

Media Release:

Taiwan-Based China Steel Structure Co. Ltd. Outlook Revised To Negative On Similar Parent Action; 'twA-/twA-2' Ratings Affirmed

April 16, 2020

Rating Action Overview

- Taiwan-based China Steel Structure is the first local company to specialize in steel structure production. It had EBITDA of NT\$370 million in 2019.
- We recently revised down the outlook on China Steel Structure's parent company, China Steel, to negative from stable. The ratings and outlook on China Steel Structure will move in the same direction as those on its parent company.
- We expect China Steel Structure's ratio of EBITDA interest coverage to stay above 3x with sufficient buffer during the current down, supporting by a declining steel price.
- On April 16, 2020, we revised our outlook on the long-term issuer credit rating to negative from stable. At the same time, we affirmed our 'twA-/twA-2' issuer credit ratings on China Steel Structure.
- The negative outlook reflects the outlook on the parent China Steel and indicates a likely deterioration in the parent company's credit metrics in 2020 and the downside risk around the timing and strength of an operating recovery.

Rating Action Rationale

The ratings and outlook on CSS follow those on its parent company. The outlook revision on **China Steel Structure Co. Ltd.** follows our earlier outlook revision on the long-term rating on its parent company, **China Steel Corp.** This reflected the weakening fundamentals in the global steel industry. The downturn is likely to have a negative effect on the operating performance of China Steel and its subsidiary Dragon Steel Corp. over the next 12-24 months. We believe China Steel's ratio of funds from operations (FFO) to debt could fall below 12% in 2020 due to the slump in demand amid the spread of the COVID-19 outbreak and potential oversupply mainly from Chinese manufacturers.

The ratings on China Steel Structure reflect our view that the company is a strategically important member of the China Steel Corp. We assess China Steel Structure to be of strategic importance to the parent China Steel group by helping to maintain the group's position in the domestic steel market. The ratings also reflect China Steel Structure's leading position in Taiwan's steel structure market and the company's strong interest coverage.

PRIMARY CREDIT ANALYST

Irene Lai
Taipei
+886-2-8722-5825
irene.lai
@spglobal.com
irene.lai
@taiwanratings.com.tw

SECONDARY CONTACT

Jin Dong, CFA
Taipei
+886-2-8722-5821
jin.dong
@spglobal.com
jin.dong
@taiwanratings.com.tw

However, weak profitability amid intensive competition, as well as the company's high debt leverage and heavy reliance on short-term debt to support its working capital needs offset these credit strengths.

Outlook

The negative outlook on China Steel Structure reflects the negative outlook of the China Steel Corp. group, and our expectation that China Steel Structure will remain a strategically important subsidiary over the next two years. The negative outlook reflects our expectation a deterioration in China Steel's ratio of FFO to debt to 9%-12% in 2020 from 13.6% in 2019. There exists substantial downside risk on the rating due to a possible lengthy period before governments bring the COVID-19 outbreak under control, which could lead to a delayed and dampened recovery in demand. This may curb China Steel's ability to restore its cash flow generation to the pre-outbreak level or uplift its ratio of FFO to debt back above 12% over the next 12-18 months.

Downward scenario

We could lower the long-term rating on China Steel Structure if:

- we lower the stand-alone credit profile of China Steel which could occur if China Steel's ratio of FFO to debt weakens to below 12% for an extended period such as if the company's profitability weakens significantly. The potential reasons for this weakening are:
 - A prolonged COVID-19 outbreak that seriously damages the global economy and curbs its ability to recover, leading to an extensive industry downturn with shrinkage in demand and intense competition,
 - Persistently high raw material prices that weaken the company's margin materially, or
 - China Steel's adoption of a much more aggressive capex plan that curbs the company's ability to deleverage, which will keep its debt at an elevated level for an extended period.
- we believe China Steel Structure's relationship to the group and potential group support weakens, as indicated by a decline in China Steel's ownership in the company, or
- China Steel Structure's EBITDA interest coverage worsens to below 3x for an extended period, which may result from a deteriorating operating margin caused by stiffer competition.
- China Steel Structure's profitability weakens due to material losses.

Upward scenario

We could revise the outlook back to stable if:

- we revise the outlook on China Steel Corp. to stable because China Steel's ratio of FFO to debt has returned to 12% or above on a sustainable basis. This could happen if governments are able to effectively contain the COVID-19 outbreak and a subsequent economic recovery pushes the steel industry back on track over the next 12 months.

Ratings Score Snapshot

Issuer Credit Rating: twA-/Negative/twA-2

Note: The descriptors below are on a global scale.

Business Risk: Fair

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- **Country risk:** Intermediate
- **Industry risk:** Moderately High
- **Competitive position:** Fair

Financial Risk: Aggressive

- **Cash flow/Leverage:** Aggressive

Anchor: twbbb

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Negative (-1 notch)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Less than adequate (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile (SACP): twbbb-

- **Group stand-alone credit profile:** twa+
- **Entity status within group:** Strategically important (+3 notches from SACP)

Related Criteria & Research

Related Criteria

- Criteria | Corporates | Industrials: Key Credit Factors For The Engineering And Construction Industry - November 19, 2013
- General Criteria: Group Rating Methodology - July 01, 2019
- Understanding Taiwan Ratings' Rating Definitions, www.taiwanratings.com - June 26, 2018
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities - November 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Media Release: Taiwan-Based Steel Producer China Steel Corp. Outlook Revised To Negative On Weak Demand; 'twAA-/twA-1+' Ratings Affirmed, www.taiwanratings.com - April 16, 2020

(Unless otherwise stated, these articles are published on www.standardandpoors.com, access to which requires a registered account)

Ratings List

Ratings Affirmed; Outlook Revision

	To	From
China Steel Structure Co. Ltd.		
Issuer Credit Rating	twA-/Negative/twA-2	twA-/Stable/twA-2

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