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Maybank KE Retail Research

Rubber chemical producer, China Sunsine's (CSSC) 1Q19 net profit declined 26% to Rmb110.2m, broadly in line with expectations.

Revenue fell 20% to Rmb686.6m, dragged by lower ASP of Rmb17,637 (-24% y/y, -7.7% q/q) due to reduced price of raw materials, namely aniline.

However, sales volume expanded to 38,715 tonnes (+5.2%), with growth across accelerators (+1.5%), insoluble sulphur (+18.4%) and anti-oxidants (+3.2%) despite Chinese New Year breaks. This was attributed to additional 10,000 tpd line and its flexible pricing strategy.

Geographically, international sales of 14,703 tonnes (+26%) overshadowed falling domestic sales of 24,012 tonnes (-4.5%) due to domestic tyre makers' low production utilisation rates.

Gross margin narrowed 0.6ppt to 34.3%. Notably, gross margin has been holding up above 30% since 4Q17 despite weaker q/q ASPs following its peak in 3Q18.

Bottom line was dented by higher selling & distribution expense of Rmb23.3m (+4%) arising from higher freight costs as a result of increased overseas sales volume, but cushioned by lower admin cost of Rmb71.5m (-14%) on reduced staff cost.

Operating cash flow ballooned to Rmb155.4m (1Q18 Rmb43.4m) on improved working capital, bringing net cash position to Rmb1.17b, representing 40.8% of market cap or cash/share of $0.48. This provides ample war chest for its expansion plan under negotiation without the need for financing.

On outlook, management expects ASPs for rubber chemicals to remain pressured by low raw material prices, as well as intensifying competition from the return of producers that previously did not meet government's environmental standards.

However, the group has undertaken a strategy of higher production to stimulate sales volume since 3Q18, and this will likely cushion the potential of reduced ASP amid industry headwinds. Its recent expansion of 10,000 tonnes of insoluble sulphur and rubber accelerators should help drive the strategy forward.

Notably, following the deadly Yancheng explosion in Mar '19, the Chinese government is conducting heightened safety inspections to all chemical companies in China.

Such safety inspection and stringent regulatory requirements may disrupt the supply of raw materials and rubber chemicals and lead to higher ASPs, which could in turn benefit the larger and eco-compliant companies such as CSSC.

Valuation-wise, CSSC is trading at 5.7x forward P/E, in line with its historical mean, but below 12.7x industry average.

Increase in aniline prices or significant regulatory developments on chemical companies will provide near-term upside to the stock.