CMBI Credit Commentary

Initiate coverage on Chinese leasing sector

Initiate buy on FRESHK 2 ⅝'24, FRESHK 3 ⅜'25, BCLMHK Float 24-25s and CDBFLC 2 ⅞'30

Leasing companies in China can be broadly classified into 2 categories: commercial leasing companies and financial leasing companies. Financing leasing companies enjoy lower funding costs than that of commercial leasing companies given their more diversified funding channels and more stringent regulatory requirements. Hence, the RV analysis should also be separated between commercial leasing companies and financial leasing companies, factoring in their fundamental differences.

For commercial leasing companies, FRESHKs are our picks because of the more attractive risk-return profiles than those of peers such as BOCAVI, CHNAAR and PINIFL. Within the FRESHK curve, we pick **FRESHK 2 ⅝ 03/03/24** as a short-dated carry play, and **FRESHK 3 ⅜ 02/18/25** for its better risk-return profile. At 97.7, FRESHK 2 ⅝ 03/03/24 is trading at a YTM of 9.1%. For FRESHK 3 ⅜ 02/18/25, it is trading at YTM of 10.4% at 91.5.

For financial leasing companies, we pick **BCLMHK Float 09/05/24, BCLMHK Float 12/10/24**, and **BCLMHK Float 03/02/25** as short-dated and low beta plays under an uncertain interest rate environment. They are trading at YTM of 6.6-6.8% with cash prices close to par. BCLMHK Float 24-25s also present 79-94bps yield pick-up over the senior notes of BOCOM.

Additionally, we consider **CDBFLC 2 ⅞ 09/28/30** (Tier 2 bond, callable 09/28/25) a yield pick-up play over its own senior unsecured bonds and its parent's senior bonds. At 92.7, CDBFLC 2 ⅞ 09/28/30 is trading at YTC of 6.9%. It offers a yield pick-up of 117bps and 142bps over CDBLFD 2 03/04/26 and SDBC 1 10/27/25.

Table 1: Summary of our picks

Bond	Ask price	YTM/YTC (Ask)	o/s amt (USDmn)	Rating (M/S/F)	Guarantor
FRESHK 2 ⅝ 03/03/24	97.7	9.1%	450	-/BBB-/-	-
FRESHK 3 ⅜ 02/18/25	91.5	10.4%	300	-/BBB-/-	-
BCLMHK Float 09/05/24	100.2	6.6%	400	A3/-/A	-
BCLMHK Float 12/10/24,	100.0	6.8%	600	A3/-/A	-
BCLMHK Float 03/02/25	99.8	6.8%	500	A3/-/A	-
CDBFLC 2 ⅞ 09/28/30	92.7	6.9%	700	-/BBB+/A-	-

Source: Bloomberg.

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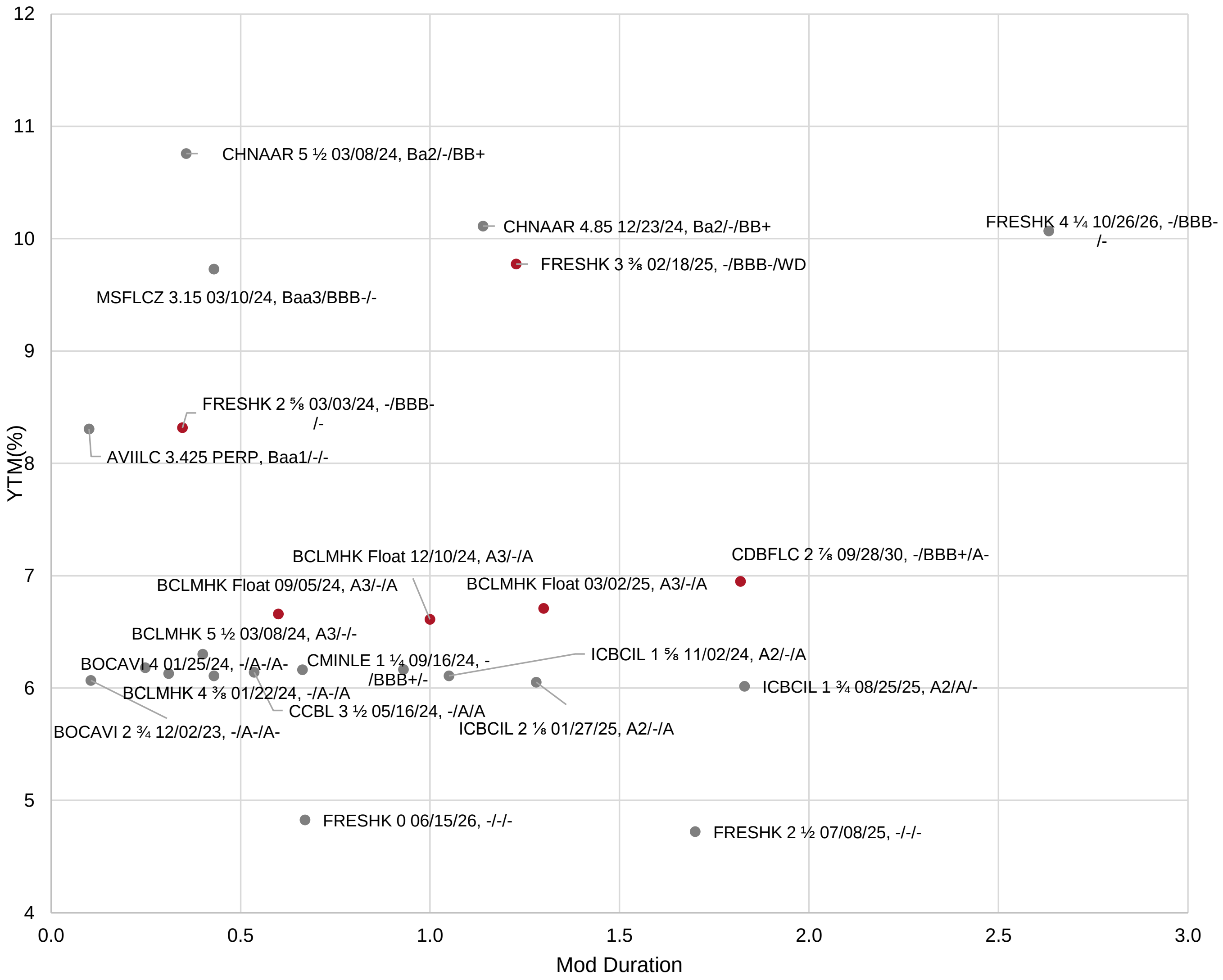
Chart 1: Actively traded China leasing bonds (M/S/F)



Source: Bloomberg.

A quick anatomy of the financial and commercial leasing companies

Leasing companies in China can be broadly classified into 2 categories: commercial leasing companies and financial leasing companies. Commercial leasing companies are classified as non-financial institutions while financial leasing companies are non-bank financial institutions.

Most of the financial leasing companies are owned by banks or large corporates. Financial leasing companies are allowed to operate a wider range of activities including to take deposits from non-bank shareholders and access to interbank market for funding. See Table 2.

Financial leasing companies are therefore subject to more stringent regulatory requirements despite both commercial leasing and financial leasing companies are regulated by The National Administration of Financial Regulation (NAFR). The required minimum CET1/Tier1/total capital ratios are 7.5%/8.5%/10.5% respectively, there are also requirements on the degree of concentration in single client financing and non-performing assets allowance. For commercial leasing companies, the maximum assets at risk to net assets ratio should not be higher than 8x. See Table 3.

On the bright side, financing leasing companies enjoy lower funding costs than that of commercial leasing companies given their more diversified funding channels and more stringent regulatory requirements. See Table 4.

Hence, we consider commercial leasing companies and financial leasing companies two subsets of a sector, the RV analysis should also be separated, factoring in their fundamental differences.

Table 2: Comparison of business scope of financial leasing and commercial leasing companies

	Financial leasing companies	Commercial leasing companies
Overlapped business	Financial leasing	Financial leasing and operating leasing
	Transferring or accepting financial leasing assets	Transferring or accepting financial leasing and operating leasing assets
	Accepting lease deposits from the lessee	Accepting lease deposits from the lessee (financial leasing and operating leasing)
	Investing in Fixed Income securities	Investing in Fixed Income securities
	Disposal of leased properties	Disposal and maintenance of leased properties
	Economic consulting	Consulting on financial leasing and operating leasing
Unique business	Absorbing deposits over 3 months from non-bank shareholders	
	Interbank lending	
	Lending from financial institutions	
	Overseas lending	

Source: NFRA

Table 3: Regulation requirement for financial/commercial leasing company

	Financial leasing companies	Commercial leasing companies
Common regulation requirements		
Degree of concentration of single client financing	≤30%	≤30%
Degree of concentration of single group client financing	≤50%	≤50%
Ratio of a single related client	≤30%	≤30%
Ratio of all related parties	≤50%	≤50%
Ratio of a single related Shareholder	≤100%	≤100%
Investment in fixed-income securities	≤20%	≤20%
Specific regulation requirements		
Capital adequacy ratio	>10.5%	-
Tier-one capital adequacy ratio	>8.5%	-
Core tier-one capital adequacy ratio	>7.5%	-
Ratio of interbank lending	≤100%	-
Financial leasing and other leasing assets / total assets	-	≥60%
Risky assets / net assets	-	≤8x
Ratio of allowance to non-performing finance lease related assets	>150%	-
Ratio of allowance to total finance lease related assets	>2.5%	-

Source: NFRA

Table 4: Financing cost of selected companies

	Company	2020	2021	2022	1H23
Commercial leasing	BOCAVI	3.20%	2.90%	3.10%	3.90%
	CHNAAR	3.34%	2.96%	4.20%	5.72%
	FRESHK	4.63%	4.41%	4.01%	4.26%
	PINIFL	4.28%	4.17%	3.94%	-
Financial leasing	BCLMHK	2.77%	2.33%	2.57%	-
	CCBL	3.11%	3.22%	2.58%	-
	CDBALF	2.95%	3.01%	2.91%	3.41%
	CMINLE	3.00%	2.92%	2.79%	-
	MSFLCZ	3.23%	3.38%	3.31%	-
	ICBCIL	2.49%	2.33%	2.84%	-

Source: CCXI, Company fillings

Pick FRESHK 2 ⅝ 03/03/24 and FRESHK 3 ⅜ 02/18/25 in commercial leasing universe

Far East Horizon (FEH) continues to have better operating performance with more diversified operations and better profitabilty. We consider FRESHKs offering more attractive risk-return profiles than those of peers such as BOCAVI, CHNAAR and PINIFL. Among FRESHKs, we pick **FRESHK 2 ⅝ 03/03/24** as short-dated carry play, and **FRESHK 3 ⅜ 02/18/25** for better risk return profile. At 97.7, **FRESHK 2 ⅝ 03/03/24** is trading at a YTM of 9.1%. For **FRESHK 3 ⅜ 02/18/25**, it is trading at YTM of 10.4% at 91.5.

More diversified operations and better profitability

FEH's revenue and profit steadily increased since FY19 despite the pandemic. In 1H23, FEH's revenue rose 3.6% yoy to RMB18.4bn and the attributable profit increased by 8.2% to RMB3.1bn. The impairment loss in 1H23 was 30% less than 1H22 at RMB723mn. FEH has diversified revenue sources across from nine different industries. In 1H23, urban public utility (45.1%), engineering construction (13.3%), culture and tourism (9.1%) accounted for majority of its net-interest earning assets (see Table 5). Its exposure to more cyclical sectors such as construction, aviation and shipping is lower, reflected by its more stable ROA and ROE. See Table 6 for comparison between FEH and its peers.

Compared to commercial leasing company with single industry focus such as BOCAVI and CHNAAR, FEH shows a more stable profitability trend over the past few years. Besides, FEH outperformed its peers in both ROA and ROE in 1H23. FRESHK's leverage ratio, calculated with assets at risk divided by total equity, was 4.0x at Dec'22, well below the regulatory maximum of 8x.

Analysis based on standalone credit profile given more remoted linkage with Sinochem

Based on figures for FY22, FEH is the largest leasing company by revenue and the 3rd largest by assets in China. it was once 100% owned by Sinochem Group and Sinochem HK, indirectly wholly owned by Sinochem Group. Currently, Sinochem is the second largest shareholder of FEH and owns a 21.3% stake. FEH's chairman and CEO Kong Fanxing is the largest shareholder with a 21.8% stake. We take a bottom-up approach in analyzing FEH as the linkage between Sinochem and FEH has been more remoted over the years. FEH does not have credit enhancement from or cross default trigger to Sinochem. The members of senior management of FEH do not hold position in Sinochem Group. Moreover, FEH does not have connected transactions with Sinochem or any outstanding borrowings from Sinochem as at Jun'23 (RMB35mn at Jun'22 and RMB700mn at Dec'20).

Table 5: FEH's net interest-earning assets by industry

	FY19		FY20		FY21		FY22		1H23	
	RMB mn	% of total	RMB mn	% of total	RMB mn	% of total	RMB mn	% of total	RMB mn	% of total
Urban public utility	73,733	36.3%	102,528	43.6%	117,740	45.6%	137,914	51.0%	125,812	45.1%
Engineering construction	23,647	11.6%	26,194	11.1%	27,017	10.5%	24,125	8.9%	36,286	13.0%
Culture & tourism	30,965	15.2%	25,629	10.9%	25,447	9.8%	21,769	8.0%	25,993	9.3%
Healthcare	31,240	15.4%	28,380	12.1%	26,852	10.4%	24,624	9.1%	23,244	8.3%
Transportation & logistics	13,808	6.8%	13,967	5.9%	14,560	5.6%	14,677	5.4%	18,787	6.7%
Public consuming	9,035	4.4%	11,668	5.0%	14,988	5.8%	16,606	6.1%	16,893	6.1%
Machinery	8,547	4.2%	11,561	4.9%	15,051	5.8%	14,401	5.3%	14,058	5.0%

Chemical & medicine	4,108	2.0%	5,669	2.4%	7,304	2.8%	8,458	3.1%	9,472	3.4%
Electronic information	8,066	4.0%	9,818	4.2%	9,418	3.6%	8,027	3.0%	8,243	3.0%
Total	203,149	100.0%	235,414	100.0%	258,379	100.0%	270,601	100.0%	278,787	100.0%

Source: Company fillings

Table 6: Comparison of major commercial leasing players

	Company	Total revenue (RMB mn)	Total assets (RMB mn)	ROA	ROE	NPL ratio	Net debt/ EBITDA	Gearing ratio	Assets at risk to net assets (<8x)
FY20	BOCAVI	14,994	172,046	2.16%	10.68%	-	12.26x	71.33%	-
	CHNAAR	2,934	39,046	1.44%	12.34%	-	11.94x	80.10%	-
	FRESHK	29,042	299,927	1.80%	14.24%	1.10%	18.28x	84.91%	5.34x
	PINIFL	19,423	277,961	1.44%	9.77%	1.24%	30.93x	85.21%	6.41x
FY21	BOCAVI	15,936	174,317	2.35%	10.65%	-	10.84x	70.38%	-
	CHNAAR	2,680	40,904	1.09%	9.20%	-	12.41x	80.90%	-
	FRESHK	33,644	335,880	1.96%	14.57%	1.06%	19.82x	84.20%	5.19x
	PINIFL	19,989	273,954	1.56%	10.11%	1.21%	26.90x	83.88%	5.84x
FY22	BOCAVI	16,841	161,118	0.09%	0.38%	-	8.84x	68.86%	-
	CHNAAR	3,726	49,426	0.14%	1.20%	-	10.26x	81.50%	-
	FRESHK	36,586	346,995	1.93%	14.13%	1.05%	17.84x	84.89%	4.66x
	PINIFL	19,541	258,384	1.37%	8.34%	1.17%	29.14x	83.14%	5.63x
1H23	BOCAVI	7,745	167,301	1.14%	4.89%	-	11.16x	69.21%	-
	CHNAAR	2,145	58,256	0.68%	6.43%	-	10.12x	83.00%	-
	FRESHK	18,362	361,363	1.97%	13.27%	1.05%	20.13x	84.38%	4.24x
	PINIFL	9,722	251,871	1.20%	7.02%	1.19%	27.87x	83.90%	5.88x

Note: CHNAAR in HKD mn. Assets at risk is total assets minus cash and bank balances and government bonds
Source: Company fillings, CMBI Research

Access to different funding channels despite increasing reliance on short-term funding

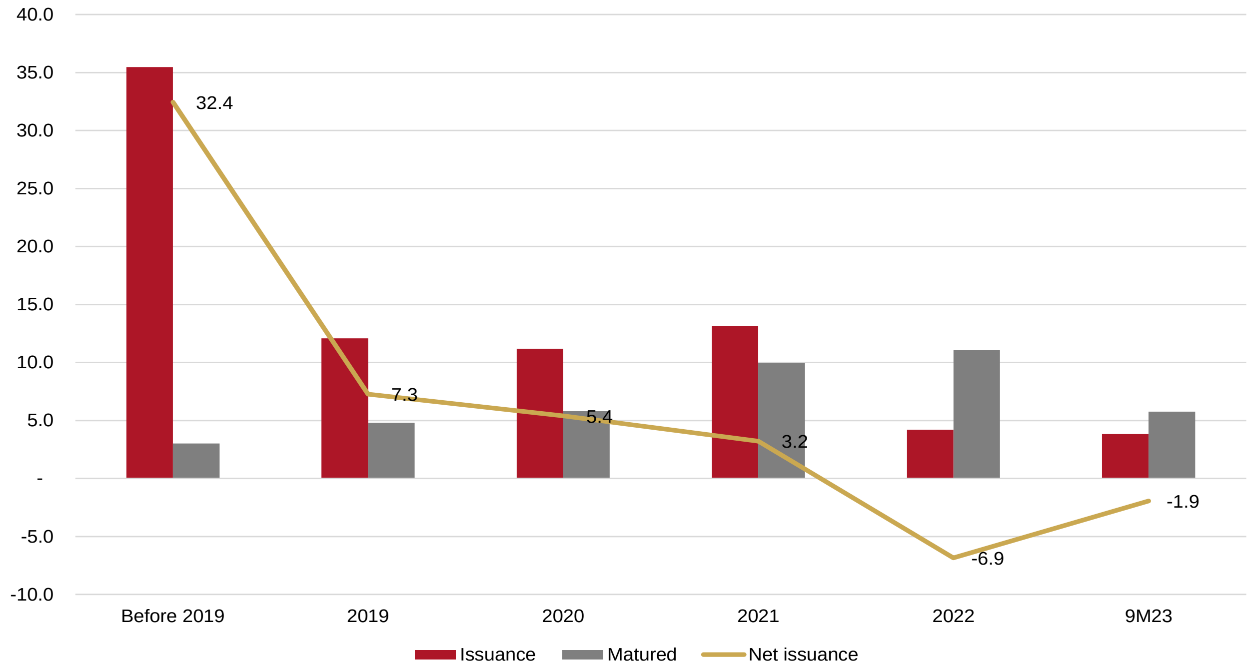
We notice that FEH, as its peers, experienced net redemption in onshore and offshore bond markets. Additionally, FEH, as other leasing peers do, relies on short-term funding and around half of FEH's total debts are due within a year since FY19. As at Jun'23, the short-term debts was RMB153.6bn, accounted for 57.2% of total debts. Its weighted average tenor of onshore bonds also shortened to 1.3 years in 9M23 from 2.1 years in FY19 due to increasing issuance of super-short commercial papers (SCP), of which the funding cost is lower (see Table 7). Besides, the weigthed average funding costs of onshore bonds decreased to 4.26% in 9M23 from 4.95% in FY19. We believe that these changes reflected the higher funding costs in bond markets, FEH turned to shorter tenor loan market for lower-cost funding. FEH's total loans increased to RMB268.2bn in 1H23 from RMB205.2bn in FY20.

In the onshore bond market, FEH has net redemption for RMB35.4bn, RMB12.1bn and RMB21.9bn in FY21, FY22 and 9M23, respectively. See Chart 3. For offshore, FEH is yet to tap the bond market since Oct'21 but has redeemed cUSD1bn offshore bonds since then. Currently, FEH has three straight USD bonds totaled USD1.1bn due in Mar'24-Oct'26, two CBs including USD250mn CB puttable in Jun'24 at 106.15 and USD300mn CB due Jul'25.

We expect FEH to meet the short-term dues with its available funding channels, and to lower its average financing cost by raising short-term bonds. We take comfort from its adequate credit lines with undrawn bank lines of RMB220bn (cUSD30bn) as at Jun'23. We take additional comfort that FEH has a positive net liquidity gap of RMB32.7bn (see Table 8) as at Jun'23, and its assets at risk divided by net assets of 4.24x at Jun'23, well below the regulatory maximum of 8x.

We also notice that FEH's plan to issue of 2-yr corporate bonds of RMB1.5bn announced on 18 Oct'23. This demonstrates its ability to access onshore bond markets for long-term financing, the increasing reliance on short-dated funding is more of a choice to lower funding funding costs.

Chart 2: USD bonds issuance of Chinese leasing companies (USD bn)



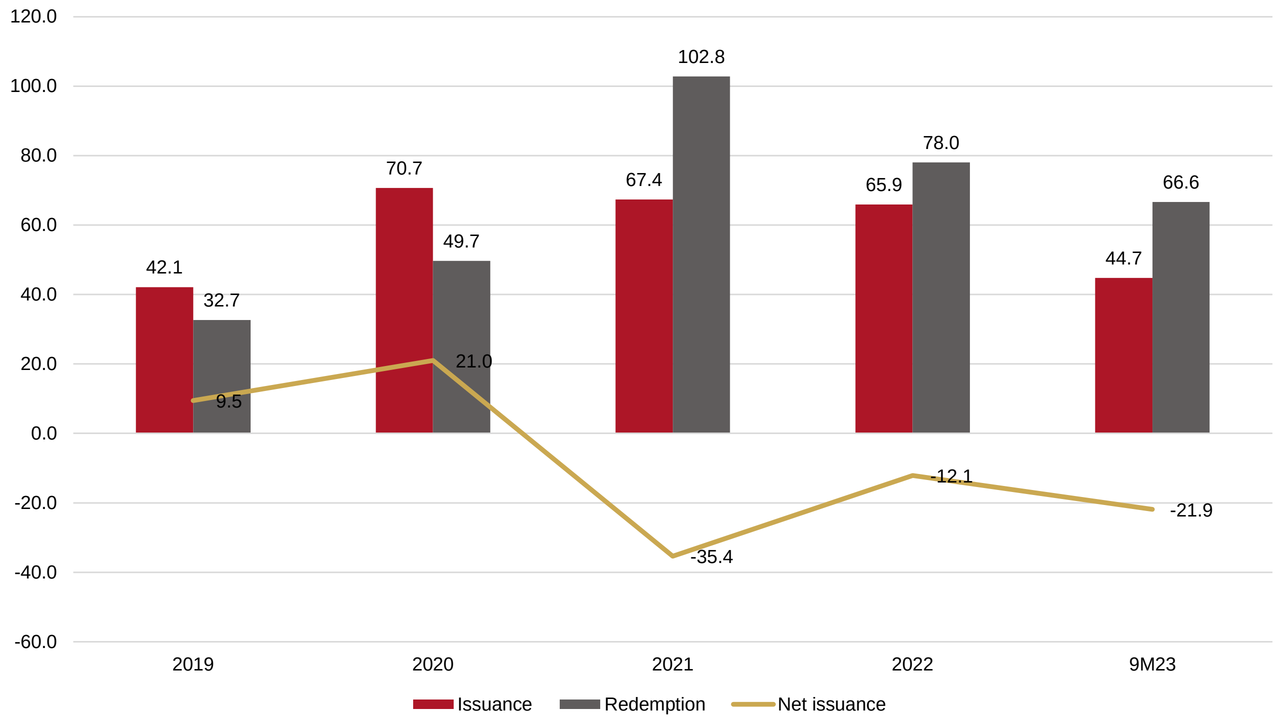
Source: Bloomberg

Table 7: Weighted average cost and tenor of FEH's onshore bond issuance

	MTN	Corporate bond	Commercial paper	Super-short commercial paper	Weighted average tenor (years)	Weighted average cost
2019	3.88%	3.98%	-	2.57%	2.1	4.95%
2020	3.35%	3.47%	-	1.85%	2.3	4.63%
2021	4.09%	3.65%	-	3.14%	1.4	4.41%
2022	3.76%	3.63%	-	2.39%	1.9	4.06%
9M23	4.97%	4.52%	4.35%	3.49%	1.3	4.26%

Source: Wind, CMBI Research

Chart 3: FEH's onshore bonds (incl. ABS/ABN) financing (RMB bn)



Source: Wind, CMBI Research

Table 8: FRESHK's net liquidity gap as at Jun'23

RMB mn	On demand	<3 months	3 to 12 months	1 to 5 years	Over 5 years	Undated	Total
Total financial assets	23,696	50,148	134,748	136,050	1,529	2,534	348,705
Total financial liabilities	414	55,295	128,362	127,733	4,202	-	316,006
Net liquidity gap	23,282	(5,146)	6,387	8,316	(2,673)	2,534	32,699

Source: Company fillings

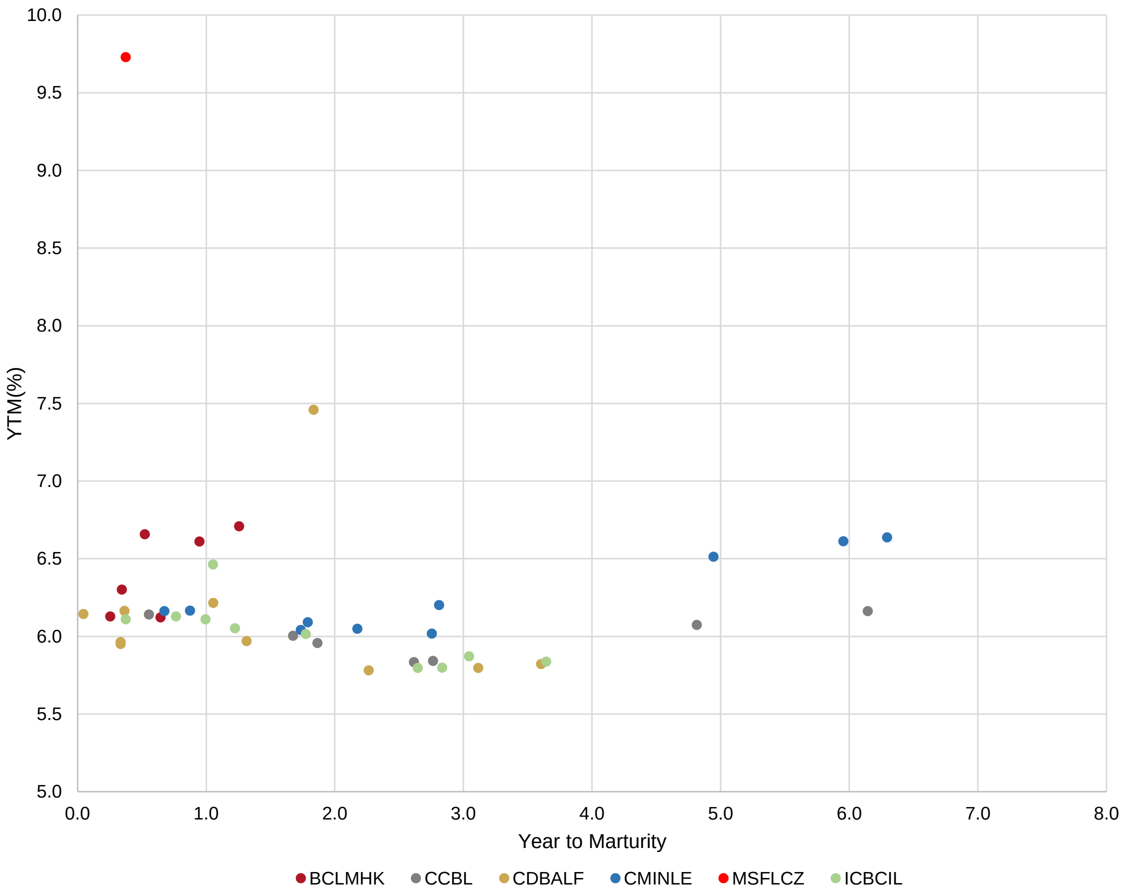
Prefer BCLMHK Float 24-25s and CDBFLC 2 ⅞ 09/28/30

Most of the large Chinese banks have their financial leasing arms, including BOCOM's BOCOM Leasing and CDB's China Development Bank Leasing. As non-bank financial institutions, financial leasing companies are allowed to operate a wider range of businesses such as taking deposits from non-bank shareholders and tapping interbank market for funding. Meanwhile, financial leasing companies are required to maintain minimum CET1/Tier1/total capital ratios of 7.5%/8.5%/10.5% respectively. There are also regulatory requirements on the degree of concentration in single client financing and non-performing assets allowance. As financial leasing companies have access to more diversified funding channels and are subject to more stringent regulatory requirements, they have been enjoying lower funding costs than commercial leasing companies.

Within the financial leasing space, we view **BCLMHK Float 09/05/24**, **BCLMHK Float 12/10/24**, and **BCLMHK Float 03/02/25** as lower beta plays under the uncertain interest rate environment. They are trading at YTM of 6.6-6.8% with cash prices close to par. BCLMHK Float 24-25s also present 79-94bps yield pick-up over the senior notes of BOCOM with similar maturity (see Chart 5).

Regarding the yield pick-up opportunities over bonds of their parent banks, we consider the pick-up of the 142bps for **CDBFLC 2 ⅞ 09/28/30** (Tier 2 bond, callable 09/28/25) over its parent CDB's senior bond SDBC 1 10/27/25 most attractive. At 92.7, CDBFLC 2 ⅞ 09/28/30 is trading at YTC of 6.9%.

Chart 4: Actively traded financing leasing companies' bonds



Source: Bloomberg.

Table 9: Comparison of selected financial leasing companies

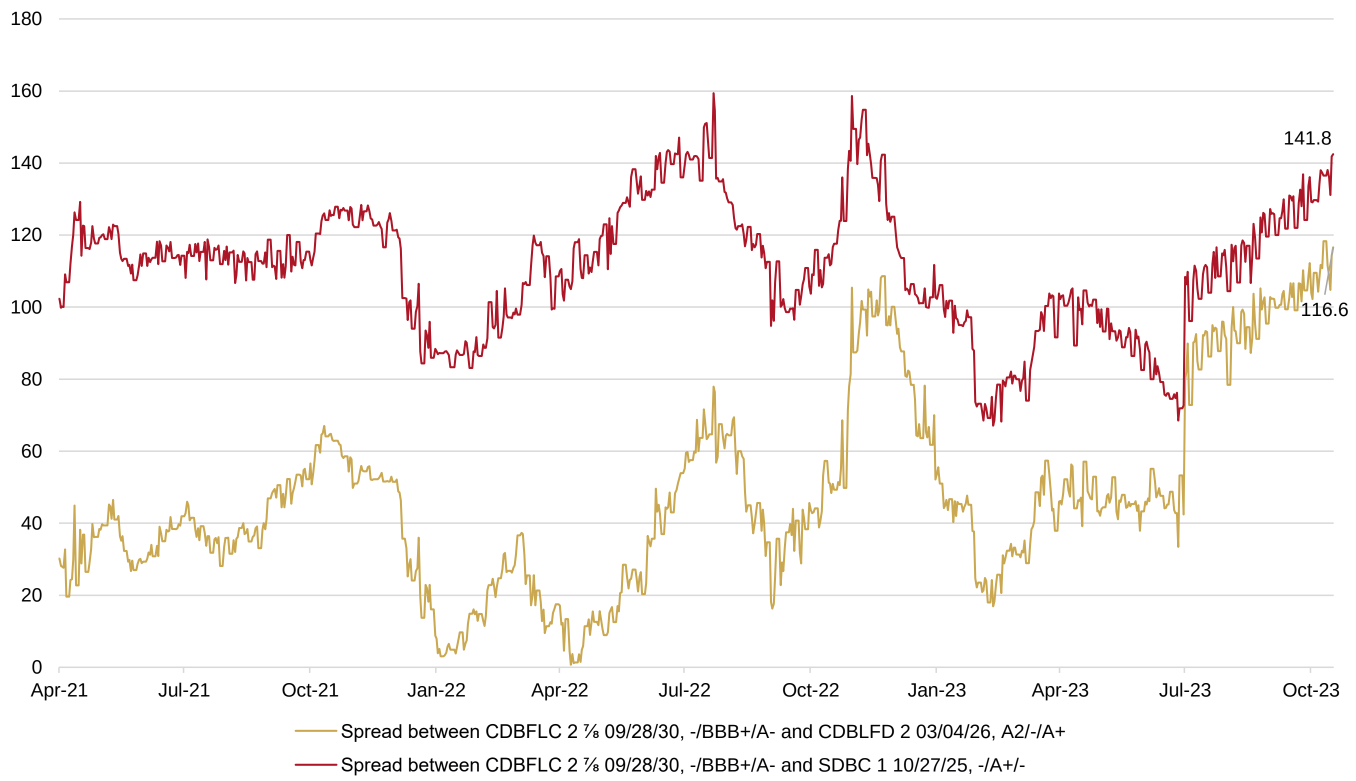
Period	Ticker	Rating (M/S/F)	ROA	NPL	EBITDA/ Net Debt	Total capital adequacy ratio (>10.5%)	Concentration of single client financing (<30%)
FY22	BCLMHK	A2/A-/A	1.13%	1.12%	20.5x	12.36%	10.40%
FY22	CCBL	A2/A/A	0.62%	2.49%	38.7x	18.45%	11.80%
1H23	CDBALF	A1/A/A+	1.09%	0.78%	26.8x	12.33%	12.96%
FY22	CMINLE	A3/BBB+/-	1.35%	0.36%	23.7x	13.28%	11.33%
FY22	MSFLCZ	Baa3/BBB-/-	0.59%	1.70%	34.8x	11.37%	10.47%
FY22	ICBCIL	A1/A/A	0.07%	1.49%	34.1x	13.09%	11.33%

Source: Company fillings.

Chart 5: Spread between BCLMHKs and senior unsecured notes of BOCOM

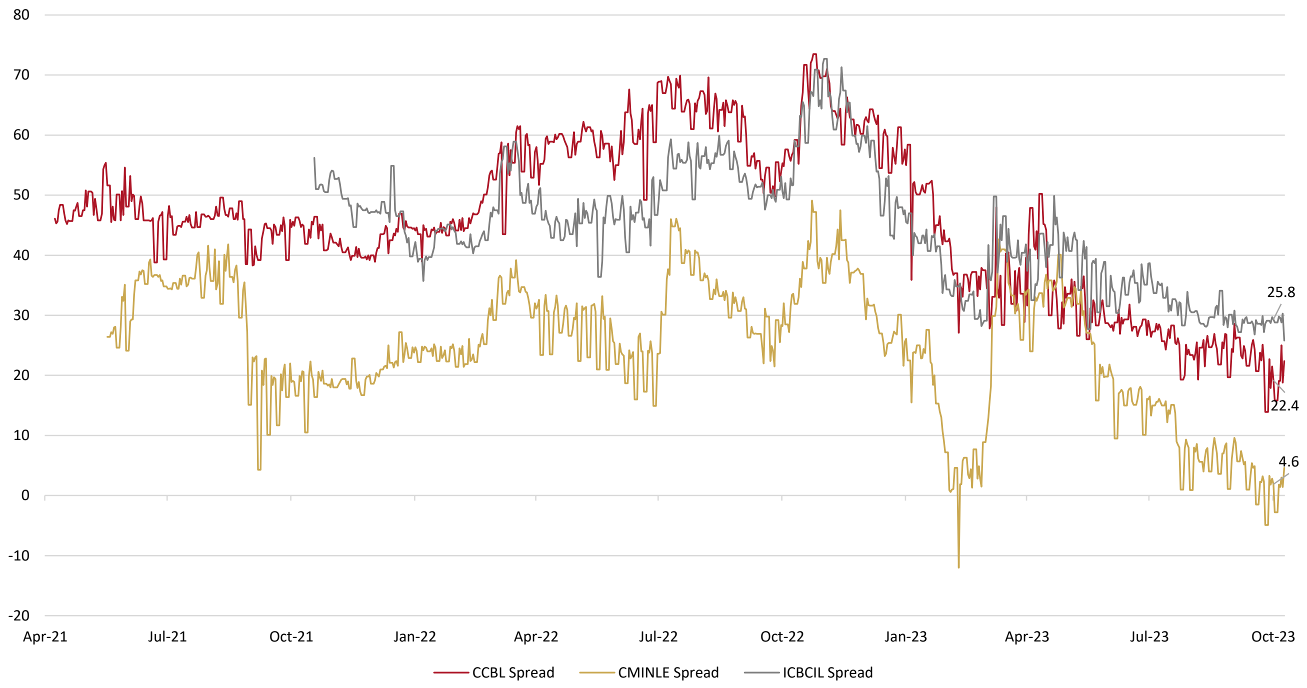
Source: Bloomberg.

Chart 6: Spread between CDBFLC 2 ⅞ 09/28/30 and senior unsecured notes of CDB leasing and CDB



Source: Bloomberg.

Chart 7: Spread between CCBL/CMINLE/ICBCIL and senior unsecured notes of CCB/CHINAM/ICBCAS



Source: Bloomberg.

Strong implied support from parent banks given the cross default or acceleration clauses

All Chinese financing leasing companies that have outstanding USD bonds are consolidating entities of their parents. Hence, the financing leasing subsidiaries' default or acceleration of payments will trigger the cross default if acceleration of payments of their respective parents. The threshold of cross or acceleration default is low at USD25-50mn. We expect the support such as credit lines from parent banks to be forthcoming should support is necessary in view the strong financial positions of parent banks, cross default clauses and majority shareholdings.

Table 10: Cross default clauses to shareholders

Ticker	Shareholder	Shareholding	Shareholder's cross default	Cross default with shareholder	Cross default threshold (USD mn)
BCLMHK	Bank of Communication	100%	Y	the Issuer or any of its subsidiaries	25
CCBL	China Construction Bank	100%	Y	the Bank or any of its subsidiaries	25
CDBALF	China Development Bank	64.4%	Y	the Bank or any of its subsidiaries	50
CMINLE	China Merchants Bank	100%	Y	the Bank, any relevant branch or any of the bank's subsidiaries	25
MSFLCZ	Minsheng Bank	55.0%	Y	the Bank or any of its subsidiaries	25
ICBCIL	ICBC	100%	Y	the Issuer or any of the Bank's subsidiaries	30

Source: Bloomberg, CMBI Research.

Appendix

Key financial data of FRESHK

RMB mn	FY19	FY20	FY21	FY22	1H23
Total revenue	26,856	29,042	33,644	36,586	18,362
-Financial services (interest income)	15,842	16,522	19,168	21,678	11,085
-Advisory services (fee income)	4,574	3,836	3,179	1,823	473
-Revenue from industrial operation	6,521	8,811	11,435	13,233	6,890
-Tax and surcharges	(80)	(127)	(138)	(147)	(86)
Cost of sales	(12,525)	(14,076)	(16,431)	(18,128)	(9,909)
-Borrowing costs	(8,039)	(8,070)	(8,937)	(9,008)	(5,009)
-Costs for industrial operation	(4,486)	(6,007)	(7,494)	(9,120)	(4,900)
Gross profit	14,331	14,966	17,213	18,458	8,453
Attributable profit	4,338	4,576	5,512	6,129	3,071
Total assets	260,571	299,927	335,880	346,995	361,363
Cash and cash equivalent	3,990	11,877	15,659	15,904	21,382
Net interest-earning assets	203,149	235,414	258,379	270,601	278,787
ST debts	87,981	104,169	122,858	123,599	153,565
LT debts	76,288	101,868	107,950	128,235	115,135
Total debts	164,269	206,037	230,808	251,834	268,700
Gearing ratio	84.1%	84.9%	84.2%	84.9%	84.4%
Asset quality ratios					
Non-performing asset ratio	1.1%	1.1%	1.1%	1.1%	1.1%
Provision coverage ratio	246.1%	252.2%	241.8%	240.0%	234.9%
Write-off of non-performing asset ratio	40.3%	52.9%	40.3%	50.1%	21.1%
Overdue interest-earning assets (over 30 days)	1.3%	1.0%	0.9%	0.9%	0.9%
Profitability ratios					
ROA	1.8%	1.8%	2.0%	1.9%	2.0%
ROE	15.0%	14.2%	14.6%	14.1%	13.3%
Net interest margin	3.7%	3.8%	4.1%	4.7%	4.4%
Cost to income ratio	33.5%	33.9%	35.3%	36.8%	41.8%

Source: Company filling, CMBI Research.

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