

**CNFinance Holdings Limited**

NYSE: CNF

**Maintaining Rating & Raising Target****BUY, \$5.50**

November 29, 2021

**MARKET DATA**

Share Price:	US\$	4.95
Market Cap:	US\$	339.47 M
52wk Range:	US\$	2.95 - 6.34
Ave. Volume:		308,000
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	1,964.14 M
Total Debt:	RMB	8,649.34 M
Book Value:	RMB	3,923.56 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	476.19
Jun	802.10	449.92	451.51A	503.77
Sep	678.93	475.96	456.99A	530.95
Dec	596.93	421.11	452.85	569.33
<b>REV</b>	<b>2,970.23</b>	<b>1,844.82</b>	<b>1,786.41</b>	<b>2,080.24</b>
<i>P/S</i>	<i>0.73</i>	<i>1.17</i>	<i>1.21</i>	<i>1.04</i>

**Diluted EPS**

	2019A	2020A	2021e	2022e
Mar	0.09	(0.05)	0.06A	0.04
Jun	0.11	0.02	0.04A	0.05
Sep	0.12	0.03	0.01A	0.05
Dec	0.04	0.07	(0.06)	0.05
<b>EPS</b>	<b>0.36</b>	<b>0.08</b>	<b>0.06</b>	<b>0.19</b>
<i>P/E</i>	<i>4.05</i>	<i>20.45</i>	<i>25.54</i>	<i>8.21</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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**Possible Move Towards True Platform Model**

**Possible Shift In Model.** Management noted on the conference call last week that demand for home equity loans remains strong, which likely coincides with the national push to support SMEs. Restrictions continue to limit funds available from trust companies, but CNF stated it gets first priority due to the amount of origination it does relative to its peers. However, the Company is moving aggressively towards the use of capital from commercial banks, with a target to end 2022 with 30% of origination coming from commercial bank capital. The use of commercial bank capital could change the business model to one that is strictly a lending platform generating service revenue, as the commercial bank would hold the loans and free CNF from needing to invest in the subordinated level it does now, and enable it to push more volume through the platform. This could potentially eliminate Interest Expense, Collaboration Costs, Provision for Credit Losses, Taxes & Surcharges, and Realized Gains on Sales of Investments, and enable it to operate as a pure platform. As this would change the model in a significant way and is still in the testing phase, we are limiting the inclusion of commercial lending in our model at this time. We would expect to know more about the shift by the time CNF reports its year end results in roughly four months, which should include the sale of all of its higher capital requirement legacy loans.

**Origination Surprises In Q3.** Third quarter loan origination beat our estimate, at RMB 3.1 billion, and CNF ended the quarter at RMB 11.1 billion in loans outstanding. Interest & Service Fees of RMB 454.8 million was higher than expected for the amount of origination as the Company has been able to inch up its charged interest rate as it is not formally required to adhere to the 4x LPR rule. The interest rate charged by trust companies crept up in the quarter as a percent of loans outstanding, at RMB 219.1 million. Sales Partner payouts totaled RMB 101.5 million, which reflected the reduction in the rate paid on new loans. Provision for Credit Losses was quite a bit higher than the last two quarters, at RMB 32.6 million, and will be an item to watch in the coming quarters as it clears out legacy loans and looks to move into commercial bank-backed loans. The remainder of the operating expenses were roughly as expected, resulting in Net Income of RMB 19.0 million, or 0.01 per share.

**Model Update.** We made a few tweaks to the model, but the biggest change is the pending sale of the legacy traditional models loans, which is expected in the current quarter and will drive Q4 to a Net Loss of RMB 80 to RMB 100 million. As noted above, we have left out potential changes from the commercial bank lending model.

**Maintaining Rating & Raising Target.** The pending sale of its higher capital requirement legacy loans and potential to move towards a true platform model with commercial bank backing could be a big boost to CNF. As such, we are reiterating our Buy rating on CNFinance and raising our target price from \$4.50 to \$5.50. Our target price is based on a Price-to-Earnings multiple of 9 times our 2022 currency-adjusted Diluted EPS estimate of RMB 0.19 per ordinary share, converted to ADS.

## 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 56.3% of total loan origination volume in 2020, and 56.4% in 2019. 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, 2020, 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

	Q1:20A	Q2:20A	Q3:20A	Q4:20A	2020A	Q1:21A	Q2:21A	Q3:21A	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	3,824,500	3,117,500	2,774,734	12,558,534	3,135,899	3,438,513	3,768,290	3,970,322	14,313,024
Total Outstanding Loan Principal	10,800,000	9,800,000	10,400,000	9,700,000	1,828,688	10,300,000	11,600,000	11,100,000	11,137,634	1,775,724	11,807,333	12,466,646	13,117,436	14,313,024	2,067,316
Interest & Financing Fee on Loans	489,188	449,918	472,464	417,118	16,134	421,980	448,807	454,870	450,067	10,690	473,240	500,651	527,672	565,753	12,926
Interest on Deposits	4,498	4,149	3,495	3,992	1,844,822	3,082	2,701	2,123	2,784	1,786,414	2,952	3,117	3,279	3,578	2,080,242
<b>Total Interest and Fees</b>	<b>493,686</b>	<b>454,067</b>	<b>475,959</b>	<b>421,110</b>	<b>1,844,822</b>	<b>425,062</b>	<b>451,508</b>	<b>456,993</b>	<b>452,851</b>	<b>1,786,414</b>	<b>476,192</b>	<b>503,767</b>	<b>530,951</b>	<b>569,331</b>	<b>2,080,242</b>
Interest Expense	(200,894)	(186,760)	(184,349)	(159,312)	(731,315)	(156,259)	(194,982)	(219,126)	(196,393)	(766,760)	(202,203)	(213,914)	(225,460)	(241,731)	(883,308)
<b>Net Interest &amp; Fees Income</b>	<b>292,792</b>	<b>267,307</b>	<b>291,610</b>	<b>261,798</b>	<b>1,113,507</b>	<b>268,803</b>	<b>256,526</b>	<b>237,867</b>	<b>256,459</b>	<b>1,019,655</b>	<b>273,989</b>	<b>289,853</b>	<b>305,491</b>	<b>327,601</b>	<b>1,196,934</b>
Collaboration Cost for Sales Partners	(94,271)	(103,972)	(112,480)	(104,381)	(415,104)	(98,068)	(106,692)	(101,521)	(125,473)	(431,754)	(124,476)	(131,686)	(138,794)	(148,810)	(543,767)
<b>Net Int &amp; Fees Income After Collab</b>	<b>198,521</b>	<b>163,335</b>	<b>179,130</b>	<b>157,417</b>	<b>698,403</b>	<b>170,735</b>	<b>149,834</b>	<b>136,346</b>	<b>130,985</b>	<b>587,900</b>	<b>149,513</b>	<b>158,167</b>	<b>166,698</b>	<b>178,790</b>	<b>653,168</b>
Provision for Credit Losses	(220,840)	(56,532)	(31,088)	28,459	(280,001)	(13,723)	(14,653)	(32,589)	(22,582)	(83,547)	(11,835)	(11,407)	(14,960)	(19,024)	(57,224)
<b>Net Interest &amp; Fees Income</b>	<b>(22,319)</b>	<b>106,803</b>	<b>148,042</b>	<b>185,876</b>	<b>418,402</b>	<b>157,012</b>	<b>135,181</b>	<b>103,757</b>	<b>108,404</b>	<b>504,354</b>	<b>137,678</b>	<b>146,760</b>	<b>151,738</b>	<b>159,767</b>	<b>595,943</b>
Gains on Sales of Investments, Net	3,054	5,258	7,232	4,609	20,153	3,918	3,643	2,492	(145,000)	(134,947)	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	22,228	12,341	33,413	116,087	38,374	40,517	42,632	46,517	168,039
<b>Total Non-Interest Revenue</b>	<b>40,499</b>	<b>48,277</b>	<b>44,596</b>	<b>56,174</b>	<b>189,546</b>	<b>52,023</b>	<b>25,871</b>	<b>14,833</b>	<b>(111,587)</b>	<b>(18,860)</b>	<b>43,374</b>	<b>45,517</b>	<b>47,632</b>	<b>51,517</b>	<b>188,039</b>
Employee Compensation & Benefits	(45,355)	(46,119)	(46,687)	(52,213)	(190,374)	(48,956)	(52,053)	(47,744)	(48,425)	(197,178)	(49,176)	(50,406)	(51,666)	(52,958)	(204,205)
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)	(8,374)	(10,578)	(10,911)	(36,569)	(11,472)	(12,137)	(12,792)	(13,715)	(50,117)
Operating Lease Cost	(6,826)	(5,976)	(4,362)	(4,556)	(21,720)	(4,155)	(3,662)	(3,721)	(3,777)	(15,315)	(3,833)	(3,891)	(3,949)	(4,009)	(15,682)
Other Expenses	(19,793)	(34,818)	(39,375)	(27,642)	(121,628)	(29,711)	(18,618)	(26,255)	(27,568)	(102,152)	(27,706)	(28,398)	(29,108)	(29,836)	(115,048)
<b>Income Before Income Tax</b>	<b>(82,306)</b>	<b>40,759</b>	<b>74,796</b>	<b>129,453</b>	<b>162,702</b>	<b>114,815</b>	<b>73,653</b>	<b>25,600</b>	<b>(98,556)</b>	<b>115,512</b>	<b>86,049</b>	<b>94,630</b>	<b>99,039</b>	<b>107,952</b>	<b>387,670</b>
Income Tax Expense	16,543	(15,573)	(24,647)	(24,172)	(47,849)	(29,235)	(8,407)	(6,571)	20,650	(23,563)	(22,660)	(24,848)	(25,973)	(28,246)	(101,727)
<b>Net Income</b>	<b>(65,763)</b>	<b>25,186</b>	<b>50,149</b>	<b>105,281</b>	<b>114,853</b>	<b>85,580</b>	<b>65,246</b>	<b>19,029</b>	<b>(77,906)</b>	<b>91,949</b>	<b>63,389</b>	<b>69,781</b>	<b>73,066</b>	<b>79,706</b>	<b>285,942</b>
<b>Basic EPS</b>	<b>(0.05)</b>	<b>0.02</b>	<b>0.04</b>	<b>0.08</b>	<b>0.08</b>	<b>0.06</b>	<b>0.05</b>	<b>0.01</b>	<b>(0.06)</b>	<b>0.07</b>	<b>0.05</b>	<b>0.05</b>	<b>0.05</b>	<b>0.06</b>	<b>0.21</b>
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
<b>Diluted EPS</b>	<b>(0.05)</b>	<b>0.02</b>	<b>0.03</b>	<b>0.07</b>	<b>0.08</b>	<b>0.06</b>	<b>0.04</b>	<b>0.01</b>	<b>(0.05)</b>	<b>0.06</b>	<b>0.04</b>	<b>0.05</b>	<b>0.05</b>	<b>0.05</b>	<b>0.19</b>
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%	14.5%	4.2%	-17.2%	5.1%	13.3%	13.9%	13.8%	14.0%	13.7%

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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**Other Disclosures**

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

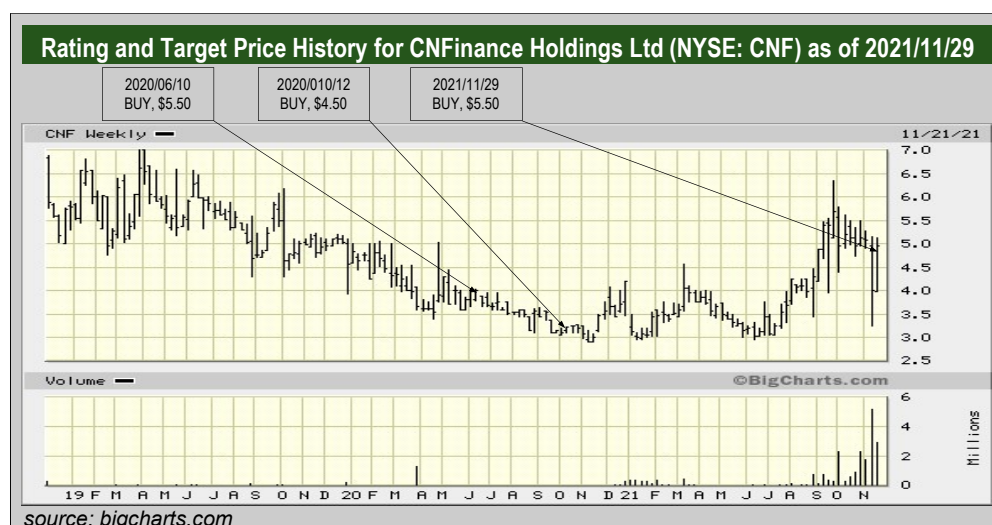
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## DISCLOSURES (continued)

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