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Big-Four AMCs too Stressed to Maximize their Business Expansion Potential

State Ownership Ensures Big-Four AMCs' Stable Funding

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Overview of Big-Four AMCs' Credit Quality	
Business Position	Capital and asset pressure restrains the Big-Four AMCs' ability to expand non-performing asset-related business. Non-performing assets sharply declined in 2023, and we expect such downward trend to continue over the next 12 months.
Capital and Earnings	Their profitability and earnings quality worsen and some have suffered severe losses, leading to substantial strains on capital. Certain companies are in urgent need of capital replenishment. Given the continued downswing in the property sector in 2024, the Big-Four AMCs would come under earnings pressure over the next 12 months.
Risk Position	Their asset quality deteriorates amid the current round of economic downturn. Reserve coverage for problem debt assets is markedly insufficient.
Funding and Liquidity	They sustain stable access to funding. Their funding and liquidity are not sensitive to the decline in capital, earnings, and asset quality as investors strongly expect them to receive government support.
Government Support	We see steady likelihood of the four AMCs receiving government support over the next 12 months, which should underpin their stable issuer credit quality as such.
Key Monitoring Factor	Capital replenishment for Great Wall over the next 12 months. Earnings sustainability for CITIC AMC over the next 12 months. China's property sector recovery in 2025.

China's government and regulatory authorities require the Big-Four AMCs (Cinda, Orient, CITIC AMC (former China Huarong), Great Wall) to play a critical role in mitigating financial risks. In an article published in May 2024 urging non-bank financial institutions to better serve high-quality development, the Non-bank Financial Institution Regulation Department of the National Administration of Financial Regulation (NAFR) emphasized AMCs' essential role in performing counter-cyclical functions and providing financial aid and highlighted their position as the "stabilizer" for the financial system, the "firewall" against financial risks, and the "firefighter" to tackle financial crisis.

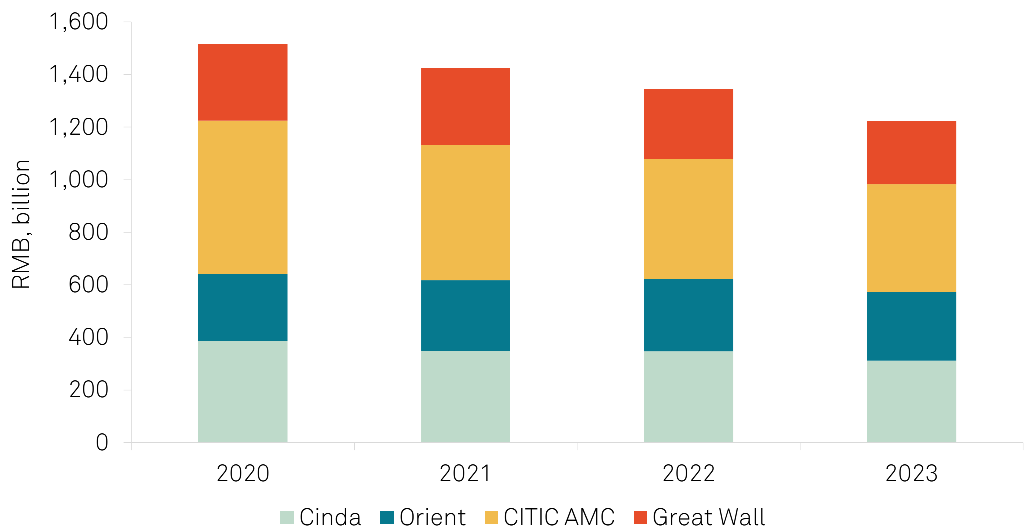
We think the Big-Four AMCs will try their best to aid the financial sector as per regulatory requirement, but what they can do is limited amid the present economic downturn, given the significant pressure on their capital, earnings, and asset quality. Some of these AMCs themselves have become the targets to be rescued. The Big-Four AMCs saw a shrinkage in their non-performing asset business in 2023. As of the end of the year, their overall non-performing assets reduced by 9% YoY to 1.22 trillion RMB. Specifically, Cinda, Orient, CITIC AMC, and Great Wall suffered a decrease of 9.9%, 4.9%, 10.7%, and 9.1%, respectively. Non-performing assets to parent's total assets ratio for these four AMCs stood at 42%, 49%, 50%, and 72%, down by 1.8ppts, 3.7ppts, 10.4ppts, and 4.6ppts, respectively.

The Big-Four AMCs have limited ability and willingness to participate in the burden-relieving campaign for the property sector, due to the eroded asset quality and capital strains facing them and the enormous risks associated with certain property aid projects. In January 2023, the PBOC granted a special relending quota specifically for the five largest AMCs to encourage them to help ease property developers' burden. This quota totaled 80 billion RMB with interest rate set at 1.75%. According to PBOC's latest disclosure on the use of structural monetary policy tools, only 20.9 billion RMB of loans were issued under this special program as of the end of the first quarter of 2024. We attribute the low proportion of loan issuance to the following two aspects: 1) the stress on asset quality and capital poses an obvious constraint on AMCs' ability to rescue other institutions. 2) AMCs need to make independent decisions and undertake relevant risks in their relending activities, so the elevated risks in property projects make them reluctant to increase by a large scale the property aid programs they are involved in.

Chart 1

The Big-Four AMCs' Non-Performing Asset Scales Move Down Amid Current Economic Downturn, Indicating Their Limited Counter-Cyclical Functions

Changes in the Big-Four AMCs' Total Non-Performing Assets



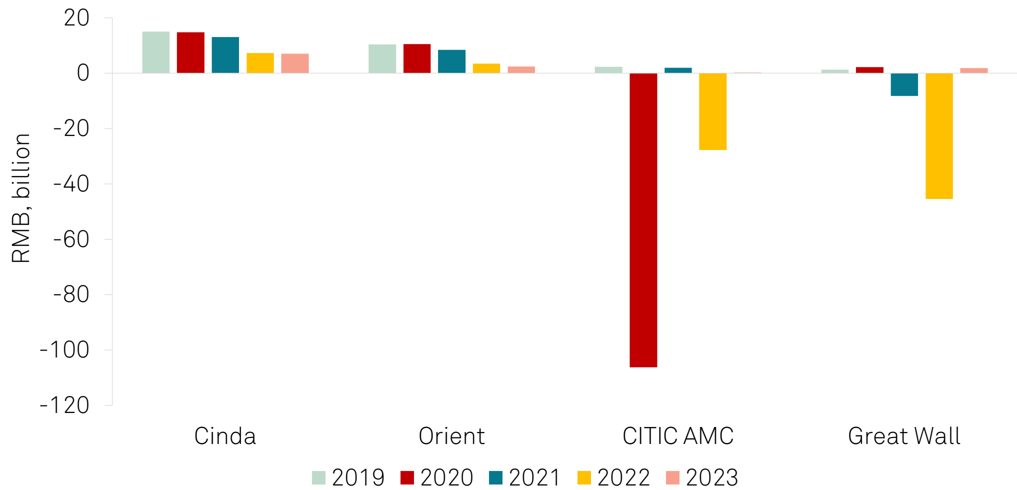
Source: Public information of companies, S&P Global (China) Ratings.

Their profitability from main businesses has weakened. The severe operating losses suffered by Great Wall and CITIC AMC in recent years were mainly led by: 1) the substantially higher pressure faced by AMCs on asset impairment and valuation shrinkage compared to other financial institutions, owing to AMCs' naturally weak asset quality and their large exposure to property sector. 2) Their high leverage levels, which amplify losses during economic downward cycle. Our data analysis suggests that reasons for earnings decline included marked decrease in revenue from non-performing asset business, reduced valuation on outstanding non-performing assets, surging credit impairment loss on outstanding non-performing assts, and loss on investments.

Chart 2

AMCs are Prone to Massive Losses During Economic Downturn Due to Their High Leverage and High-Risk Assets

The Big-Four AMCs' Earnings Over the Past Five Years



Source: Public information of companies, S&P Global (China) Ratings.

Table 1

AMCs	2022-2023 Earnings Overview
Cinda	Net profit down by 44% YoY to 7.2 billion RMB in 2022. Net profit at 7 billion RMB with ROAE of 3.29% in 2023.
Orient	Net profit down by 59% YoY to 3.5 billion RMB. Net profit down by 32% YoY to 2.4 billion RMB with ROAE of 1.51% in 2023. Net profit down by 55% YoY to 244 million RMB in 2024Q1 and loss attributable to owners of the parent was 301 million RMB.
CITIC AMC	Net loss was 27.8 billion RMB in 2022, equivalent to 26% of net assets at the beginning of the year. Net profit at 200 million RMB with ROAE of 0.43% in 2023.
Great Wall	Net loss was 45.4 billion RMB, representing 70% of net assets at the beginning of the year. Net profit was 1.8 billion RMB in 2023. Net profit down by 79% YoY to 140 million RMB in 2024Q1.

Source: Public information of companies, S&P Global (China) Ratings.

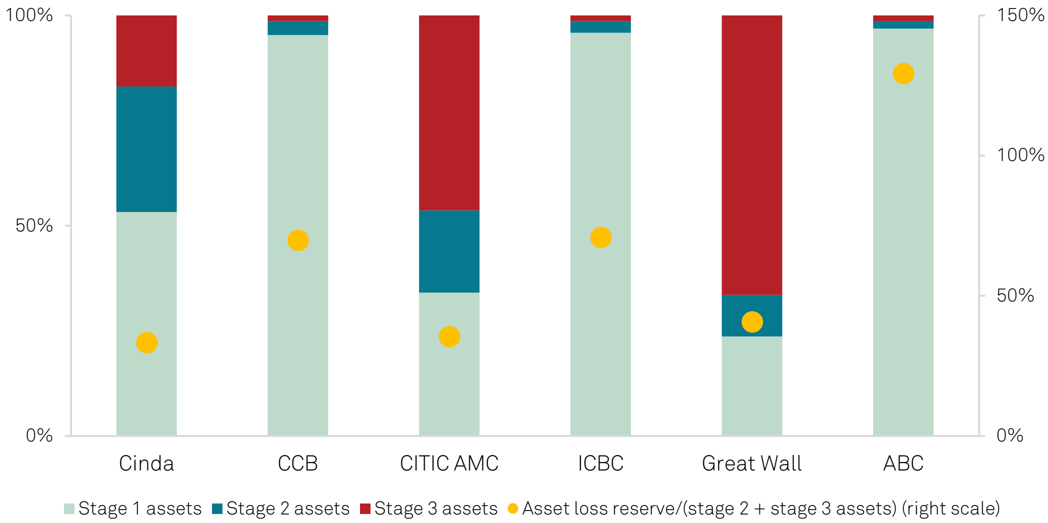
Some AMCs are troubled by poor earnings quality. CITIC AMC's earnings were mainly contributed by unsustainable non-operating income in 2023. Despite a net profit of 200 million RMB, its operating loss came to 40.4 billion RMB if disregarding non-operating revenue and expenses, equivalent to 80% of its net assets at the beginning of the year.

We expect the Big-Four AMCs to face continued challenges on earnings and capital in the following 12 months. In our view, a significant rebound in the property market is unlikely in 2024, rendering AMCs' asset quality under consistent stress. Besides, AMCs' reserve coverage for problem assets remains low, indicating continued provisioning pressure. The Big-Four AMCs' reserve coverage for stage 2 and stage 3 assets is far below banks' average, posing significantly higher risk regarding inadequate provisioning compared to that faced by an average bank. This has led to AMCs' poor earnings quality. As of the end of 2023, Cinda, CITIC AMC, and Great Wall's reserve coverage for stage 2 and stage 3 assets stood at 33%, 36%, and 41%, respectively (stage 2 and stage 3 assets are defined as non-performing debt assets included in debt investments by Cinda and as financial assets included in debt investments by CITIC AMC and Great Wall), in contrast to a reserve coverage of 86% by the Big-Four banks. We project an additional provisioning of 12 billion RMB, 116.1 billion RMB, and 29.4 billion RMB to be made by the above three AMCs, respectively, assuming a rise in their reserve coverage for stage 2 and stage 3 assets to 70%, equivalent to 6%, 242%, and 151% of their net assets at the end of 2023, respectively.

Chart 3

The Big-Four AMCs' Asset Quality and Reserve Coverage are Significantly Weaker than the Banking Industry

Asset Quality and Reserve Coverage Ratios of AMCs and Mega Banks as of the End of 2023



Note: According to IFRS 9, stage 1 assets are financial instruments that have not had a significant increase in credit risk since initial recognition. Stage 2 assets include financial instruments that have had a significant increase in credit risk since initial recognition but do not have objective evidence of impairment. Stage 3 assets are financial assets that have objective evidence of impairment at the reporting date.
Note 2: ICBC, CCB, and ABC's portfolios consist of loans and advances measured at amortized cost and those measured at fair value through other comprehensive income. CITIC AMC and Great Wall's portfolios consist of financial assets classified as debt investments. Cinda's portfolio is composed of non-performing debt assets classified as debt investments.
Source: Public information of companies, S&P Global (China) Ratings.

Table 2

AMCs	Earnings/Capital Quality and Provisioning Pressure Analysis
Cinda	We think the company's reserve gap is controllable and should not severely harm its capital. Cinda enjoys best earnings quality and least capital pressure among the Big-Four AMCs. As of the end of 2023, its reserve coverage for stage 2 and stage 3 non-performing debt assets classified as debt investments was 33.3%, down by 15.1ppts from 2022. An additional provisioning of 12 billion RMB is needed if this reserve coverage ratio increases to 70%, equal to 6% of its net assets at the end of 2023. Cinda owns a high proportion of goodwill assets, which accounted for 11% of its net assets as of the end of 2023. These goodwill assets were obtained through the acquisition of Nanyang Commercial Bank in 2016.
Orient	Details of stage 2 and stage 3 assets in debt investments are not disclosed. As of the end of 2023, the company's total investment assets fell by 12.4% YoY to 248.1 billion RMB, of which overdue debt assets totaled 65.4 billion RMB, or 26% of total investment assets. Credit loss reserve for debt investments dropped by 11.6% YoY to 26.5 billion RMB, and reserve coverage for overdue assets stayed at 40.6%. A further 19.3 billion RMB needs to be provisioned to lift that reserve coverage ratio to 70%, equivalent to 12% of its net assets at the end of 2023. The parent's profit was achieved primarily through reversal of provisioning. The company reversed 1.918 billion RMB of credit loss reserve in 2023 (a total of 2.53 billion RMB was provisioned in 2022). Reversed credit impairment loss accounted for 80% of the parent's pre-tax profit.

CITIC AMC	The company's potential reserve gap would severely weaken its capital. Its non-operating revenue in 2023 is unsustainable. As of the end of 2023, the company's reserve coverage for stage 2 and stage 3 debt investment assets was 35.5%, up by 1.6ppts from 2022. An additional provisioning of 116.1 billion RMB is needed to boost the reserve coverage ratio to 70%, equal to 242% of net assets at the end of 2023. Its capital quality is poor. As of the end of 2023, other capital instruments amounted to 19.9 billion RMB, accounting for 41% of total owner's equity. Despite delivering a net profit of 200 million RMB, the company generated operating loss of 40.4 billion RMB excluding the impact from non-operating revenue and losses, equal to 80% of its net assets at the beginning of 2023. It achieved positive net profit mainly because of the recognition on the 41.6 billion RMB of non-operating revenue from value adjustment to long-term equity investments in CITIC Limited and China Everbright Bank. This was a one-off adjustment and is not sustainable. The company holds a 5.01% stake in CITIC Limited and 7.08% in China Everbright Bank, with book value of 34.6 billion RMB and 32.4 billion RMB, respectively. Both investees are listed companies. As of December 31, 2023, market capitalization for CITIC Limited and China Everbright Bank came at 10.3 billion RMB and 12.1 billion RMB, respectively, remarkably lower than their book value. If the company sells its investments in both investees at market price, it would incur about 40 billion RMB in loss. The company apply equity method to its equity investments in CITIC Limited and China Everbright Bank and could recognize gains/losses on such investments based on its shareholdings in and the net profits of the two investees going forward. Net profit attributable to the owners of parent was 57.594 billion RMB and 40.79 billion RMB for CITIC Limited and China Everbright Bank, respectively, in 2023. Should the two investees maintain stable profitability, the company would realize about 5.8 billion RMB in profit in 2024 based on its shareholdings. The company receives dividends from CITIC Limited and China Everbright Bank, whose 3-year average dividend payout ratio maintains at round 25%. In other words, assuming both investees sustain their earnings and dividend payout ratios at the current level, the company would earn cash dividend of 1.5 billion RMB on these investments in 2024.
Great Wall	The company's capital base is fragile due to the massive losses in recent years, As of the end of 2023, the company's reserve coverage for stage 2 and stage 3 debt investment assets was 40.8%, up by 0.5ppt YoY. An extra 29.4 billion RMB needs to be provisioned for enhancing the reserve coverage ratio to 70%, an amount equal to 151% of its net assets at the end of 2023. The company's capital quality is weak. As of the end of 2023, its other capital instruments totaled 10 billion RMB, making up 51% of total owner's equity.

Source: Public information of companies, S&P Global (China) Ratings.

CITIC AMC and Great Wall's massive operating losses eroded their capitals significantly, forcing up their leverage ratios to a large extent. As of the end of 2023, the leverages for Cinda, Orient, CITIC AMC, and Great Wall (excluding their bank subsidiaries), measured by debt to net assets ratio, were 5.8x, 4.4x, 18.4x, and 39.5x, respectively. The noticeable high leverages of CITIC AMC and Great Wall are primarily the result of their severe losses in recent years.

We expect capital increase arrangements from the government to shore up AMCs suffering serious capital inadequacy. CITIC AMC's capital was substantially reduced following the huge loss in 2022. Back in 2021, the company's capital was supplemented through a capital injection plan by the central government covering numerous financial institutions, including the company. The market expects its current capital gap to be addressed via government support.

Debt investment assets of the Big-Four AMCs under continued pressure. As of the end of 2023, Cinda's stage 2 and stage 3 non-performing debt assets classified as debt investments accounted for 47% of its total non-performing debt assets, up by 22.6ppts YoY. For CITIC AMC and Great Wall, the stage 2 and stage 3 debt investment assets represented 66% and 76% of total debt investment assets, up by 2.1ppts and 7.1ppts YoY, respectively. Orient's overdue debt investments made up 26.4% of its total debt investments, 3.6ppts higher compared to 2022.

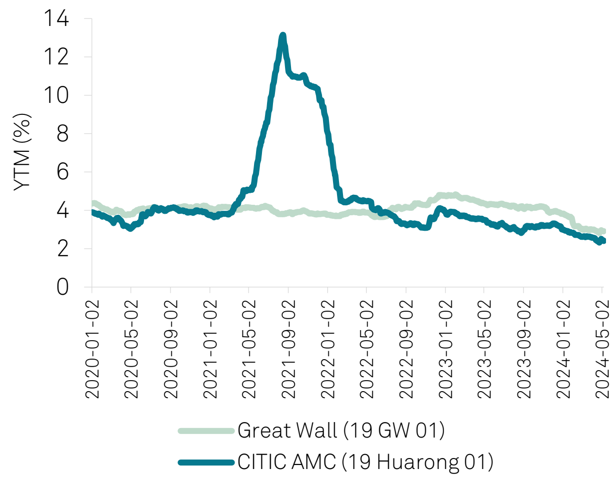
Large real estate exposure drags on AMCs' asset quality. In recent years, the downswing in the real estate sector has led to mounting pressure on the quality of AMCs' assets relating to existing properties. As of the end of 2023, the Big-Four AMCs' average exposure to real estate and construction on consolidated balance sheet was about 33%, compared to a mere 7% for the Big-Four banks. Among Cinda's non-performing debt assets at parent level, real estate exposure was 44.4 billion RMB as of the end of 2023, down by 17% YoY and accounting for 64% of its total non-performing debt portfolio.

Dim outlook for the quality of the Big-Four AMCs' mark-to-market assets. A large portion of non-performing assets held by the Big-Four AMCs are financial assets held for trading, the risk of which is measured based on fair value and not through risk-based classification approach. In 2023, profit/loss from changes in fair value of financial assets held for trading for Cinda, Orient, CITIC AMC, and Great Wall recorded -5.9 billion RMB, -1.7 billion RMB, -5.3 billion RMB, and 3.3 billion RMB, respectively. While Great Wall was the only one posting profit from this portion of assets, it reported loss of 23.5 billion RMB under the same category in 2022.

Albeit strains on capital, earnings, and asset quality, the Big-Four AMCs would maintain stable access to funding thanks to their ownership structures; we expect no liquidity stress facing them over the next 12 months. In 2020, China Huarong received timely support from the government and avoided default despite bearing a loss of 106.3 billion RMB. Since then, valuations on the Big-Four AMCs' bonds have become resilient against their capital, earnings, and asset quality. Investors have strong expectation on government intervention to save them.

Chart 4

ChinaBond Valuation for High-Grade Bonds Issued by CITIC AMC and Great Wall



CITIC AMC reported massive net loss of 106.3 billion RMB on its 2020 annual report published in August 2021, leading to a sell-off of its bonds at discount on the open market. ChinaBond yield to maturity for 19 Huarong 01 jumped to about 13% in August 2021 and soon resumed to the normal level following a series of risk-mitigating measures such as capital injection and introduction of CITIC Group as a new shareholder. On April 30, 2024, when Great Wall announced its huge loss for 2022, the capital market didn't react dramatically to this information, as indicated by a ChinaBond yield to maturity of 2.9% for 19 GW 01 on May 6, 2024.

Note: Maturities for these two bonds are different, as 19 GW 01 matures on April 1, 2029, and 19 Huarong 01 on November 14, 2024.
Source: Wind, S&P Global (China) Ratings.

Regardless of sharp changes in ownership structures recently, the Big-Four AMCs still maintain close ties with the central government and are unlikely to see government aid receding due to such changes over the next 12 month. China Huarong was once provided with capital aid by the government in 2021. During the same year, the company raised capital via private offering of A-shares and H-shares, with total proceeds raised hitting 42 billion RMB. Investors participating in the private placement included CITIC Group, Zhongbao Ronshine Private Equity Fund, Cinda, China Life Insurance (Group), and ICBC Financial Asset Investment. Following this capital increase, the Ministry of Finance gradually reduced its stake and CITIC Group became the company's largest shareholder. In January 2024, China Huarong was renamed CITIC AMC. According to sources, Cinda, Orient, and Great Wall are likely to be incorporated into China Investment Corporation, a China's sovereign wealth fund wholly owned by the State Council.

Table 3

The Big-Four AMC's Ownership Structures as of End of 2023

	Largest shareholder (shareholding)	Second largest shareholder (shareholding)	Third largest shareholder (shareholding)
Cinda	Ministry of Finance (58%)	Social Security Fund (12.81%)	Oversea Lucky (5%)
Orient	Ministry of Finance (71.55%)	Social Security Fund (16.39%)	China Telecom (5.64%)
CITIC AMC	CITIC Group (26.46%)	Ministry of Finance (24.76%)	Zhongbao Ronshine Private Equity Fund (18.08%)
Great Wall	Ministry of Finance (73.53%)	Social Security Fund (18.97%)	China Property & Casualty Reinsurance (3.64%)

Source: Public information of companies, S&P Global (China) Ratings.

Regulators require major shareholders of the Big-Four AMCs to ensure their capital adequacy. According to Implementing Measures for the Administrative Permission Items of Non-bank Financial Institutions issued by NAFR, financial asset management companies are required to state explicitly in the articles of association that major shareholders should add capital to the financial asset management company in time of need.

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