

Credit Opinion

7 August 2023

Ratings	
Senior Unsecured Debt Rating	A _g -
Long-Term Credit Rating	A _g -
Outlook	Stable
Category	Financial Institution
Domicile	China
Rating Type	Solicited Rating

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Zhongyuan Asset Management Co., Ltd

Surveillance credit rating report

CCXAP affirms Zhongyuan Asset Management Co., Ltd.'s long-term credit rating at A_g-, with stable outlook.

Summary

The A_g- long-term credit rating of Zhongyuan Asset Management Co., Ltd. ("Zhongyuan AMC" or the "Company") reflects the Company's (1) strong franchise and local advantage as the largest local AMC in Henan Province; (2) sufficient capital adequacy on the back of capital injection from the local government; and (3) good access to funding.

However, the rating is constrained by the Company's (1) moderate asset quality; (2) management challenges from higher regulatory requirements; (3) relatively weak profitability; and (4) modest liquidity profile.

The rating also reflects our expectation of a high likelihood of support from the Henan Provincial Government, given Zhongyuan AMC's (1) major ownership by the Henan Provincial Government; (2) relatively high strategic importance in the regional systemic financial stability; and (3) solid supporting track record from the government including capital injections.

The stable outlook on Zhongyuan AMC's rating reflects our expectation that the willingness and ability of the local government to provide support is unlikely to change, and that the Company will sustain its leading market position and solid financial profile in the next 12 to 18 months.

Rating Drivers

- High likelihood of government support from the Henan Provincial Government when needed
- Strong franchise and local advantage as the largest local AMC in Henan Province
- Moderate asset quality with high operating and concentration risk
- Management challenges from business diversification and higher regulatory requirements
- Relatively weak profitability constrained by impairments and economic slowdown
- Sufficient capital adequacy on the back of capital injection from local government
- Modest liquidity profile moderated by good access to funding

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the likelihood of receiving government support increases such as greater strategic importance or more policy roles in Henan Province; and (2) the Company's standalone credit profile improves, such as improved profitability and asset quality, with stable asset growth and long track record.

What could downgrade the rating?

The rating could be downgraded if (1) the likelihood of receiving government support decreases such as significantly decreasing ownership from the Finance Department of Henan Province; or (2) the Company's standalone credit profile worsens, such as deteriorated capital adequacy, sharp decrease in asset quality, or unexpected decline in liquidity.

Key Indicators

	2020FY	2021FY	2022FY
Total Assets (RMB billion)	63.6	59.5	70.7
Total Equity (RMB billion)	10.8	15.2	16.2
Total Revenue (RMB billion)	3.3	3.0	3.1
Net Profits (RMB million)	180.9	215.5	247.5
Pre-Tax Income/Average Assets (%)	0.2	0.3	0.5
Return on Equity (%)	1.6	1.7	1.6
Capital Adequacy Ratio (%)	16.9	25.6	22.9
Asset Impairment/Tangible Assets (%)	0.1	0.6	0.7
Realizable Assets/Short-term Debt (%)	6.0	16.5	4.6
Secured Debt/Tangible Assets (%)	10.4	13.0	10.4

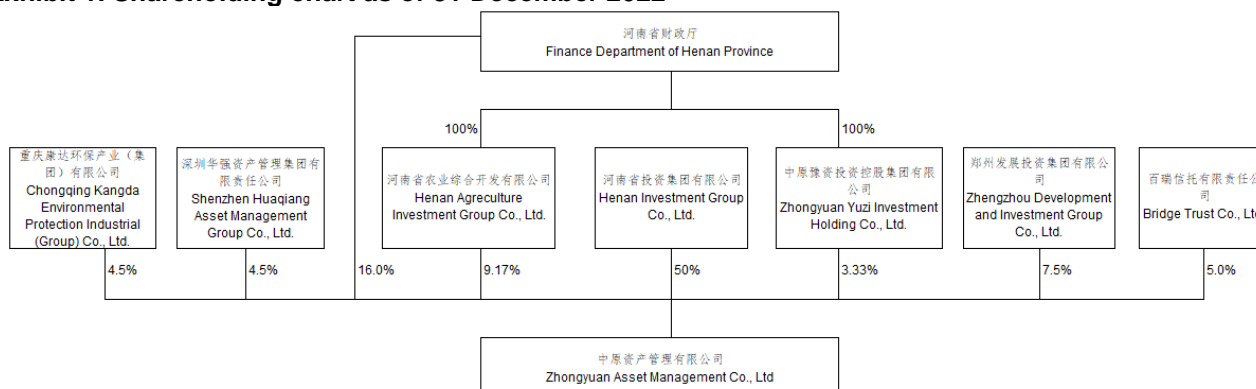
All ratios and figures are calculated using CCXAP's adjustments.
Source: CCXAP research

Corporate Profile

Zhongyuan AMC was established in August 2015 as the first local distressed AMC in Henan Province and the only local AMC under the direct management of the Finance Department of Henan Province. It is one of the key provincial financial platforms of Henan Province and undertakes the strategic role of resolving regional financial risk and promoting the upgrade of local industries in the province. The Company was jointly established by a number of state-owned and privately-owned companies, with a solid capital base. As of 31 December 2022, the Finance Department of Henan Province was the largest shareholder of Zhongyuan AMC that directly and indirectly held 78.47% of the Company's shares.

Zhongyuan AMC primarily engages in the core business of distressed asset management and gradually expands to other businesses such as equity investment, supply chain finance, financial leasing, and other investments. As of 31 December 2022, the Company reported total assets of RMB70.7 billion and net assets of RMB16.2 billion.

Exhibit 1. Shareholding chart as of 31 December 2022



Source: Company information, CCXAP research

Rating Considerations

Strong franchise and local advantage as the largest local AMC in Henan Province

Zhongyuan AMC is one of the top AMCs in China and the market leader in Henan Province. It is also the only local AMC under the direct management of the Finance Department of Henan Province and the first local AMC licensed by the China Banking and Insurance Regulatory Commission ("CBIRC") in Henan Province to engage in the batch transfer of distressed assets from financial institutions. With a strong state-owned background and distinct geographic advantages, the Company has swiftly built up its franchise and established sound relationships with local government authorities, financial institutions, and corporations. For example, it has set up 7 municipal-level asset management joint ventures with the local governments to resolve distressed assets in these cities of Henan Province.

Zhongyuan AMC's core business is the management of distressed assets acquired from local institutions. It has two types of business models including (1) acquisition-and-disposal, and (2) acquisition-and-restructuring. Under the acquisition-and-disposal model, the Company acquires distressed assets or non-performing loans ("NPL") from local financial institutions at a discount, and then realizes profit from resolving these assets including collection, litigation, liquidation, restructuring and disposal. Under the acquisition-and-restructuring model, the Company acquires distressed assets mainly from non-financial corporations with short-term liquidity pressure at a discount. The Company will enter into a restructuring agreement with the original creditors and debtors, and then earns profit from the difference between the acquisition price and final repayment from the obligors.

Comparing with the big four state-owned AMCs, Zhongyuan AMC has a good understanding of local companies and collaterals, which helps better evaluate risk and makes more accurate valuations on targeted investments. Zhongyuan AMC undertakes a strong role in resolving the distressed assets for regional banks in Henan Province. In 2022, Zhongyuan AMC acquired a large amount of distressed assets from local financial institutions including Zhongyuan Bank, Luoyang Bank and Pingdingshan Bank, with an original value of RMB55.0 billion and acquisition cost of RMB25.4 billion. The Company's cumulatively acquired distressed assets from financial institutions of RMB105.8 billion as of 31 December 2022, at an average discount rate of around 46.1%. The

Company has resolved around 60.2% of its distressed assets from financial institutions, showing good operating efficiency and recovery. In order to reduce its operational risks, the Company continued to reduce its exposure to non-financial corporations with outstanding distressed assets of RMB5.6 billion at end-2022, representing a YoY decrease of 2.5%.

Moderate asset quality with high operating and concentration risk

Zhongyuan AMC's asset quality is moderate with its large exposure to distressed asset management business. The Company holds non-performing assets such as overdue loans and receivables from debtors with liquidity issues. These kinds of assets require a longer time to resolve, particularly during economic contraction. The distressed asset management business involves numerous documentations and legal actions that pose a higher operating risk. It also takes time for the Company to construct a comprehensive risk management system to fit into its business operations.

In addition, most of Zhongyuan AMC's distressed assets are in Henan Province and concentrated mainly in the sectors of manufacturing, wholesale and retail, and real estate, which have been subject to the disruptions of the COVID-19 pandemic and the slowdown in China's economic growth. While Zhongyuan AMC could find more business opportunities from higher distressed asset formation during economic downturn, it is likely to face considerable asset strains and more difficulties in resolving assets when the weak economic condition sustains. The concentrated asset portfolio of the Company also makes its operating performance suffer from local regulatory and economic changes.

Apart from its distressed asset management business, Zhongyuan AMC also involves in investment banking and equity investment businesses. For investment banking business, the Company involves the investment in debt restructuring, debt for equity swap, and opportunistic funds. It has a relatively large but reducing exposure in investment banking business, with an outstanding investment of RMB6.4 billion as of 31 December 2022. Meanwhile, the Company had equity investments of RMB12.5 billion, which increased by 8.5% YoY. The Company's large investments including both listed and non-listed companies are subject to the changes of capital market conditions and valuation methods. There are also high uncertainties on the exit of its non-listed investments.

However, we believe that Zhongyuan AMC's operations would benefit from the strong economic fundamentals and institutional strength of Henan Province. Henan Province ranks as one of the top five provinces by GDP for over a decade, with matured development in agriculture, smelting, manufacturing, food processing and chemical productions. It also has good financial development with sufficient scale and efficiency.

Management challenges from business diversification and higher regulatory requirements

Zhongyuan AMC is regulated by the local government and the CBIRC. In 2019, CBIRC has tightened the regulatory supervision on local AMCs and issued the "Notice on Strengthening the Supervision and Management of Local Asset Management Companies" (《关于加强地方资产管理公司监督管理工作的通知》), to emphasize that the local AMCs should focus on their main business of distressed asset management.

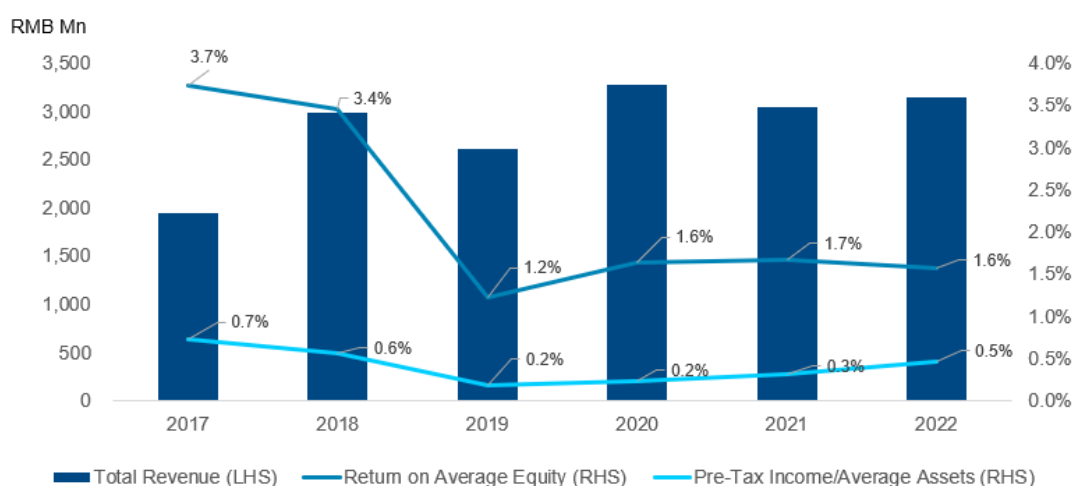
As a licensed institution, Zhongyuan AMC is subject to increasing monitoring from the authorities and it has to comply with higher level of regulatory requirement. The Company's business diversification to other financial businesses such as factoring, leasing and investment banking also increased its management challenges, which require expertise in the specific sectors and a better risk management system.

Relatively weak profitability constrained by impairments and economic slowdown

The distressed asset management business represented a material source of revenue for Zhongyuan AMC. The interest and disposal income from this business dropped significantly from RMB1.6 billion in 2019 to RMB681.9 million in 2021. However, there was a slight increase in interest and disposal income in distressed asset management business in 2022, which recorded at RMB922.1 million, representing a YoY increase of 35.2%. The impairments costs continued to increase due to the Company's prudent financial management in response to market change. Its asset and credit impairments increased to RMB495.8 million in 2022, accounting for 0.7% of its tangible assets.

Zhongyuan AMC's profitability remains relatively weak as seen by its low ratio of pre-tax income to assets and return on equity. From 2020 to 2022, the average of the Company's return on assets and return on equity were low at 0.3% and 1.6%, respectively.

Exhibit 2. Zhongyuan AMC's revenue and profitability ratios from 2017 to 2022



Source: Company information, CCXAP research

As Zhongyuan AMC has increased its equity investments in 2022, the Company's profitability is still subject to the change of capital market given its investment in equities. Investment income and income from fair value change represented a majority of its bottom-line profit. Valuation on stocks may suffer during adverse economic conditions or weak market confidence. Such volatility could negatively affect the Company's financial performance.

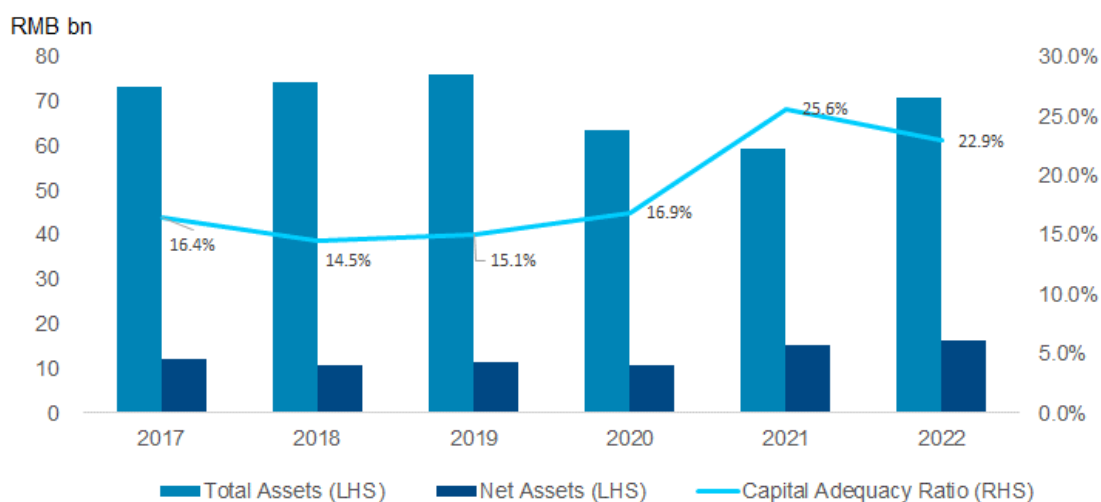
Overall, the Company's profitability will remain weak over the next 12 to 18 months as we expect that the difficulties in resolving distressed assets remain high and the weak market confidence may exist longer that affects market valuation.

Sufficient capital adequacy on the back of capital injection from the local government

Zhongyuan AMC's capital adequacy is sufficient which is largely supported by the capital injection from its largest shareholder. In December 2021, the Finance Department of Henan Province provided a RMB4.3 billion capital injection to the Company, which has significantly enhanced its capital base. The government increased its capital by another RMB700 million to RMB10 billion by the end of 2022. However, as the Company increased its investments in 2022, the capital adequacy ratio (calculated by net assets/total assets) slightly decreased to 22.9% as of end-2022 from 25.6% as of end-2021, which may reduce the Company's loss-absorption buffer

against unexpected market volatilities.

Exhibit 3. Zhongyuan AMC's capital adequacy ratio from 2017 to 2022



Source: Company information, CCXAP research

Nevertheless, we expect the Company's ability in generating internal capital remains modest given its weak profitability. Zhongyuan AMC recorded a retained loss of RMB2.4 billion as of 31 December 2022. Overall, we expect the Company to maintain sufficient capital over the next 12 to 18 months, given its ongoing strategy in credit risk mitigation, improving risk management structure as well as the long-term strategic position for the local government.

Modest liquidity profile moderated by good access to funding

Zhongyuan AMC's liquidity profile was modest with reliance on wholesale funding, particularly bank borrowings, to support its business. Wholesale funding generally is more confidence-sensitive and less resilient to market-driven stresses. Bank borrowings accounted for around 86.7% of its total debts as of 31 December 2022. However, given its state-owned background, the Company maintains a good relationship with diversified domestic banks which could reduce potential refinancing risk. It has sufficient credit lines from various domestic banks, such as China Development Bank, Bank of China, and Zhongyuan Bank. As of 31 March 2023, the Company had total credit facilities of RMB70.5 billion with an undrawn amount of RMB25.1 billion. In particular, the China Development Bank provided credit facilities of RMB20.0 billion with an undrawn amount of RMB13.6 billion.

Zhongyuan AMC has also broadened its financing channels and sought other sources of funding, providing it with good financial flexibility. It has accessed to the onshore debt capital market and issued different financial products in the onshore bond market such as corporate bonds, MTNs and PPNs. From January 2022 to June 2023, it issued 8 tranches of bonds with coupon rates from 3.05% to 4.99%, raising RMB4.9 billion in total.

External Support

High likelihood of government support as the largest AMC in Henan Province

We expect a high likelihood of government support from the Henan Provincial Government provided to Zhongyuan AMC in times of need. This expectation incorporates our considerations of the Company's (1) major ownership by the Henan Provincial Government; (2) strong strategic and functional role in resolving regional financial risk and promoting local industry upgrade; and (3) solid supporting track record from the government

including capital injections.

Zhongyuan AMC has a very important position in the financial system of Henan Province. Being the first established asset management company that approved by the former CBIRC, Zhongyuan AMC has a strong strategic and functional role in maintaining regional financial stability in Henan Province and boosting the implementation of major strategies of the local government in order to accelerate the local economic development.

The Company has a close operational linkage with the local government and has received solid track record of support from it. As the major shareholder of Zhongyuan AMC, the Henan government appointed most of the board members and senior management, with strong supervision on the Company's major decisions. The chairman and vice chairman of the board of directors were appointed by the Henan Provincial Government. Furthermore, according to the government document, the Henan government and its SOEs has increased the Company's capital base to RMB10 billion by the end of 2022. We expect the local government's propensity to support the Company is strong, which is unlikely to change in the near to medium term.

Structural Consideration

Zhongyuan AMC's senior unsecured debt rating is in line with its long-term credit rating. We believe that government support will flow through the Company given its strong strategic importance in the regional systemic financial stability, thereby mitigating any differences in an expected loss that could result from structural subordination.

Rating Methodology

The methodology used in this rating is the Rating Methodology for [Finance Companies \(April 2019\)](#).

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