

GLOBAL ECONOMY AND FINANCIAL MARKETS SHORT COMMENTARY



30 April, 2021

Huarong Bonds tumbled after report regulators consider restructuring

China Huarong Asset Management Co.'s dollar bonds slumped as much as 40% after it failed to publish its financial year results by March 31 deadline. Further, Reorg Research reported that regulators are considering options for the company that include restructuring the debt of its offshore unit.

Huarong's background

Four asset management companies (AMCs) in China are established in 1999 by the Ministry of Finance as a bad bank, one for each of the four commercial state-owned banks, Great Wall Asset Management for the Agricultural Bank of China, Orient Asset Management for the Bank of China, Huarong Asset Management for the Industrial and Commercial Bank, and Cinda Asset Management for the China Construction Bank respectively. They play a key role in supporting Chinese commercial bank by disposing non-performing loans (NPLs).

After years, the AMCs business had become more diversified. Huarong in particular, under former chairman Lai Xiaomin's watch, Huarong's business expanded aggressively, including securities trading, trusts, lending, real estate and other financial services, deviating from the original mandate of disposing bad debts. Through aggressive merger and acquisition, noting that Huarong's assets surged 60-fold in the five years to 2017. In 2018, Lai was accused for 'serious violations of discipline and laws' of bribery and corruption offenses of receiving 270 million yuan in illicit payment and was executed in January 2021.

Since then, China Banking and Regulatory Commission (CBRC) issued draft regulations which promised greater oversight of AMCs and instructed them to focus more upon NPLs as their core business competence and dedicating more sources. Huarong has started trimming non-core businesses amid regulatory pressure returning to its roots.

Bonds selloff and default fears

Fears in Asia's credit markets and a sell-off in Huarong's bonds in the past two weeks was triggered by it

failed to publish its annual result by the deadline amid worries about restructuring continues, the offshore bonds price of Huarong tumbled by as much as 40%. Global major ratings agencies have further added stress on review for a potential downgrade. Huarong is a major player in Chinese financial market with about \$22 billion debt and have investment-grade ratings from global credit raters.

Later, the company explained that the delay was due to its auditor needed more time to finalize a transaction. Tensions were eased after the company said to have prepared funds for full repayment of a \$600 million offshore bonds due on April 27. In addition, Chinese regulators asked Chinese banks to provide loans to Huarong so as not to destabilize its cash flow and reduce the risk of market contagion.

According to market watcher, Huarong has submitted an overhaul plan to regulators and now awaiting final approvals from Chinese authorities. Huarong is still determining the value of its stakes in some onshore and offshore units and finalizing which ones will be sold, one of the reasons that it late releasing its annual results. However, Huarong still has not said if it will default or have a corporate restructuring plan.

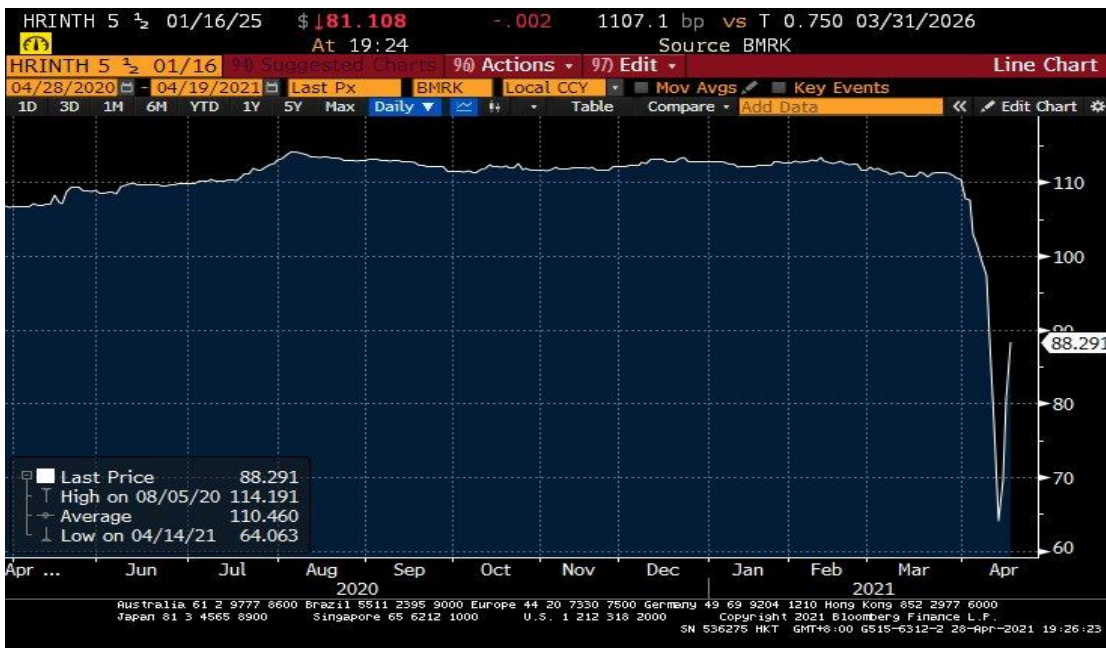
Huarong's net income has slumped 92% in the first half of 2020 as the value of some assets dropped in the wake of the Covid-19. The company's market value also has tumbled to about \$5 billion from more than \$15 billion when it initially listed in 2015.

Prices on some Huarong's dollar bonds fall to record lows

The company's 5.5% bond maturing in 2025 fell as much as 42%, Bloomberg-compiled prices show. A 4.5% perpetual note slumped more than 50% to 48.5 cents on 15 Apr.

While prices plunged to record lows on 15 Apr, the securities continue to trade at historically low levels as investors look for more clarity on the company's finances and overhaul plan. After the company stated that its business environment and operations have had no major changes recently and Chinese regulator said that the bad-debt manager was operating normally and had sufficient liquidity, the firm's dollar bonds rallied three days in a row after the decline.

Price of a Huarong bond with maturity date of Jan 2025



Source: Bloomberg

Conclusion

It is not the first time defaults by stated-backed Chinese companies in recent years, such as car producer Huachen, chip producer Tsinghua Unigroup, coalminer Yongcheng coal & electricity Holding Group. Panic in bond market that investors reassessed the creditworthiness of debt issued by the Chinese state-owned companies, Chinese regulators has grappled with the risk of credit-market contagion in result triggered a sell-off in Chinese bonds.

The question has been raised again regarding if the government will bail out state-owned companies if they ever run into trouble in China's credit market. Despite Huarong has stated itself has access to liquidity and is making payments on time, bond prices suggested that investors are bracing for a potential restructuring.

But we can tell that Chinese government wants to send a message since a few years ago that 'even state-backed firms such as Huarong do not enjoy blanket government guarantees'. Chinese authorities have tried to strike a balance between adhering market-based principle that investors should bear and avoiding a sudden loss of confidence that might spiral into a crisis that would hurt future investments in China.

Indeed, Chinese government is in a dilemma. If the authority chooses to bail out those companies like Huarong, whether through an injection of funds or by discharging its bad debts to others. It would definitely set a bad example and run in the opposite direction to the market-oriented principle.

But if Chinese authorities let the companies went defaulted, it could possibly trigger a chain reaction of financial risks. For now, given that the China Banking and Insurance Regulatory Commission said a few days ago that Huarong's operations are normal that its liquidity is sufficient, there are signs authorities

might be preparing to provide support to the company. Bloomberg reported that the Finance Ministry might transfer its controlling stake in Huarong to a unit of the nation's sovereign wealth fund that has more experience resolving debt risks.

Source: WSJ, Bloomberg, SCMP, Reuters, the Standard, Yahoo Finance,

Important Note & Disclaimer:

- ◆ The document is property of AMG FINANCIAL GROUP. All information in this document is strictly for information purposes only and should not be considered as an invitation, an offer, or solicitation, to invest or a recommendation to buy or sell any particular security or to adopt any investment strategy mentioned herein. AMG Financial Group Limited (here after AMG) endeavors to ensure the accuracy and reliability of the information provided but do not guarantee its accuracy or reliability and accept no liability for any loss or damage arising from any inaccuracies or omission. Some of the information in this document may contain projections or other forward looking statements regarding future events or future financial performance of countries, markets or companies. These statements are only predictions and actual events or results may differ materially. Any opinion or estimate contained in this document is made on a general basis and is not to be relied on by the reader as advice. AMG reserves the right to make changes and corrections to its opinions expressed in this document at any time, without notice to the recipients of this document. Any unauthorized disclosure, use or dissemination, either whole or partial, of this document is prohibited and this document is not to be reproduced, copied, and made available to others. Investment involves risks. The value of any investment and the income from it can rise as well as fall as a result of different market risks, such as currency and market fluctuations. Past performance figures shown are not indicative of future performance. The recipients of this document should seek for professional advice if they are in any doubt about any of the information contained herein. This material has not been reviewed or approved by the Securities and Futures Commission.

For any comments, please send email to us at enquiries@amgwealth.com.

AMG FINANCIAL GROUP

40/F, 118 Connaught Road West, Hong Kong

Telephone: (852) 3970 9531 Facsimile: (852) 3426 2650