Source: Bloomberg

Xinyi Glass

HK$8.24 - BUY

Brokers Poll.

Financials					
Year to 31 December	17A	18A	19CL	20CL	21CL
Revenue (HK$m)	14,728	16,014	17,181	20,167	23,052
Adjusted net profit (HK$m)	3,697	3,699	3,704	4,851	6,086
Adjusted EPS (HK¢)	91.9	91.7	91.8	120.2	150.8
CL/consensus (11) (EPS%)	-	-	96	93	108
Adj EPS growth (% YoY)	20.1	(0.2)	0.1	31.0	25.5
Adjusted PE (x)	9.0	9.0	9.0	6.9	5.5
Dividend yield (%)	5.8	6.3	6.3	7.2	9.1
FCF yield (%)	(3.5)	1.5	2.9	5.1	7.9
PB (x)	1.8	1.8	1.6	1.4	1.3
ROE (%)	25.6	23.0	21.4	22.0	24.6
Net debt/equity (%)	29.6	28.6	21.0	15.8	8.7

Source: www.clsa.com

evalu@tor The Global Equities Database

Financials at a glance

Year to 31 December	2017A	2018A	2019CL	(% YoY)	2020CL	2021CL
Profit & Loss (HK$m)						
Revenue	14,728	16,014	17,181	7.3	20,167	23,052
Cogs (ex-D&A)	(8,438)	(9,222)	(10,085)		(11,575)	(13,070)
Gross Profit (ex-D&A)	6,290	6,792	7,096	4.5	8,592	9,982
SG&A and other expenses	(1,970)	(2,320)	(2,544)		(2,860)	(3,084)
Op Ebitda	4,320	4,472	4,552	1.8	5,732	6,898
Depreciation/amortisation	(921)	(1,004)	(1,030)		(1,099)	(1,158)
Op Ebit	3,399	3,468	3,523	1.6	4,633	5,739
Net interest inc/(exp)	(107)	(142)	(136)		(118)	(97)
Other non-Op items	1,404	1,644	1,588	(3.4)	1,312	1,641
Profit before tax	4,696	4,970	4,975	0.1	5,826	7,283
Taxation	(682)	(723)	(742)		(965)	(1,187)
Profit after tax	4,014	4,248	4,233	(0.3)	4,861	6,096
Minority interest	0	(11)	(11)		(11)	(11)
Net profit	4,014	4,237	4,222	(0.4)	4,851	6,086
Adjusted profit	3,697	3,699	3,704	0.1	4,851	6,086
Cashflow (HK$m)	2017A	2018A	2019CL	(% YoY)	2020CL	2021CL
Operating profit	3,399	3,468	3,523	1.6	4,633	5,739
Depreciation/amortisation	921	1,004	1,030	2.6	1,099	1,158
Working capital changes	(1,332)	(481)	(119)		(365)	(358)
Other items	(901)	(1,053)	(967)		(1,183)	(1,400)
Net operating cashflow	2,086	2,938	3,466	18	4,183	5,140
Capital expenditure	(3,254)	(2,453)	(2,500)		(2,500)	(2,500)
Free cashflow	(1,168)	485	966	99.1	1,683	2,640
M&A/Others	1,448	1,705	2,081	22.1	1,401	1,746
Net investing cashflow	(1,806)	(748)	(419)		(1,099)	(754)
Increase in loans	792	1,503	(634)		162	(561)
Dividends	(1,926)	(2,078)	(2,077)		(2,386)	(2,994)
Net equity raised/other	1,136	(53)	-		-	-
Net financing cashflow	2	(628)	(2,711)		(2,225)	(3,555)
Incr/(decr) in net cash	283	1,562	336	(78.5)	860	831
Exch rate movements	-	-	-		-	-
Balance sheet (HK$m)	2017A	2018A	2019CL	(% YoY)	2020CL	2021CL
Cash & equivalents	3,051	4,613	4,949	7.3	5,809	6,640
Accounts receivable	1,243	1,278	1,352	5.8	1,587	1,814
Other current assets	3,638	3,268	3,401	4.1	3,679	3,959
Fixed assets	12,929	13,079	14,635	11.9	16,119	17,542
Investments	4,416	4,724	4,309	(8.8)	4,309	4,309
Intangible assets	3,497	3,812	3,727	(2.2)	3,644	3,562
Other non-current assets	1,532	1,906	1,906	0	1,906	1,906
Total assets	30,305	32,679	34,278	4.9	37,052	39,732
Short-term debt	2,068	3,094	2,898	(6.4)	2,948	2,773
Accounts payable	923	920	1,007	9.5	1,156	1,306
Other current liabs	2,166	2,588	2,588	0	2,588	2,588
Long-term debt/CBs	6,399	6,875	6,437	(6.4)	6,549	6,162
Provisions/other LT liabs	443	499	499	0	499	499
Shareholder funds	18,237	18,625	20,770	11.5	23,234	26,326
Minorities/other equity	69	78	78	0	78	78
Total liabs & equity	30,305	32,679	34,278	4.9	37,052	39,732
Ratio analysis	2017A	2018A	2019CL	(% YoY)	2020CL	2021CL
Revenue growth (% YoY)	14.6	8.7	7.3		17.4	14.3
Ebitda margin (%)	29.3	27.9	26.5		28.4	29.9
Ebit margin (%)	23.1	21.7	20.5		23.0	24.9
Net profit growth (%)	24.9	5.6	(0.4)		14.9	25.5
Op cashflow growth (% YoY)	(15.0)	40.8	18.0		20.7	22.9
Capex/sales (%)	22.1	15.3	14.6		12.4	10.8
Net debt/equity (%)	29.6	28.6	21.0		15.8	8.7
Net debt/Ebitda (x)	1.3	1.2	1.0		0.6	0.3
ROE (%)	25.6	23.0	21.4		22.0	24.6
ROIC (%)	16.6	15.0	14.5		17.3	20.0

Source: www.clsa.com

Short-selling report arguments and our quick view

Dividends

We do not rule out that the company's Hong Kong dollar financing is to partly to fund its dividend payment, but not necessarily all dividend payments

On the other hand, Xinyi Glass made an announcement (*link*) after its 2015 results that it will pay its 2015 final dividend would be declared by deducting its share premium account, which was accumulated by the previous equity fund raising activities in Hong Kong and was in Hong Kong dollar. Thus, the payment of dividend in Hong Kong dollar instead of remitting cash out from China should have been well known.

OP margin and the build-up of cash

It true Xinyi Glass has a higher-than-peer OPM, but this is explainable.

Figure 3 compares Xinyi Glass's OPM (including and excluding other gains like FX and fair value changes) with that of Fuyao Glass (3606.HK). Xinyi Glass has a higher OPM than Fuyao. One reason is that Xinyi Glass has an integrated business model and thus its in-house float glass supply provides more than enough for self-production uses. Fuyao, on the other hand, has in-house float glass supplying only for c.80% of its production needs, thus still need to purchase float glass externally. Fuyao has been ramping-up its auto glass production base in the US since 2016, which still has a lower margin than its Chinese production base, and thus this has been a drag on its overall margin performance as well.

We also compare Xinyi Glass's margin with that of Kibing (601636.CH), another leading float glass player in China. Xinyi Glass has a higher margin than Kibing given Kibing mainly sells lower-margin float glass and a small portion of architecture glass, but Xinyi Glass has a contribution from higher-margin auto glass sales.

Figure 3

OP margin comparison

	2014	2015	2016	2017	2018
Xinyi Glass					
OP margin	13.8%	18.4%	26.0%	27.9%	28.4%
OP margin - excluding other gains	11.7%	15.1%	24.7%	25.7%	25.0%
Fuyao					
OP margin	21.9%	23.6%	23.9%	19.8%	25.2%
OP margin - excluding other gains	22.3%	20.9%	20.9%	21.9%	20.2%
Kibing					
OP margin	9.8%	8.2%	17.5%	19.1%	16.3%

Source: Respective companies, CLSA

Besides, the improvement in Xinyi Glass's margin in 2016-2018 vs 2014-2015 was due to improvement in the float glass industry from its trough in 2014-2015, and saw Xinyi Glass significantly increase its production scale in 2014-2015 with new bases in Sichuan and Yingkou which started to yield fruit when the market recovered. Its capacity growth then slowed afterwards given the limitations of new production line permits in China, and thus the company shifted its expansion focus overseas. This explains the reason behind why its cash level (due to increasing operating cashflow relative to Capex) increased faster than that of sales, i.e. a rising cash to sales ratio, especially from onshore cash, in our view.

Figure 4

Float glass prices in various regional markets across China

Source: WIND, CLSA

Figure 5

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

Source: SCI99.com, CLSA

Figure 6

Xinyi Glass: cash versus sales

HK$m	2014	2015	2016	2017	2018
OCF	1,455	2,637	3,565	3,535	4,643
Capex	(1,729)	(1,967)	(1,853)	(3,254)	(2,453)
- *Annual effective float glass capacity (kt)*	*4,234*	*4,251*	*4,900*	*5,290*	*5,400*
growth	*20%*	*0%*	*15%*	*8%*	*2%*
FCF	(274)	67Nj Ḫ			

Tax

We have argued that funding of dividend payment by Hong Kong dollar debt is not wrong. The apparent drop in profit from Hong Kong, as shown by the reduced HK profit tax, could be a result of the increase in expenses in Hong Kong(including interest expenses and other corporate expenses), not necessary the Company not recognizing enough profit in Hong Kong to cover such expenses. Note that this could also be a result of tax planning, given that 13 of the companies' subsidiaries in China enjoys high-tech enterprise income tax benefit with preferential ng ή Ͽ Ƭ benefit ο B ni ķ ξ ӟ Ủ ᴺ ecogrof ẹ rr = 1 §

Figure 8

Xinyi Glass: depreciation expenses versus losses on the disposal of plant and machinery	2014	2015	2016	2017	2018
Depreciation expense	643	749	819	971	993
- In which: Plant and machinery	537	632	685	790	813
Year-end net book amount of plant and machinery	7,093	8,374	7,870	9,239	8,923
Gain/(losses) on disposal of property, plant and equipment	109	(18)	(11)	(17)	(11)
Gain/(losses) on disposal as % of depreciation of previous year		-3.4%	-1.7%	-2.5%	-1.4%
Gain/(losses) on disposal as % of net book amount of previous year		-0.3%	-0.1%	-0.2%	-0.1%

Source: Company, CLSA

Incentive for fraud

Figure 10

Earnings sensitivity analysis

	Change in 19CL core profit
1% increase in float glass price	+1.6%
1% increase in auto glass price	+0.8%
1% increase in architecture glass price	+0.7%
1% increase in soda ash price	-0.5%
1% increase in unit fuel cost	-0.7%

Source: CLSA

Figure 11

Valuation of Xinyi Glass

PE basis	
20CL EPS (HK$)	1.20
Target multiple (x)	9.5
Fair value (HK$)	11.40
PB basis	
19CL BVPS (HK$)	5.15
Target multiple (x)	2.0
Fair value (HK$)	10.30
Average (HK$)	10.90
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Companies mentioned

Xinyi Glass (868 HK - HK$8.24 - BUY)
Fuyao Glass (3606 HK - HK$23.80 - O-PF)
Kibing (N-R)
Xinyi Energy (3868.HK) (N-R)
Xinyi Solar (968 HK - HK$3.69 - BUY)

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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
23 May 2019	BUY	10.90	14 Dec 2017	BUY	10.70
26 Feb 2019	BUY	11.60	31 Oct 2017	BUY	9.50
03 Dec 2018	BUY	12.10	17 Jul 2017	BUY	9.60
31 Jul 2018	BUY	12.90	14 Dec 2016	BUY	8.35
27 Jun 2018	BUY	13.60	08 Nov 2016	BUY	8.30
01 May 2018	BUY	14.30	08 Sep 2016	BUY	8.35
27 Feb 2018	BUY	14.70	03 Aug 2016	BUY	7.25
24 Jan 2018	BUY	13.10			

Source: CLSA

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