

China Glass (3300 HK)

Takeaways from investor conference call

We invited the management of China Glass to share with investors the industry outlook and business development last week. Investors' questions were mainly about the industry supply and the Company's restructuring plan. Key takeaways: (1) Effective capacity of float glass (for the industry) will likely drop over the coming years due to the need of cold repair, which will support float glass price; (2) In contrast to the potential reduction of effective capacity for the industry, China Glass capacity growth has been on a good track; (3) Restructuring plan is largely confirmed. CNBM Group's float glass capacity will likely be injected into China Glass.

- Float glass price to be supported by the potential decline in effective supply.** It is estimated that around 270-280 production lines are in operation at present. Out of these capacities, around 100 lines started operation in 2011 following the launch of RMB 4 trillion stimulus package. Majority of these lines will need to suspend production for cold repair in the foreseeable future. This, together with the strict government control over the new capacity approval, will likely result in a decline in the effective capacity over the coming three years.
- Capacity growth on good track.** As at end-May, China Glass had a daily float glass capacity of 5.1kt. After the commencement of two new lines (total 1kt) in Jun, the capacity reaches 6.1k tonnes. The capacity is expected to further increase to 6.8kt after including Longtai project (700t) by end-Jul.
- Restructuring roadmap largely confirmed.** CNBM Group has three listed platforms, namely China Glass, Triumph Science & Technology (600552 CH, NR), Luoyang Glass (1108 HK / 600876 CH, NR). Going forward, China Glass will likely consolidate all the float glass business under CNBM Group. CNBM Group has a total of 6kt of daily capacity of float glass, a similar scale to that of China Glass.
- Our take.** In 1Q21, revenue from glass products surged 73% YoY to RMB793mn, driven by 40% YoY increase in sales volume. On the back of strong float glass price (+51% YoY in 1H21), China Glass is set to benefit from a strong operating leverage. We expect profit surprise, progress on M&A and restructuring will serve as major share price catalysts this year. China Glass is currently trading at 1.4x 2020 P/B, a significant discount to 4.5x of Xinyi Glass (868 HK, NR).

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20A
Revenue (RMB mn)	2,618	2,369	3,159
YoY growth (%)	2.4	-9.5	33.3
Net income (RMB mn)	93	83	-85
EPS (RMB)	0.055	0.049	-0.051
YoY growth (%)	51.8	-10.6	N/A
Consensus EPS (RMB)	N/A	N/A	N/A
EV/EBITDA (x)	10.1	11.1	10.3
P/E (x)	30.7	34.9	N/A
P/B (x)	1.5	1.5	1.4
Yield (%)	0.0	0.0	0.0
ROE (%)	4.7	4.0	-4.1
Net gearing (%)	101.3	117.4	121.5

Source: Company data, CMBIS

NOT RATED

Current Price

HK\$1.89

China Industrials

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Stock Data

Mkt Cap (HK\$ mn)	3,421
Avg 3 mths t/o (HK\$ mn)	16
52w High/Low (HK\$)	1.96/0.34
Total Issued Shares (mn)	1,810

Source: Bloomberg

Shareholding Structure

Triumph Science & Technology Group*	23.01%
Legend Holdings	22.80%
Others	54.19%

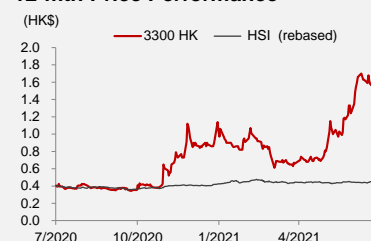
*Note: Owned by CNBM Group
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	46.8%	50.0%
3-mth	180.3%	186.5%
6-mth	62.3%	57.5%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

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Conference call takeaways:

Introduction

Float glass ASP

- The industry is robust at the moment. Future price is currently at RMB2,800/tonne while spot price is even higher. This is equivalent to RMB150 / weight case.

Industry inventory level

- Several weeks ago, the inventory level for the industry as a whole was only 3-5 days. While over the past two to three weeks the inventory level slightly increased to 7-10 days, it remained at the historical low level.

China Glass:

- Since Triumph Technology became the largest shareholder of China Glass five years ago, a lot of works have been done by the management to improve the business performance.
- This year, all operating production lines are likely running at decent profitability.
- Besides, the management has introduced a lot of initiatives on capacity and efficiency management.
- M&A projects are also in good progress.

Q&A

Question: What's the cold repair cycle for the industry?

Answer:

Industry supply:

- For the industry as a whole, the number of production lines with quotas in China is estimated at ~300.
- Going forward, the government is unlikely to ease the approval of new production line due to need to achieve environmental and carbon emission targets. Float glass supply will be even tighter going forward.
- The cold repair cycle is normally 6-8 years. Some new furnaces can operate 10 years before cold repair.
- Due to the robust industry demand at present, some old production lines in the market has been running for 10 years without cold repair. However, such situation is unsustainable and there is imminent need for these capacities to come offline.
- It is estimated that around 270-280 production lines are in operation at present. Out of these capacities, around 100 lines started operation during the period after the 4 trillion stimulus package in 2011. Majority of these lines will need to stop for cold repair in the near term.
- As a result, the effective capacity of float glass will be reduced over the coming three years.

Question: Any capacities with production quota but not in operation? Any opportunities for China Glass to make acquisition?

Answer:

At present, new capacity addition is very difficult to get approval from the government.

There are two types of capacities that have quotas but not in operation:

- Type 1: At normal cold repair stage. Unlikely for these project owners to sell given that the operation is not a problem.
- Type 2: Capacities running at operational or financial difficulties, which are forced to sell. This is similar to China Glass' newly acquired project in Fujian. However, this type of projects is very limited in the market.

Question: Is there a policy that any capacity suspended for two-year is equivalent to a loss of the production quota?

Answer:

Such situation existed, despite the lack of official documents available. By the end of 2021, production lines not in operation for two years will mean a loss of the production quota. Therefore, these capacities will likely be sold. However, such projects are not widely available in the market. China Glass has been actively looking for such projects.

Question: What's the restructuring target of China Glass?

Answer:

Current shareholding structure:

- Triumph Science & Technology Group (owned by CNBM Group): 23.01%
- Legend Holding: 22.8%

CNBM Group has already launched the 15th FYP. The “3+1 strategy” has been finalized.

- Display and new materials: Triumph Science & Technology
- New energy glass: Luoyang Glass (1108 HK / 600876 CH, NR)
- Float glass and special glass: China Glass
- Research institute

China Glass is expanding to solar glass business. For example, Suqian project is a solar glass capacity project.

At present, there is no concrete timetable of restructuring. The overlapped business (such as solar glass business) will be handled properly at the interest of shareholders of both companies.

Question: What's the float glass capacity owned by Triumph Science & Technology?

Answer:

Production capacity (daily) of Triumph:

- Heilongjiang: Two production lines (total: 600t x2)
- Henan: Two lines (total: 600t x2)
- Luoyang: 700t + 650t
- Dezhou: 600t
- Qinhuangdao: 500x 3 (acquired last year)
- Sichuan: One new line for glass supply to Wuliangye this year
- **Total 10 production lines**

China Glass currently has 12 production lines. Both companies have ~6,000 tonnes of daily capacity.

China Glass restructuring plan will likely take reference to Luoyang Glass recent restructuring model.

Question: What's the cost structure? Which players would China Glass benchmark to?

Answer:

For China Glass, certain production lines' profitability has reached the tier-one level (though not all lines). The overall gross margin improvement has been satisfactory so far.

- Soda Ash: Given the central procurement at group level, cost is the lowest across the industry. Normally, China Glass can achieve cost of RMB100-200/tonne lower than peers. Sometimes even RMB500 lower.
- Energy: Mainly natural gas. Cost is still higher than peers. Cost level will have room to drop further.
- Silicon sand: China Glass owns sand mines but not enough to fully supply the internal use. There is no major difference among players in terms of cost as the absolute amount is not very high.

Going forward, China Glass will benchmark the cost efficiency to the tier-one industry players.

Question: What are the key demand drivers?

Answer:

Apparent demand is on the rise due to the following factors:

- **Property:** While property is not a high growth sector due to government policy, there has been structural change for the demand for glass products. For example, the use of double insulation glass has been increasing. Besides, there is a rising trend of using triple insulation glass (for voice and temperature reduction). This structural trend has boosted the demand for each unit of property completion. On the other hand, designs with more glass usage in both office and residential will also boost the glass demand.
- **New Energy (Solar glass).** Double glass application: Ultra-clear glass is used in backsheet.
- **New Energy vehicles.** New growth driver on top of traditional vehicles.
- **Home appliance.** For example, certain plastics components of air conditioners and refrigerators have been replaced with glass.

Question: What's the capacity expansion plan?

Answer:

- Fujian Longtai acquisition: SGM will be held on 16 Jul for approval.
- First production line: Started operation 1 May.
- Second production line (500t) will be ready soon.
- Third production line (600t) is in construction.

China Glass capacity (daily) target:

China:

- May 2021: 5100t
- Currently at 6,100t after adding two new lines (total 1000t)
- Will add 700t (Longtai project) by the end of Jul.
- **Total: 6,800t**
- **7,500t in total after the commencement of Longtai second line**

Overseas: 1200t

- Nigeria: 600t (started operation in 2019)
- Kazakhstan: 600t to start operation by end 2021 (at construction stage but progress affected by COVID-19)

China Glass total: 8,700t (China and overseas)

Question: How's the cash flow? How to manage the debt level?

Answer:

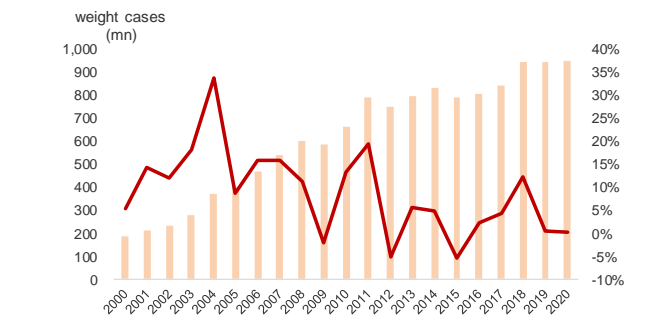
- Cash flow is very good YTD.
- 2020 average finance cost down 1ppt from 2019. Expects further decline in finance cost this year.
- That said, China Glass currently put the focus on growth and therefore the scale of debt will likely increase.

Figure 1: Spot price of float glass in China +51% YoY in 1H21



Source: Wind, CMBIS

Figure 2: Glass production in China



Source: Wind, CMBIS

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