

Lianhe Global has affirmed ‘BB’ global scale Long-term Issuer and Issuance Credit Rating to China Hongqiao Group Limited; Issuer Rating Outlook Revised to Stable

HONG KONG, 09 July 2020 – Lianhe Ratings Global Limited (“Lianhe Global”), an international credit rating company, has affirmed ‘BB’ global scale Long-term Issuer Credit Rating to China Hongqiao Group Limited (“China Hongqiao” or “the company”). The Outlook is revised to Stable from Positive.

Lianhe Global has also affirmed ‘BB’ global scale Long-term Issuance Credit Rating to the senior unsecured USD notes issued by China Hongqiao at the same time. A full list of affirmed issuance ratings is included in this press release.

The Issuer Rating affirmation reflects China Hongqiao’s leading market position, economy of scale, vertically integrated production platform and highly self-sufficient production. However, China Hongqiao’s rating is constrained by its relatively flat growth, capacity constraints, concentration of clients and moderately high financial leverage.

The Issuer Rating Outlook revision reflects our expectation that China Hongqiao’s pace of overseas growth will be slower than expected and its operating performance will continue to be impacted in 2020 before gradually recovering in 2021 and 2022 amid the global economic slowdown with sluggish market environment, although its leading market position, economy of scale and cost advantage will continue to support its operating performance and credit profile.

Key Rating Rationales

Leading Market Position: China Hongqiao is one of the world’s largest aluminum producers which mainly focuses on sales of molten aluminum alloy and alumina primarily in China with an annual production capacity of 6.46 million tons. The company has expanded its business to Europe, India and Malaysia. In response to the nation’s environmental protection policies, the company plans to migrate aluminum production capacity of approximately 2,030,000 tons (about one third of its total annual production capacity) to Yunnan Province. Migration of the first one million tons of capacity has been undergoing and is expected to be completed with production ramped up by 2021. The new plants in Yunnan will enjoy clean energy resources and lower electricity costs, with supportive policies from the Yunnan Provincial Government. China Hongqiao would implement the capacity target step-by-step and in stages, including the proposed migration of the company’s certain existing production equipment to the green aluminum innovation industrial park, to avoid an abrupt decline in output during the capacity migration. Annual capex including cost of migration is expected to be c. RMB4-5 billion in the next 12-24 months.

Challenging Market Condition Weighs on Growth: China Hongqiao's aluminum alloy products output recorded a 11.3% y-o-y decrease in 2019, mainly due to the impact of the Chinese government's production restriction during the winter season, the company's replacement of existing production facilities (320 kA and 400 kA) with more advanced facilities (600 kA) and the effects of the rainstorm caused by Typhoon Lekima. The company has increased its effort on the sales of alumina to make up for the lost revenue.

Since the beginning of 2020, COVID-19 has brought significant impact on domestic industrial production, investment and consumption, and at the same time, it also gave rise to profound impact on the global supply chain system. Given the current situation, we expect global economic growth to remain sluggish in 2020 and China Hongqiao to experience a further dip in performance, before gradually picking up in 2021 and 2022. The company's bauxite mine in Guinea has been under production and the company is planning to start construction of alumina and electricity plans there as early as end of 2021, subject to feasibility study currently being conducted.

Vertically Integrated Production Platform: China Hongqiao has established a vertically integrated production platform comprising stable supply of bauxite, refinery plants (of bauxite), one of the world's largest alumina smelters with captive power plants, as well as aluminum fabrication plants etc. The vertically integrated production platform enables China Hongqiao to keep costs under control to stay competitive.

Highly Self-sufficient: China Hongqiao is able to source over 80% of its raw material (i.e. bauxite) and electricity consumption via its vertically integrated production platform. This platform insulates China Hongqiao from market price gyration of the two major cost components of aluminum production: raw material (i.e. bauxite) and electricity. This high degree of self-sufficiency enables China Hongqiao to keep costs under control to stay competitive.

Stable Leverage with Moderate Liquidity: China Hongqiao's leverage in terms of debt over EBITDA is expected to remain stable at 4.5-5x in the next 12-24 months, as the company's business gradually recovers with stabilizing yet slightly improving margins. China Hongqiao has moderate liquidity as it had RMB39.0 billion cash on hand at end-1Q 2020 to cover its RMB30.6 billion debt due in the remaining of 2020. In addition, the company had RMB25.1 billion debt (primarily onshore bonds) to be due in 1H 2021, which represented c. 30% of its debt portfolio at end-1Q 2020. We believe China Hongqiao will be able to refinance such, although market and execution risks remain. China Hongqiao had unutilized credit line of c. RMB15.0 billion at end-1Q 2020.

Rating Sensitivities

We would consider downgrading China Hongqiao's rating if it were to increase to its financial leverage as measured by its EBITDA interest coverage consistently below 3x or debt over EBITDA leverage consistently above 5.5x, or it suffers a significant deterioration in EBITDA margin below 20% consistently.

We would consider upgrading China Hongqiao's rating if it were to successfully execute its overseas projects including the Guinea and Indonesia projects, which results in revenue growth consistently and maintain its current financial leverage as measured by its EBITDA interest coverage and debt over EBITDA leverage commensurate with the 'BB' rating category.

Any rating action on China Hongqiao's rating would result in a similar rating action on the USD notes.

Full List of Issuance Ratings

- USD200 million 7.375% senior unsecured notes due 2023 affirmed at 'BB'
- USD300 million 7.125% senior unsecured notes due 2022 affirmed at 'BB'

About Lianhe Global

Lianhe Global is an international credit rating company that provides credit ratings to corporations, banks, non-bank financial institutions, local government financing vehicles, and other asset classes around the globe. Lianhe Global also provides credit risk research and other services related to credit ratings.

Rating Methodology

The principal methodology used in this China Hongqiao's rating is Lianhe Global's General Corporate Rating Criteria published on 16 July 2018 which can be found at the website www.lhratingsglobal.com.

Note: The above Issuer/Issuance Credit Ratings are solicited at the request of the rated entity or a related third party.

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