China Chemicals Industry

Accelerating upcycle in the chemical industry

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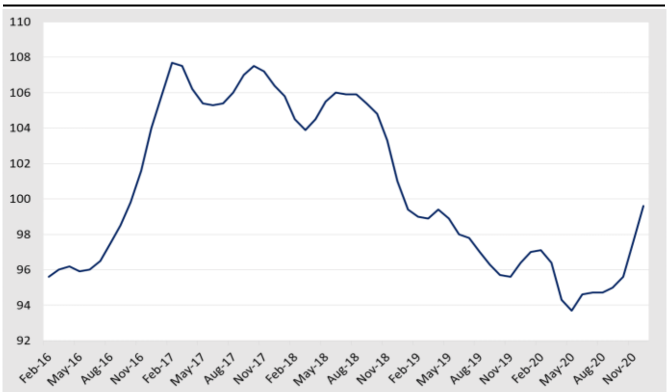
- The world's second largest economy grew by 2.3% in 2020, the only major country to report growth. Industrial production was a significant driver of growth, surging 7% YoY in December 2020.
- We highlight two SGX-listed companies which are benefitting from this upswing in industrial demand and chemical prices – **China Sunsine Chemicals (CSSC SP, TP: S$0.53)** and **Jiutian Chemical (JIUC SP, TP: S$0.155).**

Rising chemical prices. Chemical product prices have turned around since the lows set in April 2020 and have accelerated since November 2020. According to the China chemical producer price index which measures the overall factory prices of chemical products (this includes raw materials, intermediates and end products), the current level was reported at 100 as of December 2020, up 10.1% compared to the low of 90.8 reported in April 2020 and up 5.7% YoY. However, it was still down 10.6% compared to February 2017.

Figure 1: Producer Price Index: Chemical



Previous year = 100
Source: National Bureau of Statistics, KGI Research

The bull cycle is still early. There are currently two key factors upholding the upcycle: demand-pull and cost-push. China is leading the world in terms of containing COVID-19 and has largely resumed production in 1H20. As the epicenter of the earliest outbreak, China initiated the most draconian restriction measures back in February and March 2020. As a result, economic recovery resumed the following month.

Other countries still not fully operational. Meanwhile, other countries and regions, especially the US and Europe, are still reporting a high number of Covid-19 cases. While vaccination has begun, normalization of production and business activities still has a long way to go. Therefore, China has been the only fully operating factory for the world since April 2020. Exports from China grew by 4% YoY in 2020, and this is despite the ongoing appreciation of its currency. China recorded its seventh consecutive months of growth, mainly supported by demand for medical supplies and electronics products for working from home.

Figure 2: China total export growth YoY

Source: National Bureau of Statistics, KGI Research

Rising crude oil prices leads to higher chemical prices. Crude oil is the base of production for most chemical products. With the gradual reopening of economies and the resumption of production and business activities, crude oil demand has steadily recovered. Meanwhile, OPEC and Russia have extended output cuts. US President Joe Biden is pushing for cleaner energy (ie. anti-fracking), and he recently took executive action to temporarily ban oil and gas leasing on public lands in the US.

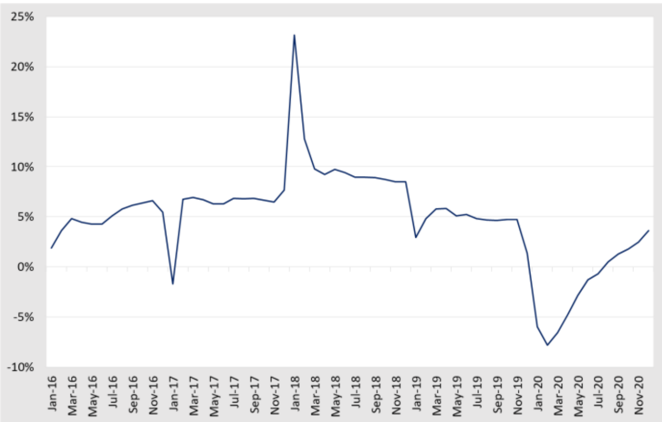
Taking all these into account, crude oil prices have been steadily going up since March 2020 (back then, oil futures dropped to negative for the first time). High crude oil prices will eventually translate to higher prices of chemical products, directly and indirectly, as crude oil is the raw material used to refine and produce other derivatives while petroleum is one of the sources to maintain production.

Figure 3: Brent crude prices

Source: Bloomberg, KGI Research

Other input costs are rising. Other important sources of energy pushing production costs higher are electricity and coal. After entering winter season, China's demand for coal surged in 4Q20. However, owing to geopolitical factors, China sharply cut down the imported coal from Australia during the peak demand period. Consequently, some areas had to initiate a new round of restriction of industrial electricity supply to prioritize residential electricity supply during the period. The unexpected intermittence of industrial production due to power shortage resulted in a wider supply gap which caused average selling prices (ASPs) to spike.

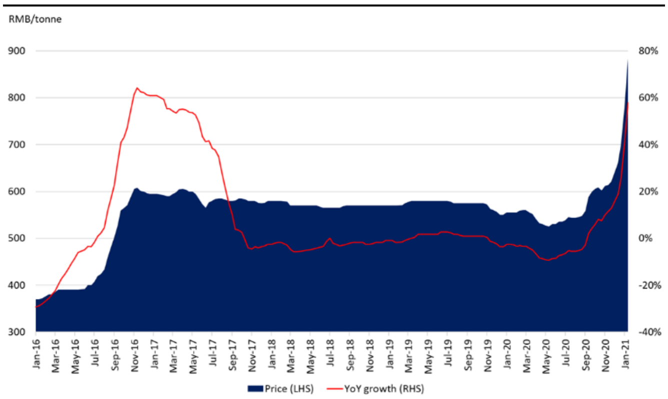
Figure 4: China electricity demand growth YoY



Source: National Bureau of Statistics, KGI Research

On the other hand, coal is not only used for power generation, but also for heating. In the process of producing a significant amount of chemical products, heat is required. China still heavily relies on coal rather natural gas to generate heat. Prices of thermal coal, the main type of coal to generate power and heat, hit a record high in early January 2021. Therefore, it will also factor into higher ASPs for chemical products.

Figure 5: China Shanxi Superior Mixed Coal GAR 5500 coal performance



Source: Bloomberg, KGI Research

Chinese New Year is coming in the next two weeks and travelling during the spring period has started. Factories and production plants will gradually reduce workload. The low season of manufacturing industry will last for at least half a month. Therefore, the supply and demand for chemical products will cool off during the period.

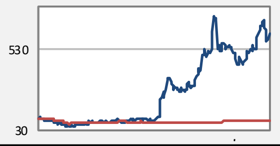
China still pulling growth. However, Europe and US have shown little signs of a significant economic recovery. China remains the locomotive to pull the global economy out of recession. Raw materials and ASPs are expected to correct in the near term, but the upcycle of the chemical industry will not end here. We are upbeat that supply and ASPs will remain buoyant in 1H21.

Two companies to take for the ride. In this report, we highlight two SGX-listed companies that are riding on the cyclical turnaround of the chemical industry. These are China Sunsine Chemical and Jiutian Chemical.

Jiutian Chemical Group

- Average Selling Prices (ASP) are once again near all-time highs as demand remains resilient and supply stays tight. Industry sources point to low inventories in the supply chain, which could lead to even higher ASPs in 2021.
- China's economy has benefited from supply disruptions in the rest of the world. We see this trend continuing this year and could surprise on the upside if trade tensions were to ease under the new US administration.
- On a micro level, Jiutian has focused on improving operational efficiency, raising its utilisation rates in order to take advantage of the favourable environment.
- We do not have formal coverage of Jiutian but estimate that it should trade at least 15.5 Sing cents based on 7x earnings of RMB 201mn in FY2021F.

Not Rated			
Price as of 2 Feb 21 (SGD)	0.100	**Performance (Absolute)**	
12M TP ($)	0.155	1 Month (%)	22.0
Previous TP ($)	-	3 Month (%)	15.9
Upside, incl div (%)	54.8	12 Month (%)	488.2
Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	199		
Issued Shares (mn)	1,988		
Vol - 3M Daily avg (mn)	154.5		
Val - 3M Daily avg ($mn)	14.9		
Free Float (%)	71.9%		
Major Shareholders		**Previous Recommendations**	
Anyang Longyu	27.6%	19-Nov-20	Not Rated
		21-Aug-20	Not Rated



Financials & Key Operating Statistics

YE Dec Rmb	2015	2016	2017	2018	2019
Revenue	678.0	708.5	1124.4	1308.3	1054.5
PATMI	-8.7	0.6	70.8	22.1	-248.4
Core PATMI	-8.7	0.6	70.8	22.1	45.1
Core EPS	-8.7	0.0	3.9	1.2	2.5
Core EPS growth (%)	nm	nm	nm	-68.8	104.5
Core P/E (x)	-5.7	1551.6	12.8	41.2	20.1
DPS (SGCents)	0.0	0.0	0.0	0.0	0.0
Div Yield (%)	0.0	0.0	0.0	0.0	0.0
Net Margin (%)	-1.3	0.1	6.3	1.7	-23.6
Gearing (%)	2.5	18.6	-7.0	13.2	14.4
Price / Book (x)	0.1	2.0	1.7	1.7	3.0
ROE (%)	-1.8	0.1	12.8	3.8	-82.5

Source: Company Data, KGI Research

The bigger the better? Jiutian is now the second largest Dimethylformamide (DMF) producer in China, with a total annual capacity of 150,000 tons of DMF and methylamine (MA). Both these chemicals are important ingredients in industries as diverse as consumer goods, petrochemicals, electronics, pharmaceutical and fertilisers.

Enjoying the good times. DMF and MA are enjoying ASPs that are rising due to favourable supply-demand dynamics. On the supply side, the closure of a competitor that had 180,000 tons of DMF/MA capacity pushed Jiutian to second largest producer in China. Meanwhile, the demand side is experiencing strong momentum from traditional industries like Polyurethane, animal feed and pesticides.

Figure 1: Quarterly operating performance

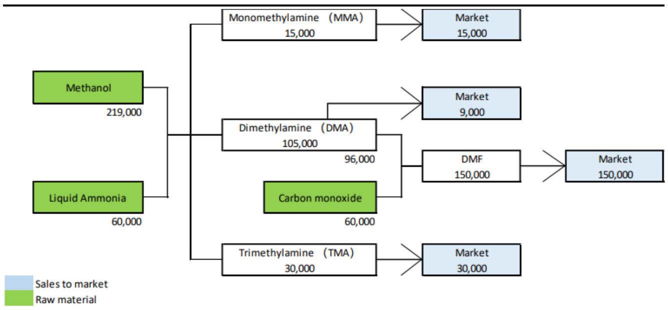
RMB (mn)	1Q 2020	2Q 2020	3Q 2020
Revenue	199.4	276.4	267.0
Net Profit	2.8	32.6	51.3
EPS	0.1	1.6	2.6
Capacity Utilisation	**1Q 2020**	**2Q 2020**	**3Q 2020**
Dimethylformamide	56%	56%	44%
Methylamine	89%	100%	90%
Average Selling Price (RMB)	**1Q 2020**	**2Q 2020**	**3Q 2020**
Dimethylformamide	4,725.0	4,512.0	6,195.0
Methylamine	6,735.0	7,041.0	7,421.0

Source: Company, KGI Research

Getting even better. In addition to the traditional sector demand, Jiutian's chemicals are experiencing rising demand in high growth sectors such electric batteries, semiconductors, electronics, and medicine. At the moment, Jiutian can produce 15,000 tons of Monomethylamine (MMA), which is a versatile building block used in various applications such as lithium batteries.

Accelerated growth via M&A. In management's 3Q20 results briefing, the company is exploring potential acquisition targets in high growth sectors, including downward integration and plant expansion. Given the favourable dynamics in China's chemical sector and the dominant position that Jiutian enjoys, this could be a significant re-rating for its share price.

Figure 2: Jiutian's capacity



Source: Company

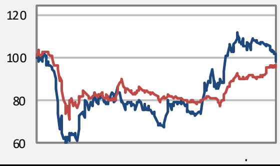
Valuation & Action: Jiutian is worth at least 15.5 Sing cents in our view, based on 7x earnings of RMB 201mn, which we estimate it can achieve in FY2021F based on ASPs of RMB 9,000 and 28% gross profit margins. We expect gross profit margins to sustain above the 3-year average of 10% given the reasons cited earlier.

Risks: Decline in ASP of its two main products, DMF and methylamine, is a key risk to earnings.

China Sunsine Chemicals Holdings Ltd

- We will give a detailed update when China Sunsine's FY20 full year results are out. We currently have an OUTPERFORM rating with a TP of S$0.47. However, in the short term and as a trading opportunity, we recommend a **trading TP of S$0.53** given that the current upward momentum is improving.

Outperform - Maintain			
Price as of 2 Feb 21 (SGD)	0.47	**Performance (Absolute)**	
12M TP (S$)	0.53	1 Month (%)	-6.1
Previous TP (S$)	0.47	3 Month (%)	15.2
Upside (%)	14.0	12 Month (%)	-1.6
Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	451		
Issued Shares (mn)	971		
Vol - 3M Daily avg (mn)	0.9		
Val - 3M Daily avg ($mn)	0.4		
Free Float (%)	37.8%		
Major Shareholders		**Previous Recommendations**	
Success More Group	60.5%	10-Oct-19	OP $0.7
Dimensional Fund Advisors	1.2%	19-Nov-19	OP $0.6
		18-Aug-20	OP $0.47



Financials & Key Operating Statistics

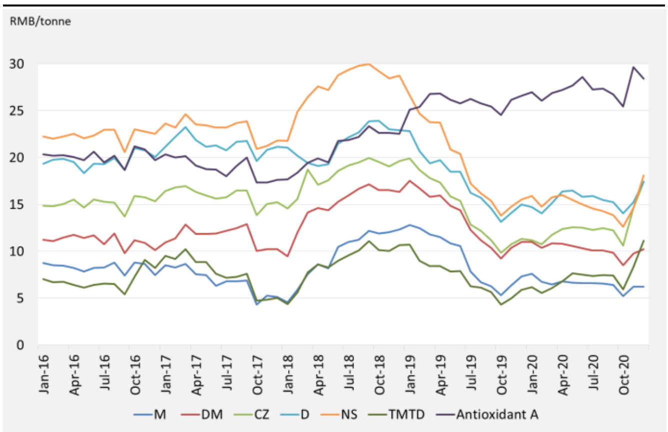
YE Dec (RMB m)	FY17	FY18	FY19	FY20F	FY21F
Revenue	1695.9	3283.3	2691.6	2205.9	2540.1
PATMI	341.3	641.3	388.9	187.0	249.2
Core PATMI	341.3	593.3	388.9	187.0	249.2
Core EPS (RMB cents)	70.8	120.7	79.7	19.2	25.6
Core EPS grth (%)	48.6	70.4	-34.0	-75.9	33.2
Core P/E (x)	4.8	2.8	4.3	8.9	6.7
DPS (SGCents)	3.0	5.5	1.0	0.8	1.0
Div Yield (%)	9.0	16.4	3.0	2.3	3.1
Net Margin (%)	12.5	19.5	14.4	8.5	9.8
Gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Price / Earnings (x)	4.8	2.8	4.3	8.9	6.7
Price / Book (x)	1.0	0.7	0.7	0.6	0.6
ROE (%)	19.6	27.6	15.3	7.0	8.6

Source: Company Data, KGI Research

Profit margin has bottomed out. Rubber chemicals fully turned around in 2020 despite COVID-19. On average, multiple types of accelerators and anti-oxidants dropped to the lows in 3Q19 and formed a double bottom together with the previous lows of 4Q17.

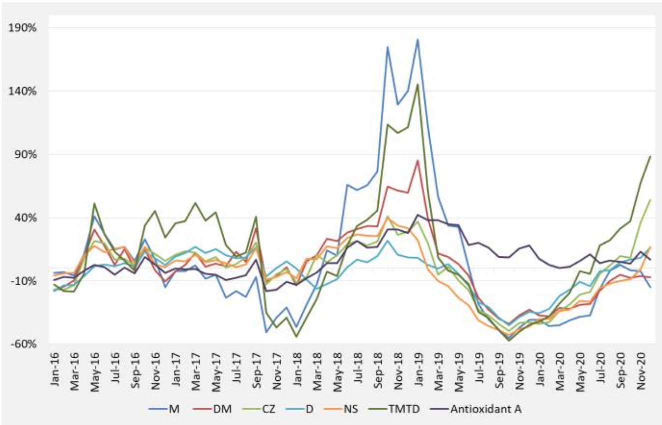
Interestingly, both price spreads and YoY changes touched similar levels in these two periods. We believe that the strong market resiliency is due to the much lower breakeven operating costs for market leaders compared to the medium and smaller players in the market. Therefore, economy of scale is an important moat in the rubber chemical industry.

Figure 1: Price spread between rubber chemicals and aniline



Source: Company, KGI Research

Figure 2: Growth of price spread between rubber chemicals and aniline



Source: Company, KGI Research

Figure 3: Sunsine price gaining a bullish momentum

Source: Company, KGI Research

Valuation & Action: We will give a detailed update after China Sunsine's FY20 full year results. For now, we have an OUTPERFORM rating with a TP of S$0.47. However, for the purpose of short-term trading opportunity, we recommend a **trading TP of S$0.53** given a current improving upward momentum.

Risks: Decline in profit margins due mainly to a drop of ASPs of rubber chemicals.

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Rating	Definition
Outperform (OP)	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.
Neutral (N)	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.
Underperform (U)	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
Not Rated (NR)	The stock is not rated by KGI Securities.
Restricted (R)	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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