Credit Opinion

8 February 2024

Ratings	
Category	Financial Institution
Domicile	Hong Kong
Rating Type	Solicited Rating
Long-Term Credit Rating	A_g-
Outlook	Stable

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Far East Horizon Limited

Surveillance credit rating report

CCXAP affirms Far East Horizon Limited's long-term credit rating at A_g-, with stable outlook.

Summary

The A_g- long-term credit rating of Far East Horizon Limited ("FE Horizon" or the "Company") is underpinned by the Company's (1) leading market position as one of the largest financial leasing companies in China by total assets; (2) sound profitability with steady income growth; and (3) strong access to funding and good asset-liability management.

However, the rating is constrained by (1) decelerating industry growth due to tightening regulations; (2) board economic slowdown pressure that challenged asset quality; and (3) the Company's high industry concentration of leasing portfolio.

We also consider the Company's good operating track record in China and the moderate support from its key shareholder, namely, Sinochem Holdings Corporation Ltd. ("Sinochem Holdings").

The stable outlook on FE Horizon's rating reflects our expectation that the Company will maintain its strong business position, risk management ability and liquidity over the next 12 to 18 months.

Rating Drivers

- Decelerating industry growth due to tightening regulations
- Leading market position as one of the largest financial leasing companies in China
- Asset quality challenged by broad economic slowdown pressure
- Sound profitability with steady income growth
- Diversified financing channels and good asset-liability management

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if the Company (1) obtains stronger support from its shareholders; (2) improves its regional and industrial diversifications; and (3) improves its asset quality and the sustainability of its profitability.

What could downgrade the rating?

The rating could be downgraded if the Company (1) demonstrates a material decline in asset quality, such as surging problem assets and impairment losses; (2) shows a sharp decrease in profitability; or (3) has severely weakened asset-liability management and liquidity position.

Key Indicators

	2020FY	2021FY	2022FY	2023H1
Total Assets (RMB billion)	299.9	335.9	347.0	361.4
Total Equity (RMB billion)	45.3	53.1	52.4	56.5
Total Revenue (RMB billion)	29.2	33.8	36.7	37.4
Net Profits (RMB billion)	5.0	6.2	6.6	7.0
Pre-Tax Net Income/Average Assets (%)	2.7	3.1	3.0	3.0
Return on Equity (%)	11.6	12.7	12.5	13.1
Realizable Assets/Short-Term Debt (%)	14.4	15.4	14.0	14.5
Asset Impairment/Tangible Assets (%)	0.9	0.4	0.5	0.4
Problem Loans/Net Loans (%)	1.1	1.1	1.1	1.1

All ratios and figures are calculated using CCXAP's adjustments. 2023H1 figures are annualized for the last twelve months ended 30 June 2023.

Source: Company data, CCXAP research

Corporate Profile

FE Horizon was founded in 1991 and has been listed on the Main Board of the Stock Exchange of Hong Kong Limited (Stock Code: 3360.HK). The Company is one of leading financial leasing companies in China that provides all-round financial services to wide-ranging customers. It adopts a “finance + industry” business model that engages in financial leasing business and industrial operations. FE Horizon also specializes in providing customized financing solutions through equipment-based financial leasing and other services such as commercial factoring and related consultations. As of 30 June 2023, the Company had a total asset of RMB361.4 billion and a net asset of RMB56.5 billion. It had net interest-earning assets of RMB278.8 billion as of the same date.

Sinochem Holdings is the key shareholder of FE Horizon, indirectly holding 21.3% equity interests of the Company as of 30 June 2023. Sinochem Holdings is one of the largest state-owned oil companies in China and is wholly owned by the State-owned Assets Supervision and Administration Commission of the State Council ("State Council SASAC").

Rating Considerations

Decelerating industry growth due to tightening regulations

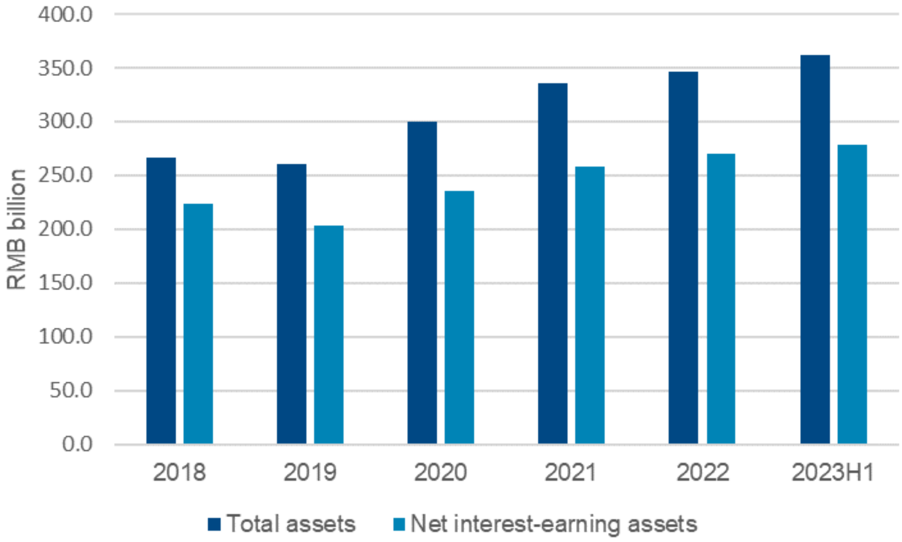
Finance lease is another financing solution besides obtaining loans from lending institutions. Over the past years, Chinese leasing companies have offered corporate customers more flexible and cost-effective financing solutions, particularly for small and medium-sized enterprises ("SMEs") with limited access to traditional lending institutions. The sector is now under a stricter regulatory environment as the China Banking and Insurance Regulatory Commission ("CBIRC") has become the regulator for all Chinese finance leasing companies since April 2018, which was previously regulated by the Ministry of Commerce. The CBIRC issued various regulation policies, such as the "*Interim Measures for the Supervision and Administration of Financial Leasing Companies*" (融资租赁公司监督管理暂行方法) in June 2020 and *"Regulations on off-site Supervision of Financial Leasing Companies"* (融资租赁公司非现场监管规程) in February 2022. In addition, several provincial-level cities have successively introduced regulatory implementation rules for financing leasing companies.

As a stricter regulatory environment combined with sluggish internal momentum, the growth rate of the number of leasing companies and contract balances has shown negative growth in recent years. As of 30 September 2023, there were around 9,170 financial leasing companies in China, a decrease of 670 from 9,840 as of the end of the previous year; while the balance of financing leasing contracts decreased by 1.6% to RMB5.8 trillion from RMB 5.9 trillion as of the end of the previous year. The decelerating market growth will also intensify market competition and weaken the pricing margins of financing leasing companies, thereby restricting FE Horizon's business expansion. We believe that the tightening regulations will improve the regulatory framework for the industry, strengthen the supervision of leasing companies, and reduce the chance of market crunches in the long run. The regulatory change also requires a higher standard of management and internal control for financial leasing companies and increases their management pressure. We see that such impact is limited to FE Horizon because it has already developed a well-established risk management framework as a market leader in the industry.

Leading market position as one of the largest financial leasing companies in China

FE Horizon has a strong market position in China's financial leasing sector with reputable branding and long-standing client relationships. It ranks one of the top five financing leasing companies in China by total assets and total equities (including those bank-supported leasing companies). As of 30 June 2023, the Company had a total asset of RMB361.4 billion and net interest-earning assets of RMB278.8 billion, growing from RMB335.9 billion and RMB258.4 billion at end-2021, respectively.

Exhibit 1. Total assets and net interest-earning assets from 2018 to 2023H1



Source: Company information, CCXAP research

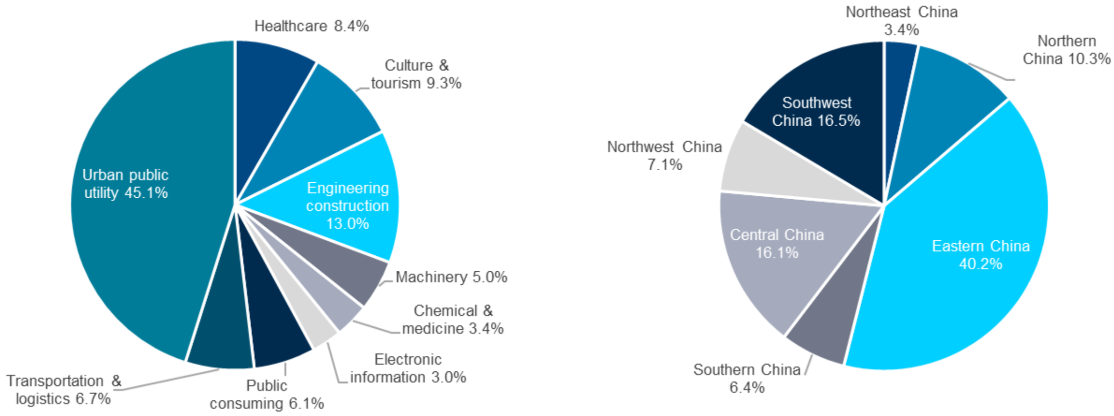
FE Horizon has a long operating history of more than 30 years. It has developed good technical know-how in different sectors and has maintained deep relationships with more than 20,000 clients. It currently focuses on nine major industries, namely, healthcare, culture & tourism, engineering construction, machinery, chemical & medicine, electronic information, public consumption, transportation & logistics, and urban public utility, which have experienced continued growth. The Company's distinctive industrial understanding, supported by its "finance + industry" business strategy and industry expertise, also enables it to provide customized and integrated financial services to its clients. Moreover, as a market leader in the industry, FE Horizon has sufficient resources to invest in fintech tools improving its service efficiency and risk management ability.

Asset quality challenged by broad economic slowdown pressure

FE Horizon has a good track record in managing credit risks and has sustained a prudent investment appetite which is positive to its credit quality. FE Horizon maintained its steady asset quality. As of 30 June 2023, its non-performing asset ratio (calculated by non-performing assets/net interest-earning assets) was stable at 1.05% compared with the level at end-2022 and decreased by 1bp from the level at end-2021. At the same time, the percentage of special mention assets to net interest-earning assets decreased to 6.5% compared with 7.0% at end-2022 and 8.1% at end-2021. However, the Company's asset quality is undermined by China's broad slowdown pressure, and there could be operating and financial challenges for the Company's clients, which in turn adversely affect its asset quality.

FE Horizon has concentrated leasing asset portfolios in the urban public utility sector which is subject to higher policy and regulatory risk. As of 30 June 2023, urban public utility accounted for 45.1% of its total net interest-earning assets, followed by engineering construction (13.0%), culture & tourism (9.3%), healthcare (8.3%), and transportation & logistics (6.7%). The clients in the urban public utility sector are distributed across sub-sectors including urban infrastructure construction, urban operation and municipal services, which mainly consist of state-owned enterprises with lower credit risk. The sector concentration risk could be mitigated by FE Horizon's diversified client base. The largest single leasing client accounted for around 0.9% of its net assets and the top ten clients accounted for 7.9% as of 30 June 2023. In addition, we expect that the Company's receding from regions with relatively weak economic fundamentals will help lower its regional credit risk. The percentage of net interest-earning assets in northeast China decreased to 3.4% in 2023H1 from 4.1% in 2022H1; while the percentage of net interest-earning assets in eastern China increased to 40.2% in 2023H1 from 36.6% in 2022H1.

Exhibit 2. FE Horizon's net interest-earning assets (by sectors and regions) as of 30 June 2023



Source: Company information, CCXAP research

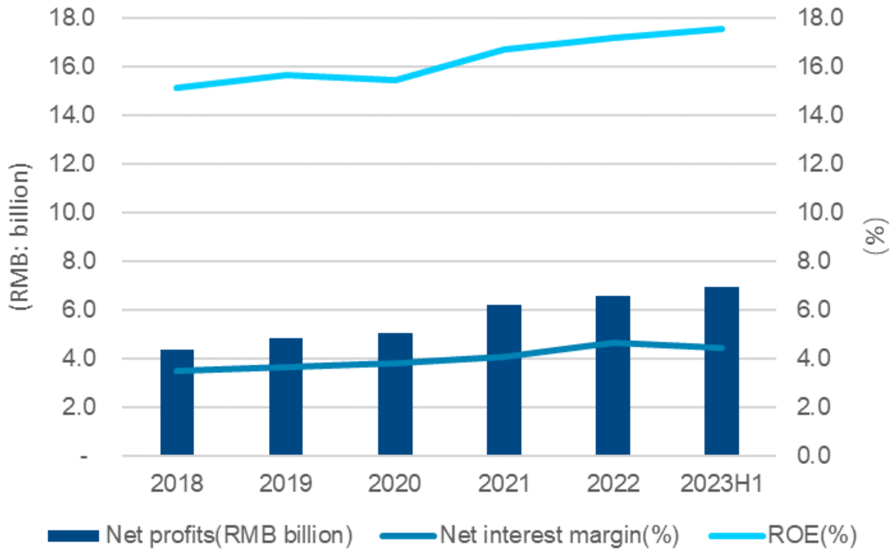
FE Horizon also increased its inclusive finance exposure to target small and midsize customers, which normally have a higher risk compared to normal corporate clients. As of 30 June 2023, the interest-earning assets of inclusive finance increased by 22.7% to RMB29.0 billion, accounting for 10.4% of the Company's net interest-earning assets. The investment exposure remains small and the Company established a subsidiary in late 2019 to operate and manage this segment separately. Nevertheless, FE Horizon's inclusive finance investments are unseasoned with short operating history and the risk control practices will remain to be tested.

Sound profitability, with steady income growth

FE Horizon's total revenue maintains steady growth, mainly driven by the expansion of industrial operation services and financial services. From 2020 to 2022, its total revenue increased to RMB36.7 billion from RMB29.2 billion, with a compound annual growth rate ("CAGR") of 12.2%; its revenue from industrial operation services increased to RMB13.2 billion from RMB8.8 billion over the same period, with a CAGR of 22.5%; its revenue from financial services increased to RMB21.7 billion from RMB16.5 billion over the same period with a CAGR of 14.5%, due to the steady increase in net interest-earning assets and strong pricing power.

FE Horizon's profitability is sound with an average pre-tax net income/asset ratio of 3.0% and an average return on equity of 12.6% over the past three years. The Company has demonstrated a track record of stable profitability while growing scale. Its net profit increased to RMB6.6 billion in 2022 from RMB5.0 billion in 2020, with a CAGR of 14.5%. Its net interest margin ("NIM") increased largely from 3.83% in 2020 to 4.67% in 2022, as supported by the increasing yields on its interest-earning assets and well-managed financial costs. The Company uses derivatives to hedge foreign exchange risks, which significantly reduces the impact of foreign exchange fluctuations on the Company's profitability.

Exhibit 3. Net profits, net interest margin and return on equity from 2018 to 2023H1



Note: 2023H1 figures are annualized for the last twelve months ended 30 June 2023.

Source: Company information, CCXAP research

FE Horizon also has higher pricing power than its other financial leasing peers as the Company has deepened its client relationship with the engagement of widened project areas such as public-private partnerships, asset management companies and private equity investments. We expect that FE Horizon's profitability is likely to continue to outperform that of its peers in China. FE Horizon's expanding business scale in equipment operation segment is also believed to help it maintain a good overall margin, while the Company's hospital operation businesses remain less profitable.

Reliance on wholesale funds is offset by its strong access to funding

FE Horizon, similar to most leasing companies, relies on confidence-sensitive wholesale funds to finance its operations. The potential for unexpected changes in the availability and cost of market-based funding inherently implies greater operational risks for the Company, as compared to the retail deposit-funded banking institutions. Nevertheless, it could be offset by its diversified funding channels with its listed status. FE Horizon has low-cost and relatively stable borrowings from diversified banks and financial institutions. It also has strong ability to raise funds in onshore and offshore debt capital markets. For example, the Company issued two tranches of free trade zone offshore bond (pearl bond) with a tenor of 3 years and a size of RMB900 million in the first half of 2023. FE Horizon is very active in debt capital markets with outstanding bonds (including perpetual bonds) of approximately RMB92.3 billion as of 30 June 2023. It also has a good track record in accessing innovative financial products such as ABS and ABN. On 25 May 2023, Horizon Construction Development Limited, an integrated equipment operation service provider under the Company in the field of construction, was officially listed on the Main Board of the Hong Kong Stock Exchange with stock code 9930.HK.

FE Horizon's liquidity buffer is moderate given its low level of liquid assets. As of 30 June 2023, the Company had realizable assets of RMB22.2 billion which only accounted for approximately 14.5% of its short-term debt. The low level of liquid assets could be mitigated by FE Horizon's good asset-liability management that does not have a significant duration mismatch. Around 55.6% of the Company's leasing and loan receivables maturity within 1 year, which roughly matched the duration of the Company's debt profile, the Company also has a large amount of credit facilities from banks. As of 30 June 2023, the top ten banks have provided credit facilities of RMB311.1 billion, with available credit facilities RMB103.8 billion. In addition, FE Horizon has limited usage of secured debt with a relatively low secured debt/tangible assets ratio of 13.6% as of the same date, demonstrating good financial flexibility.

Moderate support from the key shareholder

FE Horizon is one of the core investments of Sinochem Holdings, which is the key shareholder and indirectly owns 21.3% of FE Horizon's equity interest through its subsidiary. Sinochem Holdings is one of the four state-owned oil companies in China and is wholly owned by State Council SASAC. Sinochem Holdings is China's biggest agricultural input company and leading chemical service company. It plays a very highly strategic role in national development, particularly in energy, agriculture and chemicals. We have considered the Company's moderate support from its shareholder. For example, Sinochem Holdings has provided liquidity facilities through its financial subsidiary to FE Horizon.

Rating Methodology

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

A credit rating is the analytical result of current credit worthiness and forward-looking opinion on the credit risk of a rated entity or a debt issue. Credit ratings issued by CCXAP are opinions on the current and relative future credit risk of the rated entities or debt issues, but do not address any other risks, including but not limited to liquidity risk, market price risk, and interest rate risk.

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