

Initiate Coverage

# Oi Wah Pawnshop Credit Holdings 1319 HK

## Prospects heating up for alternative lenders

- *Recommended Buy rating at target price of HKD3.0*
- *Oi Wah was the largest pawn loan service provider in Hong Kong in 2011, with a market share of ~9.4% for the year.*
- *Oi Wah is one of the few financing service providers in Hong Kong holding both pawnbroker and money lender licenses, allowing it to offer products and services including pawn loans, mortgage loans, and individual loans to customers.*
- *Oi Wah's total outstanding balance of loans and advances granted by licensed money lenders in Hong Kong increased at a four-year CAGR of 15.5% between 2008 and 2012. We expect it to continue growing at a four-year CAGR of 12.7% between 2013 and 2017.*

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### Stock Data (1319 HK)

Rating	BUY
Price (HK\$)	1.52
Target Price (HK\$)	3.0
12m Price Range (HK\$)	0.84-1.7
Market cap. (HK\$m)	608.0
Daily t/o (HK\$m)	5.9
Free float (%)	37.5
Source: Bloomberg	

**Largest pawnshop operator in HK:** Founded in 1975, Oi Wah Pawnshop Credit Holdings Ltd. is the largest pawnshop operator and one of the established one-stop shop credit providers in Hong Kong. Since 2009, the company began a mortgage loan lending business as well. While the company's pawn broking business has experienced steady growth in recent years, its mortgage loan lending business is expected to be its growth driver going forward. In our view, the government's cooling measures on the local property market will boost demand for mortgage loan products, providing significant expansion opportunities for money lenders such as Oi Wah.

**Profit has potential to grow at a CAGR of 76.2% over the next 3 years:** Between FY13A and FY16F we expect Oi Wah's earnings to increase at a three-year CAGR of 76.2% on the back of organic growth in its pawn broking business, strong demand for its mortgage loan products, and expansion in net interest margin (NIM) in its mortgage loan lending business. Excluding listing expenses, FY14F earnings of the company is projected to be HKD44.8m, representing an annualized growth rate of 97.3%.

**We initiated Oi Wah with TP of HKD3.0:** At HKD1.56 per share, the company is trading at 7.8x its projected FY15F EPS, or at a FY15F PE/G of 0.08x. We believe the company is undervalued given our projected three-year net earnings CAGR of 76.2% and its high earnings visibility. Based on an FY15F PEG of 0.15x, we arrive at our target price of HKD3.0 representing a potential upside of 93.5%.

**Table 1: Financials and Valuation**

	FY12A	FY13A	FY14F	FY15F	FY16F
<b>Turnover (HKD m)</b>	66.4	71.7	91.5	149.4	191.8
Turnover growth (YoY)	21.3%	8.1%	27.5%	63.3%	28.4%
<b>Operating profit (HKD m)</b>	40.1	31.1	54.5	119.0	161.3
Operating profit growth (YoY)	20.2%	9.0%	27.8%	61.4%	28.1%
<b>Net profit (HKD m)</b>	33.4	22.7	40.7	90.6	124.2
Net profit growth (YoY)	41.5%	-32.0%	79.3%	122.4%	37.1%
EPS (HKD)	0.1	0.1	0.1	0.2	0.3
DPS (HKD)	0.0	0.0	0.0	0.1	0.1
P/E (x)	13.7	20.0	15.1	7.6	5.5
Dividend Yield	-	-	2.0%	4.0%	5.4%

Source: SBI E2-Capital, Company data

## Investment Thesis

**Fast expanding industry:** Oi Wah's total outstanding balance of loans and advances granted by licensed money lenders in Hong Kong increased at a four-year CAGR of 15.5% between 2008 and 2012. Per estimates, the value of loans and advances granted by licensed money lenders should increase at a four-year CAGR of 12.7% between 2013 and 2017, reaching HKD50.0b in 2017. It is estimated that the total outstanding balance of loans and advances granted by licensed money lenders will increase by 16.1% YoY in 2014.

**Opportunities abound from government's cooling measures over property market:** The cooling measures on the HK property market introduced by the HKSAR Government have lowered the available liquidity in the property market, leading to a decline in property prices as well as an elongation of the selling process. Property owners may not be interested in selling their properties for financing needs. Further, guidelines introduced by the HKMA have brought difficulties to borrowers who wish to obtain property financing from authorized institutions. Borrowers who have difficulties selling their properties due to the imposition of the Special Stamp Duty (SSD) and the Buyer's Stamp Duty (BSD), or those who do not meet the additional requirements imposed by banks, may need to seek alternatives when obtaining financing. This will serve as a boost to demand for loan products offered by licensed money lenders.

**Largest pawn broker in HK:** According to an Ipsos Report, Oi Wah was the largest pawn loan service provider in Hong Kong in 2011 in terms of loan amounts granted and number of pawnshops. The aggregate amount of pawn loans granted by the company amounted to 9.4% of the total value of loans and advances granted by all pawn loan service operators in Hong Kong in 2011. The company has 12 pawnshops in various locations in Hong Kong including in commercial districts and in areas within residential clusters.

**One-stop shop credit provider:** Oi Wah is one of the few financing service providers in Hong Kong holding both pawnbroker and money lender licenses, allowing it to offer services and products including pawn loans, mortgage loans, and individual loans to customers.

**Pawn broking business supports operations:** Interest income generated from its pawn broking business has proven to be a stable source of revenue for Oi Wah, covering all its operating expenses. In FY10A, FY11A, FY12A, and FY13A, the company's operating expenses accounted for 58.3%, 61.4%, 51.8%, and 74.4%, respectively, of interest income generated from the company's pawn broking business. Between FY10A and FY13A, interest income generated from the company's pawn broking business increased at a three-year CAGR of 12.0%. We expect that going forward the organic growth in the company's pawn broking business will remain stable while its mortgage business will become the company's growth driver.

**Efficient operations:** As of the end of August 2013, the company had 55 staff members, with total staff costs, including directors' emoluments for the period, amounting to HKD9.0m. Operating income for the same period was HKD44.2m, with staff costs accounting for only 20.4% of the company's operating income. As the company has a well-developed operations platform and experienced staff who can handle the rapid expansion in its business, Oi Wah is not likely to increase its investment in wage expenses.

**Sufficient funding:** Oi Wah's sources of funding include: 1.) Its equity and retained earnings; 2.) a loan from shareholders; and 3.) a bank loan and overdraft. Following its IPO in March 2013 and a top-up placement in February 2014, the company raised about HKD155.0m. Further, major shareholders have agreed to provide a shareholders' loan of HKD100.0m to the company in FY14F. The company is expected to obtain loan and standby facilities of about HKD110.0m from the banks in 2014. Based on our forecasts, the company's retained earnings will reach HKD168.1m by the end of FY14F. Consequently, when including the aforementioned increase in equity, we expect the company to amass resources of more than HKD690.0m from its lending business.

**'Listed' status has helped:** Following its IPO on the HKEx Main board in March 2013, Oi Wah improved its fund raising capability and expanded its sources of funding. The company now can more readily obtain credit facilities from banks thanks to its public company status, as well as raising capital via equity markets.

**Broad client base:** In FY13A and 1H FY14A, the pawn loans granted by the company were HKD541.6m and HKD254.1m, respectively. The average transaction amount for both FY13A and 1H FY14A were HKD3,900.0, implying the respective number of transactions for the two periods to be 138,872 cases and 65,154 cases. For its mortgage business, the number of transactions for FY13A and 1H FY14A were 84 cases and 99 cases, respectively. The aforementioned figures suggest that the company has a broad customer portfolio which cover individuals who have immediate need for cash, high net-worth individuals and households, and SMEs with properties.

**Mortgage lending expected to be growth driver of company's bottom line:** Between FY10A and FY13A, the interest income generated from the company's mortgage business increased at a three-year CAGR of 270.1%. In 1H FY14A, interest

income from mortgages surged 348.3% YoY to HKD13.0m. In 1H FY14A, the company's number of mortgage loans granted surged more than two-fold to 99 transactions from 29 transactions in the corresponding period last year. Oi Wah's mortgage business is expected to be the company's major earnings growth driver with the interest income of the mortgage business receiving a boost from increases in net interest margin and from alternative sources of funding.

**NIM on mortgage loans has room to grow:** Net interest margin (NIM) on secured loans granted by First Credit (8215 HK) was 15.5% for the period ended December FY12A. NIM for HK Finance's (1273 HK) property mortgage loan business increased to 20.6% for the period ended August 1H FY13A from 18.8% for the corresponding period in the previous year. During the same period, HK Finance's NIM on first property mortgage loans and subordinate property mortgage loans were 15.3% and 25.1%, respectively. Compared to its listed peers, the NIM on the company's mortgage loan business was 13.5% only for 1H FY14A. We expect the NIM of the division to expand based on stronger demand and the company granting more subordinate property mortgage loans with much higher effective interest rates.

**Table 2: NIM on the group's loan portfolio**

NIM (%)	FY10A	FY11A	FY12A	FY13A	1H FY14A
Pawn loan	42.4	42.9	42.1	43.5	43.5
Mortgage loan	9.0	9.9	12.7	12.5	13.5
Overall	41.5	40.5	37.2	34.0	26.3

Source: Company data

**Experienced management team:** The senior management team of the company has more than 39 years of experience in the finance and credit industry in HK. For example, Mr. Chan Chart Man, founder and Executive director of Oi Wah, has over 37 years of experience in finance and pawn loaning. Chairman Chan Kai Ho Edward has over 12 years of experience in business management and pawn loaning, and is currently the chairman of the Hong Kong and Kowloon Pawnbrokers Association Limited and honorary chairman of the Macau General Chamber of Pawnbrokers.

**High earnings visibility and transparency:** The company's business model is simple: With more fund inflows, it can grant more loans and earn more interest income. Its operations are just as simple and proven to be efficient. Further, the company is required to announce when it enters into sizeable loan transactions providing an added level of transparency.

## Business Overview

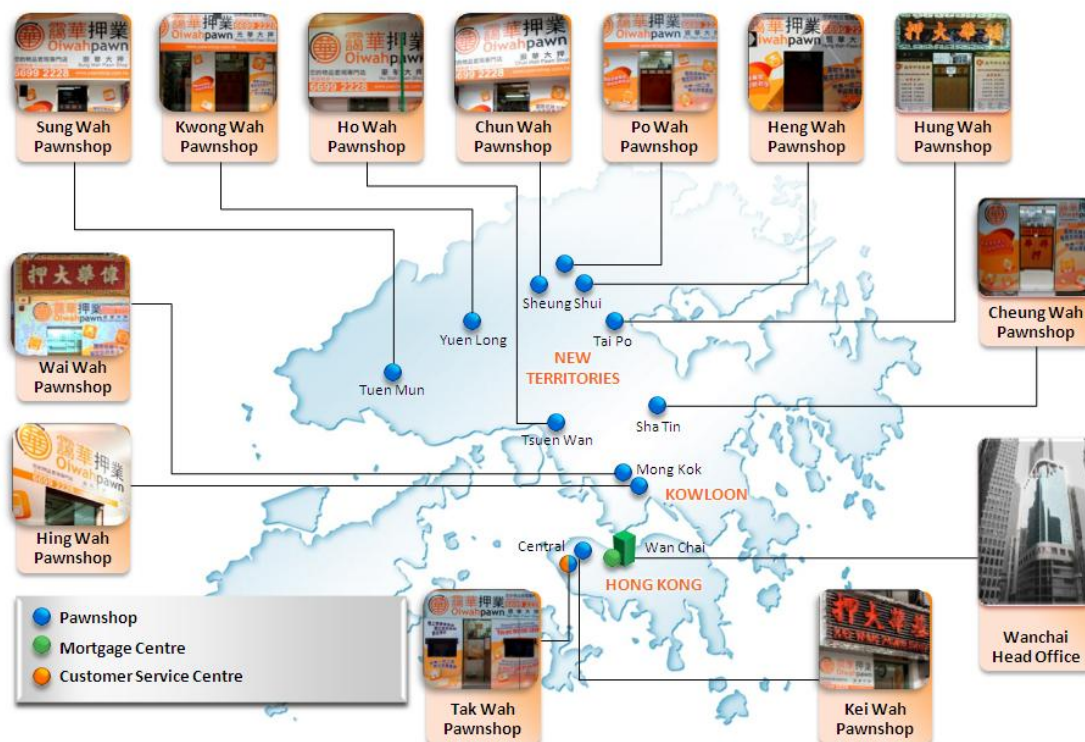
### Pawnshop division

Pawn loans are loans provided whereby personal property, such as gold, jewelery, diamonds, watches, and consumer electronic products are used as collateral to secure a specified loan amount.

According to an Ipsos Report, Oi Wah was the largest pawn loan service provider in Hong Kong in 2011 in terms of loan amounts granted and number of pawnshops. The aggregate amount of pawn loans granted by the company amounted to approximately 9.4% of the total value of loans and advances granted by all pawn loan service operators in Hong Kong in 2011.

Oi Wah's first Pawn shop was established in Hong Kong in 1975. The company has developed a network of pawnshops with 12 shops in various locations in Hong Kong including in commercial districts and in areas within residential clusters. The company has set up a customer service center on the premises of Tak Wah Pawn shop located in Central to provide customers with private and personalized pawn loan services and customer service support.

**Table 3: Pawn shop network**



Sources: Company data

**Dual licenses provide flexibility:** Under the pawnbrokers ordinance, it is stipulated that interest rate charges shall not exceed 3.5% per lunar month for any pawn loan amount not exceeding HKD100,000. Conversely, the money lenders ordinance does not impose a limitation on the loan amount granted, but stipulates that the effective rate of interest charged on loans granted shall not exceed 60.0% per annum. Oi Wah is one of the few financing service providers in Hong Kong having both a pawnbrokers license and a money lenders license which provides the company with the flexibility in granting pawn loans with different interest rates, loan amounts, and terms to suit the different needs of its customers, and also enables the company to issue mortgage loans.

**Table 4: Terms of the pawn loans granted on pawnbrokers license and money lender license**

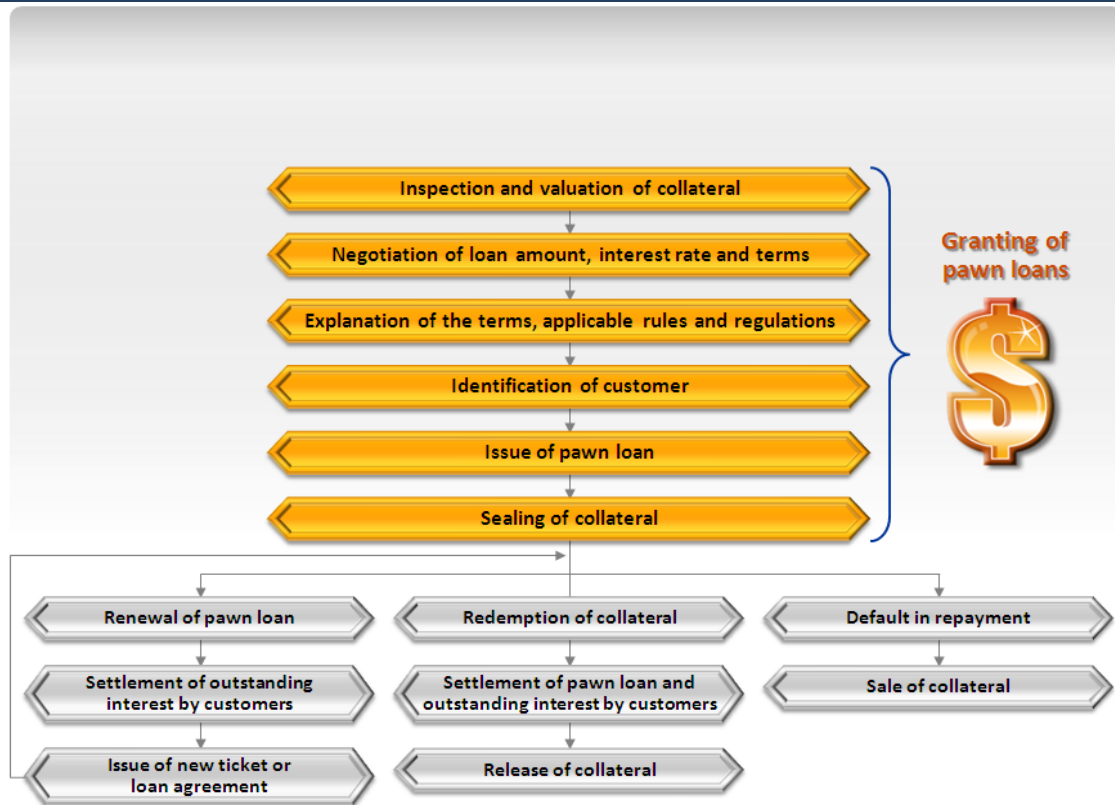
	Pawnbrokers License	Money Lenders License
Loan amount	Not exceeding HK\$100,000	No restriction
Interest rate	Not exceeding 3.5% per lunar month	Not exceeding 3.5% per lunar month
Term	Four lunar months	Mutually agreed term of one to four lunar months
Documentation	Tickets	Loan agreements

Sources: Company data

**Tenure of pawn loan:** Oi Wah generally provides terms for four lunar months at an interest rate of 3.5% per lunar month to its customers for pawn loans not exceeding HKD100,000. During the term of the pawn loan, customers may redeem their collateral at any time by repaying the loan amount and the outstanding interest. Customers may also renew the terms of their pawn loans after paying the outstanding interest for the previous term. Upon the expiry of the pawn loans, the collateral becomes the property of the pawnbrokers assuming the terms of the loan were not redeemed or the loan was not renewed. The company may sell the collateral that was not redeemed.

**Loans granted under money lenders license:** Its money lenders license has been providing Oi Wah flexibility in granting pawn loans with different interest rates, loan amounts, and terms, such as loans exceeding HKD100,000 to its customers. The company's money lenders license allows it to carry on money lending at each of its pawnshops. Pawn loans granted under the money lenders license are also secured by personal property. The procedures for granting such pawn loans are similar to that for granting pawn loans pursuant to its pawnbrokers licenses.

**Table 5: Pawn loan business model**



Sources: Company data

**Pawn loan procedures:** When a customer presents collateral at an Oi Wah pawnshop, the staff at the shop will examine the physical collateral in accordance with internal procedures. The staff will check the genuineness and condition of the collateral, as well as question the source of the collateral presented. Upon the satisfaction of the above, the staff will then value the collateral in accordance with Oi Wah’s internal standards.

Upon inspection and valuation of the collateral, Oi Wah will offer a loan amount to the customer. The customer may negotiate with the staff at the pawnshop the actual offered loan amount, and the pawnshop may adjust the loan amount offered with reference to the credibility of the customer and the associated loan amount. The pawnshop will also lower the loan amount to suit the customer’s needs. The loan amount Oi Wah’s pawnshop offers to customers is always lower than the valuation of the collateral.

Staff at Oi Wah’s pawnshops will explain to the customers the terms of the pawn loan and the applicable rules and regulations in Hong Kong in connection with pawn loans, including but not limited to, the term of the pawn loan, the calculation of interest, the renewal method, and the consequences of default in repayment.

In the event that the customer accepts the loan amount and terms offered by Oi Wah’s pawnshop, the staff will check in its internal database to see if the collateral is an unlawful good and whether the customer has been blacklisted. The customer is required to present his identification documents to staff at the pawnshop before the issuance of the pawn loan. Information such as the customer’s name, number of identification document, residential address, details of collateral, amount of pawn loans granted, date of grant, expiry date, and ticket or loan agreement number are all entered into Oi Wah’s computer system.

Two staff members at the pawnshop will check the accuracy of the information on the ticket or in the loan agreement and the amount of the pawn loan before handing the ticket or loan agreement and the cash over to the customer. The ticket or loan agreement presents information such as name, identification number and residential address of customer, loan amount granted, collateral, and date of expiry.

The customer is required to sign the seal of the plastic bag in which his/her collateral will be stored in the shop until the conclusion of the loan transaction. The seal is one-off in nature and unless the collateral is redeemed by the customer or is being sold by Oi Wah’s pawnshop upon default of repayment of the pawn loan, the plastic bag will not be opened after it is sealed. The sealed plastic bag containing the collateral will be placed together with the relevant ticket or loan agreement and stored in a safe within the relevant pawnshop.

Before the end of the term of the pawn loan, the customer may return to the relevant pawnshop to apply for a renewal of the pawn loan. Customers are required to present the ticket or loan agreement, and pay the outstanding interest calculated on a lunar monthly basis. A new ticket or loan agreement with a new expiry date and bearing the same terms as the previous pawn loan will be issued to the customer.

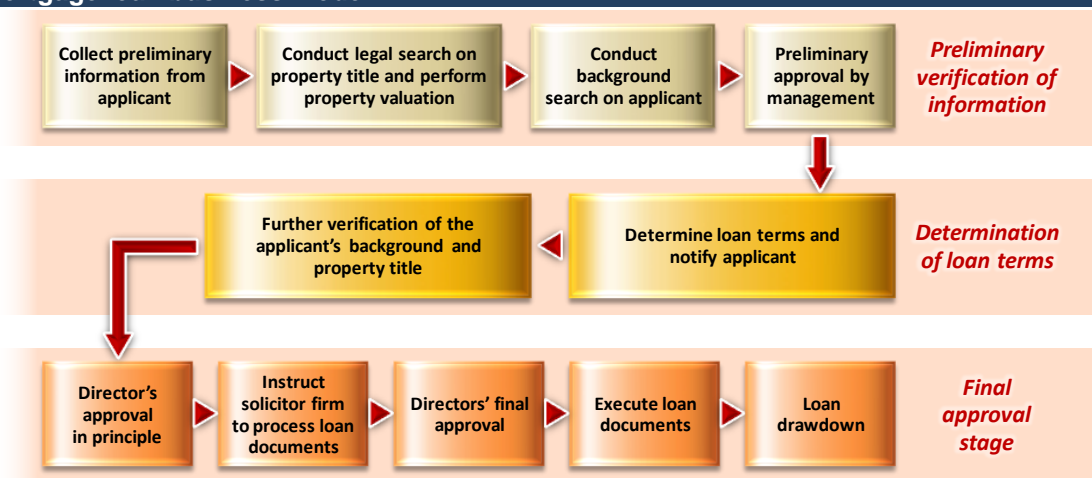
On or before the expiry date of the pawn loan, the customer may redeem his/her collateral from the relevant pawnshop by presenting the ticket or loan agreement and repaying the amount of the pawn loan together with the outstanding interest calculated on a lunar monthly basis. The staff at the relevant pawnshop will then return the collateral to the customer.

By the end of the term of the pawn loan, if the customer has not redeemed the collateral or renewed the pawn loan it will be assumed that the customer has defaulted on the repayment of the pawn loan. At the sole discretion of the company, a grace period of up to six weeks may be provided to customers after the end of the loan period during which the company's relevant pawnshop may allow the customer to renew the pawn loan and/or redeem their collateral. In case the collateral is not redeemed or the loan is not renewed before the expiry of four lunar months, the collateral shall become the property of the pawnbroker. The company will proceed to dispose of or sell the collateral.

### Mortgage loan services

The company's mortgage loan business operates under its money lenders license. It serves its mortgage loan customers at its mortgage centre in Wan Chai, offering both first mortgage loans, which are secured by the first mortgage on the real estate in question, and subordinated mortgage loans, which are secured by mortgages subordinated to the first or higher ranking mortgages charged on the mortgaged real estate. The mortgaged real estate accepted by the company include residential properties such as apartments, village houses, and commercial real estate such as parking lots and offices, and its mortgage loans are offered to both individuals and corporate customers.

**Table 6: Mortgage loan business model**



Sources: Company data

**Preliminary verification of information:** After receiving the applicant's information in relation to the real estate to be mortgaged and the requested amount of the loan, staff of the company will obtain proof of identity, background, and contact details from the applicant. Staff will also conduct a background search, credit search, and bankruptcy and insolvency searches of the applicants. For applications of subordinated mortgage loans, details on the status of repayment and outstanding loan amount under the first mortgage, and copies of bank statements and bank books will also be obtained from applicants. In the event that the shop's staff considers a personal guarantee to be required for a mortgage loan, the staff will obtain information regarding the financial background of the guarantor and will conduct a credit search and bankruptcy and insolvency searches against the guarantor. If necessary, the staff may consult an independent surveyor firm for preliminary valuation of the real estate to be mortgaged. Such information will then be submitted to the management of the company for preliminary approval. The company does not accept real estate that is located outside Hong Kong as pledges.

**Determination of loan terms:** Executive directors will determine the offer terms of the mortgage loan, such as the amount and the interest rate of the loan and the period of repayment, considering the applicant's background and other factors such as:

- tenure of the loan;
- encumbrances on the mortgaged real estate;
- liquidity and marketability of the mortgaged real estate;
- the outstanding loan from the first mortgage loan, in the case of subordinated mortgage loans under application;
- the status of repayment of the first mortgage loan, in the case of subordinated mortgage loans under application; and
- valuation of the mortgaged real estate.

The company places strong emphasis on the valuation of the mortgaged real estate in determining the loan terms. It will also make reference to the prevailing market terms offered by competitors of similar scale in Hong Kong in order to stay competitive.

**Final approval stage:** After receiving the customer's acceptance of the offer letter in response to the company's letter of confirmation, executive directors will perform further credit assessment of the applicant and approve the application if they think the borrower and the real estate being pledged both pass the associated tests. In some cases, the company will engage surveyor firms to prepare valuation reports when necessary. The company's staff may also conduct on-site visits to the real estate in question to examine its condition if and when necessary.

The company will then appoint a solicitor firm to process the legal documents in relation to the mortgage loan and notify the customer of the loan approval after Oi Wah is informed of the good standing of the titles of the real estate. The drawdown of the loan will then be subject to the signing of the mortgage loan agreement and any other related documents prepared by the solicitor firm.

To ensure the repayment ability of both corporate customers and elderly customers, the company may also require a personal guarantee from the company's directors and ultimate shareholders and a third party for elderly customers. The company generally grants first mortgage loans with a loan-to-value ratio of no more than 75.0% of the market value of the real estate. In connection with the grant of subordinated mortgage loans, the loan-to-value ratio with respect to the outstanding primary mortgage loan amount and subordinated loan amount will generally not in aggregate exceed 75.0% of the market value of the real estate and will also depend on the company's assessment on the repayment capacity of the borrower.

### **Key features of typical mortgage loan agreements**

**Repayment of loans:** Borrowers are required to settle their outstanding loans by monthly installments generally in check form, and the company will deposit the relevant check on the designated date of the month.

**Early repayment:** The company allows early repayment or partial repayment during the repayment period for mortgage loans. In some cases, the company may charge the customer a handling fee ranging from 1% to 12% of the loan amount and the company may require the customers to bear the legal and valuation costs associated with early repayment. The company will arrange for the redemption of titles of the underlying real estate when it has received the relevant fees and the total outstanding repayment amounts.

**Late payment:** For any payment of a loan, interest, or fees that a customer is unable to pay as they come due, the company reserves the right to demand immediate repayment of the loan with interest and to enforce its rights as the mortgagee to sell the underlying real estate. If the customer fails to pay the monthly mortgage installments for three days after the due date and the company's staff has exhausted various means to follow up on the late payment, the customer is considered to have defaulted on the repayment of the loan. The customer is generally required to pay a sum of up to HKD1,000 as an administrative fee.

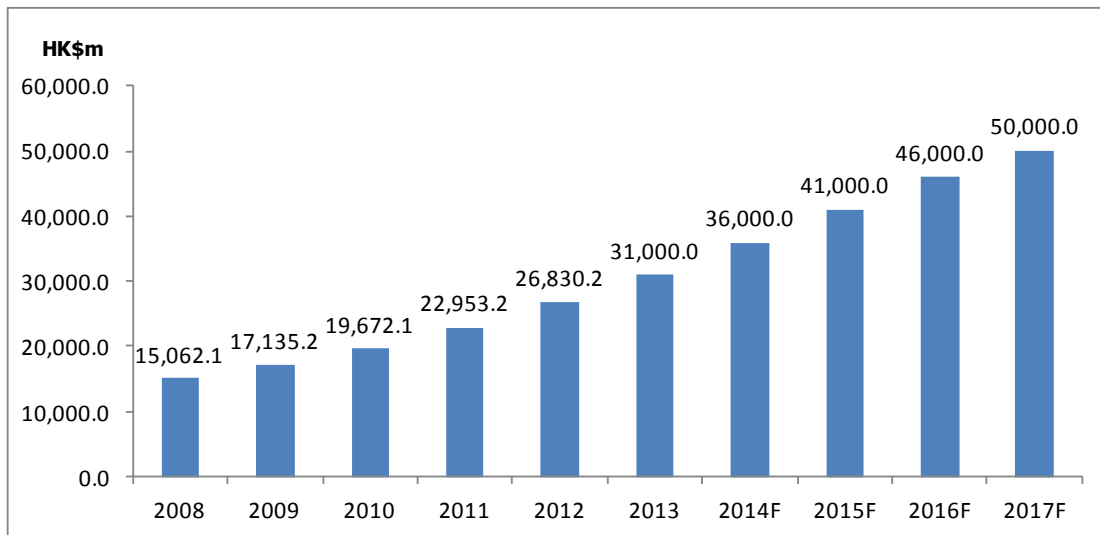
**Top-up mortgage:** The company's loan agreements do not restrict customers to top-up their mortgage with the company. A new set of loan agreements will be entered into between the customers and the company which may or may not come with the same terms of the original loan documents.

**Administrative, legal, and valuation fees:** Customers shall bear the legal and valuation fees under circumstances in which: (i) the loan amount is less than HKD500,000; or (ii) the term of the loan is less than six months. The company also charges customers administrative fees for such loans that are not drawn within 45 days after the loan agreements are executed and such administrative fees are usually equivalent to the monthly interest of the loans offered.

## Industry Overview

**Double-digit growth in HK money lending industry:** The money lending industry in HK has experienced double digit growth for the past five years. The total outstanding balance of loans and advances granted by licensed money lenders (excluding margin financing by securities brokers) increased at a four-year CAGR of 15.5% between 2008 and 2012. Per estimates, the value of loans and advances granted by licensed money lenders will increase at a four-year CAGR of 12.7% between 2013 and 2017, reaching HKD50.0b in 2017. It is estimated that the total outstanding balance of loans and advances granted by licensed money lenders will increase by 16.1% YoY in 2014.

**Table 7: Outstanding balance of loans granted by licensed money lenders (ex-margin financing)**



Sources: Euromonitor International estimates and various sources of information

**Overview of money lending industry in HK:** As of the end of October 2013, there were 156 licensed banks, 21 restricted licensed banks, 24 deposit taking companies, and 1,088 licensed money lenders in Hong Kong. Between 2007 and 2012, the number of licensed money lenders in Hong Kong increased at a five-year-CAGR of 5.8%, from 741 in 2007 to 984 in 2012.

The licensed money lending market remains fragmented as only a fraction of all 1,088 licensed money lenders are mid- or large-sized establishments and many of which are small-sized. Other forms of money lenders are lending arms of securities brokerages or finance companies which lend only to their existing clients for stock transactions.

The number of small-sized licensed money lenders typically fluctuates. Due to their relatively small client and capital bases and limited sources of funding, many of them cannot survive the intense competition within the industry. On the other end of the spectrum, as mid- and large-size licensed money lenders have sizable client bases and sufficient capital and sources of funding, they tend to remain more stable in number.

**Products offered by licensed money lenders:** Licensed money lenders in Hong Kong offer both secured and unsecured loans to address the financing needs of both individual and corporate clients. They offer a variety of loan products which are broadly categorized by type of borrower and whether or not collateral is pledged against the loan. Offer terms vary on a case-by-case basis on such factors as borrower profile, credit history, asking quantum, collateral pledged, repayment preferences, and prevailing market interest rates. Major types of loan products are described as follows:

**Property mortgage loans:** A property mortgage loan is a loan secured by property, wherein the issuing licensed money lender holds the property deed or title until receipt of the full repayment inclusive of interest and other administration fees. In the event of default, the loan provider can seize the property and sell it to settle the borrower's outstanding debt. Normally the loan taken to finance the initial purchasing of the property itself is known as the first mortgage, and the subsequent loan is known as the subordinate mortgage. In the event of a default, creditors will be paid in sequence. Lenders thus associate subordinate mortgages with higher risks and in turn charge higher interest rates as a form of compensation. In Hong Kong, most first mortgages are provided by authorized institutions.

**Individual loans:** Most of the individual clients of licensed money lenders have immediate financing needs. Since some of them do not possess valid proof of income or assets that could serve as collateral for secured loans, or they have poor credit



histories, they are lacking in access to financing from authorized institutions such as banks. Licensed money lenders offer loan products to individual clients with terms between six to twelve months with some as short as a single month. Licensed money lenders charge higher interest rates on individual loans to compensate the higher risk assumed.

**Corporate loans:** SMEs and corporations who are unable to access capital markets through authorized institutions due to higher loan default and delinquency risk turn to licensed money lenders as an alternative source of financing. Similar to individual clients, business clients may be new or facing liquidity issues, and hence are unable to meet requirements of authorized institutions. Loans taken up by corporations for their business needs tend to be of a larger amount and hence are backed by collateral. Thus, it is common for businesses to take out collateral loans against their properties, accounts receivables, shares or invoices, among others assets on hand. Loans sought may be used to manage short-term operational cash flows, for the purchase of equipment and facilities, or for general business expansion. Loan-to-value ratios offered by licensed money lenders are more favorable than those of authorized institutions.

**Banks vs. money lenders:** Loans granted by authorized institutions (e.g. licensed banks, restricted licensed banks, deposit taking companies) account for more than 99.0% of the total outstanding balance of loans and advances granted in Hong Kong. Authorized institutions are subject to the supervision of the HKMA and regulations under the Banking Ordinance. While the authorized institutions are able to receive deposits from customers as one of the sources of funding for their money lending business, the HKMA imposes restrictions on authorized institutions regarding the provision of credit facilities to borrowers.

On the other hand, licensed money lenders and regulations over money lending transactions are governed by the Money Lenders Ordinance. Anyone wishing to carry out business as a money lender must apply for a license from the Licensing Court. In contrast to authorized institutions, licensed money lenders enjoy greater flexibility and autonomy in operational options in terms of loan sizes, requirements of proof of income, ranges of collateral acceptable for securing loans, and loan-to-value ratios. They also offer increasingly sophisticated products and services and are therefore well-positioned to cater to the urgent needs of individuals and SMEs.

Licensed money lenders play an important role in supporting the credit needs of Hong Kong's businesses and individuals. Potential borrowers with urgent and large financial needs may find it difficult to meet the application criteria of authorized institutions. Loan application criteria through licensed money lenders are less strict. Sometimes, borrowers are not even required to present their income statements as licensed money lenders focus directly on borrower creditworthiness and repayment ability. Since licensed money lenders are themselves responsible for managing risk exposure, the threshold for such factors as loan-to-value (LTV) ratio and loan-to-salary ratio are set internally. Overall, the threshold of money lenders is set higher than that of authorized institutions to maintain competitiveness.

### **Opportunities arise from government's cooling measures**

**Government's measures imposed on property transactions:** To curb speculation in the local property market, the HKSAR Government introduced cooling measures on real estate transactions, including:

- the Buyer's Stamp Duty (BSD) in October 2012, which imposed an extra 15% charge on the stated consideration or market value of the property for residential properties acquired by any persons, including corporate buyers, except for permanent residents of Hong Kong; and
- the introduction of the Special Stamp Duty (SSD) first in November 2010 and further extended in October 2012 on residential properties of all values at the point of resale if the properties are resold within a certain period of time of acquisition.

**HKMA's measure on provision of mortgage loans:** HKMA has also introduced tighter measures on the provision of mortgage loans by authorized institutions, including stricter application requirements, lower debt servicing ratios (DSR), and lower loan-to-value (LTV) ratios for certain applications of mortgage loans for commercial and industrial properties. For stress testing on mortgage loan applicants' affordability, it advises to lift the debt servicing ability to 3.0% from 2.0%. Further it advises to lower the LTV ratio on mortgage loan applications for non-residential property by 10.0%. It also imposes a limit on the maximum LTV ratio and DSR ratio for standard car park space mortgage loans to the level applicable to non-residential property mortgage loans and to limit the maximum mortgage loan tenure for car park space to 15 years.

**Effects of the measures:** The number of residential mortgage loans made and the aggregate gross loan amount had been decreasing since 2010. In particular, the number of residential mortgage loans made fell by approximately 19.9% from 95,854 in 2011 to 76,743 in 2012, whilst the aggregate gross loan amount recorded a 15.8% decrease from approximately HKD227.8b in 2011 to HKD191.9b in 2012. This is in line with recent efforts of the Hong Kong Government to curb speculation on the property market, which began with the introduction of the Special Stamp Duty (SSD) in November 2010. Following the increase of SSD measures and the imposition of the BSD on all residential properties acquired by non-permanent residents and on all corporate purchases in the 4Q of 2012, transactions in the property market slowed and relevant price growth

moderated towards year-end 2012. The total number of sale and purchase agreements registered in 2012 fell by 4.0% to 81,333 compared to that in 2011. According to the September 2013 issue of the HKMA's "Half-yearly monetary and financial stability report", housing prices of residential properties in Hong Kong have softened and transaction volume has declined noticeably since February 2013 following the introduction of the ad valorem stamp duty and more prudent measures by the Hong Kong Government and the HKMA.

**Opportunities for money lenders:** Since both the SSD and the BSD have lowered liquidity in the property market, leading to a decline in the property prices as well as elongating the selling process, property owners may not be interested in selling their properties for financing needs since overall selling opportunities in the property market have become less attractive. Further, measures introduced by the HKMA have brought difficulties to borrowers who wish to obtain financing from authorized institutions such as banks. Borrowers who have difficulties selling their properties due to the imposition of the SSD and BSD, or those who do not meet the additional requirements imposed by banks may need to seek alternatives for obtaining financing. This increased demand will boost demand for the loan products and services offered by licensed money lenders.

## Financial Analysis

Between FY10A and FY12A, the company's net earnings increased at a two year CAGR of 28.5%, from HKD20.2m to HKD33.4m. The company's net earnings for FY13A dropped 32.0% YoY to HKD22.7m, mainly due to listing expenses incurred in FY13A of HKD11.2m. Excluding such expenses, the company's net earnings are HKD33.9m. The company's revenue and net earnings income increased by 19.3% YoY and 28.7% YoY, respectively, to HKD42.0m and HKD15.1m for 1H FY14A. We expect the company's earnings to increase by 79.3% YoY to about HKD40.7m. Excluding its IPO listing expenses of HKD4.9m recognized in FY14F, the company's net earnings is projected to be HKD44.8m. Earnings for FY15F and FY16F are projected to be HKD90.6m and HKD124.2m, respectively. The company's projected three-year net earnings CAGR between FY13A to FY16F is expected to be 76.2%.

Our projections are mainly based on assumptions about the company's interest income, which is affected by demand for the company's loan products, composition of its loan portfolio, net interest margin, and its sources of funding. Our projections are subject to risks including changes in the general economy, change in the company's cost of funding and sources of funding, and the prospective changes in government and HKMA policies on the local property market.

**Interest income:** Between FY10A and FY13A, the company's interest income increased at a three-year CAGR of 16.9%, from HKD40.5m to HKD64.7m. Three-year CAGR of interest income generated on mortgage loans for the period was 270.1%, against a three-year CAGR of interest income generated from pawn loans for the period of 12.0%. Respective three-year CAGRs of interest income on mortgage loans, pawn loans, and total interest income are projected to be 120.5%, 19.9%, and 41.5%, respectively, for the period between FY13A and FY16F.

### Revenue breakdown

**Table 10: Revenue breakdown**

	FY10A (HK\$m)	FY11A (HK\$m)	FY12A (HK\$m)	FY13A (HK\$m)	FY14F (HK\$m)	FY15F (HK\$m)	FY16F (HK\$m)
Interest earned on loan receivables							
-Pawn loans	40.4	45.3	52.4	56.7	59.5	85.8	97.9
-Mortgages	0.2	0.8	3.2	8.0	29.4	55.9	85.3
<b>Total interest income</b>	<b>40.5</b>	<b>46.1</b>	<b>55.5</b>	<b>64.7</b>	<b>88.9</b>	<b>141.8</b>	<b>183.1</b>

Source: The Company and SBI forecasts

**Loan portfolio composition:** The company started its mortgage loan business in FY10A. Between FY10A and FY13A, the company's mortgage loan portfolio increased at a three-year CAGR of 239.5%. As of the end of FY10A, mortgage loans accounted for 3.1% of the company's total loans receivable, with its share reaching 49.2% as of the end of FY13A. We expect the proportion of mortgage loans receivable within the company's total loans receivable to reach 73.9% as of the end of FY14A. For FY15F and FY16F, the proportion of mortgage loans receivable within the company's total loans receivable are both assumed to be 70.0%.

### Loan receivable:

**Table 11: Loan Receivable**

	FY10A (HK\$m)	FY11A (HK\$m)	FY12A (HK\$m)	FY13A (HK\$m)	FY14F (HK\$m)	FY15F (HK\$m)	FY16F (HK\$m)
Pawn loans	91.1	102.8	118.0	117.3	135.1	194.9	222.2
Mortgages	2.9	22.2	32.6	113.5	383.1	454.7	518.5
Unsecured loans	0.6	0.6	0.5	0.0	0.5		
<b>Gross loan receivables</b>	<b>94.6</b>	<b>125.6</b>	<b>151.1</b>	<b>230.8</b>	<b>518.7</b>	<b>649.6</b>	<b>740.7</b>

Source: The Company and SBI forecasts

**Net interest margin:** Since the NIM on mortgage loans is on average about 30ppts lower than that on pawn loans, the company's net interest margin inevitably dropped to 34.0% for FY13A from 41.5% for FY10A. As we assume the proportion of mortgage loans receivable to total loans receivable to reach 73.9% as of the end of FY14F, we expect the company's overall NIM to drop to 21.8% for FY14A from 34.0% for FY13A. Nevertheless, we expect the company's overall NIM to improve to 23.0% for FY15F and further to 26.3% for FY16F, on the enhancement of mortgage loan NIM. NIM of the company's mortgage loans granted for FY13A and 1H FY14A were 12.5% and 13.5%, respectively. We estimate the NIM of mortgage loans granted by the company to increase to at least 18.8% for both FY15F and FY16F, as the company is expected to grant more

subordinate property mortgage loans with much higher effective interest rates. A 1ppt increase in NIM on mortgage loans granted will increase the FY15F net earnings by 3.5ppts.

**Sources of funding:** Funding for the company's money lending business in FY14F, FY15F, and FY16F are expected to amount to HKD690.0m, HKD698.7m, and HKD775.2m, respectively. The company's sources of funding include cash flow generated from operations, HKD155.0m raised from equity markets via IPO and private placement in FY14F, a shareholders loan of HKD100.0m, and standby banking facilities and a bank loan of HKD110.0m. Only 15.9% of the company's funding bears any additional cost, thus, by our estimation, the company is less vulnerable to interest rate fluctuation at this stage. Further, the company's fund raising capability improved and its sources of funding expanded following its IPO on the HKEx Main board in March 2013. The company now can more readily obtain credit facilities from banks thanks to its public company status, enabling the company to raise funds via equity markets.

**Financial ratios:** As of the end of February 2013, the company was in a net debt position of about HKD49.1m. The company's current ratio and gearing ratio were about 3.0x and 35.5%, respectively. We expect at the end of February 2014 for the company's net debt to reduce to about HKD24.2m as the company raised HKD155.0m from equity markets in FY14F. Its current ratio is expected to improve significantly to 6.4x, and its gearing ratio is projected to improve to 35.7%.

**Return on equity:** For FY13A, ROE and ROA of the company were 8.3% and 5.7%, respectively. Based on our earnings forecast, the company's ROE and ROA for FY14F are projected to be 8.4% and 5.9%, respectively. ROE and ROA for FY15F are expected to increase to 16.0% and 11.0%, respectively. Respective FY16F ROE and ROA are projected to be 18.5% and 12.5%.

**Valuation:** At HKD1.56, the company is trading at 7.8x of the projected FY15F EPS, or a FY15F PE/G of 0.08x. The company is undervalued given our projected three-year net earnings CAGR of 76.2% and its high earnings visibility. Based on the FY15F PEG of 0.15x, we arrive at a target price at HKD3.01, representing an upside potential of 93.5%.

**Table 12: Ratio Analysis**

	FY12A	FY13A	FY14F	FY15F	FY16F
<b>Growth (YoY)</b>					
revenue	21.3%	8.1%	27.5%	63.3%	28.4%
Operating profit	20.2%	9.0%	27.8%	61.4%	28.1%
Net profit	41.5%	-32.0%	79.3%	122.4%	37.1%
<b>Margins</b>					
EBIT margin	60.5%	43.4%	59.6%	79.7%	84.1%
Net profit margin	50.3%	31.7%	44.5%	60.6%	64.7%
<b>Other Ratios</b>					
Return on average assets	19.7%	9.9%	8.5%	12.0%	13.6%
Return on average equity	55.9%	43.6%	27.0%	28.5%	31.1%
dividend payout ratio	-	-	30.0%	30.0%	30.0%
<b>Valuation Measures</b>					
P/E (x)	13.7	20.0	15.1	7.6	5.5
P/B (x)	4.5	3.1	1.3	1.1	0.9
Dividend yield	-	-	2.0%	4.0%	5.4%

Source: SBI E2-Capital, company data

**Table 13: Income Statement (HKD m)**

	FY12A	FY13A	FY14F	FY15F	FY16F
Turnover	66.4	71.7	91.5	149.4	191.8
Other revenue	0.8	1.6	2.3	1.9	2.0
Other net income	0.1	0.0	0.0	0.0	0.0
<b>Operating income</b>	67.3	73.4	93.8	151.3	193.9
Operating expenses	-27.1	-42.2	-39.3	-32.7	-33.0
(Charge for) / credit to impairment losses on loans receivables	-0.1	0.0	0.0	0.3	0.4
<b>Profit from operation</b>	40.1	31.1	54.5	119.0	161.3
Finance costs	-0.1	-0.8	-5.7	-10.5	-12.5
<b>Pre-tax profit</b>	40.0	30.3	48.8	108.5	148.7
Income tax	-6.6	-7.6	-8.0	-17.9	-24.5
<b>Net profit</b>	33.4	22.7	40.7	90.6	124.2

Source: SBI E2-Capital, company data

**Table 14: Balance Sheet (HK\$ m)**

	FY12A	FY13A	FY14F	FY15F	FY16F
<b>Non-current assets</b>					
Fixed assets	1.4	1.7	1.9	2.2	2.4
Loan receivables	6.6	29.8	44.8	62.0	64.1
Deferred tax assets	0.2	0.2	0.2	0.2	0.2
<b>Total</b>	<b>8.2</b>	<b>31.7</b>	<b>47.0</b>	<b>64.4</b>	<b>66.8</b>
<b>Current assets</b>					
Repossessed assets	6.9	5.2	8.8	12.7	14.5
Loan receivables	144.4	200.8	473.6	593.5	677.1
Trade and other receivables	16.5	16.7	6.4	4.6	4.9
Trading securities	0.0	0.0	0.0	0.0	0.0
Cash and cash equivalents	10.4	19.8	149.0	155.3	231.7
<b>Total</b>	<b>178.2</b>	<b>242.5</b>	<b>637.8</b>	<b>766.0</b>	<b>928.1</b>
<b>Current liabilities</b>					
Accruals and other payables	2.4	5.6	18.5	36.9	49.6
Bank loans and overdrafts	3.4	68.5	72.9	110.4	150.4
Obligation under finance leases	0.2	0.2	0.2	0.2	0.2
Current taxation	3.2	5.9	8.0	17.9	24.5
<b>Total</b>	<b>9.1</b>	<b>80.1</b>	<b>99.6</b>	<b>165.4</b>	<b>224.8</b>
<b>Non-current liabilities</b>					
Obligations under finance lease	0.4	0.2	0.2	0.2	0.2
Amounts due to shareholders	42.0	0.0	100.0	100.0	100.0
<b>Total</b>	<b>42.3</b>	<b>0.2</b>	<b>100.2</b>	<b>100.2</b>	<b>100.2</b>
Capital reserves	12.1	0.1	4.5	4.5	4.5
Retained earnings	122.8	57.0	312.4	312.4	312.4
<b>Total equity</b>	<b>134.9</b>	<b>193.8</b>	<b>485.0</b>	<b>564.8</b>	<b>669.9</b>
<b>Net assets</b>	<b>134.9</b>	<b>193.8</b>	<b>485.0</b>	<b>564.8</b>	<b>669.9</b>

Source: SBI E2-Capital, company data

**Table 15: Cash Flow Statement (HK\$ m)**

	FY12A	FY13A	FY14F	FY15F	FY16F
<b>Operating Cash flow</b>					
Profit before tax	40.0	30.3	48.8	108.5	148.7
Depreciation	0.3	0.4	0.4	0.4	0.4
Finance costs	0.1	0.8	5.7	10.5	12.5
Other	0.0	0.0	0.0	-0.3	-0.4
<b>Operating Cash flow before W/C</b>	40.4	31.6	54.9	119.1	161.3
Change in Working Capital	-28.0	-77.9	-268.2	-120.4	-74.7
Tax paid	-4.4	-4.9	-7.9	-14.6	-22.3
<b>Cash flow from operation</b>	8.0	-51.3	-221.2	-15.9	64.3
<b>Investing Activities</b>					
Purchases of PPE	-0.4	-0.7	-0.7	-0.7	-0.7
Other	0.2	0.0	0.0	0.0	0.0
<b>Cash flow from investing activities</b>	-0.2	-0.7	-0.7	-0.7	-0.7
<b>Financing Activities</b>					
Changes in amount due to shareholders	-1.7	3.0	100.0	0.0	0.0
Finance costs paid	-0.1	-0.8	-0.1	0.0	0.0
Change in bank loans	2.5	60.3	7.7	40.0	40.0
Change in bank overdraft	0.0	0.0	-3.3	-2.5	0.0
Dividend paid	-1.0	-5.9	0.0	-12.2	-27.2
Capital element of finance lease paid	-0.1	-0.2	0.0	0.0	0.0
Proceeds from IPO	0.0	0.0	84.7	0.0	0.0
Other	0.0	0.0	165.5	0.0	0.0
<b>Cash flow from financing activities</b>	-0.5	56.4	354.4	25.3	12.8
Net increase in cash and cash equivalent	7.2	4.5	132.5	8.7	76.4
Cash and Cash equivalents at the Beginning of the year	2.4	9.6	14.0	146.5	155.3
<b>Cash and Cash Equivalents at the End of the year</b>	9.6	14.0	146.5	155.3	231.7

Source: SBI E2-Capital, company data

**Valuation.** At HK\$1.56, the group is trading at 7.8x of the projected FY15F EPS, or a FY15F PE/G of 0.08x. The group is undervalued given our projected three-year net earnings CAGR of 76.2% and its high earnings visibility. Based on the FY15F PEG of 0.15x, we arrive our target price at HK\$3.0, representing an upside potential of 93.5%.

**Table 16: Peer comparison table**

Company	Ticker	Mkt Cap (HK\$ m)	3M avg turnover (HK\$ m)	2012E P/E (x)	2013E P/E (x)	P/book (x)	ROIC (%)	ROE (%)	ROA (%)	Dvd Yield (%)	Net Debt/Total Equity
<b>Peers (HK)</b>											
Oi Wah Pawnshop Credit Holdings	1319 HK	624.00	5.81	20.53	N.A	N.A	15.50	13.81	9.86	0.00	25.33
HK Finance Group	1273 HK	390.10	0.51	N.A	10.44	N.A	N.A	16.90	8.02	0.00	73.88
Hong Kong Building & Loan	145 HK	273.88	3.19	5.07	N.A	0.52	3.29	11.07	9.92	0.00	-0.84
First Credit	8215 HK	175.20	2.13	N.A	N.A	0.55	N.A	-11.44	-10.15	0.00	13.91
<b>Average</b>		<b>365.80</b>	<b>2.91</b>	<b>12.80</b>	<b>10.44</b>	<b>0.53</b>	<b>9.39</b>	<b>7.58</b>	<b>4.41</b>	<b>0.00</b>	<b>28.07</b>
<b>Peers (China)</b>											
China Financial Services	605 HK	2,002.62	4.49	8.93	9.14	1.04	12.09	16.36	13.38	1.56	1.07
China Huirong Financial Holdings	1290 HK	1,732.65	2.41	N.A	N.A	N.A	N.A	20.08	12.02	0.00	26.78
Flying Financial Service Holdings	8030 HK	418.43	0.09	7.28	N.A	0.94	N.A	15.42	13.74	9.23	-39.92
China Assurance Finance Group	8090 HK	2,473.22	3.00	N.A	N.A	N.A	N.A	N.A	N.A	0.00	-2.03
Credit China Holdings	8207 HK	3,208.52	10.89	13.51	16.60	2.22	13.87	17.34	11.66	1.46	11.76
Aeon Credit	900 HK	2,839.23	0.31	9.96	N.A	1.22	9.49	12.73	4.94	5.16	133.84
<b>Average</b>		<b>2,112.45</b>	<b>3.53</b>	<b>9.92</b>	<b>12.87</b>	<b>1.35</b>	<b>11.82</b>	<b>16.39</b>	<b>11.15</b>	<b>2.90</b>	<b>21.92</b>
<b>Peers (Japan)</b>											
Acom Co. Ltd	8572 JP	36,195.94	90.08	N.A	20.37	1.43	2.08	6.00	1.73	N.A	179.89
Aiful Corporation	8515 JP	12,471.57	465.21	6.29	5.57	1.25	2.10	17.04	3.42	N.A	235.74
Asax Co. Ltd	8772 JP	1,081.89	3.41	7.26	N.A	0.60	3.64	8.56	3.53	N.A	132.32
<b>Average</b>		<b>16,583.13</b>	<b>186.23</b>	<b>6.78</b>	<b>12.97</b>	<b>1.10</b>	<b>2.61</b>	<b>10.53</b>	<b>2.89</b>	<b>N.A</b>	<b>182.65</b>
<b>Peers (Taiwan)</b>											
Chailease Holding	5871 TT	18,204.83	159.63	N.A	10.66	N.A	N.A	N.A	N.A	N.A	N.A
Taiwan Acceptance	9941 TT	4,652.62	19.27	15.31	13.08	2.92	N.A	20.50	4.25	N.A	371.86
<b>Average</b>		<b>11,428.72</b>	<b>89.45</b>	<b>15.31</b>	<b>11.87</b>	<b>2.92</b>	<b>N.A</b>	<b>20.50</b>	<b>4.25</b>	<b>N.A</b>	<b>371.86</b>
<b>Average of all</b>		<b>5,782.98</b>	<b>51.36</b>	<b>10.46</b>	<b>12.27</b>	<b>1.27</b>	<b>7.76</b>	<b>12.64</b>	<b>6.64</b>	<b>1.74</b>	<b>83.11</b>

Source: SBI E2-Capital, company data

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