

Media Release:

Chung Hung Steel Corp. Outlook Revised To Stable Following Similar Parent Action; 'twA/twA-1' Ratings Affirmed

April 28, 2023

Rating Action Overview

- **Chung Hung Steel Corp.** is a specialized downstream steel processor with production capacity of 2.4 million tons for hot-rolled coils and revenue of new Taiwan dollar (NT\$) 44.5 billion in 2022.
- We recently revised the rating outlook on Chung Hung's parent company, **China Steel Corp.**, to stable from positive. We view Chung Hung as a highly strategic subsidiary of China Steel; therefore, the ratings and outlook on Chung Hung move in tandem with those on the parent.
- The downward outlook revision on China Steel reflects China Steel's weakened profitability and rising capex, and therefore our view that the company is unlikely to enhance its ratio of FFO to debt to above 30% over the next two years.
- We have affirmed our 'twA' long-term and 'twA-1' short-term issuer credit ratings on Chung Hung Steel.

Rating Action Rationale

Outlook revision follows our similar action on China Steel. The outlook revision on Chung Hung Steel follows the same action we took on the outlook on our long-term rating on its parent, China Steel. This action incorporates our view that a rebound in steel demand will be delayed amid uncertainty over the pace of global economic recovery. China Steel's profitability and operating cash flow generation have weakened during 2022 and into the first quarter of 2023 but are likely to improve from the second half 2023. Furthermore, persistent high capital expenditure (capex) for facility upgrades, construction of China Steel's offshore wind farm, and funding for prework of a blast furnace revamping planned for 2025 could constrain improvement in China Steel's debt leverage over the next two years. We forecast the parent's ratio of funds from operations (FFO) to debt will remain between 20%-25% in 2023-2024, which is below our 30% upward rating trigger.

The ratings on Chung Hung Steel reflect our view of the company's role within the China Steel group. We view Chung Hung Steel as a highly strategic member of the China Steel group. This reflects the fact that China Steel is the single largest shareholder with about a 40% shareholding in Chung Hung Steel which gives China Steel control over Chung Hung Steel's board of directors. Chung Hung Steel's operations are very important to the group to maintain a dominant share in the domestic steel market. Therefore, we assess the long-term rating on Chung Hung Steel at one

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notch below China Steel's stand-alone credit profile, and the ratings and outlook on Chung Hung will move in tandem with those on its parent.

Outlook

The stable rating outlook on Chung Hung Steel reflects the stable outlook on China Steel, given our view of Chung Hung Steel as a highly strategic subsidiary. The outlook reflects our view that China Steel's profitability could recover gradually in 2023-2024, underpinned by delayed demand recovery for steel products from the second half of 2023. We anticipate that China Steel's debt will remain flat due to improving operating cash flow generation, despite rising capex. These factors could strengthen China Steel's ratio of FFO to debt to 20%-25% in 2023-2024.

Downward scenario

We could lower the long-term rating if:

- China Steel's ratio of FFO to debt weakens to close to 12% for an extended period, possibly due to (a) a prolonged industry downturn with contraction in demand and intense competition, (b) persistently high raw material prices that materially squeeze the company's profit margin, or (c) China Steel adopts a much more aggressive capex plan that curbs its ability to deleverage and results in elevated debt for an extended period; or
- China Steel's link with the Taiwan government weakens from our current assessment of strong, which may happen if the government materially lowers its ownership stake. However, we view this scenario to be remote over the next two years.

Upward scenario

We may raise the long-term rating if:

- China Steel could sustain its profitability and lower its debt, such that the ratio of FFO to debt stays above 30% on a sustainable basis. Such improvement could be achieved by (a) continued debt reduction through strong operating cash flow generation without aggressive investments and capex or (b) China Steel's cost competitiveness and product mix further strengthen, accompanied by a sustained demand and supply balance in the regional steel market.

Ratings Score Snapshot

Issuer Credit Rating: twA/Stable/twA-1

Note: The descriptors below are on a global scale

Business Risk: Weak

- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Weak

Financial Risk: Significant

- Cash flow/Leverage: Significant

Anchor: twbbb

Modifiers

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

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Stand-alone credit profile: twbbb

- Group stand-alone credit profile (which excludes external support): twa+
- Entity status within group: Highly strategic (one notch below the group credit profile)

ESG credit indicators: E-2, S-2, G-2

Related Criteria & Research

Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021
- 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: Principles Of Credit Ratings - February 16, 2011

Related Research

- Media Release: China Steel Corp. Outlook Revised To Stable On Weaker Demand, Rising Capex; 'twAA-/twA-1+'Ratings Affirmed – April 28, 2023
- Taiwan Ratings' Ratings Definitions – November 11, 2021

(Unless otherwise stated, these articles are published on www.taiwanratings.com)

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Chung Hung Steel Corp.		
Issuer Credit Rating	twA/Stable/twA-1	twA/Positive/twA-1

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.taiwanratings.com for further information. Complete ratings information is available to subscribers of Rating Research Service at rrs.taiwanratings.com.tw. All ratings affected by this rating action can be found on Taiwan Ratings' public website at www.taiwanratings.com.

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