



# China Sunshin Chemical Holdings

## (CSSC SP/CHSN.SI)

### BUY

Price as of 25 Oct 2017	0.965
12M target price (S\$)	1.390
Previous target price (S\$)	na
Upside, incl. div (%)	46.7

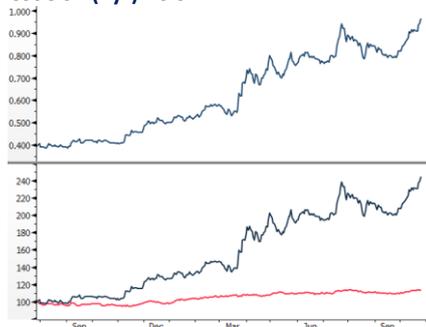
### Trading data

Mkt Cap (S\$m) / (US\$m)	474 / 349
Issued Shares (m)	492
Ave Daily Traded (3-Month) Vol / Val	1.0m / \$0.9m
52 week lo / hi	\$0.39 / \$0.99
Free Float	38.7%

### Major Shareholders

Success More Group	59.7%
--------------------	-------

### CSSC SP (1yr) VS STI



Source: Bloomberg

Colin Tan  
65 26202 1193  
colin.wh.tan@kgi.com

See the last page for important disclosures.

## Deep-Value; Robust Growth; Solid-Moat

### Event

We were recently hosted by management on a site visit to China Sunshin's plants in Shanxian and Dingtao in Shandong Province, China. Sunshin is a leading producer of rubber accelerators and is riding on the uptrend in rubber tyre consumption.

### Impact

**Early investments towards environmental protection helped placed Sunshin ahead of the competition.** Increasing environmental pressures by authorities have impacted total production of rubber chemicals in China, leading to declines in total output of rubber accelerators and anti-oxidants as productions from non-compliant firms were stopped or shut down. Sunshin, on the other hand, has **seen minimal impact to its production output** due to early infrastructure investment to adhere to stringent environmental standards.

**Building a solid moat through its competitive strengths.** Sunshin has several competitive advantages that would help sustain its leading position in its competitive market from our observations. These include **large untapped land** which could facilitate further expansion in production capacity and **strong engineering capabilities** needed not only to boost productivity yield but also necessary to minimise safety incident risks in the rubber chemical facilities. Given its large land use that it has, Sunshin could ramp up production capacity in rubber accelerators and insoluble sulphur to 150,000 tons (72% increase from current capacity) and 70,000 tons (250% increase from current), according to the management.

### Valuation & Action

We like Sunshin for its robust growth potential and its competitive strengths that could sustain its long-term growth potential. We recommend a BUY on the stock and ascribe a fair value of S\$1.39, pegged to 10x FY18F P/E. Note that the implied P/E multiple is still well below that of its peer, Yanggu Huatai (300121 CH), which is trading at 18x forward P/E, as well as that of other tire manufacturers on a simple average basis.

### Risks

Mainly regulatory risks in China; slowdown in rubber tyre consumption.

### Financials & Key Operating Statistics

YE Dec RMB mn	2015	2016	2017F	2018F	2019F
Revenue	1,859	2,037	2,606	2,868	3,108
PATMI	195	222	299	329	358
Core PATMI	190	222	299	329	358
Core EPS (RMB cents)	40.88	47.66	62.95	68.15	74.10
Core EPS grth (%)	(13.6)	16.6	32.1	8.3	8.7
Core P/E (x)	11.6	9.9	7.5	6.9	6.4
DPS (SGD cents)	1.00	1.50	2.60	2.80	3.00
Div Yield (%)	1.0	1.6	2.7	2.9	3.1
Net Margin (%)	10.5	10.9	11.5	11.5	11.5
Price / Book (x)	1.9	1.6	1.3	1.2	1.0
ROE (%)	17.9	17.5	19.5	18.0	17.0

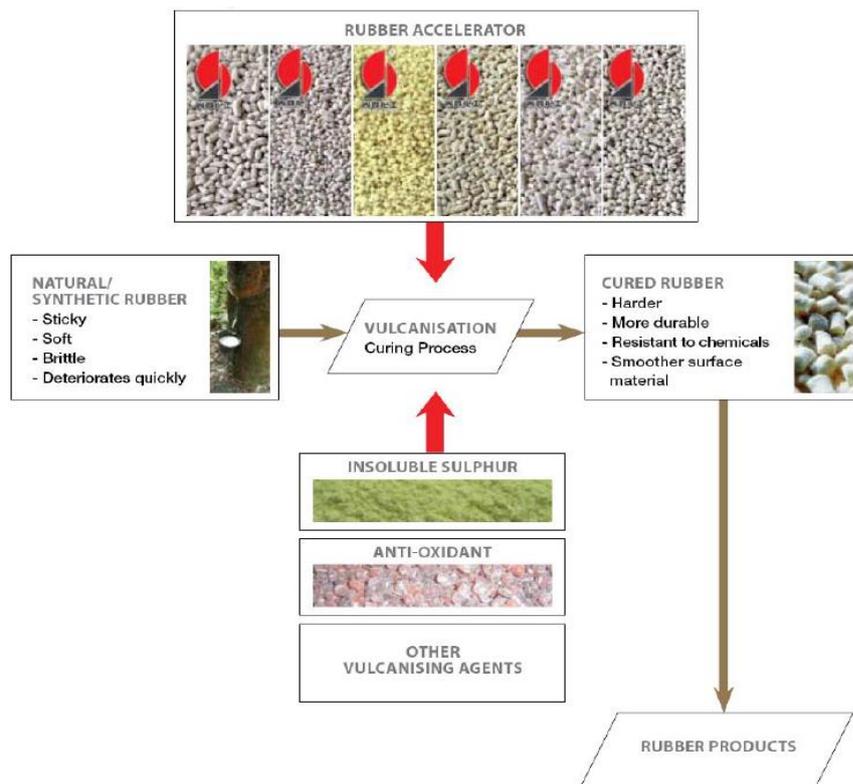
Source: Company Data, KGI Research

### Production facilities

Sunsine operates three facilities, which are located at Shanxian, Dingtao, and Weifang within Shandong province, China. The Shanxian plant occupies about 600mu of land and produces rubber chemical additives that comprises rubber accelerators (RA), insoluble sulphur (IS) and anti-oxidant (AO). Dingtao (c.280mu) focuses only on IS and Weifang (c.280mu) does only RA.

The rubber additives are essential chemicals used in the production of rubber and rubber-related products. The bulk of the chemicals are sold to tyre makers, which consume most of the rubber to fuel the growth in automotive industry globally.

**Figure 1: Illustration of chemical additives used in making rubber products**



Source: Company presentation

**Top leading producer of rubber accelerators in China**

Currently, the top four leading RA producers in PRC comprises China SunSine (中国尚舜), Tianjin Kemai (天津科迈), Willing New Materials (蔚林新材料), Yanggu Huatai (阳谷华泰), which accounts for about 201,000 tons or 60% of RA production in China.

**Table 1: Comparison of annual capacity of rubber accelerators among domestic competition**

Company	Annual Capacity 2016
China SunSine 中国尚舜	87,000 tons
Tianjin Kemai 天津科迈	51,000 tons
Yanggu Huatai 阳谷华泰	30,000 tons

Source: Company

**Reputable global brands among its large customer base**

Sunsine serves over 1,000 customers globally and two-thirds of the global top 75 tyre makers. Top international brands include Michelin, Bridgestone, Goodyear and Pirelli while some of the top local tyre makers are also amongst Sunsinе’s long-serving customers.

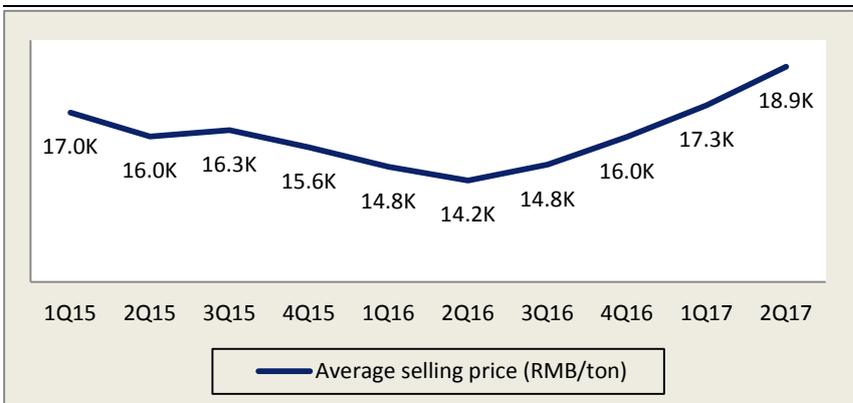
**Figure 2: Top tyre makers, globally and domestically, served by Sunsinе**



Source: Company presentation

**Sunsine could see higher gross margins from demand-supply imbalance in rubber accelerators.** China’s total production in rubber accelerators and anti-oxidants rubber chemicals have reportedly declined to about 208,000 tons (3.2% YoY drop) and 197,000 tons (4.4% YoY drop) respectively for the first half of 2017, as productions from non-compliant firms were stopped or shut down. This has led to escalating prices in rubber chemicals and could lead to a positive effect via higher margins for Sunsinе, which continues to serve the top global tyre makers globally and domestically.

**Figure 3: Sunsinе’s overall average selling prices of rubber chemical products (RMB/ton)**



Source: Company data, KGI Research

**Environmental consideration in production ups the barrier for competition.** Management has adopted a pro-environmental approach in the early years and has invested in wastewater treatment and sulphur recycling plants in its Shanxian facility. The company has started to reap the fruits of its efforts when the government started to strictly enforce environmental standards throughout in China, impacting competitors’ productions while Sunsine continues to meet increasing orders for its rubber chemical products.

The recycling plant helps extract hydrogen sulphide, an air pollutant, produced from the production process, which could be reused for the production of accelerators MBT (a type of RA) and IS. The plant apparently boasts a recovery rate of 99.5% and saves about RMB 10m-20m a year.

**Figure 4: View of Sunsine's sulphur recycling facility in Shanxian**



Source: KGI Research

**Driving productivity through automation**

Sunsine also employs automated production lines which helped sustained high productivity without overreliance on labour, thus mitigating the impact from rising labour costs in China. Current workforce is about 2,200 workers, with staff wages accounting about 9.6% of revenue in FY2016.

**Figure 5: Automated line used in packing anti-oxidant TMQ**



Source: KGI Research

**Centralised heating plant satisfy Sunshin’s own needs of steam supply**

The Shanxian facility is also equipped with a centralised coal-fired heating plant (Guangshun heating plant) which generates steam and electricity for Sunshin’s use. Guangshun heating plant comprises two boilers and has brought about an estimated cost savings of RMB20-30m a year. Sunshin is adding an additional boiler and one electricity generator, which are expected to complete by end of the year, to cope with the higher energy demand in line with higher production output.

Figure 6: Two operating boilers and one being constructed in Shanxian



Source: KGI Research

Figure 7: Control room for Guangshun heating plant



Source: KGI Research

**Other ongoing expansion projects**

Sunshin has also added 10,000-ton production line of TBBS (a product type of RA) in 2016 and is currently pending approval to commence commercial production, expected by the end of 2017. Approval from the authorities was delayed apparently due to preparation of the five-yearly China Communist Party Congress throughout the country which ended earlier in the week.

Separately, another 10,000 ton production line of IS will also be added to the Dingtao plant by the end of 2017. The additional capacity will help fulfil incremental demand for Sunshin’s rubber chemical products and is expected to fuel earnings growth into FY18F onwards.

Figure 8: Dingtao facility which occupy c. 280mu land; focuses only on production of insoluble Sulphur



Source: KGI Research

Figure 9: Large untapped land parcel in Dingtao, able to accommodate additional production lines totaling 40,000-ton capacity.



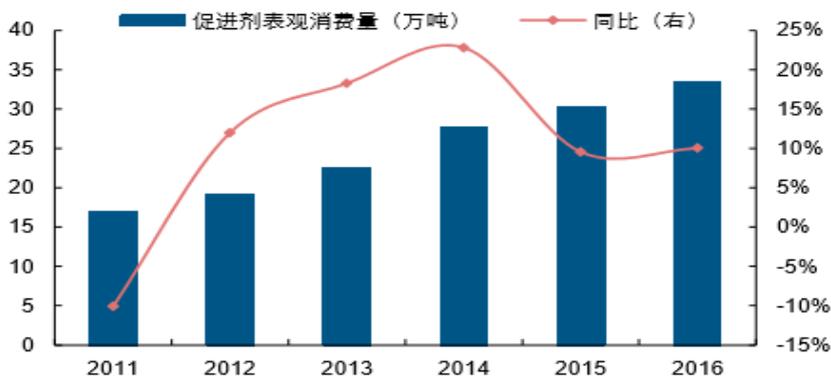
Source: KGI Research

**Investment Merits**

A key investment merit of Sunshin is its lucrative cash-generative business that generates a ROIC of about c.20% over the last three years. We project a similar ROIC level, if not better, over the next five years in view of its leading market position, competitive advantages and robust growth potential underpinned by growing consumption of rubber.

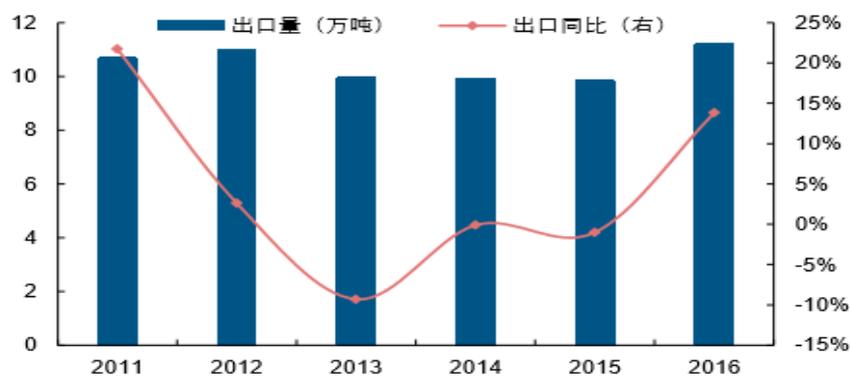
Global market size for accelerators exceeded 600,000 tons, with China accounting for about half of it and is expected to grow further. With strong demand growth for rubber accelerators and increasing environmental pressures on errant competitors, Sunshin would likely benefit from the current market trends.

**Figure 10: China’s consumption of rubber accelerators (expressed in 10,000 tons) continue to grow since 2011**



Source: chyxx.com

**Figure 11: China’s export of rubber accelerators (expressed in 10,000 tons) climbing in 2016**



Source: chyxx.com

### Valuation

We valued SunSine at a target price of S\$1.39, pegged to FY18F P/E of 10x which is still below that of its peers and other tyre manufacturers. We factor in the following assumptions:

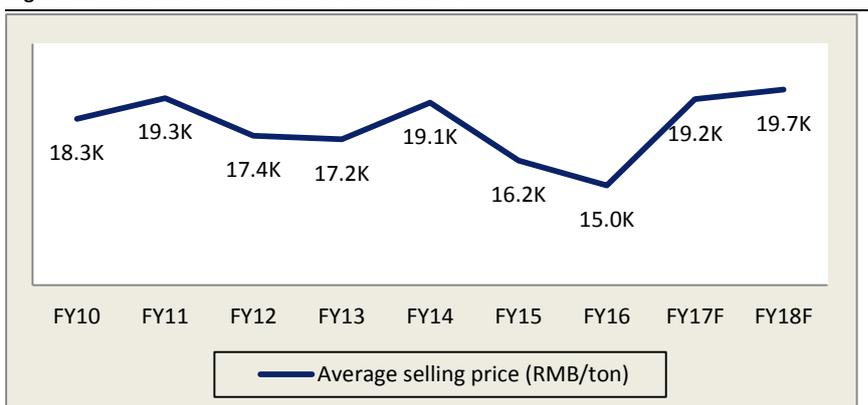
- Operations for the new 10,000-ton production line for accelerator TBBS and 10,000-ton line for insoluble sulphur should start to kick in FY18F after approval, adding to total production output forecast (c. 146,000 tons in rubber additives) in line with increasing demand.
- Overall average selling price (ASP) of SunSine's rubber chemicals projected to reach 19,000 RMB/ton and hover above that level in FY18F. Previously, ASP reached the 19,000 RMB/ton level in FY11 and FY14.

Upside catalysts would probably include stronger-than-expected earnings growth in the coming third quarter results and new dividend policy that stipulates higher payout ratio (ideally > 30%) from the current 20% (which is far too conservative in our view).

### Downside risks

Downside risks may include slowdown in rubber tyre consumption which accounts for about 2/3 of global rubber output. Environmental scrutiny in China currently serves as a boon although it may possibly turn to be a bane should SunSine start to turn lax on compliance to environmental standards.

**Figure 12: Overall ASP of SunSine's rubber chemicals**



Source: Company data, KGI Research

**Figure 13: Peer comparison with other rubber chemical producers and tire manufacturers**

Ticker	Company	Last Price	Market Cap (\$\$ m)	ROE (%) Current	P / E (x)		P / B (x)		Div Yield (%)		Gearing (%) Current
					Last FY	FY+1	Last FY	FY+1	Last FY	FY+1	
CSSC SP	China SunSine Chemical Hldgs	SGD 0.97	474	19.5	5.0	7.5	0.8	1.3	2.1	2.7	0.0
<b>Rubber Chemicals</b>											
300121 CH	Shandong Yanggu Huatai Che-A	CNY 14.12	836	27.8	32.6	18.8	7.8	4.8	0.5	0.7	40.8
LXS GY	Lanxess Ag	EUR 67.92	9,975	6.1	29.7	17.7	2.2	2.3	1.1	1.3	48.2
EMN US	Eastman Chemical Co	USD 90.47	17,832	20.2	11.1	12.3	2.4	2.6	2.5	2.3	58.4
<b>Simple Average</b>				<b>18.1</b>	<b>24.5</b>	<b>16.3</b>	<b>4.2</b>	<b>3.2</b>	<b>1.4</b>	<b>1.4</b>	<b>49.1</b>
<b>Tyre Manufacturers</b>											
000887 CH	Anhui Zhongding Sealing Pa-A	CNY 20.00	5,057	16.3	-	19.7	-	3.2	-	0.5	40.7
601966 CH	Shandong Linglong Tyre Co -A	CNY 19.11	4,697	-	29.2	17.7	4.0	2.5	0.6	-	-
5108 JP	Bridgestone Corp	JPY 5424.00	52,647	12.7	12.4	13.9	1.5	1.7	3.3	2.6	16.7
5101 JP	Yokohama Rubber Co Ltd	JPY 2512.00	5,084	6.9	17.9	12.2	1.0	1.1	2.5	2.3	48.1
MLFP	Michelin (Cgde)	EUR 123.45	35,728	-	11.5	13.3	1.8	1.9	3.1	2.8	-
GT US	Goodyear Tire & Rubber Co	USD 34.06	11,666	26.2	8.2	11.2	1.7	1.7	1.0	1.2	54.1
CTB US	Cooper Tire & Rubber	USD 37.30	2,648	17.8	8.3	11.1	1.9	1.6	1.1	1.1	22.0
161390 KS	Hankook Tire Co Ltd	KRW 57300.0	8,588	12.9	8.2	9.3	1.2	1.1	0.7	0.8	28.0
073240 KS	Kumho Tire Co Inc	KRW 6420.00	1,227	-11.7	-	-	1.2	1.0	0.0	0.0	71.0
<b>Simple Average</b>				<b>11.6</b>	<b>13.7</b>	<b>13.5</b>	<b>1.8</b>	<b>1.8</b>	<b>1.5</b>	<b>1.4</b>	<b>40.1</b>

Source: Bloomberg, KGI Research

**Financials**

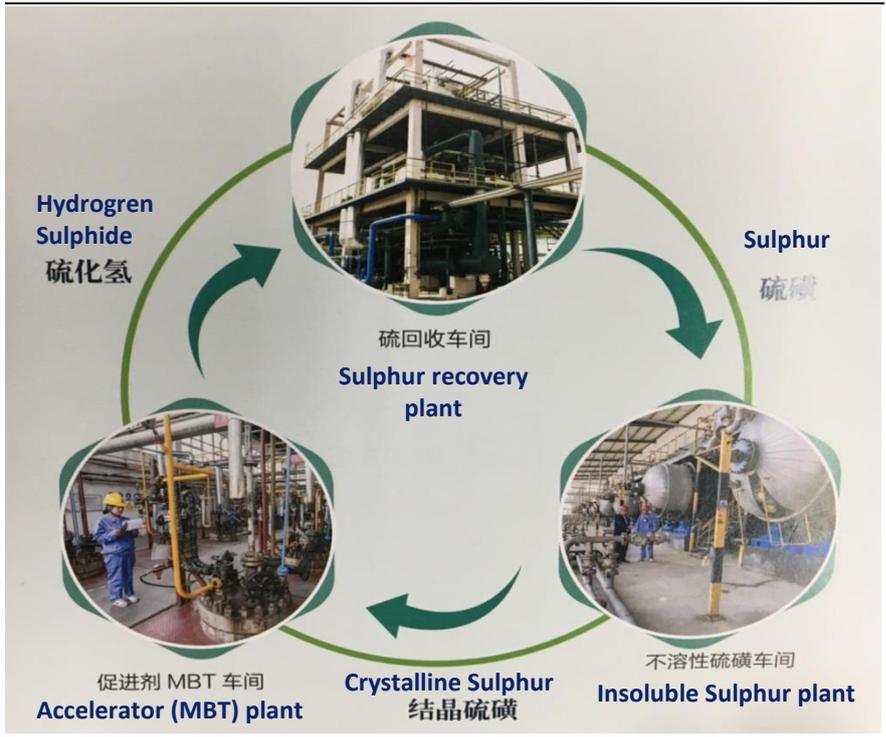
FYE 31 December

<b>INCOME STATEMENT (RMB mn)</b>	<b>2015</b>	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>
Revenue	1,859.1	2,036.9	2,605.9	2,868.0	3,108.1
Gross Profit	492.0	540.4	706.2	765.8	829.9
<b>Operating Profit</b>	<b>296.7</b>	<b>311.4</b>	<b>396.1</b>	<b>435.9</b>	<b>472.4</b>
Interest Expense	(10.4)	(4.4)	0.0	0.0	0.0
Interest Income	1.2	2.4	1.9	3.2	5.1
<b>Profit Before Tax</b>	<b>287.5</b>	<b>309.5</b>	<b>398.0</b>	<b>439.2</b>	<b>477.5</b>
Income Tax	(92.3)	(87.8)	(99.5)	(109.8)	(119.4)
<b>PATMI</b>	<b>195.2</b>	<b>221.7</b>	<b>298.5</b>	<b>329.4</b>	<b>358.1</b>
Adjusted PATMI	190.3	221.7	298.5	329.4	358.1
<b>BALANCE SHEET (RMB mn)</b>	<b>2015</b>	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>
Cash and Equivalents	341.3	275.9	463.3	727.1	1,032.0
Accounts Receivable	496.7	629.2	805.0	886.0	960.2
Inventory	141.5	145.4	197.8	218.9	237.2
<b>Total current assets</b>	<b>979.5</b>	<b>1,050.6</b>	<b>1,466.1</b>	<b>1,831.9</b>	<b>2,229.4</b>
Net Property, Plant, and Equipment	562.8	549.4	532.5	460.8	380.2
Other assets	43.7	42.5	42.5	42.5	42.5
<b>Total assets</b>	<b>1,585.9</b>	<b>1,642.5</b>	<b>2,041.1</b>	<b>2,335.2</b>	<b>2,652.0</b>
Accounts Payable	210.3	222.7	282.7	312.8	339.0
Borrowings (Current)	144.9	0.0	0.0	0.0	0.0
Other current liabilities	55.4	58.2	58.2	58.2	58.2
<b>Total current liabilities</b>	<b>410.6</b>	<b>280.9</b>	<b>340.9</b>	<b>371.0</b>	<b>397.2</b>
LT Borrowings	0.0	0.0	0.0	0.0	0.0
Other non-current liabilities	0.0	0.0	0.0	0.0	0.0
<b>Total liabilities</b>	<b>410.6</b>	<b>280.9</b>	<b>340.9</b>	<b>371.0</b>	<b>397.2</b>
Shareholder's Equity	1,175.3	1,361.6	1,700.2	1,964.2	2,254.8
Minority Interest	0.0	0.0	0.0	0.0	0.0
<b>Total equity</b>	<b>1,175.3</b>	<b>1,361.6</b>	<b>1,700.2</b>	<b>1,964.2</b>	<b>2,254.8</b>
<b>Total liabilities and equity</b>	<b>1,585.9</b>	<b>1,642.5</b>	<b>2,041.1</b>	<b>2,335.2</b>	<b>2,652.0</b>
<b>CASH FLOW STATEMENT (RMB mn)</b>	<b>2015</b>	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>
<b>Net Profit</b>	<b>195.2</b>	<b>221.7</b>	<b>298.5</b>	<b>329.4</b>	<b>358.1</b>
Depreciation	94.0	96.0	96.9	106.7	115.6
Other non-cash adjustments	9.6	6.5	0.0	0.0	0.0
Changes in working capital	133.2	(124.1)	(168.1)	(71.9)	(66.3)
Deferred taxes	(1.9)	2.7	0.0	0.0	0.0
<b>Cash from operations</b>	<b>430.1</b>	<b>202.9</b>	<b>227.3</b>	<b>364.2</b>	<b>407.4</b>
Capex	(30.4)	(82.6)	(80.0)	(35.0)	(35.0)
Other investing	(19.0)	3.0	0.0	0.0	0.0
<b>Cash in investing</b>	<b>(49.5)</b>	<b>(79.6)</b>	<b>(80.0)</b>	<b>(35.0)</b>	<b>(35.0)</b>
Dividends paid	(31.5)	(33.2)	(45.8)	(65.4)	(67.5)
Equity raised / (bought back)	0.0	(3.2)	85.9	0.0	0.0
Borrowings raised / (repaid)	(120.2)	(148.0)	0.0	0.0	0.0
Other financing	(0.2)	(4.3)	0.0	0.0	0.0
<b>Cash from financing</b>	<b>(151.9)</b>	<b>(188.6)</b>	<b>40.1</b>	<b>(65.4)</b>	<b>(67.5)</b>
FX Effects, Others	(0.1)	0.0	0.0	0.0	0.0
<b>Net increase in cash</b>	<b>228.7</b>	<b>(65.3)</b>	<b>187.4</b>	<b>263.8</b>	<b>304.9</b>
Beginning cash	109.9	338.6	273.3	460.7	724.5
Ending cash	338.6	273.3	460.7	724.5	1,029.4
<b>KEY RATIOS</b>	<b>2015</b>	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>
Core EPS (RMB cents)	40.9	47.7	62.9	68.2	74.1
Core EPS Growth (%)	(13.6)	16.6	32.1	8.3	8.7
DPS (RMB cents)	4.9	7.4	12.7	13.7	14.7
Div Yield (%)	1.0	1.6	2.7	2.9	3.1
Price/Book	1.9	1.6	1.3	1.2	1.0
<b>Profitability (%)</b>					
Gross Margin	26.5	26.5	27.1	26.7	26.7
EBITDA margin	20.6	20.0	18.9	18.9	18.9
Net Margin	10.5	10.9	11.5	11.5	11.5
Return on Equity	17.9	17.5	19.5	18.0	17.0
ROIC	17.8	19.5	21.7	21.3	21.6
<b>Financial Structure (x)</b>					
EBIT / Interest Expense	28.4	71.3	-	-	-
Debt / Capital	0.1	0.0	0.0	0.0	0.0

Source: Bloomberg, KGI Research

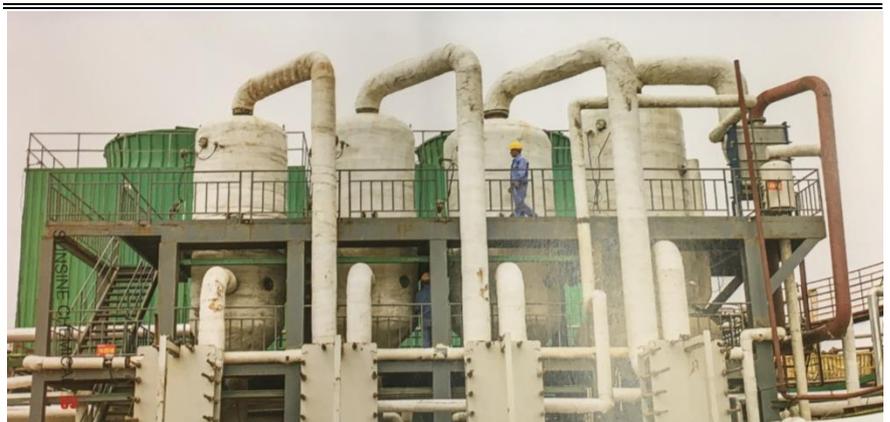
**Appendix**

**Figure 14: Exhaust gas treatment process in Shanxi plant**



Source: Company, KGI Research

**Figure 15: Waste water treatment plant in Shanxi**



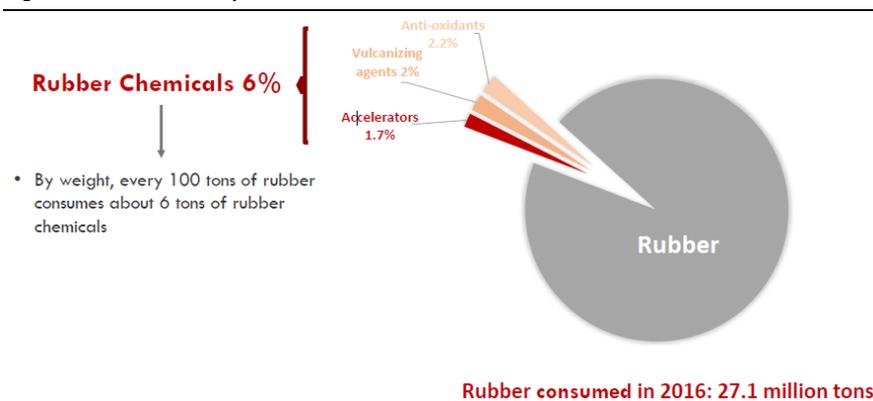
Source: Company

**Table 2: Types of rubber accelerators produced by Sunshine**

Accelerator types	Chemical Group	Vulcanisation Speed	Comments
MBT (M), MBTS (DM)	Thiazole	Semi ultra fast	Most widely used accelerators in the rubber industry for the production of wide variety of goods such as cycle tyres and tubes, footwear, beltings, hoses and other moulded and extruded goods
DPG (D)	Guanidine	Slow	Used along with Thiuram class in Polychloroprene compounds to achieve good processing safety
CBS (CZ), TBBS (NS), DCBS (DZ)	Sulfenamides	Fast-delayed action	Most popular in the tire industry due to their delayed action as well as faster cure rate offered by them during vulcanization of rubber compounds containing furnace blacks.
TMTD (TT)	Thiuram	Ultra fast	Most preferred primary accelerator for sulfur cured low-unsaturation content rubbers like butyl (IIR) and EPDM.

Source: Nocil

**Figure 16: Global consumption of Rubber Chemicals**



Source: Company Presentation

**KGI's Ratings**

Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
<b>BUY</b>	>10% total return over the next 12 months
<b>HOLD</b>	-10% to +10% total return over the next 12 months
<b>SELL</b>	<-10% total return over the next 12 months

**Disclaimer**

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities. This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. You should independently evaluate particular investments and consult an independent financial adviser before dealing in any securities mentioned in this report.

This report is confidential. This report may not be published, circulated, reproduced or distributed and/or redistributed in whole or in part by any recipient of this report to any other person without the prior written consent of KGI Securities. This report is not intended for distribution and/or redistribution, publication to or use by any person in any jurisdiction outside Singapore or any other jurisdiction as KGI Securities may determine in its absolute discretion, where the distribution, publication or use of this report would be contrary to applicable law or would subject KGI Securities and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by KGI Securities to be reliable. However, KGI Securities makes no representation as to the accuracy or completeness of such sources or the Information and KGI Securities accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. KGI Securities and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of KGI Securities and its connected persons are subject to change without notice. KGI Securities reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) KGI Securities, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) KGI Securities, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; and (3) the officers, employees and representatives of KGI Securities may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business".)

However, as of the date of this report, neither KGI Securities nor its representative(s) who produced this report (each a "research analyst"), has any proprietary position or material interest in, and KGI Securities does not make any market in, the securities which are recommended in this report.

Each research analyst of KGI Securities who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of KGI Securities or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including KGI Securities' total revenues, a portion of which are generated from KGI Securities' business of dealing in securities.

Copyright 2017. KGI Securities (Singapore) Pte. Ltd. All rights reserved.