

China Hongqiao Group Limited

Surveillance Report

Summary

Issuer Rating	BB+
Outlook	Positive
Location	China
Industry	Metals and Mining (Aluminum)
Date	30 April 2024

Operating Data:

China Hongqiao Group Limited	2022	2023
Revenue (RMB: in million)	131,699	133,623
Reported Gross Margin (%)	13.8	15.7
Annual Production Capacity of aluminum alloy (Tons: in million)	6.5	6.5
Production Volume of aluminum alloy (Tons: in million)	6.0	6.3

Source: China Hongqiao

Analysts

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Applicable Criteria

General Corporate Rating Criteria (31 December 2021)

Lianhe Ratings Global Limited (“Lianhe Global”) has affirmed ‘BB+’ global scale Long-term Issuer and Issuance Credit Ratings of China Hongqiao Group Limited; Issuer Rating Outlook remains Positive

Summary

The Issuer Rating reflects China Hongqiao Group Limited’s (1378.HK) (“China Hongqiao” or “the company”) established leading market position, cost advantage backed by its vertically integrated production platform and economy of scale, as well as the steady financial performance supported by the prevailing high aluminum prices. However, China Hongqiao’s rating is constrained by the cyclical nature of the aluminum industry and its regulation and concentration risks.

The Positive Outlook reflects our expectation that China Hongqiao will maintain its profit margin recovery, operating performance and improve its operating efficiency, given its strong cash generation capability and its advanced cost advantage. Moreover, the production capacity migration will further enhance the company’s competitive advantage.

Rating Rationale

Steady Revenue Growth with Solid Aluminum Price Ahead: China Hongqiao reported a year-on-year growth of 1.5% for its total revenue to RMB133.6 billion in 2023. The revenue growth was mainly attributed to the increase in sales volume of aluminum alloy products and alumina products, though it was partially offset by the ASP decline of its major products.

Aluminum alloy products, which is China Hongqiao’s major source of income and contributed 70.8% of the total revenue in 2023, recorded a 5% increase in sales volume and a 6.4% decrease in ASP in 2023. On the other hand, alumina products recorded a 25% surge in sales volume with a slight ASP decline of 0.8% in 2023. As a result, the contribution of alumina products to the total revenue increased to 19.9% in 2023, compared with 16.2% in 2022.

The aluminum price has been in the rising trend since the beginning of 2024, which was mainly driven by the increasing domestic demand supported by the economic recovery, as well as the production capacity ceiling imposed by the Chinese government. Given the global environmental regulations and concerns on aluminum production, together with the limitation and restrictions of energy supply (such as electricity, coal, etc.) in China, it is unlikely that the aluminum supply will experience any significant increase driven by any significant expansion of production capacity. Together with the continuous recovery on aluminum demand, the prevailing demand-supply dynamics should be favorable to the aluminum price, which is likely to either stay flat or achieve a moderate growth in the next 12 months.

Profitability Recovery Given the Stabilizing Raw Material Cost: China Hongqiao’s reported gross margin rebounded to 15.7% in 2023, compared with the trough of 13.8% in 2022. The declining and stabilizing raw material cost helped the gross margin recovery of China Hongqiao’s aluminum alloy products to 17.4% in 2023, representing a 3.9 percentage points increase from 13.5% in 2022.

The raw material cost surged in 2022, which was mainly led by the complex market situation and accelerating inflation. Nevertheless, it has been stabilizing from the peak since 2023. Except for the uncertainty led by the event-driven risk and tightening of environmental regulations, the raw material cost is likely to stay flat in the next 12 months. It would be favorable for China Hongqiao to maintain or improve its profit margin in the next 12 months.

Production Capacity Migration on the Way: In response to the environmental protection policies in China and to enhance its cost competitiveness, China Hongqiao is migrating its aluminum production capacity to Yunnan Province. The company expects that the migration of c. 2 million tons of production capacity in Wenshan Autonomous Prefecture, Yunnan Province, will be completed by the end of 2024. Following the increasing demand for aluminum production powered by clean energy, the capacity migration is likely to strengthen China Hongqiao's competitive advantage in the aluminum industry in China.

Leading Market Position and Cost Advantage Remains Intact: China Hongqiao maintains its market position as the world's leading aluminum producer. The company possesses one of the world's largest aluminum and alumina production capacities, which consists of 6.46 million tons of aluminum and 19.5 million tons of alumina. Also, China Hongqiao has established a vertically integrated production platform comprising a stable supply of bauxite, refinery plants (of bauxite), one of the world's largest alumina smelters with captive power plants, as well as aluminum fabrication plants, etc.

The vertically integrated production platform enables China Hongqiao to keep costs under control to stay competitive. China Hongqiao has signed long-term contracts with its upstream raw material suppliers and it has also established long-term business relationships with its downstream clients. Given its economies of scale and vertically integrated production platform, the company enjoys a substantial cost advantage. Considering that there is little product differentiation for aluminum, we believe being the lowest-cost producer is critical in the aluminum industry.

Tightened Liquidity Despite Improved Financial Matrix: Following the continuous achievement in deleveraging and optimizing capital structure, China Hongqiao's total debt increased slightly to RMB63.4 billion at end-2023 from RMB60.1 billion at end-2022, but remained low compared with end-2021 and before. Given the increase in the equity base, the company's debt capitalization ratio decreased further to 37.3% at end-2023 from 38.3% at end-2022.

China Hongqiao's financial leverage, as measured by debt over EBITDA, lowered to 2.8x at end-2023 from 3.2x at end-2022. At the same time, its interest coverage ratio also improved to 6.9x at end-2023 from 6.2x at end-2022.

China Hongqiao's unrestricted cash increased to RMB31.7 billion at end-2023 from RMB27.4 billion at end-2022. However, its reported short-term debts increased to RMB49.1 billion at end-2023 from RMB43.4 billion at end-2022. As a result, its unrestricted cash/short-term debt ratio remained low at 64.5% at end-2023. Nevertheless, China Hongqiao maintains smooth access to the capital market including equity placement, offshore and onshore bond issuance, convertible bond issuance, etc., which offer the company an ample buffer to the market volatility.

Rating Sensitivities

We would consider downgrading China Hongqiao's rating if (1) it were to increase its financial leverage as measured by its EBITDA interest coverage consistently below 4.0x or debt over EBITDA leverage consistently above 4.0x, or (2) it suffers a significant

deterioration in operating performance in terms of revenue, margin or cash flow generation, or its liquidity is materially worsened.

We would consider upgrading China Hongqiao's rating if (1) it maintains its operating performance, and (2) it migrates its production capacity to Yunnan province smoothly without compromising its operation efficiency, reducing its production and sales volume, and (3) it continues to demonstrate prudent financial management and maintain its financial leverage as measured by its EBITDA interest coverage and debt over EBITDA leverage consistently.

Company Profile

China Hongqiao is a leading large-scale aluminum producer that mainly focuses on producing and selling aluminum and aluminum products in China. It was established in 1994 by Mr. Zhang Shiping (father of the current Chairman Mr. Zhangbo) and has been listed on the Hong Kong Stock Exchange (1378.HK) since 2011.

Zhang's family was the largest shareholder and held c. 64.2% stake of China Hongqiao through Trust Company at end-2023. CITIC Group Corporation continued to be the strategic cooperater of China Hongqiao and was the second-largest shareholder, holding c. 12.0% shares of China Hongqiao.

China Hongqiao's Shareholder Structure at end-2023

Shareholder	Percentage
Hongqiao Holdings ⁽¹⁾	64.1%
Mr. Zhang Bo	0.1%
CITIC Group Corporation ⁽²⁾	12.0%
Other Public Shareholders	23.8%
Total	100.0%

(1) Wholly owned by a trustee who holds such interests in shares on behalf of the Zhang's Family

(2) Mainly held by CTI Capital Management Limited, a subsidiary of CITIC Group Corporation. The rest was held by other CITIC Group Corporation's other subsidiaries.

Source: China Hongqiao

Key Financial Assumptions

- Reported gross margin: c. 17% in 2024-2026
- Capital expenditure: RMB8-9 billion per annum for 2024-2026

Key Financial Metrics

2022A-2026F	Debt/EBITDA	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	2.5x	7.6x	35.6%	0.6x

Source: China Hongqiao's annual reports and Lianhe Global's adjustments and forecasts

Full List of Issuance Ratings

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

- USD500 million 6.25% senior unsecured notes due 2024 affirmed at 'BB+'

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