

Zhejiang Glass



Gem in Ash

Not Rated

Key points:

- Leading flat glass manufacturer in Zhejiang.
- Soda ash capacity to double, price stable.
- Soda ash to generate RMB579.1m in profit in FY12/08F.
- Undemanding valuation compared with peers.

China Industrials

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Business summary. Zhejiang Glass (ZJG) is China's leading local flat glass manufacturer, with a 78.7%-owned soda ash subsidiary Qinghai Soda Ash Co Ltd (QSAC). In FY12/07A, its glass segment contributed 65.8% of its total RMB2,322.2m revenue and 36.3% of RMB445.7m operating profit. The soda ash division contributed 34.2% and 60.9%, respectively.

Stock data

Price	HK\$5.62
12 mth range	HK\$3.50-12.00
Market cap.	US\$567.0m
No. shares o/s	785.0m
Daily t/o, 3 mth	US\$1.2m
Free float %	27.2%
Major shareholder	Feng Guangcheng- 49%
Ticker	739.HK/0739 HK

Glass division

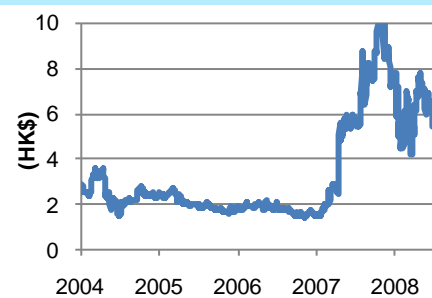
Expanding capacity. The company's flat glass daily capacity currently stands at 4,500tonnes (90,000 weight cases). A new line is under construction and, when launched in 4Q, will boost capacity by 500tonnes.

Financial summary

Year to Dec	07A
Yield (%)	n/a
ROE (%)	15.4
Net gearing (%)	133.6
Net debt/sh. (HK\$)	3.258
BV/sh. (HK\$)	2.55
Consensus EPS (HK\$)	
- 12/08F	0.800
- 12/09F	1.272

Margin erosion. Despite the relatively high flat glass price (RMB81.0 – 82.0 per weight case), soaring raw materials costs have eroded the company's profit. ZJG expects to earn RMB3.0 – 5.0 per weight case this year, which will translate into net profit of RMB69.3 – 115.5m.

Price Chart



Oversupply concerns. We believe oversupply is a potential threat given: 1) China's property market uncertainties; 2) world's weakening economy. According to a report by the China Architectural and Industrial Glass Association (CAIGA), the country's capacity will increase by 57.0m weight cases (about 10.0%) in 2008.

Positive factors. The government plans to phase out inefficient capacity (about 30.0m weight cases) during the 11th Five-year Plan (2006 – 2010). However the exact policy has yet to be announced. Rebuilding efforts after the Sichuan earthquake should also stimulate demand.

Soda ash division

Background. ZJG's soda ash business is a provincial partnership project between Qinghai and Zhejiang. QSAC, launched in Dec 2005, is the operating entity for this business.

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Deal with Sinhoo. The company reached an agreement with Zhejiang Sinhoo Group in 2007 to sell 35.0% in QSAC for RMB904.6m. The transaction will be split into three tranches (RMB300.0m in Jun 2007, RMB200.0m in Jul 2008 and RMB404.6m in May 2009).

Output estimate. Capacity in FY12/07A was 1.2m tonnes and actual output 0.9m tonnes, which is expected to reach 1.1m tonnes in FY12/08F. Phase II of a 1.2m tonne plant is under construction and scheduled to come on stream in 4Q boosting soda ash output to 1.8m in FY12/09F and 2.1m in FY12/10F. Transportation bottlenecks are a concern and the company is seeking support from the local government.

Price trend. The price of soda ash is high (RMB1,750 – 1,800 per tonne, VAT included) in China, though slightly lower down from the RMB1,900 per ton level at the beginning of the year. We expect it to remain solid this and next year due to China's expanding glass production capacity and strong demand from other sectors.

FY12/08F earnings. The company estimates its unit cost (all costs to derive EBT) at RMB800.0 in FY12/08F. With its preferential tax treatment (five-year exemption and another five years at half rate from 2006), we calculate QSAC's net profit at RMB805.1m in FY12/08F, of which around RMB579.1m will belong to ZJG.

Our view.

Corporate governance. The total capex for the soda ash plant's Phase II of RMB1.3 – 1.4bn (RMB800.0m for FY12/08F) is funded by bank loans and equity financing. In May 2008, the company issued 64.2m new shares at HK\$6.05 each to raise HK\$388.2m, to expand its glass production. ZJG's substantial shareholders include Mr. Feng Guangcheng (48.9%) and International Finance Corporation (13.7%).

Valuation. China's flat glass industry is mature and cyclical, with keen competition. The company's growth potential is capped by the sector's geographic segmentation and high transportation costs. ZJG's most valuable asset is its soda ash operation, in our view. In the A-share market, soda ash producers are trading at an average forward P/E of 14.4x.

Table 1: P&L

Year to Dec (RMBm)	05A	06A	07A
Revenue	1,195.6	1,520.5	2,322.2
Cost of sales	(944.9)	(1,352.2)	(1,754.9)
Gross profit	250.8	168.3	567.3
Other gains – net	21.2	47.3	21.2
Distribution and selling expenses	(24.7)	(52.3)	(70.6)
General, administrative and other operating expenses	(33.3)	(57.2)	(72.2)
Operating profit	213.9	106.1	445.7
Finance costs – net	(89.3)	(156.2)	(123.3)
Loss from disposal of a subsidiary	(1.4)	n/a	n/a
Profit / (loss) before income tax	124.7	(51.5)	322.4
Income tax expenses	(50.1)	(8.4)	(25.5)
Profit / (loss) before minority interest	74.6	(59.9)	296.9
Minority interest	(0.5)	2.9	(21.1)
Net profit	74.1	(57.0)	275.8
EPS - basic (RMB)	0.128	(0.091)	0.383
Dividend	20.9	n/a	n/a

Source: Company data

Table 2: Peer comparison

Company name	Ticker	Mkt Cap (US\$m)	Last Price (Local)	His P/E(x)	Curr-Yr Fwd P/E(x)	Nxt-Yr Fwd P/E(x)	ROE (%)
Glass peers							
China Glass	3300 HK	123.0	2.30	9.7	n/a	n/a	16.4
Fuyao Group	600660 CH	2,051.6	7.17	15.6	12.3	9.5	28.9
Luoyang Galss	600876 CH	160.2	3.72	n.a.	26.6	20.7	n.a.
Yaohua Glass	600716 CH	380.5	4.78	130.2	n.a.	n.a.	4.8
<i>Average</i>				51.8	19.4	15.1	
Soda ash peers							
Shuanghuan Science & Tech	000707 CH	832.2	12.55	n.a.	13.9	10.5	5.9
Shandong Haihua	000822 CH	1,088.8	8.84	21.1	11.5	11.4	10.4
Sanyou Chemical	600409 CH	1,296.0	9.66	26.1	12.7	9.9	21.9
Jinjing Science & Tech	600586 CH	865.7	10.27	24.5	19.6	13.1	14.6
<i>Average</i>				23.9	14.4	11.2	
Zhejiang Glass	739 HK	567.0	5.62	12.9	7.0	4.4	15.4

Source: Bloomberg