CNFinance Holdings Limited

NYSE: CNF

Maintaining Rating & Reducing Target
BUY, $4.50

September 30, 2020

MARKET DATA

Share Price:	US$	3.11
Market Cap:	US$	213.28 M
52wk Range:	US$	3.06 - 5.23
Ave. Volume:		4,000
Basic S/O:		68.58 M
Fully Diluted S/O:		83.96 M
Float:		7.06 M
Institutional (SDI) %:		35%
Insider %:		36%
Dividend/Yield:		0.00 / 0.00%

FINANCIAL DATA (mrq)

Cash:	RMB	2,369.93 M
Total Debt:	RMB	7,501.30 M
Book Value:	RMB	3,560.21 M
EBITDA (ttm):	RMB	N/A
CFFO (ttm):	RMB	N/A

Auditor: KPMG Huazhen LLP

Revenue (in Millions)

RMB	2018A	2019A	2020e	2021e
Mar	1,063.20	892.30	489.19A	563.04
Jun	1,071.57	802.10	449.92A	665.77
Sep	1,116.12	678.93	484.21	802.68
Dec	1,039.60	596.93	474.54	966.61
REV	**4,278.82**	**2,970.23**	**1,897.85**	**2,998.10**
P/S	*0.34*	*0.49*	*0.76*	*0.48*

Diluted EPS

RMB	2018A	2019A	2020e	2021e
Mar	0.15	0.09	(0.05)A	0.02
Jun	0.18	0.11	0.02A	0.04
Sep	0.17	0.12	(0.02)	0.06
Dec	0.14	0.04	0.01	0.08
EPS	**0.62**	**0.36**	**(0.04)**	**0.19**
P/E	*1.70*	*2.74*	*N/A*	*5.49*

Note: Shares outstanding above are adjusted on a 20:1 ADS basis. Diluted EPS is based on Ordinary Shares in RMB, not in USD per ADS.

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Cut In Max Lending Rate Forces Industry To Adjust

New Max Lending Rate Results In Changes To CNF's Platform. On August 20, the Supreme People's Court of China set a new cap on interest charged in private lending arrangements, which now stands at four times the one-year loan prime rate (LPR). The LPR currently sits at 3.85%, meaning the max private lenders can charge is 15.4% annually. This was a sharp decline from the 24% interest that was previously allowable. The impact on CNF is significant as it had been lending at 19.2%. After much discussion with the Company over the last month, it appears CNF will make a few tweaks to its model, however the profit per loan will be reduced going forward. The 3.8% reduction will likely result in all parties on the lending side taking a small hit. Sales Partners will likely be charged a slightly lower rate for the 85% of the loan they are borrowing for the loans they originate. Loans will likely have twelve month terms to qualify for cheaper lending rates from the trust partners, who may have to take a haircut on returns to accommodate the new law. Finally, CNF will likely be unable to continue charging the 2% service fee on loans through its platform. Assuming a 9.0% interest rate from the trust partner and a 13.5% rate charged to the Sales Partner, the ROIC of each loan will still fall quite a bit. The opportunity for CNF is that this change may force the market to consolidate faster onto the CNF platform as small lenders will have reduced margins due to the tighter spread between its capital costs and the new max lending rate, as well as having more importance placed on credit quality than before. Having a platform that provides high end credit checking and access to cheaper trust capital could be the only way some small lenders are able to stay in business. The return on invested capital to CNF will fall considerably as compared to the previous rates, but the ROIC is still higher and less capital intensive than the model it had before launching the platform. Ideally, small lenders will begin flocking to the platform and drive origination volume faster than previously thought, thus dropping more income to CNF's bottom line.

Maintaining Rating & Reducing Target. The sharp reduction in the legal interest rate limit is undoubtedly a negative for CNF. However, the change hurts all participants in the private lending industry by slashing margins, which ultimately could drive more participants onto a platform that provides credit and back office services and access to cheaper trust capital. Despite the change, we remain optimistic on the future of CNFinance and its model, thus we are reiterating our Buy rating, but reducing our target price from $5.50 per share to $4.50 per share to account for the negative near term impact of the policy change. Our target price is based on a Price-to-Earnings multiple of 8 times our 2021 currency-adjusted Diluted EPS estimate of RMB 0.19 per ordinary share, converted to ADS. We also expect to see the multiple rise over time as the Company proves out the platform and increases active sales partners and loan originations.

PLEASE SEE PAGES 5 & 6 FOR IMPORTANT DISCLOSURES

COMPANY OVERVIEW

New Max Lending Rate Results In Changes To CNF's Platform. On August 20, the Supreme People's Court of China set a new cap on interest charged in private lending arrangements, which now stands at four times the one-year loan prime rate (LPR). The LPR currently sits at 3.85%, meaning the max private lenders can charge is 15.4% annually. This was a sharp decline from the 24% interest that was previously allowable. The impact on CNF is significant as it had been lending at 19.2%. After much discussion with the Company over the last month, it appears CNF will make a few tweaks to its model, however the profit per loan will be reduced going forward. The 3.8% reduction will likely result in all parties on the lending side taking a small hit. Sales Partners will likely be charged a slightly lower rate for the 85% of the loan they are borrowing for the loans they originate. Loans will likely have twelve month terms to qualify for cheaper lending rates from the trust partners, who may have to take a haircut on returns to accommodate the new law. Finally, CNF will likely be unable to continue charging the 2% service fee on loans through its platform. Assuming a 9.0% interest rate from the trust partner and a 13.5% rate charged to the Sales Partner, the ROIC of each loan will still fall quite a bit. The opportunity for CNF is that this change may force the market to consolidate faster onto the CNF platform as small lenders will have reduced margins due to the tighter spread between its capital costs and the new max lending rate, as well as having more importance placed on credit quality than before. Having a platform that provides high end credit checking and access to cheaper trust capital could be the only way some small lenders are able to stay in business. The return on invested capital to CNF will fall considerably as compared to the previous rates, but the ROIC is still higher and less capital intensive than the model it had before launching the platform. Ideally, small lenders will begin flocking to the platform and drive origination volume faster than previously thought, thus dropping more income to CNF's bottom line.

Q2:20 Results Mixed. CNF reported second quarter loan origination of RMB 1,883.2 million, better than the year ago period, but slightly below our forecast. Net Interest Income, however, was better than expected due to lower interest expense. Collaboration Costs also came in better than expected, which ultimately resulted in Net Profit of RMB 25.2 million, or 0.02 per share.

Model Update. We adjusted our model to account for the 15.4% interest rate, the higher sales partner rate, lower trust company interest rate, and removal of the service fee. We also made a slight reduction in expected Provisions for Credit Losses, as the lower rate will likely result in the platform accepting borrowers with stronger credit. The net result of all this was a reduction in 2021 Net Income from RMB 0.25 per share to RMB 0.19 per share.

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RISKS

Fluctuations in Interest Rates

On August 20, China reduced the allowable interest rate from private lenders substantially, which cut into CNF's margins. Should the LPR be reduced or another change be passed through CNF may not be able to operate profitably. Additionally, Increases in required interest rates by trust partners or more competitive home equity loan rates by competitors could shrink the Company's margins and profitability.

Changing Industry Regulations

Despite operating in a market largely left untouched by traditional banks, the home equity loan market is subject to a variety of regulations which CNF must stay in compliance with. For example, should the structural leverage ratio of 3:1 be reduced the Company and its sales partners would hold the burden of making larger capital contributions at the time of loan origination. There are also numerous regulations surrounding the method of marketing financial products to clients directly and through third parties that must be managed.

Dependence on Trust Companies

CNF's ability to originate home equity loans is dependent on the availability of trust company capital, of which FOTIC funds roughly 70%, the loss of which could cripple its platform capabilities.

Dependence on Sales Partners

After the change in business model in early 2019, the Company is now wholly reliant on its outside sales partners to drive loan origination customers. This new model is relatively unproven given the short time it has been in place and there are no assurances it will be as effective as the Company expects. Additionally, CNF's financial results may be lower than expected should sales partners source applicants at a reduced pace or find alternative channels to originate client loans. There are also no assurances the sales partners will be able to provide enough capital to meet its 20% equity requirement for each loan it originates, which could slow growth.

Downturn in Chinese Real Estate Prices

Reduced real estate prices would limit the home equity applicants have to take out loans on CNF's platform, and would reduce the value of the collateral held by the trust companies thereby placing a great potential liability on CNF should loans default.

Strength of the Chinese Economy

A downturn in the Chinese economy due to trade wars, COVID-19, or any other factor could reduce the need for MSEs to seek growth capital loans, which would reduce the pool of applicants on CNF's platform. Additionally, a weaker economy could result in more delinquencies, which would force CNF to make top-up payments on those loans.

Second Lien Interests

Loans secured by a second lien interest accounted for 56.4% of total loan origination volume in 2019, and 58.1% in 2018. Should these borrowers default, CNF may have a difficult time collecting the full amount of its security interest.

Foreign Currency Exchange

CNF's stock trades in U.S. Dollars, while it conducts business in Chinese Yuan. Changes in the exchange rates could have an adverse effect on financial performance and the value of the common stock.

Illiquid Trading

The Company's stock trades far less than $1,000,000 per day, which may make it difficult to buy or sell a large position in the open market without moving the stock price.

Material Weaknesses over Financial Reporting

CNF's auditor found a material weakness in internal controls over financial reporting for the year ending December 31, 2019, related to the lack of sufficient financial reporting and accounting personnel with US GAAP and SEC reporting requirement experience and a failure to establish and communicate policies regarding US GAAP. Management is in the process of hiring more financial staffing. We note that CNF's auditor is PCAOB-compliant.

Disclosure Requirements

As a foreign issuer, CNF is not required to issue formal 10-Q and 10-K filings, but rather 20-F annual reports and less comprehensive 6-K filings each quarter. As a result, there may be less information available to evaluate CNF as compared to companies filing under standard disclosure requirements.

ESTIMATED INCOME STATEMENT

(000s of RMB)	Q1:19A	Q2:19A	Q3:19A	Q4:19A	2019A	Q1:20A	Q2:20A	Q3:20e	Q4:20e	2020e	Q1:21e	Q2:21e	Q3:21e	Q4:21e	2021e
Total Loan Origination Volume	997,600	1,667,100	1,708,800	2,000,000	6,373,500	1,166,900	1,883,200	2,857,140	3,752,044	9,659,284	4,221,263	4,824,495	5,454,540	6,111,398	20,611,695
Total Outstanding Loan Principal	14,400,000	13,000,000	11,900,000	10,104,900	10,104,900	10,800,000	9,800,000	11,283,140	13,368,084	13,368,084	15,880,546	18,705,041	22,992,681	27,220,879	27,220,879
Interest & Financing Fee on Loans	888,222	797,953	675,479	591,828	2,953,482	489,188	449,918	484,208	474,536	1,897,850	563,036	665,773	802,681	966,611	2,998,101
Interest on Deposits	4,068	4,088	3,450	5,074	16,680	4,498	4,149	5,925	7,642	22,213	8,744	9,254	13,993	20,549	52,540
Total Interest and Fees	**892,290**	**802,100**	**678,929**	**596,902**	**2,970,221**	**493,686**	**454,067**	**490,133**	**482,178**	**1,920,064**	**571,780**	**675,027**	**816,674**	**987,160**	**3,050,641**
Interest Expense	(409,334)	(368,916)	(294,776)	(236,808)	(1,309,834)	(200,894)	(186,760)	(207,537)	(219,550)	(814,741)	(246,785)	(291,816)	(351,825)	(423,677)	(1,314,103)
Net Interest & Fees Income	**482,956**	**433,184**	**384,153**	**360,094**	**1,660,387**	**292,792**	**267,307**	**282,596**	**262,628**	**1,105,323**	**324,994**	**383,211**	**464,850**	**563,483**	**1,736,538**
Collaboration Cost for Sales Partners	(9,268)	(31,582)	(57,416)	(75,777)	(174,043)	(94,271)	(103,972)	(181,797)	(120,945)	(500,985)	(159,039)	(188,059)	(226,731)	(273,036)	(846,866)
Net Int & Fees Income After Collab	**473,688**	**401,602**	**326,737**	**284,317**	**1,486,344**	**198,521**	**163,335**	**100,799**	**141,683**	**604,338**	**165,955**	**195,152**	**238,118**	**290,447**	**889,672**
Provision for Credit Losses	(173,274)	(94,788)	(54,863)	(39,810)	(362,735)	(220,840)	(56,532)	(48,766)	(34,463)	(360,601)	(27,267)	(23,323)	(29,983)	(35,972)	(116,545)
Net Interest & Fees Income	**300,414**	**306,814**	**271,874**	**244,507**	**1,123,609**	**(22,319)**	**106,803**	**52,033**	**107,219**	**243,736**	**138,688**	**171,829**	**208,136**	**254,475**	**773,127**
Gains on Sales of Investments, Net	6,311	5,806	18,250	3,447	33,814	3,054	5,258	2,500	2,500	13,312	2,500	2,500	2,500	2,500	10,000
Other Gains, Net	11,547	21,997	61,800	(697)	94,647	37,445	43,019	41,030	42,535	164,028	43,311	42,511	47,030	49,493	182,345
Total Non-Interest Revenue	**17,858**	**27,803**	**80,050**	**2,750**	**128,461**	**40,499**	**48,277**	**43,530**	**45,035**	**177,340**	**45,811**	**45,011**	**49,530**	**51,993**	**192,345**
Employee Compensation & Benefits	(56,470)	(51,232)	(52,994)	(67,439)	(228,135)	(45,355)	(46,119)	(46,811)	(49,151)	(187,436)	(48,215)	(49,420)	(50,656)	(51,922)	(200,214)
Share-based Compensation Expense	(3,972)	(3,972)	(3,972)	(3,972)	(15,888)	(15,518)	(15,518)	(12,414)	(11,173)	(54,623)	(10,056)	(9,050)	(8,145)	(7,331)	(34,581)
Taxes & Surcharges	(20,704)	(15,224)	(11,771)	(19,991)	(67,690)	(12,994)	(11,890)	(28,571)	(37,520)	(90,976)	(40,102)	(45,833)	(49,091)	(55,003)	(190,028)
Operating Lease Cost	(10,361)	(9,510)	(8,700)	(8,036)	(36,607)	(6,826)	(5,976)	(6,066)	(6,157)	(25,024)	(6,249)	(6,343)	(6,438)	(6,534)	(25,564)
Other Expenses	(45,606)	(38,155)	(35,194)	(63,723)	(182,678)	(19,793)	(34,818)	(35,340)	(35,870)	(125,822)	(37,126)	(38,425)	(39,770)	(41,162)	(156,483)
Income Before Income Tax	**181,159**	**216,524**	**239,293**	**84,096**	**721,072**	**(82,306)**	**40,759**	**(33,640)**	**12,382**	**(62,804)**	**42,751**	**67,769**	**103,566**	**144,515**	**358,601**
Income Tax Expense	(45,638)	(55,661)	(61,956)	(23,113)	(186,368)	16,543	(15,573)	8,578	(3,157)	6,391	(10,901)	(17,281)	(26,409)	(36,851)	(91,443)
Net Income	**135,521**	**160,863**	**177,337**	**60,983**	**534,704**	**(65,763)**	**25,186**	**(25,062)**	**9,225**	**(56,414)**	**31,849**	**50,488**	**77,157**	**107,664**	**267,158**
Basic EPS	**0.10**	**0.12**	**0.13**	**0.04**	**0.39**	**(0.05)**	**0.02**	**(0.02)**	**0.01**	**(0.04)**	**0.02**	**0.04**	**0.06**	**0.08**	**0.19**
Basic S/O	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643
						8,168	13,182	20,000	26,264						
Diluted EPS	**0.09**	**0.11**	**0.12**	**0.04**	**0.36**	**(0.05)**	**0.02**	**(0.02)**	**0.01**	**(0.04)**	**0.02**	**0.04**	**0.06**	**0.08**	**0.19**
Diluted S/O	1,467,786	1,467,786	1,467,786	1,467,786	1,467,786	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643	1,371,643
Net Margin	15.2%	20.1%	26.1%	10.2%	18.0%	-13.3%	5.5%	-5.1%	1.9%	-2.9%	5.6%	7.5%	9.4%	10.9%	8.8%

DISCLOSURES

Distribution of Ratings

Rating	Count	Percent	I.B. last 12 months Count	I.B. last 12 months Percent
BUY	10	100%	0	0%
HOLD	0	0%	0	0%
SELL	0	0%	0	0%
NO RATING	0	0%	0	0%

Explanation of Ratings

BUY: Describes undervalued stocks we expect to provide a total return (capital appreciation + yield) of 15% or more in the next twelve month period.

HOLD: Describes fully valued stocks we expect to provide a total return (capital appreciation + yield) of plus or minus 15% in the next twelve month period.

SELL: Describes overvalued stocks we expect to provide a total negative return (capital depreciation + yield) of 15% or more in the next twelve month period.

NO RATING: Describes stocks that have their investment rating and/or target price temporarily removed for fundamental or compliance-based reasons.

Analyst Certification

I, William Gregozeski, CFA, certify that all of the views expressed in this research report accurately reflect my personal views about the subject security and subject company. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Other Disclosures

Company	Disclosures
CNFinance Holdings Limited	8

1. Greenridge Global makes a market in the security of the subject company.
2. The analyst serves as an officer, director, or advisory board member of the subject company.
3. The analyst or a member of the analyst's household has a financial interest in the securities of the subject company, including, but not limited to a long position, short position, rights, warrants, futures, or options.
4. Greenridge Global or an affiliate of Greenridge Global has managed or co-managed a public offering of the security of the subject company in the last 12 months.
5. Greenridge Global or an affiliate of Greenridge Global has received compensation for investment banking services from the subject company in the last 12 months.
6. Greenridge Global expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.
7. Greenridge Global or an affiliate of Greenridge Global beneficially own 1% or more of the common stock of the subject company as calculated in accordance with Section 13(d) of the Securities Exchange Act of 1934.
8. The subject company is, or during the past 12 months was, a client of Greenridge Global, which provided non-investment banking, securities-related services to, and received compensation from, the subject company for such services.
9. An affiliate of Greenridge Global received compensation from the subject company for products or services other than investment baking services during the past 2 months.

DISCLOSURES (continued)

Other Disclosures

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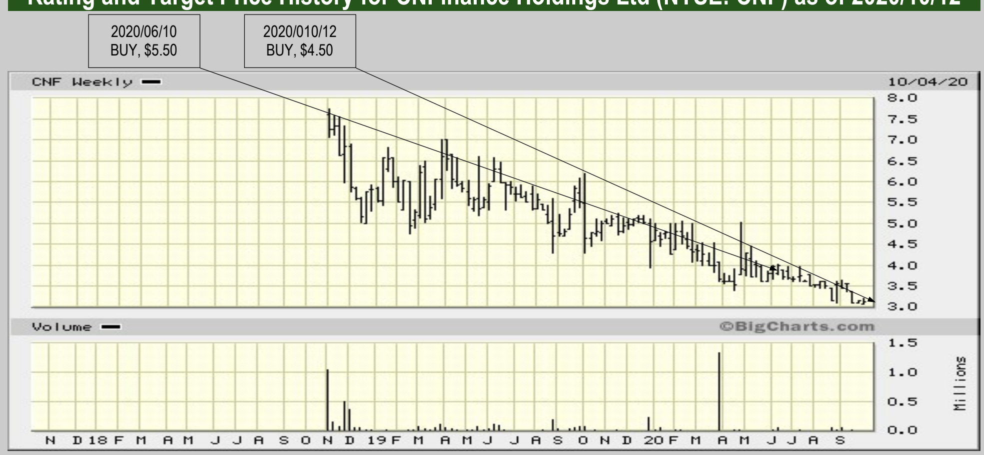
Rating History

Rating and Target Price History for CNFinance Holdings Ltd (NYSE: CNF) as of 2020/10/12



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