

CNFinance Holdings Limited
NYSE: CNF

Maintaining Rating & Target
BUY, \$4.50

December 10, 2020

MARKET DATA

Share Price:	US\$	3.48
Market Cap:	US\$	238.66 M
52wk Range:	US\$	2.90 - 5.20
Ave. Volume:		10,000
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	1,686.71 M
Total Debt:	RMB	6,063.65 M
Book Value:	RMB	3,633.03 M
EBITDA (ttm):	RMB	N/A
CFFO (ttm):	RMB	N/A

Auditor: KPMG Huazhen LLP

RMB 2018A 2019A 2020e 2021e

Revenue (in Millions)

Mar	1,063.20	892.30	489.19A	536.42
Jun	1,071.57	802.10	449.92A	679.32
Sep	1,116.12	678.93	475.96A	838.05
Dec	1,039.60	596.93	454.31	1,040.06
REV	4,278.82	2,970.23	1,878.03	3,093.84
<i>P/S</i>	<i>0.36</i>	<i>0.53</i>	<i>0.83</i>	<i>0.50</i>

Diluted EPS

Mar	0.15	0.09	(0.05)A	0.03
Jun	0.18	0.11	0.02A	0.03
Sep	0.17	0.12	0.03A	0.05
Dec	0.14	0.04	0.04	0.06
EPS	0.62	0.36	0.05	0.18
<i>P/E</i>	<i>1.81</i>	<i>2.92</i>	<i>25.55</i>	<i>6.49</i>

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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Change In Max Lending Rate Does Not Appear To Negatively Impact CNF After All

Change In Max Lending Rate Does Not Appear To Negatively Impact CNF After All. After initially changing its loans following the August 20 interest cap on private lending at 15.4% (four times the one-year loan prime rate), it now appears CNF is not bound by those rules. The Company has been in contact with regulators about the change, and now believes that the ruling applies only to private lenders, not institutional lenders (technically, the trust companies act as the lender on CNF's platform). This stance was strengthened by a court case in Wenzhou, which ruled the same. While management will continue dialogue with the regulators and follow related court cases, it feels comfortable moving back to the previous terms of its loans, being one to three years with interest rates around 19.2%. In adjusting our model, we are assuming a 1.5% service fee and Senior Interest Rates and Sales Partner Interest Rates around previous levels, although all these terms will be subject to continued adjustments. Additionally, we have assumed a longer average duration of the loan portfolio, which will positively impact Net Profit, however this will largely be seen starting in 2022.

Q3:20 Results Better Than Expected. CNF reported third quarter loan origination of RMB 3,093.4 million, better than our estimate and 64% higher than Q2:20, showing continued demand in China's post-COVID economy, despite the August 20 ruling. Another bright spot was the number of facilitating sales partners exceeded 1,000 for the first time, at 1,020, showing acceleration of partners to the platform, which will ultimately drive Net Profit. Net Profit for the third quarter was RMB 50.1 million, or 0.03 per diluted share, well above our estimate due to lower sales partner collaboration expenses. Management guided for Q4:20 Net Profit to be between RMB 50 million and RMB 100 million, however this will likely come on lower origination than Q3 due to National Day observance and reduced availability of loans from trust companies after stronger demand post-COVID; this is not expected to be a recurring issue going forward.

Maintaining Rating & Target. The ability to revert back to longer duration, higher interest rate loans is a big win for CNFinance, now and even more so in the future. Additionally, the continued consolidation in the industry should see more and more sales partners join the platform, which will in turn drive faster profit growth. We remain quite bullish on CNF's long term potential and are reiterating our Buy rating and \$4.50 target price on CNFinance. Our target price is based on a Price-to-Earnings multiple of 8 times our 2021 currency-adjusted Diluted EPS estimate of RMB 0.18 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.

RISKS

Fluctuations in Interest Rates

On August 20, China reduced the allowable interest rate from private lenders substantially, however it is now believed this does not apply to CNF due to the trust companies being the lender of record. Should this apply to CNF or another similar change be enacted, the Company 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 that CNF must stay in compliance with. For example, should the structural leverage ratio of 3:1 be reduced, CNF and its sales partners would have to make 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	Q3:20A	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	3,093,400	2,639,471	8,782,971	4,092,545	4,847,776	5,673,936	6,575,480	21,189,737
Total Outstanding Loan Principal	14,400,000	13,000,000	11,900,000	11,300,000	10,800,000	9,800,000	10,400,000	10,400,000	9,782,971		12,292,066	15,614,792	18,800,428	23,829,208	
Interest & Financing Fee on Loans	888,222	797,953	675,479	591,828	2,953,482	489,188	449,918	472,464	450,098	1,861,668	529,801	669,765	825,965	1,023,111	3,048,642
Interest on Deposits	4,068	4,088	3,450	5,074	16,680	4,498	4,149	3,495	4,217	16,359	6,617	9,553	12,080	16,952	45,202
Total Interest and Fees	892,290	802,100	678,929	596,902	2,970,221	493,686	454,067	475,959	454,314	1,878,026	536,417	679,318	838,046	1,040,064	3,093,844
Interest Expense	(409,334)	(368,916)	(294,776)	(236,808)	(1,309,834)	(200,894)	(186,760)	(184,349)	(179,818)	(751,821)	(214,480)	(269,544)	(329,107)	(400,317)	(1,213,448)
Net Interest & Fees Income	482,956	433,184	384,153	360,094	1,660,387	292,792	267,307	291,610	274,496	1,126,205	321,937	409,774	508,939	639,747	1,880,397
Collaboration Cost for Sales Partners	(9,268)	(31,582)	(57,416)	(75,777)	(174,043)	(94,271)	(103,972)	(112,480)	(108,296)	(419,019)	(167,233)	(227,609)	(306,482)	(397,993)	(1,099,316)
Net Int & Fees Income After Collab	473,688	401,602	326,737	284,317	1,486,344	198,521	163,335	179,130	166,200	707,186	154,705	182,165	202,456	241,754	781,080
Provision for Credit Losses	(173,274)	(94,788)	(54,863)	(39,810)	(362,735)	(220,840)	(56,532)	(31,088)	(10,045)	(318,505)	(13,481)	(23,014)	(26,502)	(33,247)	(96,244)
Net Interest & Fees Income	300,414	306,814	271,874	244,507	1,123,609	(22,319)	106,803	148,042	156,155	388,681	141,223	159,151	175,955	208,507	684,836
Gains on Sales of Investments, Net	6,311	5,806	18,250	3,447	33,814	3,054	5,258	7,232	5,000	20,544	5,000	5,000	5,000	5,000	20,000
Other Gains, Net	11,547	21,997	61,800	(697)	94,647	37,445	43,019	37,364	31,128	148,956	33,524	35,488	38,455	43,326	150,793
Total Non-Interest Revenue	17,858	27,803	80,050	2,750	128,461	40,499	48,277	44,596	36,128	169,500	38,524	40,488	43,455	48,326	170,793
Employee Compensation & Benefits	(56,470)	(51,232)	(52,994)	(67,439)	(228,135)	(45,355)	(46,119)	(46,687)	(47,621)	(185,782)	(48,088)	(49,290)	(50,522)	(51,785)	(199,685)
Share-based Compensation Expense	(3,972)	(3,972)	(3,972)	(3,972)	(15,888)	(15,518)	(15,518)	(15,518)	(15,518)	(62,072)	(9,311)	(9,311)	(9,311)	(9,311)	(37,243)
Taxes & Surcharges	(20,704)	(15,224)	(11,771)	(19,991)	(67,690)	(12,994)	(11,890)	(11,900)	(10,091)	(46,875)	(11,038)	(13,953)	(17,208)	(21,315)	(63,513)
Operating Lease Cost	(10,361)	(9,510)	(8,700)	(8,036)	(36,607)	(6,826)	(5,976)	(4,362)	(4,427)	(21,591)	(4,494)	(4,561)	(4,630)	(4,699)	(18,384)
Other Expenses	(45,606)	(38,155)	(35,194)	(63,723)	(182,678)	(19,793)	(34,818)	(39,375)	(39,966)	(133,952)	(41,364)	(42,812)	(44,311)	(45,861)	(174,349)
Income Before Income Tax	181,159	216,524	239,293	84,096	721,072	(82,306)	40,759	74,796	74,660	107,909	65,453	79,712	93,429	123,862	362,455
Income Tax Expense	(45,638)	(55,661)	(61,956)	(23,113)	(186,368)	16,543	(15,573)	(24,647)	(18,036)	(41,713)	(19,065)	(22,701)	(26,199)	(33,959)	(101,923)
Net Income	135,521	160,863	177,337	60,983	534,704	(65,763)	25,186	50,149	56,624	66,196	46,388	57,011	67,231	89,903	260,532
Basic EPS	0.10	0.12	0.13	0.04	0.39	(0.05)	0.02	0.04	0.04	0.05	0.03	0.04	0.05	0.07	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
Diluted EPS	0.09	0.11	0.12	0.04	0.36	(0.05)	0.02	0.03	0.04	0.05	0.03	0.04	0.05	0.06	0.18
Diluted S/O	1,467,786	1,467,786	1,467,786	1,467,786	1,467,786	1,371,643	1,486,101	1,486,101	1,486,101	1,457,487	1,486,101	1,486,101	1,486,101	1,486,101	1,486,101
Net Margin	15.2%	20.1%	26.1%	10.2%	18.0%	-13.3%	5.5%	10.5%	12.5%	3.5%	8.6%	8.4%	8.0%	8.6%	8.4%

Source: CNF documents filed with the SEC and Greenridge Global estimates

DISCLOSURES**Distribution of Ratings**

Rating	Count	Percent	<u>I.B. last 12 months</u>	
			Count	Percent
BUY	9	90%	0	0%
HOLD	0	0%	0	0%
SELL	1	10%	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.

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Other Disclosures

<u>Company</u>	<u>Disclosures</u>
CNFinance Holdings Limited	8

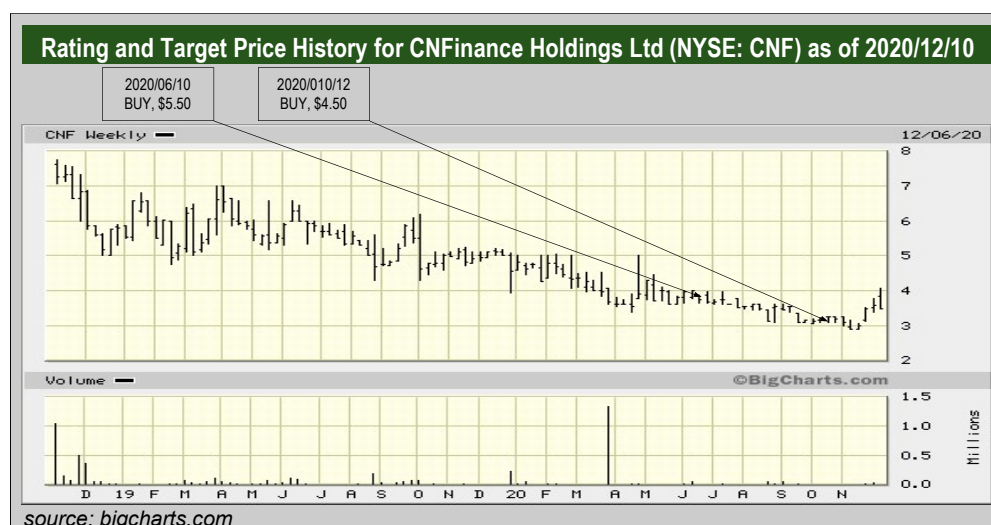
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