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China | Finance

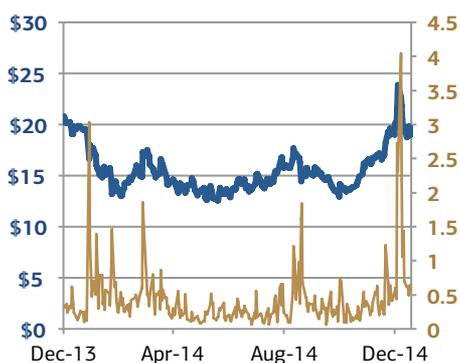
Noah Holdings (NOAH US)

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Call notes

Noah Holdings (NOAH US) one-year share price in USD (blue) and volume (gold, in mln shares)



Source: Bloomberg

Noah Holdings (NOAH US)

Price	USD 19.69
Rating	SELL
Price target	0
Difference	100%
Market Cap	USD 1.13 bln
Simple Moving Avg.	1.264 mln
P/E	16.5x

Source: Bloomberg

+ Into the equities markets

On December 18, J Capital hosted a conference call with the CFO of Noah Holdings, Ching Tao, and her IR team. Ms. Tao rebuffed suggestions that China's property and finance markets are becoming riskier and talked about the company's new drive into equities products.

+ Choosy

Ms. Tao maintained that Noah's superior risk management and selectivity have supported very high returns and cites one property fund that returned 78%. She said that the best locations have seen no decline in price.

+ Selling to institutions

Noah has established an institutional sales team to sell investments to insurance companies, banks, and other financial institutions.

+ Asset swings

The quarter-to-quarter swings of 30% or more in the nature of assets under management seem at odds with the average duration of the investments of 2-7 years, with some terms as long as 10 years.

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Noah worries

There has been no decline for Noah's sales in spite of the Jingtai default, and next year is smooth sailing.

On December 18, Noah's CFO spent an hour on a conference call with J Capital clients. In advance, we had sent a list of questions, and Ching Tao spent the first half hour of the call responding to those questions.

Deferred revenues

The company's deferred revenues seem to track assets under management. We asked whether they represent future management fees, success fees, carry on PE assets, or something else. Noah responded that the company receives revenues six months to one year in advance for management fees and that the increase in deferred revenues is related to the increase in private equity fund products, and the company is confident that AUM will continue to grow.

The deferred revenues were:

- Q1 2014: USD 9.8 mln
- Q2 2014: USD 20.1 mln
- Q3 2014: USD 19.8 mln. In this quarter, AUM remained the same because of a lot of products matured.

Wanjia Win-Win

Last summer, recipients of funding from Wanjia Win-Win, a private equity company in which Noah owns a 35% stake and for which Noah had raised money, was disclosed to have embezzled the funds. Regulators subsequently froze the Wanjia accounts related to this investment, called Jingtai. Noah said that Jingtai had violated the terms of the asset management plan and is confident that the plan will repay upon maturity. Ms. Tao did not say whether the funds are still frozen. The company does not provision for losses from Wanjia.

Institutional Sales

In Q2 2014, the company established a new brand and team called "Nuode Institutional Wealth" selling to insurance companies, banks, and listed corporations.

The company is reducing its exposure to real estate despite a positive view of the market.

We have not found a website for the Nuode branch, but Noah has a sales relationship with Lord Abbett funds, whose Chinese name is “Nuode.” The Lord Abbett Nuode funds are traded on the Shanghai exchange and saw December appreciation of 92%.

Sales costs

Noah’s relationship managers are compensated in salary, commission, and bonuses, based on transaction value and AUM. Sales costs total 20-22% of total sales, and this consists principally of compensation to the RMs. Commissions are also given on a portion of management fees.

PPDAI

Noah holds less than 3% of this “peer-to-peer” lending company. The total investment in the recent round was USD 50 mln.

Active clients

The number of active clients for Noah has increased in each quarter. Noah says there has been little impact from the Jingtai/Wanjia Win-Win incident on clients’ willingness to invest through Noah.

Real estate-related revenues

In 2014, the real estate-related revenues totaled:

- Q1: 64%
- Q2: 46%
- Q3 42%

The company is actively diversifying away from real estate. Equity products are strong, and private equity companies are looking to invest in public equities in order to have better exit opportunities.

However, Noah has a positive view of the real estate market. “Some of this is cultural; Chinese people like to invest in real estate,” said Ms. Tao.

She believes that China’s real estate industry is consolidating and the top developers are acquiring projects from smaller ones. The larger developers seek financing from Noah because of speed of execution. Noah’s completion time for lending to a new project is

Going from 0 to 30% of assets in public equities, Noah clarifies that these investments mostly represent shares in Fund of Funds in public markets.

two to four months.

Noah's risk control in real estate is very strong, and the company does not believe that it is at risk in real estate. The company's products have never realized a loss that was borne by Noah clients.

Project pipeline comes from the developers themselves, who have short-term needs for capital. Clients also refer projects.

To receive very high returns on real estate, the company sometimes extends loans and sometimes takes equity in projects. Some projects have "come to maturity earlier than expected," meaning that the developer decides to repay principal and interest to date a year or two earlier.

Typical returns are high: one real estate fund that recently matured in Chengdu had an IRR of 29%. A real estate fund in Fujian had an IRR 78%.

Noah believes that property prices are not falling in the top locations in the Tier 1 and Tier 2 cities. Although asset quality is declining overall, the top locations and stronger developers are not seeing any declines at all.

Noah cannot estimate performance fees, 7.6 bln USD AUM. Of that amount, 2.5 bln has carry terms.

Average transaction value and product mix

In Q3 this year, transaction value per client RMB 4.2 million, a 21.6% decrease from the corresponding period in 2013. The fluctuation was caused by the product type: private equity products have a minimum contribution of RMB 10 mln, while public-equity products require only RMB 1 mln. In Q3, the contribution of public-equity products went from 5% to 30%.

Of the USD 7.6 bln AUM, real estate project loans and private equity funds represent USD 5 bln (66%), down from 74% in Q2. The private equity FoF is USD 1.4 bln (18%). This is up from 14% in Q2. The hedge fund FoFs and family offices is USD 1.2 bln (16%, up from 12% in Q2). Trust products have dropped, as they have actively managed away from that.

The average duration of the assets in fixed-income assets is typically one to three years, but private equity and real estate

assets have longer durations.

Demand

The company does not see and slowing in demand for wealth management services. Between Q2 and Q3, sale of fixed-income products slowed down.

Sales offices

Asked about a discrepancy in the last quarter report, which showed both 57 and 60 branch offices, Noah was asked to clarify. The company says it has branch offices in 60 cities.

SEC correspondence

The company has agreed with its auditor on changes needed and responded in August to the SEC queries.

Equity products

Noah is focused on the equity and equity-linked space, and equity-linked products rose to 30% of the underlying assets distributed in Q3 from nil in previous quarters. These products include funds of funds in hedge funds. Fixed income is now 56% of total products.

The company raised money for Alibaba's IPO but was not able to get an allocation of shares.

The principal buyers of the equity products are retail clients. Many of the equity products are not stocks but other types of exchange-traded products, for example, trusts, bonds, ETFs.

Fee structure

For its managed assets, Noah generally receives half the management fee and half the performance fee, as well as a commission on sales of funds. Generally speaking, Noah will receive a 1% commission on funds raised on behalf of private equity and hedge funds, 1% of AUM as a management fee, and 10% of the gain in value on the funds under management. However, not all of the fund agreements contain carry terms.

Recurring service fees amount to roughly half the company's revenue, and Noah has reported that it usually must take a small equity share in the management companies of funds from which it receives a management fee. This share tends to be 1-3%.

We believe that management fee revenue represents the majority of “recurring service fees.”

At the end of the last quarter, AUM totaled USD 7.6 bln. If the company receives an average of 1% in management fees, then annualized, these would total USD 76 mln based on Q3 AUM. This is roughly equivalent to the USD 74 mln in recurring service fees reported for 2013.

But average asset duration is over two years, and yet Noah has seen the underlying assets go from virtually no equities in Q2 to 30% equity-related products in Q3, and from 74% real estate-related products in Q1 to 42% real estate-related in Q3. Those swings seem to be too great to make sense. The numbers would make sense if Noah’s managed FoFs were trading in and out of the investee funds quarter to quarter.

Risk

Noah participates in the General Partnership in underlying funds for which it raises money and owns 1-2% of the management companies, and so the management company financials are not consolidated up to Noah. Revenues from GPs are nevertheless booked as related party revenues, because Noah uses its wealth management business to raise money for the managed funds.

If there were a loss in a fund, that would not impact Noah. The company offers no “legally binding” guarantees.

The company does not think it appropriate to reserve against defaults or record contingent liabilities should the underlying funds show losses.

Recent sales by insiders

The company said that sales by Quan Investments and Neil Shen are normal and not related to any loss of confidence in Noah Holdings.

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