Jiangsu Shagang Group Company Limited

Surveillance Report

Summary	
Issuer Rating	BBB+
Outlook	Stable
Location	China
Industry	Steel
Date	30 October 2023

Operating Data:
Jiangsu Shagang Group Company Limited

	2021	2022
Total Revenue (RMB: in million)	187,915	173,635
Utilization Rate (Pig Iron)	91.8%	95.5%
Utilization Rate (Crude Steel)	105.3%	103.9%
Utilization Rates (Steel Products)	98.7%	94.7%

Source: Shagang

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Applicable Criteria
General Corporate Rating Criteria (31 December 2021)
General Corporate Rating Criteria: Addendum (30 August 2022)

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 Stable.

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. 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-valueadded products.

The Stable 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 exhibit a prudent manner in containing its financial leverage. Although Shagang's revenue and profitability are under pressure mainly given the weakening industry demand, we expect them to stabilize gradually in the next 12-24 months.

Rating Rationale

Weakening Demand on Steel Products, Slow Recovery Ahead: The demand for steel products has been undermined since 2022, which was mainly due to the weak property market. The demand for building materials, which is one of the major consumption markets for steel products, continues to suffer from the weak property construction activities. On the other hand, in view of stimulating the economic recovery, the Chinese government supports the infrastructure construction activities, which may benefits the demand for steel products. Moreover, the demand of steel products on some other industries, such as car manufacturing and shipbuilding, remains solid. Having said that, the demand for these activities could only partially offset the impact from the deteriorating demand from the property industry.

Following the decline to the trough in steel demand since 2022, we expect the steel demand is likely to stabilize in the next 12-24 months. At the same time, we expect the recovery is likely to be a slow one until a significant turnaround in the property market.

Decline in Revenue and Profit Margin, Flexible Strategies in Response: In view of the weakening demand of steel products as mentioned, Shagang implemented some alterments in its operation strategies. For instance, the company lowered its inventories volume and made it more closely tied with the sales order volume, which lowered its inventory risk and the capital employed. Also, Shagang switched some of its existing production capacities from products with weak demand (such as building materials) to other products with relatively solid demand.

Shagang's reported total revenue dropped by 7.6% year-on-year to RMB173.6 billion in 2022 (or RMB169.4 billion if excluding Global Switch). This trend continued as the company reported another 13.2% year-on-year decrease on its reported total revenue to RMB75.3 billion in 1H2023. The drop in revenue was mainly due to the decrease in both ASP and sales volume of its major products. Although there was slight decrease in the raw material cost at the same time, Shagang's reported gross margin still dropped to 7.9% in 2022, compared with 14.4% in 2021. Nevertheless, its reported gross margin stabilized and slightly rebounded to 8.6% in 1H2023. We expect Shagang's reported total revenue and gross margin is likely to stablilize in the next 12-24 months, given its cost control measures. The possibility of the recovery will hinge on the recovery of its sales volume.

Withdrawal from Potential Acquisition on Nanjing Iron, Uncertainty on the Timing of Global Switch's Disposal: On 16 October 2023, Shagang signed an agreement to voluntarily withdraw from the transaction involing the potential acquisition of stake in Nanjing Iron. Shagang will receive a compensation following the withdrawal. While we believe this potential acquisition will push up Shagang's financial leverage, we expect the withdrawal will make room for the company to reallocate its financial resources for deleveraging in the next 12-24 months. Shagang does not have plans of significant acquisiton and capacity expansion which may involve a large amount of capital expenditure at the moment.

Also, the disposal plan for the Global Switch is still in progress, but it remains uncertain on the consideration and timing of the disposal. We believe the transaction will help to improve Shagang's financial position, but we are concerned if Shagang is able to complete the transaction in the near term.

Continuous Effort in Deleveraging: Deleveraging remains one of Shagang's operation target. Shagang's financial leverage, as measured by gross debt/capitalization, increased slightly to 44.0% at end-2022 from 43.0% at end-2021, given the company was preparing for the potential acquisition of Nanjing Iron during the period. We expect Shagang's financial leverage to stabilize in the next 12-24 months, following the withdrawal from the acquisition of Nanjing Iron and steady capital expenditure given no significant capacity expansion plan.

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 2023.

Shagang's Shareholding Structure at end-June 2023	
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

- Reported gross margin of c. 9-11% for 2023-2025
- Utilization rates above 95% for 2023-2025
- Annual capex of c. RMB3 billion for 2023-2025

Key Financial Metrics

2021A-2025F	Debt/EBITDA	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	3.7x	8.1x	39.5%	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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