

## Xinyi Glass (868 HK)

**Overweight**

Price: HK\$7.85

20 Nov 2017

Price Target: HK\$12.00

PT End Date: 31 Dec 2018

Strong pricing due to environmental constraints on supply

We have seen additional shortages in the glass market due to closures in Hebei, near Beijing, presumably for environmental reasons. According to China Glass Website ([Glass.com.cn](http://Glass.com.cn)), there have been as many as nine production lines shut down in Hebei Shahe, with about 4% of total production in China. This contributes to higher average costs for glass in China. Some 40-50% of glass production in China still uses oil or coal for fuel and these are the first lines to be shut for environmental reasons (100% of XYG's production uses natural gas).

**We see sentiment improving for XYG due to the following reasons:**

- Normally price for glass falls in November but looks like it's still strong in 2017
- XYG has been a laggard compared to other commodity related SMIDs – (XYG has outperformed HSCEI by about 4% in 2017 – paper SMIDs still outperformed HSCEI by 40% YTD)
- XYG has a relatively low P/E – JPMe 2018 P/E of 6.8x (SMID industrial average is 10x) and XYG's (2013 to 2017) average forward P/E of 7x but a peak of 15x P/E)

Figure 1: Price of float glass in China



Source: Bloomberg

Please see our last update, "[Xinyi Glass: Lifting PT to HK\\$12 - Winner from trend of lower energy costs](#)", dated 5 Sept, for more details.

## 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.

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### SMID-Caps

**Leon Chik, CFA** <sup>AC</sup>

(852) 2800-8590

leon.hk.chik@jpmorgan.com

**Bloomberg** JPMA CHIK <GO>

**Christine Wang**

(852) 2800-8528

christine.wang@jpmorgan.com

J.P. Morgan Securities (Asia Pacific) Limited

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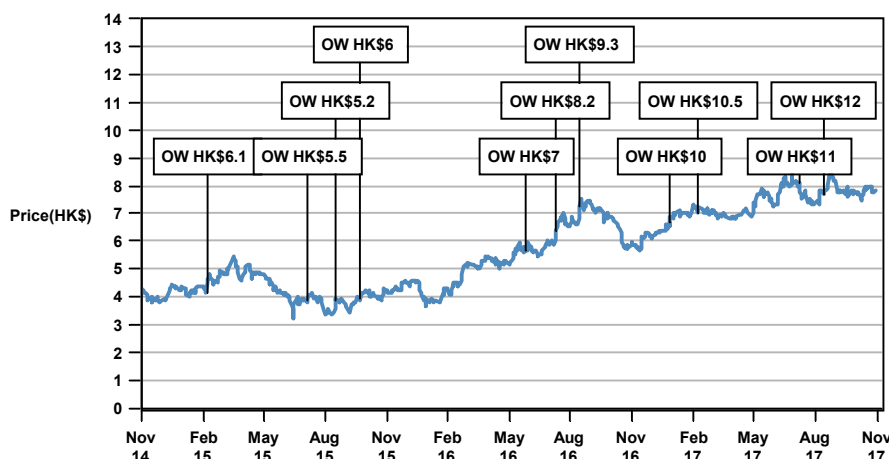
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Xinyi Glass (0868.HK, 868 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
02-Mar-15	OW	4.15	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	5.67	7.00
02-Aug-16	OW	6.40	8.20
07-Sep-16	OW	7.26	9.30
18-Jan-17	OW	6.68	10.00
28-Feb-17	OW	7.04	10.50
31-Jul-17	OW	8.08	11.00
05-Sep-17	OW	7.65	12.00

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

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