



# China Sunshin Chemical Ltd

## (CSSC SP/CSSC.SI)

### Bargain hunting

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- 3Q19 results plunged due to profit margin compression. ASP continued to fall while raw material prices spiked as a result of the supply cuts in the upstream sector.
- The 20,000-tonne of TBBS capacity expansion is still on track. We expect the increase in volume to partially offset the ongoing soft ASP.
- We maintain OUTPERFORM but lower our TP from S\$1.40 to S\$1.20 given the prolonged weak market outlook. Our TP implies a 15% potential upside from the last closing price of S\$1.04.

#### Financials & Key Operating Statistics

| YE Dec (RMB m)       | FY17     | FY18     | FY19F    | FY20F    | FY21F    |
|----------------------|----------|----------|----------|----------|----------|
| Revenue              | 1695.9   | 3283.3   | 2750.0   | 2850.5   | 3312.9   |
| PATMI                | 341.3    | 641.3    | 445.2    | 391.4    | 367.3    |
| Core PATMI           | 341.3    | 593.3    | 445.2    | 391.4    | 367.3    |
| Core EPS (RMB cents) | 70.8     | 120.7    | 91.2     | 80.2     | 75.2     |
| Core EPS grth (%)    | 48.6     | 70.4     | -24.4    | -12.1    | -6.2     |
| Core P/E (x)         | 7.5      | 4.4      | 5.8      | 6.6      | 7.1      |
| DPS (SGCents)        | 3.0      | 5.5      | 3.7      | 3.2      | 3.0      |
| Div Yield (%)        | 2.9      | 5.3      | 3.5      | 3.1      | 2.9      |
| Net Margin (%)       | 12.5     | 19.5     | 16.2     | 13.7     | 11.1     |
| Gearing (%)          | Net cash | Net cash | Net cash | Net cash | Net cash |
| Price / Earnings (x) | 7.5      | 4.4      | 5.8      | 6.6      | 7.1      |
| Price / Book (x)     | 1.5      | 1.1      | 1.0      | 0.9      | 0.8      |
| ROE (%)              | 19.6     | 27.6     | 16.9     | 13.4     | 11.5     |

Source: Company Data, KGI Research

**Plunge in 3Q19 performance due to margin compression.** Sunshin reported a substantial fall of 27% YoY and 44% YoY in gross profit and net profit in 3Q19. The weakest performance since 3Q17 was due mainly to the overall market downturn that further depressed ASPs of rubber chemical products. GPM and NPM further dropped to 28.5% and 12.3% respectively as ASP continued to fall while raw material prices have bottomed out since 1Q19.

The weak ASP was due to downstream customers (mainly tyre producers) cutting production as automobile demand softened. Meanwhile, raw material prices unexpectedly spiked in September and rallied even higher in October. For example, average aniline prices jumped 10.1% MoM to RMB6,930/tonne in September and touched RMB8,000/tonne recently. The sharp jump was due to raw material producers shutting down several production lines for inspection and maintenance.

**Potentially weak 4Q19.** As a result of the higher raw material prices, profit margins have been under pressure over the past few months. Management is currently negotiating with clients for an upward adjustment to ASP, but the weaker margins have continued to spill over into the first month of 4Q19. The longer it takes for ASP to recover, the longer the weak performance is expected to extend.

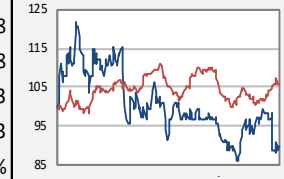
#### Outperform - Maintain

|                             |      |                               |      |
|-----------------------------|------|-------------------------------|------|
| Price as of 12 Nov 19 (SGD) | 1.04 | <b>Performance (Absolute)</b> |      |
| 12M TP (S\$)                | 1.20 | 1 Month (%)                   | -8.0 |
| Previous TP (S\$)           | 1.40 | 3 Month (%)                   | -2.8 |
| Upside (%)                  | 15.4 | 12 Month (%)                  | -5.9 |

#### Trading data

|                           |       |
|---------------------------|-------|
| Mkt Cap (\$mn)            | 508   |
| Issued Shares (mn)        | 488   |
| Vol - 3M Daily avg (mn)   | 0.3   |
| Val - 3M Daily avg (\$mn) | 0.3   |
| Free Float (%)            | 38.0% |

#### Perf. vs STI Index (Red)



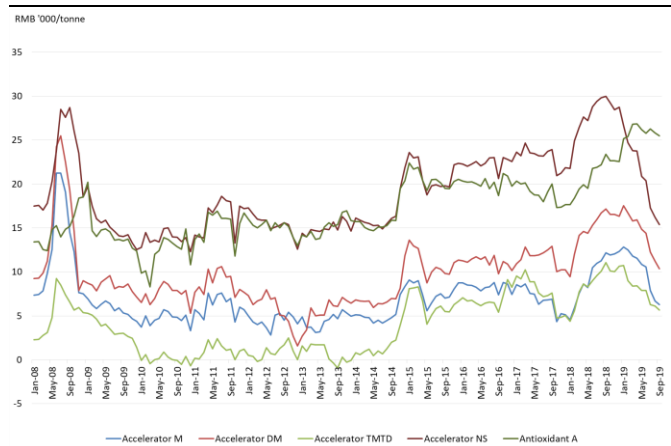
#### Major Shareholders

|                          |       |
|--------------------------|-------|
| Success More Group       | 60.1% |
| Dimensional Fund Advisor | 1.4%  |

#### Previous Recommendations

|           |          |
|-----------|----------|
| 11-Oct-19 | OP \$1.4 |
|-----------|----------|

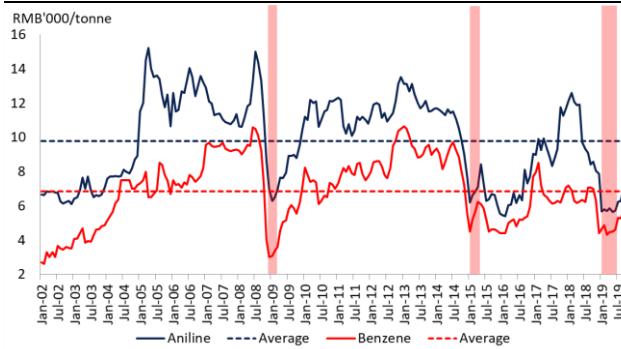
Figure 1: Spread between rubber chemical products and aniline



Source: CEIC, KGI Research

**Valuation & Action:** We maintain our OUTPERFORM recommendation but lower our target price from S\$1.40 to S\$1.20, based on our updated DCF model. The soft ASP is expected to extend in the near term, and profit margins will continue to narrow due to the weak market outlook. However, we believe that Sunshin's new capacity should be able to partially offset the decline of ASP in FY20F.

**Risks:** The ASP adjustment lags behind the movement of raw material prices. The downstream clients are under pressure due to soft tyre demand. Hence, Sunshin may not be able to negotiate for the timely upward adjustment to ASP. Furthermore, raw material prices could rise further in the short term due to the upstream supply shortage, which could weaken profit margins and profitability.

**Figure 2: Aniline and benzene prices rebound**


Source: CEIC, KGI Research

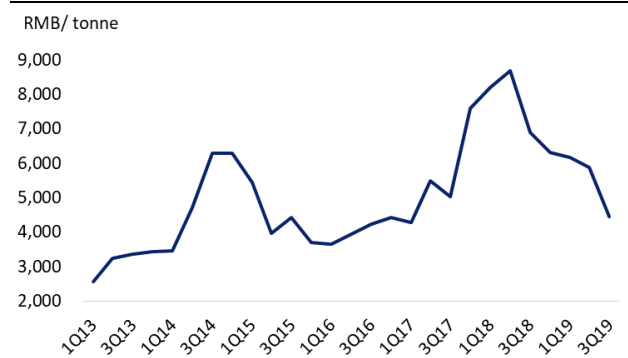
**Expect new capacity to mitigate the price headwinds.** The respective average capacity utilisation rate of rubber accelerators, insoluble sulphur, and anti-oxidants was 90.7%, 100.5%, and 101.6% YTD, which indicates that Sun sine's productivity remained healthy. The total sales volume grew by 11.2% YoY in 9M19 due mainly to the Phase I of the 10,000-tonne newly-added TBBS capacity, which partially offset the 26.3% decrease in overall ASP during the period. Phase II of the 20,000-tonne of TBBS to be installed is still on track. As a result, the 11.6% growth in capacity in FY20F is expected to buffer the further downturn in ASP.

**Slash forecast and lower valuation.** We lower our FY19F, FY20F, and FY21F net profit forecast by 10%, 27%, and 26% due mainly to the prolonged weakness in ASP and narrowing profit margins. Accordingly, we lower our target price to S\$1.20 from the previous S\$1.40, implying a 15% potential upside from the last closing price of S\$1.04. We maintain our OUTPERFORM rating.

**Figure 4: ASP and sales volume projection**

|                                 | FY19F  | FY20F  | FY21F   |
|---------------------------------|--------|--------|---------|
| <b>Sales volume (tonnes)</b>    |        |        |         |
| Accelerators                    | 89,240 | 99,510 | 111,150 |
| Insoluble Sulphur               | 29,700 | 29,400 | 29,700  |
| Anti-oxidant                    | 42,750 | 42,750 | 42,750  |
| <b>Realised ASP (RMB/tonne)</b> |        |        |         |
| Accelerators                    | 20,377 | 19,121 | 20,806  |
| Insoluble Sulphur               | 9,999  | 10,199 | 10,811  |
| Anti-oxidant                    | 13,550 | 13,821 | 14,512  |
| <b>Sales (RMB m)</b>            |        |        |         |
| Accelerators                    | 1,818  | 1,903  | 2,313   |
| Insoluble Sulphur               | 297    | 300    | 321     |
| Anti-oxidant                    | 579    | 591    | 620     |

Source: KGI Research

**Figure 3: Gross profit/tonne**


Source: Company data, KGI Research

**Figure 5: Valuation**

| RMB mn                  | FY19F | FY20F | FY21F |
|-------------------------|-------|-------|-------|
| Net income              | 445   | 391   | 367   |
| Net capex               | (68)  | (70)  | (75)  |
| Change in net WC        | 52    | (64)  | (0)   |
| Change in borrowing     | -     | -     | -     |
| FCFE                    | 429   | 257   | 292   |
| Beta                    | 1.2   |       |       |
| Required rate of return | 10.5% |       |       |
| Growth                  | 0.5%  |       |       |
| FX (SGD/RMB)            | 5.10  |       |       |
| TP (SGD)                | 1.20  |       |       |

Source: KGI Research

YE 31 Dec

| <b>INCOME STATEMENT (RMB m)</b> | <b>FY17</b>  | <b>FY18</b>  | <b>FY19F</b> | <b>FY20F</b> | <b>FY21F</b> |
|---------------------------------|--------------|--------------|--------------|--------------|--------------|
| <b>Revenue</b>                  | <b>2,738</b> | <b>3,283</b> | <b>2,750</b> | <b>2,851</b> | <b>3,313</b> |
| Cost of sales                   | (1,950)      | (2,157)      | (1,898)      | (2,052)      | (2,418)      |
| <b>Gross Profit</b>             | <b>788</b>   | <b>1,126</b> | <b>853</b>   | <b>798</b>   | <b>894</b>   |
| <b>EBITDA</b>                   | <b>567</b>   | <b>809</b>   | <b>643</b>   | <b>583</b>   | <b>626</b>   |
| Depreciation & Amortisation     | 90           | 98           | 106          | 111          | 116          |
| <b>EBIT</b>                     | <b>477</b>   | <b>712</b>   | <b>536</b>   | <b>472</b>   | <b>510</b>   |
| <b>Profit from Operations</b>   | <b>1,922</b> | <b>2,744</b> | <b>2,138</b> | <b>1,964</b> | <b>2,147</b> |
| Net Finance (Expense)/Inc       | -            | -            | -            | -            | -            |
| <b>Profit before Tax</b>        | <b>477</b>   | <b>712</b>   | <b>536</b>   | <b>472</b>   | <b>510</b>   |
| Income tax                      | (136)        | (70)         | (91)         | (80)         | (143)        |
| <b>PAT</b>                      | <b>341</b>   | <b>641</b>   | <b>445</b>   | <b>391</b>   | <b>367</b>   |
| PAT Normalized                  | 341          | 593          | 445          | 391          | 367          |

| <b>BALANCE SHEET (RMB m)</b>        | <b>FY17</b>  | <b>FY18</b>  | <b>FY19F</b> | <b>FY20F</b> | <b>FY21F</b> |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Cash and bank balances              | 500          | 1,039        | 1,420        | 1,682        | 1,980        |
| Inventories                         | 212          | 217          | 258          | 266          | 269          |
| Trade receivables                   | 638          | 691          | 572          | 650          | 683          |
| Others                              | 75           | 70           | 66           | 70           | 75           |
| <b>Current Assets</b>               | <b>1,425</b> | <b>2,016</b> | <b>2,317</b> | <b>2,667</b> | <b>3,007</b> |
| PP&E                                | 662          | 691          | 646          | 606          | 566          |
| Others                              | 41           | 40           | 39           | 38           | 37           |
| <b>Non-current Assets</b>           | <b>703</b>   | <b>731</b>   | <b>685</b>   | <b>644</b>   | <b>603</b>   |
| <b>Total assets</b>                 | <b>2,128</b> | <b>2,747</b> | <b>3,002</b> | <b>3,311</b> | <b>3,610</b> |
| Trade payables                      | 71           | 63           | 52           | 62           | 66           |
| Borrowings                          | -            | -            | -            | -            | -            |
| Others                              | 314          | 359          | 319          | 329          | 362          |
| <b>Current Liabilities</b>          | <b>385</b>   | <b>422</b>   | <b>371</b>   | <b>391</b>   | <b>428</b>   |
| Bank loans                          | -            | -            | -            | -            | -            |
| <b>Non-current liabilities</b>      | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     |
| Shareholders equity                 | 1,742        | 2,326        | 2,631        | 2,920        | 3,182        |
| <b>Total Equity</b>                 | <b>1,742</b> | <b>2,326</b> | <b>2,631</b> | <b>2,920</b> | <b>3,182</b> |
| <b>Total Liabilities and Equity</b> | <b>2,128</b> | <b>2,747</b> | <b>3,002</b> | <b>3,311</b> | <b>3,610</b> |

| <b>CASH FLOW STATEMENT (RMB m)</b>  | <b>FY17</b>  | <b>FY18</b>  | <b>FY19F</b> | <b>FY20F</b> | <b>FY21F</b> |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Profit before tax                   | 477          | 712          | 536          | 472          | 510          |
| Depreciation & non cash adjustments | 90           | 98           | 106          | 111          | 116          |
| Change in Working Capital           | (83)         | (2)          | 52           | (64)         | (0)          |
| Income Tax Paid                     | (100)        | (84)         | (91)         | (80)         | (143)        |
| Interest Paid                       | -            | -            | -            | -            | -            |
| Others                              | 2            | (22)         | (4)          | (5)          | (5)          |
| <b>CF from operating activities</b> | <b>387</b>   | <b>701</b>   | <b>599</b>   | <b>434</b>   | <b>478</b>   |
| Purchase/Disposal of PPE            | (209)        | (130)        | (68)         | (70)         | (75)         |
| Others                              | 4            | 4            | 4            | 5            | 5            |
| <b>CF from investing activities</b> | <b>(205)</b> | <b>(125)</b> | <b>(64)</b>  | <b>(65)</b>  | <b>(70)</b>  |
| Dividends Paid                      | (47)         | (59)         | (136)        | (106)        | (111)        |
| Debt Raised / (Repaid)              | -            | -            | -            | -            | -            |
| Equity Raised / (Bought Back)       | 86           | (2)          | (15)         | -            | -            |
| Others                              | 10           | 8            | -            | -            | -            |
| <b>CF from financing activities</b> | <b>50</b>    | <b>(52)</b>  | <b>(150)</b> | <b>(106)</b> | <b>(111)</b> |
| Net increase in cash & cash equiv.  | 231          | 523          | 385          | 263          | 298          |
| FX effects                          | (9)          | 16           | -            | -            | -            |
| Beginning Cash                      | 274          | 496          | 1,035        | 1,420        | 1,682        |
| <b>Ending Cash</b>                  | <b>496</b>   | <b>1,035</b> | <b>1,420</b> | <b>1,682</b> | <b>1,980</b> |

| <b>KEY RATIOS</b>              | <b>FY17</b> | <b>FY18</b> | <b>FY19F</b> | <b>FY20F</b> | <b>FY21F</b> |
|--------------------------------|-------------|-------------|--------------|--------------|--------------|
| <b>Profitability</b>           |             |             |              |              |              |
| Core EPS                       | 70.8        | 120.7       | 91.2         | 80.2         | 75.2         |
| Core EPS Growth (%)            | 48.6        | 70.4        | (24.4)       | (12.1)       | (6.2)        |
| DPS (SGD Cents)                | 3.0         | 5.5         | 3.7          | 3.2          | 3.0          |
| Dividend Yield (%)             | 2.9         | 5.3         | 3.6          | 3.1          | 2.9          |
| <b>Profitability</b>           |             |             |              |              |              |
| Gross margin                   | 28.8%       | 34.3%       | 31.0%        | 28.0%        | 27.0%        |
| EBITDA margin                  | 20.7%       | 24.6%       | 23.4%        | 20.4%        | 18.9%        |
| Net margin                     | 12.5%       | 19.5%       | 16.2%        | 13.7%        | 11.1%        |
| ROE                            | 19.6%       | 27.6%       | 16.9%        | 13.4%        | 11.5%        |
| ROA                            | 16.0%       | 23.3%       | 14.8%        | 11.8%        | 10.2%        |
| <b>Financial Structure (x)</b> |             |             |              |              |              |
| Interest coverage              | -           | -           | -            | -            | -            |
| Total Debt/Equity              | -           | -           | -            | -            | -            |
| Net Gearing                    | Net cash    | Net cash    | Net cash     | Net cash     | Net cash     |

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| <b>Rating</b>           | <b>Definition</b>   |
|-------------------------|---|
| <b>Outperform (OP)</b>  | We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.  |
| <b>Neutral (N)</b>      | We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.   |
| <b>Underperform (U)</b> | We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.  |
| <b>Not Rated (NR)</b>   | The stock is not rated by KGI Securities.   |
| <b>Restricted (R)</b>   | KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances. |

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