

Xinyi Glass

XYG 1H21 NDR takeaways

6 August 2021

Key Takeaway

XYG reported core 1H21 NP of HKD4.65 bn, up 330% yoy and 14.5% HOH. With supply-demand expected to tighten into the peak season, XYG expects pricing to stay at historically high levels for 2H21. However, there are no plans to raise prices further in the near term, given recent government scrutiny on prices. XYG expects the upcycle in float glass to continue into 2022 due to a strong house completion cycle in 2019-2020, driving c.10% volume growth for 2022.

Float glass remains the bread and butter. Float glass remains the company's core earnings driver, accounting for 70.9% of sales with GPM of 55.3% for 1H. For 2H, FG prices may hover at current high levels, despite entering the peak season to avoid further government scrutiny over prices. Nevertheless, current float glass prices are 26.2% higher than the average in 1H21, so 2H margins will likely be higher HoH. While soda ash prices are on the rise, XYG has a competitive advantage given its bulk purchase agreements and access to overseas imports. In 2H, XYG will receive additional volume contribution from 2400t/d capacity in Hainan after cold repair. For 2022, two additional lines will commence in Guangxi and Liaoning with 1300t/d and 800t/d capacity, respectively, so visibility of its volume growth is quite high. In the long run, XYG aims to maintain a 10% annual growth rate for FG capacity expansion.

Auto glass - Tax savings, new products and shift toward aftermarket sales.

1) XYG's Malaysia plant plans to add 400k pcs of new capacity in 2022, which should generate over RMB30 mn export tax saving every year after its full ramp-up. Current auto glass exported from China to US is subject to a 25% duty.

2) The company is expanding its product offering on high-end fronts such as ADAS, HUD, and Sunroof. These products generate a higher margin than traditional auto glass.

3) Aftermarket glass sales account for 87% of XYG's auto glass sales, and therefore they have been more resilient despite the auto chip shortage, which has impacted OEM glass sales. Compared to OEM glass, aftermarket glass sales are more dependent on China's car ownership penetration and maintenance rate instead of new car sales. However, chip shortages are showing signs of recovery, which could boost OEM segment sales in 2H.

Architectural glass demand on track. Similar to float glass, architectural glass will benefit from accelerated house completion cycle as three red line policy takes effect (see our [Connect the dots](#)). While for long-term prospects, the company's Low-E and multilayer insulation glass penetration rate should increase further, given the country's impetus toward green construction and energy saving. XYG expects c.5% growth annually for this segment.

JEF View: We upgrade our FY21/22E earnings by 5.7%/10.3% to adjust for higher glass prices and lower tax rates from the company's Malaysia auto glass line. Our new TP is HKD 42.6/sh based on 4.37 FY22E PB and 32% FY22E ROE, derived using the Gordon Growth model. This also implies 15.4 FY21E and 14.8 FY22E PER. Risks include government intervention to lower glass prices, higher-than-expected soda ash, and natural gas prices.

Target | Estimate Change

China (PRC) | Basic Materials

RATING	BUY
PRICE	HK\$29.65 [^]
MARKET CAP	HK\$120.2B / \$15.5B
PRICE TARGET (PT)	HK\$42.59 (FROM HK\$37.30)
UPSIDE SCENARIO PT	HK\$58.06
DOWNSIDE SCENARIO PT	HK\$21.01

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

FY Dec

HKD	2020A	2021E	2022E	2023E
EPS	1.59	↑2.77	↑2.88	↑2.75
Prev.		2.62	2.61	2.46
FY P/E	18.6x	10.7x	10.3x	10.8x

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XINYI GLASS (868 HK)

Estimates				
HK\$	2020A	2021E	2022E	2023E
Rev. (MM)	18,615.9	↑ 29,024.7	↑ 31,097.4	↑ 32,795.2
<i>Previous</i>		21,319.2	22,867.9	23,513.9
Net Profit	6,422.2	↑ 11,199.4	↑ 11,615.5	↑ 11,115.8
<i>Previous</i>		10,575.5	10,531.3	9,951.1
EBITDA (MM)	7,527.0	↑ 13,239.2	↑ 14,041.8	↑ 13,325.2
<i>Previous</i>		12,497.4	12,679.7	11,807.3
EPS	1.59	↑ 2.77	↑ 2.88	↑ 2.75
<i>Previous</i>		2.62	2.61	2.46
P/E	7.6x	↓ 10.5x	↓ 10.1x	↓ 10.6x
<i>Previous</i>		12.3x	12.3x	13.0x
P/B	1.8x	↓ 3.5x	↓ 3.0x	↓ 2.6x
<i>Previous</i>		3.9x	3.4x	3.0x

Valuation				
	2020A	2021E	2022E	2023E
FY P/E	18.6x	10.7x	10.3x	10.8x

Market Data		Financial Summary	
52-Week Range:	HK\$34.20 - HK\$12.06	Book Value (MM)	HK\$27,881.6
Total Entprs. Value	HK\$125.4B	Book Value/Share	HK\$6.90
Avg. Daily Value MM (USD)	40.30	Return on Avg. Equity	0.3%
Float (%)	40.4%	Long-Term Debt (MM)	HK\$7,794.8
		Minority Interest (MM)	HK\$9.0
		Dividend Yield	0.1%
		Cash & ST Invest. (MM)	HK\$5,304.1
		NAV	HK\$27,973.35
		Net Debt/Equity	0.2%

The Long View

Scenarios

Base Case

We value XYG based on 4.37x FY22E PB with an expected ROE of 32%, derived using our Gordon Growth model with WACC of 8% and terminal growth of 2.5%. In our base case scenario, we assume a GPM of 54%. PT of HK\$42.6.

Upside Scenario

In our bull case scenario, we forecast a GPM of 65%, giving us an ROE of 39% and implying a PT of HK\$58.1.

Downside Scenario

In our bear case scenario, we assume a GPM of 37%, similar to the average GPM of the company in the last five years, giving us an ROE of 20% and implying a PT of HK\$21.0.

Investment Thesis / Where We Differ

XYG is the largest and most profitable float glass producer in China with c.13% market share. It has a strong track record, delivering c.20% CAGR in revenue and profit since 2006, while adhering to its high dividend payout policy of c.50%. XYG is uniquely positioned with its strong balance sheet to gain market share via M&A, as we estimate float glass effective capacity growth of 26% and c.10% in 2021 and 2022, respectively. Float glass prices are also expected to stay elevated in the next two years as supply has remained tight, while demand is firing on all fronts. With a more consistent earnings outlook for its float glass business, its focus on ESG and its associate stakes in Xinyi Solar and Xinyi Energy, we believe XYG's multiple is on a structural re-rating track.

Catalysts

Inventory destocking continues to historical lows, which would drive up glass prices as we approach the 2H peak season.

Q&A Session

Q1: What is the impact of MIIT's recent meeting on FG price?

Ans: We see no sign from the meeting that the government will interfere the market. Market sentiment remains stable after the meeting with the price stays steady. Capacity swap policy published on July 20 used to create a huge turmoil on the market, and you would see our stock price has dropped more than 20% after that, but for this time, we believe the message sent by the government is just to maintain the supply chain stability by encouraging supply discipline among glass producers. The price hike this year was mainly due to the high raw material cost and S/D mismatch while no speculation sentiment was detected. For 2H price outlook, the current price level has already fallen above my top-line projection by jumping more than 90% since the year beginning. The price would hover on its high, while capacity switch-on/-off would create fluctuation as 20% of industry capacity is still on halt now.

Q2: Would peak season start from Q4 lead FG price going up further?

Ans: As I previously mentioned, the current FG price level of RMB 2700/t has already been beyond my expectation. The future price trend would depend on the SD dynamics while I expect the current price level would last for another 1-2 months.

Q3: How would raw material prices like soda ash affect the company's performance in 2H?

Ans: Soda ash price would remain stable on its current price. For XYS, margin improvement is more important, offsetting the negative impact due to raw material price hike. The company has started the practice 5-6 years ago to secure the cost from upstream channels through bulk purchase and access to overseas import.

Q4: Could you provide us a more specific guideline for the construction glass sector? What is the Low-E glass penetration rate in China now and its % of sector revenue?

Ans: Most construction glass contracts were secured in the long term, 5-6 months back to house sector's peak season in 2H20. If we take a further look at the housing construction cycle, current glass sales are mainly serving the new housing started between 2018 and 2019 when the housing sector was on top. From 2H onwards, we expected more overseas projects would flow in after the recovery post COVID and therefore support the segment demand. Currently, over 95% of architectural glass sector sales are from Low-E. By increasing the % of double-/triple-layer insulating glass sales, we expect that glass usage/pc would increase which should further raise our sales volume and ASP. Old building renovation projects that required a huge amount of glass consumption could also contribute to sector revenue increase. Low-E penetration rate remains low at 40% compared to other developed countries (80%).

Q5: Could you talk more about company's conversion between solar glass production line and float glass production line?

Ans: The company converted its FG production lines into SG lines in last Q4 whilst the solar glass price surged to its historical high RMB 42/sqm (RMB 6-7000/t). The conversion was easy to implement since no hardware change is needed; however, the company has fixed lines into FG production this year since now FG is more profitable.

We have seen some other players were incentivized to shift capacity into solar glass production.

Q6: For auto glass sector, what is XYG's OEM penetration rate now?

Ans: XYG is now supplying auto glass for BYD, Geely, Beijing Autos, GAC, Chery, etc. While OEM sales grows rapidly, the company is still focusing on aftermarket market. OEM sales only count for 13% of total auto glass sales.

Q7: What is XYG's future capacity expansion plan? Any criteria on acquiring external production lines?

Ans: Company's acquisition is really dependent on timing and opportunity. We acquired 2400/t additional capacity in Hainan this year from its previous owner. The original production lines were poorly managed and lose-making, so we seized the opportunity. XYG would act discreetly and keep looking for good opportunities, but no specific criteria would apply. For the long-term growth plan, we aim to keep 10%/5%/10% capacity growth rate for FG/Auto/Construction sectors every year respectively.

Q8: What would be company's normalized margin level in the next 3-5 years?

Ans: For next year, company's margin should be sustained by strong downstream demand. It would become difficult for new entrants to expand capacity or open new lines in the short term since cold repair and ramp-up take time, however. It is hard to give an exact number for XYG's future margin level.

Q9: How much tax savings that the company could benefit from its Malaysia new plants?

Ans: Currently, 100% of XYG's auto glass export to US is produced domestically. By establishing factory in Malaysia, 25% export tax could be saved, so everyone can do the math. The project is delayed due to pandemic lockdown, and we would accelerate the process if the situation shall ease.

Exhibit 1 - Company Snapshot: XYG

Xinyi Glass (868.HK)		Gross profit by segment (2020)					Risk/Reward analysis						
Ticker	868.HK												
Rating	Buy												
Target price	42.6												
Share price (Aug 6, 2021)	30.8												
Upside/Downside	39%												
Number of shares (mn)	4,055												
Market cap (US\$ mn)	15,987												
Liquidity (3M avg. US\$ mn)	35												
Income statement (HKD mn)		2019	2020	2021E	2022E	2023E	Key assumptions		2019	2020	2021E	2022E	2023E
Revenue		16,258	18,616	29,025	31,097	32,795	Auto Glass ASP (HK\$/piece)		278	256	261	264	264
Gross Profit		5,883	7,771	15,690	16,660	16,072	Construction Glass ASP (HK\$/sqm)		101	115	121	122	123
GPM		36%	42%	54%	54%	49%	Float Glass ASP (HK\$/tonne)		1,967	2,479	2,642	2,721	2,640
EBITDA		5,731	7,527	13,239	14,042	13,325	Auto Glass volume ('000 piece)		16,200	18,000	19,350	19,530	20,507
EBIT		4,558	6,361	11,846	12,508	11,668	Construction Glass volume ('000 sqm)		37,528	42,990	49,848	54,833	60,316
EBIT margin		28%	34%	41%	40%	36%	Float Glass volume ('000 tonnes)		5,040	5,715	8,200	8,539	9,150
Net interest expense		(182)	(155)	(168)	(198)	(182)	Auto Glass unit GP		129	121	151	162	146
Associates and JV		640	1,124	1,289	1,168	1,368	Construction Glass unit GP		39	50	55	55	50
Pre-tax Profit		5,016	7,330	12,967	13,478	12,854	Float Glass unit GP		1,967	2,479	2,642	2,721	2,640
Net Profit		4,478	6,422	11,199	11,615	11,116	Valuation metrics		2019	2020	2021E	2022E	2023E
Core Net Profit (ex-Associate)		3,766	5,143	9,718	10,272	9,542	P/E		7.8	7.6	11.1	10.7	11.2
Core NPM		28%	34%	39%	37%	34%	PB		1.7	1.8	3.7	3.2	2.8
Balance sheet (HKD mn)		2019	2020	2021E	2022E	2023E	PEG		1.4	0.2	0.2	2.9	(2.6)
Cash and liquid assets		5,142	5,304	6,465	10,200	13,689	EV/Sales		2.5	2.9	4.5	4.1	3.8
Trade Receivables		3,086	4,916	7,665	8,212	8,661	EV/EBITDA		7.0	7.2	9.8	9.0	9.3
Total Assets		36,254	45,071	52,638	59,915	67,367	EV/FCF		44.3	74.5	22.7	15.0	15.5
Trade Payables		3,349	3,917	4,816	5,215	6,040	FCF Yield %		2.6%	1.5%	4.6%	6.8%	6.4%
Interest bearing debt		10,810	11,574	12,574	13,574	14,574	Dividend Yield %		6.3%	6.5%	4.4%	4.6%	4.4%
Shareholders Equity		20,846	27,882	33,534	39,396	45,006	Target price implied PE			26.7	15.4	14.8	15.5
Net Debt		5,667	6,270	6,109	3,374	885	Target price implied PB			6.2	5.1	4.4	3.8
Cash flow (HKD mn)		2019	2020	2021E	2022E	2023E	Target price implied EV/EBITDA			23.6	13.4	12.5	0.0
Cash flow from operations		3,779	4,504	8,901	11,598	11,275	Key company metrics		2019	2020	2021E	2022E	2023E
Net capex		(2,875)	(3,773)	(3,193)	(3,110)	(3,280)	Revenue growth %		2%	14%	56%	7%	5%
FCF		904	731	5,708	8,488	7,995	EPS growth %		6%	43%	74%	4%	-4%
Comparison to consensus		2019	2020	2021E	2022E	2023E	Core EPS growth %		5%	37%	89%	6%	-7%
EPS (HKD mn)		1.12	1.59	2.77	2.88	2.75	ROE		23%	26%	36%	32%	26%
Consensus EPS (HKD mn)				2.61	2.83	2.94	ROA		14%	16%	25%	22%	19%
% diff to Bloomberg cons				6.2%	1.6%	-6.4%	ROIC		15%	18%	26%	23%	20%
DPS		0.55	0.79	1.37	1.42	1.36	Net Debt to Equity		27%	22%	18%	9%	2%
BVPS		5.19	6.90	8.30	9.75	11.14	Interest Cover (x)		16.6	33.0	56.8	44.4	38.7

Source: Company Financials, Jefferies

Company Description

Xinyi Glass

Xinyi Glass is the largest glass manufacturer in China engaged in the production of float glass, auto glass, and construction glass. It is the parent company of Xinyi Solar, a solar glass producer, and Xinyi Energy, a solar farm operator.

Company Valuation/Risks

Xinyi Glass

Our PT of HK\$42.6 is based on 4.37x FY22E PB with expected ROE of 32%, derived using our Gordon Growth model with WACC of 8% and terminal growth of 2.5%. Risks include lower-than-expected solar glass prices, changes to capacity swap policy in supply, and weaker-than-expected demand, in particular property completions.

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

Recommendation Completion	August 6, 2021 , 07:29 ET.
Recommendation Distributed	August 6, 2021 , 07:29 ET.

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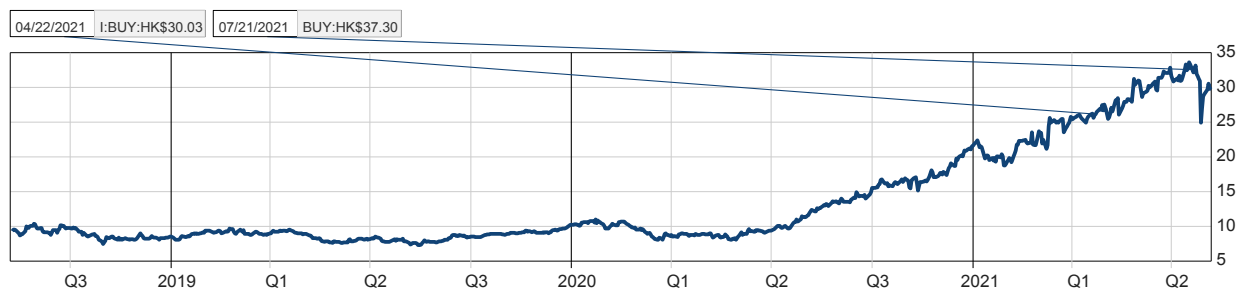
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Rating and Price Target History for: Xinyi Glass (868 HK) as of 08-05-2021



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:

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Distribution of Ratings

Distribution of Ratings						
			IB Serv./Past12 Mos.		JIL Mkt Serv./Past12 Mos.	
	Count	Percent	Count	Percent	Count	Percent
BUY	1818	63.21%	163	8.97%	26	1.43%
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