Lianhe Global publishes the 'BBB+' global scale Long-term Issuer Credit Rating of Jiangsu Shagang Group Company Limited; Outlook is Stable

HONG KONG, 18 May 2021 – Lianhe Ratings Global Limited ("Lianhe Global"), an international credit rating company, publishes the 'BBB+' global scale Long-term Issuer Credit Rating of Jiangsu Shagang Group Company Limited ("Shagang" or "the company"). The Outlook is Stable.

The Issuer Rating reflects Shagang's competitive market position as the largest private steel producer in China, above average operating efficiency and above industry-average utilization rates, and strong operating cash flow. The company's rating is constrained by its low raw materials self-sufficiency which makes it vulnerable to commodity price fluctuations, slow margin growth in key products amid rising raw materials costs, and relatively high yet stabilizing financial leverage in relation to its "BBB" category credit profile.

The Stable Outlook reflects our expectation that Shagang will sustain a stable and sizable scale of operation, continue to exhibit a prudent manner in reducing and containing its financial leverage, and maintain its positive operating cash flow and liquidity position.

Key Rating Rationales

Leading and the Largest Private Steel Producer in China with Sizeable and Stable Operations: Shagang is one of the largest steel producers in the world and China's largest private steel producer, with a total production capacity of crude steel of c. 42 million tonnes at end-2020. The company was ranked 87th in the China Top 500 Enterprises and 351st in the Fortune 500 list in 2020, following China Baowu Steel Group which was ranked 111st and Hesteel Group which was ranked 218th, making it the top three steel producers from China on the Fortune 500 list in 2020. Shagang primarily focuses its sales in the Eastern China region such as Jiangsu, Zhejiang, Shanghai, which is a key steel consumption area and presents good fundamentals in terms of steel demand.

Under various guidelines and announcements made by the Chinese authorities such as the National Development and Reform Commission ("NDRC") in 2019, we believe that industry consolidation will continue to be the key theme in the next 3-5 years. In order to expand capacity, construction of new facilities is unlikely and mergers and acquisitions will be the primary means to do so.

High Capacity Utilization Rates and Operating Efficiency: Shagang has been maintaining an over 95% utilization rate in its pig iron and crude steel production in the past few years, above industry average, thanks to its continuous investments in the research and technological advancement to aid production streamlining and standardization. Shagang is also able to achieve an increase in per capita crude steel production in the past few years.

In terms of environmental protection and low emission standards, the Chinese authorities such as the Ministry of Ecology and Environment have set goals of upgrading steel production facility to reduce energy consumption, and emissions. Shagang has invested c. RMB6 billion in facilities upgrade for environmental protection, and we expect the company to continue to invest in this area, with annual CAPEX of c. RMB3 billion in the next 12-24 months.

Key Products Faced with Price Fluctuations: Rebars, hot-rolled and wire products accounted for c. 67% of Shagang's production and sales volume in 2020. High value-added products such as cold-rolled products, which command a higher average selling price (ASP), accounted for only c. 7% of its total production and sales volume.

Under the backdrop of the global economic slowdown and the impact of COVID-19, real estate construction activities in China significantly slowed down in Q1 2020. Gradual recovery in steel demand has been seen since 2H 2020. We expect steel demand to continue recovering and increasing in the next 12 months, driven by global stimulus incentives to boost economic growth.

In 2020, the average selling prices (ASP) for Shagang's products experienced a drop in tandem with the industry trend. There were price surges in various steel products in Q1 2021, and we expect prices to stabilize in 2H 2021 and the ASP for Shagang's key products to remain at higher level vis-à-vis 2020's in the next 12-18 months.

***Upstream Expansions Provide Partial Supply Stability Amid Rising Raw Materials Cost; Slight Margins Improvement*:** Shagang has a low self-sufficiency rate in iron ore, with over 90% of needs being sourced externally, a majority from overseas. Decrease in the global supply of iron ore resulted from production disruption and stagnant output growth from key iron ore producers led to an increase in the price of iron ore. We expect the price of iron ore to remain at a relatively high level in the next 12 months.

Shagang has expanded upstream (even though total amount is small) and built long-term relationships with key and reputable raw material suppliers. The Jimblebar and Savage River mines in Australia supply a total of c. 3.4 million tonnes of iron ore to Shagang per annum. Shagang has also established strategic partnerships with reputable coke and coal suppliers such as Shenhua Group, Yankuang Group and Shanxi Coking Coal Group.

With raw materials cost at a relatively high level, despite the better prospect of growth in ASP of steel products, we expect the average per tonne gross margin of Shagang's steel products to improve to c. 15-18% level in the next 12-18 months, as compared with over 20% level in 2017 and 2018.

***Access to Array of Financing Channels; Investments in Financial Products Dilute Cash Position Yet Provide Financial Flexibility*:** Shagang has strong access to an array of financial channels on the onshore capital market. It has established close business relationships with key banks which enable the company to obtain relatively low-cost financing for its operations. At end-2020, Shagang had c. RMB10.7 billion of cash on hand and unutilized credit lines of c. RMB178 billion to cover its short-term debt of c. RMB31.7 billion.

Shagang has been able to generate good operating cash flow and we expect the company to continue to generate c. RMB10-12 billion of operating cash flow per annum in the next 12-24 months. Shagang has a relatively low working capital requirement, particularly in terms of receivables and payables, as sales and procurement are conducted on a payment in advance basis.

At end-2020, Shagang also had c. RMB20 billion of financial products, primarily consisting of short-dated non-high-risk products with tenors ranging from 3-9 months. The average return on these financial products was between 3-5%, which provides another source of financial flexibility though diluting the fully liquid cash position.

***Acquisition of Stakes in Internet Data Centre Owner and Operator Adds to Leverage; Business Potentials to be seen*:** Following the acquisition of a further 24.01% stake in internet data centre owner and operator Global Switch Holdings Ltd. (Global Switch) in 2019, Shagang currently owns c. 51.7% of Global Switch on a see-through basis and consolidates it into its financials. Global Switch has a strong market position in the internet data centre segment. As Global Switch is being run operationally and financially as a standalone entity with minimal involvements and connection with Shagang, and Shagang primarily only exhibits ties via its majority shareholder role, we consider the linkage between Shagang and Global Switch, from a credit perspective, to be weak and assess Shagang's profile on a deconsolidated basis.

Funding for the acquisition of Global Switch added to the financial leverage of Shagang. EBITDA Interest coverage decreased to c. 6-7x in 2019 and 2020 vs c.10-13x in 2017 and 2018. As Shagang gradually controls its financial leverage level, we expect Shagang to maintain an EBITDA/Interest coverage of c. 6x and a debt/EBITDA ratio at c. a 4-5x level in the next 12-18 months.

Shagang targets to leverage its own resources and network in China and Global Switch's strong expertise. That said, short-term synergies will be mostly on the transfer of technological know-hows in assisting Shagang to improve its own data analytical framework, in our view. We also continue to observe developments on any potential restructuring of Global Switch in the near to medium term.

Rating Sensitivities

We would consider downgrading Shagang's rating if it were to (1) aggressively expand into non-core businesses which results in an increase in its financial leverage[1] as measured by total debt/EBITDA to over 5.0x or a decrease in its EBITDA interest coverage to below 6.0x consistently, and/or (2) its operating performance were to deteriorate such that its revenue, margins or operating cash flow experiences a material decline or liquidity profile is worsened.

We would consider upgrading Shagang's rating if it were to (1) considerably increase its operating scale while maintaining competitive position in its core markets, and (2) reduce and

[1] On a deconsolidated basis

maintain its financial leverage[1] as measured by total debt/EBITDA at below 3.0x or EBITDA interest coverage at above 8.0x consistently.

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 Shagang'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.

Contact Information

Primary Analyst
Ben Yau
Director
(852) 3462 9586
ben.yau@lhratingsglobal.com

Committee Chairperson
Alex Kung
Senior Director
(852) 3462 9577
alex.kung@lhratingsglobal.com

Business Development Contact
Joyce Chi
Managing Director
(852) 3462 9569
joyce.chi@lhratingsglobal.com

Disclaimer

Credit rating and research reports published by Lianhe Ratings Global Limited ("Lianhe Global" or "the Company" or "us") are subject to certain terms and conditions. Please read these terms and conditions at the Company's website: www.lhratingsglobal.com

A credit rating is an opinion which addresses the creditworthiness of an entity or security. Credit ratings are not a recommendation to buy, sell, or hold any security. Credit ratings do not address market price, marketability, and/or suitability of any security nor its tax implications or consequences. Credit ratings may be subject to upgrades or downgrades or withdrawal at any time for any reason at the sole discretion of Lianhe Global.

All credit ratings are the products of a collective effort by accredited analysts through rigorous rating processes. No individual is solely responsible for a credit rating. All credit ratings are derived by a credit committee vesting process. The individuals identified in the reports are solely for contact purpose only.

Lianhe Global conducts its credit rating services based on third-party information which we reasonably believe to be true. Lianhe Global relies on information including, but not limited to, audited financial statements, interviews, management discussion and analysis, relevant third-party reports, and publicly available data sources to conduct our analysis. Lianhe Global has not conducted any audit, investigation, verification or due diligence. Lianhe Global does not guarantee the accuracy, correctness, timeliness, and/or completeness of the information. Credit ratings may contain forward-looking opinions of Lianhe Global which may include forecasts about future events which by definition are subject to change and cannot be considered as facts.

Under no circumstances shall Lianhe Global, its directors, shareholders, employees, officers and/or representatives or any member of the group of which Lianhe Global forms part be held liable to any party for any damage, loss, liability, cost, expense or fees in connection with any use of the information published by the Company.

Lianhe Global receives compensation from issuers, underwriters, obligors, or investors for conducting credit rating services. None of the aforementioned entities nor its related parties participate in the credit rating process aside from providing information requested by Lianhe Global.

Credit ratings included in any rating report are solicited and disclosed to the rated entity (and its agents) prior to publishing. Credit rating and research reports published by Lianhe Global are not intended for distribution to, or use by, any person in any jurisdiction where such use would infringe local laws and regulations. Any user relying on information available through credit rating and research reports is responsible for consulting the relevant agencies or professionals accordingly to comply with the applicable local laws and regulations.

All published credit rating and research reports are the intellectual property of Lianhe Global. Any reproduction, redistribution, or modification, in whole or part, in any form by any means is prohibited unless such user has obtained prior written consent from us.

Lianhe Global is a subsidiary of Lianhe Credit Information Service Co., Ltd. The credit committee of Lianhe Global has the ultimate power of interpretation of any methodology or process used in the Company's independent credit ratings and research.