CCXAP affirms Tianfeng Securities Co., Ltd.’s long-term credit rating at A_g-, with a stable outlook.

Hong Kong, 5 July 2024 – China Chengxin (Asia Pacific) Credit Ratings Company Limited (“CCXAP”) has affirmed the long-term credit rating of Tianfeng Securities Co., Ltd. (“TFS” or the “Company”) at A_g-, with stable outlook.

The A_g- long-term credit rating of TFS is underpinned by (1) good operating environment in China, where the capital market is mature, highly efficient and stable; (2) the Company’s established franchise in China’s securities market; and (3) increasing business and financial support from TFS’s parent and the Hubei Provincial Government.

However, the rating is constrained by the Company’s (1) weak profitability undermined by the intensified competition in financial sector; (2) moderate investment risk from proprietary trading segment; and (3) moderately high risk appetite as compared with other peers.

The rating also reflects TFS’s ownership and control by the Hubei Provincial Government through Hubei Hongtai Group Co., Ltd. (“Hongtai Group”). We expect the Company will receive solid support from the Hubei Provincial Government through Hongtai Group when needed, given its high importance to Hongtai Group and reputational risk to the local government.

Corporate Profile

Founded in March 2000 and headquartered in Wuhan, TFS is a fast-growing medium-sized securities firm in Hubei Province and was listed on the Shanghai Stock Exchange in October 2018 (Stock code: 601162.SH). Its principal businesses include brokerage, investment banking, asset management, research, private equity investment and proprietary trading. TFS aims to provide clients with one-stop financial services through comprehensive business coverage and diversified product offerings.

In February 2023, Hongtai Group received 5.99% of the shares of TFS from Hubei United Development Investment Group Co., Ltd. and became the controlling shareholder of TFS. The Hubei Provincial Government is the ultimate owner, holding TFS indirectly through multiple state-owned enterprises, including the Hongtai Group. As of 31 December 2023, Hongtai Group remained the controlling shareholder of TFS by directly holding 13.84% of TFS’s shares and together with its party acting in concert, Wuhan Trading Group Co., Ltd. (“Wuhan Trading”), held 22.62% of TFS’s shares in aggregate.

Rating Rationale

Credit Strengths

Good operating environment in China, where the capital market is mature, highly efficient and stable. TFS is domiciled in China and derives most of its revenue from China. The Chinese capital market has experienced rapid growth over the past decade. It has become the second-largest capital market in the world in terms of outstanding debt securities and equity market capitalization, which has promoted the sustainable development of China's financial intermediaries, especially securities firms.

Established franchise in China's securities market. TFS is a securities firm with a well-established product portfolio covering securities brokerage, investment banking, asset management, securities trading, and private equity. Diversified service and product offerings enable it to achieve synergies across different business lines and encourage it to develop the Tianfeng Brand. The Company has grown rapidly over the past few years. Its total assets increased from RMB59.9 billion at end-2019 to RMB99.5 billion at end-2023, while its net assets increased from RMB17.5 billion to RMB24.6 billion.

High likelihood of receiving parental and government support when needed. We expect a high level of support for TFS from the Hubei Provincial Government through Hongtai Group when needed. This is based on the high strategic importance of TFS to Hongtai Group and the increasing ties between the two parties. TFS is the major securities firm under Hongtai Group's development blueprint and has a significant strategic position in regional financial development. If Hongtai Group fails to support TFS, it would bring reputational risks to the Hubei Provincial Government. Hongtai Group is the only financial holding company that is directly and wholly owned by the Hubei Provincial Government.

Credit Challenges

Weak profitability undermined by the intensified competition in financial sector. The opening up of China's securities market may further heighten the competition among Chinese securities sectors and undermine the revenue growth and profitability of medium-sized securities firms who are disadvantaged on price competition. TFS's profitability, measured by return on assets ("ROA"), is still relatively weak with high fluctuation. The ROA from 2021 to 2023 was 0.8%, -1.7% and 0.5%, respectively.

Moderate investment risk from proprietary trading segment. The Company's financial performance is to a certain extent correlated with the change of China's capital market due to its exposure to proprietary trading business. The Company's proprietary trading fluctuated in recent years. With high market fluctuations combined with the misjudgement in the timing of strategy, the Company's revenue from the proprietary trading business dropped significantly by more than 80% YoY in 2022. In 2023, the revenue from proprietary trading increased by more than 400% YoY to RMB2.0 billion, which was the main factor for the rise in the Company's profit.

Moderately high risk appetite as compared with other peers. TFS's risk appetite is moderately high as compared with other peers. The Company reported a risk asset to total asset ratio of 34.9% as of 31 December 2023, comparing to that of 34.6% at end-2021. Risk assets are mainly measured by the financial assets reported as level 2 or level 3 in the hierarchy, whose values are determined based on limited observable inputs or subjective financial models. TFS's investment book contains a proportion of investments in illiquid securities and these investments might entail larger tail risk in extreme market conditions and bring challenges to its risk management ability.

Rating Outlook

The stable outlook on TFS's rating reflects our expectation that the Company will maintain a strong market position in China's securities market. We also expect it to receive more support from its parent and the government in the next 12 to 18 months.

What could upgrade the rating?

The rating could be upgraded if (1) the willingness and ability of Hongtai Group and the Hubei Provincial Government to support the Company strengthen; (2) the Company's business profile improves and becomes resilient across market cycles with a stronger market position; and (3) the Company's credit metrics improve, such as pre-tax margin and risk to total assets ratio, on a sustained basis.

What could downgrade the rating?

The rating could be downgraded if (1) the willingness and ability of Hongtai Group and the Hubei Provincial Government to support the Company weaken; (2) the macroeconomics or capital market environment deteriorates significantly in China that harms the Company's profitability and asset quality; or (3) financial position weakens such as increase in leverage or eroded liquidity and funding.

Rating Methodology

The methodology used in this rating is the Rating Methodology for Securities Industry (August 2017).

Regulatory Disclosures

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http://www.ccxap.com/en/rating_services/category/6/

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