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**China: Huarong's investment in its rescuer CITIC raises eyebrows**



In 2021 one of China's largest distressed debt asset managers, China Huarong Asset Management (Huarong), was on the brink of default. The company had been loss-making for years and, following a crash in its own bond prices, Huarong eventually had to be rescued by a government backed consortium led by the state-owned conglomerate CITIC Group. The 2021 bailout, saw CNY50bn (USD7.7bn) of new capital injected into Huarong, and CITIC Group raise its shareholding to 26.46% becoming Huarong's largest shareholder in 2022. It therefore came as a huge surprise that Huarong, which had still been incurring net losses in the first half of 2023, last week announced it would purchase a 5.01% stake in CITIC Limited, the Hong Kong listed subsidiary of its previous rescuer CITIC Group, for HKD13.6bn (USD1.74bn).

Huarong had been originally created by the Chinese government in 1999 as one of four state-owned distressed debt management companies put in charge of taking over the non-performing loans of the four largest Chinese banks prior to their IPOs. However, Huarong had more recently been viewed as pursuing a strategy that went well beyond its original mandate. In 2018 signs that all was not well at Huarong became clear when its then-Chairman Lai Xiaomin became the target of a graft probe and was eventually removed from his post. He was sentenced to death for bribery, embezzlement and bigamy and executed in January 2021.

Huarong had been a big investor in China's offshore real estate bonds via its proprietary trading arm. The sector's crash in 2021 contributed to a massive earnings write-down which triggered the CITIC bailout. CITIC Group was brought in as a white knight to recapitalise Huarong and to realign its focus on its core business of distressed debt

management. However, even after the rescue, losses at the property debt trading arm continued to be recorded, contributing to a net loss of USD4bn for Huarong in 2022. The loss was so large that it had an impact at the CITIC Group level which, according to Standard and Poor's, incurred a USD1bn equity investment loss that year.

In recent weeks, Huarong's offshore bond prices stabilized (admittedly at a significant discount to the bonds of other Chinese state-owned enterprises), but its recent financials remained poor as it reported a net loss of USD676m in the first half of 2023. It is therefore quite astonishing that Huarong announced that it would acquire a stake in CITIC Limited, the Hong Kong-listed arm of CITIC Group, at a 30% premium to the latest market price using proceeds of assets disposals. On the same day, Huarong said it would change its name to China CITIC Financial Asset Management and change its logo to match with the one of the CITIC Group for "leveraging the brand value of CITIC Group, promoting business conduct and further facilitating high-quality transformation and development of the company."

Proposed Change	Before Change	After Change
Full name of the Company (Chinese)	中國華融資產管理股份有限公司	中國中信金融資產管理股份有限公司
Short name of the Company (Chinese)	中國華融	中信金融資產
Full name of the Company (English)	China Huarong Asset Management Co., Ltd.	China CITIC Financial Asset Management Co., Ltd.
Short name of the Company (English)	China Huarong	CITIC Financial AMC

Proposed Change	Before Change	After Change
Logo		

*Source: China Huarong Asset Management Co., Ltd Announcement*

Market reaction to the acquisition was positive although we do admit to being a little confused by the strategic thinking of the management's decision. While it is not rare to see a once bailed-out company eventually returning cash to its white knight, it is surprising to see this happen in an elapsed time period of only two years amidst a challenging environment for the Chinese High Yield debt asset class and at a time when the bailed-out company is still losing money. In addition, from a credit standpoint perspective it needs to be asked why Huarong is injecting cash into its higher credit rated state-backed parent. In the stock exchange announcement Huarong said part of the rationale of the investment is to diversify its asset base even though it appears to go against the previously stated aim to refocus its operations back on distressed debt asset management.

It remains unclear whether the acquisition was directed by CITIC Group as a means of syphoning cash from its subsidiary, as a way to support the share price of its Hong Kong-listed arm, or if it is a genuine transformational move by China Huarong to more closely integrate itself into the CITIC Group.

Shortly after the announcement Standard & Poor's published a note to state that the deal won't impact the credit risk of Huarong as ultimately both entities, CITIC Group and Huarong, remain under the Ministry of Finance (MoF), noting that the MoF is Huarong's second largest shareholder. S&P argues that the state support should remain the same. The market, however, took a more positive view as the Huarong curve was up 2-4 points on the day of the announcement.

One could argue that if Huarong was able to convince the market that its credit profile is now aligned with the A3/BBB+ rating of CITIC Group, the cost of the 5% investment in CITIC Limited is cheap considering the potential reduction in funding cost for the USD9.2bn worth of outstanding Huarong USD bonds. Renaming the company could therefore be seen as a masterstroke decision by the Huarong board if it indeed allows Huarong to cut its cost of financing to those of the CITIC Group.

As one of the larger China exposures in the JKC Asia Bond 2025 fund, the portfolio was able to capture the rally in Huarong bonds as investors began pricing in the further integration between CITIC Group and Huarong. Concurrently, Huarong's stock price also enjoyed a 30% bump post announcement.

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