China XD Plastics Co Ltd
Form 10-K
March 25, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2012

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File No. 001-34546

CHINA XD PLASTICS COMPANY LIMITED
(Exact name of registrant as specified in its charter)

| Nevada | 04-3836208 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| No. 9 Dalian North Road, Haping Road Centralized Industrial Park, Harbin Development Zone, Heilongjiang Province, P. R. China | |
| (Address of principal executive offices) | 150060 (Zip Code) |

Registrant's telephone number, including area code: (86) 451-8434-6600

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, $0.0001 | NASDAQ Global Market |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by checkmark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by checkmark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No x

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by checkmark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer o | Accelerated filer o |
| Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company x |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of June 30, 2012 was approximately $72,853,606.

As of March 20, 2013, there were 47,563,772 shares of common stock, par value US$0.0001 per share, outstanding.

Documents incorporated by reference: None.

CHINA XD PLASTICS COMPANY LIMITED
FORM 10-K ANNUAL REPORT
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2012

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PART I

ITEM 1. BUSINESS.

Our Business

China XD Plastics Company Limited ("China XD", "we", and the "Company", and "us" or "our" shall be interpret accordingly) is one of leading specialty chemical companies engaged in the research, development, manufacture and sale of modified plastics primarily for automotive applications in China. Through our wholly-owned subsidiary Heilongjiang Xinda Enterprise Group Company Limited ("Xinda Group"), we manufacture and sell modified plastics, primarily for use in the fabrication of automobile parts and components. We develop our products using our proprietary technology through our wholly-owned research laboratory, Heilongjiang Xinda Enterprise Group Macromolecule Material Research Center Company Limited. ("Xinda Group Material Research"). Xinda Group Material Research is a professional macromolecular material research and development institution and has 246 certifications from manufacturers in the automobile industry as of December 31, 2012. We are the only company certified as a National Enterprise Technology Center in modified plastics industry in Heilongjiang Province. Our research and development (the "R&D") team consists of 118 professionals and 18 consultants, including three consultants who are members of Chinese Academy of Engineering, and one consultant who is the former chief scientist of Specialty Plastics Engineering Institute of Jilin University. As a result of the combination of our academic and technological expertise, we have a portfolio of 69 patents, one of which we have obtained the patent rights and the remaining 68 of which we have applications pending in China as of December 31, 2012.

Modified plastic is produced by changing the physical and/or chemical characteristics of ordinary resin materials. In order for plastics to be used to produce automobile parts and components, they must satisfy certain physical criteria in terms of mechanical functionality, stability under light and heat, durability, flame resistance, and environmental friendliness. Our unique proprietary formulas and processing techniques enable us to produce low-cost high-quality modified plastic materials, which have been certified by many of the major domestic and international automobile manufacturers in China. In addition, we also provide specially engineered plastics and environment-friendly plastics for use in oilfield equipment, mining equipment, vessel propulsion systems and power station equipments.

China XD's primary end-market is the Chinese automotive industry that has been rapidly growing for the past few years where our modified plastics are used by our customers to fabricate the following auto components: exteriors (automobile bumpers, rearview and sideview mirrors, license plate parts), interiors (door panels, dashboard, steering wheel, glove compartment and safety belt components), and functional components (air conditioner casing, heating and ventilation casing, engine covers, and air ducts). Our specialized plastics are utilized in more than 23 automobile brands manufactured in China, including leading brands such as AUDI, BMW, Toyota, Buick, Mazda, Volkswagen, Cherry, Geely, and Hafei new energy vehicles. As of December 31, 2012, 246 of Xinda Group's automotive-specific modified plastic products have been certified by one or more of the automobile manufacturers in China and are in commercial production. As of December 31, 2012, 38 of our products were in the process of product certification by automobile manufacturers.

We operate three manufacturing bases in Harbin, Heilongjiang in the People's Republic of China (the "PRC"). Prior to December 2012, we had approximately 255,000 metric tons of annual production capacity across 58 automatic production lines utilizing German twin-screw extruding systems, automatic weighing systems and Taiwan conveyer systems. In December 2012, we further expanded our third production base in Harbin with additional 135,000 metric tons of annual production capacity, bringing total installed production capacity in our three production bases to 390,000 metric tons across an additional 30 new production lines.

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Our History

China XD, formerly known as NB Payphones Ltd. and NB Telecom, Inc., was originally incorporated under the laws of the state of Pennsylvania on November 16, 1999. On December 27, 2005, we migrated to the state of Nevada.

On December 24, 2008, we acquired Favor Sea Limited ("Favor Sea (BVI)"), a British Virgin Islands corporation, which is the holding company for Harbin Xinda Macromolecule Material Co., Ltd. ("Harbin Xinda") and Harbin Xinda's wholly-owned subsidiary, Harbin Xinda Macromolecule Material Research Institute ("Research Institute"). Harbin Xinda is a high-tech manufacturer and developer of modified plastics, which was established in September 2004 under the laws of the PRC. In December 2010, our management determined that the Research Institute could not meet the Company's development needs, including meeting the criteria to be a National Enterprise Technology Center. As a result, the Research Institute was deregistered.

On June 11, 2010, Harbin Xinda established Harbin Xinda Macromolecule Material Engineering Center Co., Ltd. ("Xinda Engineering Center") to focus on research and development of high-end products such as engineering plastics, modified PA, alloy plastics and modified ABS. Xinda Engineering Center was deregistered in 2012 as part of our group restructuring.

On October 14, 2010, Harbin Xinda established Heilongjiang Xinda Software Development Company Limited ("Xinda Software") to develop software applications that provide certain standard and programmable technical services remotely.

On December 10, 2010, Harbin Xinda established Harbin Xinda Macromolecule Material Research Center Co., Ltd. ("Xinda Macromolecule Research Center") to focus on research and development of products such as modified PP and environment-friendly modified plastics. Xinda Macromolecule Research Center was deregistered in 2012 as part of our group restructuring.

On March 31, 2011, Harbin Xinda established a wholly-owned subsidiary, Harbin Xinda Macromolecule Material Testing Technical Co., Ltd. ("Xinda Testing"), to develop a nationally recognized testing laboratory and provide testing services of macromolecule materials, engineering plastics and other products.

In response to our rapid business expansion and in order to be eligible for beneficial tax policies for certain regions in China, we developed a group restructuring plan.

From August 2011 to December of 2012, Harbin Xinda established (i) Harbin Meiyuan Enterprise Management Service Company Limited. ("Meiyuan Training") in Harbin to provide all year round training to both our existing and new employees, accommodate our customers and business partners as well as host industry conferences; and (ii) Heilongjiang Xinda Enterprise Group Technology Center Company Limited ("Xinda Group Technology Center") in Harbin to focus on long-term research and development projects.

Xinda Group, a wholly-owned subsidiary of HK Engineering Plastics Company Limited and the proposed direct parent company of all of our PRC-based operating subsidiaries after the group restructuring was established in December 2011. Harbin Xinda Plastics Material Research Center Company Limited ("Xinda Material Research Center") was established in December 2011 to focus on research and development of products close to commercialization phase.

Three companies, Haikou Xinda Plastics New Materials Company Limited. ("Haikou New Materials"), Haikou Xinda Plastics New Materials Enterprise Technical Center Company Limited ("Haikou Technical Center"), and Haikou Xinda Software Development Company Limited ("Haikou Software") were established in December 2011 and are based in

Haikou, the capital of Hainan province in the PRC. Harbin Xinda Plastics Composite Material Company Limited ("Xinda Composite") and Harbin Xinda Plastics New Material Company Limited ("Xinda Plastics New") were established in December 2011.

Xinda Group Material Research was established in December 2012.

Part of the restructuring plan is for Harbin Xinda to transfer its ownership of subsidiaries to Xinda Group. As of December 31, 2012, we have completed internal transfer of three subsidiaries to Xinda Group: Xinda Software, Xinda Group Technology Center and Xinda Testing as shown in the organization chart below. Harbin Xinda is being merged into Xinda Group and will be deregistered. Meiyuan Service changed its name to Heilongjiang Xinda Enterprise Group Meiyuan Training Center Co. Ltd. ("Meiyuan Training") to better reflect its nature of operation upon completion of the restructuring. Haikou New Materials, Haikou Technical Center and Haikou Software are planned to be deregistered in 2013. Xinda Group Technology Center, Xinda Testing and Xinda Material Research Center will be deregistered and merged into Xinda Group Material Research in 2013, whose major functions include technical support for our production bases, research and development of modified plastic products for applications in areas such as automotive, high-speed rail, aircraft and others, customer post-sales support, and collaboration with industry leading universities and institutions. Our restructuring is expected to be completed approximately by June 30, 2013.

Corporate Structure The corporate structure of the Company as of December 31, 2012 was as follows:

The planned corporate structure of the Company after the restructuring is as follows:

Starting in 2013, we plan to establish a production base, research and development and training center in Sichuan Province to develop market for our products in Southwest China and its adjacent regions.

Our Industry

According to a research report prepared exclusively for the Company and issued by Frost & Sullivan in February 2012, China is estimated to have consumed approximately 14.3 million Metric Ton ("MT") of modified plastic products in 2012, representing an increase of 9.2% compared to 2011. With China being the world's leading manufacturing center and with rising domestic individual consumption, we believe that demand for modified plastics from China will continue to increase in the foreseeable future. As shown in Figure 1, the market demand for modified plastics will reach 15.6 million MT in 2013 and 18.5 million MT in 2015, representing compound annual growth rates ("CAGR") of 7.8% and 11.9% by sales volume and revenue from 2010 to 2015. Currently, demand for our products is primarily driven by the Chinese automotive industry. In order for plastics to be used in automobile parts and components, they must satisfy specific physical criteria in terms of mechanical functionality, stability under light and heat, durability, flame resistance, and environmental friendliness. Modified plastics are usually found in interior materials, door panels, dashboards, mud flaps, chassis, bumpers, oil tanks, gas valves, grilles, unit heater shells, air conditioner shells, heat dissipating grids, wheel covers, and other components.

Figure 1: Analysis of Chinese Modified Plastics Market: Sales Volume and Revenue (China), 2005-2015E

Source: Frost & Sullivan

According to Frost & Sullivan's report, the Chinese automotive modified plastics market has experienced rapid development from 2005 to 2010, with more than a six-fold growth in terms of revenue and more than a four-fold increase in terms of sales volume during this period. The market demand is projected to reach 2.8 million MT in 2013. As illustrated in Figure 2, the Chinese automotive modified plastics market is expected to sustain rapid increase in terms of revenue and sales volume, with CAGR of 18.8% and 14.2% from 2010 to 2015, respectively. Approximately 51% of the automotive modified plastic consumed in 2010 was imported from outside of the PRC or manufactured by multinational and joint venture companies. We believe that the demand for automotive modified plastic in China will grow continuously due to the fast growing Chinese automotive market, increasing use per unit of plastic content in automobiles and favorable government incentives and regulations. Moreover, domestic producers will likely gain larger market share from imports as they are able to manufacture products with comparable quality at highly competitive prices and close proximity to their customers. We believe that the following are the key drivers for the automotive modified plastic industry in China.

Figure 2: Analysis of Chinese Automotive Modified Plastics Market: Sales Volume and Revenue (China), 2005-2015E

Source: Frost & Sullivan

Continual Growth in Chinese Auto Demand

According to the statistics by the China Association of Automobile Manufacturers ("CAAM") in 2012, China's production volume of automobiles increased from 5.7 million units in 2005 to 19.27 million units in 2012. The market is expected to sustain the growth with a CAGR of 5.9% from 2010 to 2015, reaching 24.3 million units in 2015. China has exceeded the United States to become the world's largest auto market as measured by the number of automobiles sold. We believe the growth momentum in China's auto sales will remain strong over the next five years. The automotive industry in China is still in its infancy with passenger car ownership of 69 vehicles per 1,000 inhabitants in 2011, which is significantly below the developed countries' average of 824 and global average of 473 according to the Economist Intelligence Unit as shown in Figure 3 below.

Figure 3: Overview of Chinese Macro Economy:
Vehicle Per 1,000 People Comparison (Units per 1,000 People), 2005-2015E

Source: National Bureau of Statistics, US Department of Energy, Eurosta, Frost and Sullivan

According to the National Bureau of Statistics, the total number of Chinese automobile parts has experienced a rapid growth because of the economic development and the incentive policies issued by the government. The number maintained a booming trend from 31.8 million units in 2005 to 112 million units in 2012, and is forecasted to hit a record of 134 million units in 2013 and 192 million units by 2015, with a CAGR of 19.8% between 2010 and 2015 as shown in Figure 4.

Figure 4: Overview of Chinese Macro Economy: Growth of Automotive Parts, 2005-2015E

Source: National Bureau of Statistics

Rising personal income in China is one of the key drivers for the rapid growth of the Chinese automobile industry. As shown in Figure 5, China has shown strong economic growth with its GDP increased from approximately RMB 18,493.7 billion in 2005 to RMB 51,517.8 billion in 2012, and is expected to sustain the steady growth from 2012 to 2015. Per Capita Consumption Expenditure of Urban Household also shows an optimistic picture with a total nominal increase of 116.6% between 2005 and 2010, and is forecasted to reach RMB 22,551.6 by the end of 2015. Moreover, cars have become more affordable in China as local or joint venture automobile manufacturers continuously expand their production to achieve economies of scale to lower production cost and source cheaper auto parts locally. Growing income and decreasing vehicle prices will continue to make car ownership more affordable for China's rising middle class.

Figure 5: Overview of Chinese Macro Economy: Growth of Nominal GDP and Per Capita Consumption Expenditure of Urban Household (China), 2005-2015E

Source: National Bureau of Statistics, International Monetary Fund, and Frost & Sullivan

Benefit and Increasing Use of Plastics in Automobiles

(1) Cost Reduction: The primary demand driver for modified automotive plastics arises out of the cost-reduction characteristics evidenced by the plastics material inclusion in the automobile manufacturing process. Modified plastics can deliver the same performance as metallic materials at approximately a tenth of the cost. In addition, modified plastics can substitute some kinds of more expensive engineering plastics. This benefit of modified plastics will become more significant with the increasing competition in automobile manufacturing industry to improve efficiency and reduce costs.

(2) Vehicle Emissions Reduction: Plastic components impact fuel efficiency by saving approximately 2.5 liters of fuel per kilograms ("kg") used (equivalent to 6kg of CO2 emissions) over the lifetime of the vehicle. Automobile manufacturers have been reducing vehicle weights in an attempt to reduce emissions and increase efficiencies. Modified plastics reduce the weight of components by 40% compared with traditional metallic materials.

(3) Performance and Safety Improvement: The development of advanced plastics applications lead to the improvement in performance through reducing the number and weight of the vehicle parts, causing the fuel consumption per vehicle to drop significantly. In addition, the lower net weight of the vehicles improves handling performance and thereby eliminates the likelihood of losing control in case of emergency stops. The involvement of modified plastics in automotive applications results in significant improvement of the safety features of the vehicle parts, like seat belts, air bags, and air bag containers in the recent years.

(4) New Applications: Plastics reduce the number of the required parts used in automobile manufacturing and introduce new design possibilities. Conventional materials struggle to compete against this open innovation platform associated with the plastics industry. In addition, the performance benefits associated with plastic materials continue to create a competitive advantage for the plastics industry.

(5) Increasing Use of Plastics per Vehicle: Weight of modified plastics per vehicle in China continually increased from 2005 to 2010, and is forecasted to reach 152.0 kg by the end of 2015, with a growth rate of 45.5% as shown in Figure 6. Although the weight of modified plastics per vehicle in China will still be less than that in North America and Europe, the highest growth rate indicates the huge potential for market growth. In 2010, plastic use in China is estimated to be about 104.5 kg per vehicle, representing 8% of the vehicle weight, whereas models imported from Europe contain on average as much as 190 kg per vehicle, or 15% of the vehicle weight. In addition, the Chinese government's goals regarding electric and hybrid vehicles may also push the market further as weight concerns are more important for these vehicles than for traditional passenger cars.

Figure 6: Comparison of Weight of Modified Plastics per Vehicle in China, North America, and Europe, 2005, 2010, 2015E

Source: Frost & Sullivan, American Chemistry Council's Plastics Industry Producers' Statistics Group

Increasing Substitution of Imports

Though China's automotive plastic market has been dominated by foreign or joint venture ("JV") companies, Chinese suppliers are continually gaining market share. It is estimated that automotive plastics imported and manufactured by multinational and JV companies accounted for 45% of the total China automotive plastic supply in 2011, decreasing from 65.0% in 2005 according to a report by Frost & Sullivan. Compared to foreign competitors including JV companies, local manufacturers can largely benefit from the lower cost and geographical convenience in China and their product sales can be customized with time-efficient after sales services and technical supports. As the local production capacity of both domestic and foreign companies has been expanding, share of imports is expected to decrease to 10.0% and that of multiple national companies (the "MNC") and JV companies is expected to decrease to 25% by the end of 2015, while the share of domestic manufacturers is forecast to rise to 65.0% in 2015 as they expand at a greater rate than MNC and JV in China.

The financial crisis beginning in 2008 and the European debt crisis beginning in 2011 forced global automakers and suppliers to concentrate on their cost structure and pricing mechanisms. Many automakers accelerated cost reduction initiatives. Moving manufacturing operations to and sourcing raw materials from low cost regions have emerged as key measures to save costs. With its huge consumer market, low labor costs and high-quality manufacturing and logistics infrastructure, China is a location favored by global auto and component makers who source parts and components not only for their local operations in China but also for their global operations. As a result, we believe that China's local plastic suppliers will benefit from such global outsourcing trends and increasingly become a good substitute for expensive imported plastic products. JV manufacturers based in China in automotive plastics sector have been slow to invest and expand in China.

Favorable National Government Policies

In the past decade, the Chinese government has adopted a number of policies and initiatives intended to encourage the development of the Chinese modified plastics industry and stimulate the growth of the Chinese automobile industry.

Since 2000, modified plastics, including engineering plastics, have been categorized as a prioritized industrialization area by a series of government guidelines or development plans. Some of these policies include:

It was stated in the "Outline of China's Twelfth Five-year Plan (2011)" that new functional materials, advanced structural materials, common base materials, fiber of high performance and its compounded material are key development directions of new material industry.

It was stated in the "Catalogue for Guidance on Adjustment of Industrial Structure (2011)" promulgated by the National Development and Reform Commission on March 27, 2011, that the country is currently promoting the development of production equipment of polycarbonate by the use of non-phosgene method, with annual output of 60000t/year and above, production of engineering plastic including liquid crystalline polymer (LCP) and development and application of bleeding modification and alloying; development and production of water – absorbed resin, conductible resin and biodegradable polymers; development and production of new polyamide including nylon 11, nylon 1414 and nylon 46, nylon with long carbon chain and heat resistant nylon.

It was stated in the "Guidance on Key Areas of Industrialization of High Technology with Current Priority in Development (2011)" jointly promulgated by the National Development and Reform Commission, the Ministry of Science and Technology, the Ministry of Commerce and the State Intellectual Property Office on June 23, 2011 that modified technologies applied to general plastics, including new engineering plastics and plastic alloy, new special engineering plastics, fire resistant modified plastics, and modified technology of general plastics, are currently prioritized areas to develop and industrialize in China's macromolecule materials sector.

A series of modified plastics technologies have been listed in the "National Support for Key High-tech Fields" as stated in the Circular on the Issuance of the Administrative Measure for the Recognition of High-tech Enterprise jointly promulgated by the Ministry of Science and Technology, Ministry of Finance, the State Administration of Taxation in April 2008. These technologies include special engineering plastics, macromolecular compound or new synthetic modified, etc.

In addition, with the Chinese government strongly encouraging the production of more fuel-efficient and environmentally friendly vehicles, as one means to help resolve the nation's worsening air pollution problem, especially in big cities, opportunities abound for suppliers of plastics materials and auto components.

We believe that the above government measures and programs will continue to accelerate the demand for automotive modified plastics in China.

Tightening Trend and Local Government Policies

Despite the favorable national government policies as set forth above, in the past couple of years, the Chinese government has implemented certain measures to control the pace of economic growth and discontinued certain

stimulus measures implemented to deal with the recent global financial crisis, including incentives for consumers to purchase automobiles.

Since 2011, in order to resolve the extreme traffic congestion, Beijing government has been implementing a vehicle purchase quota policy, which limits the maximum vehicles sold in Beijing per month to 20,000. Other cities which have begun to show signs of traffic congestion have also begun to implement similar measures to control traffic congestion, including the limited automobile licenses policy implemented in Shanghai and the imposition of congestion charges in Shenzhen. The termination of nation-wide preferential policies can negatively affect consumer demand for new vehicles, and local restrictive measures over automobile purchases in major cities may result in the reduction in the sale of vehicles nationwide.

Our Products

Modified plastic is processed by adding chemical agents to basic plastics to generate or improve certain physical and/or chemical characteristics of plastic, such as heat resistance, hardness, tensile strength, wear resistance, and flame resistance. Based on the type of materials, modified plastics include modified common plastics, such as polypropylene (PP), acrylonitrile butadiene styrene (ABS), modified engineering plastics, such as polyamides (PA or nylon), environment-friendly plastics and specialty engineering plastics.

Our products are organized into seven product groups, based on their physical characteristics, as set forth below:

| Product Group | Brand Name | Number of Products Certified | Characteristics | Automotive or Other Application |
|---|---|---|---|---|
| Modified PP | COMPNIPER | 41 | High fluidity and impact resistance | Interior parts, such as inner panels, instrument panels and box lids |
| | COMPWIPER | 55 | Resistance to low temperature and impact | External parts, such as front and back bumpers and mudguards |