Credit Opinion

5 July 2024

Ratings	
Category	Financial Institution
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	A_g-
Outlook	Stable

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Tianfeng Securities Co., Ltd.

Surveillance credit rating report

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

Summary

The A_g- 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) 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. Hongtai Group is the controlling shareholder of TFS, with a direct holding of 13.84% and an aggregate 22.62% of stakes together with its party acting in concert. In June 2024, Hongtai Group announced to increase its shareholding in TFS through open market purchases over the next 12 months.

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 and investment risk that is subject to proprietary trading portfolio
- Moderately high risk appetite as compared with other peers
- Improved liquidity and funding position
- 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 such as increase in leverage or eroded liquidity and funding.

Key Indicators

	2021FY	2022FY	2023FY
Total Assets (RMB billion)	96.6	98.2	99.5
Total Equity (RMB billion)	25.8	23.8	24.6
Total Revenue (RMB billion)	4.4	1.7	3.4
Net Profit (RMB billion)	0.6	(1.5)	0.4
Pre-tax Margin (%)	15.9	(109.0)	9.4
Return on Assets (%)	0.8	(1.7)	0.5
Net Assets/Total Assets (%)	26.7	24.3	24.7
Risk Assets/Total Assets (%)	34.6	33.2	34.9
Liquidity Ratio (%)	119.9	150.5	165.2
Funding Ratio (%)	113.3	134.0	155.2

All ratios and figures are calculated using CCXAP's adjustments.

Source: Company data, CCXAP research

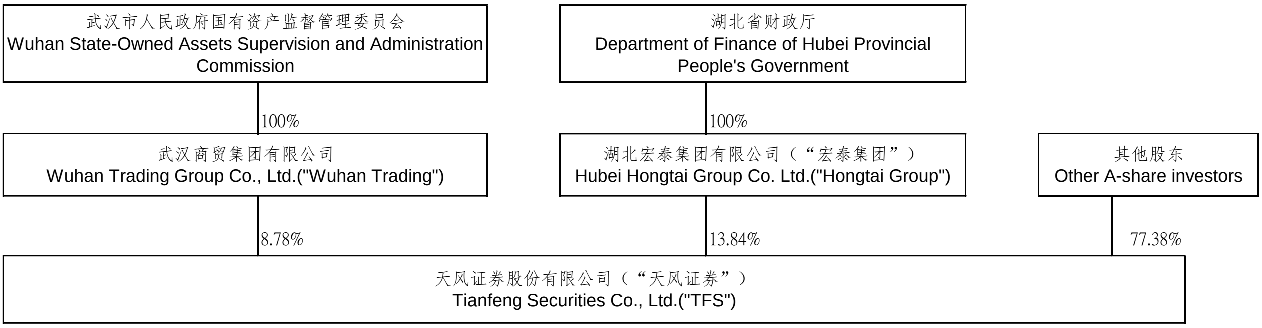
Corporate Profile

Founded in March 2000 and headquartered in Wuhan, TFS is a fast-growing medium-sized securities firm in Hubei Province 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.

TFS reported total assets of RMB99.5 billion and net assets of RMB24.6 billion, as of 31 December 2023.

Exhibit 1. TFS's shareholding structure as of 31 December 2023



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. 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.

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 to list innovative companies and boost the development of strategic emerging and high-tech industries. In February 2023, the China Securities Regulatory Commission ("CSRC") solicited opinions from the public on the main institutional rules for the full implementation of the stock issuance registration system, marking the reform of the stock issuance procedures. This policy marks lowering the threshold for company listing and is expected to escalate initial public offering ("IPO") activities in China. In April 2024, China's State Council has released a guideline on strengthening regulation, forestalling risks and promoting the high-quality development of the capital market. 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, the competition for traditional brokerage businesses remains intensified. The brokerage commission rate of traditional brokerage business has shown a downward trend, which constrains the margins of Chinese securities firms, including TFS. In addition, affected by the geopolitical tensions and the slowdown of the global economy, the Chinese capital market has experienced a great deal of uncertainty over 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 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.

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. Although the number of clients in the brokerage business grew steadily, the assets under custody and revenue of the brokerage business declined due to the market downturn. As of 31 December 2023, the Company's assets under custody added up to RMB195.4 billion, and the total number of customers was nearly 1.8 million. The Company continues to promote the transformation from the traditional brokerage business to an 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. The Company's investment portfolio grew steadily in 2023, with new investments dominated by debt instruments. The Company has a higher proportion of investments in illiquid assets such as 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 and investment risk that is subject to proprietary trading portfolio

TFS is a fast-growing securities firm with an increasing scale of business over the past years. However, the Company's financial performance is to a certain extent correlated with the changes in 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. In addition, its investments in associates and join-venture recorded a gain of RMB24.8 million in 2023.

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. TFS reported a loss in 2022, due to the higher asset impairment costs from its proprietary trading business segment. In the first quarter of 2024, the Company's revenue was reduced materially mainly due to lower investment as well as fee and commission income; and reported a loss in both net profit and total comprehensive income.

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.

TFS intends to lower its risk appetite and to further enhance its risk management framework. For example, it diminished the exposure to stock-pledged lending during fluctuations in the capital market. As of 31 December 2023, TFS's stock-pledged lending exposure was controlled at a low level of RMB99 million, compared to RMB456 million at end-2021. It also disposed of some underperforming investments to relieve the position in risk assets.

Improved liquidity and funding position

TFS has seen improved liquidity and funding position in recent years. The Company reported a liquidity ratio of 165.2% and a funding ratio of 155.2% as of 31 December 2023, increasing from that of 150.5% and 134.0%, respectively, at end-2022. It is underpinned by the significant increase in its cash position. TFS's liquidity is compromised by its large exposure to wholesale funding, particularly in the bond market. Its refinancing may face volatility when the 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 RMB17.6 billion in cash and settlement provision (excluding segregated cash from brokerage clients), or 17.7% of its total assets as of 31 December 2023. In terms of liquidity risk management metrics guided by China's regulatory, in 2023, TFS 's liquidity coverage ratio continued to rise and was far higher than the regulatory requirement; however, the net stable funding ratio remained relatively weak.

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. As of 31 December 2023, the Company has raised subordinated debts of RMB4.0 billion from Hongtai Group, with tenor of 5 years.

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%. We expect that Hongtai Group will increase its influence over TFS's business development and operations through its control of the board of directors. According to private placement announced in April 2023, Hongtai Group is expected to raise its stake to 26.54%, from 13.84%, after the planned subscription of RMB4 billion shares. The transaction is still subject to certain procedures and approval from regulators. According to the announcement of TFS in June 2024, Hongtai Group intends to expand its holdings of the Company via the open market by a minimum of RMB 500 million and a maximum of RMB 1 billion, within the following 12 months. To support TFS's development, Hongtai Group has already provided RMB4.0 billion of subordinated debt to TFS with the tenor of 5 years as of 31 December 2023.

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 December 2023, Hongtai Group reported total assets and net assets of RMB216.0 billion and RMB84.6 billion.

Rating Methodology

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

A credit rating is the analytical result of current credit worthiness and forward-looking opinion on the credit risk of a rated entity or a debt issue. Credit ratings issued by CCXAP are opinions on the current and relative future credit risk of the rated entities or debt issues, but do not address any other risks, including but not limited to liquidity risk, market price risk, and interest rate risk.

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