Lianhe Ratings Global

Rating Report
1 November 2022

Jiangsu Shagang Group Company Limited

Surveillance Report

Summary	
Issuer Rating	BBB+
Outlook	Positive
Location	China
Industry	Steel
Date	1 November 2021

Operating Data:
Jiangsu Shagang Group Company Limited

	2020	2021
Total Revenue (RMB: in million)	149,355	184,138
Total Production Capacity (Million tonnes)	77.0	81.5
Utilization Rate (Pig Iron)	100%	91.8%
Utilization Rate (Crude Steel)	96.7%	105.3%
Utilization Rates (Steel Products)	98.3%	98.7%

Source: Shagang

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Applicable Criteria
General Corporate Rating Criteria (31 December 2021)

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 remains 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 rate, and operating cash flow generation capability. Although Shagang's revenue and profitability are under pressure, partially owing to the weakening demand caused by the property market downturn and Covid's disruption in China, we expect them to recover gradually in the next 12-24 months as the government's investment in infrastructures could support the demand for steel products. The company's rating, however, is constrained by its low self-sufficiency in raw materials, which makes it vulnerable to commodity price fluctuations, operational concentration and relatively lack of diversification into high-value-added products.

The Positive Outlook reflects our expectation that Shagang will sustain a stable and sizable scale of operations, positive operating cash flow and its healthy liquidity position. In addition, we expect the company to continue deleveraging with the proceeds from the potential disposal of Global Switch Holdings Limited ("Global Switch"), although this effort may be partially offset by the potential acquisition of Nanjing Nangang Iron & Steel United Co., Ltd. ("Nanjing Iron") It is a Jiangsu-based steel producer with crude steel production capacity of c. 10 million tonnes, and we expect, if succeeded, the acquisition to further solidify Shagang's market position.

Rating Rationale

Leading and the Largest Private Steel Producer in China with Sizeable and Stable Operations: Shagang is China's largest privately-owned steel producer measured by crude steel output. Shagang was one of the top domestic crude steel producers in China in 2021, with a total output of c. 44 million tonnes, following China Baowu Steel Group's c. 120 million tonnes and Ansteel Group's c. 56 million tonnes, both being state-owned enterprises. Shagang's sales primarily focus on Eastern China regions such as Jiangsu, Zhejiang and Shanghai, a key steel consumption area.

High-Capacity Utilization Rates and Operating Efficiency: Shagang has been investing in research and technological advancement to aid production streamlining and standardization. The company has also been investing in facility upgrades for environmental protection and operating efficiency, in line with national policy. As a result, Shagang has decreased per tonne energy consumption and gas/waste product emissions and maintained a high utilization rate at over 95% in the past three years, compared to the industry average of c. 80%. We expect the company to continue to invest in this area, with an annual capital expenditure of c. RMB2.5-4.0 billion in the next 12-24 months.

Weakening Demand Pressures Shagang's Revenue and Profitability; Gradual Recovery Expected in the Next 12-24 months: Shagang reported strong revenue in 2021, which increased by 23.9% to RMB180.5 billion from RMB145.7 billion in 2020, excluding Global Switch. This was mainly driven by the high ASP supported by demand recovery and the high raw material (iron ore and coke) prices. The adjusted gross margin also increased to 16.2% from 14.0% over the same period.

The trend, however, reversed in the first half of 2022, partially owing to the property market downturn and Covid's disruption, causing a weak demand for steel products. As a result, the company's ASP was under pressure while the cost of production remained high. We expect 2022's whole-year revenue to decrease by c. 10%, and the adjusted gross margin to shrink to c.10%.

Nevertheless, we expect the steel market to stabilize in the next two years, considering the government has initiated large-scale infrastructure investments as the countercyclical policy, which could support the steel demand in the short to medium term. At the same time, steel production is unlikely to increase significantly amid China's supply-side reform. In addition, imported iron ore costs are expected to decrease, given weak overseas demand. Overall, we expect Shagang's organic revenue to decrease slightly while its adjusted gross margin to improve in 2023.

Disposal of Global Switch Could Support Shagang's Financial Deleveraging: Shagang used its strong cash flow from operation to deleverage in 2021. As a result, its financial leverage, as measured by adjusted gross debt/capitalization, decreased to 43.0% at end-2021 from 51.1% at end-2020. The adjusted Debt/EBITDA ratio was also reduced to c. 2.1x from c. 2.8x over the same period. Yet the weakening sales and profitability, as well as the acquisition of Nanjing Iron, would push up the company's financial leverage again in 2022. However, we expect the disposal of Global Switch to bring additional cash in for Shagang, allowing it to continue its financial deleveraging effort in the next two years.

Acquisition of Nanjing Iron Could Solidify Shagang's Market Position: We believe industry consolidation will continue to be the key theme amid Chinese supply-side reform. To expand capacity, the construction of new facilities is very unlikely, and mergers and acquisitions will be the primary means to do so. On 14 October 2022, Shagang entered an Investment Framework Agreement with Fosun Group to acquire a 60% stake of Nanjing Iron, which had a crude steel production capacity of 10 million tonnes. If succeeded, Shagang could further solidify its market position as the third largest steel producer in China and also its market share in Jiangsu and Eastern China.

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 as measured by total debt/EBITDA to over 5.0x or a decrease in its EBITDA interest coverage to below 6.0x consistently, on a deconsolidated basis, and/or (2) its operating performance were to deteriorate such that its revenue, margin 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 a competitive position in its core markets, and (2) maintain its financial leverage as measured by total debt/EBITDA at below 3.0x or EBITDA interest coverage at above 8.0x consistently, on a deconsolidated basis.

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 China's largest private steel enterprise after years of development. 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, a director 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 2022.

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

Key Financial Assumptions

- Utilization rates above 95% for 2022-2024
- Adjusted gross margin of c. 10-12% for 2022-2024
- Annual capex of c. RMB5-6 billion for 2022-2024

Key Financial Metrics

2020A-2024F	Debt/EBITDA	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	3.4x	8.5x	35.7%	0.6x

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

Full List of Issuance Rating

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 bonds:

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

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