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CMBI Credit Commentary

China AMCs – Opportunities after the collateral damage

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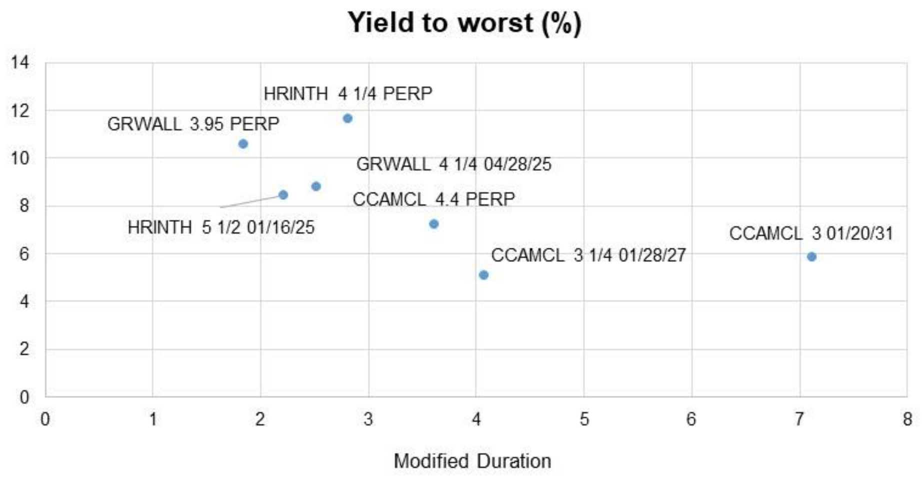
Recent Sell-off offers better entry points for HRINTH and CCAMCLs

In view of the timely publication of FY21 results by Cinda, Huarong and Orient, we believe that Great Wall's delay in releasing FY21 results should be due to its specific issues instead of industry-wide issues. After the rebound off the lows last week, cash prices of benchmark HRINTHs and CCAMCLs are still 1-4 pts lower from the levels in end of Jun'22 when Great Wall announced the further delay in releasing FY21 results. HRINTH 4.25% perps was hit down as much as 14 pts and remain 10 pts below the level at the end of Jun'22. The spill-over effect to other Chinese national AMCs, in our view, offers better entry opportunities for bonds/perps of central state-owned national AMCs.



Within the sector, we prefer list companies such Cinda and Huarong for higher data transparency. We like HRINTHs for better valuations and trading liquidity, improving credit story after the state-orchestrated recapitalization. Our picks within the HRINTH curve are **HRINTH5.25% '25** and **HRINTH 4.25% perps (callable in Sep'25 at 100)**.

For lower beta plays with stronger fundamental, we prefer CCAMCLs. Our picks are **CCAMCL 3.25%'27, CCAMCL 3%'31 and CCAMCL 4.4% perps.**

Regarding GRWALLs, we see trading value in the curve and our pick is **GRWALL 4.25%'25** and **GRWALL 3.95% perps.** That said, we prefer HRINTHs more as Huarong is an improving credit with better data transparency and lower headline risk. See appendix 1 for peer comparisons for Chinese national AMCs.

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Summary of CMBI picks on Chinese AMC sector

	Ranking	Offer price	YTW	YTC	T-spread	Modified duration	Next call date
CCAMCL 3 1/4 01/28/27	Sr Unsecured	93.0	5.1%	5.1%	197.4	4.1	28/10/2026
CCAMCL 3 01/20/31	Sr Unsecured	81.5	5.8%	5.9%	278.8	7.1	20/10/2030
CCAMCL 4.4 PERP	Jr Subordinated	90.6	7.1%	7.0%	379.3	3.6	3/11/2026
HRINTH 5 1/2 01/16/25	Sr Unsecured	94.8	8.1%	N/A	475.8	2.2	N/A
HRINTH 4 1/4 PERP	Subordinated	81.5	11.6%	11.3%	816.1	2.8	30/9/2025
GRWALL 4 1/4 04/28/25	Sr Unsecured	90.3	8.6%	N/A	515.8	2.5	N/A
GRWALL 3.95 PERP	Sr Unsecured	88.9	10.6%	10.1%	703.0	1.8	31/7/2024

Great Wall's delay in releasing FY21 results should be company-specific…

As discussed before, we view the delay of Great Wall to announce FY21 financial results due to issues specific to Great Wall instead of industry-specific issues. All other 3 national AMCs had released their FY21 results in a timely manner. According to media reports, Great Wall's delay is mainly due to the regulator's disagreement over the accounting treatment of its exposure to HNA. Our base case is Great Wall to announce FY21 results before the expiry of grace period, i.e. 29 Aug'22 and take some comfort from Fitch's comments that Great Wall's capital adequate ratio (CAR) would remain above regulatory requirement of 12.5%. As at 30 Jun'21, Great Wall's CAR was 15.59%.

…. grace period to expire by 29 Aug'22….

On 30 Jun'22, China Great Wall Asset Management (keepwell provider of GRWALL 3.125% 22, 4.375% 23 and 3.875 27) announced the failure to publish its FY21 financial report pending on "confirming valuation for certain operating projects". This is not the first time Great Wall delays the publication of financial results. It delayed the announcement of financial results in FY19 and FY18 as well although in both occasions. However, in both occasions, it managed to announce the full-year results before end of June in the respective years. As per bond covenants, Great Wall has to publish the audited results within 180 days after the end of each period (i.e. 30 Jun) with a grace period of 60 days (i.e. 29 Aug). Hence, the events of default could be triggered if the company fails to publish audited results by end of Aug'22.

…. Great Wall not a near-term default candidate

We expect Great Wall to announce the FY21 results before the end of grace period. Even if Great Wall fails to publish FY 21 results then, it can look for a temporary waiver/consent to avoid payment acceleration. The delay will therefore have limited immediate impact on its liquidity. So far, Great Wall has been honoring its payment obligations. In 1H22, it acquired RMB43.3bn and RMB9.1bn distressed assets from financial institutions and non-financial institutions, respectively. The operations of Great Wall has been largely business as usual. Given the experience of Huarong, we believe that Great Wall is not a near-term default candidate although we could see more price volatility for its bonds/perps arising from negative headlines such as rating downgrade and sizeable asset impairment.

Moody's/S&P put Great Wall rating on review for downgrade/credit watch negative because of the delay in releasing FY21 results. We recall our previous discussions with Moody's that it would not treat

Huarong's delay in FY20 results as a technical default, even after grace period. Moody's definition of default only includes principal repayment with haircut, but not an agreed upon extension and profiling of debt.

A sector with increasing strategic importance with demonstrated government support

Chinese national AMCs have been integral parts of the Chinese financial system. The Chinese government's willingness and ability to support were demonstrated in the state-orchestrated "bail-out" of Huarong. We see an increasing strategic importance of the sector under the backdrop of the slowing Chinese economy, rising defaults and NPLs.

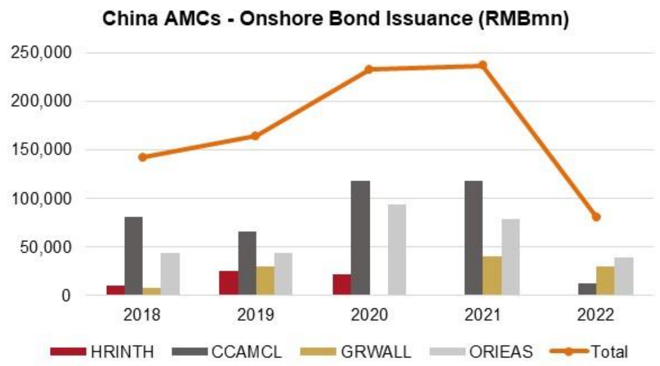
Prior to the completion of recapitalization plan (announced in Aug'21), the Chinese government ensured that all onshore and offshore debts of Huarong were serviced in a timely manner. Offshore redemption since Apr'21 totaled cUSD7.7bn, including the calls of HRINTH 2.875% perps (USD500mn) and 4.5% perps (USD1.5bn) on their first call dates in Sep'21 and Jan'22, respectively.

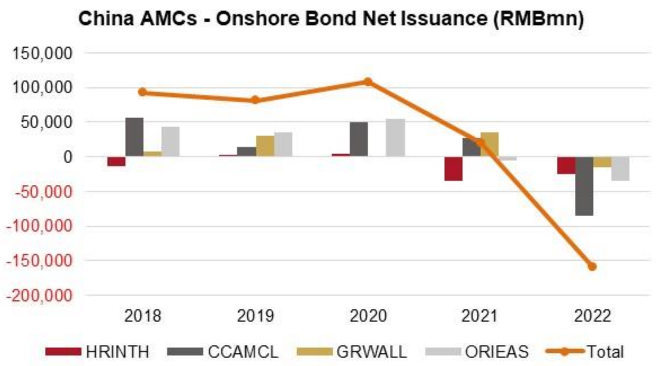
In Dec'21, a consortium led by CITIC Group, 100% owned by the Ministry of Finance (MOF), completed the capital injection (core T1) of RMB42bn to recapitalize Huarong after the huge asset impairment losses in FY20. Other participants in the consortium include Cinda, ICBC Investment, China Life and China Insurance Rongxin Fund, a PE sponsored by Chinese lifers such as Ping An, Sunshine, China Pacific, Taiping, Taikang, etc. The capital injection helped restore Huarong's capital adequacy ratio (CAR) to 12.95% in Dec'21 from 4.16% in Dec'20. Under Chinese regulations, AMCs are required to maintain CAR of no less than 12.5%.

Subsequent to the capital injection, MOF remained the largest shareholder of Huarong despite its direct stakes in Huarong reduced to 27.8% from 57.02%. CITIC Group, 100% owned by MOF, owns 23.46% direct stakes in Huarong. Altogether, MOF and CITIC Group owns 51.3% stakes in Huarong.

In Mar'22, Huarong announced that MOF would transfer 3% stakes in Huarong to CITIC Group. After completion of the equity transfer, CITIC Group will own 26.46% stakes and become the largest shareholder of Huarong. MOF's direct stakes will lower to 24.76%. That said, Huarong remains to be a majority central state-owned company, and we do not expect the equity transfer to weaken Huarong's link with the central government. As per the latest HKEX disclosure, the transfer has yet to be completed.

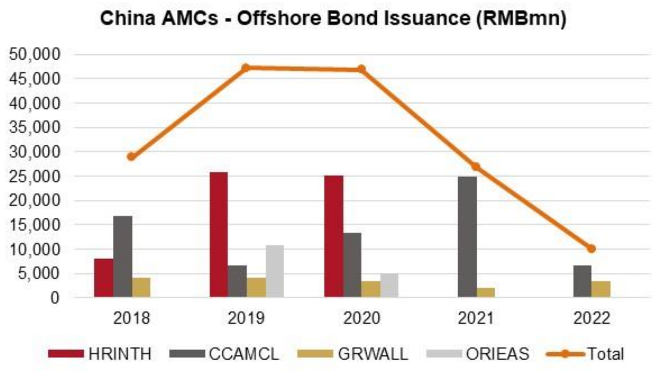
CBIRC guidance to improve AMCs' access to onshore funding channels….

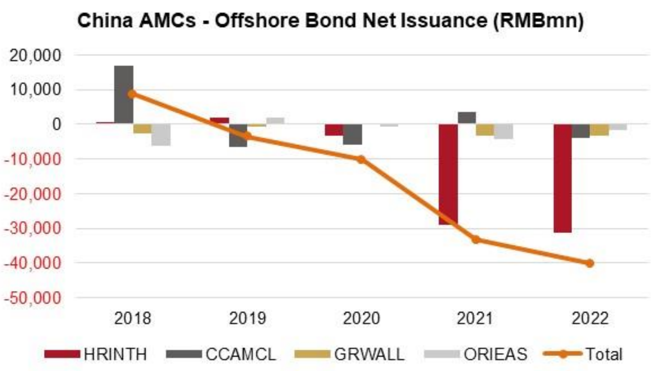




In addition to the financial support, we also see regulatory support for the national AMCs. In early Jun'22, media reported that CBIRC issued a guidance for China national AMCs to expand their distressed asset management scope and to help resolve financial risk of small-medium financial institutions. Under the guidance, the risk weighting of AMCs' onshore bonds and capital papers would lower to 25% from 100%, subject to meeting certain commercial banks regulatory conditions. The lower risk weighting will encourage banks and insurance companies to invest in AMCs' onshore bonds and capital papers, and hence help lengthen their funding costs and liability tenor. We envisage the guidance, if implemented, will increase AMCs' reliance on onshore funding channels. Recently, Cinda announced plan to issue onshore T2 capital of RMB1bn. Huarong also obtained shareholders' approval to issue up to RMB20bn undated capital bonds onshore in mid Jun'22. YTD, the onshore issuance was only RMB80.6bn, declined 29.8% over the same period last year.

…. the trend of net redemption in offshore market to continue





Partly driven by asset realignment to focus on core and onshore asset acquisitions, the amount of offshore issuance from the big-4 AMCs has been on the decline since 2020. In 2021, the gross issuance from the sector was only USD4bn, down 43% from that of 2020. YTD, gross issuance declined 25% yoy to USD1.5bn. In terms of net issuance, the sector has experienced net redemption since 2019. The amount of net redemption has increased from USD544mn in 2019 to USD5.0bn in 2021. We expect the sector to continue to record net redemption in the USD bond markets in view of the heightened focus on onshore asset acquisitions, subdued offshore USD bond markets and more friendly onshore capital markets.

Appendix 1

RMB 'mn	2021 Cinda	2021 Huarong	2021 Orient	9M21 Great Wall
Moody's issuer	A3	Baa2	A3	A3*
Senior unsecured	A3	Baa3	Baa1	Baa1*
Subordinated				
BCA/standalone	Ba2	Caa2	Ba3	Ba3*
S&P issuer	A-	BBB+	BBB+	A-*
Fitch issuer	A	BBB	A	A
Senior unsecured	A	BBB	A	A
Net Profit attributable to Equity holders	12,062	378	7,237	1,577
Net Profit	13,000	1,986	8,467	1,826
Equity attributable to Equity holders	178,801	59,344	114,514	56,954
Total Equity	201,775	103,984	157,450	65,208
Total Assets	1,564,279	1,568,422	1,205,793	654,080
ROE	6.87%	0.98%	6.43%	3.73% (annualized)
ROA	0.84%	0.12%	0.72%	0.33% (annualized)
Capital adequacy ratio	16.18%	12.95%	15.28%	15.59% (Jun'21)
Impaired distressed debt asset ratio	6%			
Coverage ratio of impaired distressed debt asset	164%			
Impaired distressed debt	8,690			
Allowance for impairment losses	14,289	40,500		
Total distressed debt asset	148,933	309,823		131,725

* Review for downgrade/credit watch negative

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