

## Credit Opinion

24 May 2023

Ratings	
Category	Financial Institution
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	A <sub>g</sub> -
Outlook	Stable

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## Tianfeng Securities Co., Ltd.

### Initial credit rating report

### CCXAP assigns first-time long-term credit rating of A<sub>g</sub>- to Tianfeng Securities Co., Ltd., with stable outlook.

#### Summary

The A<sub>g</sub>- long-term credit rating of Tianfeng Securities Co., Ltd. (“TFS” or the “Company”) 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) profitability that is subject to investment risk from the proprietary trading segment; (2) moderate but improving liquidity and funding position; 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. In February 2023, Hongtai Group became the controlling shareholder of TFS after receiving 5.99% shares from Hubei United Development Investment Group Co., Ltd. (“HUDI”). We see that relationship and operation linkage between Hongtai Group and TFS is becoming tighter.

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.

## Rating Drivers

- Established franchise in China's securities market
- Profitability that is subject to investment risk
- Moderate but improving liquidity and funding position
- Moderately high risk appetite as compared with other peers
- Strong government support after shareholder change

## Rating Sensitivities

### 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 materially because of a sizable increase in leverage or eroded liquidity and funding.

## Key Indicators

	2020FY	2021FY	2022FY
Total Assets (RMB billion)	81.4	96.6	98.2
Total Equity (RMB billion)	22.2	25.8	23.8
Total Revenue (RMB billion)	4.4	4.4	1.7
Net Profit (RMB million)	687.9	597.6	(1,455.5)
Pre-tax Margin (%)	20.4	15.9	(109.0)
Return on Assets (%)	1.1	0.8	(1.7)
Net Assets/Total Assets (%)	27.3	26.7	24.3
Risk Assets/Total Assets (%)	35.3	34.6	33.2
Liquidity Ratio (%)	121.4	119.9	150.5
Funding Ratio (%)	105.4	113.3	134.0

All ratios and figures are calculated using CCXAP's adjustments.  
Source: Company data, CCXAP research

## Corporate Profile

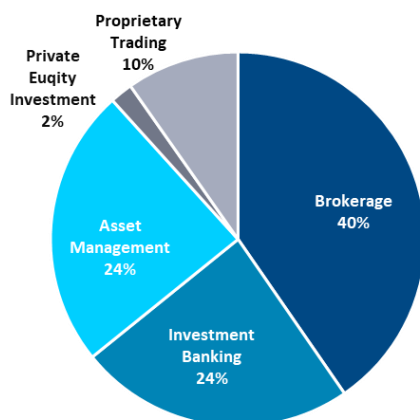
Founded in March 2000 and headquartered in Wuhan, TFS is a fast-growing medium-sized securities firm in Hubei Province. The Company was listed on the Shanghai Stock Exchange in October 2018 (Stock code: 601162.SH). Its principal businesses include brokerage, investment banking, asset management, research, private equity investment and trading. It 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 HUDI and became the controlling shareholder of TFS. The Hubei Provincial Government is the ultimate owner, holding TFS indirectly through

multiple state-owned enterprises, including Hongtai Group. As of 15 February 2023, Hongtai Group and the party acting in concert, namely Wuhan Trading Group Co., Ltd. (“Wuhan Trading”), held 22.62% of the shares of TFS in aggregate. Hongtai Group was the largest shareholder of TFS, directly holding 13.84% of the shares.

TFS reported total assets of RMB98.2 billion and net assets of RMB23.8 billion, as of 31 December 2022.

#### Exhibit 1. TFS’s revenue distribution in 2022



Source: Company information, CCXAP research

## Rating Considerations

### Mature capital market in China but competition intensifies in the securities sector

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 and 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.

Chinese regulators play an active role in the capital market and have adopted a series of measures to improve the efficiency and stability of the market. For example, in September 2021, the Beijing stock exchange was introduced with the goal of listing innovative companies and boosting the development of strategic emerging and high-tech industries. In December 2021, the Chinese government announced in the Central Economic Work Conference that the stock issuance registration system will be fully implemented on the main board, following its implementation in the Science and Technology Innovation Board and Growth Enterprise Market. This policy marks the lowering of the threshold for company listing and the increase in the initial public offering (IPO) business of securities companies. We expect that as the reform of the Chinese capital market continues, more policies will be introduced to provide a better operating environment for securities firms.

However, due to the intensified competition in traditional brokerage business in recent years, the brokerage commission rate of traditional brokerage business has shown a rapid downward trend. Since brokerage commissions are the main source of revenue for traditional securities firms, the intensified competition in the securities industry has led to continued strain on the margin of the Company's core business. In addition, affected by the COVID-19 pandemic, geopolitical tensions and the downfall of global economy, the Chinese capital market had experienced a great deal of uncertainty in the past few years. We do not expect market conditions to recover significantly in the short term, which may pose higher operational risks for traditional 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. The Company has also expanded its geographic footprint and become a national securities firm by holding branches, securities outlets, and a number of wholly owned or controlled subsidiaries across China. Diversified service and product offerings enable it to achieve synergies across different business lines and encourage it to develop Tianfeng Brand. The Company has grown rapidly over the past few years. Its total assets increased from RMB59.9 billion at end-2019 to RMB98.2 billion at end-2022, while its net assets increased from RMB17.5 billion to RMB23.8 billion. According to the Securities Association of China, the Company ranked 25<sup>th</sup> in terms of total assets and net assets in 2021, compared to 32<sup>nd</sup> and 41<sup>st</sup> in 2019.

As the key capital market service provider in Hubei, TFS has good access to different business opportunities brought by the economic growth of Hubei Province and its surrounding areas. We also expect that such advantage will be enhanced after Hongtai Group becomes the controlling shareholder of the Company. TFS will be able to enjoy the extensive network of Hongtai Group and leverage resources among the group, which is believed to strengthen the Company's market position in the near future.

From the perspective of the Company's segment distribution, securities brokerage, investment banking, asset management, and proprietary trading contributed most of its total revenue. TFS has altered its brokerage business strategy from traditional brokerage service to integrated financial services over the past few years. The Company shifted its business model from providing channel services and charging commission fees to providing customized services and tailor-made wealth management products. As of 31 December 2022, the Company's assets under management added up to RMB205.7 billion, and the total number of customers was nearly 1.7 million. The Company continues to promote the transformation from traditional brokerage business to innovative business, providing various customer-oriented products such as margin financing, stock options, online trading, stock pledged repo transactions, and agreed repurchase type securities trading.

TFS's proprietary trading is another major source of revenue, which is primarily derived from gains or losses from changes in the fair value of equity securities, fixed-income securities, and financial derivatives. Due to the high volatilities in the secondary market, the Company reduced the scale of equity and fund investment. The Company has a higher proportion of investments in illiquid assets such in trusts and asset management plans, which pose greater challenges to its risk management.

The Company also provides various investment banking services, such as IPO service, debt and equity financing, and corporate advisory. TFS has maintained a strong market position in both equity and debt capital markets. Moreover, the Company's diversified and innovative asset management product portfolios consist of equity, notes, funds, currencies, quantitative strategies, and non-standardized products.

## **Profitability that is subject to investment risk**

TFS is a fast-growing securities firm with increasing scale of business over the past years. However, 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 core businesses, particularly proprietary trading, recorded a significant decline during the broader economic slowdown and the revaluation on investment market in 2022. TFS's total revenue decreased by 60.9% YoY to RMB1.7 billion in 2022. Facing higher investment risk arising from market fluctuations, coupled with the misjudgement in timing of proprietary investment strategy, the Company had a drop in revenue from proprietary trading business to RMB382 million in 2022, representing a

YoY decrease of more than 80%. Its investments in associates and joint-venture also recorded a loss of RMB315.9 million in 2022. As a result, the Company reported a net loss of RMB1.5 billion in 2022, as compared to a net profit of RMB598.4 million in 2021 and RMB687.9 million in 2020.

The opening up of China's securities market may further heighten the competition among Chinese securities sectors and harm the profitability of medium-sized securities firms who are disadvantaged on price competition. TFS's return on assets, measured by net profit over average assets, turned negative in 2022, due to the higher asset impairment costs from its proprietary trading business segment, compared to 0.8% in 2021 and 1.1% in 2020. In the first quarter of 2023, the Company demonstrated good financial performance as underpinned by the broader market recovery and its strategic overhaul. It reported a total revenue of RMB1.4 billion, representing a YoY increase of 283%; and a net profit of RMB597.2 million.

### **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 33.2% as of 31 December 2022, comparing to that of 35.3% at end-2020. Risk assets are mainly measured by the financial assets reported as level 2 or level 3 in the hierarchy, which 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.

TFS intends to lower its risk appetite and further enhance its risk management framework. For example, it diminished the exposure to stock-pledged lending during fluctuations in the capital market. TFS's stock-pledged lending exposure greatly reduced to RMB40 million as of 31 December 2022, from RMB456 million at end-2021 and RMB1.5 billion at end-2020. It also disposed some of the underperforming investments to relieve the position in risk assets.

### **Moderate but improving liquidity and funding position**

TFS has a moderate but improving liquidity and funding position. The Company reported a liquidity ratio of 150.5% and a funding ratio of 134.0% as of 31 December 2022, increasing from that of 121.4% and 105.4%, respectively, at end-2020. TFS's liquidity is undermined by its large exposure to wholesales funding particularly in the bond market. Its refinancing may face volatility when market is under stress. The Company's short-term funding mainly consisted of financial asset repurchases and short-term debts from other financial institutions that are highly market sensitive. Nevertheless, the large scale of short-term funding can be mitigated by the Company's holding of certain liquid assets. For example, TFS held RMB12.3 billion in unrestricted cash (excluding segregated cash from brokerage clients), or 12.5% of its total assets as of 31 December 2022.

We expect that the Company's liquidity is supported by its listed status and proven record in the capital markets. In April 2021, TFS issued non-public offering shares and raised a total amount of RMB8.2 billion. We also expect the Company's liquidity will be improved as Hongtai Group becomes the largest shareholder, which will help TFS to acquire more stable funding sources and access to other financing channels.

### **External Support**

#### **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. In addition, if Hongtai Group fails to support TFS, it would bring reputational risks to the Hubei Provincial Government.

TFS is the major securities firm under Hongtai Group's development blueprint and has a significant strategic position in regional financial development. Hongtai Group has a controlling share in TFS, with the stakes from other single shareholders all below 5%. In May 2023, Hongtai Group intended to subscribe to a private placement of TFS for approximately 1.5 billion shares (representing 14.7% shares of TFS). After the private placement is completed, Hongtai Group will directly hold 26.54% of the shares of TFS, and jointly hold 34.03% of the shares with Wuhan Trading. The transaction is still pending for certain procedures and approval from regulators. We expect that Hongtai Group will increase its influence over TFS's business development and operations through its control of the board of directors.

Hongtai Group is the only financial holding company that is directly and wholly owned by the Hubei Provincial Government. It has a high strategic position in the implementation of government plans, with aims to serve the real economy, prevent financial risks, and deepen financial reforms. Hongtai Group holds and manages key financial assets on behalf of the Hubei Provincial Government, covering financial guarantees, distress asset management, banking, insurance, property exchange and equity management. It is one of the key shareholders of local financial institutions such as Hubei Bank Co., Ltd. Over the years, the Hubei Provincial Government has provided strong support to the Hongtai Group in terms of asset injections, capital injections, and equity transfers. As of 31 March 2023, Hongtai Group reported total assets of RMB183.4 billion.

## Rating Methodology

The methodology used in this rating is the [Securities Industry \(August 2017\)](#).

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