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DIVIDEND POLICY AT FUYAO GLASS

In early February 2015, Dr. Zuo Min, the chief financial officer of Fuyao Glass Industry Group., Ltd. (Fuyao), was drafting a dividend policy to be discussed at the meeting of Fuyao's board of directors in two weeks' time. Fuyao was China's largest—and the world's second largest—manufacturer of automotive glass (auto glass) in terms of 2013 sales revenues. The company had completed its domestic initial public offering (IPO) on the Shanghai Stock Exchange on June 10, 1993, when it became the first listed auto-glass manufacturer in China. Fuyao was preparing for a global IPO on the Hong Kong Stock Exchange in March 2015. Zuo expected that this global IPO would yield more than ¥5.3 billion[1] (approximately US$850 million) in cash that the company could pour into its accounts.

Zuo had served Fuyao in various capacities since he joined the company in 1989, and he had provided input on decisions concerning Fuyao's generous dividend payout policies. However, Fuyao was preparing to expand into the global market, a strategy that would require a huge capital investment, and Zuo knew very well that the support of Mr. Cho Tak Wong, founder and chairman of the company, would be a critical factor in the board's decision making. Cho and the other directors would need to know the cash projections of Fuyao in terms of its operations, expansion policy, capital structure, and dividend payout, and they would want to know how those factors meshed with Fuyao's strategy and philosophy.

INDUSTRY BACKGROUND

The global auto-glass market in 2015 was divided into two major segments: the original equipment manufacturers (OEM) market, which included glass sold to automobile manufacturers for installation on new vehicles; and the aftersales replacement glass (ARG) market for vehicle repairs. Global demand for auto glass increased from 294 million square metres in 2009 to 415 million square metres in 2013. Roland Berger, an automobile industry consulting company, projected that global demand for auto glass would

[1] ¥ = CNY = Chinese yuan renminbi; all amounts are in ¥ unless otherwise specified; US$1.00 = ¥6.25 on February 1, 2015. Expected IPO proceeds were based on the issuance of 440 million shares, total fees and expenses of 5 per cent of the issuance, and an offer price of ¥12.68 per share. Actual proceeds would differ from expectations.

increase to 528 million square metres in 2018. This increase would driven primarily by the economic recovery in the United States and Europe and the growing demand for automobiles in the emerging economies of Asia and South America.[2]

The global auto-glass market was highly concentrated. In 2013, four top players—Asahi Glass Co., Ltd. (AGC), Fuyao, Nippon Sheet Glass Co., Ltd. (NSG), and Saint-Gobain—accounted for approximately 77 per cent of the global market in terms of sales revenue. Fuyao's sales represented 20 per cent of the total global auto-glass sales, right after AGC, which was number one with 22 per cent of the total global glass market. Among Fuyao's three international competitors, Saint-Gobain was the largest in terms of revenue, but glass (including auto glass) made up only half of Saint-Gobain's Innovative Materials Division's revenues and just a quarter of Saint-Gobain's total revenues. About three-quarters of Saint-Gobain's revenues came from the manufacture and distribution of other building materials. About half of AGC's sales were glass-related (including flat glass, auto glass, and display glass), with the rest of its sales made up of electronics, chemicals, and ceramics. In contrast, almost all of NSG's revenues were glass-related, with about half from auto glass, 40 per cent from construction glass, and 10 per cent from technical glass.[3] Unlike its competitors, Fuyao specialized exclusively in auto-glass production.

The Chinese domestic auto-glass market was also highly concentrated, with approximately 89 per cent of China's auto-glass sales made by the top five domestic manufacturers (three of which were Chinese subsidiaries of Fuyao's international competitors) and 10 per cent by imports. The domestic market was expected to grow from 96.5 million square metres in 2013 to 150.6 million square metres in 2018.[4] Fuyao was the largest domestic player (63 per cent market share), followed by AGC (12 per cent), Saint-Gobain (9 per cent), Xinyi (7 per cent), and NSG (4 per cent).

High entry barriers into the auto-glass industry explained industry concentration in both the global and domestic markets. First, it was very difficult to quickly establish manufacturing and sales networks covering major automobile producers. These networks were crucial as a cost-effective way to meet OEM and ARG markets. Second, the advanced technology requirements for the production of safe, multifunctional auto glass presented barriers to potential entrants that had poor research and development (R & D) capabilities. Third, any new entrant would have to make large capital investments to establish an auto-glass manufacturing facility and ensure supplies of float glass. Fuyao had already invested in its own high-quality float glass production lines located near each of its auto-glass manufacturing facilities. Last but not least, automobile manufacturers required that the auto glass they installed should possess the safety and quality certifications prescribed by each of the countries and regions where their cars would be sold. Fuyao's auto glass already had such certification.

The auto-glass industry was experiencing several new trends. Sunroofs were becoming increasingly popular, and enhancements were being made in both the size and tilt angle of the front windshield. Each of these trends increased glass area per vehicle. Customers expected more value-added features and functions to improve driving comfort, safety, and energy efficiency, and many of these traits were being built into auto glass. In order to better control costs, optimize supply chains, and enhance quality control,

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[2] "Fuyao Glass Industry Group Limited Global Offering," Fuyao Glass, March 19, 2015, 119, accessed April 13, 2015, www.hkexnews.hk/listedco/listconews/SEHK/2015/0319/LTN20150319019.pdf, hereinafter *Prospectus*. In the *Prospectus*, filed with Hong Kong Exchanges and Clearing, Fuyao reported that it obtained the forecasts from a privately commissioned study issued by Roland Berger Enterprise Management (Shanghai) Co. in preparation for the offering.

[3] Saint-Gobain, *2015 Registration Document*, accessed October 14, 2016, www.saint-gobain.com/sites/sgcom.master/files/sg_drf2015_gb.pdf; AGC Group, *AGC Report 2015*, accessed October 14, 2016, www.agc.com/english/csr/book/pdf/agc_report_2015e.pdf; NSG Group, *Annual Report 2015: Fiscal Year Ended 31 March 2015*, accessed October 14, 2016, www.nsg.com/~/media/NSG/Site%20Content/Temporary%20Downloads/English/AR2015.ashx.

[4] *Prospectus,* 88.

auto-glass manufacturers, in close cooperation with the OEMs, modularized their products so the auto glass could be installed quickly on autobodies as they travelled along the OEMs' assembly lines.[5]

COMPANY BACKGROUND

On June 20, 1987, Fuyao was established as a Sino-foreign equity joint venture[6] under the name of Fujian Yaohua Industrial Glass Co., Ltd., with a registered capital of ¥6.27 million. At that time, a township enterprise[7] called the Fuqing County Gaoshan Special Shaped Glass Factory held a 25 per cent equity interest in Fuyao, and Fuyao was managed by Cho under a contract from the county. Since that time, Fuyao's ownership structure and management had changed several times, but effective control had remained in Cho's hands (see Exhibit 1).

Fuyao's products were sold in the domestic Chinese and overseas markets. Its major customers included the world's top 20 automobile manufacturers and China's top 10 passenger vehicle manufacturers. The average age of its business relationship with its top 10 customers was 10 years, and those customers' engineers cooperated closely with Fuyao, from the early planning stages through to the manufacturing of each new model's auto-glass needs. Fuyao's 12 auto-glass production bases in China enabled the company to offer cost-effective, just-in-time domestic delivery. Vertical integration into float glass provided a stable, high-quality glass supply. High operational efficiency further contributed to Fuyao's significant cost competitiveness. In addition, by using a flexible manufacturing system, the company could respond quickly to market changes and could manufacture auto glass in small batches.

Fuyao expanded internationally by establishing subsidiaries in Hong Kong, the United States, South Korea, Germany, Japan, and Russia, thereby raising international sales in 2012, 2013, and 2014 to 32.6 per cent, 32.0 per cent, and 33.5 per cent of total revenue, respectively. By late 2014, after the completion of an auto-glass production facility in Shenyang, Liaoning Province, China, management at Fuyao considered that further domestic production expansion would be pointless. Instead, any future production expansion would be largely international. As of early 2015, Fuyao had an auto-glass production facility in Kaluga City, Russia, which it was expanding; completion of that expansion was scheduled for the fourth quarter of 2016. Although Russia was the second-largest automobile market in Europe, Fuyao's management considered that Russia's uncertain economy and currency could increase the volatility of Fuyao's profit.

Besides its Russian facility, Fuyao was also establishing an auto-glass manufacturing plant in the U.S. state of Ohio, which was expected to be completed by December 2015. The company's expansion into the United States was driven by customers' (e.g., Honda and BMW) demand for just-in-time delivery and by the cost advantages that could be achieved as a result of considerably lower energy costs, transportation costs, and import tariffs.

To ensure timely supplies of float glass, Fuyao planned to construct two float glass production lines near its Russian facility and to retrofit and upgrade its two float glass production lines in the U.S. state of Illinois, which it had purchased in August 2014. U.S. banking and financial services company J. P. Morgan estimated that Fuyao could reduce its selling costs for auto glass by about 3 to 4 per cent by

[5] "Industry Overview," *Prospectus,* 86–7.
[6] A Sino-foreign equity joint venture is a limited liability company formed by a Chinese company and a foreign company in Chinese territory. Foreign companies typically put up at least a quarter of the total investment, while there is no minimum investment requirement for Chinese companies.
[7] Township enterprises, owned initially by communes and later by townships, were set up in the 1980s as part of the initial reforms associated with the opening up and reforming of the Chinese economy after the Cultural Revolution.

producing in the United States. At the same time, Fuyao could achieve a significant increase in sales revenues from the U.S. market.[8] The company intended to continue its long-term policy of constructing overseas manufacturing bases to meet global demand (see Exhibit 2), subject to understanding the local environments and regulations.

Fuyao had two R & D centres in China and one each in Germany and the United States. These facilities allowed Fuyao to co-design and develop auto glass that could fit with customers' product development cycles, thus enabling Fuyao to produce customized auto glass for each new model produced by its customers. As a result, the company was able to help its customers address potential manufacturing or design problems, and customer relationships were strengthened in the process. As a way to differentiate itself from its competitors, Fuyao prioritized R & D on high value-added products, introducing auto glass for environmental friendliness, low energy consumption, smart digital capabilities, and modularized features.

Fuyao's main competitors in the global market, headquartered in Japan (AGC and NSG) and France (Saint-Gobain), had limited presence in Eastern Europe. In 2010, in Russia, AGC built the world's largest float glass furnace and, in 2015, it acquired an ARG auto-glass plant in Poland. Saint-Gobain produced flat glass and construction materials and had an R & D centre in Russia, but the company performed no auto-glass production there. In 2006, NSG acquired the major British glass company, Pilkington Glass, and had a float glass production facility in Russia, but no auto-glass production. In North America, however, both AGC and NSG had substantial auto-glass manufacturing presences dating back to the 1990s, while Saint-Gobain had an ARG presence.[9]

COMPANY STRATEGY

Fuyao's goal was to solidify its dominant position in China and become the most competitive auto-glass manufacturer in the world. The company planned to strengthen its relationships with OEMs through offering more high-quality products and services and building more satellite facilities near its OEM customers so that products and services could be provided in a cost-effective and timely manner. Management planned to set up more sales offices and representative offices, and recruit global talent whenever strategic opportunities arose. Fuyao was committed to increasing R & D spending, offering better just-in-time delivery, implementing cost-control measures, streamlining production processes, and increasingly using automation to further reduce costs and increase profitability.

FINANCIAL PERFORMANCE[10]

Fuyao's revenue was ¥10.25 billion in 2012, ¥11.50 billion in 2013, and ¥12.93 billion in 2014. Net profits earned were ¥1.52 billion in 2012, ¥1.92 billion in 2013, and ¥2.22 billion in 2014. As of December 31, 2014, Fuyao had cash and cash equivalents of ¥499.1 million (see Exhibits 3 and 4). The

[8] Nick Lai, Leon Chik, Rebecca Y. Wen, and Liwen Yin, "J. P. Morgan: Fuyao Glass Industry Group—H, Crystal Clear Future—Initiate with OW," Asia Pacific Equity Research, May 5, 2015, accessed May 15, 2015, www.niuniuwang.cn/wp-content/uploads/2016/03/H3_AP201603220014021313_01.pdf.

[9] "Russia, Ukraine, CIS Countries," Saint-Gobain, accessed August 1, 2016, www.saint-gobain.com/en/russia-ukraine-cis-countries; "AGC Our Story," AGC Asahi Glass, accessed August 1, 2016, www.agc.com/english/company/history/history.html. For a report on the NSG acquisition of Pilikington, see L. Saigol, K. Suzuki, and D. Turner, "NSG and Pilkington in £2.2bn Deal," *Financial Times*, February 28, 2006, accessed August 1, 2016; www.ft.com/content/439a720c-a563-11da-bf34-0000779e2340. For information on NSG see "NSG Group Worldwide," NSG Group, accessed August 1, 2016, www.nsg.com/en/about-nsg/nsggroupworldwide.

[10] "Financial Information," *Prospectus,* 184–230.

company planned capital expenditures of ¥2.99 billion and ¥3.01 billion in 2015 and 2016, respectively, mainly to construct new auto glass and float glass manufacturing facilities in overseas markets and to upgrade any existing facilities (see Exhibit 5). Fuyao would take advantage of additional global auto-glass investment opportunities when they arose. Other than capital expenditure, Fuyao expected to use ¥523.5 million to increase its working capital in 2015.

Cash flow that would be made available for new investments and to pay out dividends would come from the combined effects of operations, selling of assets, and raising and retiring of debt and equity. The proportion of debt in the desired capital structure of Fuyao therefore affected the dividend policy. Cho had frequently told Zuo his opinion of capital structure:

> I think that if you are running a company and don't use debt, you are an idiot. You should use debt. So how much is reasonable? Less than 50 per cent is reasonable. Some are more conservative. They say less than 30 per cent is a little better. I think that less than 50 per cent is no problem. Our products are special. Our cash flow is adequate. There is no problem.

Fuyao's debt ratio as of the end of 2014 was similar to AGC's and Xinyi's, but lower than NSG's and Saint-Gobain's (see Exhibit 4). Fuyao's debt consisted primarily of bank loans, medium-term notes, and commercial paper (see Exhibit 6). Since its inception, Fuyao had never experienced obstacles in raising new debt. As of January 31, 2015, the company had the right to draw on pre-approved bank-loan funding in the amount of ¥13.17 billion without fulfilling any additional conditions.

Cho expressed pride in his relationships with the banks and his confidence that reasonable payouts of dividends could be easily financed:

> If we had to come up suddenly with one or two billion renminbi [for dividend payments], we could retain revenues and not pay expenses for two months . . . but of course we don't do it that way. When we don't have the money to pay out dividends, we borrow it from the bank. When we have the money, we return it.

Fuyao usually received payments from customers within three months after delivery of products. Its OEM customers generally contracted without minimum-purchase obligations, and some of them even contracted with alternative suppliers at the same time. As a result, unexpected delays in payment or termination of contracts could adversely affect Fuyao's operational and financial conditions. In order to avoid any cash shortages caused by these risks, Fuyao targeted a cash balance of 4 per cent of annual sales.

Although Fuyao had strong debt-financing abilities, one of the reasons for planning to issue its shares on the Hong Kong Exchange in March 2015 was to fund the company's global expansion in a way that would not be entirely debt-financed. Fuyao management considered that a reasonable equity cushion would reduce liquidity risk.

Management had decided on an offshore listing in Hong Kong rather than a subsequent primary offering (SPO) of A-shares in Shanghai because an international listing would reduce the inconveniences caused by foreign exchange controls in China and would also increase international investors' access to Fuyao shares. Hong Kong was the preferred choice of mainland issuers seeking offshore listings; in fact, mainland shares accounted for over half the value of shares traded on the Hong Kong Exchange. Another reason that Fuyao's financial advisors chose a global IPO on the Hong Kong Stock Exchange rather than a Shanghai SPO involved the investors' tastes: Chinese domestic investors were keener on growth stocks than were international investors. The international investors placed greater value on companies like Fuyao that had a steady performance and a stable and rising dividend payout.

DIVIDEND POLICY

Since its domestic A-share IPO in 1992, Fuyao had implemented *stock* dividends on seven occasions, issued primary shares in an SPO, conducted two rights issues, and increased share capital on three occasions through conversions of capital reserves.[11]

Concerning *cash* dividends, Fuyao's articles of association endeavoured to

> pay dividends out of our after-tax profit only after we have made the following allocations: recovery of accumulated losses from previous years, if any; allocations to statutory reserve fund of 10 per cent of our after-tax profit until the amount in the statutory reserve fund reaches 50 per cent of our registered capital; and allocations to a discretionary reserve fund.

Fuyao's articles of association also stated its intention "to distribute cash dividends of at least 20 per cent of its distributable profits each year unless it expected to make significant investment or incur significant capital expenditures in the following year."[12]

The company declared cash dividends of ¥1.01 billion for 2012 and 2013, representing ¥0.5 per A-Share (see Exhibit 7). Fuyao management considered that shareholders appreciated dividends and observed that Fuyao's stock price typically went up around the time when management announced that it would pay such dividends. Cho commented:

> Fuyao's projected cash flow is extremely stable. That's why I could boastfully distribute 50 per cent of profits without a care. If I didn't distribute it, it would have to go to pay back the bank, but that is not a good deal. The company belongs to the shareholders. Why not use debt? Debt has several advantages: (1) the interest cost of debt is a pre-tax expense, so it is tax deductible; (2) all countries have adopted [a] loose monetary policy, printing money like there's no limit; (3) from an investor's point of view, we should enjoy the returns of our investment, distribute back a little profit, take it easy for a bit. That's the way it is.

Since the turn of the century, Chinese securities regulators, concerned about the low dividend payout rate of many listed firms, promulgated various guidelines to encourage companies to pay cash dividends or justify non-cash dividends (see Exhibit 8).

Zou was aware that Cho was in favour of paying dividends, having once heard the chairman say:

> I also like money. I work myself half to death, but [if I] don't declare dividends, where can I get money from? I work here as the chairman, but my salary is very little. Every year, I only make a few tens of thousands of U.S. dollars. It's only enough for my own expenses. But what about my wife and kids?

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[11] A *stock dividend* gives holders of existing shares additional shares in proportion to their existing holdings. A *rights issue* gives existing shareholders the right but not the obligation to purchase additional shares. The strike price of the rights issue is typically set at a discount to the current share price.
[12] "Dividend Policy," *Prospectus*, 227.

Besides Cho, Fuyao had one other major shareholder: the Heren Charitable Foundation. Cho, a conscientious Buddhist, had set up the Heren Foundation in 2011, donating to it 14.48 per cent of the shares of Fuyao. The foundation served as a vehicle through which Cho could direct his considerable charitable activities. With that donation, Cho became the foremost philanthropist in China.[13] Did the cash flow needs of such a large shareholder enter into the dividend decision-making of Fuyao? Cho commented:

> In my heart, the most important thing is the Fuyao Group. This is my lifeblood, my work. I set up the Heren Foundation with a donation. The Chinese people said that I contributed ¥3.5 billion. My stock at the time I donated it was worth ¥3.5 billion. If the foundation needs money, it can sell stock. I have no undertaking to assure that it receives dividends.

As Zuo turned his thoughts to the board briefing paper that he needed to write for recommending a dividend policy, his mind shifted back to Fuyao's upcoming global IPO. Clearly, whatever policy he chose to advocate should also accord with the tastes of the new international investors.

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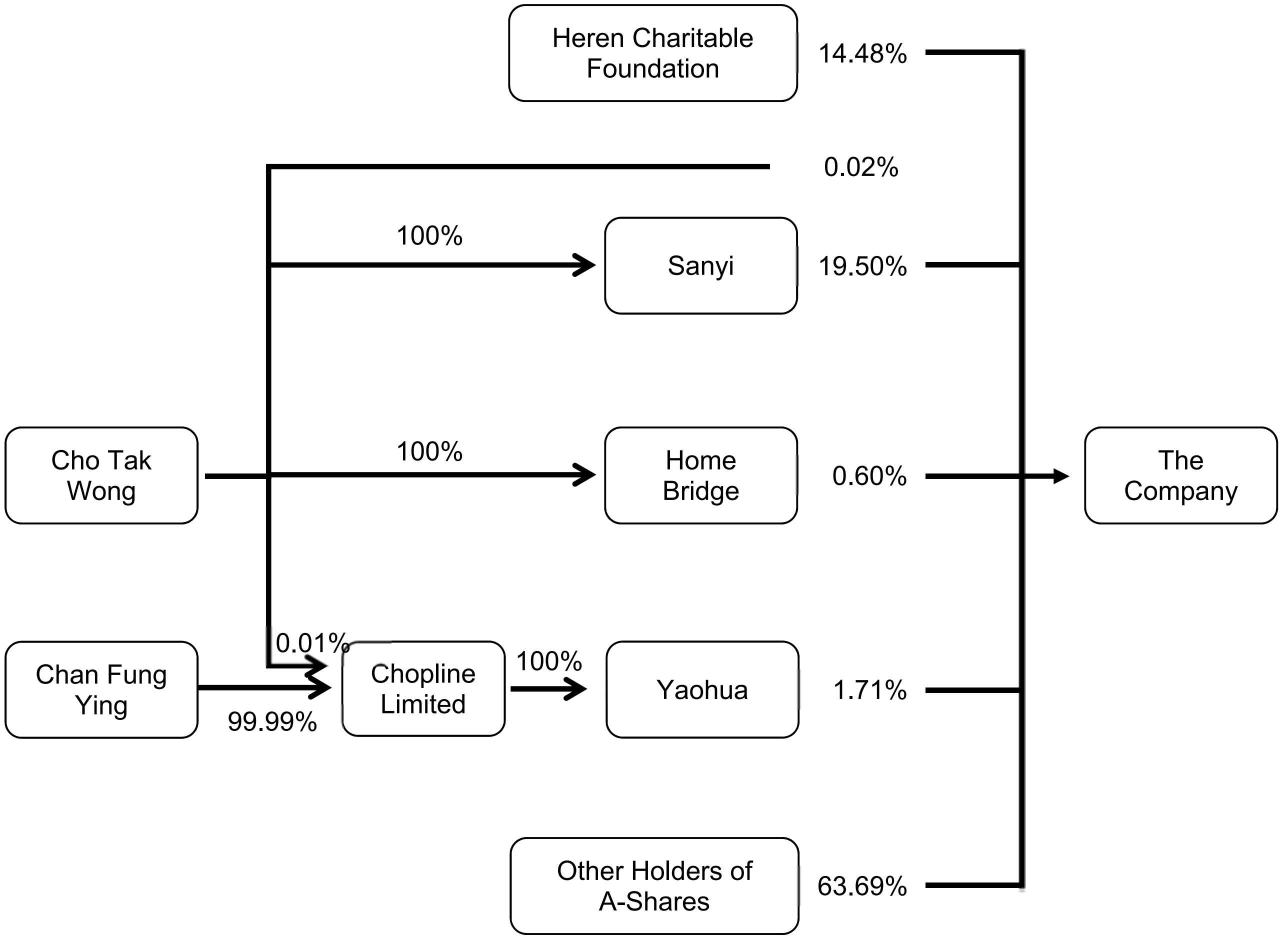
[13] Lydia Chen, "Charity Receives Massive Donation," *Shanghai Daily,* April 14, 2011, accessed March 16, 2016, www.fuyaogroup.com.hk/download/Charity%20receives%20massive%20donation.pdf.

EXHIBIT 1: FUYAO'S OWNERSHIP STRUCTURE AS OF JANUARY 31, 2015



Note: Heren Charitable Foundation's highest decision-making body was its council, which, in 2015, comprised nine members, including Mr. Cho Tak Wong's brother, Mr. Cao Degan, and two non-executive directors of Fuyao. Sanyi, Home Bridge, and Yaohua were 100 per cent directly and indirectly owned by Mr. Cho Tak Wong and his wife, Ms. Chan Fung Ying.

Source: "Fuyao Glass Industry Group Limited Global Offering," HKEX News, March 19, 2015, accessed April 13, 2015, www.hkexnews.hk/listedco/listconews/SEHK/2015/0319/LTN20150319019.pdf.

EXHIBIT 2: PRODUCTION CAPACITY, UTILIZATION, AND EXPANSION PLANS

	Float Glass			Auto Glass		
	capacity (thousands of tonnes) utilization (%)			capacity (thousands of tonnes) utilization (%)		
Existing Facilities	**2012**	**2013**	**2014**	**2012**	**2013**	**2014**
China						
Northern China						
Capacity	395.0	199.0	230.0	24.7	23.1	27.1
Utilization	93.7	94.0	73.0	77.5	91.3	77.9
Central and Eastern China						
Capacity	-	-	-	23.5	28.6	33.1
Utilization	-	-	-	86.4	87.1	85.5
Southern China						
Capacity	474.0	474.0	500.0	29.6	30.7	35.0
Utilization	94.3	92.8	87.8	82.1	90.6	88.3
Southwestern China						
Capacity	281.0	341.0	328.0	14.2	14.2	15.1
Utilization	96.8	95.9	84.8	80.3	85.9	93.4
Russia						
Capacity	-	-	-	-	-	4.0
Utilization	-	-	-	-	-	n.a.

	Float Glass			Auto Glass		
Planned Facilities	**2015**	**2016**	**2017**	**2015**	**2016**	**2017**
China (all regions)	0.0	0.0	0.0	6.0	0.0	n.a.
Russia	0.0	0.0	450.0	0.0	8.1	n.a.
United States	150.0	150.0	0.0	12.1	0.0	n.a.

n.a. = not available

Note: Northern China included Beijing, Jilin, Shenyang, and Inner Mongolia; Central and Eastern China included Henan, Hubei, and Shanghai; Southern China included Fujian and Guangdong; and Southwestern China included Chongqing.

Total commitment to the auto-class production facilities in Kaluga City, Russia, was approximately US$200 million. As of December 31, 2014, Fuyao had invested approximately US$116 million. Fuyao expected to use the funds raised from its global offering (approximately ¥785.2 million) for the second phase of construction of the auto-glass production facility. Fuyao planned to construct an auto-glass grade float-glass production facility with annual capacity of approximately 450,000 tonnes near its Russian auto-glass production facility. The construction was expected to start in 2016, to be completed by the end of 2017. An amount of ¥1.57 billion, raised from Fuyao's global offering, was expected to be used for the float-glass facility.

Fuyao expected to use the approximately ¥1.83 billion raised from its global offering for investment in the auto-glass production facility in the U.S. state of Ohio; this facility was expected to be completed by December 2015. Fuyao planned to retrofit and upgrade its two U.S. production lines (purchased at US$56 million in 2014) to manufacture float glass that was of an auto-glass grade. The U.S. production lines were expected to provide production capacity of 300,000 tonnes and additional commerce production for Fuyao in the fourth quarter of 2015 and the third quarter of 2016, respectively.

Source: "Fuyao Glass Industry Group Limited Global Offering," HKEX News, March 19, 2015, accessed April 13, 2015, www.hkexnews.hk/listedco/listconews/SEHK/2015/0319/LTN20150319019.pdf.

EXHIBIT 3: CONSOLIDATED FINANCIAL STATEMENTS

a. Balance Sheet	millions of ¥		
	2012	**2013**	**2014**
ASSETS			
Non-current assets	**8,095**	**8,671**	**10,261**
Property, plant, and equipment	7,142	7,416	8,823
Leasehold land and land use rights	523	780	875
Intangible assets	121	111	157
Investments in joint ventures	104	130	161
Long-term receivables	25	19	-
Long-term prepaid rental expenses	67	62	56
Deferred income tax assets	113	153	189
Current assets	**5,065**	**6,012**	**6,630**
Inventories	1,907	1,877	2,169
Trade and other receivables	2,647	3,215	3,549
Derivative financial instruments	0	2	4
Restricted cash	24	11	8
Cash and cash equivalents	487	490	499
Assets of disposal group classified as held-for-sale	-	417	402
Total assets	13,160	14,683	16,891
EQUITY			
Equity attributable to equity holders of the company	**6,988**	**7,858**	**8,814**
Share capital*	2,003	2,003	2,003
Share premium	184	184	184
Other reserves	854	944	874
Retained earnings	3,947	4,727	5,753
Non-controlling interests	**4**	**3**	**4**
Total equity	6,992	7,862	8,818
LIABILITIES			
Non-current liabilities	1,009	1,241	1,622
Borrowings	880	918	1,213
Deferred income tax liabilities	8	63	74
Deferred income on government grants	121	260	336
Current liabilities	5,160	5,581	6,451
Trade and other payables	1,825	2,374	2,795
Current income tax liabilities	206	259	282
Borrowings	3,126	2,899	3,336
Derivative financial instruments	-	8	2
Current portion of deferred income on government grants	3	7	14
Liabilities of disposal group classified as held-for-sale	-	32	22
Total liabilities	6,169	6,822	8,073
Total equity and liabilities	13,160	14,683	16,891

*As of December 2014, 2,002,986,332 A-shares had been issued and were outstanding.

EXHIBIT 3 (CONTINUED)

b. Income Statement	millions of ¥		
	2012	**2013**	**2014**
Revenue	10,247	11,501	12,928
Cost of sales	(6,420)	(6,831)	(7,566)
Gross profit	3,828	4,671	5,363
Distribution costs and selling expenses	(779)	(877)	(982)
Administrative expenses	(763)	(908)	(1,031)
Research and development expenses	(236)	(389)	(518)
Other income	63	54	46
Other (losses)/gains – net	(48)	0	(43)
Operating profit	2,065	2,552	2,834
Finance income	2	3	14
Finance costs	(226)	(202)	(241)
Finance costs – net	(224)	(199)	(227)
Share of results of joint ventures	22	26	31
Profit before income tax	1,862	2,379	2,638
Income tax expense	(338)	(462)	(422)
Profit for the year	1,524	1,917	2,217
Earnings per share for profit attributable to equity holders of the company during the year			
Basic and diluted earnings per share (expressed in ¥ per share)	0.76	0.96	1.11
Dividends proposed	1,001	1,001	n.a.

EXHIBIT 3 (CONTINUED)

c. Cash Flow Statement	millions of ¥		
	2012	**2013**	**2014**
Cash flow from operating activities			
Cash generated from operations	2,772	3,199	3,565
Income tax paid	(346)	(382)	(435)
Net cash generated from operating activities	2,426	2,817	3,131
Cash flow from investing activities			
Proceeds from disposal of PP&E (including leases)	40	311	75
Purchases of PP&E (including leases and intellectual property	(1,507)	(1,881)	(2,793)
Interest received	2	3	14
Government grants received relating to PP&E	83	151	93
Net cash used in investing activities	**(1,383)**	**(1,417)**	**(2,612)**
Cash flows from financing activities			
Borrowings and repayments	(380)	(186)	741
Dividends paid to the company's shareholders	(801)	(1,001)	(1,001)
Interest paid	(197)	(209)	(254)
Capital Injections	14	0	4
Net cash used in financing activities	(1,364)	(1,396)	(511)
Net (decrease)/increase in cash and cash equivalents	**(320)**	**5**	**7**
Cash and cash equivalents at beginning of the period	808	487	492
Cash and cash equivalents at end of the period	**487**	**492**	**499**

Note: "PP&E" is property, plant, and equipment; figures may not add up exactly due to rounding errors.

Source: Simplified from "Fuyao Glass Industry Group Limited Global Offering," HKEX News, March 19, 2015, accessed April 13, 2015, www.hkexnews.hk/listedco/listconews/SEHK/2015/0319/LTN20150319019.pdf.

EXHIBIT 4: FINANCIAL PERFORMANCE MEASURES

a. Fuyao Glass Historical Performance	**2014**	**2013**	**2012**	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**
Revenue (millions of ¥)	12,928	11,501	10,247	9,689	8,508	6,079	5,717	5,166	3,935	2,911
Net Income (millions of ¥)	2,217	1,917	1,525	1,513	1,788	1,118	246	917	614	392
Total Assets (millions of ¥)	16,891	14,683	13,160	12,212	10,567	9,051	9,333	9,462	7,594	6,551
Gross Margin Percentage (%)	41.48	40.61	37.35	36.56	40.42	42.05	31.32	36.18	34.76	30.51
Net Income Margin Percentage (%)	17.15	16.66	14.88	15.61	21.01	18.39	4.30	17.76	15.60	13.46
Dividend Payout Ratio	n.a.	0.52	0.66	0.53	0.64	0.30	-	0.54	0.51	-
Dividend Yield Ratio	n.a.	0.06	0.06	0.05	0.04	0.01	0.00	0.02	0.01	0.00
Return on Assets (%)	13.12	13.05	11.58	12.39	16.92	12.35	2.64	9.69	8.08	5.98
Return on Equity (%)	25.14	24.38	21.86	24.27	30.60	25.49	7.53	26.01	21.07	17.73
Sustainable Growth Rate (%)	n.a.	11.70	7.43	11.41	11.01	17.84	7.53	11.96	10.32	17.73
Current Ratio	1.03	1.08	0.98	1.04	1.00	0.99	0.78	0.88	0.94	0.92
Debt Ratio	0.48	0.46	0.47	0.49	0.45	0.52	0.65	0.63	0.62	0.66
Capitalization Ratio	0.34	0.33	0.36	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

	For Year Ended December 31, 2014				
b. Competitive Performance	**Fuyao**	**AGC**	**NSG**	**Saint-Gobain**	**Xinyi**
Revenue (millions of ¥)	12,928	67,415	30,305	279,167	8,689
Net Income (millions of ¥)	2,217	1,024	(824)	6,480	1,092
Total Assets (millions of ¥)	16,891	103,867	46,259	304,667	16,827
Gross Margin (%)	41.48	24.61	24.13	6.81	25.17
Net Income Margin (%)	17.15	1.52	(0.03)	2.32	12.57
Dividend Payout Ratio	n.a.	1.31	0.00	0.73	0.43
Dividend Yield Ratio	n.a.	0.037	0.00	0.03	0.01
Return on Assets (%)	13.12	0.99	(1.78)	2.13	6.49
Return on Equity (%)	25.14	1.73	(9.45)	5.17	8.85
Sustainable Growth Rate (%)	n.a.	(0.53)	(9.45)	1.40	5.04
Current Ratio	1.03	1.76	1.03	1.35	1.00
Debt Ratio	0.48	0.43	0.81	0.59	0.41
Capitalization Ratio	0.34	0.33	0.72	0.40	0.33

n.a. = not available

Notes: Sustainable growth rate = return on equity × (1 – dividend payout ratio); Debt ratio = total liabilities ÷ total assets; Capitalization ratio = total debt ÷ the sum of total debt + total equity; Ratios for AGC and NSG are for the whole group rather than for their glass divisions. AGC and NSG statements originally in JPY have been translated to ¥ at the rate of 1 JPY = ¥ 0.05; Saint-Gobain statements originally in EUR have been translated to ¥ at the rate of 1 EUR = ¥ 6.8; Xinyi statements originally in HKD have been translated to ¥ at the rate of 1 HKD = ¥0.8. AGC announced dividends twice in 2014; we used the closing price on December 31, 2014 to calculate dividend yield; As of December 31, 2014, 10-year, risk-free government treasury bond rates were 3.62 per cent, 0.33 per cent, and 1.30 per cent in ¥, euros, and Japanese yen, respectively.

Source: Created by authors using the subject companies' audited financial statements.

EXHIBIT 5: PLANNED CAPITAL EXPENDITURES, 2015 AND 2016

Location and Type of Expenditure	Year ended December 31,	
	2015	2016
	(millions of ¥)	
United States		
Auto glass	760	255
Float glass	250	455
U.S. subtotal	1,010	710
Russia		
Auto glass	32	470
Float glass	0	525
Russia subtotal	32	995
Others		
Auto glass in Shenyang	190	-
Auto-glass technology upgrades	1,400	1,000
Float-glass technology upgrades	200	200
Other	158	100
Others subtotal	1,948	1,300
Total	**2,990**	**3,005**

Source: "Fuyao Glass Industry Group Limited Global Offering," HKEX News, March 19, 2015, accessed April 13, 2015, www.hkexnews.hk/listedco/listconews/SEHK/2015/0319/LTN20150319019.pdf.

EXHIBIT 6: BORROWINGS (MILLIONS OF ¥)

Debt Type	As of December 31			As of January 31
	2012	2013	2014	2015
Non-Current				
Long-term bank borrowings	617.0	924.0	1,198.0	1,198.6
Medium-term notes	399.5	399.5	399.6	399.7
Less: current portion of non-current borrowings	(136.3)	(406.0)	(385.0)	(385.0)
Subtotal	880.2	917.5	1,212.6	1,213.3
Current				
Short-term bank borrowings	1,146.4	1,260.6	2,640.9	2,687.3
Short-term commercial papers	1,843.1	1,232.7	309.7	311.3
Current portion of non-current borrowings	136.3	406.0	385.0	385.0
Subtotal	3,125.8	2,899.3	3,335.6	3,383.6
Total	4,006.0	3,816.8	4,548.2	4,596.9

Note: Fuyao's principal banking relationships were with Agricultural Bank of China, Industrial and Commercial Bank of China, China Construction Bank, Bank of China, China Construction Bank, The Export-Import Bank of China, Citibank, and Deutsche Bank.

Source: "Fuyao Glass Industry Group Limited Global Offering," HKEX News, March 19, 2015 accessed April 13, 2015, www.hkexnews.hk/listedco/listconews/SEHK/2015/0319/LTN20150319019.pdf.

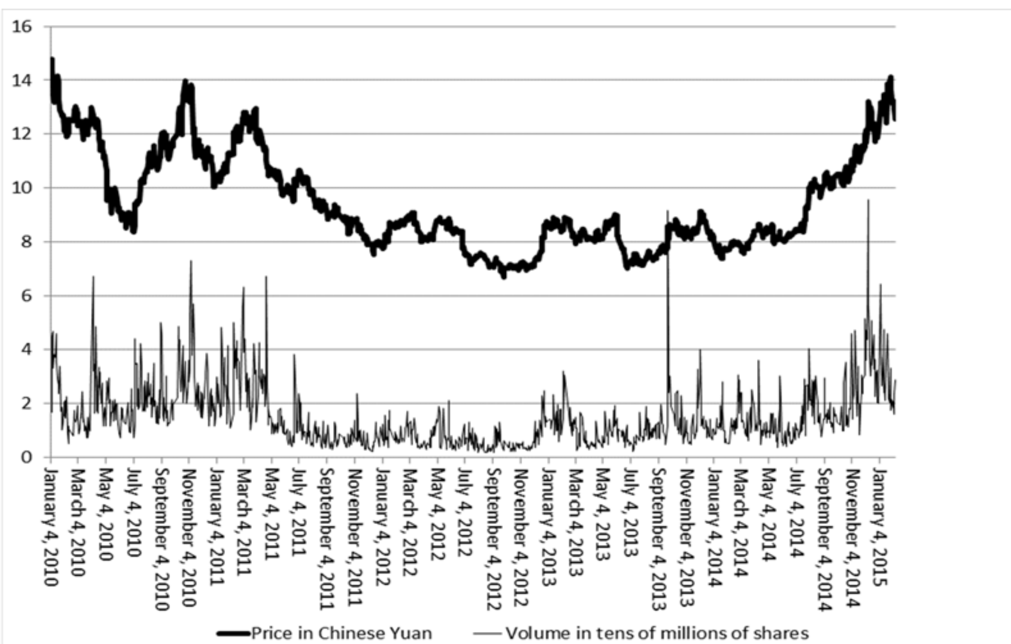
EXHIBIT 7: STOCK PRICES AND DIVIDEND PAYOUTS

a. Stock Price Change around Dividend Payment

Year	Dividend RMB	Event	Date	Fuyao Ending Share Price (¥)	3-Day Fuyao Return (%)	3-Day SSE Return (%)	Fuyao minus SSE (%)
2014	0.50	Payout	May 19, 2014	8.08	1.25	−0.84	2.08
		Ex-Dividend	May 13, 2014	8.59	−5.93	1.81	−7.74
		Announcement	February 25, 2014	8.00	0.00	−3.49	3.49
2013	0.50	Payout	June 7, 2013	8.10	−4.86	−5.55	0.69
		Ex-Dividend	June 3, 2013	9.00	−8.94	−1.98	−6.97
		Announcement	March 19, 2013	8.42	1.66	1.70	−0.03
2012	0.40	Payout	July 6, 2012	7.60	−0.66	−2.57	1.91
		Ex-Dividend	June 27, 2012	8.40	−6.92	0.15	−7.07
		Announcement	April 25, 2012	8.28	2.64	0.67	1.97
2011	0.57	Payout	April 8, 2011	12.16	2.13	0.71	1.42
		Ex-Dividend	March 30, 2011	12.95	−8.48	−1.89	−6.59
		Announcement	March 2, 2011	12.59	1.50	−0.07	1.58
2010	0.17	Payout	April 29, 2010	11.11	−2.03	−1.29	−0.74
		Ex-Dividend	April 20, 2010	11.82	−7.30	−3.15	−4.15
		Announcement	March 10, 2010	12.45	0.08	−0.06	0.14

Note: "Announcement" refers to the date on which Fuyao announced the amount and payment date of the dividend; "Ex-Dividend" refers to the first date on which holders of record of the stock were not entitled to receive the declared dividend; "Payout" refers to the date on which holders of record received the dividends; "Payout SSE" refers to the Shanghai Stock Exchange 180 Index.

b. Historic Prices and Trading Volumes for Fuyao on the Shanghai Stock Exchange



Source: Created by the authors from "Fuyao Glass Industry Group Co Ltd," Bloomberg, accessed March 17, 2016.

EXHIBIT 8: TAX AND REGULATORY ISSUES CONCERNING DIVIDENDS

Date	Regulation Name	Key Content
2013-12-27	Opinions on Further Enhancing the Protection of Small Investors' Rights and Interests to Promote the Construction of a Comprehensive Capital Market System	Listed companies should disclose dividend policies, particularly commitments and detailed plans for cash dividend payments. Failure to implement such commitments should be documented . . . . Independent directors and relevant intermediaries should explicitly express their opinions on whether a company's profit distribution policy might harm small investors' rights and interests.
2013-11-30	No. 3 Guideline for the Supervision of Listed Companies—Cash Dividend Distribution of Listed Companies	*Article 2*: Listed companies shall firmly establish an awareness to reward shareholders, improve cash dividend distribution strictly in accordance with the Company Law, the Securities Law, and their articles of association; maintain consistency, rationality, and stability of dividend distribution policies; and ensure truthfulness of disclosure of dividend distribution. *Article 4*: Listed companies shall prioritize cash dividend over stock dividends. Where conditions for cash dividend distribution are met, profit shall be distributed in cash. Where profit distribution is carried out in stock dividends, consideration shall be given to factors such as company growth performance and dilution of net assets per share. *Article 5*: The boards of directors of a listed company shall, taking into consideration industry characteristics, the company's development stage, business operation model, profitability, and significant capital expenditures, and in accordance with the procedures specified in their articles of association, develop differentiated cash dividend policies applicable to the following situations: (i) Where a company is mature and has no significant capital expenditures, the cash dividend payout ratio shall be no less than 80 per cent of profits; (ii) Where a company is mature but has significant capital expenditures, the cash dividend payout ratio shall be no less than 40 per cent of profits; and (iii) Where a company is in a growth stage and has significant capital expenditures, the cash dividend payout ratio shall be no less than 20 per cent of profits.
2012-11-16	Notice of the Ministry of Finance, the State Administration of Taxation, and China Securities Regulatory Commission on Issues Concerning the Implementation of Differential Individual Income Tax Policies on Dividends and Bonuses of Listed Companies	Where an individual acquires the stock of a listed company from a public offering of the company or from the stock market, if the stock holding period is one month or less, the income from dividends and bonuses shall be included in the individual's taxable incomes in full amount; if the stock holding period is more than one month up to one year, the income from dividends and bonuses shall be included in the taxable incomes at the reduced rate of 50 per cent for the time being; and if the stock holding period is more than one year, the income from dividends and bonuses shall be included in the taxable incomes at the reduced rate of 25 per cent. Individual income taxes on the aforesaid incomes shall be collected at the uniform rate of 20 per cent.

Source: Created by the authors from data obtained from the regulations cited in columns one and two of the above table, issued by the China Securities Regulatory Commission.