

Fuyao Group (3606 HK)

A next growth cycle is coming

China | Auto & Parts | Company Initiation

27 March 2015

China's largest and the world's second largest automotive glass producer

Fuyao Glass with the headquarters located in Fuzhou mainly produces automotive glass and float glass. About 96% of its revenue comes from automotive glass and the float glass is mainly supplied for the company itself. The company is now China's largest and the world's second largest automotive glass manufacturer. According to the sales volume in 2013, it took up 63% shares of China's automotive market, and 72% shares of the glass OEM market for passenger cars in China; it also owned 20% market shares in the global automotive glass market.

Excellent Profitability brought about by efficient operation management

Ever since 2000, the company has been continuously expanding in accordance with the domestic automotive main engine plants, at the same time extending foreign markets; in the recent 14 years, it has reported the rapid and extremely steady growing of sales revenue, which increased from 750 million Yuan to 12, 800 million Yuan, and the annual compound growth rate is 22.5%. The net margin grew from 150 million Yuan to 2.2 billion Yuan and the annual compound growth rate was 21%. For the recent 10 years, the company's average gross margin is above 35%, which remains around 40% in the past three years; the average net profit rate is close to 16% and average ROE is around 30%.

We believe the reasons why Fuyao Glass has remained such excellent profitability come from the following competitive advantages:

- 1) Fuyao enjoyed lower logistics and consumption costs than other competitors at home concerning base amount and layout, and build competitive advantages in costs and supplies' promptness, which is also good for establishing stable partnership with clients.
- 2) The company has established a flexible production mode "varieties of products in small quantities", appealing to the trend of the whole automobile market.
- 3) Fuyao focuses more on the automobile glass and continuous R&D enabled its products been recognized by the Four major Vehicle Series.
- 4) The efficient corporate governance system. The solid management will better push forward the formulation of the strategic decisions of the company.

The overseas market will be the next core objective

To obtain more room for growth, the company is planning to expand further in the international market. At present, the company owns a production base of automobile glass in Russia, and is building a production base in America and another one in Russia respectively. The proportions of the overseas revenues to the total business revenues for 2011, 2012, 2013 and 2014 are respectively 31.5%, 32.6%, 32.0%, 32.2% and 33.5%. The net amount of the capital raising of Fuyao Glass is about 6.21 billion to 7.15 billion HK\$. The 80% of the money will be used to expand the overseas production lines.

We predict that with the successive operation of the production lines in Russia and America in the following 2 years, the company's overseas income contribution is expected to increase quickly and become the powerful engine of the company's next growth cycle.

Accumulate (Initiation)

IPO Price range HKD 14.8 - 16.8

TARGET HKD 19.7

COMPANY DATA

O/S SHARES (MN) :	2403
MARKET CAP (HKD MN) :	NA
52 - WK HI/LO (HKD):	NA / NA

SHARE HOLDING PATTERN, %

Sanyi Development Limited	15.57
Heren Charitable Foundation	11.56

PRICE PERFORMANCE, %

	1M	3M	1Y
Fuyao	NA	NA	NA
HIS index	NA	NA	NA

PRICE VS. HSI

Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY14	FY15E	FY16E	FY17E
Net Sales	12928	14587	16739	19474
Net Profit	2214	2810	3331	3929
EPS, CNY	1.11	1.17	1.36	1.61
P/E, x	12.0	11.3	9.7	8.2
BVPS, CNY	4.39	4.77	5.50	8.19
P/BV, x	3.0	2.8	2.4	1.6
DPS (CNY)	0.75	0.80	0.90	1.02
Div. Yield (%)	5.7%	6.1%	6.8%	7.7%

Source: Company reports, Phillip Securities Est.

Zhangjing (+ 86 51699400-103)

zhangjing@phillip.com.cn

Investment Thesis

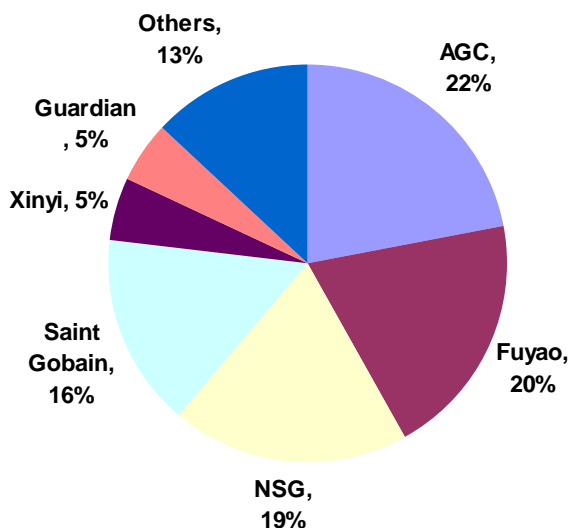
The dividend payout rate of the company in the recent years keeps high (over 50%), and overseas expansion can enable the company to enjoy the cheaper natural gas and other energy sources more adequately; in addition, the company is expected to develop clients in the field of higher gross margins such as low-emission construction glass, and the new round of performance growth of the company will be opened again under the condition of the stable growth of gross margin.

As analyzed above, we expected EPS expectation of the Company to RMB 1.15/1.36/1.61 for 2015/2016/2017. We covered the company initially with the target price of 19.7, respectively 13.3/11.4/9.6x P/E for 2015/2016/2017, 17.3% upside from the issue price cap, "Accumulate" rating.

Company Profile: China's largest and the world's second largest automotive glass producer

Fuyao Glass with the headquarters located in Fuzhou mainly produces automotive glass and float glass. About 96% of its revenue comes from automotive glass and the float glass is mainly supplied for the company itself. The company is now China's largest and the world's second largest automotive glass manufacturer. According to the sales volume in 2013, it took up 63% shares of China's automotive market, and 72% shares of the glass OEM market for passenger cars in China which was close to two times of the total market shares of the manufacturers with the ranking from the second to the sixth; it also owned 20% market shares in the global automotive glass market. The company was listed in A-stock market in 1993, and the current market value is about 30 billion Yuan.

World top 6 auto glass manufacturers



Source: Company report, Phillip Securities Hong Kong Research

The company's main clients include the top twenty automotive manufacturers in the world and the top ten passenger car manufactures in China. The customers, includes joint-venture passenger car manufacturers, like Shanghai General Motors Co., Ltd., FAW-Volkswagen, Shanghai Volkswagen, Beijing Hyundai, Dongfeng Nissan, and major international auto manufacturers, such as Toyota, Volkswagen, General Motors Corp., Ford, Hyundai, Renault-Nissan, Fiat, Honda, BMW, Mercedes-Benz, Bentley, Rolls-Royces and Porsche.

Industry overview of automotive glass market

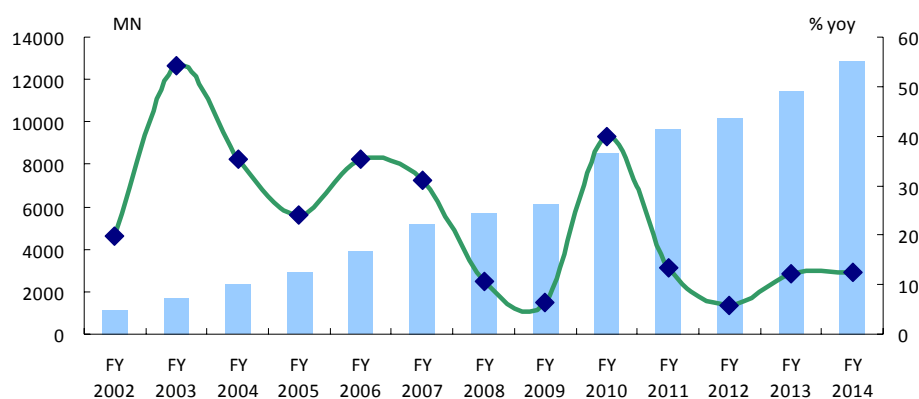
Automotive glass consists of two market segments: new car supporting market and after-sales fittings market; and the market share ratio of the two is about 8:2 (for global market) and 9:1 (for China). According to the data of Roland Berger, for the new car supporting market, it increased at a compound growth rate of 10.1% from 2009 to 2013, which was higher than 6.6%, the compound growth rate of global automotive market in the same period. Main cause of the growth was the market's increasing demand for large windshield and the growing popularity of auto sunroof. It is expected that sales volume of global new car supporting market and the compound annual growth rate in 2018 will respectively reach 423 million m² and 5%. While the rate of increase of global after-sale fittings market's was slightly smaller; from 2009 to 2013, the annual compound growth rate was 5.0%; up to 2018, it is expected to reach 105 million m² and 4.6% annual compound growth rate. The entire market sales are 4.8 times of Fuyao's current total production capacity.

As far as the Chinese automotive glass market is concerned, the after-sale market's growth rate is higher than that of the new car supporting market, which is mainly determined by the features of the stage that the Chinese automobile market is in. It is expected that up to 2018, the annual compound growth rates of new car sales and after-sale supporting will be respectively 9.0% and 11.7%, and the market sales will be respectively 133.3 and 17.3 million m², which accounts for 1.37 times of the current total production capacity of Fuyao Glass.

Profitability brought about by efficient operation management

Ever since 2000, the company has been continuously expanding in accordance with the domestic automotive main engine plants, at the same time extending foreign markets; in the recent 14 years, it has reported the rapid and extremely steady growing of sales revenue, which increased from 750 million Yuan to 12, 800 million Yuan, and the annual compound growth rate is 22.5%.

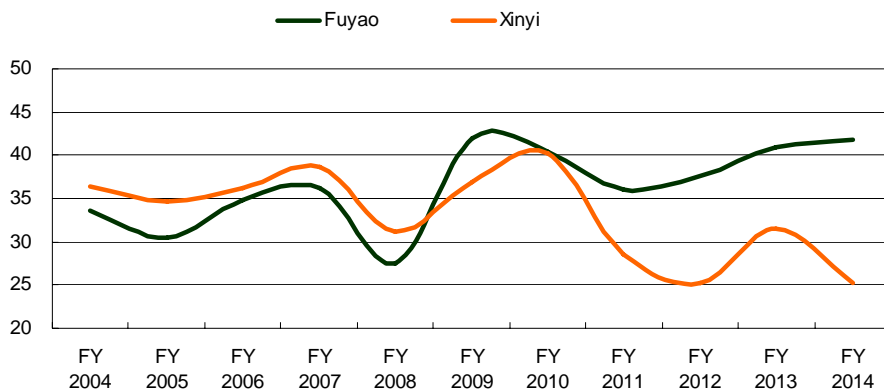
Fuyao's revenue trend



Source: Phillip Securities Hong Kong Research

The net margin grew from 150 million Yuan to 2.2 billion Yuan and the annual compound growth rate was 21%; there were two profit droppings, one of which was caused by the 2008 financial crisis and the other was in 2011, due to the overdrawn consumption of cars brought about by government's subsidy policy, the cardinal number year-on-year basis was relatively high, and there was a loss in subsidiary corporation's architectural-grade float glass on account of adjustment on real estate market. For the recent 10 years, the company's average gross margin is above 35%, which remains around 40% in the past three years; the average net profit rate is close to 16% and average ROE is around 30%.

Fuyao's gross margin trend and comparison



Source: Phillip Securities Hong Kong Research

We believe the reasons why Fuyao Glass has remained such excellent profitability come from the following competitive advantages:

1) The company currently owns 110.3 million m2 of capacity of automotive glass and 1058 thousand tons of production capacity of float glass; the production capacity use ratio is maintained at a high level from 85% to 95%. Fuyao Glass possesses 12 production bases in 8 provinces of China and covers all nearby main automotive production bases of China, so as to more effectively make lower logistics and consumption costs than other competitors at home concerning base amount and layout, and build competitive advantages in costs and supplies' promptness, which is also good for establishing stable partnership with clients.

Fuyao's production base distribution



Source: Company report, Phillip Securities Hong Kong Research

2) After many years of accumulation, the company has already established a flexible production mode incorporating the information control system, materials storage and transport system, and digitally controlled processing equipment, and is able to respond quickly to the customer needs, satisfying the requirement for the production of "varieties of products in small quantities", effectively reducing the costs, and increasing the diversity of products. The company has adapted itself to the characteristics of the development trend of the global automobile market.

3) The company is one of the few producers of automobile glass whose products have been both recognized by the international clients of matching products and certified by the Four major Vehicle Series. Compared with other competitors, Fuyao focuses more on the automobile glass. The continuous investment in the research and development has enabled the company to possess the advanced capabilities of design and development of high-end products.

4) The efficient cost control system and corporate governance system. More than 80% of the float glass of the company is self-supplied. The vertical product chain system ensures the stable and controllable supply of raw materials. The company is a private enterprise. The founder has been its Chairman for more than 20 years. The solid management will better push forward the formulation of the strategic decisions of the company.

The overseas market will be the next core objective of the company

To obtain more room for growth, the company is planning to expand further in the international market. At present, the company owns a production base of automobile glass in Russia, and is building a production base in America and another one in Russia respectively. The proportions of the overseas revenues to the total business revenues for 2011, 2012, 2013 and 2014 are respectively 31.5%, 32.6%, 32.0%, 32.2% and 33.5%. In 2014, the company has reported an increase of 12.4% in total revenues, with the total revenues amounting to 12.9 billion Yuan. The net profit attributing to shareholders amounted to 2.22 billion Yuan, representing an increase of 15.8% yoy. The earning per share was 1.11 Yuan. The gross margin was 42.3%, increasing by 0.9ppts yoy.

In the view of various regions, the incomes of the domestic market grow by 14% yoy in 2014, and the overseas market is more excellent, with the growth of 17% yoy. The capital expenditure of the company in 2014 increased to 2.8 billion Yuan, with the growth of 48% yoy, and it is predicted to approach 3 billion Yuan in 2015. The net amount of the capital raising of Fuyao Glass is about 6.21 billion to 7.15 billion Hongkong dollars. The 80% of the money will be used to expand the overseas production lines:

About 35% will be used for the glass production facilities automation in Ohio of America and this project is predicted to be completed in December, 2015, and the annual production capacity is designed to be 12.1 million m²;

About 30% will be used for the glass production facilities automation in Russia, and the automotive float glass production line project with the annual capacity of 0.45 million tons is predicted to be completed at the end of 2017;

About 15% will be used to build the automated glass production facilities in Russia, and design the second-phase automotive glass base with the capacity of 8.1 million m², which will be accomplished at the end of 2016;

In addition, about 10% will be used to supplement the circulating funds; about 10% will be used to repay the bank loan.

We predict that with the successive operation of the production lines in Russia and America in the following 2 years, the company's overseas income contribution is

expected to increase quickly and become the powerful engine of the company's next growth cycle.

Valuation

The dividend payout rate of the company in the recent years keeps high (over 50%), and overseas expansion can enable the company to enjoy the cheaper natural gas and other energy sources more adequately; in addition, the company is expected to develop clients in the field of higher gross margins such as low-emission construction glass, and the new round of performance growth of the company will be opened again under the condition of the stable growth of gross margin.

As analyzed above, we expected EPS expectation of the Company to RMB 1.15/1.36/1.61 for 2015/2016/2017. We covered the company initially with the target price of 19.7, respectively 13.3/11.4/9.6x P/E for 2015/2016/2017, 17.3% upside from the issue price cap, "Accumulate" rating.

Peer Comparison

Ticker	Name	Mkt Cap (HKD)	BEst P/B	BEst P/B:2FY	BEst P/E:1FY	BEst P/E:2FY
CNY						
600660 CH Equity	FUYAO GROUP GLASS IND	36792	2.53	2.21	12.59	10.80
600819 CH Equity	SHANGHAI YAOHUA PILKII	9548	N/A	N/A	N/A	N/A
HKD						
868 HK Equity	XINYI GLASS HOLDINGS LT	17726	1.33	1.18	8.73	7.15
200012 CH Equity	CSG HOLDING CO LTD - B	21352	1.18	1.08	9.20	8.03
425 HK Equity	MINIH GROUP LTD	16449	1.62	1.45	11.52	9.84
1108 HK Equity	LUOYANG GLASS COMPAN	3969	N/A	N/A	N/A	N/A
3300 HK Equity	CHINA GLASS HOLDINGS L	1611	N/A	N/A	N/A	N/A
JPY						
5201 JP Equity	ASAHI GLASS CO LTD	56674	0.78	0.77	23.47	23.00
USD						
GLW US Equity	CORNING INC	227443	1.44	1.35	14.63	13.46

Source: Bloomberg, Phillip Securities Hong Kong Research

Financials

FYE DEC	FY12	FY13	FY14	FY15F	FY16F	FY17F
Valuation Ratios						
P/E (X), adj.	17.8	13.8	12.0	11.3	9.7	8.2
P/B (X)	3.9	3.4	3.0	2.8	2.4	1.6
Dividend Yield (%)	3.7%	3.8%	5.7%	6.1%	6.8%	7.7%
Per share data (RMB)						
EPS, (Basic)	0.76	0.96	1.11	1.17	1.36	1.61
EPS, (Diluted)	0.76	0.96	1.11	1.15	1.36	1.61
DPS	0.50	0.50	0.75	0.80	0.90	1.02
BVPS	3.48	3.92	4.39	4.77	5.50	8.19
Growth & Margins (%)						
Growth						
Revenue	5.8%	12.2%	12.4%	12.8%	14.8%	16.3%
EBIT	6.0%	23.6%	11.2%	24.1%	18.5%	17.7%
Net Income, adj.	0.8%	25.7%	15.6%	26.9%	18.5%	17.9%
Margins						
Gross margin	37.4%	40.6%	41.5%	42.6%	43.2%	43.5%
EBIT margin	20.4%	22.4%	22.2%	24.4%	25.2%	25.5%
Net Profit Margin	14.9%	16.7%	17.1%	19.3%	19.9%	20.2%
Key Ratios						
ROE	23.1%	25.9%	26.6%	27.5%	26.6%	23.5%

Income Statement (RMB mn)						
Revenue	10247	11501	12928	14587	16739	19474
Gross profit	3828	4671	5363	6214	7231	8471
EBIT	2086	2578	2865	3555	4214	4961
Profit before tax	1862	2379	2638	3351	3976	4689
Tax	338	462	422	536	636	750
Profit for the period	1524	1917	2217	2815	3340	3939
Minority interests	0	0	2	5	9	10
Total capital share	2003	2003	2003	2403	2443	2443
Net profit	1524	1916	2214	2810	3331	3929

Source: PSR

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd

250 North Bridge Road, #06-00 Raffles City Tower,
Singapore 179101

Tel : (65) 6533 6001 Fax: (65) 6535 3834

www.phillip.com.sg

INDONESIA

PT Phillip Securities Indonesia

ANZ Tower Level 23B, Jl Jend Sudirman Kav 33A,
Jakarta 10220, Indonesia

Tel (62) 21 5790 0800 Fax: (62) 21 5790 0809

www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd.

15th Floor, Vorawat Building, 849 Silom Road,
Silom, Bangrak, Bangkok 10500 Thailand

Tel (66) 2 2268 0999 Fax: (66) 2 2268 0921

www.phillip.co.th

UNITED STATES

Phillip Futures Inc.

141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA

Tel (1) 312 356 9000 Fax: (1) 312 356 9005

MALAYSIA

Phillip Capital Management Sdn Bhd

B-3-6 Block B Level 3, Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450 Kuala Lumpur

Tel (60) 3 2162 8841 Fax (60) 3 2166 5099

www.poems.com.my

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd.

No 436 Heng Feng Road, Green Tech Tower Unit 604
Shanghai 200 070

Tel (86) 21 5169 9400 Fax: (86) 21 6091 1155

www.phillip.com.cn

FRANCE

King & Shaxson Capital Ltd.

3rd Floor, 35 Rue de la Bienfaisance
75008 Paris France

Tel (33) 1 4563 3100 Fax : (33) 1 4563 6017

www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia

Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia

Tel: (61) 3 9618 8238 Fax: (61) 3 9200 2277

www.phillipcapital.com.au

HONG KONG

Phillip Securities (HK) Ltd

11/F United Centre 95 Queensway Hong Kong

Tel (852) 2277 6600 Fax: (852) 2868 5307

www.phillip.com.hk

JAPAN

Phillip Securities Japan, Ltd

4-2 Nihonbashi Kabutocho, Chuo-ku
Tokyo 103-0026

Tel: (81) 3 3666 2101 Fax: (81) 3 3664 0141

www.phillip.co.jp

INDIA

PhillipCapital (India) Private Limited

No. 1, 18th Floor, Urmi Estate, 95 Ganpatrao Kadam Marg,
Lower Parel West, Mumbai 400013

Tel: (9122) 2300 2999 Fax: (9122) 6667 9955

www.phillipcapital.in

UNITED KINGDOM

King & Shaxson Ltd.

6th Floor, Candlewick House, 120 Cannon Street
London, EC4N 6AS

Tel (44) 20 7929 5300 Fax: (44) 20 7283 6835

www.kingandshaxson.com

SRI LANKA

Asha Phillip Securities Limited

Level 4, Millennium House, 46/58 Navam Mawatha,
Colombo 2, Sri Lanka

Tel: (94) 11 2429 100 Fax: (94) 11 2429 199

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