Jiangsu Shagang Group Company Limited

Surveillance Report

Summary	
Issuer Rating	BBB+
Outlook	Positive
Location	China
Industry	Steel
Date	4 November 2021

Operating Data:
Jiangsu Shagang Group Company Limited

	31 Dec 2019	31 Dec 2020
Total Revenue (RMB: in million)	144,231	152,911
Production Capacity[1] (Tonnes: in million)	76	76
Utilization Rate (Pig Iron)	98.4%	100%
Utilization Rate (Crude Steel)	97.7%	96.7%
Utilization Rates (Steel Products)	98.9%	98.3%

1) Excluding associated companies
Source: Shagang

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Applicable Criteria
General Corporate Rating Criteria (16 July 2018)

Lianhe Global has affirmed 'BBB+' global scale Long-term Issuer and Issuance Credit Rating of Jiangsu Shagang Group Company Limited ("Shagang" or "the company"); Issuer Rating Outlook Revised to Positive.

Summary

The Issuer Rating reflects Shagang's competitive market position as the largest private steel producer in China, operating efficiency and above industry-average utilization rates, and operating cash flow generation capability, which aid its financial deleveraging efforts. The company's rating is constrained by its low raw materials self-sufficiency which makes it vulnerable to commodity price fluctuations, operational concentration and the lack of diversification into high value-added products on a relative basis.

The Positive Outlook reflects our expectation that Shagang will sustain a stable and sizable scale of operation, while continue to improve its financial leverage below the quantitative threholds of our upgrade scenario, and maintain its improved margins, positive operating cash flow and liquidity position.

Rating Rationale

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 has been maintaining a steady production capacity and output and is expected to continue the trend given the supply side reform. We believe 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 very unlikely and mergers and acquisitions will be the primary means to do so. In May 2021, Anyang Iron & Steel (安阳钢铁) and the company signed a letter of intent to conduct mixed-ownership reform (混合所有制改革) with an intent for the company to be a controlling shareholder. If this initiative succeeds, Shagang's market position in terms of total production capacity could further solidify.

The company was ranked 87th on the China Top 500 Enterprises and 308th on the Fortune 500 list in 2021, following China Baowu Steel Group who was ranked 72nd and Hesteel Group who was ranked 200th. Shagang's sales primarily focus on the Eastern China region such as Jiangsu, Zhejiang and Shanghai, which is a key steel consumption region and presents decent fundamentals in terms of steel demand.

High Capacity Utilization Rates and Operating Efficiency: Shagang has been investing in the research and technological advancement to aid production streamlining and standardization. The company has also been investing in facilities upgrade for environmental protection and operating efficiency, in line with the national policy. We expect the company to continue to invest in this area, with annual capex of c. RMB5-6 billion in the next 12-24 months.

In terms of technological indictors, Shagang has been able to decrease per tonne energy consumptions and gas/waste products emissions, and maintain an over 95% utilization rate in its pig iron, crude steel and steel products production in the past three years, verse an industry average of c. 80%.

Price of Key Products on Increasing Trend; Expected to Stabilize in the Short- to Medium-Term: Rebars, hot-rolled and wire products continued to account for c. 65-70% of Shagang's production and sales volume in 2020, largely unchanged from that in 2019. High value-added products such as cold-rolled products, which command higher average selling prices (ASP), accounted for only c. 7-8% of the total production and sales volume. Rebars are key materials in the real estate industry while hot-rolled products are used in heavy industries such as auto manufacturing.

The two major consumption markets for steel products are construction (real estate and infrastructure) and general industrials. These markets generally present supply and demand cyclicality. With the gradual recovery of the global economy and the various economic initiatives around the globe, demand for steel products is expected to stay steady. In 2019 and 1H 2020, ASP for Shagang's products experienced drop in tandem with the industry. Since the beginning of 2021, ASP for Shagang's key products have exhibited a strong uptrend, especially for cold-rolled products. The increase in steel prices has already put pressure on downstream industries, and the various government policies such as export restriction and cancellation of tax rebates are expected to lead to a stabilization of the ASP for steel products in the next 12-18 months.

Rising Raw Materials Cost Partially Offsetting Product Price Increase; Limiting Margin Growth: Iron ore, coal and coke are the key materials in steel production, with iron ore making up over 50% of steel producers' production cost. Shagang has a low self-sufficiency rate in iron ore, with over 90% of needs being sourced externally, of which a majority is from overseas. Economic recovery has resulted in increases in commodity prices, and procurement cost for iron ore and coke increased notably in 1H 2021. Cost for iron ore has decreased slightly since Q3 2021 which partially alleviates the situations. We expect raw material costs to remain at a relatively high level in the next 12-18 months, vis-à-vis the level in 2018- 2020.

Shagang has a 10% stake in Wheelarra JV, which owns the Jimblebar mine in Western Australia. The company also owned Grange Resources Limited, which owns the Savage River mine in Australia. The Jimblebar and Savage River mines supply a total of c. 3.5 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. The increase in raw material prices have partially offset the increase in ASP of key products. We expect average per tonne gross margin of Shagang's steel products to be at c.16-18% level in the next 12-18 months.

Access to Array of Financing Channels; Cash Flow Generation Capability to Remain Intact Aiding Deleveraging: Shagang has strong access to an array of financial channels on the onshore market. It has established close business relationships with key national banks to obtain relatively low-cost financings. The company has also tapped the offshore bond market with a debut issuance of USD300 million in May 2021. At end-June 2021, Shagang had c. RMB10.1 billion of cash (c. RMB7.6 billion unrestricted) on hand and unutilized credit line of c. RMB111.1 billion to cover its short-term debt of c. RMB23.3 billion. Shagang has been able to demonstrate operating cash flow generation capabilities and we expect the company to continue to generate c. RMB12-13 billion of operating cash flow per annum in the next 12-24 months. Shagang has relatively low working capital requirement, particularly in terms of receivables and payables, as sales and procurements are conducted on payments in advance basis.

Excluding Global Switch Holdings Limited ("Global Switch"), which continues to be run independently from an operational and financial perspective, Shagang's reported total debt decreased from c. RMB56.3 billion at end-2019 to c. RMB53.2 billion at end-2020, and to c. RMB50.4 billion at end-June 2021. EBITDA Interest coverage was c. 9.2x in 2020, compared with c. 6.7x in 2019 and 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. 9-10x and a debt/capitalization ratio at c. 40% level in the next 12-18 months.

Shagang targets to leverage its own resources and network in China to promote Global Switch's strong market position and expertise in China, with a plan to set up pilot points in tier 1 cities such as Shanghai, to ultimately make Global Switch a strong big data player in China. Business potentials of such a plan remains to be seen, and 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.

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

Company Profile

Shagang is a Chinese steel producer that focuses on producing a series of steel products which are widely used in construction, shipbuilding, automobiles and other fields. It was established in 1975 and became the largest private steel enterprise in China after years of developments. Shagang's two subsidiaries, Jiangsu Shagang Co., Ltd. and Grange Resources Limited, are listed on the Shenzhen Stock Exchange (002075.SZ) and Australia Stock Exchange (GRR.ASX) respectively.

Mr. Shen Wenrong, the chairman of Shagang, is Shagang's controlling shareholder. Mr. Shen holds the company's shares directly by himself and indirectly through Zhangjiagang Free Trade Zone Runyuan Stainless Steel Trade Co., Ltd. (张家港保税区润源不锈钢贸易有限公司) at end-June 2021.

Shagang's Shareholding Structure as of 30 June 2021

Shareholder	Percentage
Shen Wenrong	29.3%
Zhangjiagang Bonded Zone Xinghengde Trade Co., Ltd.	29.1%
*Zhangjiagang Free Trade Zone Runyuan Stainless Steel Trade Co., Ltd.	17.7%
Others	23.9%
Total	**100.0%**

Note:
**Zhangjiagang Free Trade Zone Runyuan Stainless Steel Trade Co., Ltd. is 50.0% owned by Shen Wenrong and 48.3% owned by Zhangjiagang Bonded Zone Xinghengde Trade Co., Ltd.*

Source: Shagang

[1] On a deconsolidated basis

Key Financial Assumptions

- No increase in production capacity with utilization rates above 95% for 2021-2023
- Average per tonne gross margin of c. 16-18% for 2021-2023
- Annual capex of c. RMB5-6 billion for 2021-2023

Key Financial Metrics

2019A-2023F	Debt/EBITDA	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Avg	2.43x	10.19x	44.04%	0.29x

Source: Shagang's annual reports and Lianhe Global's adjustments and forecasts

Full List of Issuance Ratings

A full list of affirmed issuance rating is included below. Any action on Shagang's rating would result in a similar rating action on its USD notes:

- USD300 million 3.30% senior unsecured bonds due 2024 affirmed at 'BBB+'

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