

CNFinance Holdings Limited
 NYSE: CNF

Maintaining Rating & Target
BUY, \$4.50
June 2, 2021
MARKET DATA

Share Price:	US\$	3.19
Market Cap:	US\$	218.77 M
52wk Range:	US\$	2.90 - 4.58
Ave. Volume:		15,000
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	2,223.74 M
Total Debt:	RMB	7,048.35 M
Book Value:	RMB	3,834.46 M
EBITDA (ttm):	RMB	N/A
CFFO (ttm):	RMB	N/A

Auditor: KPMG Huazhen LLP

RMB	2019A	2020A	2021e	2022e
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Revenue (in Millions)

	2019A	2020A	2021e	2022e
Mar	892.30	489.19	421.98A	504.54
Jun	802.10	449.92	461.28	515.60
Sep	678.93	475.96	500.92	544.59
Dec	596.93	421.11	501.42	575.05
REV	2,970.23	1,844.82	1,888.68	2,139.78
<i>P/S</i>	<i>0.47</i>	<i>0.76</i>	<i>0.74</i>	<i>0.65</i>

Diluted EPS

	2019A	2020A	2021e	2022e
Mar	0.09	(0.05)	0.06A	0.05
Jun	0.11	0.02	0.04	0.05
Sep	0.12	0.03	0.05	0.05
Dec	0.04	0.07	0.05	0.06
EPS	0.36	0.08	0.20	0.21
<i>P/E</i>	<i>2.61</i>	<i>13.17</i>	<i>5.20</i>	<i>4.80</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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Platform Continues To Show Flexibility And Profitability During Periods Of Uncertainty

Net Income Surprises In Q1. CNF reported first quarter loan origination of RMB 2.8 billion and Total Interest and Fees of RMB 425.1 million, both slightly below our estimate. Interest Expense, however came in quite a bit lower than expected due to lower rates charged by its lending partners. Provision for Credit Losses stayed low thanks to the new model and Other Gains provided a lift to Net Income at RMB 48.1 million. Net Income for the quarter was RMB 85.6 million, or 0.06 per share, both well above our estimate due to the lower Interest Expense and higher Other Gains.

Access To Capital May Constrain Origination Growth. During the conference call, management discussed the ongoing difficulty of obtaining enough capital to lend on the platform. While it continues to search for new lending partners, it also guided for lower origination volume for the remainder of the year, at roughly RMB 3.0 billion per quarter. The Company did note that the reduced origination was solely a function of the availability of capital and not due to a reduction in demand for loans. As such, we lowered our origination estimate for 2021 to RMB 12.2 billion and our 2022 estimate from RMB 20.6 billion to RMB 15.2 billion.

Model Update. The aforementioned reductions in origination volume did not have as large of an impact as would be expected due to the lower rate the Company is paying to its trust partners and the higher Other Gains it is reporting. The Other Gains are generated from sales of loans and from sales partners buying back defaulted loans or the forfeited equity position from sales partners on loans that defaulted and were not bought back or topped up. The net result is our estimates for the remainder of 2021 stayed as is and our 2022 EPS estimate fell from 0.24 to 0.21 due to the flatter origination growth.

Maintaining Rating & Target. There continues to be a relative amount of uncertainty in forecasting CNF due to the continued changes to lending laws and the ramifications those are having on lending partners. Despite this, it is clear the Company's platform is flexible enough to weather any changes and de-risks CNF's position compared to its old model. With a positive outlook for the platform, we 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 forward twelve month currency-adjusted Diluted EPS estimate of RMB 0.19 per ordinary share, converted to ADS. We did lower our multiple slightly due to the potential for lower origination growth compared to previous expectations.

RISKS

Fluctuations in Interest Rates

On August 20, China reduced the allowable interest rate from private lenders substantially. While CNF does not believe it applies it is ultimately up to the trust companies as to what rates are charged as they are the lender of record. 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)	Q1:20A	Q2:20A	Q3:20A	Q4:20A	2020A	Q1:21A	Q2:21e	Q3:21e	Q4:21e	2021e	Q1:22e	Q2:22e	Q3:22e	Q4:22e	2022e
Total Loan Origination Volume	1,166,900	1,883,200	3,093,400	2,700,000	8,843,500	2,841,800	2,966,653	3,138,848	3,318,737	12,266,038	3,506,628	3,702,842	3,907,708	4,121,571	15,238,749
Total Outstanding Loan Principal	10,800,000	9,800,000	10,400,000	9,700,000	10,300,000	10,300,000	12,783,103	12,533,239	12,930,491	12,266,038	12,930,866	13,667,054	14,435,914	15,238,749	
Interest & Financing Fee on Loans	489,188	449,918	472,464	417,118	1,828,688	421,980	457,442	497,159	497,541	1,874,122	500,987	512,010	540,982	571,237	2,125,217
Interest on Deposits	4,498	4,149	3,495	3,992	16,134	3,082	3,835	3,760	3,879	14,556	3,556	3,588	3,609	3,810	14,562
Total Interest and Fees	493,686	454,067	475,959	421,110	1,844,822	425,062	461,277	500,919	501,420	1,888,678	504,543	515,598	544,591	575,047	2,139,779
Interest Expense	(200,894)	(186,760)	(184,349)	(159,312)	(731,315)	(156,259)	(207,684)	(223,297)	(222,118)	(809,357)	(221,320)	(224,420)	(237,119)	(250,380)	(933,239)
Net Interest & Fees Income	292,792	267,307	291,610	261,798	1,113,507	268,803	253,593	277,622	279,303	1,079,321	283,223	291,178	307,472	324,667	1,206,540
Collaboration Cost for Sales Partners	(94,271)	(103,972)	(112,480)	(104,381)	(415,104)	(98,068)	(101,634)	(101,715)	(104,621)	(406,038)	(110,236)	(116,366)	(122,950)	(129,827)	(479,379)
Net Int & Fees Income After Collab	198,521	163,335	179,130	157,417	698,403	170,735	151,959	175,907	174,682	673,283	172,987	174,812	184,522	194,840	727,161
Provision for Credit Losses	(220,840)	(56,532)	(31,088)	28,459	(280,001)	(13,723)	(14,635)	(12,750)	(6,790)	(47,897)	(10,841)	(10,429)	(16,622)	(19,356)	(57,249)
Net Interest & Fees Income	(22,319)	106,803	148,042	185,876	418,402	157,012	137,324	163,157	167,892	625,386	162,146	164,382	167,900	175,484	669,912
Gains on Sales of Investments, Net	3,054	5,258	7,232	4,609	20,153	3,918	5,000	5,000	5,000	18,918	5,000	5,000	5,000	5,000	20,000
Other Gains, Net	37,445	43,019	37,364	51,565	169,393	48,105	38,349	37,600	38,791	162,845	42,025	44,418	46,917	49,526	182,886
Total Non-Interest Revenue	40,499	48,277	44,596	56,174	189,546	52,023	43,349	42,600	43,791	181,763	47,025	49,418	51,917	54,526	202,886
Employee Compensation & Benefits	(45,355)	(46,119)	(46,687)	(52,213)	(190,374)	(48,956)	(50,180)	(51,434)	(52,720)	(203,291)	(51,685)	(52,977)	(54,302)	(55,659)	(214,624)
Share-based Compensation Expense	(15,518)	(15,518)	(15,518)	(15,518)	(62,072)	(4,692)	(4,692)	(4,692)	(4,692)	(18,768)	(2,815)	(2,815)	(2,815)	(2,815)	(11,261)
Taxes & Surcharges	(12,994)	(11,890)	(11,900)	(12,668)	(49,452)	(6,706)	(11,542)	(12,658)	(12,732)	(43,638)	(12,931)	(13,299)	(14,051)	(14,837)	(55,118)
Operating Lease Cost	(6,826)	(5,976)	(4,362)	(4,556)	(21,720)	(4,155)	(4,217)	(4,281)	(4,345)	(16,998)	(4,410)	(4,476)	(4,543)	(4,611)	(18,041)
Other Expenses	(19,793)	(34,818)	(39,375)	(27,642)	(121,628)	(29,711)	(31,197)	(33,536)	(35,213)	(129,657)	(35,389)	(36,274)	(37,181)	(38,110)	(146,954)
Income Before Income Tax	(82,306)	40,759	74,796	129,453	162,702	114,815	78,846	99,156	101,982	394,799	101,941	103,959	106,924	113,977	426,800
Income Tax Expense	16,543	(15,573)	(24,647)	(24,172)	(47,849)	(29,235)	(21,302)	(26,481)	(27,202)	(104,220)	(26,713)	(27,227)	(27,983)	(29,782)	(111,706)
Net Income	(65,763)	25,186	50,149	105,281	114,853	85,580	57,544	72,675	74,780	290,578	75,228	76,731	78,940	84,195	315,094
Basic EPS	(0.05)	0.02	0.04	0.08	0.08	0.06	0.04	0.05	0.05	0.21	0.05	0.06	0.06	0.06	0.23
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	(0.05)	0.02	0.03	0.07	0.08	0.06	0.04	0.05	0.05	0.20	0.05	0.05	0.05	0.06	0.21
Diluted S/O	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	1,486,101	1,486,101	1,486,101	1,486,101	1,486,101
Net Margin	-13.3%	5.5%	10.5%	25.0%	6.2%	20.1%	12.5%	14.5%	14.9%	15.4%	14.9%	14.9%	14.5%	14.6%	14.7%

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	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.

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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.

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

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