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RESPONSE TO THE QUERIES ON ANNUAL REPORT 2019 FROM SIAS

The Board of Directors (the "**Board**") of China Sunsine Chemical Holdings Ltd. (the "**Company**", and together with its subsidiaries, collectively the "**Group**") wishes to provide the following information in response to queries from Securities Investors Association (Singapore) ("**SIAS**") published on its website with regards to our annual report for the financial year ended 31 December 2019 ("**AR2019**") published and released on 14 April 2020.

<u>Query 1</u>:

FY2018 was a record year for the group as the Chinese government implemented strict environmental protection policies that affected the supply chain. In FY2019, the industry normalised and the group achieved revenue of RMB2.69 billion, which was a decline of 18%, despite a 11% increase in sales volume. Net profit dropped 39% to RMB 388.9 million from FY2018.

The average selling price for the rubber chemicals decreased by 26% to RMB 15,970 per ton in FY2019 as compared to RMB 21,535 per ton in FY2018 (page 10 of the annual report).

As stated in the chairman's statement, in 2019, the group maintained its market leadership position as the world's largest rubber accelerator producer and China's largest insoluble sulphur producer (page 6).

Based on the company's estimate, it commands a 33% market share in the domestic market and a 20% share of the overseas market.

(i) Given that the group has a market leadership position, coupled with its strong environmental focus, how much pricing power does the group have for its products?

(ii) How does the group differentiate itself from other producers?

(iii) What are the levers available to the group to maintain/improve its profit margin?

<u>Company's response</u>:

(i) The Group is the world largest producer of Rubber Accelerators and China's largest producer of Insoluble Sulphur. Our customers are mainly the world's giant tire makers, such as Bridgestone, Sumitomo, Michelin, Goodyear, Pirelli, etc as well as the big Chinese tire makers, such as Hangzhou Zhongce, GITI Tire, Shanghai Double Coin Tyre, etc, which are much bigger than us, and therefore, may have a relatively stronger bargaining power than us, depending on the factors affecting pricing. The Group's Average Selling Price ("**ASP**") are determined based on a lot of factors, such as the pricing trends of raw materials, especially the main raw material Aniline; the demand for our products; the competition we are facing; the customers placing the orders as there may be some variation in the prices quoted to the customers depending on their specific requirements; the types of rubber accelerators purchased by customers,; the terms of the purchases by customers (such as volume for the year, quarter, month); our capacity and actual production for the particular product required; time horizons for delivery, etc. Notwithstanding the above, our ASP is generally higher than the market price due to our brand name. It is also noted that the Group operates in a highly competitive industry, and the main raw material Aniline is a derivative of benzene (ultimately derived from crude oil), and its pricing is readily available in the market, ie such information is readily available to our customers as well.

(ii) The Group has been operating in this rubber chemicals industry since 1995 and has been well recognised by its customers for providing high quality products which consistently meet their requirements, with high reliability of supply, even during periods of disruption (for example during supply chain interruptions due to environmental issues affecting the industry during certain period in the past), thereby earning us goodwill and trust with our customers. Most of our competitors are relatively smaller, and may offer only certain categories of products such as rubber accelerators or anti-oxidants or insoluble sulphur (a vulcanizing agent) or just a few products. However, the Group is unique in its ability to offer the full range of the main rubber chemical products with high quality standards to meet our tire-makers' requirements.

As a testament to the Group's achievement, it was accredited by the China's Ministry of Industry and Information Technology ("**MIIT**") as a China National Champion Manufacturing Enterprise[1]. The selection of the enterprises is organized jointly by MIIT and the China Federation of Industrial Economics ("**CFIE**") and is part of an initiative under the Made in China 2025 strategic plan of the Chinese government that aims to complete the enhancement of 200 Manufacturing Champion enterprises in various market segments by 2020.

In summary, we view our competitive advantage in the following areas - our ability to provide high quality products, large-scale production, full product range of rubber chemicals, competitive pricing due to economies of scale, compliance with national environmental protection laws and regulations, alignment of production, sales and marketing strategy, and continuous innovative production technology. Eventually our goal is to build the Sunsine brand as a world famous brand to better serve the global rubber industry.

(iii) Under current situation of uncertainty, with the evolving COVID-19 pandemic, which has negatively affected the global demand for tires and therefore our products, we understand the challenges faced by our customers and will continue to support them with our reasonable and flexible pricing, which we are able to do due to our strong financial position and zero debt. To maintain or enhance our profit margin, the Group has signed strategic cooperation agreements with certain suppliers to obtain better pricing support with guaranteed purchasing volumes, as well as focus more on improving our operational processes to reduce wastage and control our costs, and look for opportunities to automate our production process to increase productivity. We will monitor and strengthen our cashflow management so that we are able to ride this down-cycle and are well-positioned to support our customers when the demand normalises, which we believe will happen as the replacement tire market is relatively stable and inelastic given that consumers will still need to replace their tires after some time even if they do not replace their vehicles.

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[1] "*Champion Manufacturing Enterprises" are defined as enterprises focusing on specific manufacturing segments for the long-term, with internationally leading technology, and the market share of a single product among the top 3 globally. Awarded enterprises enjoy priority application for a series of programs with funding from the government, including technical support, industrial foundation development, major special projects and energy conservation and emission reduction.*

Query 2:

As noted in the chairman's statement (page 6), the group's 2020 expansion plans include the following 3 projects:

(a) *Phase II 20,000-ton high-end rubber accelerator TBBS project (trial production to be completed by June 2020, and commercial production in the second half of 2020);*

(b) *Phase I 30,000-ton Insoluble Sulphur project located in the Shanxian New Chemical Zone (expected to be completed by the end of 2020); and*

(c) *30,000-ton Anti-oxidant TMQ project located in Shanxian (expected to be completed by the end of 2020)*

The budgets for the above-mentioned projects are RMB 270 million (phase 1), RMB 60 million and RMB 150 million respectively.

(i) *How is the group going to fund the capital expenditure for the 3 projects?*

(ii) *How is management adjusting its plans given that the global supply chain of its customers has been severely disrupted by the COVID-19 pandemic?*

(iii) *Would the three projects be sufficient to propel the group into the next stage of growth or would other investments be made in the near term?*

(iv) *How significant is the risk that the industry will experience overcapacity as competitors ramp up their production capacities as well?*

Company's response:

(i) As at 31 December 2019, the Group's cash and bank balances amounted to RMB 1,279.9 million, and the Group's cash flow remains healthy. The Group intends to fund these 3 expansion projects internally without any borrowings.

(ii) Although the COVID-19 pandemic has severely disrupted the global supply chain, China has largely brought the virus under control and gradually resumed its economic activities. As such, the management does not plan to adjust its expansion plans at this moment and will continue with its original plans, as we believe the demand for our rubber chemicals will eventually come back as our customers' inventory gets depleted over time.

(iii) These three projects will add a total of 80,000 tons per annum capacity to the Group's existing capacity. It will further strengthen the Group's market leadership position. The management believes that these three projects, of which one of them is projected to complete by end of June 2020 and the other two projected to complete by end of 2020, will further propel us ahead of our peers, given that under current situation of uncertainty, only those companies which are financially strong are able to take advantage of the situation by investing in future growth projects and thereby gain a competitive advantage in the industry.

(iv) Some of our competitors are also ramping up their production capacities, but some of the smaller players are facing financial difficulties and are struggling. The management is of the view that, after this pandemic period, our industry will further consolidate, whereby the bigger players will be even bigger, and smaller players will exit the market permanently. As this is a competitive industry, the risk of overcapacity in the industry is real, and over the last 10 years we have seen periods of overcapacity and resultant decline in ASP, and as the industry consolidates, equilibrium is then restored and returns go up.

<u>Query 3</u>:

During the financial year, the group spent RMB19.6 million (SGD 3.9 million) buying back 6.98 million of its own shares (adjusted for stock split) in the open market. These shares are kept as treasury shares as at 31 December 2019.

The average price paid for the treasury shares bought in 2019 is approximately S$0.5575 per share.

Since then, the company has bought back a further 3.38 million shares and kept as treasury shares in 2020. Shares were as low as $0.265 as global markets traded lower due to the pandemic.

The company has carried out a stock split "[t]o increase the liquidity of our shares and broaden the shareholders' base" (page 6).

(i) Would the board reconcile why it carried out a share split to increase liquidity and subsequently carried out regular share buybacks (which would decrease the liquidity)?

As shown in the financial highlights on page 3, the company has a history of carrying out stock buybacks and holding them as treasury shares and then placing out the treasury shares. As much as 27.7 million shares were held as treasury shares in FY2016 before they were placed out in 2017.

(ii) Would the active share buyback distract management from the core operations?

On 26 November 2018, SGX Regco, in its Regulator's Column, had highlighted the risks in companies doing share buy-back.

In particular, companies must not pay more than 105% of the average closing market price of the security over the last 5 consecutive active trading days. In addition, SGX guided that companies should aim to buy back shares at relatively low prices and not be seen to buy at increasing higher prices which could be interpreted as influencing the closing prices.

Also, the regulator stated that purchases that exceeded 30% of the daily on-market traded volume were excessive. Doing so may interfere with the normal trading of shares and result in the artificial inflation of the trading volume and price of the security.

The Regulator's Column on share buy-backs can be found here:
https://www.sgx.com/media-centre/20181126-what-companies-should-observe-whenconducting-share-buy-backs

On 24 March 2020, the company bought back 282,800 shares by way of market acquisition. Based on historical trading data retrieved from SGX, 624,000 shares were traded that day. Accordingly, the company accounted for 45% of the day's trading volume.

(iii) *What is the oversight of the board on the company's share buyback?*

(iv) *Would the board be reviewing the company's share buy-back practices (both in price and volume) to ensure that they are more in line with SGX rules? This would ensure that the company buys back shares in a responsible manner that does not artificially interfere with the price and volume of the security, as noted in the Regulator's Column.*

Company's response:

(i) At the time when the Company undertook the share split, the Company's share price was around S$1.10 and the daily trading volume was approximately 300,000 shares. As such, the Board decided to split the Company's shares in order to increase the liquidity of our shares and broaden the shareholders' base. However, after the split, the trading volume did not significantly increase. It should be noted that trading liquidity of the shares are influenced by, among other things, market sentiments and events which are beyond the control of the Company and which may not be affected by the operating results of the Company. The Company believes that share buyback is one of the ways to reward our shareholders when the market is undervaluing its fundamental value. It is noted that the market may not be efficient at all times, and there are periods of exuberance while there are other periods whereby the market is badly affected by negative sentiments leading to under valuation of the Company. In early 2020, due to the uncertainty of the COVID-19 pandemic, the Company's share price was trading at as low as S$0.265, which was only approximately 0.5 times its net asset value. In order to increase shareholder value and improve the return of equity, the Company bought back some of its own shares and kept them as treasury shares. The Board believes there is no conflict with the share split carried out during end 2019, and its execution of its share buyback mandate that was approved by its shareholders at its last AGM. It should also be noted that the number of shares repurchased is not significant and is unlikely to affect liquidity of the trading of the Company's shares. Based on feedback from its shareholders, the Company's share buyback has been generally welcomed by its shareholders.

(ii) The Company executes its share buyback when it deems that its shares have fallen way below its fair value, ie when it appears to be very undervalued. Such situation has happened during certain periods of time in the past. The Company does not believe that the Management is or will be distracted from its core business by undertaking share buybacks. Normally, when the Company decides to buy back its own shares, our Chief Financial Officer ("**CFO**") will give instructions, including the estimated maximum number of shares and the calculated maximum price allowed under the Company's share buyback mandate, to our designated stockbroker. The share purchase order is then executed based on normal market operations and at the end of the day, the stockbroker provides the details of the filled order to the CFO. Under such circumstances, our CFO is not concerned about the share purchase and price movements during the market day as that is left to our stockbroker, and he is able to focus on the core operational and financial matters. The Company believes that such active share buyback exercises of the Company in the past has increased the confidence of its shareholders in the Company.

(iii) On 24 March 2020, the Company bought back 282,800 shares by way of market acquisition, which accounted for approximately 45% of that day's trading volume. The Board has delegated the execution of share purchases to the CFO as he has the relevant experience and competence, and the Board's trust in discharging this responsibility. As mentioned in (ii) above, our CFO estimated a maximum number of shares to buy on a particular day and then instruct our stockbroker to execute the purchase order. Based on the average trading volume of 1.32 million for 5 trading days before 24 March 2020, our CFO gave instruction to buy back a maximum of 300,000 shares, but did not anticipate or realise that the trading volume for that day was much lower. We have learnt from this episode and will advise our stockbroker to be mindful of SGX RegCo's guideline of not exceeding 30% of daily trading volume in future execution of share buybacks.

(iv) The Company has taken note of this and will ensure that our stockbroker will be reminded in writing to observe this SGX guideline each time instructions are given to execute daily share buybacks on behalf of the Company, and to monitor the trading volume of the Company's shares closely, so that the market price will not be artificially affected by the Company’s shares purchase order.

BY ORDER OF THE BOARD

Xu Chengqiu
Executive Chairman
26 May 2020