

Pujiang International Group Limited

Initial Issuer Report

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BB-’ global scale Long-term Issuer Credit Rating to Pujiang International Group Limited; Outlook is Stable

Summary

The Issuer Rating reflects Pujiang International Group Limited’s (2060.HK) (“Pujiang” or “the company”) established track record and leading position in the bridge cables and pre-stressed materials markets, and its stable margins. However, the rating is constrained by Pujiang’s limited operating scale and working capital intensive business model with a moderately weak liquidity profile.

The Stable Outlook reflects our expectation that Pujiang will continue to maintain its market position and revenue growth, especially with successfully bidding of key large projects, while remaining prudent on its expansion pace with demonstrated efforts to manage its working capital needs and improve its financial leverage.

Key Rating Rationales

Leading Bridge Cables and Major Pre-stressed Materials Manufacturer in China: Pujiang is a leading bridge cables and major pre-stressed steel materials manufacturer in China with 30 years of experience. It is the largest supplier of bridge cables for the construction of super-long-span bridges in China. The presence of high entry barriers due to the requirement of operating track record, technological know-hows and capital investments characterize the nature of the bridge cables industry with only a few key players dominating the market. The contribution from the bridge cables segment accounted for 38%, 49% and 53% of Pujiang’s revenue and 58%, 66% and 68% of Pujiang’s gross profit in 2018, 2019 and 2020, respectively. We expect the company to maintain its competition market position, despite its limited operating scale.

We expect Pujiang to have moderate growth opportunities and prospects in the next 12-18 months with a revenue growth of c. 20-25% per annum given the Chinese government’s initiatives to boost infrastructure investments and the need to maintain and replace bridge cables. The company will tender for a few large bridge and building projects in 2021 and 2022, which, if successful, could boost the company’s revenue scale in the next two years. We believe Pujiang stands a decent chance to win a few of those projects, given the track record, technology and specifications required.

However, Pujiang’s business is subject to project delays, as shown during the COVID-19 pandemic in 2020. The delays in construction and hence revenue recognition schedule would affect the stability of the company’s financial and operation performance, given the lesser buffer that the company has with a limited scale.

Working Capital Intensive Model and Capital Expenditure Spending Plan Weighs on Cash Flow: Pujiang has high working capital requirements as the company needs to prepay its key suppliers in its bridge cables and pre-stressed materials business, and to provide deposit guarantees for its projects. At end-2019 and end-2020, prepayments amounted to RMB1.09 billion and RMB1.36 billion, and accounted for c. 29.3% and c. 29.6% of its total assets, respectively. Pujiang’s key suppliers and customers are primarily large or state-owned

Summary

Issuer Rating	BB-
Outlook	Stable
Location	China
Industry	Building Materials
Date	19 July 2021

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Applicable Criteria

General Corporate Rating Criteria (16 July 2018)

companies, which present relatively lower counterparty risk. However, Pujiang will need to constantly finance its working capital in order to secure its operation which inherently puts pressure on its operating cash flow.

Pujiang plans to upgrade and expand its production facilities, and invests in building its research and development centres, in the next 2-3 years. We expect capex to be c. RMB150-210 million per annum. Its galvanized pre-stressed materials production capacity is expected to be doubled to 60,000 tons per annum by end-2022, which we believe could aid Pujiang's growth given the currently high demand for such product in China.

Increase in Financial Leverage to Peak in the Near-term; Moderately Weak Liquidity Profile with Reliance Mainly on Short-term Financings: Pujiang's financial leverage, as measured by its total debt/EBITDA, increased sharply from 3.8x at end-2019 to 5.3x at end-2020. The increase in total debt from RMB950 million at end-2019 to RMB1.6 billion (68% increase) at end-2020 was primarily due to the financing for the company's investment in Shanghai International Superconductor Technology Co. Ltd. and preparation of its proposed privatization of its NASDAQ-listed subsidiary Ossen Innovation Co., Ltd. ("Ossen Innovation", 奥盛创新). Pujiang also has 23.4% equity interest in Shanghai Push Medical Device Co., Limited, a medical equipment company. We do not expect these investments to bring in immediate EBITDA impact to the company's financial performance, although there could be opportunities to monetize such investments in 2-3 years.

We expect Pujiang to gradually reduce its financial leverage via containing its debt growth, while improving its EBITDA, in the next 12-18 months. With the fair growth prospect and the company's ability to maintain stable margins (gross margin of c. 25-27% and EBITDA margin of c. 14-16%, on a blended basis), we expect Pujiang's EBITDA to grow in tandem with its revenue growth, and its total debt/EBITDA ratio to gradually come down to 4.0-4.5x in the next 18-24 months.

Pujiang mainly relies on short-term borrowings, which accounted for c. 63% of the company's total debt at end-2020, to finance its operations. The company has established relationship with key banks and has demonstrated track record of rolling over its short-term borrowings. Pujiang's liquidity profile is moderately weak. At end-2020, the company had c. RMB1.1 billion of cash on hand (c. RMB891 million unrestricted) and unutilized credit lines of c. RMB0.6 billion to cover its short-term debt of c. RMB1 billion.

Rating Sensitivities

We would consider downgrading Pujiang's rating if it were to (1) increase to its financial leverage as measured by its EBITDA interest coverage consistently below 2.0x or debt over EBITDA leverage consistently above 5.5x, or (2) it suffers a significant deterioration in operating performance in terms of revenue, margin or cash flow generation, or its liquidity is worsened.

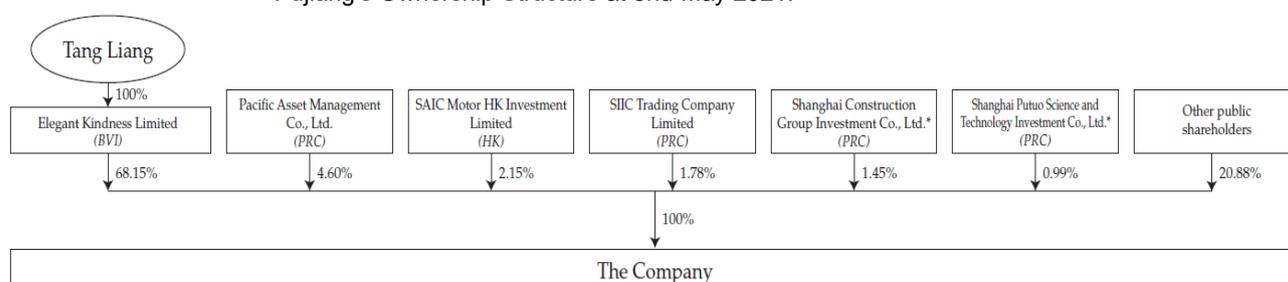
We would consider upgrading Pujiang's rating if it were to significantly improve its operating scale, while continue to demonstrate prudent financial management and maintain its financial leverage as measured by its EBITDA interest coverage consistently above 3.5x and debt over EBITDA leverage consistently below 3.5x, and improve its liquidity position.

Company Profile

Pujiang is a manufacturer and seller of long-span bridge cables and prestressed steel materials in China. It was first established as a state and collective jointly-owned enterprise named Shanghai Pujiang Cable Factory in 1989. It was then converted into a joint stock company and renamed as Shanghai Pujiang Cable Co., Ltd. ("Shanghai Pujiang") in 2001. The company has been listed on the Hong Kong Stock Exchange since 28 May 2019. (Stock code: 2060.HK)

After several shareholding consolidation, Dr. Tang Liang acquired a controlling interest in Shanghai Pujiang through Ossen Group PRC (奧盛集團中國) in 2010 and became the ultimately controlling shareholder of the company. At end-May 2021, Dr. Tang Liang held 68.15% of the company's shares through Elegant Kindness Limited ("Elegant Kindness"), which was wholly owned by himself.

Pujiang's Ownership Structure at end-May 2021:



Source: Pujiang's

Business Profile

Pujiang is principally engaged in the manufacturing and sales of cable and prestressed steel materials for various infrastructure construction like long-span bridge and airport etc. The cables business was operated by its subsidiaries Shanghai Pujiang, Zhejiang Pujiang Cable Co., Ltd. and Shanghai Pujiang Cable Installation Engineering Co., Limited, while the prestressed materials business was operated by Ossen Innovation.

Pujiang acquired a 40% equity stake of Shanghai International Superconductor Technology Co. Ltd. ("Shanghai Superconductor", 上海國際超導科技有限公司), through capital injection of RMB166 million in July 2020, and became the largest shareholder of Shanghai Superconductor. Shanghai Superconductor is principally engaged in the research and development of superconducting cables technologies that can reduce power loss and thus saving energy and improving transmission efficiency. Meanwhile, Shanghai Push Medical Device Technology Co., Limited ("Push Medical", 上海普實醫療器械科技有限公司), a company with 23.4% equity held by Pujiang, has been preparing the application for A-shares listing to the Shanghai Stock Exchange since September 2020. At the same time, Pujiang proposed privatization of Ossen Innovation, a subsidiary with approximately 65.9% of shares held by the company and listed on NASDAQ (stock code: OSN), to streamline the company's corporate structure and improve operational efficiency.

Total revenue of the company was approximately RMB1,947 million in 2020, representing an increase of 7.4% as compared with RMB1,812 million in 2019. This was mainly due to the increase in the revenue from the cable business, which accounted for only c. 38% of the company's revenue in 2018 but c. 53% in 2020. Revenue from the prestressed materials business decreased slightly by c. RMB6 million from 2019 to 2020 due to the decrease in sales of rare earth coated prestressed products, though it was partially offset by the increase in the sales of galvanized products.

Pujiang's reported gross margin was approximately 26.6% in 2020, as compared with 25.2% in 2019. This slightly improvement was mainly due to the increase in revenue from the cable business with a higher profit margin and the increase in gross profit margin of galvanized prestressed products in the company's prestressed materials business.

Revenue (RMB in '000) / % of total	FY2018		FY2019		FY2020	
Cable Business	518,797	37.5%	883,523	48.7%	1,023,893	52.6%
Prestressed Materials Business	864,538	62.5%	928,892	51.3%	923,209	47.4%
Total	1,383,335	100.0%	1,812,415	100.0%	1,947,102	100.0%

Source: Pujiang's 2019-2020 annual reports

Market Position

Pujiang is a leading bridge cables and major pre-stressed steel materials manufacturer in China with 30 years of experience. It is the largest supplier of bridge cables for the construction of super-long-span bridges in China. The presence of high entry barriers due to the requirement of operating track record, technological know-hows and capital investments characterize the nature of the bridge cables industry with only a few key players dominating the market.

We believe the bridge cables and pre-stressed materials markets are expected to continue to grow in the near future in tandem with economic growth, particularly in China, given the macroeconomic dynamics and stimulus initiatives.

Financial Profile

Pujiang has high working capital requirements. We expect the company to continue financing its working capital and capital expenditure primarily via debt instruments. We expect Pujiang to continue having a breakeven level or negative operating cash flow in the next 12-18 months. We expect capex to be in the range of RMB150-210 million per annum. Pujiang has not been paying dividend but it is expected to start paying dividend at a ratio of c. 20%.

We expect Pujiang to gradually reduce its financial leverage via containing its debt growth, while improving its EBITDA, in the next 12-18 months. With the fair growth prospect and the company's ability to maintain stable margins (gross margin of c. 25-27% and EBITDA margin of c. 14-16%, on a blended basis), we expect Pujiang's EBITDA to grow in tandem with its revenue growth, and its total debt/EBITDA ratio to gradually come down to 4.0-4.5x in the next 18-24 months.

Key Assumptions

- c. 20%-25% increase in revenue for 2021-2023
- EBITDA margin of c. 16-19% for 2021-2023
- Annual capex of RMB150-210 million for 2021-2023

Key Financial Metrics

2019A-2023F	Debt/EBITDA	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	5.0x	2.8x	48.6%	0.9x

Source: Pujiang's 2019-2020 annual reports, Lianhe Global's adjustments and forecasts

Liquidity

Pujiang's liquidity is moderate. The company had total cash on hand of c. RMB1.1 billion (unrestricted cash of RMB891 million) at end-2020, compared with its short-term debt of RMB1 billion. The company also had unutilized bank credit facilities of c. RMB0.6 billion.



The company relies on short-term borrowings, which accounted for c. 63% of the company's total debt at end-2020, to finance its operations. Pujiang has established relationship with key banks and has demonstrated track record of rolling over its short-term borrowings.

Appendix I: Pujiang's Rating Factors

Rating Factors	Weight	Initial Rating
I. Market Demand Analysis	15.0%	bb+
II. Business Analysis¹	45.0%	b+
III. Financial Analysis²	40.0%	bb-
IV. Base Score	100.0%	bb-
V. Industry Risk		bbb
Base Rating		bb-
VI. Qualifiers		
Liquidity		Neutral
Corporate Governance		Neutral
Debt Structure and Financial Policy		Neutral
Idiosyncratic Analysis		Neutral
Stand-Alone Creditworthiness (SAC)		bb-
VII. External Support		
Corporate Entity Support		Not Applicable
Issuer Credit Rating		BB-/Stable

Source: Lianhe Global

¹ Business Analysis contains sub-factors of market position, diversification, competitive position, operating efficiency and profitability.

² Financial Analysis contains sub-factors of debt/EBITDA, EBITDA interest coverage, debt/capitalization and quick ratio.

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