

Fitch Publishes Jiangsu Shagang Group's First-Time 'BBB-' Rating; Outlook Stable

Tue 18 May, 2021 - 上午 2:05 ET

Fitch Ratings - Hong Kong - 18 May 2021: Fitch Ratings has published China-based steel-maker Jiangsu Shagang Group Co., Ltd.'s Long-Term Foreign-Currency Issuer Default Rating and foreign-currency senior unsecured rating of 'BBB-'. The Outlook is Stable.

The ratings are supported by Shagang's leading cost position, large operating scale, strong profitability, cash-flow generation and an adequate financial structure. The Stable Outlook reflects our expectation that Shagang's operation will remain steady and its business and financial profiles will stay strong.

KEY RATING DRIVERS

Large Chinese Steel Producer: Shagang is China's third-largest and the world's sixth-largest steel producer, with total crude steel production of 41 million tonnes (mt) in 2020, including associate companies. It has a leading market position in eastern China, where over 40% of domestic steel products are consumed, with the country accounting for half of the globe's steel production. Shagang offers a range of high-value-added products, such as cold-rolled coil and special steel that is used in automobiles, home appliances, shipbuilding and high-end engineering.

High Efficiency, Low-Cost Position: Shagang's production base in Zhangjiagang city is the world's largest steel plant with 23mt of crude steel produced in 2020. The company maintains a utilisation rate of over 95%, which is significantly higher than the industry average of around 80%. This, as well as economies of scale and efficient cost management, contribute to Shagang's positions on the first and second quartile of global steel cost curve, according to CRU.

Strong Financial Profile: Shagang maintains a strong financial profile, as indicated by robust cash flow generation and low net leverage. It had a high EBITDA margin of around 18% in 2017-2018, but the higher iron ore price drove the margin down to around 11% in 2019-2020. We expect the EBITDA

margin to rebound and remain at 12% from 2021, given strong steel demand and continued supply-side rationalisation efforts.

Shagang had low net leverage, as measured by total net debt with equity credit/operating EBITDA, of below 1.5x in 2017-2018. This increased to 2.0x in 2019-2020 following its acquisition of global data-center service provider, Global Switch Holdings Limited (BBB/Stable) as well as lower profitability. However, we expect leverage to gradually fall back to around 1.0x by 2023 on continued positive free cash flow generation and a moderate capex plan. We forecast healthy EBITDA interest coverage of around 10x, given the company's low borrowing costs.

Deconsolidation of Global Switch: Fitch rates Shagang on a standalone basis and deconsolidates its 51.71% owned subsidiary, Global Switch. This is because the subsidiary operates independently in terms of business operation and financing, bolstered by a shareholder agreement that gives Global Switch management control of its operation.

DERIVATION SUMMARY

Shagang's peers include ArcelorMittal S.A. (AM, BB+/Positive), China Baowu Steel Group Corporation Limited (A/Stable; Standalone Credit Profile: bbb), Gerdau S.A. (BBB-/Stable), PAO Severstal (BBB/Stable), PJSC Novolipetsk Steel (NLMK) (BBB/Stable) and PJSC Magnitogorsk Iron & Steel Works (MMK, BBB/Stable).

AM is the world's second-largest steel producer by output and installed capacity, with leading positions in its key regions. It is the most diversified steel producer by product type and geography and benefits from increased vertical integration into iron ore; it meets more than half of its iron ore needs from its own output. Shagang's business profile is less competitive, but this is offset by its stronger financial structure.

Baowu has become the world's largest steel company after its merger with Magang Group Holding Co. Its Standalone Credit Profile is supported by its large operational scale and geographical diversification across China. Baowu and Shagang have similar financial profiles with adequate coverage and leverage metrics.

Gerdau is comparable in scale with Shagang. It is geographically diversified across the Americas and its electric arc furnace-based profile provides high operating flexibility. Gerdau also has a similar leverage profile due to its

asset-divestment strategy, which has led to a significant reduction in gross debt. We expect its leverage to stay at around 2.5x.

Russian peers PAO Severstal, NLMK and MMK have stronger cost positions than Shagang, as they sit in the first quartile of the global steel cost curve due to higher raw-material integration, domestic currency weakness against the dollar and lower energy costs. Their leverage profiles are among the strongest in the steel industry, with FFO gross leverage sustained at below 1.5x.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Revenue of CNY178 billion in 2021 to normalise to CNY157 billion in 2023 (2020: CNY149 billion)
- EBITDA margin of around 12% from 2021 to 2023 (2020: 11%)
- Capex of CNY5 billion a year from 2021 to 2022
- Investment outflow of CNY3 billion a year from 2021 to 2023

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Higher vertical integration and product diversification into more value-added products

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Total net debt with equity credit/operating EBITDA exceeding 2.5x for a sustained period
- Steel-making gross profit/t of below CNY450 for a sustained period

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Comfortable Liquidity: Shagang had readily available cash of CNY9 billion and short-term debt of CNY32 billion at end-2020. It had unused uncommitted facilities of CNY178 billion, but we believe this is appropriate, as committed facilities do not exist in China. Shagang also has CNY20 billion in wealth-management products, which it says are short-term bank wealth-management products that are raised to earn interest spread and have a maturity schedule that matches its bank borrowings. We reclassify CNY18 billion of these wealth-management products as cash in Shagang's leverage, as the assets are invested in low-risk fix-income instruments, including policy bonds, government bonds and central bank notes.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ENTITY/DEBT	RATING ACTIONS	
		RATING
Jiangsu ShagangLT Group Co., Ltd.	IDR	BBB-
senior unsecured	LT	BBB-
		Publish
		Publish

[VIEW ADDITIONAL RATING DETAILS](#)

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

- [Corporate Rating Criteria \(pub. 22 Dec 2020\) \(including rating assumption sensitivity\)](#)
- [Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\) \(including rating assumption sensitivity\)](#)
- [Sector Navigators - Addendum to the Corporate Rating Criteria \(pub. 01 May 2021\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

- Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 ([1](#))

ADDITIONAL DISCLOSURES

- [Dodd-Frank Rating Information Disclosure Form](#)
- [Solicitation Status](#)
- [Endorsement Policy](#)

ENDORSEMENT STATUS

Jiangsu Shagang Group Co., Ltd. EU, UK Endorsed

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