

Fuyao Group (3606.HK)

Overseas layout will finally start to be paid back

China | Auto & Parts | Company Update

5 March 2018

Investment Summary

- Exchange Loss Causes the Results of 2017Q3 to Decrease by 1.5%
- Core Profit Increase is Great, and Q3's Net Profit Actually Rises by 20%
- Enhancing the Market Share and Better Sales Structure
- Overseas Business is Entering the Right Path, Global Expansion is being Continually Advanced

Investment Thesis

Stable position in the industry, the continuous optimization of product mix, and high dividend rate provide a greater margin of safety for the Company's share price. The sound development of overseas business will bring high resilience of earnings, which is promising. We maintain the "Accumulate" rating, with target price to be HK\$ 34, equivalent to 16x P/E for 2018. (Closing price as at 1 March 2018)

Accumulate (Maintain)

CMP: HKD 31.15

(Closing price as at 1 March 2018)

TARGET: HKD 34.00 (+9%)

COMPANY DATA

O/S SHARES (MN) :	2509
MARKET CAP (HKD MN) :	15725
52 - WK HI/LO (HKD):	35/ 23.65

SHARE HOLDING PATTERN, %

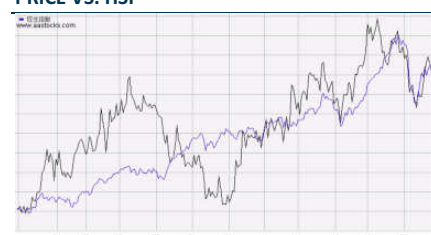
Sanyi Development Limited	15.57
Heren Charitable Foundation	11.56

Peer Comparison

Ticker	Name	Market cap	PE			PB (MRQ)
			TTM	17E	18E	
3606.HK	Fuyao	63157	20.76	18.09	13.93	3.57
0425.HK	Minth	38270	20.97	17.80	14.40	3.68
0868.HK	Xinyi	33705	11.98	11.12	9.25	2.71
1316.HK	Nexteer	32433	15.79	15.00	12.72	4.27
0819.HK	Tianneng	6555	7.83	6.44	5.34	1.71
600741.SH	Huayu	79449	12.37	12.03	10.97	2.01
002085.SZ	Wanfeng	30157	33.85	25.83	22.02	5.17
600699.SH	Joyson	25754	27.49	21.41	18.29	1.93

Source: Wind, Phillip Securities Hong Kong Research

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY15	FY16	FY17E	FY18E
Net Sales	13573	16621	19491	22057
Net Profit	2605	3143	3306	4440
EPS, CNY	1.10	1.25	1.32	1.77
P/E, x	23.8	22.1	19.7	14.6
BVPS, CNY	6.55	7.19	7.69	8.74
P/BV, x	4.0	3.9	3.4	3.0
DPS (CNY)	0.75	0.75	0.79	1.06
Div. Yield (%)	2.9%	2.7%	3.0%	4.1%

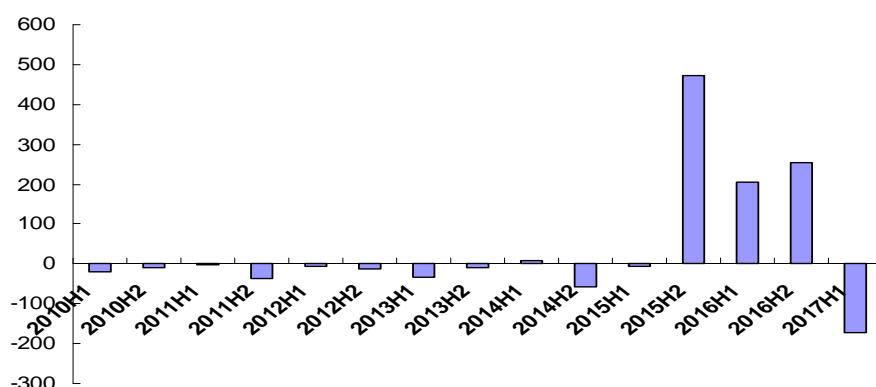
Source: Company reports, Phillip Securities Est.

Exchange Loss Causes the Results of the First Three Quarters of 2017 to Decrease by 1.5%

The revenue of Fuyao Glass in the first three quarters of 2017 increased by 15.6% yoy to RMB13.4 billion; the net profit attributable to the parent company was RMB2.14 billion, slightly down by 1.5% yoy; the basic EPS was RMB0.85, from RMB0.87 of the same period of the previous year. Mainly as a result of the exchange losses due to the appreciation of RMB, the exchange loss in the first three quarters was RMB0.3 billion (RMB0.13 billion in the third quarter), while the exchange profit in the same period of the previous year was RMB0.21 billion.

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Fuyao`s Foreign exchange gains (mil RMB)



Source: Phillip Securities Hong Kong Research

Core Profit Increase is Great, and Q3`s Net Profit Actually Rises by 20%

If the impact of exchange was excluded, the net profit in the first three quarters would increase by 17.8% yoy, and the main business would tend to continually greatly increase. On a closer look at quarters, EPS in the first three quarters reached RMB0.28, RMB0.27 and RMB0.30, respectively from last year`s RMB0.23, RMB0.35 and RMB0.29, respectively. Under the disadvantageous condition of dramatic RMB appreciation in Q3, the Company`s single-quarter result still kept growing slightly. If the impact of exchange was excluded, the actual profit of Q3 increased greatly by more than 20% yoy.

Enhancing the Market Share and Showing a Steady Improvement in Sales Structure

The Company`s sales volume increases at a speed higher than that of the automobile industry in the downstream (China+5%, America -1.9%), indicating that the market share of products of the Company is growing. In recent years, the Company has been expanding the production scale by upgrading the production line, and enhancing the raw material utilization rate by enriching product categories of high added value and featuring a strong cost control ability. Fuyao Glass`s gross margin basically remains stable and its overall gross margin is 42.8%, despite that the price of raw material, i.e., soda ash had been on the increase in the first three quarters. Specifically, the gross margin of Q3 increased 0.6 ppts to 42.5% qoq. We think that this is mainly associated with the proportional growth of the products of high added value of the Company and the gradual improvement of the profitability of the American factory.

Overseas Business is Entering the Right Path, Global Expansion is being Continually Advanced

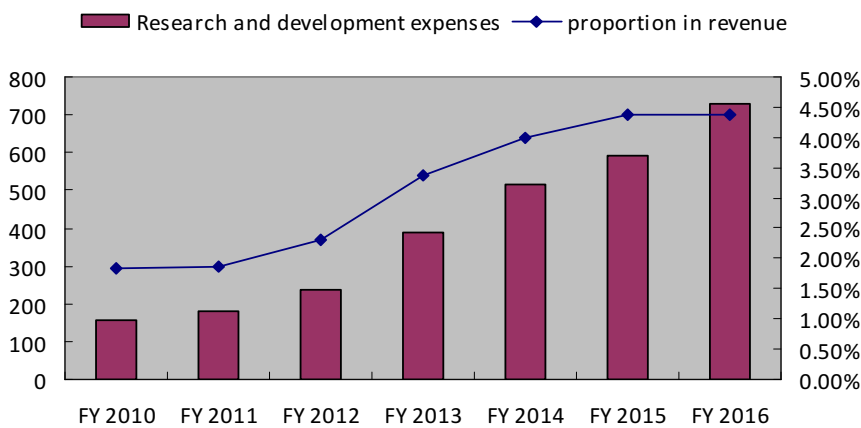
Fuyao Glass`s automobile glass factory in Ohio, America has started to make profit: It reported a profit of USD2,195 thousand from June to September, and it is predicted that only a slight loss was accumulatively generated in 2017, and a profit will be contributed in 2018. The profit of the float glass factory, Mt.Zion, America in the first three quarters was USD7.50 million, and it is predicted that the year`s profit will be more than USD10 million. The Company`s overseas layout will finally be paid back.

The net cash flow from operating activities of the first three quarters increased by 14.55% to RMB3.1 billion yoy. Specifically, that of Q3 was RMB1.4 billion, an increase of 13% yoy and a surge of 110% qoq. This indirectly indicates that the Company`s overseas business has started to be paid back positively, and the American factory`s profitability is rapidly restoring.

Fuyao Glass`s market shares in the domestic supporting automobile glass market and the global automobile glass market are 65% and 20%, respectively. There is huge

room for improvement in the overseas market. After the completion and commissioning of Phase I (3 million sets) of the factory in Ohio, America at the end of 2016, the supplementary Phase II of 2.5 million sets has also been completely installed and is predicted to be gradually put into production in February. The American factory's total productivity is expected to reach 5.5 million sets. At the same time, the Company's global productivity expansion is still being progressed; it plans to invest in an automobile glass project of 4 million sets in Suzhou City, Jiangsu Province; float glass factories in Benxi City, Liaoning Province, Germany and Russia are also in the planning. We predict that Fuyao Glass's leading position will be further consolidated, as its domestic and overseas industrial layout is being constantly improved.

Fuyao's R&D expenses



Source: Phillip Securities Hong Kong Research

Risks

Demand for automobiles keeps sluggish; cost of raw materials increases; RMB appreciates

Catalyst

Success market development of overseas automobile market; rebound of domestic demand for automobile; depreciation of RMB

Financials

FYE DEC	FY13	FY14	FY15	FY16	FY17F	FY18F
Valuation Ratios						
P/E (X), adj.	25.6	22.2	23.8	22.1	19.7	14.6
P/B (X)	6.2	5.6	4.0	3.9	3.4	3.0
Dividend Yield (%)	2.0%	3.1%	2.9%	2.7%	3.0%	4.1%
Per share data (RMB)						
EPS, (Basic)	0.96	1.11	1.10	1.25	1.32	1.77
EPS, (Diluted)	0.96	1.11	1.04	1.25	1.32	1.77
DPS	0.50	0.75	0.75	0.75	0.79	1.06
BVPS	3.92	4.39	6.55	7.19	7.69	8.74
Growth & Margins (%)						
Growth						
Revenue	12.2%	12.4%	5.0%	22.5%	17.3%	13.2%
EBIT	23.6%	11.2%	12.1%	23.6%	1.4%	33.8%
Net Income, adj.	25.7%	15.8%	17.4%	20.7%	5.2%	34.3%
Margins						
Gross margin	40.6%	41.5%	41.5%	42.0%	42.9%	43.8%
EBIT margin	22.4%	22.2%	23.7%	23.9%	20.6%	24.4%
Net Profit Margin	16.7%	17.2%	19.2%	18.9%	17.0%	20.1%
Key Ratios						
ROE	25.9%	26.6%	20.6%	18.2%	17.7%	21.5%
Income Statement (RMB mn)						
Revenue	11501	12928	13573	16621	19491	22057
Gross profit	4671	5363	5635	6973	8356	9661
EBIT	2578	2865	3213	3970	4024	5384
Profit before tax	2379	2638	3042	3919	4063	5437
Tax	462	422	435	777	756	995
Profit for the period	1917	2217	2607	3142	3307	4442
Minority interests	0	2	2	-2	1	2
Total capital share	2003	2003	2509	2509	2509	2509
Net profit	1916	2219	2605	3143	3306	4440

Source: PSR

(Financial figures as at 1 March 2018)

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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