

Investment Assessment Report

China Huarong Asset Management Co., Ltd.

Yan Haixiang version 2.1.4

QUICK FACTS ABOUT HUARONG

Company Type	Public
Foundation	1999
Employee	10,947
Traded as	Unlisted (A share) SEHK: 2799 (H share) SHSC: 2799 SZSC: 2799 DB: CHE
ISIN	CNE100002367
Industry	Financial services
Founder	Chinese Government
Headquarters	Beijing, China
Area served	China (Mainland and Hong Kong)
Key people	Wang Zhanfeng (Party Secretary) Lai Xiaomin (former Chairman)
Services	Financial asset management
Revenue	CN¥75.4 billion (2015)
Operating income	CN¥22.2 billion (2015)
Net income	CN¥14.5 billion (2015)
Total assets	CN¥866.5 billion (2015)
Total equity	CN¥98.1 billion (2015)
Credit Rating	S&P Issuer Credit Rating BBB+
Next Announcement Date	08/28/20
P/E	CNY 19.76
Est. P/E (Dec 2020)	4.80
T12M EPS	0.04
Est. EPS	0.15
Owner	Ministry of Finance of China (63.36%) Warburg Pincus (5.27%) Fabulous Treasure Investments (4.39%) China Life Insurance Group (4.22%)
Parent	Ministry of Finance of China
Key Executive and Board Members	Wang, Zhanfeng -Executive Chairman of the Board Li, Xin -President & Executive Director Li, Yonghua -Head of the Financial Department Wu, Jinglong -Member of the Senior Management Ngai, Wai Fung -Joint Company Secretary
Website	www.chamc.com.cn/
Headquarter	No. 8 Financial Street Xicheng District Beijing, Beijing Province, 100033, China

BUSINESS OVERVIEW

Business Segments

Huarong mainly focuses on three areas of business: Distressed Asset Management, Financial services, and Asset Management.

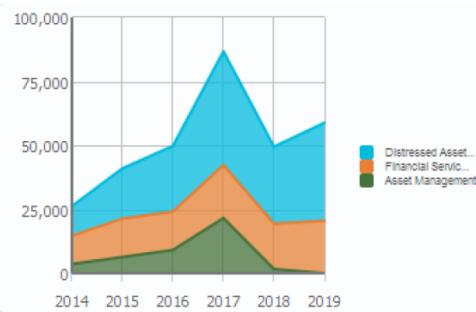


Fig 1. Huarong Business Segment
*Segments with negative values, such as corporate eliminations, are excluded from the total & percentage calculations and do not

	2019 Rev	3Yr Gr
Distressed Asset Management	69.79B	11.24%
Financial Services	33.58B	11.15%
Asset Management and Investment	14.31B	-12.96%

Table 1. Segment Revenues & Growth

Asset Management

Out of the three segments that Huarong operates on, Asset Management has seen the lowest revenue over the years, and the 3-year average revenue growth is as low as -12.96%. Significant doubt has been placed on the continuity of the segment.

Not only Huarong, this phenomena is observed in various asset management companies across the globe. A strong dollar and a shift toward

lower-fee products and fund types have added to revenue margin pressures for some asset managers. The latter is a secular pressure, but the former should be cyclical. Shifts toward cheaper products, such as fixed-income from equities, as well as to index from active add to margin pressure. Despite endeavours to leap the industry out of this dilemma, Franklin, Lazard, Invesco, T. Rowe and BlackRock's fee margins

generally continued to drop in 1Q after 2016-2019 declines. (See figure 2.)

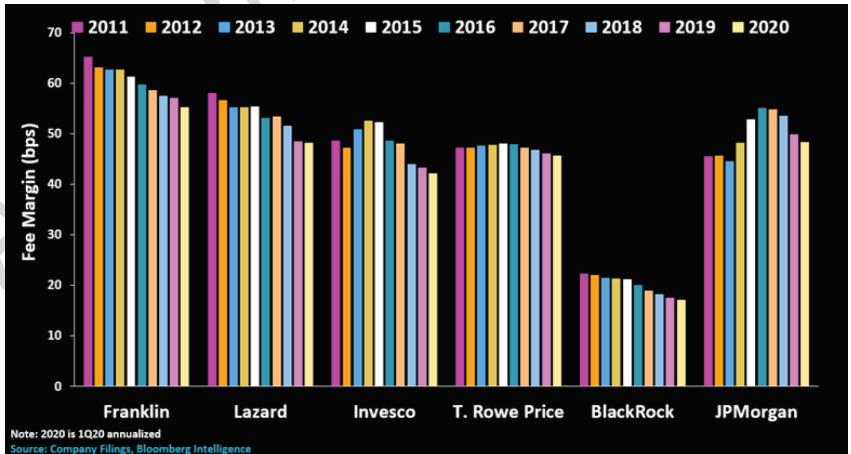


Fig 2. Investment Management Fee Margin

Shown below, funds in the 0-10 bp expense-ratio tier have garnered over half of flows cumulatively and in almost every individual year from 2013-19.

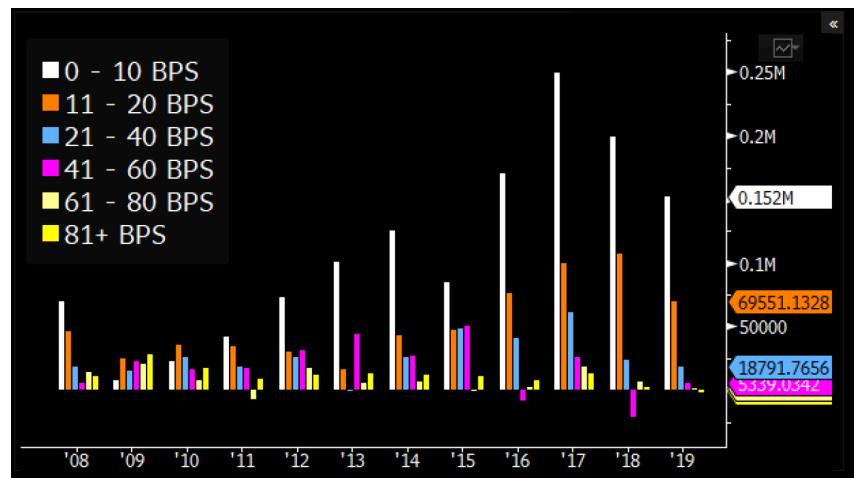


Fig 3. Capital Flows by Expense Ratio (\$Million)

Fig 6. Amount of Distressed Assets under Management

Low management charges explain the continually decreasing profit margin for Asset Management companies.

On the other hand, money market assets have seen a major capital inflow over the first half of this financial year. As illustrated in Fig 4., Money-market assets have declined only slightly in June, after growth through May of about \$1.2 trillion (32%) from February as investors shifted to more conservative positions. About 85% of growth was in institutional funds, which increased 44%, while retail-related rose by 13%. Fixed-income mutual-fund and ETF inflows have accelerated in June after May inflows recovered from April outflows. This follows a record-worst month and quarter for bond outflows in March and 1Q, based on ICI data back to 1990. Equity flows remain negative in June though outflows have slowed from May. Aggregate inflows in 2Q so far are \$84 billion. (Fig 5.)

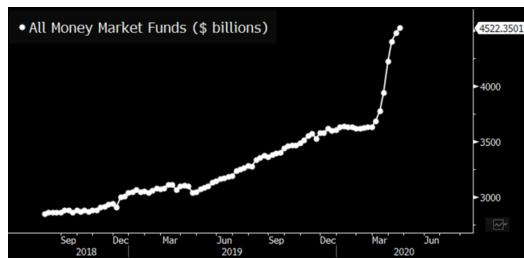


Fig 4. Money Market Funds' Assets

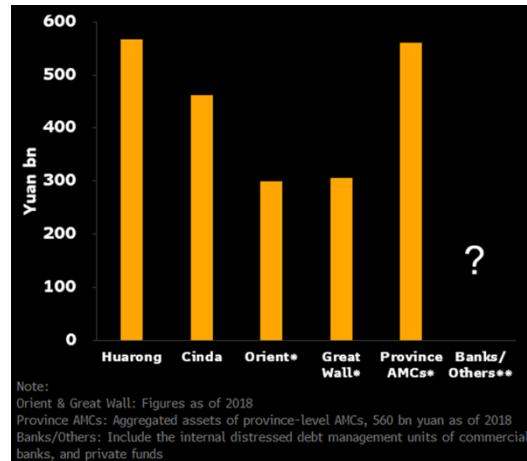


Fig 5. Combined ETF & Mutual Fund Flows (\$Million)

Distressed Asset Management

Competition is increasing in China's distressed debt market, which will introduce more discipline to the sector but may also lower returns. The growing supply of NPLs means there is ample room for more players. Apart from Huarong, Cinda, Orient, Great Wall and few others are also owned by the Ministry of Finance, hence their main duties are bound to distressed asset management and serve as stabilizer in times of elevated systematic financial risk that observed in the market ever since 2018, when the US started the trade war against China and forces the country to further open up its control on financial market.

In March 2020, Chinese regulators announced the creation of a fifth nation-wide bad debt asset manager, in giving a license to Jiantou Zhongxin Asset Management, a central government owned platform. There are also reportedly around 56 different province-level AMCs, which are individually much smaller but which could potentially leverage their capital to grow assets to 1.5 trillion yuan. (Fig 6.)



tackle persistent market wait-and-see mood, and sluggish international trades since the outbreak of COVID-19, Huarong's probability of default remains low. (further discussed under fixed-income below)

Takeover Defence

Process to Change Company Bylaw

Company may amend the Articles where necessary. Amendments to the Articles shall not be in conflict with laws and regulations. The Company shall amend the Articles in any of the following circumstances: (1) any terms contained in the Articles becoming inconsistent with the provisions of the amended Company Law and other relevant laws and regulations from time to time; (2) changes of the Company resulting in the non-compliance with the Articles; (3) a resolution being passed by the shareholders' general meeting to amend the Articles. Any amendments to the Articles which are subject to approval by relevant authorities shall be filed to the relevant authorities for approval. Where an amendment to the Articles shall be subject to registration, the Company shall register such amendments in accordance with the laws. The board of directors shall amend the Articles in accordance with the resolution and authorization in relation to the amendments to the Articles passed at a shareholders' general meeting and the opinion given by the relevant authorities and shall register the amendments with the competent authority. Amendments to the Articles shall be adopted by shareholders' general meeting by special resolution.

% of Shareholder Approval Required to Amend Bylaws 66.67%

Supermajority Shareholder Approval Required to Amend Bylaws
Only Board Can Amend Bylaws
Change of Control Agreement with CEO

Yes

No

No

Table 2. Takeover Defence

Voting Procedure to Fill Vacant Board Seats

The shareholders' general meeting is the organ of authority of the Company and shall exercise the functions and powers in accordance with the laws to elect and replace the directors. The board of directors shall convene an extraordinary general meeting to elect a new director to fill the vacancy.

Comparable Peers

Huarong Asset Management focuses on three areas of business and is classified as Asset Management according to Capital IQ industry catalogue. Based on information of market capitalization, business development cycle, and main operating fields.

Company Comp Set
China Cinda Asset Management Co., Ltd. (SEHK:1359)
China Everbright Bank Company Limited (SHSE:601818)
China International Capital Corporation Limited (SEHK:3908)
Guotai Junan Securities Co., Ltd. (SHSE:601211)
Huatai Securities Co., Ltd. (SHSE:601688)
Chongqing Rural Commercial Bank Co., Ltd. (SEHK:3618)
Ping An Bank Co., Ltd. (SZSE:000001)
China Merchants Securities Co., Ltd. (SHSE:600999)
Industrial Bank Co., Ltd. (SHSE:601166)
Industrial and Commercial Bank of China Limited (SEHK:1398)

Table 3.
List of Comparable Companies

FUNDAMENTAL ANALYSIS

Financial Statements

Balance Sheet

Total Assets have been increasing since 2014 as Huarong has completed several major investment over the years, in a bid to diversify its investment holdings. (discuss further under Investment) However, the biggest contributor is trading asset securities, which include options, swaps and other derivatives to serve the purpose of risk hedging as well as occasional speculative activities.

Account receivables have been increasing, which indicates deteriorating credit standing of the counterparty. (Fig 7.) Further investigation should be placed on the company's credit screening process. However, it is worth noticing that this increase in A/R accounts may be due to the impact of the Sino-US trades war that takes place by the end of 2017, which causes Huarong to absorb in larger amount of distressed assets that have lower repaying capabilities.



Fig 7. Assets Breakdown

From 2017 to 2019, except customer loans, stage 2 and 3 assets, namely assets with increased credit risk and credit impaired assets, have been increasing in numbers. Scenarios are worse for debt instruments at FVOCI and debt instruments at amortized cost. (Table 4.)

	FY19	FY18	FY17
Customer Loans			
Stage 1	93.7%	94.1%	93.8%
Stage 2	2.8%	3.6%	4.7%
Stage 3	3.5%	2.3%	1.5%
Past due over 90 days %	2.2%	1.7%	2.4%
Finance Lease Receivables	71	101	98
Stage 1	89.9%	93.2%	95.3%
Stage 2	6.6%	5.2%	3.4%
Stage 3	3.5%	1.6%	1.3%
Past due over 90 days %	3.4%	2.0%	2.5%
Debt Instruments at FVOCI	104	147	158
Stage 1	63.0%	90.3%	97.8%
Stage 2	29.2%	7.6%	2.1%
Stage 3	7.8%	2.2%	0.1%
Past due over 90 days %	10.7%	1.1%	n/a
Debt Instruments at Amortized Cost	706	663	678
Stage 1	70.4%	76.4%	88.1%
Stage 2	10.2%	13.8%	8.9%
Stage 3	19.4%	9.7%	3.0%
Past due over 90 days %	11.5%	10.1%	2.4%

Under IFRS 9, Expected Credit Losses must be modelled for the above assets
*Stage 2 indicates credit risk has increased significantly since origination
**Stage 3 indicates the asset is credit impaired

Table 4. Asset Loans in terms of Stages

Type of Asset	Risk Weight
Financial NPLs, acquired via wholesale auction	50%
Financial NPLs, acquired via other means	75%
Distressed receivables from Non-Financial Enterprises	100%
Other corporate and individual debt	150%
Equity investment in Financial Institutions	250%
Equity investment in corporates arising from policy reasons	100%
Follow-on investments arising from distressed debt assets	150%
Market-style Debt Equity Swap assets	150%
Other equity investments in corporates	400%
Fixed Assets not for own use, arising from seizure of collateral	100%
Fixed Assets not for own use, arising for other reasons	400%
On-balance sheet assets arising from restructuring projects	50%

Table 5. Regulatory Risk Weights

Assets with increased credit risk take around 37.0% of the entire asset universe that Huarong is holding by the end of 2019, compared to merely 2.2% in 2017. The Basel III regulatory risk weights (Table 5.) can serve as a guidance for asset credit risk with different categories.

Growth in LT and ST Liabilities

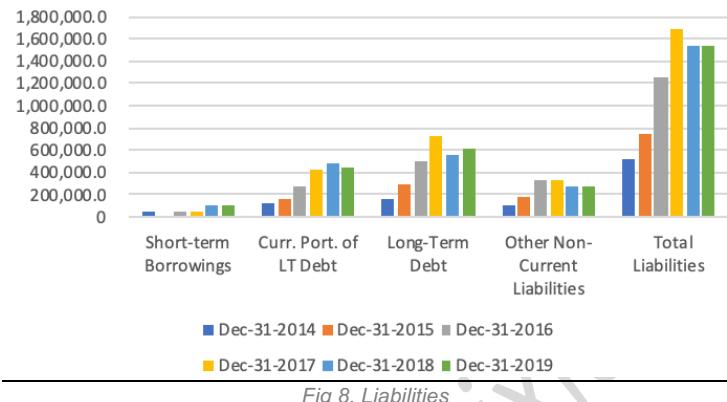


Fig 8. Liabilities

Since 2015, Huarong has relied heavily on Long-term debts as a major financing source (88% in 2019) to resolve its current dilemma of shrinking operation revenue. (Fig 8.) This approach does help Huarong to overcome short-term under-pricing of its stock (discussed under Equity) and increased cost of equity due to deteriorating financial performance over the years, but it adds on to its credit risk as S&P has recently downgraded its credit rating from A- to BBB+.

Income Statement

Huarong's weak returns come mainly from the investments segment. The bulk of those assets are in Hong Kong subsidiary Huarong International Holdings, which is downsizing but still held 194 billion yuan of assets at end-2019. This unit accounted for 10 billion yuan in losses before tax in 2018; no figure was reported for 2019 but it likely still accounts for the losses. Other units under Investments include Huarong Trust and various onshore financial investments.

Gross Revenue & Net Operation Margin%



Fig 9. Shrinking Revenues

RMB billion	Distressed			Investments			Financial Services		
	FY19	FY18	YoY	FY19	FY18	YoY	FY19	FY18	YoY
Total Income	70	65	8%	14	18	-20%	34	30	11%
Interest, Fee Expense	(35)	(38)	-7%	(14)	(17)	8%	(17)	(15)	8%
Operating Cost	(7)	(7)	-5%	(2)	(3)	-2%	(5)	(5)	-2%
Impairment Cost	(7)	(6)	27%	(13)	(8)	0%	(6)	(6)	0%
Profit Before Tax	20	13	52%	(13)	(10)	39%	6	4	28%
Assets	853	866	-2%	348	355	-2%	574	546	5%
Net Assets	106	114	-7%	5	6	-17%	51	48	7%
Return on Assets	2.3%	1.5%		-3.9%	-2.7%		1.0%	0.8%	

Table 6. Deterioration of Investment Management segment

Financial Ratios

Profitability

Huarong and Cinda's performance diverged in 2H19 with the former reporting a loss due to a sharply deteriorating credit portfolio and elevated impairment losses, while the latter saw some pressure but remained profitable. Income trends were similar, with lower interest income on restructuring-type distressed debt, as they downsized their portfolios. Gains on disposal-type distressed assets improved, and both enjoyed a rebound in market valuations.

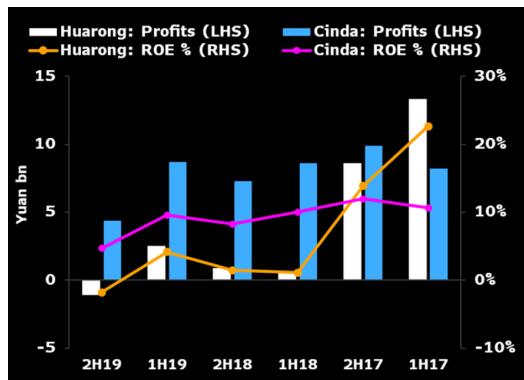


Fig 10. Profitability and ROE

Leverage

Huarong has relied on Debts as financing source heavily as its stock continues to underperform its counterparties and investors are withdrawing from holding Huarong's stock. This has pushed the Leverage ratio (defined as Debt/Equity) over 700% by the end of 2019. High leverage ratio and pessimistic profit outlook cast doubt on Huarong's repayment capability. (Fig 11.)

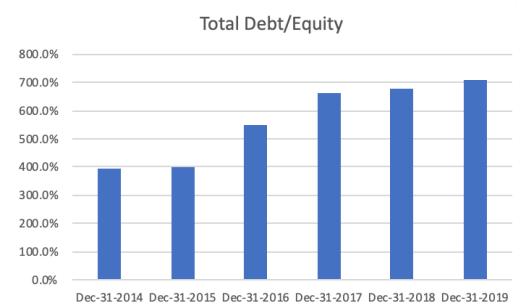


Fig 11. Leverage Ratio

By the end of 2019, Huarong is bound to repay 52.3% of its total debt obligation outstanding within the next year (2020), which poses considerable pressure to Huarong's 2020 profitability, given the bleak economic outlook and decreased needs for asset management in mainland China. (Fig 12.)

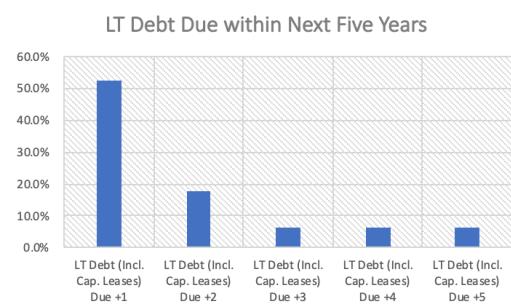


Fig 12. LT Debt Due within Next Five Years

	Huarong 2H19	Cinda 2H19	Orient 9M19	Great Wall FY18	Zhong- yuan 9M19
Group, Consolidated Balance Sheet					
Assets	1,705	1,513	1,120	669	75
Total Equity (incl MI & perpetuities)	163	188	128	65	11
Shareholder's Equity*	121	144	93	57	3
Total Equity/Assets	9.6%	12.5%	11.4%	9.6%	14.8%
Shareholder's Equity/Assets	7.1%	9.5%	8.3%	8.4%	3.9%
Parent Company, Unconsolidated Balance Sheet					
Assets	827	729	463	461	47
o/w Investment in Subs	26	39	44	28	5
Total Equity (incl MI & perpetuities)	127	136	89	61	6
Shareholder's Equity*	127	115	89	61	6
Shareholder's Equity/Assets	15.3%	15.8%	19.2%	13.2%	12.5%
Capital Ratio (Reported)	15.3%	16.8%	13.3%	N/A	N/A
Group Assets/Company Assets	2.1x	2.1x	2.4x	1.5x	1.6x

*Excluding perpetual capital instruments and minority interest

Table 7. Leverage Metrics Across AMCs

Company-level equity to assets rose to 15.3% at FY19 from 15.0% in FY18, while company-level capital ratio rose to 15.3% from 13.6%. The stronger improvement in capital may reflect a changing asset mix that allows for lower risk-weighting. At group level, equity to assets was 7.1% at FY19, similar to the previous year. Huarong also reports a leverage ratio defined as interest-bearing liabilities to equity, which declined to 9.2x from 10.2x over the year.

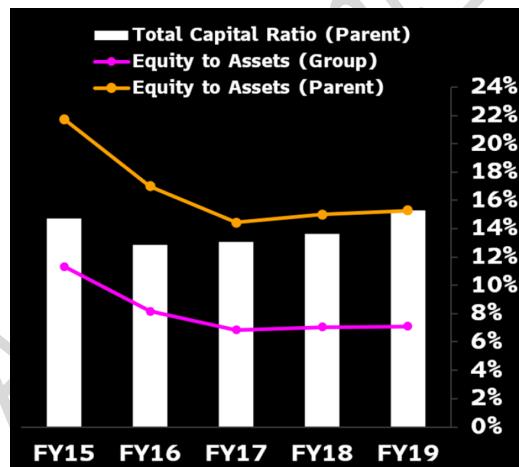


Fig 13. Capital Ratio and EA Ratio

While Huarong's capital ratio remains above the regulatory benchmark and indicate healthy standing, its equity-to-assets have fallen around 7% at Parent company and 3% at group level. This is linked to the recent takeover of the past financial institution, now renamed as Huarong International Financial Holdings Ltd, while the company's capitalisation remains low due to large outflow of equity investments as investors become conservative.

MACROECONOMIC ANALYSIS

Market Outlooks

Interbank Overnight Repo Rate

The signals are clear that monetary support will be strengthened. The PBOC indicated that the growth rates of M2 and aggregate social financing this year could be slightly higher than the expansion in nominal GDP.



Fig 14. China's Interest Rate

As incentives to stimulate investment and consumption, the SHIBOR-3M and China Financial Institution Average Lending Rate remain low following a downscale of the benchmark rate by the central bank of China. Effect remains to be observed as this policy sinks and reflects in market indicators.

China – Recovery from COVID-19

China's activity rebound showed a bit more balance in May -- though a renewed Covid-19 outbreak is a reminder that the economy remains in a delicate position. The YoY rate of fixed asset investment have been recovering to historical average, but not fully recovered.



Fig 15. China Activity Data



Fig 16. China Public and Private Investment

INDICATOR	4Q19	1Q20	2Q20	3Q20	4Q20	2019	2020	2021
GDP (Percent YoY)								
Baseline Case ("BC")	6.0	-6.8	3.8	5.3	6.1	6.1	2.1	8.2
Upside	6.0	-6.8	4.2	5.8	6.3	6.1	2.4	8.2
Downside	6.0	-6.8	3.7	4.2	4.5	6.1	1.4	7.5
Trade War	6.0	-6.8	3.8	5.3	5.1	6.1	2.1	7.9
CPI (Percent YoY YTD) (BC)	2.9	4.9	4.2	3.6	2.8	2.9	2.8	0.5
One-year Loan Prime Rate (BC)	4.15	4.05	3.85	3.65	3.45	4.15	3.45	3.35

As of April 21, 2020

Actual / Forecast / Forecast / Forecast / Forecast

Fig 17. China GDP Forecast

The outlook for China's GDP (2020) remains conservative (2.1% for baseline estimation), while investor consensus has been formed that following 2021 will see a GDP growth of 8.2% (baseline estimation) as consumption and purchasing power will be fully unleashed post COVID-19. (Fig 17.)

The latest readings on high-frequency indicators of China's economy suggest momentum slowed in the first half of June. Another outbreak of Covid-19 in Beijing -- which prompted local restrictions on some activity -- casts more uncertainty over the strength of the recovery going forward as consumers and businesses learn to live with virus risks.

However, it is estimated that as the first batch vaccine will be released to market later this year, China's economy will continue to recover, and nationwide lockdown is unlikely to happen again. In the graph below, red indicates weaker performance while green represents stronger performance. (Fig 18.)



Fig 18. China Economy Recovery Index

Industry Analysis

Retail Financial Services

China is taking a big step to increase labour market mobility. The State Council plans to eliminate barriers for rural migrants to enter Hukou household registration systems in cities with less than 3 million residents, and to lower the barriers in cities of 3-5 million. Guidelines issued in April on increasing flexibility in the allocation of production factors – including labour - could provide further impetus.

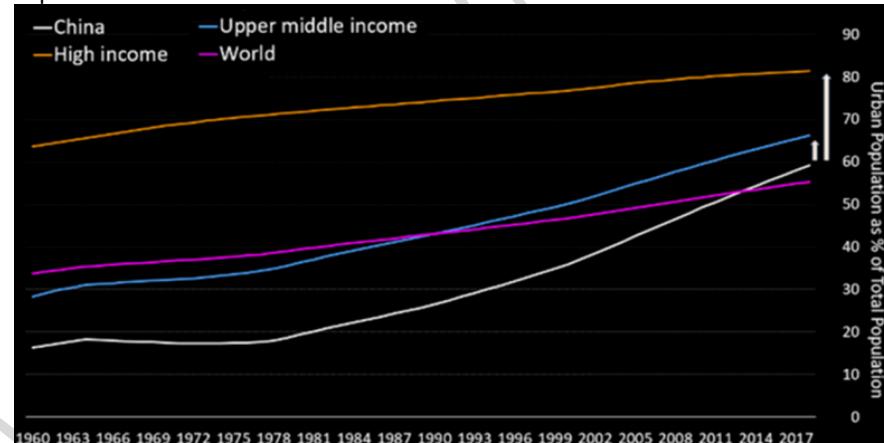
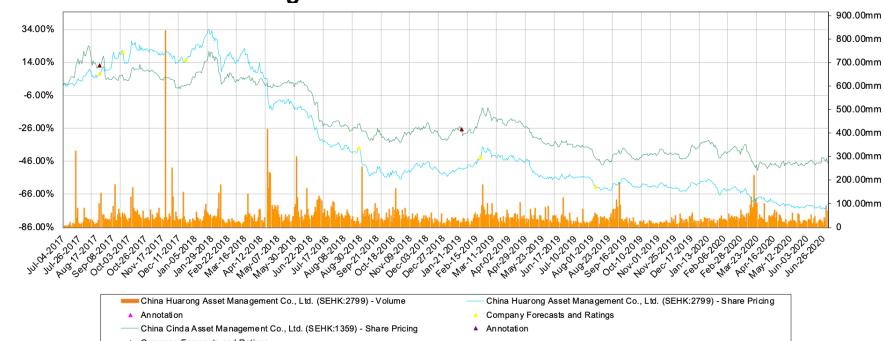


Fig 19. China Urbanization Rate – Room to Rise

Continuous urbanization speaks louder on growing middle class and the purchase power that comes along. As China accelerates its progress of poverty alleviation and enhancing admission rate of higher education, demands for asset management and retail financial services will continue to grow.

EQUITY ANALYSIS

Market Price and Trading Volume



Like all other asset management companies in the world, both Huarong and Cinda see a market tank in around July of 2018, when most investors believe both countries are not fully braced and the results of this war could persist long enough. Since then the share price continues the downward trend until now, with Huarong consistently underperforms Cinda since May 2018. (Fig 10.)



Market investors remain pessimistic over Huarong's future performance as the pandemic continues to limit financial activates and thereby cast doubt on Huarong's capability of generating sustainable revenue for days to come. A relatively strong SELL signal is expressed. (Fig 21.)

Net Capital Flow

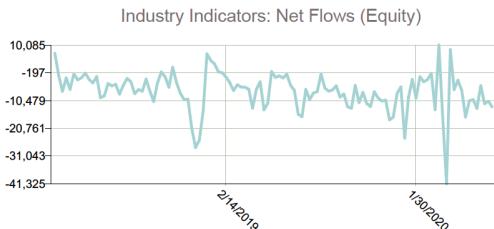


Fig 21. Net Capital Flow – Equity

*Source: ICI Investment Company Institution, Currency: HKD, Unit: N/A, Periodicity: Semi-Annually

Since beginning of 2018, capital starts to withdraw from Huarong in the equity market, in anticipation of weaker performance especially in the asset management industry. This has forced Huarong to significantly alter its capital structure by allowing heavier weights of debt financing. In short term, stock market recovery is not foreseeable as the fundamental cause of such underperformance has not changed. (Fig 21.)

Dividend



Fig 22. Dividend (Huarong & Cinda)

Attempting to attract capitals from retail investors by enhancing dividend rate in the first quarter of 2018, Huarong failed to achieve its intended goal as such behaviours are viewed negatively by analysts as it will likely drain out Huarong's liquidity, especially in times of great uncertainty and debts pile up. As shown in Fig 22. above, Huarong Dividend has fallen to below 1.00% level, lower than Cinda's 5.00%.

Stock Holders

Top Huarong stock holders include:

- CHINA MINISTRY OF FINANCE 49.42%
- WARBURG PINCUS LLC 8.23%
- FABULOUS TREASURE INVESTMENTS LT 6.85%
- CSI AMC CO LTD 3.15%
- PANTAI JUARA INVESTMENTS LTD 3.01%
- CICC STRATEGIC INVESTMENT LTD 2.99%
- COFCO CORP 2.76%

HUARONG TOP SHAREHOLDERS (2020)

CHINA MINISTRY OF FINANCE	49%
WARBURG PINCUS LLC	8.23%
FABULOUS TREASURE INVESTMENTS LT	6.85%
CSI AMC CO LTD	3.15%
PANTAI JUARA INVESTMENTS LTD	3.01%
CICC STRATEGIC INVESTMENT LTD	2.99%
COFCO CORP	2.76%
Others	3%

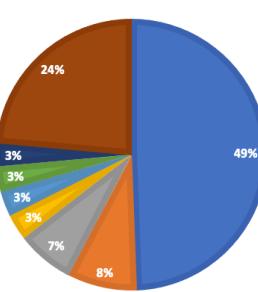


Fig 26. Top stock holders

Ministry of Finance, Warburg, and Fabulous collectively owns 64% of Huarong's shares. (Fig 26.)

Historically these three entities seldom alter their holdings, which is a positive sign. Similar situation applies to Cinda, Orient, Great Wall, as well as Zhongyuan, where the MOF owns majority of their shares. Hence, even if private entities may withdraw capital from the above said entities, the presence of MOF will demonstrate support from the government, which stabilizes market speculation and uphold the company's going concern assumption.

Institutional Investor Movement

A breakdown of each entity's historical holdings are displayed below. From 2015 till present, the top three shareholders of Huarong has not altered their holdings.



Fig 27. MOF Historical Holdings (2015 – 2020)



Fig 28. Warburg Pincus Historical Holdings (2015 – 2020)



Fig 29. Fabulous Historical Holdings (2015 – 2020)

EPS

Affected by shrinking revenue and few major takeovers over the years, earnings have gone through a bit volatility since 2018. However, forecasts bounce back to 0.21 by the end of 2021 as the new Merger & Acquisitions slowly gain their capacity of earning generation. It is worth noticing that when normalised the earning figures, EPS appear to be hovering around historical mean.

Earnings Per Share

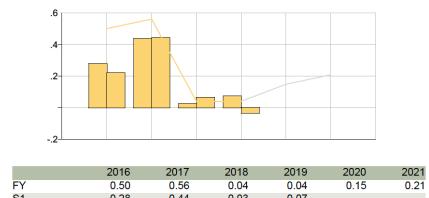


Fig 30. EPS (2016 – 2021forecasted)



Fig 24. Normalised EPS vs. EPS (Basic and Diluted)

Normalised EPS is obtained by taking out non-recurring items and asset purchases, so to reflect a more realistic picture of Huarong's EPS performance.

P/BV Ratio

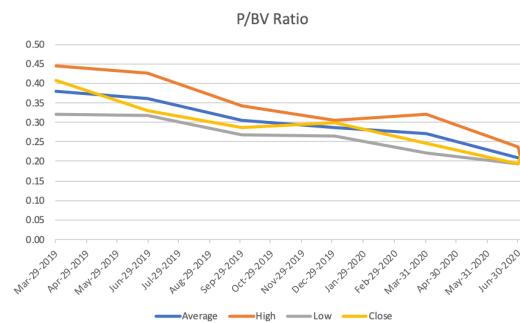


Fig 25. P/BV Ratio

Equity Performance Evaluation

The comparison targets are the asset management companies listed in the HK Stock Exchange (86 companies in total), medians and average for each of the 12 performance metrics are measured so to get an industry benchmark that Huarong is compared to.

Favourable underlying drivers include high dividend pay-out ratio, low value factor (HML), low accruals, as well as low technical. (Table 8.) However, although high dividend pay-out ratio is applauded by retail investors. Institutional investors expressed concerns as such behaviour showed little help in restoring market confidence in buying its shares, which prices continue to fall. Value for Accruals is as low as -2.69%, but has seen worsening over the years as credit collection periods extended.

Unfavourable indicators include (i) low revisions as market conditions keep worsening; (ii) low growth prospect; (iii) low profitability; (iv) high dispersion; (v) high leverage as Huarong relies heavily on debts for financing purposes and creditors demand higher yield as Huarong's credit rating for long-term bonds (both local and foreign currency) has been downgraded by S&P; (vi) low working capital as large portion of liquidity is tied up in repaying bond principals and interests; as well as (vii) low surprises.

In specific, institutional investors like MOF has expressed concerns over Huarong's low working capitals, which is valued at 1.8%, while the industry average stays 12.0%. On the other hand, market has voiced out that the central government should loosen regulatory requirements held by financial institutions to allow flexibility for them to combat recession.

2799 HK Equity Factor						
Style	Name	Value	Peer Median	Peer Low	Peer High	
Favorable						
Dividends	High	Dividend Payout 189.4%	22.0%	0.0%	189.4%	
Value	Low	P/E Ratio (2FY) 3.4x	3.7x	3.4x	34.1x	
Accruals	Low	Accrual to Assets -2.69%	-3.64%	-5.60%	1.58%	
Technicals	Low	Price vs 50D Mkt -4.9%	-3.4%	-6.7%	5.4%	
Unfavorable						
Revisions	Low	3M EPS Revision -50.8%	-28.1%	-50.8%	-5.3%	
Growth	Low	1Y Fwd Sales Growth -5.7%	1.8%	-5.7%	7.1%	
Profitability	Low	ROE LTM 1.3%	6.1%	1.3%	8.0%	
Dispersion	High	EPS Est Dispersion 57.7%	10.0%	8.4%	57.7%	
Leverage	High	Net Debt/EBITC 15.0x	9.8x	-2.3x	15.0x	
Work Cap	Low	Cash to Assets 1.8%	12.0%	0.7%	37.0%	
Technical	Low	Price vs 52W Hgt 54.9%	68.2%	54.9%	83.0%	
Surprises	Low	EPS Surprise % -81.0%	-29.6%	-81.0%	-19.0%	

Table 8. Favourable and Unfavourable Equity Performance

FIXED INCOME PERFORMANCE

Major Bondholders

Managing Firm Name Total

	Total
BLACKROCK	221345428.1
GOLDMAN SACHS GROUP INC	139890000
HSBC	121945241.3
INVESCO LTD	116209741.7
PRUDENTIAL PLC	109292204.5
ALLIANZ SE	95078142
NEUBERGER BERMAN GROUP LLC	90668700.1
MUZINICH & CO INC	83799575
PING AN UOB FUND MANAGEMENT CO LTD	83354610
JPMORGAN CHASE & CO	82735583.1

Table 9. Top 10 Bondholders of Huarong (2020.07)

Huarong Asset Management's senior perpetual bonds callable in September 2021 trade at similar spreads, or over 400 basis points, to Cinda's more junior Additional Tier 1 bonds, and could narrow. The senior perpetuities are also more than 200 bps wide of Huarong's senior bonds with bullet maturities, compared with less than 70 bps late last year. Huarong's asset quality appears to have deteriorated significantly and will remain under pressure in 2020, but the company's strategic refocus on distressed debt and its policy role in cleaning up the financial system means its credit remains underpinned by a strong likelihood of state support.

Spread and Credit Rating

Subsidiary	Type	Bid	Change	Mid	Change	Ask	Change
China Huarong International Holdings Limited	Senior	145.970	(2.596)	150.763	(2.681)	155.557	(2.766)
Huarong Finance II Co. Ltd.	Senior	137.926	(2.453)	146.447	(2.604)	154.967	(2.756)

Table 10. CDS Spread Widening

The bid-ask spread has widened around 2.60 bps over the year, indicating conservative sentiment across market investors.

Debt Type (Rating Type)	Rating	Rating Date	Last Review Date	Action	CreditWatch/Outlook
Local Currency LT	BBB+	Aug-28-2018	Dec-16-2019	Downgrade CreditWatch /Outlook	Stable
Local Currency ST	A-2	Jul-04-2014	Dec-16-2019	New Rating	-
Foreign Currency LT	BBB+	Aug-28-2018	Dec-16-2019	Downgrade CreditWatch /Outlook	Stable
Foreign Currency ST	A-2	Jul-04-2014	Dec-16-2019	New Rating	-

Table 11. S&P Credit Rating – Huarong

*source: Capital IQ

Huarong's leverage is improving but it still much less profitable and fundamentally riskier than Cinda due to the composition of its distressed assets and other subsidiaries. It's pushing in the right direction but could be highly vulnerable to economic weakness in 2020.



Fig 26. Huarong Credit Trend

Most credit drivers for Huarong remain neutral to unfavourable, and the company has a debt to equity ratio that is unhealthily high. (Fig 27.)

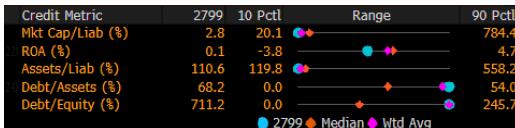


Fig 27. Credit Metrics Comparison

Here is a breakdown of how Huarong's credit rating changes from July 2015 to July 2020. Long-term credit ratings for both local and foreign currencies have been downgraded from A- to BBB+. (Fig. 28, 29, 30, 31)



Fig 28. Issuer Credit Rating (Local Currency LT)
*July 2015 to July 2020 – Downgraded at 28 Aug 2018
source: S&P Global Rating



Fig 29. Issuer Credit Rating (Local Currency ST)
*July 2015 to July 2020



Fig 30. Issuer Credit Rating (Foreign Currency LT)
*July 2015 to July 2020 – Downgraded at 28 Aug 2018



Fig 31. Issuer Credit Rating (Foreign Currency ST)
*July 2015 to July 2020

Key to the asset management companies' credit outlook and bond ratings is the expectation of government support, predicated on their size and systemic role. The large AMCs receive 4-7 notches of uplift from baseline ratings while Zhongyuan gets four. Bond ratings can vary from parent ratings. Fitch also rates the senior bullets one notch down from the parent, and the senior perpetuities an extra notch down as, despite comparable seniority, Fitch thinks the issuer could prioritize the bullets.



Table 12. Credit Rating Drivers

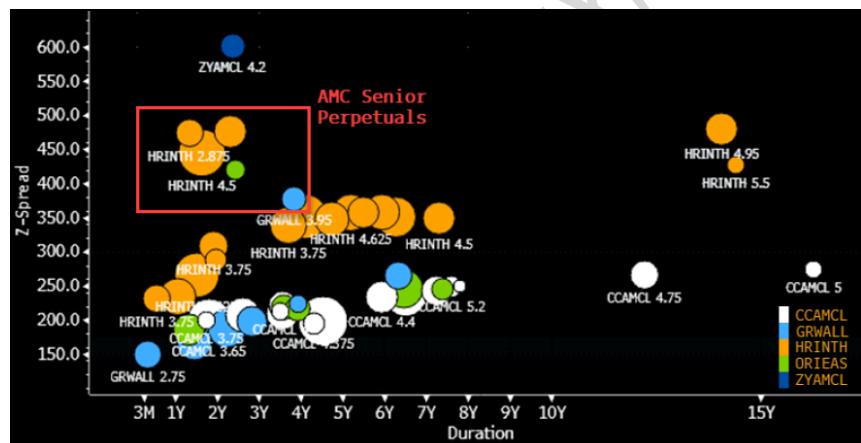


Fig 32. Z-Spread and Duration

Huarong's senior bonds maturing in 2024-27 trade 120-150 bps wide of Cinda's comparables, even though its bonds maturing in 2020-21 are at spreads 40 bps wide of Cinda's. We also note that Huarong and Cinda seniors maturing in 2047-48 are more than 190 bps apart. We previously held the view that Huarong's status as a policy tool - which underpins their credit - was at greater risk than Cinda's, due to its aggressive and undisciplined growth. But we now think the two AMCs are comparable in terms of alignment to their strategic roles.

FX Risks and Opportunities

Currency	Market Share (%)	# Securities	Amt Out/Tr Sz
CHINA RENMINBI	50.1966	43	23040731070
US DOLLAR	46.2742	34	21240300000
HONG KONG DOLLAR	0.6689	4	307041800
SINGAPORE DOLLAR	1.5744	2	722644600
EURO	1.286	1	590285000

Table 13. Huarong Bond Currency Breakdown

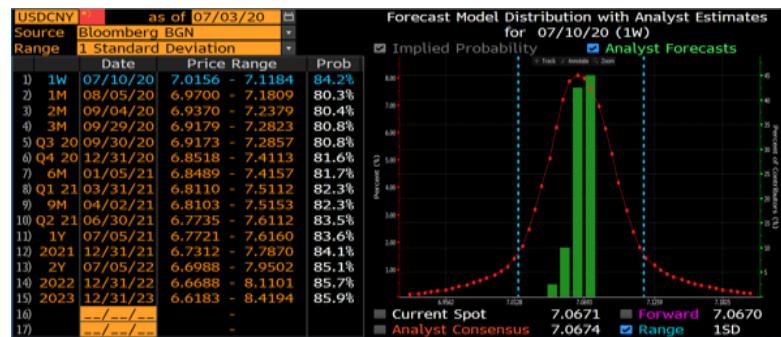


Fig 33. USD/CNY Exchange Rate Forecasts

Huarong has 46.27% debts denoted in US dollars, and is thus subject to FX fluctuates.

Market consensus is that the USD/CNY exchange rate will not deviate from current 7.0156 – 7.1184 range too much. The probability of the range remains within one standard deviation from the consensus is constant at around 83.0% until 2023. However, as the central bank of China owns plenty of foreign reserves denoted in US dollars, its ability to withstand sudden fluctuation in exchange rates remains high.

Although China was dedicated to boost domestic consumptions and accelerate industrial transformation, international trades constitute a major part of its economy. It is thus believed that the central bank will continue to maintain a high exchange rate, so to facilitate exporting and international expansions.

Net Capital Flow

Industry Indicators: Net Flows (Bond)

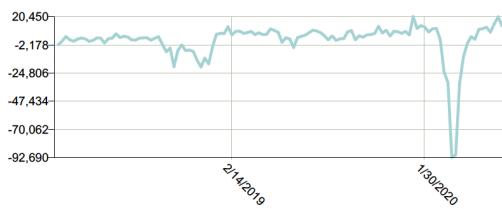


Fig 34. Net Capital Flows – Bond

*source: ICI Investment Company Institution, Currency: HKD, Unit: N/A, Periodicity: Semi-Annually

A major capital outflow is observed when Huarong's LT debt credit rating has been downgraded from A- to BBB+. (Fig 34.)

Capital Structure

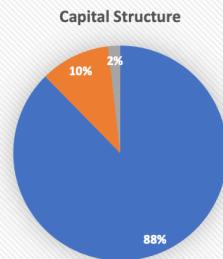


Fig 35. Capital Structure

Huarong is highly leveraged as 88% of its capital comes from issuing debts, which serves as one of the reasons for the credit downgrading.

INVESTMENT ANALYSIS AND RECENT DEVELOPMENT

Major Investment Direction

Investments by Sector

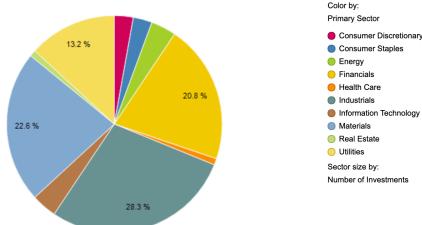


Fig 36. Investment by Sector

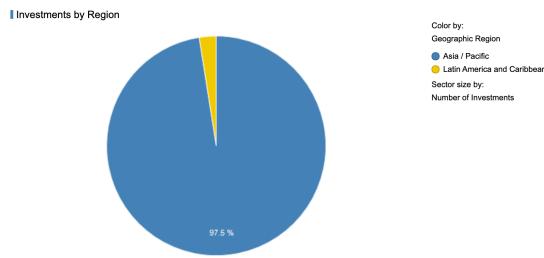


Fig 37. Investment by Region

The top three sectors that Huarong invested in are (i) Industrials (28.3%), (ii) Materials (22.6%), and (iii) Financials (20.8%). These industries are severely impacted by the pandemic and recovery is dependent on overall betterment of the market conditions.

Further research could focus on the industry forecasts and detailed analysis of the market drivers.

Recent Development

Company Name	Market Value (USD)			Position Date	Primary Industry
	% Of CSO	In mm)	Position Date		
Shanghai Yanhua Smartech Group Co., Ltd.	17.41	74.9	Mar-31-2020	Construction and Engineering	
China Animal Husbandry Industry Co., Ltd.	1.989	38.6	Jun-30-2019	Pharmaceuticals	
CNFC Overseas Fisheries Co.,Ltd	13.463	35.9	Mar-31-2020	Packaged Foods and Meats	
Huarong International Financial Holdings Limited	51.0	35.2	Dec-31-2019	Investment Banking and Brokerage	
Hubei Xingfa Chemicals Group Co., Ltd.	1.172	15.9	Mar-31-2020	Commodity Chemicals	
Panda Green Energy Group Limited	4.183	15.6	Feb-18-2020	Renewable Electricity	
Alltronics Holdings Limited	9.892	6.5	Mar-05-2020	Household Appliances	
Sino Energy International Holdings Group Limited	35.085	1.9	Sep-30-2019	Automotive Retail	

Table 14. Recent Investments

FORECAST AND ANALYST ESTIMATION

China Huarong Asset Management Co., Ltd. provided earnings guidance for the six months ended June 30, 2019. The board of directors of the company announced that the shareholders of the company and potential investors that, based on the information currently available to the Group and a preliminary review on the unaudited consolidated management accounts of the Group for the six months ended 30 June 2019, the Group is expected to record a net profit attributable to equity holders of the Company for the six months ended 30 June 2019 of not less than RMB 2 billion, while the net profit attributable to equity holders of the Company for the six months ended 30 June 2018 was RMB 685 million. The increase in interim results for the year of 2019 of the Group was mainly due to: the increase of the valuation of certain equity-based investment of the Group affected by the rise of domestic stock markets in the first half of 2019; the Group continues to deleverage and optimize debt structure, which make both of the financing scale and interest rates decline and the interest expenses decrease; the Group actively returns to the core business of distressed assets, improve the efficiency of assets disposal, with increased income from the core business.

SEHK:2799 (CNY)	2018	2019	2020	2021	2022
	EPS Normalized	0.04 A	0.04 A	0.20 E	0.27 E
EPS (GAAP)	0.04 A	0.04 A	0.20 E	0.27 E	0.21 E
DPS	0.01 A	0.01 A	0.05 E	0.06 E	0.05 E
Book Value / Share	3.09 A	3.10 A	3.23 E	3.34 E	3.48 E
Company Level (CNY)	2018	2019	2020	2021	2022
Revenue	107,253.10 A	109,900.00 E	114,800.00 E	86,429.47 E	13,209.00 E
EBIT	6,458.30 A	10,589.10 A	12,428.71 E	16,270.80 E	(64,400.00 E)
Interest Expense	(64,098.10 A)	(60,256.73 A)	(59,300.00 E)	(62,000.00 E)	(13,000.00 E)
EBT (Exc. Excep)	6,011.90 A	10,970.09 A	12,634.43 E	16,551.67 E	13,000.00 E
EBT (GAAP)	6,011.90 A	10,970.10 A	10,900.00 E	11,600.00 E	13,000.00 E
Net Income (Exc. Excep)	5,757.50 A	1,424.43 A	5,860.04 E	7,854.22 E	5,791.27 E
Net Income (GAAP)	1,575.50 A	1,424.43 A	7,735.07 E	10,500.46 E	8,040.00 E
Net Debt	1,111,504.05 A	624,102.42 A	-	-	-
Gross Margin %	42.0 E	-	-	-	-
ROE %	1.30 A	1.20 A	4.43 E	3.67 E	4.31 E
ROA %	0.10 A	-	0.44 E	0.47 E	0.54 E
TEV	70,662.05 E	87,684.30 E	69,169.27 E	67,641.21 E	66,218.59 E

Table 15. Analyst Forecasts

SUMMARY AND KEY OBSERVATION FIELDS

There is no doubt that the going concern of Huarong remains relevant as the MOF and central government will continue to provide solid support and use Huarong as a policy tool in the long run. However, for 2020 and the following years, Huarong could further improve on the use of leverage and reshuffle its business in asset management as profit margin keeps shrinking. New business models and technologies could be considered to replace the current operations, so to further cut management fee charge and appeals to a growing internet population who prefer to access financial products with mobile terminals. Besides, greater emphasis could be placed on Huarong's market share in the segment of distressed asset management as the government expressed clear signal of opening up the market to more provincial financial institutions and foreign capitals alike.

(End of report)