

A large tire cord manufacturer in China

China Automotive

Xingda International (1899 HK)

Not Rated

Background. Through its 69.5%-owned Jiangsu Xingda, Xingda International is engaged in the manufacturing and distribution of radial tire cords and bead wires.

Table 1: Offer statistics

Price range	HK\$2.45-HK\$3.08
No. of shares offered	386.0m
Over-allotment	38.6m
Fund raised	HK\$945.7m-HK\$1,188.9m
Offer P/E (FY12/06F)-fully diluted	12.2x-15.3x
Total market cap	US\$405.3m-US\$509.5m
IPO open	Dec-13
IPO close	Dec-13
Listing	Dec-21

Source: Company Data

Investment theme. Xingda International is a proxy to the high growth China auto industry. According to China Rubber Industry Association, the group is the largest independent radial tire cord manufacturer in China, in terms of sales. Furthermore, it stands to benefit from the replacement demand for radial tire in domestic market. In 2005, the group was recognized as an approved supplier of “Goodyear”. The entry barrier of radial tire cord manufacturing industry is high, as it can take up to three years for cord manufacturer to be on the vendor lists of tire manufacturers.

Margin erosion. Blended profit margin declined to 30.1% in FY12/05A from 50.0% in FY12/03A, due to the drop in ASP of major products and rise in cost of raw materials. Since the price competition in the domestic tire manufacturing industry was severe during the period, the group was not able to pass on the increase in raw material costs to its customers. As a result, its profitability was eroded. Between FY12/03A and FY12/05A, ASP of truck radial tire cords and passenger car radial tire cords declined at a 2-year compound annual rate of 6.3% and 1.2%, respectively. Meanwhile, its unit cost of raw material increased at a 2-year CAGR of 26.7%. Sales generated from truck radial tire cords and passenger car radial tire cords accounted for 82.7% and 10.6% of the group’s total sales in FY12/05A.

Passive position in the supply chain. Tire manufacturers have their own facilities for the production of radial tire cord. These manufacturers typically outsource supply of cords to independent cord manufacturers like Xingda only when their cord production capacities are fully saturated. This explains why the group has not entered into any long-term sales contracts of more than one year with its customers. To some degree, the group is competing with its own customers.

Outstanding CBs is the potential threat of shareholders’ value. The group issued convertible bonds in principal amount of US\$54.0m to Henda (owned by a family trust of Mr. Lee Shau Kee), Tetrad (Tetrad Ventures Pte Ltd., a wholly-owned subsidiary of Government of Singapore Investment Corporation) and GSSIA (Goldman Sachs Strategic Investments (Asia), a wholly-owned subsidiary of Goldman Sachs) between May 2005 and January 2006. Approximately 227.3m shares will be issued at HK\$1.853 each upon the exercise of the CBs. The CBs can be exercised starting from six month after the listing date (December 21, 2006) and will mature on May, 2008. The conversion of the CBs to shares new will further dilute the group’s EPS. Beside, the group’s profitability will be affected by the change in the estimated fair value of the share purchase options attached with the CBs. As long as the CBs are outstanding and the market price of the group’s share is higher

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than the exercise price, the group will incur a loss.

Interests in principal operating assets less than 100%. Xingda International only has 69.5% stakes in Jiangsu Xingda, which is the principal operating subsidiary of the group and is engaged in manufacturing and distribution of radial tire cords and bead wires. 30.5% of the profit from Xingda International has to be distributed to minority shareholders of Jiangsu Xingda. One minority shareholder, Xing Hong Da, a company holds 22.3% interests in Jiangsu Xingda is involved in a lawsuit in China and has been ordered by the Shanghai No.2 Intermediate People's Court to pay RMB39.0m and the related legal expenses to the claimant in the lawsuit. Since Xing Hong Da has failed to compensate the claimant, the court froze its assets, including its stakes in Jiangsu Xingda. If the balance in Xing Hong Da's account is not sufficient to pay the claimant, the court may sell its assets, include its interests in Jiangsu Xingda through auction. Nevertheless, the group is allowed to participate in this sale auction in such an event.

Table 2: Key financials

Year end Dec (RMBm)	2003A	2004A	2005A	1H05A	1H06A
Revenue	963	1,683	2,357	1,094	1,155
Gross profit	482	663	709	326	335
Operating profit	390	587	586	272	265
Pre-tax profit	350	516	321	123	195
Net profit	136	186	116	26	125
YoY % Change					
Revenue (%)	-	74.8	40.1	(53.6)	5.6
Gross profit (%)	-	37.7	7.0	(54.1)	2.9
Operating profit (%)	-	50.3	(0.2)	(53.5)	(2.7)
Pre-tax profit (%)	-	47.2	(37.8)	(61.8)	59.0
Net profit (%)	-	36.9	(37.5)	(78.0)	389.0
Gross profit margin (%)	50.0	39.4	30.1	29.8	29.0
Operating margin (%)	40.5	34.9	24.9	24.9	22.9
Pre-tax margin (%)	36.4	30.6	13.6	11.2	16.9
Net margin (%)	14.1	11.0	4.9	2.3	10.8
Receivables turnover days	110	102	113	101	135
Payable turnover days	95	48	34	43	36
Inventory turnover days	90	53	67	93	61
Gearing ratios (%)	43.4	41.0	50.0	47.9	50.6

Source: Company data

Earnings forecasts and valuation. FY12/06F net profit after fair value adjustment on the convertible bonds is projected to be no less than HK\$258.4m, representing an annualized growth rate of 125.9%. However, the group incurred loss on fair value adjustment on the CBs of RMB179.6m. Excluding such loss, the group's FY12/05A earnings would have been HK\$346.5m. The issue price range of HK\$2.45-HK\$3.08 represents a 12.2x-15.3x pro forma fully diluted FY12/06F P/E, compared with the sector average P/E of 12.4x and 10.4x for FY07F and FY08F, respectively. Its counterpart, Shougang Concord Century is trading at P/E of 7.6x and 4.3x for FY12/07F and FY12/08F, respectively.

Table 3: Peer group comparisons

Company name	Ticker	Year End	Price (HK\$)	Market cap (US\$m)	P/E (x) FY07F	P/E (x) FY08F
Norstar Founders	2339 HK	Mar	2.71	435	8.1	6.7
Shougang Concord Century	103 HK	Dec	0.71	94	7.6	4.3
Mint Group	425 HK	Dec	6.43	687	15.2	11.7
Weichai Power	2338 HK	Dec	24.1	1,023	13.6	12.3
China Metal Int'l	319 HK	Dec	2.74	366	10.8	8.5
Xinyi Glass	868 HK	Dec	3.38	698	12.1	10.3
Average					12.4	10.4

Source: Bloomberg