
| YoY change (%) | 5.5% | 12.1% | 18.1% | 16.8% | 13.0% |
| Cost of Goods Sold | (8,328) | (8,189) | (9,434) | (11,161) | (12,588) |
| YoY change (%) | 2.5% | -1.7% | 15.2% | 18.3% | 12.8% |
| Gross Profit | 3,132 | 4,659 | 5,743 | 6,560 | 7,433 |
| YoY change (%) | 14.6% | 48.7% | 23.3% | 14.2% | 13.3% |
| Gross Margin | 27.3% | 36.3% | 37.8% | 37.0% | 37.1% |
| SGA | (1,615) | (1,822) | (2,080) | (2,390) | (2,700) |
| YoY change (%) | -1.4% | 12.9% | 14.1% | 14.9% | 13.0% |
| Other Income/(Expenses) | 215 | 342 | 330 | 403 | 452 |
| Operating profit | 1,733 | 3,178 | 3,994 | 4,573 | 5,185 |
| EBITDA | 2,313 | 3,991 | 4,916 | 5,624 | 6,343 |
| EBITDA margin | 20.2% | 31.1% | 32.4% | 31.7% | 31.7% |
| Depreciation & Amortization | (580) | (812) | (922) | (1,052) | (1,158) |
| YoY change (%) | -5.2% | 40.0% | 13.6% | 14.0% | 10.1% |
| EBIT | 1,733 | 3,178 | 3,994 | 4,573 | 5,185 |
| EBIT margin | 15.1% | 24.7% | 26.3% | 25.8% | 25.9% |
| Net Interest Expense | (50) | (77) | (14) | (55) | (65) |
| Exceptional item | 379 | 159 | 0 | 0 | 0 |
| Associates | 317 | 563 | 955 | 1,068 | 1,104 |
| Gains/losses | 0 | 0 | 0 | 0 | 0 |
| Net Income Before Taxes | 2,379 | 3,823 | 4,935 | 5,585 | 6,224 |
| YoY change (%) | 49.3% | 60.7% | 29.1% | 13.2% | 11.4% |
| Tax | (266) | (607) | (691) | (726) | (809) |
| Effective Tax rate | 13.3% | 16.6% | 14.0% | 13.0% | 13.0% |
| Minority Interests | 0 | 0 | 0 | 0 | 0 |
| Net Income | 2,113 | 3,216 | 4,244 | 4,859 | 5,414 |
| YoY change (%) | 54.8% | 52.2% | 32.0% | 14.5% | 11.4% |
| Net margin | 18.4% | 25.0% | 28.0% | 27.4% | 27.0% |

Source: Company data, J.P. Morgan estimates

Table 6: Interim estimates

| Year to Dec (HK\$ MM) | 1H17 | 2H17E | 1H18E | 2H18E | 1H19E | 2H19E |
|-------------------------|-------|-------|-------|-------|-------|--------|
| Total Revenues | 6,677 | 8,500 | 7,796 | 9,925 | 8808 | 11,213 |
| Gross Profit | 2,429 | 3,314 | 2,774 | 3,785 | 3144 | 4,289 |
| EBIT | 1,605 | 2,389 | 1,838 | 2,735 | 2084 | 3,101 |
| Net Income Before Taxes | 1,923 | 3,012 | 2,245 | 3,341 | 2501 | 3,722 |
| Net Income | 1,636 | 2,608 | 1,953 | 2,906 | 2176 | 3,238 |
| Diluted EPS (HK\$) | 0.41 | 0.65 | 0.49 | 0.73 | 0.54 | 0.81 |
| Ratios | | | | | | |
| Revenue split | 44.0% | 56.0% | 44.0% | 56.0% | 44.0% | 48.2% |
| GPM | 36.4% | 39.0% | 35.6% | 38.1% | 35.7% | 38.3% |
| EBIT margin | 24.0% | 28.1% | 23.6% | 27.6% | 23.7% | 27.7% |
| NPM | 24.5% | 30.7% | 25.0% | 29.3% | 24.7% | 28.9% |
| YoY | | | | | | |
| Revenue | 13.5% | 22.1% | 16.8% | 16.8% | 13.0% | 13.0% |
| GP | 19.0% | 26.6% | 14.2% | 14.2% | 13.3% | 13.3% |
| EBIT | 23.1% | 27.4% | 14.5% | 14.5% | 13.4% | 13.4% |
| NP | 19.5% | 41.3% | 19.4% | 11.4% | 11.4% | 11.4% |

Source: Company data, J.P. Morgan estimates.

Table 7: XYG – Balance sheet

| Year-end 31Dec (HK\$MM) | 2015 | 2016 | 2017E | 2018E | 2019E |
|-------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Cash and Cash Equivalents | 1,298 | 2,763 | 1,775 | 1,515 | 1,604 |
| Inventories | 1,223 | 1,321 | 1,560 | 1,821 | 2,058 |
| Accounts receivable | 2,381 | 2,377 | 2,808 | 3,279 | 3,704 |
| Other Current Assets | 93 | 76 | 2,160 | 3,055 | 3,940 |
| Total Current Assets | 4,995 | 6,537 | 8,302 | 9,669 | 11,306 |
| Intangible Assets | 0 | 0 | 0 | 0 | 0 |
| Property and Equipment, Net | 13,177 | 12,952 | 15,245 | 16,868 | 18,476 |
| Other Assets | 3,249 | 4,534 | 4,761 | 4,999 | 5,249 |
| Non-Current assets | 16,426 | 17,486 | 20,006 | 21,867 | 23,725 |
| Total Assets | 21,422 | 24,022 | 28,308 | 31,536 | 35,031 |
| Accounts Payable | 740 | 789 | 932 | 1,089 | 1,230 |
| Other Accrued Expenses | 1,705 | 1,608 | 2,029 | 2,584 | 3,099 |
| Taxes Payable | 333 | 438 | 522 | 557 | 640 |
| ST and current LT debts | 2,514 | 3,165 | 2,780 | 2,780 | 2,780 |
| Total Current Liabilities | 4,959 | 6,000 | 6,262 | 7,009 | 7,749 |
| Long-term Debt | 3,514 | 4,509 | 4,895 | 4,895 | 4,895 |
| Other Noncurrent Liability | 223 | 266 | 314 | 367 | 415 |
| Noncurrent liabilities | 3,737 | 4,775 | 5,209 | 5,262 | 5,310 |
| Total Liabilities | 8,696 | 10,775 | 11,472 | 12,271 | 13,058 |
| Share capital | 3,217 | 3,217 | 3,217 | 3,217 | 3,217 |
| Reserves and Surplus | 9,501 | 11,431 | 13,553 | 15,983 | 18,690 |
| Total Shareholders' Equity | 12,718 | 13,181 | 16,770 | 19,200 | 21,907 |
| Minority Interest | 8 | 66 | 66 | 66 | 66 |
| Total Shareholders' Equity | 12,726 | 13,247 | 16,836 | 19,266 | 21,973 |
| Total Liabilities and Equity | 21,422 | 24,022 | 28,308 | 31,536 | 35,031 |

Source: Company data, J.P. Morgan estimates

Table 8: XYG – Cash flow statement

| Year-end 31Dec (HK\$ MM) | 2015 | 2016 | 2017E | 2018E | 2019E |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|
| EBIT | 1,733 | 3,178 | 3,994 | 4,573 | 5,185 |
| Depreciation and Amortization | 795 | 812 | 922 | 1,052 | 1,158 |
| Working Capital Changes | 539 | 14 | (314) | (322) | (256) |
| Tax Paid | (228) | (266) | (607) | (691) | (726) |
| Cash Flow From Operations | 2,838 | 3,739 | 3,995 | 4,611 | 5,360 |
| Capital expenditures | (1,914) | (1,853) | (3,216) | (2,675) | (2,766) |
| Investments and others | 243 | (1,116) | 60 | 82 | 81 |
| Net interest | (50) | (77) | (14) | (55) | (65) |
| Cash Flow from Investing | (1,721) | (3,046) | (3,170) | (2,648) | (2,750) |
| Free Cash Flow | 1,117 | 693 | 825 | 1,963 | 2,610 |
| Dividends | (608) | (1,319) | (1,862) | (2,276) | (2,568) |
| Common issue | 1 | 0 | 0 | 0 | 0 |
| Other Financing | (18) | 2,092 | 48 | 53 | 48 |
| Contribution from owner | (25) | 0 | 0 | 0 | 0 |
| Cash Flow from financing | (650) | 772 | (1,813) | (2,223) | (2,521) |
| Change in cash | 467 | 1,465 | (989) | (260) | 89 |
| Cash beginning | 831 | 1,298 | 2,763 | 1,775 | 1,515 |
| Foreign exchange changes | 0 | 0 | 0 | 0 | 0 |
| Cash at end | 1,298 | 2,763 | 1,775 | 1,515 | 1,604 |

Source: Company data, J.P. Morgan estimates

Investment Thesis, Valuation and Risks

Xinyi Glass (Overweight; Price Target: HK\$12.00)

Investment Thesis

We believe 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, with stable growth and steady margins. The key driver for growth in the rest of this year is the recovery in margins for the float glass business. In the past, we have seen peak margins for float glass hit 40% when the market is in short supply. We could see margins recover when demand improves, as new supply has slowed to a trickle since the beginning of 2014.

Valuation

Our Dec-18 PT is based on a DCF valuation that assumes a market risk premium of 6.0% and a risk-free rate of 4.2% (the yield on 10-year government notes in China). We assume a beta of 1.3 (Bloomberg beta is 1.3). Accordingly, WACC is assumed at 11.4%. We estimate free cash flow for XYG until 2025 and assume a terminal growth rate of 2.0%. The terminal growth is based on the annual growth rate expected in 2025 (the final year of the estimate period), subject to a minimum of 2% 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

Key downside risks include falling demand for construction glass, which may result from a cooling property market in China, and further weakness in PV glass demand from Europe.

Xinyi Glass: Summary of Financials

| Income Statement | | | | | | Balance Sheet | | | | | |
|--------------------------------------------|----------------|----------------|----------------|----------------|----------------|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| | FY15A | FY16A | FY17E | FY18E | FY19E | | FY15A | FY16A | FY17E | FY18E | FY19E |
| Revenue | 11,460 | 12,848 | 15,177 | 17,721 | 20,021 | Cash and cash equivalents | 1,298 | 2,763 | 1,775 | 1,515 | 1,604 |
| <i>y/y Growth</i> | 5.5% | 12.1% | 18.1% | 16.8% | 13.0% | Accounts receivable | 2,381 | 2,377 | 2,808 | 3,279 | 3,704 |
| Adj. EBITDA | 2,528 | 3,991 | 4,916 | 5,624 | 6,343 | Inventories | 1,223 | 1,321 | 1,560 | 1,821 | 2,058 |
| <i>EBITDA y/y Growth</i> | 31.8% | 57.9% | 23.2% | 14.4% | 12.8% | Other current assets | 93 | 76 | 2,160 | 3,055 | 3,940 |
| D&A | (795) | (812) | (922) | (1,052) | (1,158) | Current assets | 4,995 | 6,537 | 8,302 | 9,669 | 11,306 |
| Adj. EBIT | 1,733 | 3,178 | 3,994 | 4,573 | 5,185 | PP&E | 13,177 | 12,952 | 15,245 | 16,868 | 18,476 |
| Net Interest | (50) | (77) | (14) | (55) | (65) | LT investments | 3,249 | 4,534 | 4,761 | 4,999 | 5,249 |
| Adj. PBT | 2,379 | 3,823 | 4,935 | 5,585 | 6,224 | Other non current assets | 3,249 | 4,534 | 4,761 | 4,999 | 5,249 |
| Tax | (266) | (607) | (691) | (726) | (809) | Total assets | 21,422 | 24,022 | 28,308 | 31,536 | 35,031 |
| Minority Interest | 0 | 0 | 0 | 0 | 0 | Short term borrowings | 2,514 | 3,165 | 2,780 | 2,780 | 2,780 |
| Adj. Net Income | 2,113 | 3,216 | 4,244 | 4,859 | 5,414 | Payables | 740 | 789 | 932 | 1,089 | 1,230 |
| Reported EPS | 0.54 | 0.80 | 1.06 | 1.21 | 1.35 | Other short term liabilities | 1,705 | 2,046 | 2,550 | 3,141 | 3,739 |
| Adj. EPS | 0.54 | 0.80 | 1.06 | 1.21 | 1.35 | Current liabilities | 4,959 | 6,000 | 6,262 | 7,009 | 7,749 |
| <i>EPS y/y Growth</i> | 54.8% | 48.8% | 32.0% | 14.5% | 11.4% | Long-term debt | 3,514 | 4,509 | 4,895 | 4,895 | 4,895 |
| DPS | 0.27 | 0.40 | 0.53 | 0.61 | 0.68 | Other long term liabilities | 3,737 | 4,775 | 5,209 | 5,262 | 5,310 |
| Payout ratio | 49.1% | 49.8% | 50.0% | 50.0% | 50.0% | Total liabilities | 8,696 | 10,775 | 11,472 | 12,271 | 13,058 |
| Shares outstanding | 3,915 | 4,003 | 4,003 | 4,003 | 4,003 | Shareholders' equity | 12,718 | 13,181 | 16,770 | 19,200 | 21,907 |
| | | | | | | Minority interests | 8 | 66 | 66 | 66 | 66 |
| | | | | | | Total liabilities & equity | 21,422 | 24,022 | 28,308 | 31,536 | 35,031 |
| | | | | | | BVPS | 3.25 | 3.29 | 4.19 | 4.80 | 5.47 |
| | | | | | | <i>y/y Growth</i> | 3.1% | 1.3% | 27.2% | 14.5% | 14.1% |
| | | | | | | Net debt/(cash) | 4,730 | 4,911 | 5,900 | 6,159 | 6,070 |
| | | | | | | | | | | | |
| Cash Flow Statement | | | | | | Ratio Analysis | | | | | |
| | FY15A | FY16A | FY17E | FY18E | FY19E | | FY15A | FY16A | FY17E | FY18E | FY19E |
| Cash flow from operating activities | 2,838 | 3,739 | 3,995 | 4,611 | 5,360 | EBITDA margin | 22.1% | 31.1% | 32.4% | 31.7% | 31.7% |
| o/w Depreciation & amortization | 795 | 812 | 922 | 1,052 | 1,158 | EBIT margin | 15.1% | 24.7% | 26.3% | 25.8% | 25.9% |
| o/w Changes in working capital | 539 | 14 | (314) | (322) | (256) | Net profit margin | 18.4% | 25.0% | 28.0% | 27.4% | 27.0% |
| Cash flow from investing activities | (1,671) | (2,969) | (3,156) | (2,592) | (2,685) | ROE | 16.9% | 24.8% | 28.3% | 27.0% | 26.3% |
| o/w Capital expenditure | (1,914) | (3,138) | (3,442) | (2,913) | (3,016) | ROA | 10.0% | 14.2% | 16.2% | 16.2% | 16.3% |
| <i>as % of sales</i> | 16.7% | 24.4% | 22.7% | 16.4% | 15.1% | ROCE | 8.3% | 13.5% | 15.2% | 15.5% | 16.0% |
| Cash flow from financing activities | (650) | 772 | (1,813) | (2,223) | (2,521) | Net debt/equity | 37.2% | 37.1% | 35.0% | 32.0% | 27.6% |
| o/w Dividends paid | (608) | (1,319) | (1,862) | (2,276) | (2,568) | Sales/Assets (x) | 0.5 | 0.6 | 0.6 | 0.6 | 0.6 |
| o/w Net debt issued/(repaid) | (18) | 2,092 | 48 | 53 | 48 | Interest cover (x) | 50.3 | 51.9 | 347.8 | 101.8 | 97.1 |
| Net change in cash | 517 | 1,542 | (974) | (204) | 154 | | | | | | |
| Free cash flow to firm | 968 | 665 | 565 | 1,747 | 2,401 | | | | | | |
| <i>y/y Growth</i> | (1138.0%) | (31.3%) | (15.2%) | 209.4% | 37.4% | | | | | | |
| | | | | | | | | | | | |
| | | | | | | Valuation | FY15A | FY16A | FY17E | FY18E | FY19E |
| | | | | | | P/E (x) | 14.2 | 9.5 | 7.2 | 6.3 | 5.7 |
| | | | | | | P/BV (x) | 2.4 | 2.3 | 1.8 | 1.6 | 1.4 |
| | | | | | | EV/EBITDA (x) | 13.7 | 8.7 | 7.3 | 6.4 | 5.7 |
| | | | | | | Dividend Yield | 3.5% | 5.2% | 6.9% | 7.9% | 8.8% |

Source: Company reports and J.P. Morgan estimates.

Note: HK\$ in millions (except per-share data). Fiscal year ends Dec. o/w - out of which

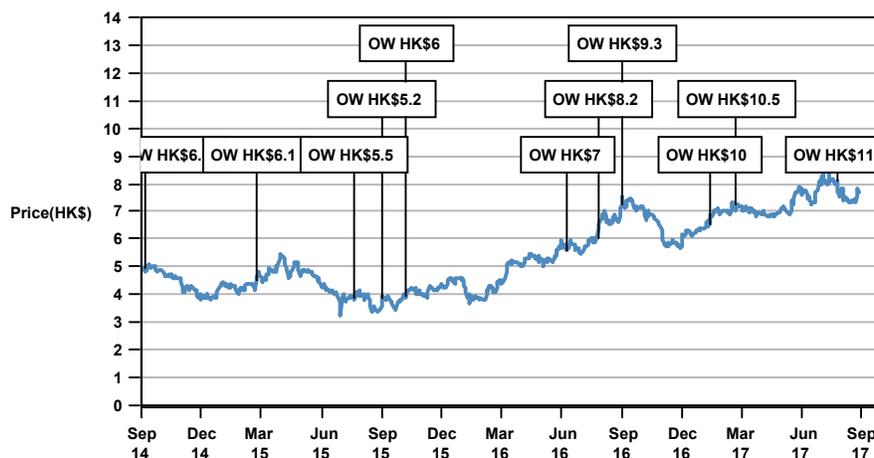
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Xinyi Glass (0868.HK, 868 HK) Price Chart



| Date | Rating | Share Price (HK\$) | Price Target (HK\$) |
|-----------|--------|--------------------|---------------------|
| 15-Sep-14 | OW | 4.92 | 6.70 |
| 02-Mar-15 | OW | 4.55 | 6.10 |
| 28-Jul-15 | OW | 3.89 | 5.50 |
| 10-Sep-15 | OW | 3.88 | 5.20 |
| 15-Oct-15 | OW | 3.95 | 6.00 |
| 17-Jun-16 | OW | 5.63 | 7.00 |
| 02-Aug-16 | OW | 6.04 | 8.20 |
| 07-Sep-16 | OW | 7.26 | 9.30 |
| 18-Jan-17 | OW | 6.56 | 10.00 |
| 28-Feb-17 | OW | 7.26 | 10.50 |
| 31-Jul-17 | OW | 8.08 | 11.00 |

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Nov 20, 2006.

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|---------------------------------------------|---------------------|-------------------|-----------------------|
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