Deutsche Bank
Markets Research

Rating
Hold

Asia
China

Resources
Construction Materials

Company
Fuyao Glass - A

Reuters	Bloomberg	Exchange	Ticker
600660.SS	600660 CH	SHH	600660

Date
31 October 2017

Initiation of Coverage

Price at 30 Oct 2017 (CNY)	27.45
Price target - 12mth (CNY)	23.00
52-week range (CNY)	27.52 - 17.39
HANG SENG INDEX	28,439

Valuation & Risks

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OP in line but weak earnings on FX losses; initiating Fuyao A with Hold

OP numbers in line but FX losses

Fuyao released 3Q17 results after market close on Wednesday. NPAT slightly decreased 1% YoY to RMB2.14bn in 9M17, representing only 67% and 66% of DB's whole year estimate and Bloomberg consensus, respectively, mainly due to FX losses of RMB300m+ in 9M17 as a result of RMB appreciation against the USD. If we strip out FX losses, Fuyao's bottom line actually increased 24% YoY in 9M17, in line with our estimate (please refer to table below).

US auto glass turned profitable in 3Q17; management optimistic about international operations

According to management at the results call yesterday, the US auto glass plant started to make a profit in 3Q17 with earnings of USD1.6m+, vs over USD10m of losses in 1H17. Management expects the momentum to continue as efficiency improves. The second phase of the US project (capacity: 2.5m sets) is completed as planned and management expects it to ramp up in Feb 2018. In addition, management sees no significant challenges in gaining market share in the US, citing improving efficiency, customer satisfaction, and R&D abilities as the main reasons.

Initiating on Fuyao-A with a Hold; risks

With this report, we initiate coverage of Fuyao A shares (600660.SS) with a Hold and a target price of RMB23. The valuation is derived from the currency translation of our H-share target price, which is set using DCF methodology, with a WACC of 7.1% (cost of equity at 8.4%, risk-free rate at 3.9%, market risk premium of 5.6%, beta of 0.8) and terminal growth of 0%. The stock is trading at 21.6x 2017 DBe EPS with 2017-19 DBe EPS CAGR of 12%. We believe the valuation is fair, and thus initiate with a Hold. Fuyao A is trading at 21.6x 2017 DBe EPS with 2017-19 DBe EPS CAGR of 12%. A share peers are trading at 23x 2017E EPS and 2017-19 EPS CAGR of 17%. Also, Fuyao is an exclusive, leading auto glass player with 65% market share in China and over 20% globally, and we believe it has competitve edge. Risks: Fuyao may face challenges during its international expansion, such as fluctuations in currency exchange rates, political and economic instability, etc. Also, automobile glass industry is competitive, thus there is pressure on Fuyao's market share if it cannot compete effectively. Other risks include: higher or lower raw materials and fuel prices; changes to the incentives provided by the PRC government could materially reduce Fuyao's profitability, e.g. a change in the preferential income tax rate.

Price/price relative



Performance (%)	1m	3m	12m
Absolute	7.7	17.3	56.9
HANG SENG INDEX	3.2	5.4	23.9

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	17.2
Net debt/equity (%)	8.3
Book value/share (CNY)	7.58
Price/book (x)	3.62
Net interest cover (x)	179.1
Operating profit margin (%)	19.5

Source: Deutsche Bank

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Forecasts and ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	13,573.5	16,621.3	20,025.0	22,098.1	24,121.1
EBITDA (CNYm)	4,192.3	5,171.4	5,448.6	6,025.7	6,565.2
Reported NPAT (CNYm)	2,604.7	3,143.4	3,187.2	3,524.4	3,860.7
Reported EPS FD(CNY)	1.10	1.25	1.27	1.40	1.54
DB EPS FD(CNY)	0.96	1.10	1.27	1.40	1.54
OLD DB EPS FD(CNY)	–	–	–	–	–
% Change	–	–	–	–	–
DB EPS growth (%)	–	14.0	16.0	10.6	9.5
PER (x)	14.9	14.3	21.6	19.5	17.8
EV/EBITDA (x)	7.8	7.6	12.9	11.6	10.6
DPS (net) (CNY)	0.75	0.75	0.76	0.84	0.92
Yield (net) (%)	5.3	4.8	2.8	3.1	3.4

Source: Deutsche Bank estimates, company data

Figure 1: Fuyao 3Q17 financial summary

Financials	3Q17	2Q17	QoQ	3Q16	YoY	9m17	9M16	YoY	DBe	% of DBe	Cons.	% of cons
Revenue	4,686	4,516	4%	4,006	17%	13,400	11,591	16%	20,025	67%	19,269	70%
GP	1,942	1,844	5%	1,677	16%	5,592	4,886	14%	8,306	67%	8,427	66%
SG&A	(934)	(915)	2%	(847)	10%	(2,774)	(2,445)	13%	(4,305)	64%	(4,221)	66%
OP	1,008	929	9%	830	21%	2,818	2,441	15%	5,449	52%	4,206	67%
NPAT	757	693	9%	719	5%	2,144	2,175	-1%	3,187	67%	3,238	66%
NPAT excl FX	890	779	14%	714	25%	2,447	1,966	24%	3,187	77%		
GPM	41.5%	40.8%		41.9%		41.7%	42.2%		41.5%		43.7%	
SG&A % of revenue	19.9%	20.3%		21.1%		20.7%	21.1%		21.5%		21.9%	
Effective tax rate	17.1%	-16.0%		-20.0%		17.6%	18.7%		18.0%			
Gearing ratio	10%	10%		-3%		10%	-3%					
AR days	83	82		83		108	102					
AP days	65	67		57		83	77					
Inventory days	99	104		107		135	142					

Source: Deutsche Bank estimates, company info, Bloomberg Finance LP

Key takeaways from 9M17 earnings call

- **US factory capacity ramp-up**: 3m sets capacity this year in the US, output guidance of 2.1m-2.3m sets (about 70% utilization rate). Management is optimistic about reaching this target. Construction of the phase II project (2.5m sets capacity) is mostly complete; management expects it to ramp up in Feb 2018.
- **Overseas profit**: In 3Q17, US auto glass started to make a profit with earnings of USD1.6m+, and US float glass profit was about USD3.0m. In 9M17, US auto glass generated a loss of USD8.7m and US float glass a profit of USD7.5m. Management expects the strong momentum to continue at the US plants, thanks to improving efficiency and customer satisfaction. The Russia operation still suffered losses in 3Q17, but management expects it to turn profitable in 4Q, as volume is picking up.
- **FX exposure**: Fuyao currently has around USD700m in cash and this matches the needs of overseas operations; the USD deposit interest rate is approximately equal to the company's USD debt interest rate.
- **ASP**: Excluding the FX impact, ASP increased 3.5% YoY in the reporting period, mainly thanks to high value-added products. This year, the company expects high value-added products to account for about 33% of total revenue, 3ppt higher than last year.
- **Production costs**: Besides a significant market price increase for soda ash, the costs of logistics, packaging, etc all increased this year. However, management is confident that it can deal with the pressure by promoting strong cost-control measures.

Model updated: 30 October 2017

Running the numbers

Asia

China

Construction Materials

Fuyao Glass - A

Reuters: 600660.SS Bloomberg: 600660 CH

Hold

Price (30 Oct 17)	CNY 27.45
Target Price	CNY 23.00
52 Week range	CNY 17.39 - 27.52
Market cap (m)	CNYm 68,862 USDm 10,355

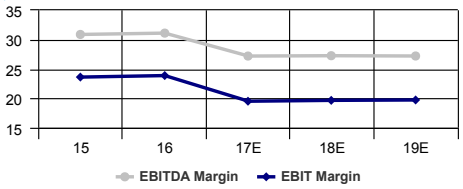
Company Profile

Fuyao Glass Industry Group Co Ltd, through its subsidiaries, manufactures and distributes automobile glass, float glass, and other industrial glassware. The Company also provides glass installation service. Fuyao Glass Industry Group markets its products internationally.

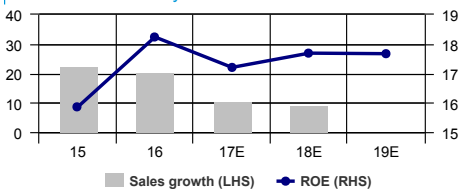
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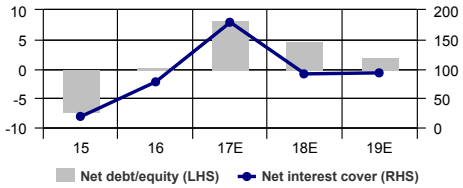
Margin Trends



Growth & Profitibility



Solvency



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Fiscal year end 31-Dec	2015	2016	2017E	2018E	2019E
Financial Summary					
DB EPS (CNY)	0.96	1.10	1.27	1.40	1.54
Reported EPS (CNY)	1.10	1.25	1.27	1.40	1.54
DPS (CNY)	0.75	0.75	0.76	0.84	0.92
BVPS (CNY)	6.5	7.2	7.6	8.3	9.1
Weighted average shares (m)	2,377	2,509	2,509	2,509	2,509
Average market cap (CNYm)	33,898	39,200	68,862	68,862	68,862
Enterprise value (CNYm)	32,718	39,251	70,447	69,877	69,355
Valuation Metrics					
P/E (DB) (x)	14.9	14.3	21.6	19.5	17.8
P/E (Reported) (x)	13.0	12.5	21.6	19.5	17.8
P/BV (x)	2.33	2.59	3.62	3.30	3.01
FCF Yield (%)	0.1	0.1	1.1	3.4	3.5
Dividend Yield (%)	5.3	4.8	2.8	3.1	3.4
EV/Sales (x)	2.4	2.4	3.5	3.2	2.9
EV/EBITDA (x)	7.8	7.6	12.9	11.6	10.6
EV/EBIT (x)	10.2	9.9	18.0	16.1	14.6
Income Statement (CNYm)					
Sales revenue	13,573	16,621	20,025	22,098	24,121
Gross profit	6,620	8,174	9,846	10,658	11,753
EBITDA	4,192	5,171	5,449	6,026	6,565
Depreciation	985	1,201	1,540	1,680	1,806
Amortisation	0	0	0	0	0
EBIT	3,207	3,970	3,909	4,346	4,760
Net interest income(expense)	-171	-51	-22	-48	-51
Associates/affiliates	0	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0	0
Other pre-tax income/(expense)	6	0	0	0	0
Profit before tax	3,042	3,919	3,887	4,298	4,708
Income tax expense	435	777	700	774	847
Minorities	2	-2	0	0	0
Other post-tax income/(expense)	0	0	0	0	0
Net profit	2,605	3,143	3,187	3,524	3,861
DB adjustments (including dilution)	-322	-396	0	0	0
DB Net profit	2,283	2,748	3,187	3,524	3,861
Cash Flow (CNYm)					
Cash flow from operations	3,000	3,532	4,938	5,325	5,443
Net Capex	-2,981	-3,485	-4,200	-3,000	-3,000
Free cash flow	19	47	738	2,325	2,443
Equity raised/(bought back)	6,524	0	0	0	0
Dividends paid	-1,502	-1,881	-2,229	-1,688	-1,849
Net inc/(dec) in borrowings	298	2,460	0	0	0
Other investing/financing cash flows	67	263	-44	-69	-72
Net cash flow	5,406	888	-1,534	569	523
Change in working capital	-503	-638	171	55	-293
Balance Sheet (CNYm)					
Cash and other liquid assets	5,905	7,199	5,665	6,234	6,757
Tangible fixed assets	10,807	13,416	16,139	17,459	18,653
Goodwill/intangible assets	154	157	158	158	159
Associates/investments	0	0	0	0	0
Other assets	7,976	9,107	8,863	9,391	10,095
Total assets	24,842	29,880	30,825	33,242	35,664
Interest bearing debt	4,719	7,245	7,245	7,245	7,245
Other liabilities	3,693	4,582	4,568	5,148	5,558
Total liabilities	8,412	11,827	11,813	12,393	12,804
Shareholders' equity	16,423	18,048	19,006	20,843	22,855
Minorities	6	5	5	5	5
Total shareholders' equity	16,430	18,052	19,011	20,848	22,860
Net debt	-1,186	46	1,580	1,011	488
Key Company Metrics					
Sales growth (%)	nm	22.5	20.5	10.4	9.2
DB EPS growth (%)	na	14.0	16.0	10.6	9.5
EBITDA Margin (%)	30.9	31.1	27.2	27.3	27.2
EBIT Margin (%)	23.6	23.9	19.5	19.7	19.7
Payout ratio (%)	68.4	59.9	59.9	59.9	59.9
ROE (%)	15.9	18.2	17.2	17.7	17.7
Capex/sales (%)	22.3	21.3	21.0	13.6	12.4
Capex/depreciation (x)	3.1	2.9	2.7	1.8	1.7
Net debt/equity (%)	-7.2	0.3	8.3	4.8	2.1
Net interest cover (x)	18.8	77.6	179.1	91.2	92.9

Source: Company data, Deutsche Securities estimates

Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Fuyao Glass - A	600660.SS	27.45 (CNY) 30 Oct 2017	NA

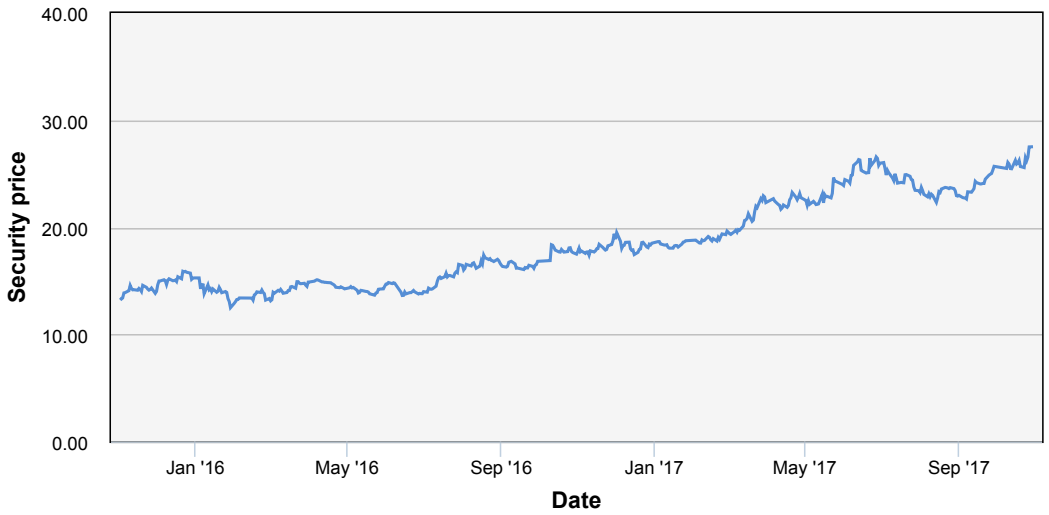
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Historical recommendations and target price. Fuyao Glass - A (600660.SS)

(as of 10/30/2017)

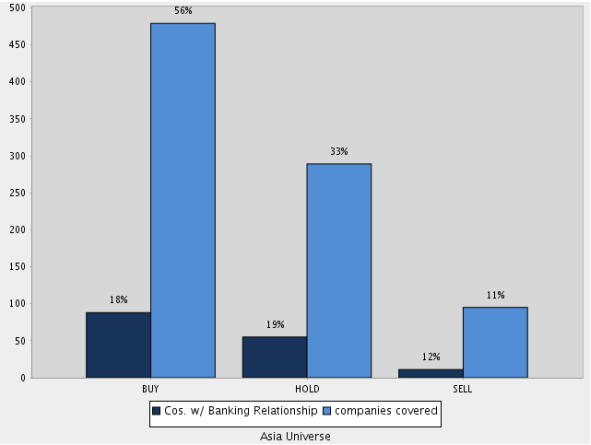


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Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.
Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

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