



RATING ACTION COMMENTARY

Fitch Revises Outlook on Shanghai Huayi to Stable from Positive; Affirms at 'BBB-'

Fri 04 Jun, 2021 - 3:41 AM ET

Fitch Ratings - Hong Kong - 04 Jun 2021: Fitch Ratings has revised the Outlook on Chinese chemical company Shanghai Huayi (Group) Company (Huayi) to Stable from Positive and affirmed the Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB-'.

The Outlook revision reflects Huayi's higher-than-expected leverage ratio in 2020. This and the new project investments and ramp-ups over 2021-2022 will result in slower deleveraging than Fitch previously forecast. The ratings were affirmed as Huayi's business profile and government support are intact, as is our expectation of improvement on the leverage profile from 2021.

Huayi is a state-owned enterprise (SOE) owned by the Shanghai State-owned Assets Supervision and Administration Commission (Shanghai SASAC). Fitch assesses the company's ratings on four factors set out in our Government-Related Entities (GRE) Rating Criteria, resulting in a two-notch uplift from its Standalone Credit Profile (SCP) of 'bb'.

KEY RATING DRIVERS

Slower Deleveraging with High Capex: We do not expect Huayi to be able to reduce leverage to below our positive trigger of 3.0x by 2023 after FFO net leverage more than doubled in 2020 to 4.7x from 2.2x in 2019. The increase was due to lower demand and weaker average selling prices (ASP) of chemical products following the Covid-19 pandemic, and high capex to expand capacity. We expect capex to remain high in

2021-2022 as Huayi continues the second and third phases of the Guangxi project to add capacity for new materials, which will offset meaningful margin recovery in 2021.

Margin Recovery and Scale Enhancement: Huayi's EBITDA margin started to recover in 2021 after falling to 6.1% in 2020 due to demand recovery and increasing ASP of coal chemical products as oil prices rebounded. Fitch expects EBITDA margin to increase to 10% in 2021, driven by a favourable market environment and additional capacity from the Guangxi project. The new project focuses on high-margin new materials, which will contribute on EBITDA improvement from 2023 while expanding Huayi's business scale.

'Strong' State Control and Support: Fitch assesses Huayi's status, ownership and control by the Shanghai government as 'Strong' because the company is strategically important to the city as the sole chemical corporation owned by Shanghai SASAC. Huayi remains 100%-owned by Shanghai SASAC. It undertakes scientific research projects in advanced materials for sectors such as national defence, large aircraft and alternative energy.

Shanghai SASAC has provided support to Huayi consistently in the form of direct subsidies and capital injections, especially for its R&D in specific chemical projects. Therefore, we have assessed the support track record factor at 'Strong'.

'Moderate' Impact on Funding: Fitch assesses the financial implications of a Huayi default as 'Moderate' because the company is an active domestic bond issuer, but its size is moderate compared with other Shanghai SOEs. A default of Huayi would only have a moderate impact on the funding market access of other Shanghai SOEs. Fitch assesses the socio-political impact of a Huayi default as 'Weak' because the company operates in a highly competitive market with a large number of players and substitute products.

Strong Linkage with Subsidiary: Fitch fully consolidates Huayi's 42.5% owned A-share listed associate, Shanghai Huayi Group Corporation Limited (Shanghai Huayi), in its analysis of Huayi as the two companies have strong operational and strategic linkages as per Fitch's Parent and Subsidiary Linkage Rating Criteria. This is evident from Huayi and its subsidiaries having significant deposits placed with and borrowings from Shanghai Huayi's financial company, which acts as the Huayi's centralised treasury. Huayi and its subsidiaries as well as Shanghai Huayi also provide raw materials to each other.

DERIVATION SUMMARY

Fitch uses a bottom-up approach to rate Huayi under our Government-Related Entities Rating Criteria, which is based on the SCP of 'bb' plus a two-notch uplift to 'BBB-', reflecting the potential support from its ultimate parent, Shanghai SASAC. The two-notch gap is similar to that between other GREs and their government parents, including Beijing Capital Group Company Limited (BBB/Stable) and Shanghai Construction Group Co., Ltd. (BBB+/Stable).

Huayi's 'bb' SCP is in line with directly comparable peer, Methanex Corp. (BB/Negative), which is the largest global supplier of methanol. Methanex enjoys a strong business profile due to its geographical diversification and low-cost base, but suffers from higher leverage and lower interest coverage ratio than Huayi.

Other 'BB' rated global chemical peers, such as EuroChem Group AG (BB/Stable), have similar leverage metrics to Huayi. Huayi's 'bb' SCP is one notch lower than the 'BB+' rating of global chemical peers such as Tata Chemicals Limited (BB+/Stable) and CF Industries, Inc. (CFI, BB+/Stable) as they have larger scale and enjoy higher margins.

KEY ASSUMPTIONS

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

- Revenue to increase by 23.4% in 2021 followed by 4%-6% growth per annum from 2022 to 2024
- Operating EBITDA margin of about 10% in 2021 and to gradually grow to 11% in 2024
- Annual capex of CNY6.5 billion in 2021, CNY5 billion in 2021 and CNY3 billion-4 billion per year from 2023 to 2024

RATING SENSITIVITIES

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

- Increasing likelihood of support from the Shanghai government

- FFO net leverage below 3.0x on a sustained basis

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

- Weakening of linkage with the Shanghai government

- FFO net leverage above 4.5x on a sustained basis

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

Adequate Liquidity: On a consolidated basis, Huayi had available cash of CNY11.3 billion and unused banking facilities of over CNY90 billion, against short-term debt of CNY14.9 billion, as of end-2020. The banking facilities are uncommitted as committed facilities are uncommon in the Chinese banking environment.

ISSUER PROFILE

Huayi is a medium-sized, state-owned chemical company. It has a highly diversified product portfolio, and is the largest producer for methanol in East China and among the three largest producers of acetic acid products in China. Over 90% of its total revenue is from China, with the rest from Thailand.

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.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡			PRIOR ⚡
Shanghai Huayi (Group) Company	LT IDR	BBB- Rating Outlook Stable		BBB- Rating Outlook Positive
	Affirmed			
senior unsecured	LT	BBB-	Affirmed	BBB-
Huayi Finance I Ltd.				
senior unsecured	LT	BBB-	Affirmed	BBB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

[Parent and Subsidiary Linkage Rating Criteria - Effective from 26 August 2020 to 1 December 2021 \(pub. 26 Aug 2020\)](#)

[Government-Related Entities Rating Criteria \(pub. 30 Sep 2020\)](#)

[Corporate Rating Criteria -- Effective from 21 December 2020 to 15 October 2021 \(pub. 21 Dec 2020\) \(including rating assumption sensitivity\)](#)

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\) \(including rating assumption sensitivity\)](#)

[Sector Navigators - Addendum to the Corporate Rating Criteria - Effective from 30 April 2021 to 15 October 2021 \(pub. 30 Apr 2021\)](#)

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](#)

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EU Endorsed, UK Endorsed

Shanghai Huayi (Group) Company

EU Endorsed, UK Endorsed

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