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HNA Group: Global Excellence with Chinese Characteristics (C)

"It is hard to run a business. If you run it well, someone might snatch it from you; If you run it terribly, someone might harm you. Would you surrender your business if someone with ill intentions came to harm or rob you?"¹ HNA Group Co-Chairman Wang Jian posed that question less than three months before his death, in April 2018, during an interview at the group's headquarters with local Chinese media. In July that year, Wang died in an apparent accident during a business trip in France: He was climbing onto a low wall to snap a picture during a sightseeing detour in Bonnieux when he fell from the height of about 50 feet. The French police declared it to be an accidental death, while online speculators in Chinese social media suspected suicide or worse.² Within two days, Chen Feng was appointed as the chairman to continue the debt-laden conglomerate's efforts to resolve the financial pressure from the acquisition binge. In his New Year message broadcast in December 2018, Chen described the liquidity trouble as "a huge sword hanging above" the company and vowed to "conquer the challenging storm" by steering its focus back to aviation.³

The Great Unwinding

Since the second half of 2017, HNA had been trying to deleverage by selling its local and foreign assets to repay debts. Chen said that HNA had sold over US\$46 billion in assets in 2018.⁴ Among the sales were stakes in Hilton, Radisson Hospitality, Avolon, and Deutsche Bank. Some of these disposals were completed via an accelerated bookbuild,^{a,5} a method often used by cash-strapped companies to gain financing. On the business side, although revenue rose slightly by 5%, it reported a loss of US\$758 million for 2018,⁶ as earnings from its subsidiaries in airline, retail sale, infrastructure investment, and technology fell across the board amid an escalating U.S.-China trade war and a slowing Chinese economy. Despite meeting the revenue threshold for inclusion, Fortune Magazine removed HNA from

^a An accelerated bookbuild is a share sale strategy where there is very little time, usually two days or less, between when a company offers shares for sale on equity capital markets and when shares are issued to buyers for immediate financing.

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its Global 500 list in 2018,^b noting that the firm faced a liquidity crunch caused by “over-leveraged expansion and irrational overseas investments.”⁷ In response, HNA said it had chosen to no longer participate in the ranking as the company concentrated on streamlining its asset portfolio and improving its financial and operational performance.⁸

As soon as Chen took the helm of HNA, he reshuffled its management by promoting his son, Chen Xiaofeng, to deputy chief executive officer and put him on the board of Swissport,⁹ the world’s biggest airport-service company, which HNA had acquired in 2015. Chen also appointed his 30-something nephew Chen Chao first as chief investment officer and later as vice president.¹⁰ The personnel changes, according to the company, were aimed to prepare HNA for a business turnaround by refocusing on three core business segments: aviation, tourism, and logistics.^c The “HNA Ten Commandments,” to which Wang Jian had not paid much attention when in control of the firm, reemerged as a centerpiece of corporate culture, and employees were quizzed frequently to recite the rules after Chen returned.¹¹

Financial Strains

HNA’s mounting loan repayment responsibilities and other financial obligations began to exert significant pressure on its business in 2018 and continued to grow over the next two years. In January 2018, multiple news reports stated that several HNA’s affiliated airlines had not paid aircraft lessors on time.¹² Credit rating agency Standard and Poor’s downgraded HNA’s credit profile from B to CCC+ in February.¹³

Initially, the Chinese government chose to support HNA in its attempts to solve its financial problems. At a June meeting led by the People’s Bank of China, government leaders assured that HNA would receive policy support, distinguishing the company from the Anbang Insurance Group and the Tomorrow Group, two other Chinese conglomerates whose assets had been taken over by authorities and whose founders were imprisoned or placed under house arrest, respectively.¹⁴ Days later, Chen Feng led a group of executives to a four-day training in Yan’an city, the cradle of the Chinese Communist Revolution; the trainees even put on the outfits of the “Chinese Red Army” for an immersive learning experience.¹⁵

Later that summer, Qianhai Air & Shipping Exchange, an HNA established platform for airline and shipping companies to receive financing from retail investors, stopped selling wealth management products to individuals, prompting disgruntled investors and ex-employees who wanted their money back to protest outside HNA’s headquarters.¹⁶ In August, HNA reported that a glitch in the financial transfer system made it unable to make timely payment on a US\$155 million bond.¹⁷ Yet the government continued to offer HNA financial support. In December, the China Development Bank, a major policy bank, stepped in to finance the purchase of eight Airbus A330 aircraft by Hainan Airlines and Lucky Air;¹⁸ the deliveries had been suspended earlier by Airbus due to delayed payments. Around that time, HNA also sought aide from China Cinda Asset Management, a state-owned enterprise specialized in absorbing nonperforming bank loans.¹⁹

At the end of 2018, HNA’s debt ratio stood at 70.6%, with total debts outstanding at US\$117 billion and cash holdings falling 68% year-on-year to US\$6.35 billion.²⁰ The next year proved no easier. From

^b Fortune removed HNA and seven other Chinese companies, including Anbang Insurance, Wanda Group, CEFC China Energy, Guodian, New China Life Insurance, Shanxi Coking Coal Group, and China General Technology Group.

^c HNA Group previously had seven business groups, ranging from aviation, logistics and infrastructure, to tourism and finance.

real estate in different parts of the world to its stake in a Hong Kong budget airline, the company continued its fire sale in 2019 as it tried to recoup the cash it had spent on debt-financed asset acquisitions. Still, creditors in April 2019 seized control of HNA assets, including luxury properties in the United States and golf courses in China owned by an HNA affiliate, after it failed to repay a loan.²¹ HNA itself missed a repayment in July and another one in December. In a speech delivered before New Year's Eve, Chen Feng revealed that the company had not paid its employees on time "occasionally" because of cashflow shortage, but he stressed that HNA had avoided triggering systemic financial risks and its flagship airline remained one of the world's top 10 carriers ranked by Skytrax. He predicted 2020 would be a "decisive year to win the war against the liquidity problem."²²

Coronavirus

In the third week of 2020, the Chinese government announced that the economy had grown at 6.1%, the slowest pace in 30 years. Meanwhile, reports arose of a mysterious pneumonia in Wuhan, a city of 11 million people in Hubei province. On January 23, the government issued a travel ban for Wuhan after the official death toll from the coronavirus that would become known as COVID-19 rose to more than a dozen and hundreds of infections were reported. More cities across the country went into lockdown to stop the virus from spreading over the next few weeks, bringing many economic activities to a halt, especially air travel. Between January 25 and February 14, Chinese carriers flew 470,000 passengers a day on average, 75% less from the same period a year ago.²³ The number dropped further to fewer than 200,000 in the following week.²⁴ At HNA, airlines passenger traffic in January fell 35% on year to 4.6 million, while passenger capacity shrank 21%.²⁵ Daily revenue of Hainan Airlines slipped to less than US\$930,000 in February from US\$21.67 million before the pandemic.²⁶ The airlines under HNA put foreign pilots on unpaid leave to cut losses.²⁷ With the Chinese government's immense but still finite resources focused on salvaging the national economy, the pandemic also proved to be the last straw for the state's support and patience for HNA.

Government Action

Market rumors about a potential takeover of HNA by the government of Hainan emerged in late February 2020. It was speculated that the bulk of airline assets were likely to be sold to China's three biggest carriers - Air China, China Southern Airlines, and China Eastern Airlines.²⁸ On February 29, HNA issued a press release, saying that it had asked the government to send in a taskforce composed of officials from Hainan's state-owned development agency, the Civil Aviation Administration of China, and the China Development Bank. The company admitted the failure of its yearslong self-rescue, and it pinned its hopes to resolve the liquidity crisis on the joint government effort.²⁹ The intervention was seen as a de facto takeover by the government.

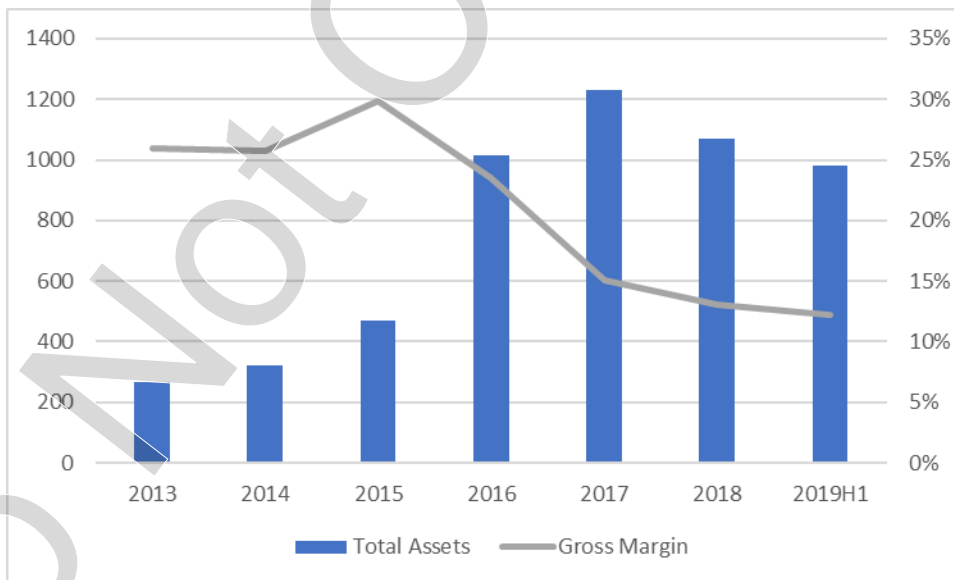
The government taskforce worked quietly through 2020 to assess HNA's situation. There were many signs of the company's deepening troubles. In September, a Chinese court banned Chen Feng from first-class flights, vacations, golf courses, and high-speed rail.³⁰ In January 2021, it was revealed that the HNA Group as a whole would also be humbled. Unable to raise funds to repay its debts, HNA Group announced it would enter bankruptcy restructuring.³¹ A Chinese business news outlet reported that up to 500 HNA affiliates would also face bankruptcy.³² Analysts predicted the restructuring would be especially complex due to HNA's infamously opaque ownership structure.³³ Soon after the bankruptcy announcement, three HNA units shared the news that shareholders had embezzled nearly US\$10 billion and that an additional US\$7.1 billion in debt guarantees had not been disclosed.³⁴

The restructuring plan for HNA Group proposed divesting the conglomerate of all but its aviation businesses, among the few HNA assets deemed potentially profitable.³⁵ The state would become a “strategic investor” in HNA.³⁶ Creditors were not promised repayment but would be offered a debt-for-equity swap in either the restructured HNA or the trust that would sell the group’s non-aviation assets.³⁷ Chen Feng, for so long the public face of HNA, was sidelined, no longer invited even to internal HNA party committee meetings.³⁸ In a note to employees on the eve of the bankruptcy announcement, Gu Gang, head of the government’s HNA taskforce, wrote that “It is only through bankruptcy and restructuring that we can be reborn.”³⁹

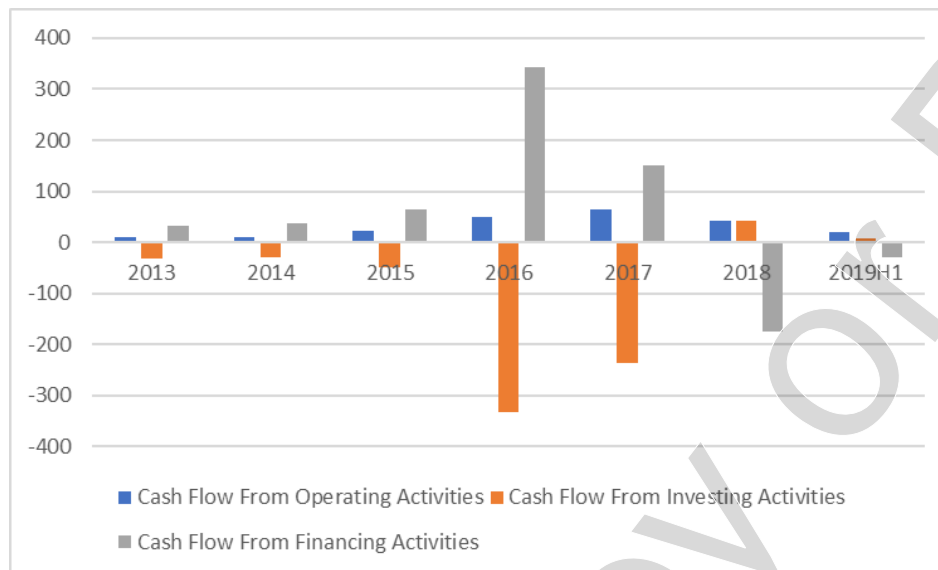
Would the HNA brand outlive its HNA Group’s vast ambitions, even as its business model proved to be built on sand? Could Chen Feng’s vision for a global HNA ever be revived in the absence of renewed government support? Was HNA’s story yet another example of how large non-state enterprises in China thrived or died according to the whims of the state?

Exhibit 1 HNA Group's bond payable and short-term borrowings (RMB in billions)

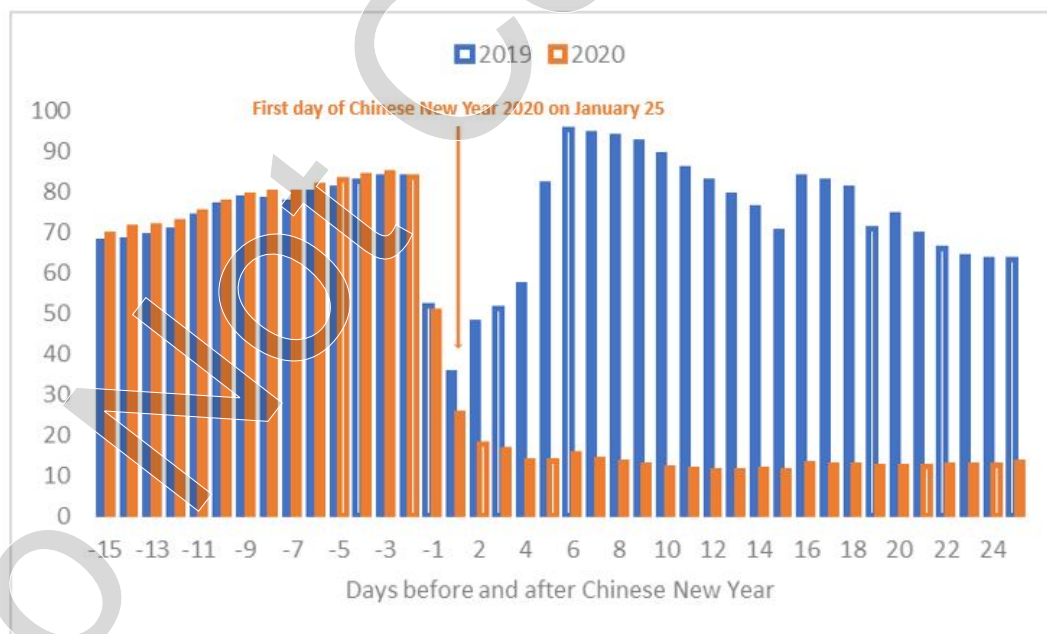
Source: Data compiled by casewriters based on HNA Group's annual bond reports, and Sealand Securities report dated May 8, 2020, <https://finance.sina.com.cn/money/bond/research/2020-05-08/doc-iirczymk0452077.shtml>, accessed February 2021.

Exhibit 2 HNA Group's gross margin decreased as assets increased (RMB in billions)

Source: Data compiled by casewriters based on HNA Group's annual bond reports, and Sealand Securities report dated May 8, 2020, <https://finance.sina.com.cn/money/bond/research/2020-05-08/doc-iirczymk0452077.shtml>, accessed February 2021.

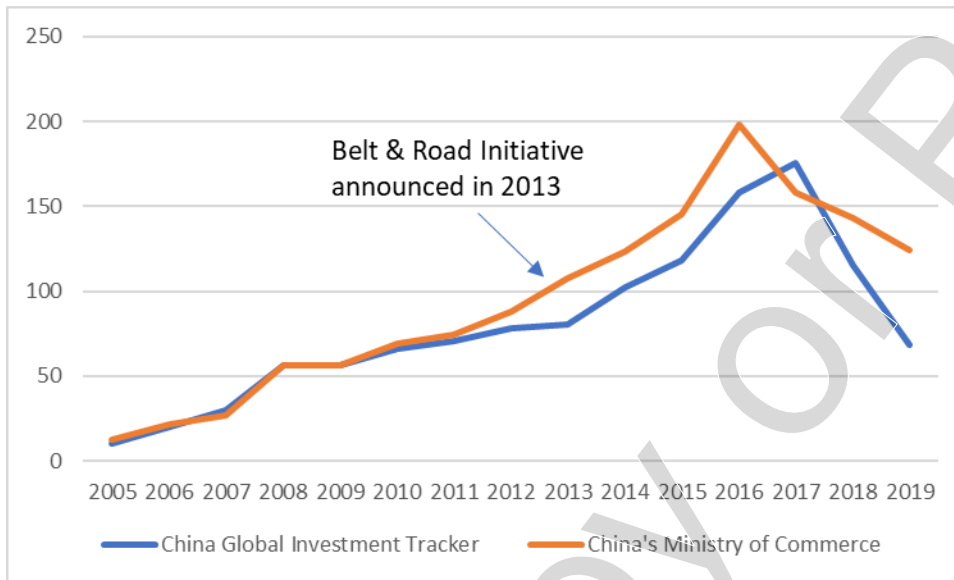
Exhibit 3 HNA Group's cash flow (RMB in billions)

Source: Data compiled by casewriters based on HNA Group's annual bond reports, and Everbight Securities report dated Aug. 19, 2019, www.fxbaogao.com/pdf?id=1386361, accessed February 2021.

Exhibit 4 Number of trips taken by Chinese around Lunar New Year period (in millions)

Source: "China to Manage HNA Debt as Virus Pushes Group Over the Edge," *Bloomberg News*, February 29, 2020, www.bloomberg.com/news/articles/2020-02-29/china-sets-up-group-to-manage-troubled-hna-s-liquidity-risk?sref=gzAxNo0s, accessed February 2021.

Note: Last bar in orange color represents data on Feb. 18, 2020.

Exhibit 5 China's outbound investment (USD in billions)

Source: Adapted by casewriters from "Tracking China's Global Economic Activities: Data Challenges and Issues for Congress," Congressional Research Service, p.1, July 14, 2020, <https://fas.org/sgp/crs/row/R46302.pdf>, accessed February 2021.

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