中誠信亞太 CCXAP

Credit Opinion

17 November 2023

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	A_g-
Outlook	Stable

Analyst Contacts

Christy Liu +852-2860 7130
Credit Analyst
christy_liu@ccxap.com

Allen Lin +852-2860 7128
Credit Analyst
allen_lin@ccxap.com

Elle Hu +852-2860 7120
Executive Director of Credit Ratings
elle_hu@ccxap.com

**The first name above is the lead analyst for this rating and the last name above is the person primarily responsible for approving this rating.*

Client Services

Hong Kong +852-2860 7111

Shandong Shipping Corporation

Initial credit rating report

CCXAP assigns first-time long-term credit rating of A_g- to Shandong Shipping Corporation, with stable outlook.

Summary

The A_g- long-term credit rating of Shandong Shipping Corporation ("SDSC" or the "Company") reflects the Company's (1) good market position as one of the largest dry bulk shippers in China; (2) established long-term relationships with key clients that help lower its business risks; and (3) good access to fundings.

However, the rating is constrained by the Company's (1) operations that are susceptible to cyclical fluctuations in the shipping industry; (2) high debt leverage with rising level of debt; and (3) large exposure to US dollars financing.

The rating also reflects our expectation of a high likelihood of support from SDSC's parent, namely Shandong Ocean Group Co., Ltd. ("SDOC"), given (1) SDSC's status as the core subsidiary of SDOC in Shipping Services; (2) moderate legal linkages with SDOC; and (3) reputation risk to the government. We believe that SDOC has strong capacity to support the Company by dint of SDOC's (1) ownership by the Shandong Provincial Government; (2) important strategic role in the development of marine industry of Shandong Province; and (3) good track record of strong shareholder and government support.

The stable outlook on SDSC's rating reflects our expectation that the Company's important position to its parent company is unlikely to change. We also expect the Company to maintain stable credit metrics and sufficient liquidity over the next 12 to 18 months.

Rating Drivers

- Good market position as one of the largest dry bulk shippers in China
- Established long-term relationships with key clients that help lower business risks
- Susceptible to cyclical fluctuations in the shipping industry
- High debt leverage and large exposure to US dollars financing
- Good access to funding
- High likelihood of support from SDOC and the government when necessary

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the government support is strengthened; or (2) SDSC's standalone credit quality improves significantly, including stronger market position, diversified operating scale, and improved credit metrics.

What could downgrade the rating?

The rating could be downgraded if (1) the government support or parental support is expected to be weakened; or (2) SDSC's standalone credit quality worsens significantly, including a material drop in market share, deterioration in credit metrics, and poor liquidity management.

Key Indicators

	2020FY	2021FY	2022FY	2023H1
Total Assets (RMB billion)	15.7	18.7	23.0	27.1
Total Equity (RMB billion)	4.3	4.7	5.1	7.6
Total Revenue (RMB billion)	3.3	4.4	5.1	2.4
Net Profits (RMB billion)	0.1	0.4	0.5	0.3
EBITDA/Revenue (%)	18.2	33.6	39.0	-
Return on Net Assets (%)	1.6	9.6	10.9	-
Total Debt/Total Capital (%)	75.0	77.0	79.4	71.2
Total Debt/EBITDA (x)	18.9	9.5	8.9	-
EBITDA/Interest (x)	1.7	2.7	2.6	-

All ratios and figures are calculated using CCXAP's adjustments.

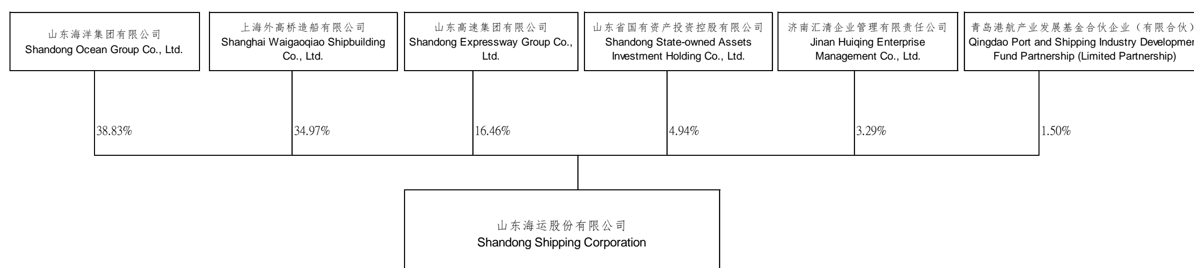
Source: Company data, CCXAP research

Corporate Profile

Established in 2010, SDSC is one of the most professional dry bulk shipping fleets in China with a leading fleet capacity. The Company is primarily engaged in shipping services, ship management, seafarer recruitment agency services and financial leasing. In May 2023, SDSC introduced a share expansion plan and privately issued new shares to SDOC and Shanghai Waigaoqiao Shipbuilding Co., Ltd. ("SWS"), raising RMB6.6 billion in total. The Company reported a registered capital and paid-in capital of approximately RMB6.1 billion and RMB5.2 billion as of the end of June 2023, respectively. SDSC is jointly owned by several large state-owned enterprises, including SDOC (holding 38.83% of shares), SWS (34.97%), and Shandong Hi-speed Group Co., Ltd ("SDHS") (16.46%), as of the same date.

SDOC and SDHS are the key state-owned enterprises under direct supervision and control by the State-owned Assets Supervision and Administration Commission of Shandong Province ("Shandong SASAC"). SWS is one of the major shipbuilders in China and a subsidiary of China State Shipbuilding Corporation Limited, the largest shipbuilding group in the world. As of 30 June 2023, SDSC reported total assets of RMB27.1 billion, accounting for around 53.5% of SDOC's total assets.

Exhibit 1. Shareholding chart as of 30 June 2023



Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2022FY

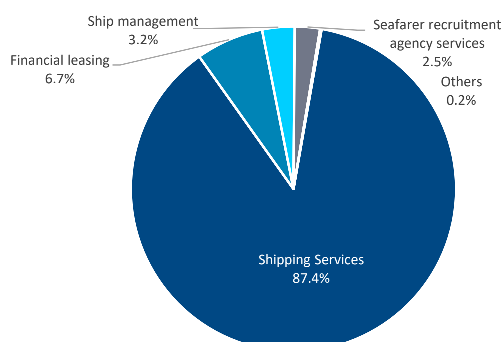
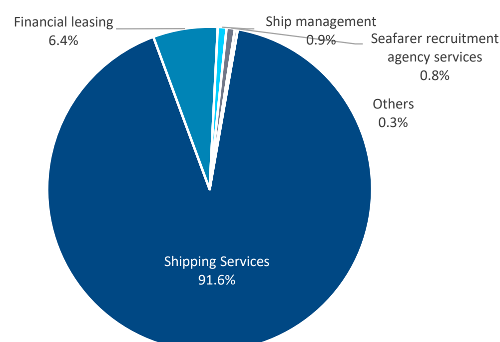


Exhibit 3. Gross profit structure in 2022FY



Source: Company information, CCXAP research

Rating Considerations

Good market position as one of the largest dry bulk shippers in China

SDSC is one of the most professional dry bulk shipping fleets in China, with solid operation experience for more than 10 years. It has a professional ship management team composed of senior captains and chief engineers and has a good safety record, which support SDSC to remain competitive in the global shipping service market. SDSC demonstrates a good position in niche markets particularly the dry bulk shipping and provides customized services for large corporates that has a stable shipping service demand. Key products of SDSC's shipping include iron ore, grains, coal, refined oil and other commodities. The Company's shipping services focus on dry bulk shipping, supplemented by liquid bulk shipping. Meanwhile, SDSC is the third largest dry bulk shipper in China in terms of controllable shipping capacity and is also steadily expanding its liquid bulk shipping capacity. Its shipping fleet consists of 101 vessels (including the vessels under construction), with a total carrying capacity of approximately 13.3 million deadweight tonnages ("DWT") as of 30 June 2023.

SDSC owns diversified, young, and competitive fleet, covering different shipping lines and major ports across the world. SDSC has ordered new ships during the downturns of the industry and disposed some inefficient

ships, the average ship age of SDSC was young of 5 years, far below the market average ship age. Young ships are normally more cost-effective and attractive to customers. All ships are complied with international environmental protection conventions. The Company also has a variety of mainstream ship types such as bulk ore carrier, Newcastle carrier, Cape of Good Hope carrier, Kamsarmax carrier, MR carrier and Panamax carrier, which can meet the needs of its key customers and help maintain long-term business relationship with them.

Established long-term relationships with key clients that help lower its business risks

SDSC adopts steady business strategy to expand its business continuously. The Company established long-term relationships with key clients, such as Vale International SA., BHP Billiton Feight Singapore Pte. ("BHP Billiton"), RWE Supply & Trading GmbH, Shell Tankers (Singapore) Private Limited ("Shell"), as well as China National Cereals, Oils and Foodstuffs Corporation ("COFCO"). Vale International SA and BHP Billiton are well-known iron ore exporters in the word, COFCO is a dominant global grain trader. The Company signs medium or long-term contracts with these customers to ensure demand for shipping services, and then outfits with vessels under self-constructions or leases according to the capacity needs of contracts. However, the concentration in key foreign clients is relatively high, and as trade relations between China and other countries change, this may affect foreign clients' choice over the SDSC's shipping services. Nevertheless, we believe that the risk of suddenly ceasing business relations with these customers is minimal.

Moreover, the changing operational model from owning carrying capacity to controlling carrying capacity helps SDSC reduce certain asset risk. The Company mainly expands its carrying capacity by leasing in recent years. The leasing method includes bare charter, time charter, and asset-light model. Under asset-light model, the cargo owner would sign a ship leasing contract with financial institution, SDSC is responsible for the management of the ship and business and charges management fee. As of 30 June 2023, the total carrying capacity of rented vessels was 8.5 million DWT, accounting for 63.7% of its total carrying capacity. Comparing with self-construction method, the leasing method requires lower capital investment in vessels and bears lower asset risks.

Furthermore, SDSC continuously control the costs of operation by improving management ability. The Company has established a good framework of operation and financial management, and built a quantitative operating model led by the finance department. SDSC possesses all-round data that supports it to daily operation and major decisions takings such as carrying capacity allocation, contact pricing, and asset acquisition. Meanwhile, The Company has set up its overseas fund management system, which is believed to help reduce capital costs and improve capital efficiency. Under the good framework of management, we expect that SDSC can continuously control the costs of operation and improve operational efficiency.

Supported by the high-quality resources from large customers and raid expansion of carrying capacity, the Company's shipped volume has grown fast in recent years. From 2020 to 2022, the compound annual growth rates of dry bulk shipping and liquid bulk shipping volume were 30.64% and 76.24%, respectively. Meanwhile, the compound annual growth rate of revenue from shipping service was 22.2%.

Susceptible to cyclical fluctuations in the shipping industry

Both dry bulk shipping and liquid bulk shipping are cyclical industries. Since 2010, the dry bulk shipping industry has experienced a painful time for years due to overcapacity and weak demand growth, with low freight rates and hurting shippers' profitability. In early 2021, driven by global economic reopening and market recovery, The Baltic Dry Index ("BDI"), which reflects the general market condition of the industry, hit the record high over the past 10 years. The liquid bulk shipping industry performed differently form the bulk shipping but demonstrated

high volatility over the past years. The increasing global tensions on trade and geographic political changes such as the conflict between Russia and Ukraine and the Israel-Gaza war may continue to give impacts on the market. SDSC intends to reduce the impact of market volatility by signing long-term contracts with key clients and diversifying its pricing model. Sport carrying capacity accounted for around 20% of SDSC's total capacity. Spot carrying capacity refers to carrying capacity which is allocated in the sport market or the rental rate is determined according to the relevant indices. However, we believe that ups and downs of the industry still challenge SDSC's operations, management, and financial performance.

Increasing business diversification through the acquisition of NOF asset package

SDSC is planning to use the capital increase of RMB6.6 billion from SDOC and SWS to acquire the NOF asset package from Shandong Huihai Ocean Engineering International Co., Ltd., and the transaction is estimated to be completed by the end of 2023. After the acquisition, the Company would add drilling platform leasing business, offshore wind turbine installation services and liquefied gas (including LPG and ethane) transportation businesses, which further enlarges SDSC's business scope and diversifies its operational risk. It would have the world's largest ultra-large liquefied ethane carry capacity. However, the Company's operation and management capabilities would bear certain challenges caused by the new business segments. Moreover, the drilling platform leasing business recorded losses for years while the situation is improved in the first half year of 2023. We should pay close attention to the improvement of profitability of the drilling platform leasing business.

High debt leverage with rising level of debt

SDSC demonstrated high debt leverage with a rising level of debt. SDSC's total debt increased from RMB11.4 billion as of the end-2020 to RMB18.8 billion as of the end-2023H1, driven by its expanding carry capacity. The total capital ratio decreased from 79.4% in 2022 to 71.2% in 2023H1 thanks to the capital injection from SDSC and SWS. Although the Company's debt leverage has declined, it remains at a high level.

In addition, the Company's financing exposure was dominant by US dollars. The funding cost of the Company may heighten during the rate-rise cycle of US dollars, which may also erode its bottom-line profitability. The Company may also suffer from the volatility of offshore market when refinancing.

SDSC has maintained relatively stable financial metrics in recent years given its business strategies and financial management. The Company's EBITDA margin was above 30% in 2021 and 2022, which is mainly driven by increasing shipping volume and rising freight rates. SDSC's EBITDA sharply increased from RMB606 million in 2020 to RMB2.0 billion in 2022. Its total debt to EBITDA ratio also improved from 18.9x in 2020 to 8.9x in 2022.

Good access to funding

SDSC has good access to diversified funding including bank loans, domestic and offshore bond, financial leasing. As of 30 June of 2023, the Company obtained total bank credit facilities of RMB29.2 billion, of which the available part was RMB13.4 billion, providing good financial flexibility. The Company has built long-term relationships with policy banks, state-owned commercial banks, and joint-stock commercial banks in China and international commercial banks, including the Export-Import Bank of China, Bank of China, China Merchants Bank, BNP Paribas, DBS Bank, etc. From January 2022 to June 2023, the Company totally issued 3 tranches of domestic bond and 1 tranche of offshore bond, raising amount of RMB1.5 billion and USD200 million, respectively. The Company is also able access low-cost fundings given its strong shareholder background.

Meanwhile, the Company maintained a good debt maturity profile that lowers its refinancing pressure. As of 30 June 2023, the ratio of short-term debt to total debt was 13.4%. The Company normally maintains cash on hand to meet its matured debt. It had cash or cash equivalents of RMB2.7 billion which was around 1.1x of its short-term debts as of 30 June 2023. The strong and stable operating cashflow from its shipping business is supportive to the repayment of its debts.

External Support

SDSC is likely to receive support from SDOC and the government, when necessary, given its (1) status as the core subsidiary of SDOC in shipping services; (2) moderate legal linkages with SDOC; and (3) reputation risk to the government. We believe that SDOC has a very strong capacity to support the Company because of its (1) ownership by the Shandong Provincial Government; (2) strategic role in the development of marine industry of Shandong Province; and (3) good track record of strong shareholder and government support.

SDSC has a very important position in SDOC's operations as the primary operating subsidiary in shipping services business. At the same time, the Company is also the sole provincial state-owned enterprise in Shandong Province whose main business is ocean shipping. The Company contributes majority of assets and profits for SDOC, which accounting for 48% and 76% of SDOC's total assets and net revenue, respectively. SDOC is an important operating entity in the Shandong Province's marine industry and its capacity to provide support is largely underpinned by Shandong Provincial Government. In our view, SDSC can receive solid support from SDOC for its daily operation management, business development, and fund lending. SDOC also has moderate legal incentives to provide necessary support to SDSC. A default by SDCS would trigger the cross-default provisions in the offshore bonds issued by SDOC. While the level of SDOC's offshore debt is moderate, we believe that the cross-default provisions are long-term as SDOC tends to refinance its offshore debt on an ongoing basis. A default by SDCS will pose reputation risk to the government as well. It is expected that the Shandong Provincial Government would provide support to SDSC through SDOC when necessary.

In May 2023, SDSC issued 3.0 billion additional shares through a non-public offering. SDOC subscribed for 859 million shares for RMB1.9 billion, while SWS, a wholly-owned subsidiary of the listed company China CSSC Holdings Limited, subscribed for 2.1 billion shares for RMB4.7 billion. SDSC's capital strength significantly enhanced due to capital increase and introduction of strategic investor. SWS is one of the large-scale shipbuilding enterprisers in China, SWS's shipbuilding business and SDSC's shipping business would contribute to business synergies.

Rating Methodology

The methodology used in this rating is the Rating Methodology for General Corporate (April 2019).

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China Chengxin (Asia Pacific) Credit Ratings Company Limited

Address: Suites 1904-1909, 19/F, Jardine House,
1 Connaught Place, Central, Hong Kong

Website: www.ccxap.com

Email: info@ccxap.com

Tel: +852-2860 7111

Fax: +852-2868 0656