

CHINA SUNSINE CHEMICAL: Rides Steady Tyre Demand

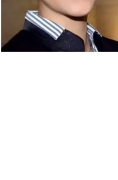
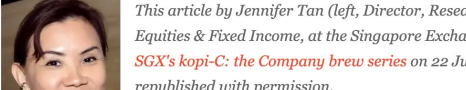
▲ Jennifer Tan 30 June 2018

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This article by Jennifer Tan (left, Director, Research & Products, Equities & Fixed Income, at the Singapore Exchange) was published in SGX's kopi-C: the Company brew series on 22 June 2018. The article is republished with permission.



Liu Jing Fu is Executive Director and CEO of SGX-listed China Sunshine Chemical Holdings Ltd. (Photo: Company)

An avid tea drinker, chemicals industry veteran Liu Jing Fu usually unwinds at the end of a long day with a steaming, amber-coloured brew. He sips black tea during the long winter months, and green tea in spring or summer.

But even during such quiet moments, work is never far from his thoughts.

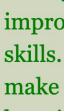
"I spend a lot of time thinking about business strategy and reading," said the Executive Director and Chief Executive Officer of SGX-listed China Sunshine Chemical Holdings Ltd.

"I read articles on the rubber chemicals

industry, to keep abreast of the latest technical developments, and management books, to improve my leadership skills. That's how you make sure you're always learning and building up your knowledge," he added.

Liu, who took on his current role in November 2013, oversees all of China Sunshine's operations and is responsible for the Group's strategic planning. Prior to this appointment, he was the General Manager of the Group's key subsidiary, Shandong Sunshine Chemical Co Ltd.

Before joining China Sunshine in 2006, Liu, 65, served as the Deputy Chairman of both Heze Petroleum Chemical Association and Heze Electrical, Mechanical and Petrochemical Association. He obtained his Bachelor's degree in Chemical Engineering from Shandong Chemical College in 1980, and became a qualified senior engineer in 1993.



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- Liu Jing Fu

CEO
China Sunshine Chemical

Listed on SGX in July 2007, China Sunshine is a key player in the natural rubber industry supply chain. The specialty chemicals company - established in 1977 - started producing rubber accelerators in 1994 in anticipation of rising demand for cars and tyres.

Today, the Group is the world's largest manufacturer of rubber accelerators - with a 20% global share - and China's biggest producer of insoluble sulphur. It counts more than 65% of the Global Top 75 tyre manufacturers - including Bridgestone, Michelin, Goodyear and Pirelli - as its customers.

Its production facilities are located at Shanxian, Weifang and Dingtao in Shandong province, with a total annual capacity of 152,000 tonnes, comprising 87,000 tonnes of rubber accelerators, 20,000 tonnes of insoluble sulphur and 45,000 tonnes of anti-oxidant. It also has a centralised heating plant at Shanxian that generates steam and electricity.

Rubber chemicals are additives blended with natural or synthetic rubber during the manufacturing process. Rubber accelerators shorten the reaction time between rubber and sulphur, while for high-temperature applications, insoluble sulphur is used in place of ordinary sulphur that melts at lower temperatures. Anti-oxidants offer anti-oxidation and anti-degradation properties to boost the quality and extend the lifespan of the final product.

An estimated 90% of the consumption of rubber chemicals is associated with the automobile industry, and 70% of the output is channelled into the production of car tyres.

Established Brand

China Sunshine has a current market capitalisation of over \$8760 million. In the 2018 year-to-date, its shares have generated a total return of more than 75%, outperforming the benchmark Straits Times Index and the broader FTSE ST All-Share Index's total returns of -0.9% and -1.6% respectively.

China Sunshine has recorded a profit every year since the management buy-out led by Chairman Xu Cheng Qiu in 1998. Prior to 2014, the Group chalked up net profits of 100 million yuan or below. But when China stepped up its pollution crackdown in 2014, the Group's earnings surged to around the 200 million yuan level between 2014 and 2016. Last year, when the central government's enforcement actions resulted in a further reduction of rubber chemical capacity, the Group generated a record full-year net profit of 340 million yuan.

Between 2013 and 2017, China Sunshine's earnings and revenues have increased by a compounded annual growth rate (CAGR) of 45.2% and 12.7% respectively.

The Group's balance sheet is also strong - it had zero debt at the end of 2016 and 2017, while cash and cash equivalents stood at 508.7 million yuan as at 31 March 2018, up from 499.6 million yuan as at 31 December 2017.

"We are focused on serving big-volume tyre makers and investing in automation, intelligent manufacturing techniques, and miniaturisation, as well as green production technologies," Liu said.

Despite grappling with intense competition and volatile raw material prices, China Sunshine continues to play to its key competitive strengths, he added.

"We have a wide product range that is reliable, of high quality, and satisfies our customers' needs - in other words, our branding is well-established," Liu said.

"At the same time, our scale keeps our cost of production low. We've also invested heavily - since the early years - in research and development, safety production, as well as environmental protection measures. All of these factors have helped cement our market leadership."

Barriers to entry are high in this industry, which remains tightly regulated by China's stringent environmental protection laws. The Group has benefitted from the government's increased enforcement action against competitors that have failed to meet strict regulatory standards.

"Such actions taken by the government have led to numerous factory closures and impacted industry output. This, in turn, has raised average selling prices as producers have factored in environmental protection costs, and is driving consolidation in the industry," Liu said.

While overall average selling prices (ASPs) jumped by 30% in 2017 over the previous year, this uptrend may not be sustained over the longer term.

"We believe the price of rubber chemicals is likely to normalise gradually, with the bigger players investing more in environmental protection and safety production measures, and some smaller players eventually complying with regulations and resuming their production," he added.

Global peers in the rubber accelerator segment include Tianjin Kemai, with an annual capacity of 51,000 tonnes, and Yanggu Huatai, with an annual capacity of 30,000 tonnes. This compares with China Sunshine's annual capacity of 87,000 tonnes.

Among insoluble sulphur producers in the country, both Yanggu Huatai and Wuxi Huasheng have an annual capacity of 10,000 tonnes each, versus China Sunshine's 20,000-tonne annual output.

This year, the Group is slated to add a 10,000-tonne high-grade TBBS rubber accelerator production line, and a 10,000-tonne insoluble sulphur line. Further capacity expansion is possible with land and ready infrastructure in place, along with its cash hoard of more than 500 million yuan.

♦ Burgeoning Demand

Looking ahead, given its focus on production technology, innovation, and R&D, China Sunshine remains optimistic about its performance, Liu said.

China's rising automobile demand will also provide an added boost, he noted.

The country's appetite for cars has expanded by a CAGR of 12.6% between 2007 and 2017, data from the China Association of Automobile Manufacturers (CAAM) showed.

Last year, China's car sales totalled 28.9 million units, up 3% from 2016, and maintaining the country's position as the largest automobile market, in both demand and supply terms, for the ninth consecutive year.

"Being the world's largest auto market, and with the Chinese population's increased purchasing power, we believe China's car sales will remain robust over the next few years," Liu added.

Likewise, the global tyre market is forecast to expand at a robust CAGR of 6.3% in value terms between 2017 and 2027, reaching a value of about US\$645 billion by end of that period, according to data from Future Market Insights.

TechSci Research has also projected brisk growth in the global automobile market over the next five years, led by the anticipated stabilisation of crude oil prices and global economic growth, which is expected to boost consumer spending, automobile sales, and by extension, tyre demand.

"New car tyre sales typically account for about 30% of the total market, with the remaining 70% coming from replacement demand," he noted.

While the industry outlook remains bright, one issue that hovers at the back of Liu's mind is the Group's talent pool.

"We need to improve the quality of our talent so that we can execute better - that is our greatest challenge," he said, adding that China Sunshine's partnerships with tertiary research institutions like Beijing's Tsinghua University will help boost R&D efforts, and provide a steady source of human capital.

"We want to maintain our focus on our people - they are our key assets and the most important feature of the Group."

"We also pride ourselves on being very customer-focused and service-oriented, and are cognisant of our duty to the community, government and society as a whole."

Liu's unwavering focus reflects his touchstone - Confucianism and its five tenets: 仁 (rén) or benevolence, 义 (yì), referring to righteousness, 礼 (lǐ), meaning courtesy, 智 (zhì) or knowledge, and 信 (xìn), referring to integrity.

"While modern science and education are useful, we cannot afford to overlook or underplay the importance of traditional values, such as filial piety, honesty and kindness, in our daily lives," noted the father of two daughters, both in their 30s.

"It is precisely such values that make us truly human."

Stock price	\$1.52
52-week Range	76.5¢ - \$1.63
Market Cap	\$8747.4m
Price Earnings	8.5 x
Dividend Yield	1.99%
1-Year Return	104%
Source: Bloomberg	

Financial results

Year ended 31 Dec (RMB 'm)	2017	2016	2015
Revenue	2,738	2,037	1,859
Gross Profit	788.1	54.4	492.0
Net Profit	341.3	221.7	195.2

Quarter ended 31 Mar (RMB 'm)	1QFY2018	1QFY2017	yoy chg
Revenue	856.9	574.6	49%
Gross Profit	298.8	140.0	113%
Net Profit	149.5	57.2	161%

Source: Company data

Outlook & Risks

- In 1Q2018, China's GDP grew 6.8%. The country's automakers sold a total of 7.22 million units in China in the quarter, representing a growth of 2.79% YoY.
- The Group believes the price of rubber chemicals is likely to normalise, with the bigger players investing more in environmental protection and safety production measures, and some smaller players eventually complying with environmental protection regulations, and resuming their production.
- With its strong balance sheet and healthy bank balance, the Group is in a good position to stay ahead of the curve and boost production capacity as and when required. It will also continue to focus on production technology and innovation, and investment in R&D, to gain a competitive edge over other producers. It remains positive on its performance over the next 12 months. Project updates:
 - It is still waiting for approval from relevant government authorities for the trial-run of the new Phase 1 10,000-tonne TBBS rubber accelerator production line.
 - It has submitted the trial-run application to relevant authorities for the new 10,000-tonne Insoluble Sulphur production line, and is awaiting approval.
 - The construction of the expansion of Guangshun Heating Plant is completed, and currently undergoing machinery testing. Management is confident of starting the trial-run by end of 2Q 2018.

China Sunshine Chemical Holdings Ltd

Listed on SGX on 5 July 2007, China Sunshine Chemical is a specialty chemical producer selling accelerators, anti-oxidant, vulcanising agents and anti-scorching agents. It is the largest producer of rubber accelerators in the world and has become the largest producer of insoluble sulphur in the People's Republic of China. It serves more than 65% of Global Top 75 tyre manufacturers, including Bridgestone, Michelin, Goodyear, Pirelli, Sumitomo, Yokohama, Hankook, as well as PRC tyre giants such as Hangzhou Zhongce, GITI Tire and Shanghai Double Coin Tyre. China Sunshine distributes its products under its own "Sunsine" brand, which has been accredited as a "Shandong Province Famous Brand". [Business Formation](#)

For the company's financial results for the quarter ended 31 March 2018, click [here](#).

The company website is: [www.chinasunsine.com](#).

The company's Stock Facts page is [here](#).

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