

CMBI Credit Commentary

First take from Corporate Day: Moody's explaining on Huarong rating - Await government support

Gradual but not drastic restructuring

We continue to believe Huarong's restructuring approach will be gradual and not drastic to offshore bondholders, as offshore market access is important to all 4 AMCs. Moody's also view rumored subsidiaries disposal of Huarong as credit positive, as this can replenish liquidity and improve capital adequacy ratio. The rating agency also cited Central Government's action plan on Huarong will have rating implication to other AMCs, considering their A3 ratings incorporate +5 to +6 notches of uplift, compared to most SOEs' uplift of +3 to +4 notches. Yet rating impact to other SOE financial institutions will be mild. **Technically, we continue to see good risk-reward on HRINTH 04/27/22 at 83, alongside its subsidiary disposal progress.**

Not a technical default, even if audited results delay after 31 Aug, 2021

Moody's will not treat Huarong's audited results delay, even after 31, Aug 2021 (60-days grace period), as a technical default.

It is only when >25% of bondholders of its any USD bonds request trustee to take action and accelerate a USD bond, then that USD bond will become due and payable. Moody's definition of default only includes principal repayment with haircut, but not an agreed upon extension and profiling of debt.

However, in a hypothetical scenario of its USD bond acceleration and discussion of extension, Moody's can take downward rating actions in view of its tight liquidity.

Moody's sees asset disposal from Huarong as credit positive

This can immediately replenish Huarong's liquidity with cash proceeds, and improve Huarong's weak capital position (Moody's capital adequacy ratio: total tangible common equity/total tangible assets was 6.7% as of Jun, 2020). In an event when these asset disposals are dragged on, Moody's will discern any further Chinese government's support gesture to evaluate its rating on Huarong.

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Timeline/next step of Moody's potential rating action

Ideally upon Huarong's release of FY2020 results, Moody's can take rating action base on FY2020 and other actions announced by Chinese Government. Current B2 BCA has some buffer for mild deterioration in asset quality. But if there's a significant impairment loss in FY2020 and there's no forthcoming capital replenishment, the standalone B2 BCA can be further downgraded.

There will be implication to Moody's rating on other AMCs

What future actions Chinese government take on Huarong AMC will have implication to the support level Moody's apply to all other AMCs, given they currently receive +5 to +6 notch of uplift, compared to +3 to +4 notch of other SOE financial institutions. But only mild impact to other SOE financial institutions, as current uplift of government support to other SOEs financial institutions is capped at +4 notch. So far Moody's has not changed its assumption of very high government support (+7 notch uplift) on Huarong. This is based on a) its ownership structure; b) it is directly controlled by Ministry of Finance (57% stake), and c) its dominance in domestic distressed AMCs industry. This compares to +5 notch uplift applies to Cinda, +6 notch uplift to Great Wall and Orient.

Moody's expects Huarong can rely on its internal resources to repay its bullet maturities in the near-term.

This is given its cash balance and large amount of financial investment, in addition to various licensed financial institution subsidiaries reported to be up for disposal (Total shareholders' equity of these subsidiaries: RMB 67.5bn, approximately 1/3 of Huarong consolidated assets)

This compares to USD 1.55bn offshore bonds due for rest of 2021, in addition to USD 500m perp callable on Sep 2021. In 2022, offshore maturity includes USD2.5bn bond, and USD2.2bn Perp.

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