Source: Bloomberg

evaluator
The Global Equities Database

Financials at a glance

Year to 31 December	2017A	2018A	2019CL	(% YoY)	2020CL	2021CL
Profit & Loss (HK$m)						
				7.3		
Cogs (ex-D&A)	(8,438)	(9,222)	(10,085)		(11,575)	(13,070)
				4.5		
SG&A and other expenses	(1,970)	(2,320)	(2,544)		(2,860)	(3,084)
				1.8		
Depreciation/amortisation	(921)	(1,004)	(1,030)		(1,099)	(1,158)
				1.6		
Net interest inc/(exp)	(107)	(142)	(136)		(118)	(97)
Other non-Op items	1,404	1,644	1,588	*(3.4)*	1,312	1,641
				0.1		
Taxation	(682)	(723)	(742)		(965)	(1,187)
				(0.3)		
Minority interest	0	(11)	(11)		(11)	(11)
				(0.4)		
				0.1		
Cashflow (HK$m)	**2017A**	**2018A**	**2019CL**		**2020CL**	**2021CL**
				1.6		
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)
				18		
Capital expenditure	(3,254)	(2,453)	(2,500)		(2,500)	(2,500)
				99.1		
M&A/Others	1,448	1,705	2,081	*22.1*	1,401	1,746
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)	-		-	-
Incr/(decr) in net cash	283	1,562	336	*(78.5)*	860	831
Exch rate movements	-	-	-		-	-
Balance sheet (HK$m)	**2017A**	**2018A**	**2019CL**		**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
				4.9		
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
				4.9		
Ratio analysis	**2017A**	**2018A**	**2019CL**		**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

Argument 1: Xinyi Glass never remitted cash from China to Hong Kong for the payment of dividends, but financed such with Hong Kong dollar debt, and thus is unable to verify profit.

Our quick view: 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

Argument 2: Signals of fraud and fake cash flow include its super-normal profitability relative peers (e.g. its OPM higher than peers like Fuyao Glass Industry Group Co Ltd.), and it has seen a build-up of non-production assets (mainly onshore cash).

Our quick view: 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

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%
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%
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

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*
- *YoY growth*	*20%*	*0%*	*15%*	*8%*	*2%*
FCF	(274)	b b	nj 36		

Tax

Argument 3: it is unable to verify Xinyi Glass's profit from the tax breakdown as it was not remitting profit to Hong Kong for dividend payments. Its Hong Kong business margin appeared to have dropped, but it did not recognise enough profit in Hong Kong to cover expenses like overhead and interest.

Our quick view: 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 Fsav t ǯ

Figure 8

Xinyi Glass: depreciation expenses versus losses on the disposal of plant and machinery

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

Argument 6: There was the incentive for fraud as the HK$732m convertible bond was due by May 2017, but the company only had HK$832m cash on han

Figure 10

Earnings sensitivity analysis

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

20CL EPS (HK$)	1.20
Target multiple (x)	9.5
Fair value (HK$)	11.40
19CL BVPS (HK$)	5.15
Target multiple (x)	2.0
Fair value (HK$)	10.30

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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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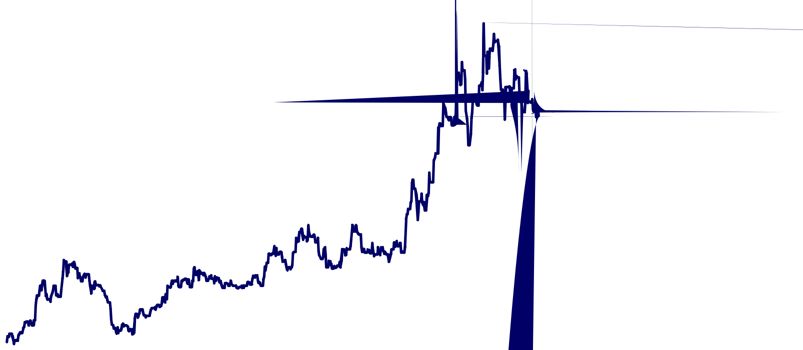
Important disclosures

Recommendation history of Xinyi Glass Holdings Ltd 868 HK



23 May 2019	BUY	10.90	14[illegible]c 2017	BUY	10.70
26 Feb 2019	BUY	11.60	31[illegible]t 2017	BUY	9.50
03 Dec 2018	BUY	12.10	17[illegible] 2017	BUY	9.60
31 Jul 2018	BUY	12.90	14[illegible]c 2016	BUY	8.35
27 Jun 2018	BUY	13.60	08[illegible]v 2016	BUY	8.30
01 May 2018	BUY	14.30	08[illegible]p 2016	BUY	8.35
27 Feb 2018	BUY	14.70	0[illegible]g 2016	BUY	7.25
24 Jan 2018	BUY	13.10			

Source: CLSA

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