December 3, 2015

ACTION

Buy

China Huarong Asset Management Co.

Return Potential: 34%

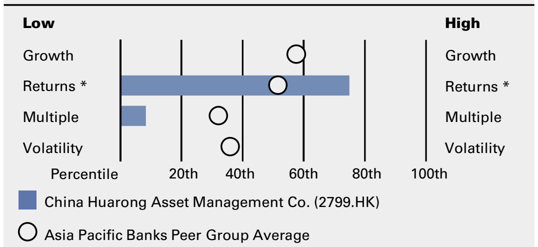
Equity Research

Leading AMC with an integrated platform, above-peer ROAE; initiate Buy

Source of opportunity

We initiate China Huarong Asset Management (Huarong) at Buy, with a 12-month target price of HK$4.1, implying 34% upside. Huarong is China's largest financial asset management company (AMC) in terms of total assets, as of 2014, with the highest net profit and ROAE among the four national AMCs. Leveraging its traditional strengths in the distressed asset management (DAM) business and promoting group synergies, Huarong aims to become a leading financial holding company. We believe it is well-positioned to deliver strong earnings growth through the economic cycle on its comprehensive financial services platform and improving group synergies.

Investment Profile



* Returns = Return on Capital. For a complete description of the investment profile measures please refer to the disclosure section of this document.

Catalyst

We forecast Huarong's NPAT to grow 35%/24%/17% in 2015E/16E/17E, or at 25% 2014-17E CAGR, driven by: **(1) strong revenue growth from DAM** at 29% 2014-17E CAGR on the back of 32% distressed asset balance expansion, offsetting gradually lower returns, **(2) stable revenue growth of 15% CAGR at financial services and asset management units** as interest rate cuts and financial market conditions may result in slower growth in banking, leasing and securities business, and **(3) lower impairment charges** in 2016E/17E on restructuring debts, factoring in gradual slowdown of restructuring debts growth to a more sustainable level and stable provision/loan ratio at c.7%.

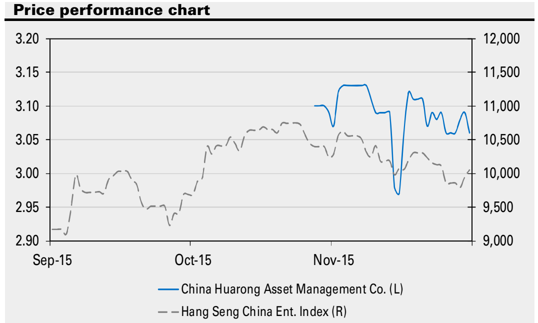
Key data	Current
Price (HK$)	3.06
12 month price target (HK$)	4.10
Market cap (HK$ mn / US$ mn)	119,554.8 / 15,421.5
Foreign ownership (%)	--

	12/14	12/15E	12/16E	12/17E
EPS (Rmb)	0.38	0.40	0.46	0.53
EPS growth (%)	13.8	5.0	13.7	16.6
EPS (diluted) (Rmb)	0.33	0.37	0.46	0.53
EPS (basic pre-ex) (Rmb)	0.38	0.40	0.46	0.53
P/E (X)	NM	6.3	5.6	4.8
P/B (X)	NM	1.0	0.9	0.8
EV/EBITDA (X)	NM	NM	NM	NM
Dividend yield (%)	NM	3.6	4.4	5.1
ROE (%)	19.1	17.1	16.8	17.3
CROCI (%)	NM	NM	NM	NM

Valuation

Our 12-month SOTP-based target price of HK$4.1 implies 1.3X 2015E P/B. We see valuation as attractive with Huarong trading at 1.0X 2015E P/B given 17%/2.5% ROE/ROA on average during 2015E-17E, stronger growth profile and less balance sheet risk than banks. Its closest comparable Cinda is trading at 0.81X 2015E P/B.

Price performance chart



Key risks

A sharp GDP/property market slowdown could lead to higher credit risks for DAM, banking and leasing assets. Further, we see rising competition from the other 3 national AMCs, provincial AMCs, and other financial institutions.

Share price performance (%)	3 month	6 month	12 month
Absolute	--	--	--
Rel. to Hang Seng China Ent. Index	--	--	--

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 12/02/2015 close.

INVESTMENT LIST MEMBERSHIP
Asia Pacific Buy List

Coverage View: Neutral

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China Huarong Asset Management Co.: Summary Financials

Profit model (Rmb mn)	12/14	12/15E	12/16E	12/17E
Total revenue	**51,060.5**	**68,204.3**	**80,824.0**	**92,424.7**
Cost of goods sold	--	--	--	--
SG&A	(5,435.3)	(7,022.8)	(8,566.5)	(9,633.0)
R&D	--	--	--	--
Other operating profit/(expense)	(6,225.6)	(9,162.2)	(8,177.5)	(7,281.8)
EBITDA	**35,913.0**	**47,835.3**	**59,268.3**	**69,976.4**
Depreciation & amortization	0.0	0.0	0.0	0.0
EBIT	**35,913.0**	**47,835.3**	**59,268.3**	**69,976.4**
Interest income	--	--	--	--
Interest expense	(17,903.7)	(23,822.2)	(29,745.5)	(35,664.2)
Income/(loss) from uncons. subs.	72.1	90.2	108.2	129.8
Others	(1,307.2)	(1,437.9)	(1,581.7)	(1,739.9)
Pretax profits	**16,774.2**	**22,665.3**	**28,049.3**	**32,702.1**
Income tax	(3,743.6)	(5,099.7)	(6,311.1)	(7,358.0)
Minorities	(2,373.9)	(3,200.1)	(3,960.2)	(4,617.2)
Net income pre-preferred dividends	**10,656.7**	**14,365.5**	**17,778.0**	**20,727.0**
Preferred dividends	(0.7)	0.0	0.0	0.0
Net income (pre-exceptionals)	**10,656.0**	**14,365.5**	**17,778.0**	**20,727.0**
Post-tax exceptionals	0.0	0.0	0.0	0.0
Net income	**10,656.0**	**14,365.5**	**17,778.0**	**20,727.0**
EPS (basic, pre-except) (Rmb)	0.38	0.40	0.46	0.53
EPS (basic, post-except) (Rmb)	0.38	0.40	0.46	0.53
EPS (diluted, post-except) (Rmb)	0.33	0.37	0.46	0.53
DPS (Rmb)	0.06	0.09	0.11	0.13
Dividend payout ratio (%)	15.2	22.5	24.5	24.5
Free cash flow yield (%)	--	--	--	--

Growth & margins (%)	12/14	12/15E	12/16E	12/17E
Sales growth	36.8	33.6	18.5	14.4
EBITDA growth	42.9	33.2	23.9	18.1
EBIT growth	42.9	33.2	23.9	18.1
Net income growth	23.1	34.8	23.8	16.6
EPS growth	13.8	5.0	13.7	16.6
Gross margin	NM	NM	NM	NM
EBITDA margin	70.3	70.1	73.3	75.7
EBIT margin	70.3	70.1	73.3	75.7

Cash flow statement (Rmb mn)	12/14	12/15E	12/16E	12/17E
Net income pre-preferred dividends	10,656.7	14,365.5	17,778.0	20,727.0
D&A add-back	0.0	0.0	0.0	0.0
Minorities interests add-back	0.0	0.0	0.0	0.0
Net (inc)/dec working capital	0.0	0.0	0.0	0.0
Other operating cash flow	0.0	0.0	0.0	0.0
Cash flow from operations	--	--	--	--
Capital expenditures	0.0	0.0	0.0	0.0
Acquisitions	0.0	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
Cash flow from investments	--	--	--	--
Dividends paid (common & pref)	0.0	0.0	0.0	0.0
Inc/(dec) in debt	0.0	0.0	0.0	0.0
Common stock issuance (repurchase)	0.0	16,151.3	0.0	0.0
Other financing cash flows	0.0	0.0	0.0	0.0
Cash flow from financing	--	--	--	--
Total cash flow	--	--	--	--

Balance sheet (Rmb mn)	12/14	12/15E	12/16E	12/17E
Cash & equivalents	26,945.3	40,271.7	60,847.1	57,229.1
Accounts receivable	--	--	--	--
Inventory	0.0	0.0	0.0	0.0
Other current assets	87,103.5	100,169.0	115,194.4	132,473.5
Total current assets	**114,048.8**	**140,440.7**	**176,041.5**	**189,702.6**
Net PP&E	3,990.7	4,190.2	4,399.7	4,619.7
Net intangibles	0.0	0.0	0.0	0.0
Total investments	106,818.3	132,056.2	156,249.8	182,266.9
Other long-term assets	375,663.3	492,685.5	615,517.6	731,442.1
Total assets	**600,521.1**	**769,372.6**	**952,208.6**	**1,108,031.4**
Accounts payable	0.0	0.0	0.0	0.0
Short-term debt	26,283.1	28,911.4	31,802.5	34,982.8
Other current liabilities	372,902.3	427,290.0	506,452.8	594,220.2
Total current liabilities	**399,185.4**	**456,201.4**	**538,255.4**	**629,203.0**
Long-term debt	48,002.1	115,205.1	184,328.2	211,977.4
Other long-term liabilities	69,801.5	83,641.8	100,232.2	120,119.9
Total long-term liabilities	117,803.6	198,846.9	284,560.4	332,097.3
Total liabilities	**516,989.0**	**655,048.3**	**822,815.8**	**961,300.3**
Preferred shares	**0.0**	**0.0**	**0.0**	**0.0**
Total common equity	**69,408.2**	**98,788.0**	**112,302.8**	**127,932.1**
Minority interest	14,124.0	15,536.4	17,090.0	18,799.0
Total liabilities & equity	**600,521.1**	**769,372.6**	**952,208.6**	**1,108,031.4**
BVPS (Rmb)	**2.12**	**2.53**	**2.87**	**3.27**

Ratios	12/14	12/15E	12/16E	12/17E
CROCI (%)	NM	NM	NM	NM
ROE (%)	19.1	17.1	16.8	17.3
ROA (%)	2.1	2.1	2.1	2.0
ROACE (%)	25.2	20.6	17.8	17.1
Inventory days	NM	NM	NM	NM
Receivables days	NM	NM	NM	NM
Payable days	NM	NM	NM	NM
Net debt/equity (%)	516.8	471.2	514.2	534.3
Interest cover - EBIT (X)	2.0	2.0	2.0	2.0

Valuation	12/14	12/15E	12/16E	12/17E
P/E (analyst) (X)	NM	6.3	5.6	4.8
P/B (X)	NM	1.0	0.9	0.8
EV/EBITDA (X)	NM	NM	NM	NM
EV/GCI (X)	--	NM	NM	NM
Dividend yield (%)	NM	3.6	4.4	5.1

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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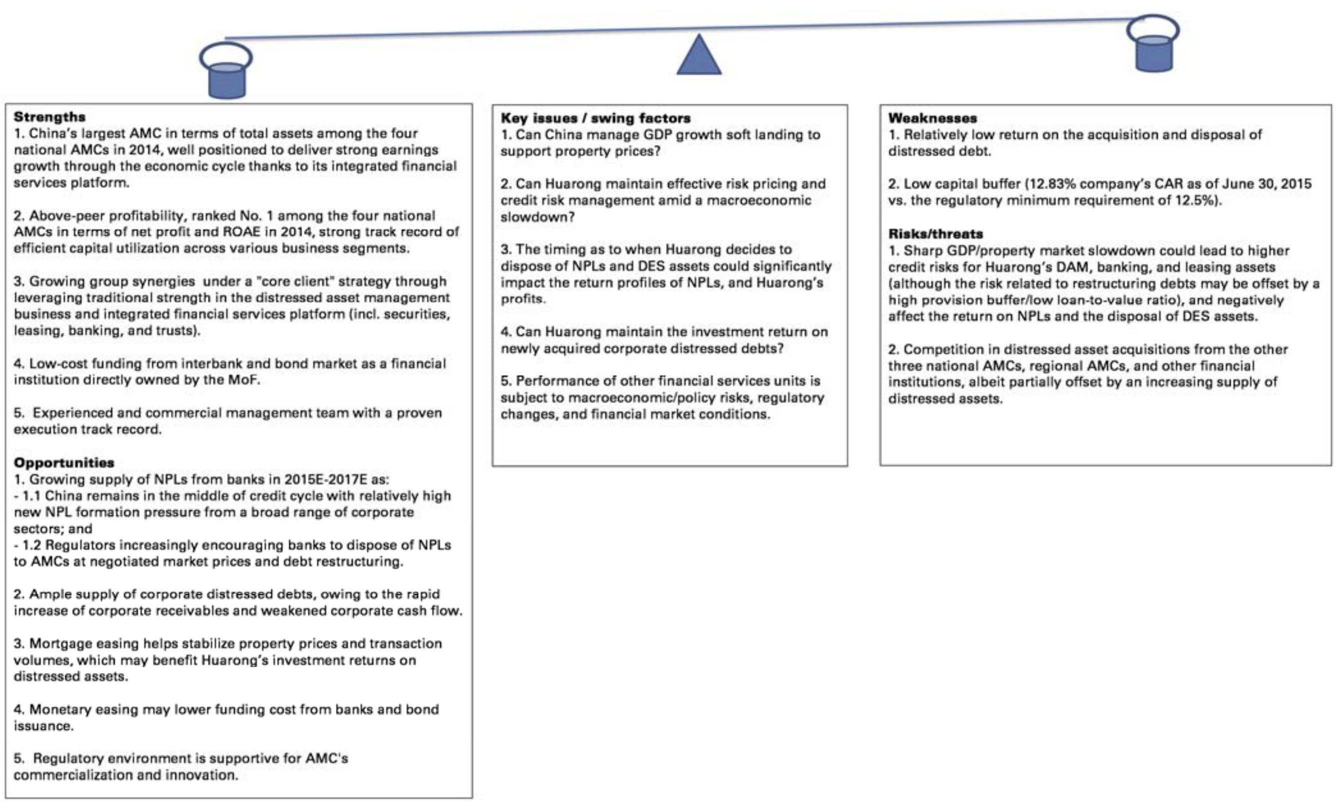
The prices in the body of this report are based on the market close of December 1, 2015, unless otherwise stated.

Exhibit 1: SWOT analysis for Huarong



Source: Company data, Gao Hua Securities Research.

Exhibit 2: One-page summary of Huarong: Strong 35%/24%/17% NPAT growth in 2015E/16E/17E, with 17.1%/16.8%/17.3% ROE

(Rmb mn except mentioned otherwise)	2012	2013	2014	2015E	2016E	2017E
Condensed financials						
Income from distressed assets mgmt	8,331	15,209	22,214	33,917	41,782	47,980
Investment income (ex DES related)	3,906	4,663	7,092	8,511	9,787	11,255
Net commission and fee income (ex FA)	3,018	4,191	4,578	5,665	5,882	6,399
Interest income	9,686	10,076	12,048	13,825	16,226	18,705
Other revenue	910	2,853	4,676	5,609	6,366	7,229
Net revenue	**25,852**	**36,991**	**50,608**	**67,526**	**80,043**	**91,569**
Operating expense	(4,861)	(7,017)	(8,469)	(10,528)	(12,598)	(14,310)
Interest expense	(9,084)	(10,931)	(17,904)	(23,822)	(29,746)	(35,664)
PPOP	**11,907**	**19,044**	**24,235**	**33,175**	**37,700**	**41,594**
Impairment charges	(2,323)	(4,850)	(6,226)	(9,162)	(8,177)	(7,282)
Operating profit	**9,583**	**14,194**	**18,009**	**24,013**	**29,523**	**34,312**
Profit before tax	9,109	13,640	16,774	22,665	28,049	32,702
NPAT	**6,986**	**10,093**	**13,031**	**17,566**	**21,738**	**25,344**
Attributable NPAT	**5,892**	**8,660**	**10,656**	**14,366**	**17,778**	**20,727**
Total assets	**315,034**	**408,367**	**600,521**	**769,373**	**952,209**	**1,108,031**
Attributable equity	**34,176**	**41,967**	**69,408**	**98,788**	**112,303**	**127,932**
Distressed asset management						
Income from distressed asset mgmt	**8,331**	**15,209**	**22,214**	**33,917**	**41,782**	**47,980**
Distressed debt asset mgmt	4,895	9,427	16,548	24,733	32,882	39,665
- Disposal	250	509	886	1,324	1,641	1,969
- Restructuring	4,645	8,918	15,662	23,409	31,241	37,696
DES mgmt	1,422	3,516	2,711	5,591	4,632	3,876
- Disposal (AFS & interest in associates)	1,160	3,159	2,477	5,358	4,420	3,683
- Div income	262	357	234	233	212	193
FA income from restructuring biz	2,014	2,266	2,955	3,593	4,268	4,439
Net value of distressed assets	**75,931**	**114,607**	**203,965**	**295,014**	**387,475**	**467,071**
Distressed debt assets	54,449	93,020	179,576	272,821	367,279	448,692
- Disposal	3,126	8,134	22,338	39,905	56,868	73,727
- Restructuring	51,322	84,886	157,239	232,916	310,411	374,965
Debt/equity swap(DES)	21,483	21,587	24,389	22,194	20,196	18,379
Return						
Disposal - return on disposal	26.4%	23.2%	9.9%	9.0%	8.0%	8.0%
Restructuring - return on period-end avg balance		12.1%	12.0%	12.0%	11.5%	11.0%
DES - exit multiple	2.9x	5.2x	1.9x	2.6x	2.2x	2.0x
DES - div yld (on avg balance)	1.2%	1.7%	1.0%	1.0%	1.0%	1.0%
Financial advisory fee rate	4.9%	3.4%	2.3%	2.0%	1.8%	1.6%
Growth rate						
Income from distressed asset mgmt		83%	46%	53%	23%	15%
Net value of distressed assets		51%	78%	45%	31%	21%

	2012	2013	2014	2015E	2016E	2017E
Growth analysis						
Revenue		43%	37%	34%	19%	14%
Net revenue		43%	37%	33%	19%	14%
PPOP		60%	27%	37%	14%	10%
NPAT		44%	29%	35%	24%	17%
Assets		30%	47%	28%	24%	16%
Liabilities		31%	45%	27%	26%	17%
DuPont Analysis						
ROE	**19.4%**	**22.7%**	**19.1%**	**17.1%**	**16.8%**	**17.3%**
leverage (x)	7.7	8.2	7.4	6.7	6.7	7.0
= ROA	**2.5%**	**2.8%**	**2.6%**	**2.6%**	**2.5%**	**2.5%**
(As % of average assets)						
Income from distressed assets mgmt	**3.0%**	**4.2%**	**4.4%**	**5.0%**	**4.9%**	**4.7%**
Investment income (ex DES related)	1.4%	1.3%	1.4%	1.2%	1.1%	1.1%
Net commission and fee income (ex FA)	1.1%	1.2%	0.9%	0.8%	0.7%	0.6%
Interest income	3.5%	2.8%	2.4%	2.0%	1.9%	1.8%
Other revenue	0.3%	0.8%	0.9%	0.8%	0.7%	0.7%
Net revenue	**9.3%**	**10.2%**	**10.0%**	**9.9%**	**9.3%**	**8.9%**
Operating expense	-1.7%	-1.9%	-1.7%	-1.5%	-1.5%	-1.4%
Interest expense	-3.3%	-3.0%	-3.5%	-3.5%	-3.5%	-3.5%
PPOP	**4.3%**	**5.3%**	**4.8%**	**4.8%**	**4.4%**	**4.0%**
Impairment charges	-0.8%	-1.3%	-1.2%	-1.3%	-0.9%	-0.7%
Operating profit	**3.4%**	**3.9%**	**3.6%**	**3.5%**	**3.4%**	**3.3%**
Profit before tax	3.3%	3.8%	3.3%	3.3%	3.3%	3.2%
NPAT	**2.5%**	**2.8%**	**2.6%**	**2.6%**	**2.5%**	**2.5%**
Balance sheet items (Rmn bn)						
Distressed assets	76	115	204	295	387	467
Loans and advances to customers	38	48	63	79	95	111
Lease receivables	48	56	64	74	85	98
Others	153	189	269	321	385	432
Total assets	**315**	**408**	**601**	**769**	**952**	**1,108**
Interest earning assets	165	200	243	295	358	401
Borrowings from central bank	0	0	0	0	0	0
Customer deposits	70	88	117	145	174	204
Borrowings	90	136	240	264	311	367
Bonds issued	3	18	48	115	184	212
Others	109	114	112	130	153	178
Total liabilities	**272**	**356**	**517**	**655**	**823**	**961**
Interest bearing liabilities	245	313	459	579	726	841
Equity attributable to equity holders	**34**	**42**	**69**	**99**	**112**	**128**
Total equity	43	53	84	114	129	147

Source: Company data, Gao Hua Securities Research.

Overview: Leading AMC with an integrated financial platform

Overview

Established in 1999, Huarong is one of China's big-four national asset management companies (the Four AMCs), specializing in non-performing loans (NPLs) – distressed assets management and investment. Huarong completed its joint-stock reform in 2012, and transitioned itself from a policy-driven institution to a commercial entity with its core business focusing on distressed assets management (DAM). It also has a comprehensive financial services platform covering banking, leasing, securities, trust, distressed-assets based investment, and asset management. The Ministry of Finance (MOF) is Huarong's largest shareholder with a 31.68% equity stake. The company is run by an experienced management team, which has a strong track record in execution and product innovation.

Huarong is ranked No. 1 in terms of total assets (US$94bn, vs. the aggregate assets of the Four AMCs of US$270bn), net profit (US$2.0bn, vs. aggregate of US$6.1bn for the Four AMCs), and ROAE (19%) in 2014 among the four national AMCs (the other three being Cinda, Oriental, and Great Wall). As at December 31, 2014, by the original value of commercial/policy distressed assets acquired by the Four AMCs, Huarong holds a market share of 20.3%/28.8%.

While the current macro backdrop presents certain challenges for AMCs in managing credit risk and return on acquired portfolios, we think the medium-term outlook remains broadly encouraging due to:

a) Ample new supply of NPLs and distressed assets from banks and non-financial enterprises.

b) A supportive regulatory environment and still high barriers to entry and concentration despite rising competition from smaller participants.

c) Policy loosening cycle (recent interest rate and RRR cuts) that helps ease funding costs and asset quality pressure.

d) Stabilizing property price and transaction volume recovery that helps ease concerns over restructuring loan exposure to property developers as well as NPL disposal return on traditional NPL business.

e) For Huarong in particular, it has prudently built up a provision buffer over its restructuring debts that could absorb an impairment ratio of more than 14%.

Company strategy: Becoming a leading financial holding company

Huarong aims to become a leading financial holding company built around its DAM business, financial services, and fund/investment management. To achieve this goal, the company plans to leverage its traditional strengths in DAM and adopt a "core client" strategy, which focuses on comprehensive financial solutions to provincial-level governments, large enterprises, and major financial institutions.

Key strengths: Above-peer ROE, growth potential of DAM, low cost funding and group synergies

The company consistently delivered above-peer ROE and earnings growth in 2012-2014, reflecting strong execution, efficient balance sheet utilization and high profitably across segments. While the current macroeconomic backdrop presents certain challenges for AMCs in managing credit risk and returns on distressed debts, we think the medium-term growth potential for the DAM business remains encouraging. Moreover, Huarong's access to low-cost funding could help the acquisition of distressed assets amid the current credit cycle, support DAM profitability, and provide a buffer against potential asset price/quality risk, in our view. We believe the diversified business platform with growing synergies is a competitive advantage for Huarong in providing flexible NPL solutions and comprehensive products and services throughout the enterprise lifecycle of clients.

Key risks: Sharp GDP/property market slowdown, competition

In our view, a sharp GDP/property market slowdown could increase the credit risk of Huarong's restructuring debts (i.e. debt assets under an "acquisition-and-restructuring" model), banking and leasing assets, and negatively affect the return on disposal debts (i.e. debt assets under an "acquisition-and-disposal" model) and debt-to-equity swap (DES) assets. However, we believe the downside risk is likely to be partially offset by lower funding costs and a still comfortable provision buffer particularly for restructuring debt investment.

Our sensitivity analysis to 2015E earnings (Exhibit 24) suggests:

- A 1ppt change (from 9%) in Huarong's disposal debt business will impact its FY15E earnings by 0.6%.
- A 1ppt change (from 12.0%) in Huarong's return on restructuring debts will impact its FY15E earnings by 8.3%.
- A 20ppt change (from 2.6X) in exit multiple of DES assets will impact Huarong's FY15E earnings by 2.9%.
- A 1ppt change (from 1.9%) in credit costs for restructuring debt portfolio will impact Huarong's FY15E earnings by 9.0%.

Moreover, we expect more competition from the other three national AMCs, local AMCs at the provincial level (15 local AMCs have received CBRC approvals as of July 2015) and other private equity investors. That said, pricing competition in NPL acquisition could moderate in 2015E due to potentially increased supply from banks, in our view. Local AMCs so far have not challenged the national AMCs mainly because: (1) They lack funding and NPL resolution options (e.g. no NPL selling to third parties), (2) they also lack relevant experience in dealing with NPLs, (3) they can only acquire NPLs from respective provinces, and (4) each province is only allowed to set up one local AMC.

Financials

We forecast Huarong's NPAT to grow 35%/24%/17% yoy in 2015E/2016E/2017E, or at 25% FY14-FY17E CAGR, driven by:

1) **Strong revenue growth from DAM at 29% CAGR 2014-2017 (vs. 22% CAGR for the group)** on the back of rapid distressed assets growth (49% CAGR for the disposal debts off a low base, and 34% CAGR for restructuring debts) offsetting a gradually lower return (on macro slowdown and competition). We estimate the share of DAM revenue contribution to the group revenue may rise to 52% in FY17E from 44% in FY14.

2) **Stable revenue growth of financial services and asset management units** at 15% CAGR (vs. 27% CAGR during 2012-2014) as interest rate cuts and financial market conditions may result in slower growth in the financial services segment including banking, leasing, and securities.

3) **Lower impairment charges in 2016E/2017E on restructuring debts.** We expect Huarong's total impairment charges on restructuring debts to peak in 2015E at Rmb6.6bn before declining to Rmb5.7bn and Rmb4.5bn in FY16E and FY17E, as we expect the growth in restructuring debts to gradually slow to a more sustainable level while Huarong maintains its provision/loan ratio stable at c.7.0%, over the same period.

Valuation

We adopt sum-of-the-parts (SOTP) as our primary method to value Huarong so as to capture the differentiated risk/return profiles of its three business segments: (1) distressed asset management, (2) financial services, and (3) asset management and others. Our 12-month target price for Huarong of HK$4.1 implies 1.3X 2015E P/B. The stock is currently trading at 1.0X 2015E P/B, translating into 34% upside.

Company profile: Becoming a leading financial holding company

Huarong's evolution in three stages

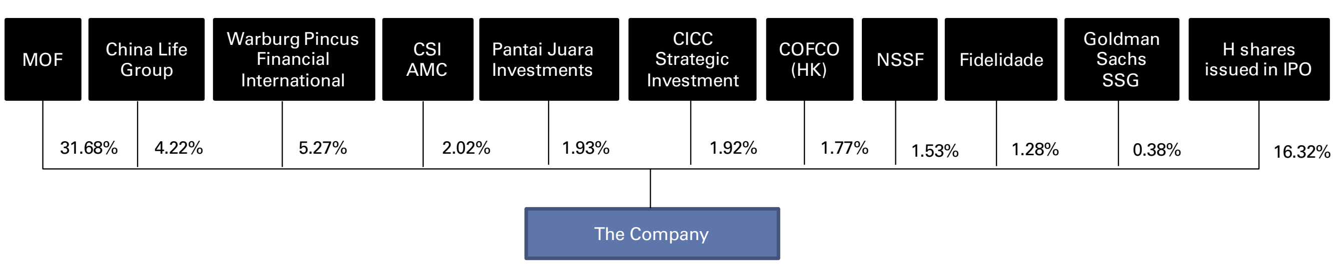
Huarong's predecessor, China Huarong Asset management Corporation, was established in 1999 by the mainland China government, along with three other AMCs to take over the NPLs of large state-owned banks. Starting with a single business model engaged in distressed assets investment, Huarong gradually built up a diverse business platform through strategic investment and restructuring through mergers and acquisitions in three stages:

(1) Policy Phase (1999-2006): Huarong's primary business was to manage and dispose of NPLs acquired from ICBC at 100% face value (Rmb412.8bn in total). In addition, it became the first AMC to dispose of distressed assets through an international bidding process in 2001, and was commissioned by the mainland China government to wind up Delong Group, a large private conglomerate, in 2004.

(2) Transition Phase (2007-2011): Huarong started its transition to commercial operations by acquiring the distressed assets of several banks via commercial methods. During the period, it established financial services subsidiaries including leasing, securities, trust, futures, and banking. In 2010, Huarong became the first AMC to conduct acquisition-and-restructuring business on a large scale, establishing a market-oriented business model.

(3) Commercialization Phase (2012-2015): Huarong completed a joint-stock reform initiative in 2012, introduced eight strategic investors in 2014, and completed an H-share IPO in October 2015. The MOF remains the company's largest shareholder with a 31.68% equity stake.

Exhibit 3: MOF is Huarong's largest shareholder, with a 31.68% stake post H-share IPO
Shareholding structure of Huarong post H-share IPO (as of November 2015)



Source: Company data.

Exhibit 4: Established in 1999, to take over NPLs from ICBC, Huarong has gradually transitioned from policy to commercial operations and established a diverse financial platform
Key historical events

Phase	Year	Event	Event	Event
I. Policy Phase	1999	Established as one of the Four AMCs as approved by State Council		
	2000	Acquired NPLs of Rmb408 bn from ICBC		
	2001	Became the first financial institution to be entrusted to conduct administrative liquidation of distressed enterprise		
	2003	Launched the first quasi-asset-securitization product that is backed by distressed assets		
	2005	Entrusted by the MOF to dispose Rmb246 bn distressed assets of ICBC		
	2006	Restructured one of the first financial leasing companies in China and renamed it as Huarong Financial Leasing	Established Huarong Rongde with foreign investors to do distressed asset-based special situations investment business	Completed the target set by the MOF for the recovery of Policy Distressed Assets
II. Transition Phase	2007	Established Huarong Securities		
	2008	Restructured Xinjiang International Trust & Investment Co., Ltd., and established Huarong Trust		
	2009	Commenced commercial transition and "core client" strategy	Restructured Zhuhai Hengqin Xindong Real Estate Development Company and established Huarong Real Estate	
	2010	Became the first AMC to conduct acquisition-and-restructuring business on a large scale	Restructured several commercial banks and a urban credit cooperative in Hunan Province, and merged them into Huarong Xiangjiang Bank	
III. Commercialization Phase	2012	Completed the joint-stock reform and incorporated China Huarong, commencing commercialized operation	Obtained approval to participate in the interbank market and issue financial bonds	
	2013	Established Huarong International as overseas strategic platform		
	2014	Introduced Rmb14.5 bn worth of investment from eight strategic investors		

Source: Company data.

Huarong's current business is grouped into three key segments

(1) Distressed asset management

This is Huarong's core business and primary source of earnings, which contributed 56% of the group's income and pretax profit in 2014. This segment consists of: (1) distressed debt asset management acquired from financial institutions and non-financial enterprises, (2) DES asset management, (3) custody and agency services for distressed assets, and (4) distressed assets-based special situations investments and property development. For different types of distressed assets, Huarong adopts diverse and customized resolution models to realize profit, as illustrated in Exhibit 6. The acquisition-and-restructuring model (restructuring debts) generated the largest share of segment revenue (65%) in 2014.

(2) Financial services

This is the second largest segment including banking, leasing, and securities businesses, which contributed 35%/33% of the group's revenue/pretax profit in 2014. Through liquidation and restructuring of distressed entities, Huarong has acquired financial licenses that would otherwise be difficult to obtain, and developed them into profitable business lines. This ensures that Huarong is able to provide a variety of financial products and services to meet client needs throughout their business lifecycles.

(3) Asset management and investment

The unit is an extension of Huarong's DAM business, providing a diverse funding source and flexible solutions, leveraging third-party and capital-light business models. The segment contributed 10%/11% of the group's income/pretax profit in 2014.

Exhibit 5: Huarong operates three key business segments: (1) distressed assets management, (2) financial services, and (3) asset management and investment

Huarong's business scope, P&L and balance sheet breakdown by segment

China Huarong Asset Management Co., Ltd. (The Company)										
Business segment	**1. Distressed Asset Management**			**2. Financial Services**				**3. Asset management and investment**		
Business Lines	1.1 Distressed debt asset mgmt 1.2 DES assets mgmt; 1.3 Custody and agency services for distressed assets 1.4 Distressed asset-based situations investments 1.5 Distressed asset-based property development			2.1 Securities and futures 2.2 Financial leasing 2.3 Banking				3.1 Asset mgmt 3.2 Financial investment 3.3 International business 3.4 Other business		
Operating Entities	The Company	Huarong Rongde	Huarong Real Estate	Huarong Securities	Huarong Futures	Huarong Financial Leasing	Huarong Xiangjaing Bank	The Company	Huarong Trust	Huarong International
% owned by the Group	100.00%	59.30%	100.00%	81.56%	75.44%	79.92%	50.98%	100.00%	98.09%	100.00%
Segmental financials in FY2014 (In millions of Rmb)										
- Revenue **- as % of total**	28,647 56%			3,800 7%		5,219 10%	8,897 17%	5,050 10%		
- PBT **- as % of total**	9,340 56%			1,146 7%		1,720 10%	2,658 16%	1,910 11%		
- Assets **- as % of total**	283,339 47%			43,041 7%		72,099 12%	165,326 28%	42,101 7%		
- Net assets **- as % of total**	47,115 56%			7,303 9%		7,330 9%	11,091 13%	10,815 13%		
- Pretax ROAE	26.3%			18.1%		25.2%	25.9%	20.6%		

Source: Company data.

Exhibit 6: Huarong adopts diverse and customized resolution models for different types of distressed assets; the acquisition-and-restructuring model generated the largest share of segment revenue (65%) in 2014

	Distressed Asset Management (DAM)				
	Acquisition-and-disposal model	**Acquisition-and-restructuring model**	**DES assets management**	**Distressed asset-based situations investments**	**Distressed asset-based property development**
Primary source of distressed assets	NPL packages from banks	Receivables from NFEs and other distressed debts from FIs	Converted from distressed debt assets of SOEs	Assets with appreciation potential and enterprises with ST liquidity issues	Property projects acquired in the course of distressed asset management
Business model	Acquire NPLs at a discount; enhance/realize values through debt restructurings, litigations and sales etc.	Enter into agreements with creditor, debtor and related parties to re-schedule repayment, guarantee arrangements and collaterals etc.	Enhance value through providing financing, restructuring, and M&A etc.; exit through sales to controlling shareholders, equity exchanges, and secondary market sales	Invest through debt, equity or mezzanine instruments; exit through debt collection, share transfers/repurchases, listing and M&A	Real estate financing (provided by parent company & financial subsidiaries) <=> property development and management (provided by Huarong Real Estate)
Primary source of revenue	Realized gains upon disposal, and unrealized gains from fair value movements	Debt repayment, and financial advisory fee	Realized gains upon disposal/equity exchange, and dividend income	Investment income, financial advisory fee	Project sales
Key growth drivers	Amount of NPLs disposed, disposal return	Balance of restructuring debt, average yield	Amount of DES assets disposed, exit multiple	Principle investment return, third party AUM	Property sales volume & price
As % of segment revenue (2014)	3%	65%	9%	9%	9%

Source: Company data.

Peer comparison: Stronger profitability, larger credit exposure but with a higher provision buffer

We identify Cinda as Huarong's closest comparable. Cinda currently maintains a leading position in the DAM business in terms of scale and asset returns, although Huarong delivered higher group ROE due to better capital utilization and profitability in its non-DAM businesses. Huarong has a more diverse revenue mix than Cinda with better cost efficiency. In our view, Huarong is more exposed to credit risks than Cinda on its restructuring debts, leasing, and banking assets. Nevertheless, the risks are partially offset by higher collaterals and provision buffer of Huarong's restructuring debt portfolio.

We think Huarong is likely to focus more on asset/profit growth over the next few years while Cinda seems to be taking a more cautious stance evidenced by a notable slowdown in restructuring debt growth in 2H14. Looking ahead, we forecast 23% total assets CAGR in 2014-2017E at Huarong vs. 16% at Cinda. We estimate NPAT to grow at 25% CAGR for Huarong vs. 15% for Cinda in 2014-2017E.

Compared with Cinda, Huarong exhibits the following key differences:

(1) Higher ROE due to higher balance sheet leverage in financial services & investment business; ROA is comparable.

(2) More exposure to restructuring debt/property, although with higher provision coverage.

(3) Smaller traditional NPL business with lower returns.

(4) Higher percentage of listed firms in DES portfolio, lower exposure to cyclical industries.

(5) Balanced revenue stream across segments, better profitability in leasing and trust, weaker in securities.

(6) Better operating efficiency due to lower CIR in non-DAM businesses.

(7) Similar credit cost but driven more by restructuring debts for Huarong.

Exhibit 7 summarizes the key statistics of Huarong and Cinda in terms of risk, profitability, and growth; while Exhibits 8-10 illustrate these aspects in more detail.

Exhibit 7: Huarong has higher profitability and growth than Cinda, but also higher risk, in our view
In 2014, unless stated otherwise

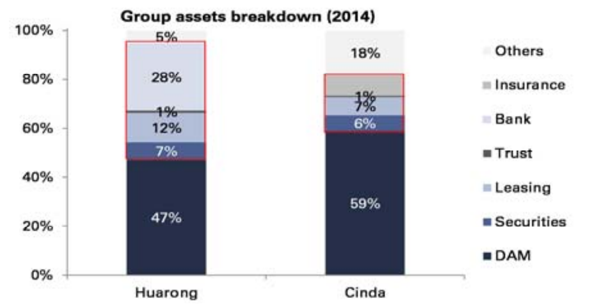
	Huarong	Cinda	Comments/Details
1. Risks	**Higher**	**Lower**	
1.1 Credit exposure	**Rmb 298 bn**, including restructuring debts, lease receivables and bank loans	**Rmb 249 bn**, including restructuring debts, lease resembles and other customer advances	Huarong's restructuring debts are more concentrated on real estate sector but with more collaterals
1.2 Impairment/overdue ratio (on restructuring debts)	Impairment: **1.6%** Overdue ratio: **3.0%**	Impairment: **1.2%** Overdue ratio: **2.7%**	We expect impairment ratio to go up to 2.0%/2.0% for Huarong/Cinda at YE17E
1.3 Provisions coverage	Restructuring debts: **6.8%** Total credit exposure: **4.6%**	Restructuring debts: **3.2%** Total credit exposure: **2.9%**	We expect Huarong to maintain stable provision ratio of c.7.0% over restructuring debts in 2015E-17E
1.4 Capital adequacy (at company level)	YE 2014: **13.6%** YE 2015E: **15.1%**	YE 2014: **18.1%** YE 2015E: **17.0%**	Regulatory minimum is 12.5%
1.5 Leverage (assets/common equities)	Group: **8.7x** DAM: **6.4x** Non-DAM: **12.5x**	Group: **5.8x** DAM: **6.2x** Non-DAM: **5.4x**	Huarong's higher leverage primarily comes from financial services & asset management
2. Profitability	**Higher**	**Lower**	
2.1 Group	Avg 2012-14 ROE: **20.4%** Avg 2012-14 ROA: **2.6%**	Avg 2012-14 ROE: **14.5%** Avg 2012-14 ROA: **2.9%**	
2.2 DAM	Avg 2012-14 pre-tax ROE: **31.4%**	Avg 2012-14 pre-tax ROE: **27.5%**	
2.3 Financial services	Avg 2012-14 pre-tax ROE: **22.3%**	Avg 2012-14 pre-tax ROE: **5.1%**	
2.4 Asset management and investment	Avg 2012-14 pre-tax ROE: **21.5%**	Avg 2012-14 pre-tax ROE: **13.4%**	
3. Growth	**Higher**	**Lower**	
3.1 Group NPAT CAGR	2012-14: **37%** 2014-17E: **25%**	2012-14: **30%** 2014-17E: **15%**	
3.2 Distressed assets CAGR	2012-14: **64%** 2014-17E: **32%**	2012-14: **53%** 2014-17E: **13%**	Cinda focused more on traditional debts while slowing the growth of restructuring debts since 2H14

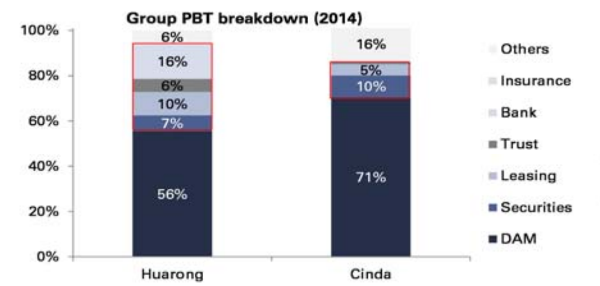
Source: Company data (2012-2014), Annual report of Cinda, Gao Hua Securities Research (2015E-2017E).

Exhibit 8: Compared to Cinda 1 – Huarong has: (a) higher ROE on higher leverage, (b) smaller size of distressed assets management segment, and (c) a more diverse revenue stream in the financial services segment (2014)

(Rmb mn, except otherwise stated)	Huarong	Cinda	Huarong vs. Cinda
Group			
Revenue	51,061	59,790	85%
Attributable NPAT	10,656	11,896	90%
Total assets	600,521	544,427	110%
Total equities	83,532	93,369	
Common equities	69,408	93,369	74%
ROAA	2.6%	2.6%	
ROAE	19.1%	14.0%	
Leverage (ROAE/ROAA)	7.4x	5.4x	
Leverage (ending total assets/total equities)	7.2x	5.8x	
Distressed asset management (DAM)			
Net balance			
Disposal/traditional debts	22,338	42,302	53%
% yoy	*175%*	*158%*	
Restructuring debts	157,239	162,109	97%
% yoy	85%	65%	
DES assets	24,389	41,564	59%
Unlisted	11,737	32,652	36%
Listed	12,652	8,912	142%
Income			
Disposal/traditional debts	886	4,077	22%
Restructuring debts	15,662	18,114	86%
DES assets	2,711	4,488	60%
Return			
IRR of disposal/traditional debts	16.0%	18.6%	
Memo: realized return during the year	*10%*	*58%*	
Yield on restructuring debts	13.1%	13.9%	
Exit multiple on DES assets	1.9x	2.1x	
Others			
Total distressed assets	203,965	245,975	83%
As % of Group assets	*34%*	*45%*	
Segment assets	283,339	320,974	88%

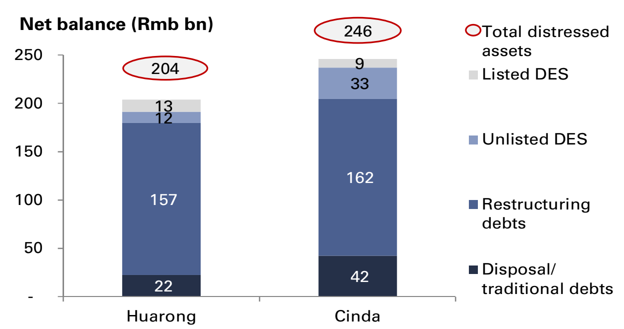
Note: "Others" include intra-segment eliminations.



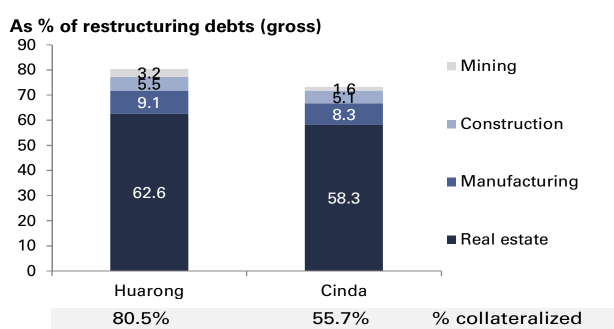


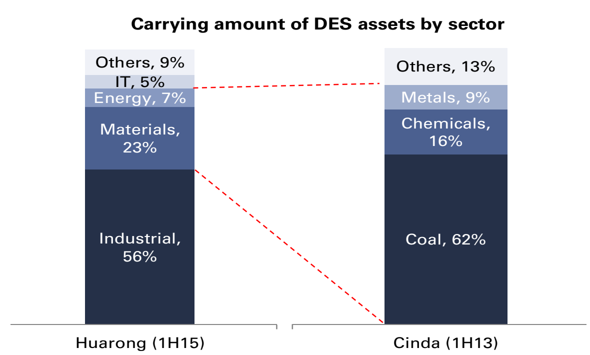
Source: Company data, Annual reports of Huarong Trust and Cinda.

Exhibit 9: Compared to Cinda 2 – in distressed assets management business, Huarong demonstrates: (a) smaller net balance, higher turnaround, and lower margin in disposal/traditional debts, (b) increased property exposure but with more collateral in restructuring debts, and (c) higher % of listed assets and lower exposure to cyclical sectors in DES assets (2014)



(Rmb mn, except otherwise stated)	Huarong	Cinda
Income		
Disposal/traditional debts	886	4,077
Restructuring debts	15,662	18,114
DES assets	2,711	4,488
Return		
IRR of disposal/traditional debts	16.0%	18.6%
Memo: realized return during the year	*10%*	*58%*
Yield on restructuring debts	13.1%	13.9%
Exit multiple on DES assets	1.9x	2.1x

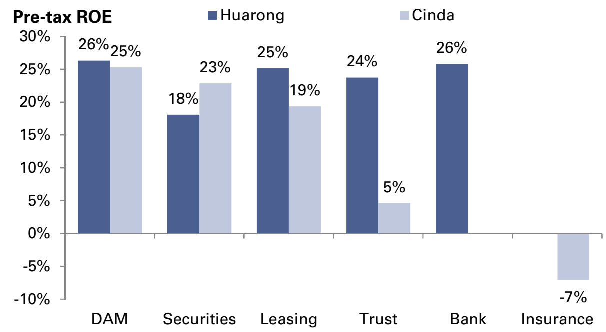


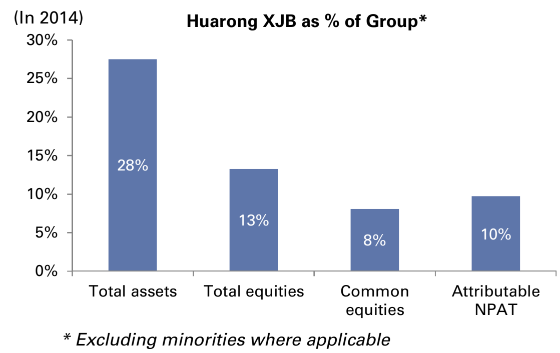


Source: Company data, Annual report of Cinda.

Exhibit 10: Compared to Cinda 3 – in financial services: (a) Huarong is stronger in leasing and trust, weaker in securities in terms of profitability in 2014[1], and (b) banking business (50.98%-owned by Huarong) accounts for 28% of total assets, 8% of common equity, and 10% of attributable NPAT (2014)
Rmb mn, unless otherwise stated

(Rmb mn, except otherwise stated)	Huarong	Cinda	Huarong vs. Cinda
Subsidiaries			
Securities			
% owned by the Group	81.56%	99.33%	
Commission	1,048	1,207	87%
PBT	1,146	1,580	73%
Total assets	43,041	34,869	123%
Net assets	7,303	7,563	97%
Pre-tax ROAE	18.1%	22.8%	
Trust			
% owned by the Group	98.09%	92.29%	
AUM	145,002	88,523	164%
Avg commission rate	1.2%	0.6%	
PBT	976	152	643%
Total assets	5,443	3,616	151%
Net assets	4,962	3,303	150%
Pre-tax ROAE	23.7%	4.6%	
Leasing			
% owned by the Group	79.92%	99.91%	
Lease receivables	63,494	37,020	172%
PBT	1,720	799	215%
Total assets	72,099	40,213	179%
Net assets	7,330	5,446	135%
Pre-tax ROAE	25.2%	19.4%	
Bank			
% owned by the Group	50.98%		
PBT	2,658		
Attributable NPAT	2,037		
Total assets	165,326		
Net assets	11,090.9		
Pre-tax ROAE	25.9%		





Source: Company data, Annual reports of Huarong Trust, Huarong Xiangjiang Bank (XJB), and Cinda.

Key strengths: Above-peer ROAE, growth potential of DAM, low cost funding, and group synergies

Huarong achieved **above-peer profit growth and ROAE** in 2012-2014, reflecting its strong execution capability in delivering efficient capital utilization and high profitability across segments. While the current macroeconomic backdrop presents certain challenges for AMCs in managing the credit risk and the returns on distressed debt, we think the medium-term **growth potential of the DAM business** remains encouraging. Moreover, Huarong's **access to low cost funding** could help the acquisition of distressed assets amid the current credit cycle, support DAM profitability and provide a buffer against potential asset price/quality risk. Further, we believe a **diverse business platform with growing synergies** is a competitive advantage for Huarong in providing flexible NPL solutions and comprehensive products and services throughout the enterprise lifecycle of clients.

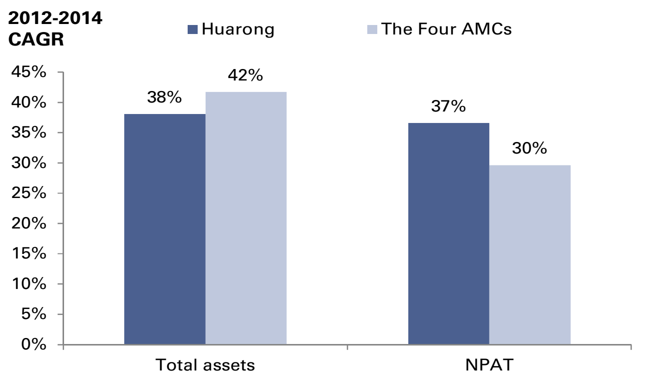
1. **Above-peer profit growth and ROAE in 2012-2014 on strong execution, efficient capital utilization and high profitability across segments**

   Huarong achieved above-peer NPAT growth of 37% CAGR in 2012-2014 (vs. an average of 30% for the Four AMCs, Exhibit 11), with DAM, banking, and securities business being the three main drivers (Exhibit 12).

[1] In 1H15, Huarong delivered higher pre-tax ROAE in securities and futures business than Cinda.

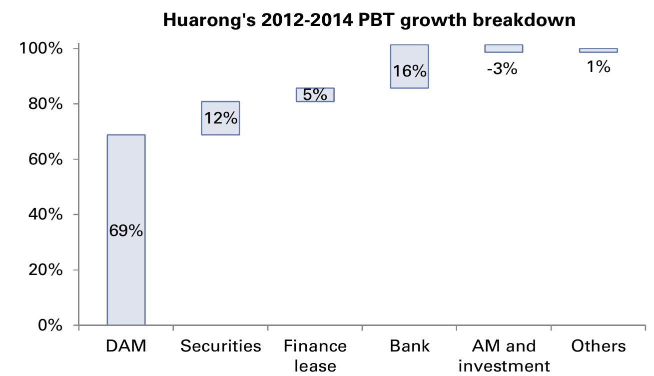
In terms of profitability, **Huarong has consistently delivered higher ROAE than its closest comparable,** Cinda[2] (Exhibit 13), on the back of: (a) Higher balance sheet leverage, (b) greater profitability in non-DAM business, and (c) fewer impairment charges on listed DES assets; reflecting the company's ability to execute in terms of delivering efficient capital utilization and high profitability across the group (especially in subsidiaries under the financial services segments), in our view (Exhibits 14-16). **We believe Huarong should be able to maintain its ROAE advantage over its peers during 2015E-2017E should there be no material credit losses** on its restructuring debts, bank loans, and/or lease receivables.

Exhibit 11: Huarong achieved above-peer net profit growth during 2012-2014…



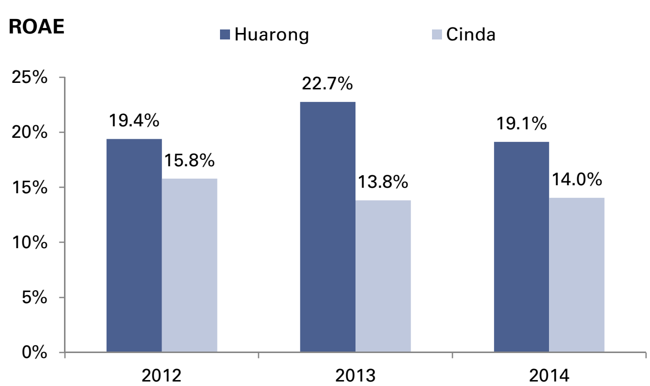
Source: Company data.

Exhibit 12: …driven by strong growth in distressed assets management, banking, and securities business



Source: Company data.

Exhibit 13: Huarong has consistently delivered higher ROAE than its closet comparable, Cinda…



Source: Company data, Annual report of Cinda.

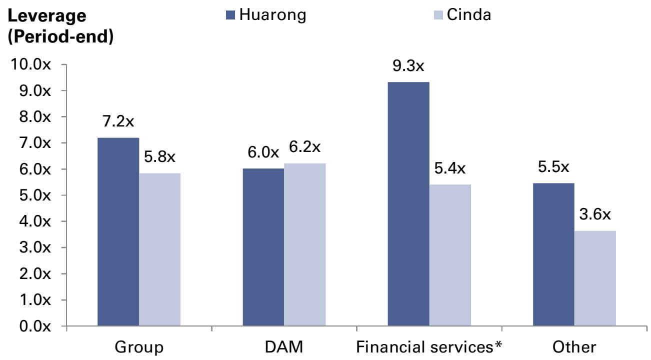
Exhibit 14: …as a result of higher balance sheet leverage, greater operating efficiency in business apart from DAM, and fewer impairment charges on listed DES assets

	Huarong			Cinda
	2012	2013	2014	2014
ROE	**19.4%**	**22.7%**	**19.1%**	**14.0%**
leverage (x)	7.7	8.2	7.4	5.4
= ROA	**2.5%**	**2.8%**	**2.6%**	**2.6%**
(As % of average assets)				
Income from distressed assets mgmt	**3.0%**	**4.2%**	**4.4%**	**5.8%**
Investment income (ex DES related)	1.4%	1.3%	1.4%	1.0%
Net commission and fee income	1.1%	1.2%	0.9%	0.4%
Interest income	3.5%	2.8%	2.4%	1.9%
Other revenue	0.3%	0.8%	0.9%	1.5%
Net revenue	**9.3%**	**10.2%**	**10.0%**	**10.6%**
Operating expense	-1.7%	-1.9%	-1.7%	-2.1%
Interest expense	-3.3%	-3.0%	-3.5%	-3.4%
PPOP	**4.3%**	**5.3%**	**4.8%**	**5.0%**
Impairment charges	-0.8%	-1.3%	-1.2%	-1.2%
Operating profit	**3.4%**	**3.9%**	**3.6%**	**3.8%**
Profit before tax	3.3%	3.8%	3.3%	3.5%
NPAT	**2.5%**	**2.8%**	**2.6%**	**2.6%**
Cost-to-income ratio (Group)	*29%*	*26%*	*25%*	*30%*
Cost-to-income ratio (DAM only)	*19%*	*17%*	*18%*	*16%*

Source: Company data, Annual report of Cinda.

[2]The other two AMCs (Orient and Great Wall) have not completed joint-stock reform and only report the financial operating results of their commercial (profitable) operations. Therefore, the ROAEs of these two are not fully comparable with Cinda's and Huarong's.

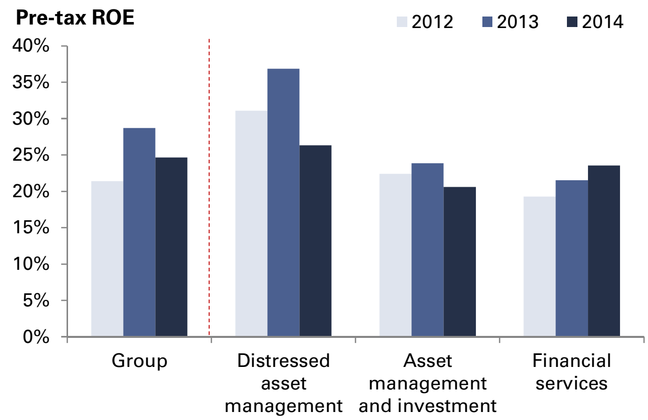
Exhibit 15: ...reflecting the company's execution capability in delivering efficient capital utilization...



*We re-group Huarong's trust business into the financial services segment for a like-for-like comparison.

Source: Company data, Annual reports of Huarong Trust and Cinda.

Exhibit 16: ...and high profitability across segments



Source: Company data.

2. Decent growth potential of its core distressed debt investment business, despite a gradual decline in returns

We see an encouraging outlook for Huarong's core distressed debt investment growth over the medium term on the back of an ample supply of bank NPLs and special-mention loans and distressed corporate debts, stemming from: (a) A protracted credit cycle as mainland China's economy slows down while many structural over-capacity issues remain, in our view; (b) an increasingly supportive regulatory environment for banks to dispose of NPLs; (c) liquidity stress at corporates as evidenced by the still declining EBIT/interest coverage ratio and growing account receivables at industrial companies in 1H15 as per the National Bureau of Statistics (NBS) data; and (d) potential supply from trust products with duration mismatch issues.

Indeed, **the current macroeconomic slowdown presents challenges for AMCs in managing credit risk and return on acquired distressed assets**, which is factored into our forecasts. However, given proper risk pricing and management are in place, **we think the downside risks are contained by**:

- The current policy loosening cycle (recent interest rate and RRR cuts) that lowers the funding cost and maintains the net interest margin of AMCs, which helps stabilize corporate solvency.
- The residential property average selling price (ASP) grew at a CAGR of 10% between 2006 and June 2015. The ASP recovered by 14% in June 2015 from its low in June 2014, according to the NBS. Residential property sales grew 12.9% yoy in June 2015. Much of Huarong's distressed debt is directly exposed to the real estate sector with property and land as collateral and, therefore, a stable property market in terms of transaction volume and ASP is important in managing the credit risk and return.
- Huarong has been prudent in that it has built up a buffer over its restructured debts to absorb an impairment ratio of more than 14% assuming a loss given default ratio of 50% (given 34.2% LTV ratio by 1H15).

3. Low cost funding to support DAM profitability and provide a buffer against potential asset price/quality risk

As a financial institution directly under the MOF, Huarong is able to tap the interbank and bond market for low-cost funding. The aggregate amount of credit lines the company obtained from banks amounted to Rmb458.9bn as at the end of 1H15 (vs. actual drawdown of Rmb155.7bn).

Huarong's average funding cost was at 3.9%/4.6% in 2013/2014, or 4.6%/5.5% excluding customer deposits at Huarong Xiangjiang Bank, based on our calculation (Exhibit 17). Financial bonds issued by Huarong in the domestic market were priced at a 105bp-133bp spread over government bonds, with a blended cost of 4.55% (Exhibit 20). These represent **a clear advantage over other distressed assets investors/non-bank lenders**. For example, funding costs for trusts and P2P lenders generally range from 8% to 20%+ (Exhibit 19).

Such funding strength lays a firm foundation for Huarong's DAM development given the capital-intensive nature of the business, in our view. Specifically, it enables Huarong to:

- Fully explore the opportunity of increasing NPLs supply from banks during the current credit cycle and to better withstand the pressure on disposal returns given the relatively low opportunity cost of holding acquired assets for a longer period.
- Provide relatively affordable debt restructuring terms to enterprises with liquidity issues but not too high credit risk, such as residential property projects closing at the presale stage.
- Prudently build up provisions on restructuring debts while still delivering reasonable ROE of around 20% (Exhibit 21).

In addition, access to the bond market for longer maturity funding helped Huarong offset the duration mismatch of assets and liabilities – it extended the weighted average maturity of debt financing from 22.9 months in 2012 to 31.0 months in 1H15.

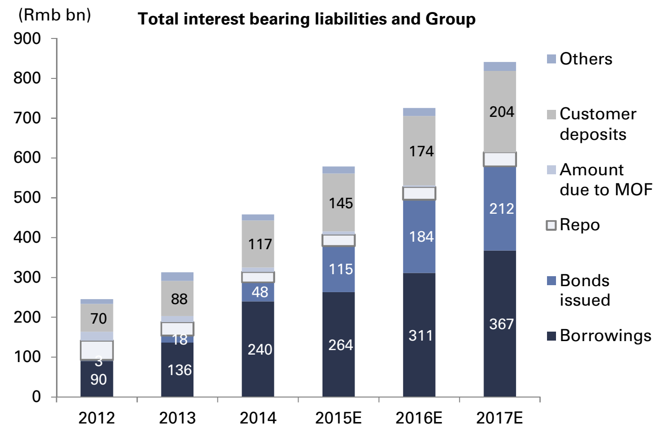
We expect Huarong to maintain funding costs at an average 4.6% in 2015E-2017E, given: (a) The majority of Huarong's interest-bearing liabilities (IBLs) already come from commercialized funding channels – the outstanding amount payable to the MOF (2.25% annual cost) was only Rmb11.4bn, or 2.5% of Huarong's total IBLs at the end of 2014; (b) proportionally more borrowings through bond issuances/bank loans undertaken by the parent company to develop its DAM business that comes at a lower cost (vs. borrowings done by financial subsidiaries such as finance leases); and (c) potentially lower interbank rates for longer on ongoing monetary loosening by the PBOC to accommodate the slowdown in economic growth.

Exhibit 17: Huarong's average funding cost was 3.9%/4.6% in 2013/2014 by our calculation; we expect it to see stable (low) funding cost in 2015E-2017E…

	2013	2014	2015E	2016E	2017E
Average funding cost	**3.9%**	**4.6%**	**4.6%**	**4.6%**	**4.6%**
Borrowings	5.5%	6.6%	6.3%	6.2%	6.2%
Bonds issued	3.5%	3.4%	4.1%	4.5%	4.5%
Repo	3.8%	3.4%	3.4%	3.4%	3.4%
Deposits from FIs	4.3%	3.6%	3.3%	3.3%	3.3%
Amount due to the MOF	2.0%	2.1%	2.1%	2.1%	2.1%
Interbank borrowings	5.1%	4.6%	4.4%	4.5%	4.5%
PBOC loans	3.5%	3.1%	3.0%	3.0%	3.0%
Customer deposits	2.1%	2.3%	2.2%	2.1%	2.0%
IBLs excl customer deposits	4.6%	5.5%	5.4%	5.4%	5.4%
(Borrowings + bonds) as % total IBLs	49.2%	62.8%	65.5%	68.3%	68.9%
(Borrowings + bonds) as % total IBLs excl customer deposits	68.4%	84.3%	87.4%	89.9%	90.9%

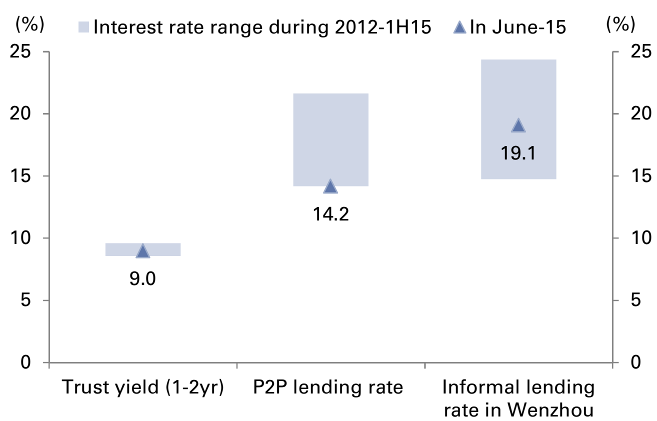
Source: Company data (2012-2014), Gao Hua Securities Research (2015E-2017E).

Exhibit 18: …given already well commercialized funding channels, proportionally more low cost bond issuance/ bank borrowings done by the parent company, and monetary loosening



Source: Company data (2012-2014), Gao Hua Securities Research (2015E-2017E).

Exhibit 19: Huarong has a clear funding advantage over other distressed asset investors/non-bank lenders
Funding cost through trust, P2P platform and other informal lending channels



Source: Wind.

Exhibit 20: Financial bonds issued by Huarong in domestic market were priced at 105bp-133bp spread over government bonds, with a blended cost of 4.55%
List of financial bonds issued by Huarong

Date of issuance	Amount (Rmb bn)	Maturity (year)	Coupon rate (%)	Spread over government bond
11/21/2013	6.0	5	5.66	1.17pp
11/21/2013	6.0	3	5.55	1.10pp
12/2/2014	10.0	5	4.80	1.33pp
12/2/2014	10.0	3	4.60	1.31pp
7/30/2015	17.5	5	4.21	1.05pp
7/30/2015	17.5	3	4.01	1.14pp
Aggregate	**67.0**		**4.55**	

Source: Wind.

Exhibit 21: The funding strength enables Huarong to provide relatively affordable restructuring terms (around 12% cost) to distressed enterprises and prudently book provisions, while still delivering reasonable ROE of 17%-22%, in our view

ROE sensitivity to funding cost in restructuring business						
ROE	**21.9%**	**17.0%**	**12.1%**	**7.1%**	**2.2%**	**-2.7%**
Leverage (x)	8	8	8	8	8	8
ROA	**2.7%**	**2.1%**	**1.5%**	**0.9%**	**0.3%**	**-0.3%**
(As % of average assets)						
Asset yield	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%
Funding cost	**4.5%**	**5.5%**	**6.5%**	**7.5%**	**8.5%**	**9.5%**
NII	7.5%	6.5%	5.5%	4.5%	3.5%	2.5%
Opex	-1.4%	-1.2%	-1.0%	-0.8%	-0.6%	-0.5%
PPOP	**6.2%**	**5.3%**	**4.5%**	**3.7%**	**2.9%**	**2.1%**
Provision	**-2.5%**	**-2.5%**	**-2.5%**	**-2.5%**	**-2.5%**	**-2.5%**
PBT	3.7%	2.8%	2.0%	1.2%	0.4%	-0.4%
NPAT	**2.7%**	**2.1%**	**1.5%**	**0.9%**	**0.3%**	**-0.3%**
Cost-to-income ratio	*18%*	*18%*	*18%*	*18%*	*18%*	*18%*
Provision as % of NIM	*33%*	*38%*	*45%*	*56%*	*71%*	*100%*

Note: Figures shown above are for illustrative purposes only. The two columns on the left correspond to Huarong's funding cost level, while the two columns on the right correspond to Trust funding cost level.

Source: Gao Hua Securities Research.

4. Integrated platform with growing synergies among three segments

We believe Huarong is well-positioned to create significant cross-selling and revenue opportunities given its strategic focus on intra-group cooperation, comprehensive product offering, and strong record of management execution. Group synergy is an important competitive advantage for Huarong given most financial services and asset management units are relatively small compared with the industry leaders in their respective fields.

Huarong adopts a "core client" strategy which focuses on in-depth coverage for large clients. As of June 30, 2015, the group signed 18 strategic cooperation agreements with 15 provincial level governments and cooperation agreements with 84 leading financial institutions and 89 large-scale enterprises. By concentrating on large clients, Huarong not only lowers its customer acquisition costs, but also better integrates its national network of 31 regional branches with eight financial services and asset management subsidiaries to offer one-stop services.

Between 2012 and 1H15, intra-group cooperation generated a total of Rmb196bn in project investments and income of Rmb23.4bn, which represented 15% of accumulated revenue during the period. The subsidiaries that have contributed the largest investments are Huarong Trust, Huarong Financial Leasing, and Huarong Securities. The subsidiaries that have achieved the largest accumulated income are Huarong Trust, Huarong Financial Leasing, and Huarong Rongde.

We assess the potential synergies among Huarong's three key business segments below:

- **There could be significant synergies between Segment 1 and Segment 3**

  We think the asset management and investment business is a natural extension of Huarong's DAM segment, adding a "capital-light" business model to the group. Segment 3 may provide flexible funding sources and NPL solutions. Furthermore, it can also leverage client resources, professional expertise, risk control capacities, and project resources derived from distressed assets management business.

- **There could be modest synergies between Segment 1 and 2**

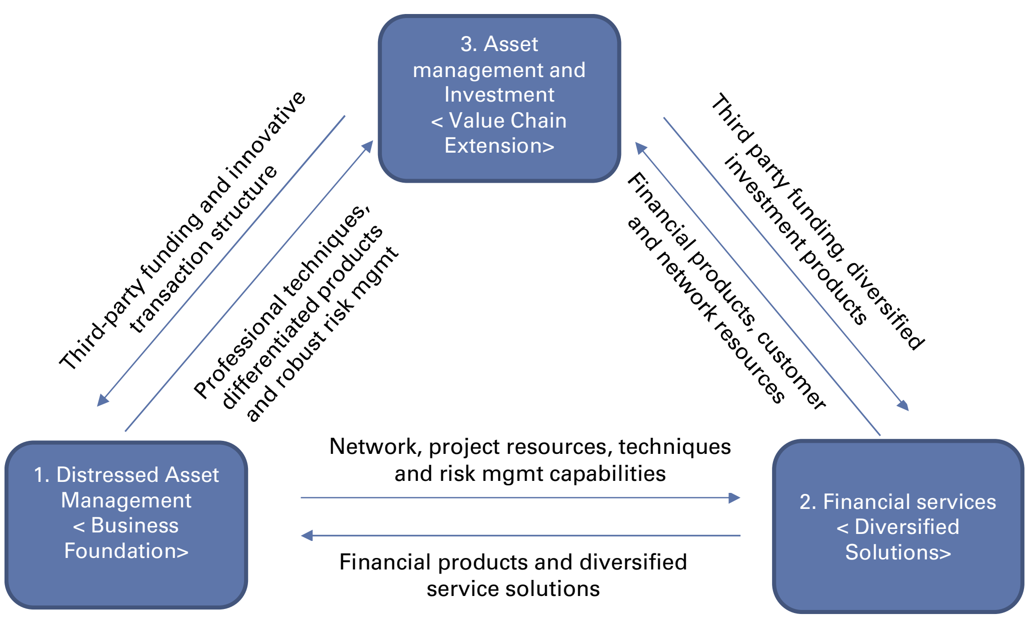
  In our view, Huarong's strong franchise in the DAM business can offer a valuable client base and network for financial services units, which would not be easily accessible for standalone financial firms that don't have the scale of industry leaders.

  On the other hand, securities business under Segment 2 can help with equity and bond offering of DES assets, and provide financial advisory services to DES projects.

- **There could be modest synergies between Segment 2 and 3**

  We think Huarong's financial services platform can offer a product and client base to Segment 3. However, the asset management unit may provide more flexible financing solutions to Huarong Bank's customers including third-party funds and trust financing services.

Exhibit 22: Huarong's three key segments operate synergistically with one another
Illustration of group synergies



Source: Company data.

Key risks: Sharp GDP/property market slowdown, competition

We believe **a sharp GDP/property market slowdown** and **increasing competition from other AMCs** are the two key risks for Huarong.

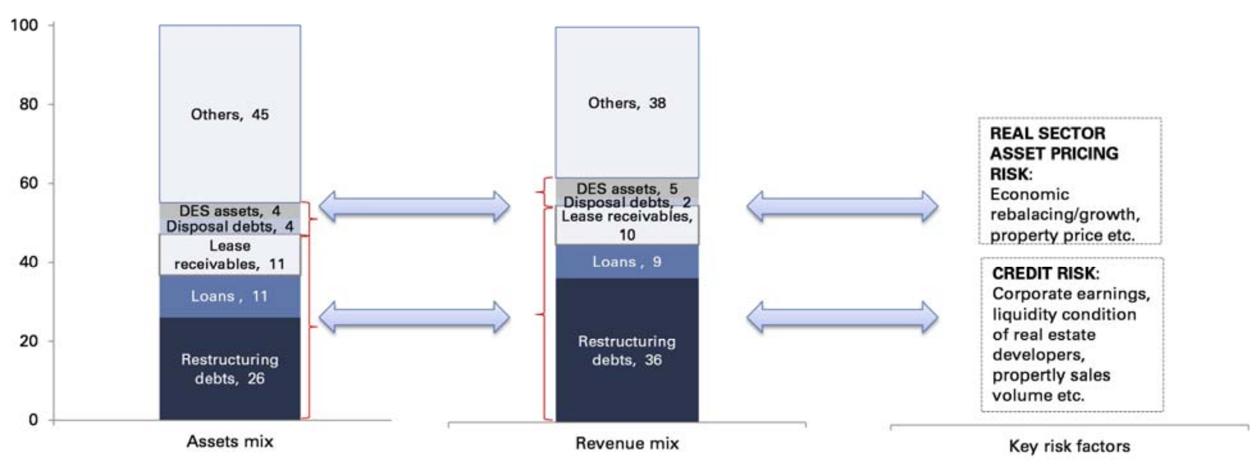
The former could lead to: (a) Higher credit risks of Huarong's restructuring debts, banking and leasing assets (partly offset by a high provision ratio and low LTV ratio), and (b) increasing difficulties/lower profitability during the disposal of NPLs and DES assets. **The latter** may raise the acquisition cost of NPLs and competition for restructuring debts in selective provinces, although we believe pricing competition may become less of a concern on rising NPL supply and that Huarong (and the other three national AMCs) still possess distinct advantages over local AMCs.

1. **A sharp GDP/property market slowdown may increase the credit risk of Huarong's restructuring debts, banking and leasing assets, and negatively affect the return on disposal debts/DES assets**

   While the DAM business adds some defensive feature to Huarong's earnings, **a meaningful part of Huarong's operations is closely tied to corporate earnings and asset pricing** (Exhibit 23). In 2014, this included: **(a) The gross credit exposure of Rmb298bn** (or 50% of group assets, and generated 55% of group revenue) that is subject to credit risk should corporate earnings deteriorate, and **(b) Rmb22bn disposal debts and Rmb24bn DES assets** (in total 8% of group assets generated 7% of group revenue), the return on which hinges on the market value of these assets. That said, we note that Huarong maintains a relatively high provision ratio (7.2% in 1H15) and low LTV ratio (34.2% in 1H15) on restructuring debts, which could help offset the credit risk in an adverse scenario – assuming a loss given a default ratio of 50%, Huarong's existing provision buffer could absorb up to an impairment ratio of 14.4% (vs. an impairment ratio of 1.6% and an overdue ratio of 3.8% reported by Huarong in 1H15).

   Exhibit 24 assesses Huarong's earnings sensitivity to a select set of key assumptions. Yield on restructuring debts, credit provisions, and funding cost are the three factors affecting 2015E NPAT the most.

Exhibit 23: Huarong's risk profile breakdown: While the DAM business adds some defensive features to Huarong's earnings, a meaningful part of Huarong's operations is closely tied to corporate earnings and asset pricing
Assets mix and revenue mix are as of 2014, in %



Source: Company data, Gao Hua Securities Research.

Exhibit 24: Huarong's earnings are sensitive to yield on restructuring debts, credit provisions, and funding cost
2015E NPAT sensitivity

	Base assumption	Change by (pp)	PBT impact (RMB mn)	As % of NPAT
2015E				
Realized return on disposal debts	9%	-1	(130)	-0.6%
Return on restructuring debts	12.0%	-1	(1,951)	-8.3%
Exit multiple of DES assets	2.6X	-20	(670)	-2.9%
Credit cost on restructuring debts	1.9%	+1	(2,099)	-9.0%
Credit cost on banking and leasing assets	0.6%	+0.5	(710)	-3.0%
Avg cost of interest-bearing liabilities	4.6%	+0.2	(1,038)	-4.4%

Source: Gao Hua Securities Research.

2. Rising competition from other AMCs may raise the acquisition cost of NPLs and lead to difficulties in acquiring restructuring debts in certain provinces

Given the high-growth potential and profitability of the distressed debt business, we expect increasing competition from other AMCs, especially the other three national AMCs. Apart from Cinda, which has consistently focused on the distressed debt business, Orient and Great Wall also shifted gears to grow more traditional/disposal business on rapid new NPL formations at Chinese banks since late 2013. With similar business licensing, funding costs, and financial holding group structure, competition among the Four AMCs may push up the acquisition cost of NPLs. However, pricing competition in NPL acquisition could be moderating in 2015E due to a potential increase in supply from banks, in our view.

The provincial governments were allowed to establish or authorize one local institution to conduct DAM since February 2012. By July 2015, there were a total of 15 local AMCs approved by CBRC. Given the potentially stronger connection with local governments, these local AMCs may be competitive in the restructuring debt markets in local provinces. Overall, we believe local AMCs may not challenge the national ones given the former's distinct disadvantages in business scope and funding, as summarized in Exhibit 25.

Moreover, we expect entities such as private equity funds to gradually enter the DAM business as the industry becomes more mature. However, similar to the case with local AMCs, we do not think the challenge is likely to be material in the near term.

Exhibit 25: The Four AMCs possess a clear advantage over local AMCs in terms of business scope and funding, in our view

	The Four AMCs	Local-government AMCs
Source of distressed assets	Nationwide Distressed assets from financial institutions. (Cinda, currently the only AMC with regulatory approval, can also acquire distressed assets from non-financial enterprises)	Respective provinces/regions/municipalities Batch transfer of distressed assets from financial institutions
Disposal method	No limit	Shall be disposed of via debt restructuring and shall not be transferred to other companies
Major shareholder	Ministry of Finance	Local governments
Source of funding	Bank loans, financial bonds, interbank borrowing, equity financing, MOF, PBOC	Unclear so far

Source: CBRC, Gao Hua Securities Research.

Financials

We forecast Huarong to post **34%/19%/14% revenue growth in 2015E/2016E/2017E** (or 22% 2014-2017E CAGR[3]) and **35%/24%/17% NPAT growth** (or 25% CAGR), mainly driven by: **(a) Strong income growth in its DAM business** (at 29% CAGR) on rapid distressed assets acquisition offsetting gradually lower returns, **(b) stable growth of financial services and asset management units** (at 15% revenue CAGR, net of commission expense) amidst some headwinds from interest rate cuts and a cooling in financial markets (from the 2H14-1H15 level), and **(c) lower impairment losses on restructuring debts after 2015E** as growth of restructuring debts gradually slows down to a more sustainable level while Huarong keeps its provision ratio (over restructuring debt balance) stable at c.7.0%.

ROA may decline modestly to 2.6%/2.5%/2.5% in 2015E/2016E/2017E from 2.6% in 2014 due to a higher portion of capital-intensive DAM business and lower yield on interest-earnings assets (IEAs) post the PBOC rate cuts. **ROE** may decline to 17.1%/16.8%/17.3% in 2015E/2016E/2017E from 19.1% in 2014 on lower balance sheet leverage. That said, there is room for Huarong to further raise the leverage of its balance sheet and enhance 2015E-2017E ROE given the company's track record of efficient capital utilization.

Exhibit 26 illustrates the 2015E-2017E NPAT growth breakdown, with its DAM business being the biggest growth driver, based on our estimates.

Exhibits 27 and 28 list our detailed assumptions behind the DAM segment and impairment charges forecasts, respectively; while Exhibits 31 and 32 summarize our forecasts for key income statement and balance sheet items, respectively:

- **DAM business: Strong 29% revenue CAGR on the back of 32% distressed assets balance CAGR and gradually declining return; contributing 52% of the group's 2017E net revenue**

  Distressed assets growth: We forecast the balance of distressed debt assets to grow at 36% CAGR amidst abundant distressed assets supply from banks and non-financial enterprises. Disposal debts (i.e. NPL packages acquired from banks) are likely to grow faster than restructuring debts off a low base (GSe: 49% CAGR). Balance of DES assets may decrease by a CAGR of 9% as Huarong gradually exits from DES legacy assets.

  Return: We forecast declining returns across the three major distressed asset categories during 2015E-2017E in light of less asset appreciation potential during the current macroeconomic downcycle, PBOC interest rate cuts, and increasing competition from the other three national AMCs and local AMCs. The magnitude of such a decline should be moderate, mitigated by an ample supply of distressed assets, Huarong's bargaining power over distressed corporates and management's discretion as to "when to dispose of what" (especially for DES assets).

- **Financial services and asset management business: Stable revenue growth of 15% CAGR (net of commission expense)**

  Net revenue from financial services and asset management business grew strongly at 27% CAGR during 2012-2014. We expect net revenue growth in 2015E-2017E to slow to 15% due to headwinds from interest rate cuts and a cooling of financial markets (from the 2H14-1H15 level), which would negatively affect Huarong's banking, leasing, and securities business. While we expect Huarong to continue to raise the provision ratio over its bank loan and lease receivables, the growth rate of the associated impairment losses charged through the P&L may have peaked in 2014 given the sharp increase in

[3] CAGR in the section refers to 2014-2017E CAGR, unless stated otherwise.

credit costs in 2014. This should help bottom line growth. We forecast 16% net profit CAGR at the group, excluding the DAM segment.

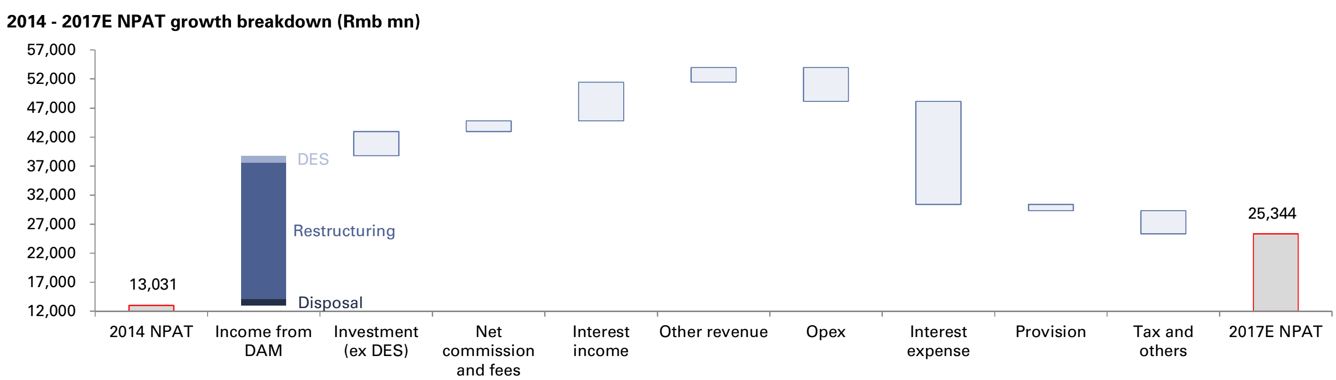
- **Impairment losses on restructuring debts: To peak in 2015E as growth in restructuring debts gradually slows down to a more sustainable level**

  The rapid growth in restructuring debts has been a major source of impairment losses at the group level, resulting in 107%/87%/80% of total impairment losses in 2012/2013/2014, as Huarong booked provisions totaling 7.1%/7.9%/6.8% of the end balance of the restructuring debts. Looking ahead, we expect Huarong to maintain a stable provision ratio of c.7.0% through 2017E given the already high level of provisions – we forecast its provision-to-impairment ratio to stay above 350% in 2017E assuming 7.0% provision ratio and 2.0% impairment ratio (Exhibit 28). Thus the additional provision requirement in 2015E-2017E would fall along with the slowdown in restructuring debts. We forecast an average of 2.1% credit cost during 2015E-2017E vs. 3.3% in 2014 for restructuring debts, and an average of 1.5% vs. 2.1% for the group's total credit exposure.

- **Balance sheet: Assets to grow at a CAGR of 23% over 2014-2017E driven by acquisition of distressed assets and robust growth of bank loans and lease receivables**

  Distressed assets acquisition would be one major driver of balance sheet expansion, followed by the growth in bank loans and lease receivables in banking and finance leasing units. We estimate the share of distressed assets to rise to 42% of total assets by 2017E from 34% in 2014.

Exhibit 26: We forecast DAM business to be the biggest growth driver during 2015E-2017E



Source: Company data (2014), Gao Hua Securities Research (2015E-2017E).

Exhibit 27: DAM business: Strong 29% revenue CAGR on the back of 32% distressed assets balance CAGR, offsetting gradually declining returns

Detailed assumptions for DAM business (in Rmb mn, unless stated otherwise)

	2012	2013	2014	2015E	2016E	2017E	YoY growth 2013	2014	2015E	2016E	2017E	2014-17E CAGR
Total distressed assets	**75,931**	**114,607**	**203,965**	**295,014**	**387,475**	**467,071**	**51%**	**78%**	**45%**	**31%**	**21%**	**32%**
Distressed debt assets	54,449	93,020	179,576	272,821	367,279	448,692	71%	93%	52%	35%	22%	36%
- Disposal	3,126	8,134	22,338	39,905	56,868	73,727	160%	175%	79%	43%	30%	49%
- Restructuring	51,322	84,886	157,239	232,916	310,411	374,965	65%	85%	48%	33%	21%	34%
DES	21,483	21,587	24,389	22,194	20,196	18,379	0%	13%	-9%	-9%	-9%	-9%
As % of total assets	*24%*	*28%*	*34%*	*38%*	*40%*	*42%*						
Total income from distressed assets	**8,331**	**15,209**	**22,214**	**33,917**	**41,782**	**47,980**	**83%**	**46%**	**53%**	**23%**	**15%**	**29%**
Distressed debt asset mgmt	4,895	9,427	16,548	24,733	32,882	39,665	93%	76%	49%	33%	21%	34%
- Disposal	250	509	886	1,324	1,641	1,969	104%	74%	49%	24%	20%	30%
- Restructuring	4,645	8,918	15,662	23,409	31,241	37,696	92%	76%	49%	33%	21%	34%
DES mgmt	1,422	3,516	2,711	5,591	4,632	3,876	147%	-23%	106%	-17%	-16%	13%
- Disposal (AFS & interest in associates)	1,160	3,159	2,477	5,358	4,420	3,683	172%	-22%	116%	-18%	-17%	14%
- Div income	262	357	234	233	212	193	36%	-34%	-1%	-9%	-9%	-6%
Financial advisory income from restructuring debts	2,014	2,266	2,955	3,593	4,268	4,439	12%	30%	22%	19%	4%	15%
As % of total revenue net of commission expense	*32%*	*41%*	*44%*	*50%*	*52%*	*52%*						
Return assumptions												
Disposal - return on disposal	26%	23%	10%	9%	8%	8%	7%	11%	14%	15%	16%	
Restructuring - return on period-end avg balance		12.1%	12.0%	12.0%	11.5%	11.0%	74%	77%	79%	80%	80%	
DES - exit multiple	2.9X	5.2X	1.9X	2.6X	2.2X	2.0X	19%	12%	8%	5%	4%	
DES - div yld (on avg balance)	1.2%	1.7%	1.0%	1.0%	1.0%	1.0%						
Financial advisory fee rate	4.9%	3.4%	2.3%	2.0%	1.8%	1.6%						

Source: Company data (2012-2014), Gao Hua Securities Research (2015E-2017E).

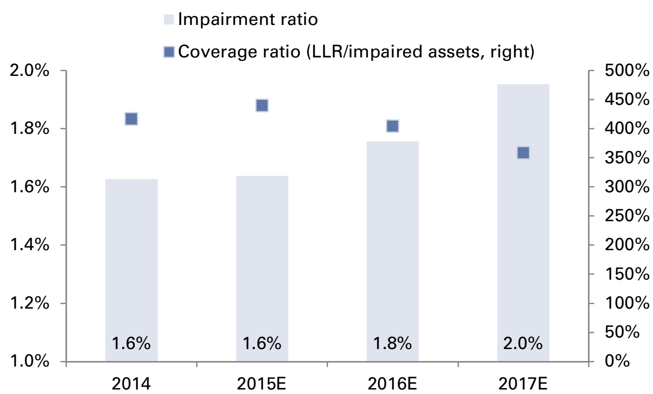
Exhibit 28: Impairment losses on restructuring debts: To peak in 2015E as growth in restructuring debts gradually slows to a more sustainable level

Detailed assumptions behind our impairment losses forecast

(RMB mn)	2012	2013	2014	2015E	2016E	2017E
Impairment losses on assets	**(2,323)**	**(4,850)**	**(6,226)**	**(9,162)**	**(8,177)**	**(7,282)**
Distressed debt assets classified as receivables	(2,550)	(3,407)	(4,334)	(6,597)	(5,652)	(4,500)
AFS	104	(785)	(507)	(1,012)	(1,012)	(962)
GSe DES related	*66*	*(817)*	*(624)*	*(1,012)*	*(1,012)*	*(962)*
as % of beginning balance of listed DES		*-9%*	*-7%*	*-8%*	*-8%*	*-8%*
Loans and advances to customers	(108)	(269)	(510)	(612)	(547)	(749)
Lease receivables	(85)	(46)	(263.6)	(286)	(263)	(315)
Others	315	(343)	(611)	(655)	(703)	(757)
Memo: losses on distressed assets as % of total	*107%*	*87%*	*80%*	*83%*	*81%*	*75%*
Memo: impairment losses as % avg assets	-0.8%	-1.3%	-1.2%	-1.3%	-0.9%	-0.7%
Gross credit exposure	**141,798**	**197,447**	**297,555**	**405,973**	**516,164**	**614,966**
Restructuring distressed debts	55,230	92,133	168,713	250,987	334,135	403,188
Loans and advances to customers	38,129	48,934	64,449	80,933	96,869	113,844
Finance lease receivables	48,439	56,380	64,393	74,052	85,160	97,934
Allowance for impairment	**(5,185)**	**(8,838)**	**(13,583)**	**(21,078)**	**(27,540)**	**(33,103)**
Restructuring distressed debts	(3,908)	(7,247)	(11,474)	(18,071)	(23,724)	(28,223)
Loans and advances to customers	(483)	(758)	(1,210)	(1,822)	(2,369)	(3,117)
Finance lease receivables	(794)	(833)	(899)	(1,185)	(1,448)	(1,763)
Provision ratio	**3.7%**	**4.5%**	**4.6%**	**5.2%**	**5.3%**	**5.4%**
Restructuring distressed debts	7.1%	7.9%	6.8%	7.2%	7.1%	7.0%
Loans and advances to customers (incl. margin loans)	1.3%	1.5%	1.9%	2.3%	2.4%	2.7%
Finance lease receivables	1.6%	1.5%	1.4%	1.6%	1.7%	1.8%
Credit cost		**-2.2%**	**-2.1%**	**-2.1%**	**-1.4%**	**-1.0%**
Restructuring distressed debts		-4.6%	-3.3%	-3.1%	-1.9%	-1.2%
Loans and advances to customers		-0.6%	-0.9%	-0.8%	-0.6%	-0.7%
Finance lease receivables		-0.1%	-0.4%	-0.4%	-0.3%	-0.3%

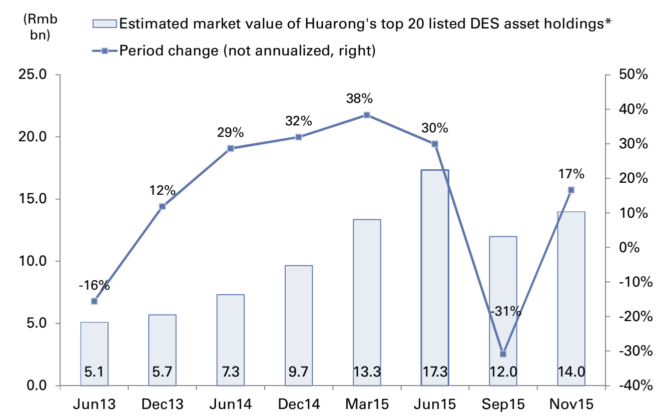
Source: Company data (2012-2014), Gao Hua Securities Research (2015E-2017E).

Exhibit 29: While the impairment ratio of Huarong's restructuring debts may gradually increase to 1.9% in 2017E (as it's not immune to the credit cycle), its coverage ratio would remain comfortable at c.350%
Asset quality of restructuring debts



Source: Company data (2014), Gao Hua Securities Research (2015E-2017E).

Exhibit 30: We estimate that the market value of Huarong's top 20 listed DES asset holdings rose 80% in 1H15 and subsequently declined 21% by end-August
As of November 27, 2015



*Note the constitution of Huarong's top 20 listed DES asset holdings is as of the end of 1H15. Historical market value is calculated based on unchanged portfolio mix over time, which is not that accurate, in our view.

Source: Company data, Datastream.

Exhibit 31: Huarong's income statement: 34%/19%/14% revenue growth in 2015E/2016E/2017E (or 22% 2014-2017E CAGR) and 35%/24%/17% NPAT growth (or 25% CAGR)
Key income statement items

INCOME STATEMENT							YoY growth				2014-17E
(RMB mn)	2012	2013	2014	2015E	2016E	2017E	2014	2015E	2016E	2017E	CAGR
Operating Revenue	**26,063**	**37,319**	**51,061**	**68,204**	**80,824**	**92,425**	**37%**	**34%**	**19%**	**14%**	**22%**
Income from distressed debt assets classified as receivables	4,645	8,918	15,662	23,409	31,241	37,696	76%	49%	33%	21%	34%
Fair value changes on distressed debt assets	250	509	886	1,324	1,641	1,969	74%	49%	24%	20%	30%
Fair value changes on other financial assets	460	942	1,289	1,676	1,844	2,028	37%	30%	10%	10%	16%
Investment income	5,328	8,179	9,804	14,101	14,419	15,132	20%	44%	2%	5%	16%
Interest income	9,686	10,076	12,048	13,825	16,226	18,705	20%	15%	17%	15%	16%
Commission and fee income	5,244	6,785	7,986	9,936	10,931	11,694	18%	24%	10%	7%	14%
Net gains on disposal of subsidiaries and associates	(60)	14	128	186	214	246	795%	45%	15%	15%	24%
Other income and other net gains or losses	510	1,897	3,258	3,747	4,309	4,956	72%	15%	15%	15%	15%
Operating expenses	**(16,480)**	**(23,126)**	**(33,051)**	**(44,191)**	**(51,301)**	**(58,112)**	**43%**	**34%**	**16%**	**13%**	**21%**
Interest expense	(9,084)	(10,931)	(17,904)	(23,822)	(29,746)	(35,664)	64%	33%	25%	20%	26%
Commission and fee expense	(211)	(328)	(452)	(679)	(781)	(856)	38%	50%	15%	10%	24%
Operating expense	(4,861)	(7,017)	(8,469)	(10,528)	(12,598)	(14,310)	21%	24%	20%	14%	19%
Impairment losses on assets	(2,323)	(4,850)	(6,226)	(9,162)	(8,177)	(7,282)	28%	47%	-11%	-11%	5%
Operating profit	**9,583**	**14,194**	**18,009**	**24,013**	**29,523**	**34,312**	**27%**	**33%**	**23%**	**16%**	**24%**
Memo: cost-to-income ratio	*29%*	*26%*	*25%*	*23%*	*24%*	*25%*					
Profit before tax	**9,109**	**13,640**	**16,774**	**22,665**	**28,049**	**32,702**	**23%**	**35%**	**24%**	**17%**	**25%**
Income tax expense	(2,123)	(3,547)	(3,744)	(5,100)	(6,311)	(7,358)	6%	36%	24%	17%	25%
Effective tax rate	23%	26%	22%	23%	23%	23%					
Profit for the year	**6,986**	**10,093**	**13,031**	**17,566**	**21,738**	**25,344**	**29%**	**35%**	**24%**	**17%**	**25%**
Equity holders of the Company	**5,892**	**8,660**	**10,656**	**14,366**	**17,778**	**20,727**	**23%**	**35%**	**24%**	**17%**	**25%**
Non-controlling interests	1,094	1,434	2,374	3,200	3,960	4,617	66%	35%	24%	17%	25%

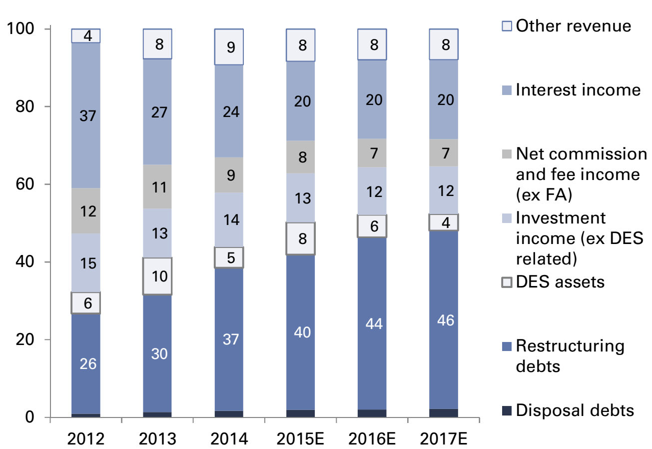
Source: Company data (2012-2014), Gao Hua Securities Research (2015E-2017E).

Exhibit 32: Huarong's balance sheet: Assets to grow at 23% CAGR with a higher portion allocated to its DAM business
Key balance sheet items

BALANCE SHEET (RMB mn)	2012	2013	2014	2015E	2016E	2017E	YoY growth 2014	2015E	2016E	2017E	2014-17E CAGR
Assets											
Cash and bank balances	16,898	21,152	26,945	40,272	60,847	57,229	27%	49%	51%	-6%	29%
Deposits with financial institutions	20,469	29,923	51,633	59,378	68,285	78,528	73%	15%	15%	15%	15%
Placement with financial institutions	950	3,071	13,628	15,673	18,023	20,727	344%	15%	15%	15%	15%
Financial assets at fair value through profit or loss	19,343	21,062	41,170	59,946	75,982	92,842	95%	46%	27%	22%	31%
Financial assets held under resale agreements	39,785	40,464	21,842	25,118	28,886	33,219	-46%	15%	15%	15%	15%
Available-for-sale financial assets	29,135	28,966	43,967	48,548	53,599	59,186	52%	10%	10%	10%	10%
Held-to-maturity investments	9,742	12,624	18,818	20,700	23,805	27,375	49%	10%	15%	15%	13%
Financial assets classified as receivables	74,922	124,320	227,033	316,670	410,915	495,570	83%	39%	30%	21%	30%
Loans and advances to customers	37,646	48,176	63,239	79,111	94,501	110,727	31%	25%	19%	17%	21%
Lease receivables	47,645	55,546	63,494	72,867	83,712	96,171	14%	15%	15%	15%	15%
Investment properties	651	628	977	1,026	1,077	1,131	56%	5%	5%	5%	5%
Interests in associates	2,904	2,855	2,863	2,863	2,863	2,863	0%	0%	0%	0%	0%
Property and equipment	3,708	4,129	3,991	4,190	4,400	4,620	-3%	5%	5%	5%	5%
Deferred tax assets	915	2,037	2,672	2,939	3,233	3,556	31%	10%	10%	10%	10%
Other assets	10,321	13,415	18,247	20,072	22,079	24,287	36%	10%	10%	10%	10%
Total Assets	**315,034**	**408,367**	**600,521**	**769,373**	**952,209**	**1,108,031**	**47%**	**28%**	**24%**	**16%**	**23%**
Liabilities											
Borrowings from central bank	40	52	80	88	97	106	53%	10%	10%	10%	10%
Deposits from financial institutions	11,889	16,018	13,660	15,709	18,065	19,872	-15%	15%	15%	10%	13%
Placements from financial institutions	-	5,828	2,111	2,322	2,554	2,810	-64%	10%	10%	10%	10%
Borrowings	89,760	136,131	239,885	263,874	311,371	367,418	76%	10%	18%	18%	15%
Financial assets sold under repurchase agreements	48,146	33,989	26,203	28,823	31,706	34,876	-23%	10%	10%	10%	10%
Due to customers	70,052	87,886	117,246	145,385	174,462	204,121	33%	24%	20%	17%	20%
Bonds and notes issued	3,487	17,886	48,002	115,205	184,328	211,977	168%	140%	60%	15%	64%
Tax payable	2,037	2,190	2,277	2,618	3,011	3,463	4%	15%	15%	15%	15%
Deferred tax liabilities	56	161	123	142	163	187	-23%	15%	15%	15%	15%
Other liabilities	46,995	55,692	67,402	80,882	97,058	116,470	21%	20%	20%	20%	20%
Total liabilities	**272,462**	**355,833**	**516,989**	**655,048**	**822,816**	**961,300**	**45%**	**27%**	**26%**	**17%**	**23%**
Equity attributable to equity holders of the Company	**34,176**	**41,967**	**69,408**	**98,788**	**112,303**	**127,932**	**65%**	**42%**	**14%**	**14%**	23%
Total equity	**42,572**	**52,534**	**83,532**	**114,324**	**129,393**	**146,731**	**59%**	**37%**	**13%**	**13%**	**21%**
Total equity and liabilities	**315,034**	**408,367**	**600,521**	**769,373**	**952,209**	**1,108,031**	**47%**	**28%**	**24%**	**16%**	**23%**

Source: Company data (2012-2014), Gao Hua Securities Research (2015E-2017E).

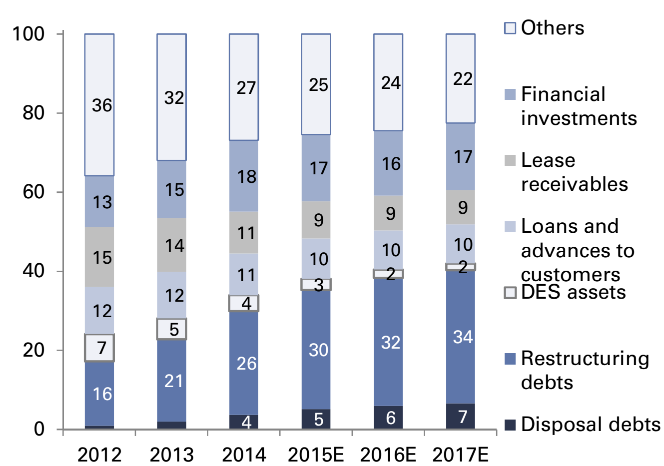
Exhibit 33: We estimate that revenue from distressed assets may contribute 52% of the group's net revenue in 2017E, up from 44% in 2014
Revenue mix, in %



Note: Revenue is net of commission expense.

Source: Company data (2012-2014), Gao Hua Securities Research (2015E-2017E).

Exhibit 34: Total balance of distressed assets may grow to 42% of total assets in 2017E, up from 34% in 2014
Asset mix, in %



Source: Company data (2012-2014), Gao Hua Securities Research (2015E-2017E).

Valuation methodology

We adopt sum-of-the-parts (SOTP) as our primary method to value Huarong so as to capture the differentiated risk/return profiles of its three business segments: (1) distressed asset management, (2) financial services, and (3) asset management and others. Our 12-month target price for Huarong of HK$4.1 implies 1.3X 2015E P/B. The stock is currently trading at 1.0X 2015E P/B, translating into 34% upside.

We value Huarong as the sum of following three parts:

- **Part I: The DAM segment:** Representing 64% of 2015E common equity; valued at 1.5X 2015E P/B based on 3-stage dividend discount model (DDM) given the capital-intensive business nature.
- **Part II: The financial services segment:** Representing 25% of 2015E common equity.
    - Securities (7% of 2015E BV) is valued at 1.3X 2015E P/B (or 1.21X 2016E P/B) based on: (a) the P/B-ROE relationship of global peers (in line with what we use to value China brokers), and (b) our estimated 2015E/2016E ROE of 18.0%/10.5% and long-term ROE of 10% for Huarong Securities.
    - Finance lease (7% of 2015E BV) is valued at 1.0X 2015E P/B, in line with the recent placement valuation (in June 2015) of FEH (an H-share listed China lessor).
    - Huarong Xiangjiang (XJ) bank (7% of 2015E BV) is valued at 0.8X 2015E P/B, slightly lower than our target P/B of 0.83X for BOCQ given similar profitability but weaker balance sheet position.
    - Unallocated capital (5% of 2015E BV) is valued at 1.0X 2015E P/B, which is the average of target P/B multiples we use for securities, lease and banking sub segments.
- **Part III: Asset management & others segments:** 11% of 2015E common equity, including the asset management segment and intra-group eliminations; valued at 1.0X 2015E P/B due to: (a) lack of listed comparables, and (b) segment ROE is relatively close to cost of equity.

From our SOTP methodology, we arrive at a 12-month target price of HK$4.1 for Huarong, corresponding to 1.3X 2015E P/B.

Exhibit 35: SOTP valuation
In Rmb mn, unless stated otherwise

	2014			2015E		2015E
	Equity	Minorities	Attributable equity	ROE	Attributable equity	P/B multiple
Part I: Distressed asset mgmt	**47,115**	**3,125**	**43,990**	**17.7%**	**62,967**	**1.5x**
Part II: Financial services	**25,724**	**8,627**	**17,097**	**16.3%**	**24,782**	**1.0x**
Huarong Sec & futures	7,303	1,683	5,620	18.0%	6,585	**1.3x**
Huarong Fin Lease	7,330	1,472	5,858	17.7%	6,764	**1.0x**
Huarong XJ bk	11,091	5,473	5,618	19.3%	6,588	**0.8x**
Un-allocated capital				n.a.	4,845	**1.0x**
Part III: Asset mgmt and others	**10,693**	**2,371**	**8,322**	**15.4%**	**11,040**	**1.0x**
Sum of the Group	**83,532**	**14,124**	**69,408**	**17.1%**	**98,788**	**1.3x**
=> Value per share (HK$)						**4.10**

Source: Gao Hua Securities Research.

Key assumptions in our 3-stage DDM for Part I DAM segment are outlined in Exhibit 36.

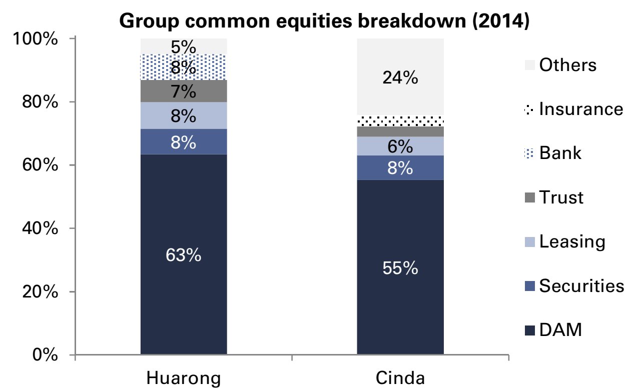
We also cross-check our SOTP valuation by applying a 3-stage DDM to the Group, and arrive at a similar 1.3X 2015E P/B implied multiple.

Exhibit 36: 3-stage DDM valuation

	Capital Asset Pricing Model				3-Stage Dividend Discount Model Assumptions											
					Stage 1		Stage 2				Terminal Stage 3					
	Risk-free rates	Mkt. Risk Prem.	Beta	Total Disc. Rate (d)	Div. CAGR	No. of Yrs	(a) ROE	(b) Div Payout	Growth = a*(1-b)	No. of Yrs	(a) ROE	(b) Div Payout	Growth = a*(1-b)	Growth fully loaded P/B	Fwd equity valuation (US$ bn)
Group	4.5%	6.5%	**1.20x**	**12.3%**	**25%**	3	**14.0%**	40%	8.4%	10	12.0%	67%	**4.0%**	**1.30X**	**20.1**
- Distressed asset management	4.5%	6.5%	**1.25x**	**12.6%**	**29%**	3	**14.5%**	40%	8.7%	10	13.0%	69%	**4.0%**	**1.50X**	**14.8**

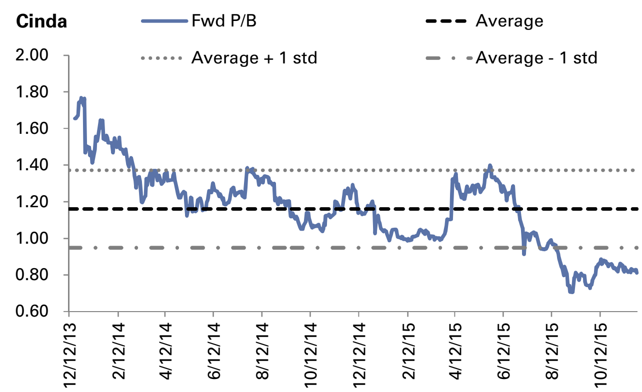
Source: Gao Hua Securities Research.

Exhibit 37: Common equity breakdown at Huarong and Cinda



Source: Company data, Annual reports of Huarong Trust and Cinda.

Exhibit 38: Valuation history of Cinda



Source: Datastream, Gao Hua Securities Research.

Exhibit 39: Valuation of H-share China financials

Ticker	Company	Rating	Price 12/1/2015	Mkt cap (US$ mn)	P/E (X) 2015E	P/E (X) 2016E	P/B (X) 2015E	P/B (X) 2016E	ROE (%) 2015E	ROE (%) 2016E	ROA (%) 2015E	ROA (%) 2016E
2799.HK	**Huarong**	**Buy**	**3.09**	**16**	**6.3**	**5.6**	**1.00**	**0.88**	**17.1**	**16.8**	**2.6**	**2.5**
1359.HK	**Cinda**	**Not Rated**	**2.88**	**13**	**5.9**	**5.3**	**0.81**	**0.73**	**14.5**	**14.5**	**2.4**	**2.3**
China banks												
3988.HK	BOC H	Neutral	3.50	132	4.6	4.4	0.67	0.61	15.2	14.6	1.1	1.1
0939.HK	CCB H	Buy	5.38	174	4.7	4.6	0.78	0.70	17.4	16.1	1.3	1.2
1288.HK	ABC H	Buy	3.00	126	4.4	4.2	0.72	0.64	17.1	16.2	1.1	1.0
3328.HK	BoCom H	Neutral	5.55	53	5.0	4.9	0.63	0.58	13.3	12.4	1.0	0.9
3968.HK	CMB H	Sell	18.56	60	6.4	6.1	1.08	0.96	17.7	16.7	1.2	1.1
0998.HK	CNCB H	Buy*	4.94	30	4.4	3.9	0.61	0.55	14.8	14.6	1.0	0.9
3618.HK	CQRCB	Neutral	4.61	6	4.7	4.3	0.75	0.66	16.8	16.6	1.1	1.1
1963.HK	BOCQ	Neutral	5.68	2	4.6	4.7	0.67	0.61	15.7	13.6	1.1	1.1
	avg.				**4.8**	**4.6**	**0.74**	**0.66**	**16.0**	**15.1**	**1.1**	**1.0**
China brokers H												
6030.HK	CITICS H	Neutral	18.10	28	9.0	12.0	1.32	1.24	16.2	10.6	3.3	2.2
6837.HK	Haitong H	Buy	13.58	20	8.7	11.3	1.22	1.14	15.6	10.4	3.0	2.0
6886.HK	Huatai H	Neutral	19.22	18	9.9	14.0	1.41	1.34	17.1	9.8	2.7	1.7
1776.HK	Guangfa H	Buy*	19.10	19	8.6	12.7	1.58	1.49	21.6	12.0	3.7	2.2
	avg.				**9.0**	**12.5**	**1.38**	**1.30**	**17.6**	**10.7**	**3.2**	**2.0**
China lessors												
3360.HK	FEH	Buy	6.82	3	7.4	6.7	1.03	0.92	14.4	14.6	2.2	2.3
2666.HK	Universal	Buy	5.90	1	10.5	8.9	1.42	1.25	16.5	14.9	3.4	3.3
	avg.				**9.0**	**7.8**	**1.22**	**1.09**	**15.5**	**14.7**	**2.8**	**2.8**

Note: *denotes stock is on our Conviction List.

Source: Datastream, Gao Hua Securities Research.

Appendix

Exhibit 40: Key statistics of Huarong Xiangjiang Bank vs. peers

FY14	Huarong	BOCQ	CQRCB	BOBJ	BONB	BONJ	Hurong vs. BOCQ
Scale (Rmb mn)							
Total assets	165,326	274,531	618,890	1,524,437	554,113	573,150	0.6x
Retail focus							
Retail loans as % of total loans	19.3	30.6	40.1	22.7	34.6	18.4	-11pp
Retail deposits % of total deposits	24.8	17.0	74.0	19.3	20.1	14.5	8pp
Exposure to local mkt							
Local loans % total loans	100	77	99+	54	49	39	23pp
Profitability(%)	**Huarong**	**BOCQ**	**CQRCB**	**BOBJ**	**BONB**	**BONJ**	**Hurong vs. BOCQ**
NIM	**3.00**	**2.61**	**3.37**	**2.39**	**2.65**	**2.73**	**0.4pp**
Loan yield	7.6	7.3	7.2	6.8	7.0	7.2	0.4pp
Deposit costs	**2.2**	**2.8**	**2.2**	**2.4**	**2.2**	**2.5**	**-0.5pp**
Cost/income ratio(%)	**40**	**37**	**42**	**32**	**38**	**36**	**2.1pp**
PPOP ROA	2.0	1.9	2.0	1.8	1.9	2.0	0.1pp
ROA	**1.31**	**1.17**	**1.22**	**1.09**	**1.10**	**1.12**	**0.13pp**
ROE	19.9	19.2	17.1	18.0	18.9	19.0	0.7pp
Profit/RWA	1.9	2.0	1.9	1.6	2.4	1.8	0.0pp
Asset quality & leverage (%)	**Huarong**	**BOCQ**	**CQRCB**	**BOBJ**	**BONB**	**BONJ**	**Hurong vs. BOCQ**
NPL ratios	0.8	0.7	0.8	0.9	0.9	0.9	0.1pp
NPL formation ratio	**0.72**	**0.68**	**0.27**	**0.36**	**0.77**	**0.96**	**0.05pp**
NPL coverage	250	319	460	356	285	326	-69pp
Adjusted L/D	**66**	**87**	**70**	**77**	**109**	**90**	**-20pp**
Adjusted provision/total credits	**1.5**	**1.7**	**3.5**	**2.6**	**1.3**	**1.7**	**-0.2pp**
Off-balance sheet items/total loans	**98**	**40**	**6**	**34**	**67**	**72**	**58pp**
Capital (%)	**Huarong**	**BOCQ**	**CQRCB**	**BOBJ**	**BONB**	**BONJ**	**Hurong vs. BOCQ**
Core tier I CAR	**9.3**	**9.6**	**10.1**	**9.2**	**10.1**	**8.6**	**-0.3pp**
Internal capital generation rates							
Equity yoy	17	14	12	15	14	19	2.9pp
RWA yoy	25	33	35	18	42	44	-8pp
GAP (Equity yoy-RWA yoy)	(8)	(19)	(23)	(3)	(28)	(25)	11pp

Source: Company data, Annual reports from respective companies.

Exhibit 41: Key statistics of Huarong leasing vs. peers

	Huarong		FEH		Cinda		Sector	
	2013	2014	2013	2014	2013	2014	2013	2014
Scale & profitability (Rmb bn)								
NPAT	1.21	1.32	1.91	2.30	0.36	0.60		
Total assets	62.3	72.1	86.5	110.7	30.8	40.2		
Common equities	6.3	7.3	14.1	16.1	2.8	5.4		
ROAA	2.09%	1.96%	2.60%	2.33%	1.41%	1.69%	1.89%	1.78%
ROAE	20.5%	19.3%	14.2%	15.2%	13.8%	14.5%	15.8%	15.7%
Leverage (ending)	9.8x	9.8x	6.1x	6.9x	10.9x	7.4x	9.1x	9.8x
Growth								
NPAT	20%	9%	26%	20%	30%	67%		
Total assets	17%	16%	43%	28%	52%	31%	18%	52%
2011-14 NPAT CAGR		23%		28%		62%		
Asset quality								
NPL ratio	1.03%	1.05%	0.80%	0.91%				
NPL coverage ratio	144%	133%	220%	220%				
Others								
Asset yield	8.1%	8.3%	7.6%	7.0%				
Funding cost	4.3%	5.3%	5.1%	5.2%				
NIS	3.8%	3.0%	2.5%	1.8%				

Note:
(1) Sector ROAA, ROAE and leverage data are based on the average of Jiangsu lease and leasing subsidiaries of BoCom, CMB, Minsheng, CCB, BOC and Huarong, while sector total assets refer to the whole financial leasing industry.
(2) We assume 25% income tax rate for Cinda Lease's profits

Source: Company data, Annual reports from FEH, Cinda, and other lessors mentioned above.

Exhibit 42: Key statistics of Huarong Securities vs. peers

	Huarong Sec		Cinda Sec		Sector
	2013	2014	2013	2014	2014
Scale & profitability (Rmb bn)					
NPAT	0.31	0.86	0.32	0.90	96.55
Total assets	22.7	43.0	18.2	33.8	4,090.0
ROAA	2.1%	2.6%	2.0%	3.5%	3.1%
ROAE	6.3%	13.6%	5.8%	14.5%	11.5%
Growth					
NPAT	90%	182%	49%	180%	119%
Total assets	217%	90%	28%	86%	97%
2011-14 NPAT CAGR		83%		84%	35%
Revenue mix (net)					
Brokerage	18%	13%	50%	36%	40%
IBD	21%	14%	8%	14%	12%
AM	5%	3%	6%	5%	5%
NII	4%	0%	10%	2%	n.a.
Trading	49%	69%	23%	41%	27%
Others	2%	1%	3%	2%	n.a.
Market share					
Brokerage	0.3%	0.3%	0.9%	0.8%	
Margin finance	0.4%	0.4%	0.8%	0.7%	
IBD - ECM	0.2%	1.4%	0.0%	1.4%	
IBD - DCM	0.1%	0.3%	0.2%	0.3%	
Others					
No. of branches		55		83	
AUM (Rmb bn)		79		37	
AUM active (Rmb bn)		23		9	

Source: Company data, Annual report from Cinda Securities, SAC.

Exhibit 43: Key statistics of Huarong Trust vs. peers

	Huarong Trust		Cinda Jingu		Sector
	2013	2014	2013	2014	2014
Scale & profitability (Rmb bn)					
NPAT	0.80	0.70	0.27	0.11	48.17
Total assets	3.6	5.4	3.5	3.6	358.6
ROAA	23.8%	15.5%	9.2%	3.0%	18.2%
ROAE	26.2%	17.1%	10.4%	3.2%	16.8%
Growth					
NPAT	23%	-12%	-48%	-61%	13%
Total assets	17%	50%	47%	3%	111%
Trust assets	38%	53%	-8%	-6%	28%
2011-14 NPAT CAGR		11%		-25%	29%
Mix					
Trust assets	98	150	94	89	13,980
% in property rights	10%	13%	23%	19%	10%
% in infrastructure	24%	19%	39%	23%	21%
Single	46%	48%	70%	57%	63%
Collective	47%	43%	24%	15%	31%
Property	6%	8%	6%	28%	7%
Active mgmt.	72%	46%	65%	78%	
Passive mgmt.	28%	51%	35%	22%	
Others					
Profit per employee(mn)	4.17	2.87	1.62	0.55	2.26

Source: Company data, Annual report from Huarong Trust, Cinda Jingu, China Trustee Association.

Disclosure Appendix

Reg AC

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