Market Flash

P2P finance

Attracts both investors and fundraisers with its business model

- The P2P finance industry is expanding rapidly, with money lending scale of RMB89.7b in 2013, a YoY increase of 291.7%
- Renrendai encountered robust growth in 2013 with total transaction volume of RMB600.2m, a YoY increase of 21.1%

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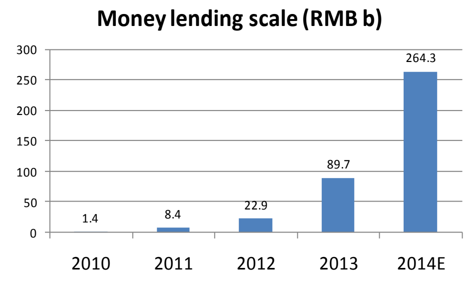
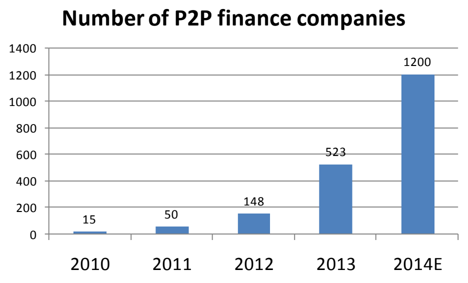
The P2P finance industry is expanding rapidly under the current tightening credit market: China's real GDP growth slowed to 7.4% YoY in 1Q 2014 from 7.7% YoY in 4Q 2013, largely because of the shrinking credit market. Sparked by concerns over potential defaults of wealth management products (WMP), China's total social financing (TSF) has experienced a 9.2% YoY decline in 1Q 2014. Specifically, a sharp reduction in trust loans (-66.0% YoY) has been observed. Meanwhile, growth of M2 slipped to 12.1% in March 2014 given China's annual M2 growth target of 13.0% for 2014.

Even though the market is expecting monetary policy to ease, including a potential cut in required reserve ratio (RRR) to be implemented by the CBRC in 2Q or 3Q 2014, the demand for credit from private companies in China is still expected to be high.

P2P financing, as a new business model focusing on servicing the private sector, acts to secure a stable source of funding for private companies without access to traditional financing from commercial banks, and is witnessing significant growth in China. (See Figure 1).

Figure 1: Money lending scale and number of P2P finance companies



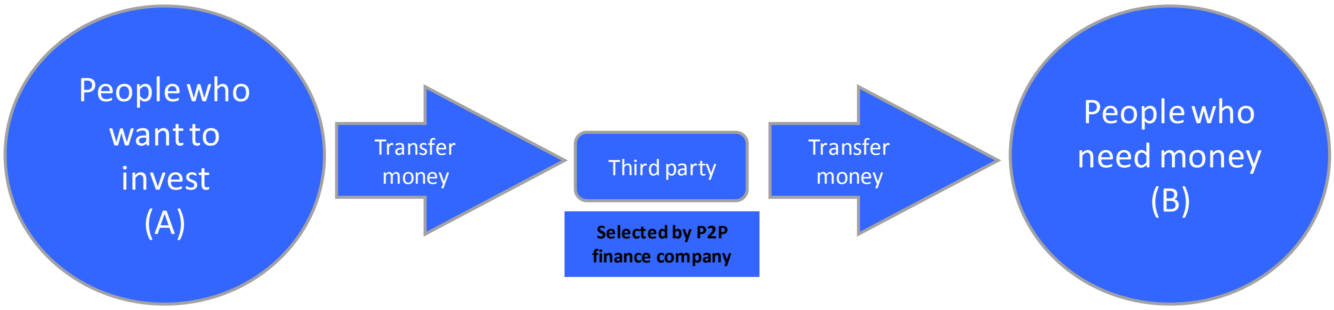


Source: P2Peye

An analysis of Renrendai's business model: Renrendai, as a subsidiary of Renrenyouxin Group, was established in 2010 and is now servicing clients in more than 30 provinces in China. The company mainly focuses on providing transparent and efficient money lending services in China through its P2P model.

For the P2P finance industry, the target clients are usually small-cap retail investors and fundraisers. Under Renrendai's business model (See Figure 2), these small-cap investors transfer their money to their own account in the third party, and then Renrendai will allocate said money to individuals or companies who need money based on the interest rate they provided. It is also worth noting that Renrendai will work with third party financial institutions (usually commercial banks) under its business model.

Figure 2: Renrendai: Business model



Target clients:	People with a small amount of money & people who need small amounts of capital (Max RMB 0.5m)
Characters:	Capital allocation has been driven by market
	Different products have been provided
	All settlements are via third party

Source: Renrendai

By the end of 2013, Renrendai has encountered explosive growth. Transaction volume increased to RMB600.2m, a 21.1% YoY increase. Breaking down the transaction volume, money lending held for 25-36 months accounted for 47.0%; money lending held for 19-24 months accounted for 23.5%; and money lending held for 13-18 months accounted for 16.7%.

This business model attracts both investors and fundraisers. For investors, no minimum threshold is required and they can choose the fundraisers directly based on their provided information, including the usage of the capital and the credit record of fundraisers. What attracts investors more is the high interest rate provided. Historically speaking, the average return falls into the range of 12.0% to 14.0%. Additionally, the contracts they made are tradable via its online platform. For fundraisers, this business has also put itself beyond the reach of other money lending methods. For example, no collateral is required from them and they can receive the money very efficiently, with the average waiting period of 1 to 3 working days.

As a risk control mechanism, and to reduce the amount of non-performing loans, fundraisers have been asked to provide some documents, including their ID cards, personal credit records from central bank, employment contract, and salary records in the most recent 3 months.

Under the whole process, Renrendai can generate profits through (i) service fees, which will be charged from fundraisers and determined by their credit rating (See Figure 3); and (ii) management fees, which is approximately 0.3% of the amount of money lending.

By the end of 2013, the total loss provision prepared by Renrendai was around RMB24.5m (See Figure 4). The ratio of total loss provision to total payable amount was 1.94%, much higher than the default loan rate of 0.64%.

Figure 3: Service fee charged to different ratings

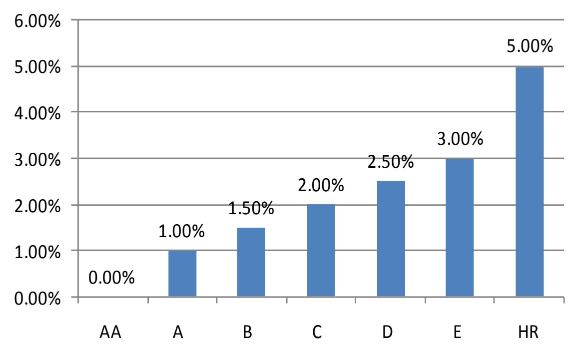
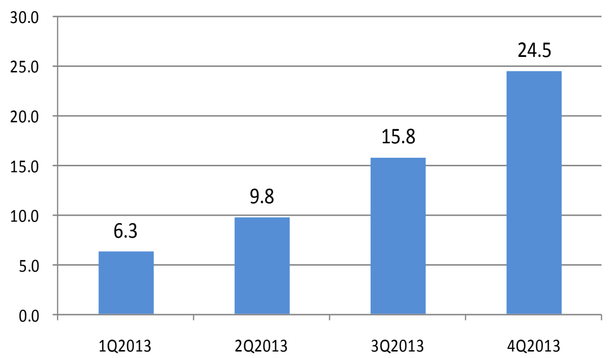


Figure 4: Historical loan loss provision (RMB m)



Source: Renrendai

In general, the products provided by Renrendai can be divided into 2 categories: One is the "Optimized Financing Plan" while the other is the "Individual Financing Plan". In terms of the "Optimized Financing Plan", the lock-up period is one year. Under this schedule, the company will gather the capital from different investors into a pool and allocate the capital at the company's discretion based on its investment strategy. Accordingly, investors neither get a chance to choose the fundraisers, nor the ways in which the money is used. For the second product, "Individual Financing Plan", investors can set the criteria by which their money is invested on their own interests, e.g., the duration of the lock-up period, rating methods, the credit ratings of the investment and usage of their money. Specifically, there are three investment rating methods provided by Renrendai: (i) rating via investigation by another subsidiary of Renrenyouxin Group, the parent company of Renrendai; (ii) rating based on the credit record of fundraisers in Renrendai; and (iii) rating based on whether the projects have been supported by other P2P finance companies.

Risks: Major risks include: 1) possible tight regulations imposed on this type of business model from CBRC and PBoC; 2) insufficient risk management; and 3) misfeasance by its management;

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