MOODY'S

Rating Action: **Moody's downgrades Haiken to Baa3; outlook remains negative**

19 Sep 2023

Hong Kong, September 19, 2023 -- Moody's Investors Service has downgraded Hainan State Farms Investment Holding Group Co., Ltd's (Haiken) issuer rating to Baa3 from Baa2, as well as its Baseline Credit Assessment (BCA) to ba3 from ba2.

At the same time, Moody's has downgraded to Baa3 from Baa2 the ratings on the senior unsecured bonds issued by Hainan State Farms International (HK) Co Ltd and guaranteed by Haiken.

The outlook on all ratings remains negative.

"The downgrade and negative outlook reflect Moody's expectation that Haiken's leverage will remain elevated due to the company's high debt balance from its acquisition of HAC and weakened earnings from lower rubber prices. The company could deleverage to a level appropriate for the BCA through earnings growth at its rubber business and realized business synergies with HAC, but this process will take time to fully materialize and entail uncertainties," says Ying Wang, a Moody's Vice President and Senior Analyst.

RATINGS RATIONALE

Haiken's Baa3 issuer rating incorporates (1) the company's ba3 BCA, which has been downgraded from ba2 due to the company's elevated leverage, and (2) a three-notch uplift based on Moody's assessment of a high likelihood of support from and the company's high level of dependence on the Hainan provincial government and ultimately the Government of China (A1 stable) in times of stress.

Haiken's BCA primarily reflects (1) the company's leading position as China's largest integrated rubber producer and the world's largest rubber processor and trader; (2) the company's effective hedging tool, including its revenue insurance mechanism, to hedge against rubber price volatility; (3) its enlarged operating scale and geographic diversification following its HAC acquisition; and (4) Haiken Group's good access to capital markets and banking facilities.

At the same time, Haiken's BCA is constrained by the company's (1) high debt leverage, driven by its HAC acquisition and the associated debt financing; and (2) exposure to rubber price volatility.

On 5 May 2023, Haiken announced the completion of its acquisition of HAC with a controlling stake of 68.1%. As a result, Haiken's debt leverage, as measured by adjusted debt/EBITDA, will likely increase to over 9.0x by the end of 2023 from about 8.2x in 2022, due to the increased debt from the acquisition and HAC's weaker standalone credit quality. Based on Moody's estimated proforma numbers for 2022, HAC accounted for about 37% of Haiken's revenue, 11% of its assets, 18% of its EBITDA and 35% of its total debt.

Moody's expects Haiken could lower its leverage gradually towards 8.0x over the next 12-18 months, through earnings growth at its rubber business, income from other non-core operations such as its tropical agricultural business, business synergies with HAC, and its planned disposal of its non-core assets.

However, the above deleveraging initiatives remain uncertain, leading to the negative outlook.

Moody's support assessment considers (1) the Hainan provincial government's 100% ownership of Haiken Group; (2)

the track record of support from the provincial government and the central government; (3) the importance of the rubber and agriculture sectors to Hainan province in terms of economic contribution and employment; and (4) the strategic importance of natural rubber as a national security resource and Haiken's leading position in China's rubber industry after its HAC acquisition.

Haiken's high dependence on the provincial and central governments reflects the common political and economic event risks that the company and the central government are exposed to.

Moody's expects the HAC acquisition to enhance Haiken's leading market position in China and globally, as well as increase its geographical diversity and expand its sourcing and distribution channels. Such a stronger business profile will allow the company to have better pricing power and a more sticky business relationship with customers and rubber farmers, enabling synergies and facilitating deleveraging.

Moody's also estimates that following the HAC acquisition, Haiken's global annual rubber processing capacity of around 2.6 million tons and annual trading volume of 3.1 million tons as of 2022 will be comparable to its largest global peers'.

In addition, Moody's considers Sinochem International's 29.2% stake in HAC and continued operational and shareholder support to HAC.

Haiken's liquidity is weak. Its reported cash balance of around RMB6.2 billion as of the end of June 2023 and projected operating cash flow over the next 12 months are insufficient to cover its maturing reported debt of around RMB10 billion and likely capital spending over the same period. Nevertheless, Haiken's refinancing risk is alleviated by the company's good access to domestic funding. Most of its banking facilities are provided by China's policy banks and the largest state-owned banks, with very low funding costs.

Environmental, social and governance (ESG) considerations have a moderately negative impact on Haiken's credit rating. The company has a highly negative exposure to environmental considerations and social risks. In addition, it has a moderately negative exposure to governance considerations, primarily due to its concentrated ownership.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Given the negative outlook, an upgrade of Haiken's rating is unlikely in the near term.

Moody's could revise Haiken's outlook to stable if its business and financial profiles improve, for example, with effective deleveraging through its business integration with HAC; or if support from the government to Haiken strengthens.

Credit metrics indicative of an outlook change to stable include Moody's-adjusted debt/EBITDA trending toward 8.0x and Moody's-adjusted EBITA/interest above 2.0x on a sustained basis.

Moody's could downgrade the ratings if its adjusted debt/EBITDA is unlikely to trend toward 8.0x.

The absence of a revenue insurance mechanism to hedge against rubber price volatility, or weakening support from the Hainan provincial government will also pressure its rating.

The methodologies used in these ratings were Protein and Agriculture published in November 2021 and available at https://ratings.moodys.com/rmc-documents/356422, and Government-Related Issuers Methodology published in February 2020 and available at https://ratings.moodys.com/rmc-documents/64864. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of these methodologies.

Hainan State Farms Investment Holding Group Co., Ltd. is one of the world's largest rubber companies and China's largest integrated rubber producer. It was ultimately 100%-owned by the Hainan government as of December 2022.

In 2022, the company reported a total revenue of RMB30.4 billion and an asset size of RMB111 billion.

The local market analyst for these ratings is Michelle Ma, +86 (106) 319-6531.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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