KerrisdaleCapital

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UP Fintech Holding Limited (TIGR)

The Robinhood of China

We are **long** shares of UP Fintech, the holding company of Tiger Brokers, which we believe is positioned to become the Robinhood of China. Love it or hate it, you have to admit that Robinhood has created an enormous amount of value for its investors in a very short time: having debuted its trading app in 2015, the company is now reportedly valued at more than $20 billion. Even in a market full of established online brokerages like E*TRADE (recently acquired for $13 billion) and TD Ameritrade (recently acquired for $26 billion), Robinhood carved out a sizable niche for itself with its low fees, user-friendly design, and mobile-first approach.

Tiger Brokers shares a similar approach but in a less mature market. Founded by a Tsinghua University computer-science graduate then in his late twenties, Tiger also launched in 2015; today, it has more than a million customer accounts, and its app facilitates over a billion dollars' worth of trades every day (more than double the prior year's level). With its low fees (commissions average 0.03%) and sleek design, Tiger has rapidly gained a following among tech-savvy Chinese millennials – 72% of its customers are under 35 years old – in part by making it cheaper and easier for Chinese citizens to invest in US-listed stocks. A strange aspect of the immense growth in the Chinese economy is that many of China's most prominent and exciting firms, like Alibaba and NIO, trade on American stock exchanges, which ordinary Chinese citizens have historically had difficulty getting access to. By streamlining and simplifying the process, Tiger has outflanked incumbent banks and brokers, which have traditionally focused on serving older and wealthier clients via physical offices and in-person salesmanship. Tiger's entrepreneurial spirit and scalable technology have also empowered it to expand into new geographic markets, like Singapore and Australia, and adjacent business lines, like IPO underwriting. Moreover, unlike so many other fast-growing companies, Tiger has actually begun to turn a profit, gaining enough operating leverage to achieve a respectable 21% pretax profit margin in the third quarter.

We believe Tiger has a long runway for continued growth. Though China is famous for its high savings rate, households have tended to invest in real estate and bank deposits, with equities accounting for a much smaller fraction of total wealth than in Western developed markets. But as more Chinese investors, especially young ones, become familiar with global capital markets, portfolios are shifting, freeing up a gargantuan addressable market. Already, Chinese household wealth totals $78 trillion, and we estimate that in 10 years it will exceed $200 trillion – almost twice the current US level. There will be room for multiple online brokerages worth tens of billions of dollars, and we believe Tiger – currently valued at $2.7 billion – will be one of them.

Despite its impressive track record and vast potential, Tiger has been overlooked. According to Bloomberg, zero sell-side firms cover the company; during its past three earnings calls, only two people, on average, asked questions. It's time to enter the tiger's den before it gets crowded.

Company Overview

UP Fintech/Tiger Brokers: Capitalization and Financial Results

Capitalization	
Share price ($)	$18.70
Fully diluted shares (mm):	
ADS outstanding	141.0
Dilutive impact of options/RSUs	3.1
Total	144.1
Fully diluted market cap ($mm)	$ 2,694

Financial results ($ mm)	2018	2019	2020Q3 LTM
Revenue	$ 34	$ 59	$ 104
Operating profit	(47)	(10)	14
Op. margin	*-140%*	*-17%*	*13%*
Diluted EPS	$ (1.28)	$ (0.06)	$ 0.05
Trade volume ($B)	$ 119	$ 100	$ 175
Margin loans	$ 0	$ 106	$ 1,041

Source: company filings, Kerrisdale analysis

Founded in 2014 by Tianhua Wu, a Tsinghua University computer-science graduate and former employee at the US-listed Chinese internet giant NetEase, Tiger Brokers began with nothing but a vision: to make it easier for Chinese-speaking investors to trade securities globally. In mainland China, companies listed on the local, RMB-denominated Shanghai and Shenzhen stock exchanges tend to be somewhat sleepy, weighted toward traditional financial and industrial firms, while up-and-coming high-tech businesses, often lacking the track record of profitability required by the exchanges, usually go public on Hong Kong or US-based exchanges. But this makes it difficult for mainland Chinese investors to actually buy into those businesses, let alone diversify their portfolios into non-Chinese assets, because capital controls designed to prop up the value of the Chinese currency limit the purchase of foreign currency to USD 50,000 per person per year, and traditional local brokerages, with their focus on face-to-face interaction and brick-and-mortar respectability, haven't made it straightforward for normal people to put dollars to work in offshore trading. Even beyond the legal restrictions of mainland China, Chinese-speaking investors globally suffered from a lack of easy-to-use online brokerage services in their own language.

By distilling this process of funding and trading into a single user-friendly mobile app, Tiger quickly caught on among younger Chinese investors, especially relatively affluent participants in the internet sector; according to a 2017 article in the *South China Morning Post,* "The majority of Tiger users are male, live in first-tier Chinese cities and work for technology and financial firms, so they have always been familiar with the technology, media, telecom (TMT) sectors. Some even own foreign assets because they work for companies that have had overseas initial public offerings…Nearly 60 per cent of Tiger users were born after 1985." (Robinhood users in the US likely have very similar demographics.) By focusing initially on trading in US-listed equities, Tiger bypassed the need to obtain a Chinese brokerage license, the supply of which is very tightly controlled; instead, Tiger users acquire dollars on their own, then wire them to one of Tiger's offshore-domiciled brokerage entities. The business is managed from Beijing but, for legal purposes, the customer trades are conducted elsewhere.

Initially, as Tiger worked to build out its own technology, it used Interactive Brokers to process and clear its customers' trades, which allowed it to launch new products more quickly but cut into profitability. Last year, however, after acquiring a US-based broker, Tiger began to self-clear more of its trades and move toward full independence. In fact, Interactive Brokers – a major player in the US online brokerage sector for decades, with a ~$30 billion market cap -- recognized Tiger's potential from early on and made a strategic investment in its shares; it now owns 7.6% of the company (source: Interactive Brokers 2019 Q3 10-Q). (Xiaomi, the massive mobile device maker, was also an early investor and currently owns 12% of Tiger (source: Capital IQ).) Interactive Brokers' discussion of its decision to invest in Tiger nicely illustrates Tiger's strengths: in April 2019, it spoke of Tiger's "huge potential" and "technological excellence," and in June 2019 added:

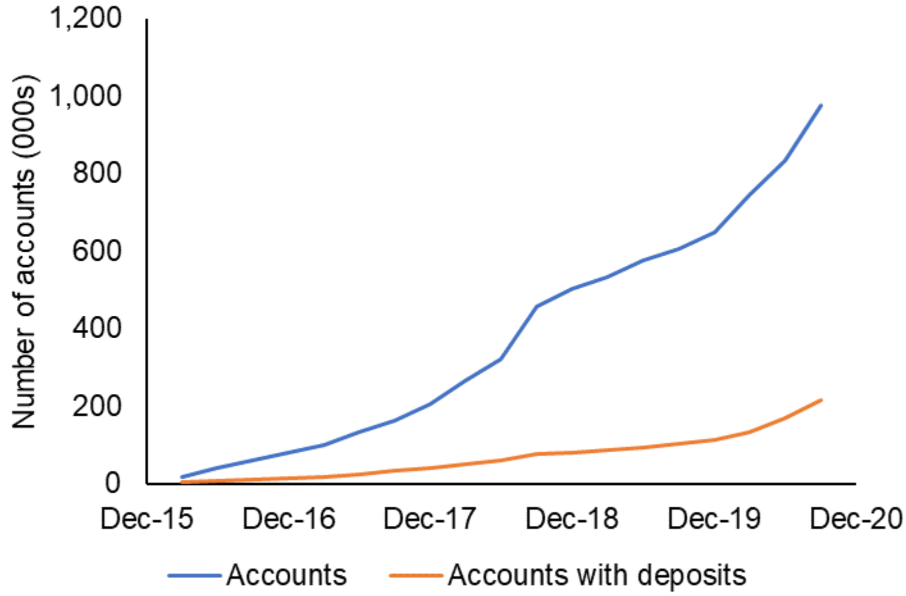
> We recently invested in Tiger Brokers, which is one of our largest introducing broker customers. And we have found that, that is more effective because we don't usually find that somebody has better technology, but that they have, like in the case of Tiger, had a Chinese language mobile app that was impressive and that they had managed to crack that nut certainly more quickly than we would have been able to.

Today, Tiger continues to crack the nut of mobile trading for a Chinese-speaking audience, hitting the "million-account milestone faster than any other online brokerage firm focusing on global Chinese investors," according to the company. Though the business model remains fairly simple – revenue is dominated by commissions (55% of the total in the latest reported quarter) and net interest income, primarily derived from margin loans (20%), with expenses dominated by the cost of software engineers – Tiger has begun to expand into adjacent business lines, including IPO underwriting (helping its customers gain early access to newly US-listed Chinese companies) and the management of employee stock ownership plans (serving many of those same companies). To be sure, Tiger has competition, primarily from Futu, another up-and-coming China-focused low-cost online broker (currently valued at $15 billion). But with such a large and rapidly growing addressable market, competition hasn't stopped Tiger from consistently winning new business.

Tiger Has an Impressive Track Record of Growth

As previously stated, Tiger's total customer accounts began to exceed 1 million in the past few months – an impressive achievement after just a few years in operation, with limited marketing. But there's an important wrinkle: due mainly to the frictions and restrictions involved in converting RMB into foreign currency, only a fraction of those accounts have actually been funded with deposits; total *funded* accounts stand at only 215,000 as of 9/30/2020. But this number too has been growing exponentially:

Tiger Brokers: Ongoing Rapid Growth in Customer Accounts

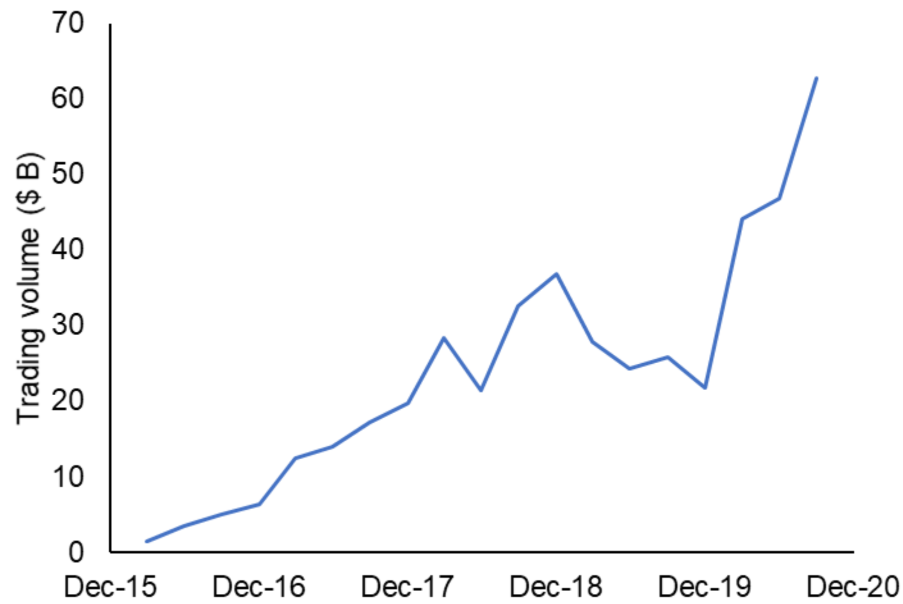


Source: company filings, Kerrisdale analysis

The large gap between total accounts and funded accounts illustrates the huge latent demand for Tiger's services: assuming users are opening accounts because they intend to eventually use them to trade – the process involves submitting official government identity documents and other personal information, so it's unlikely to be done on a lark – Tiger has the potential to increase funded accounts by a factor of 4.5x just by converting existing customers, let alone attracting new ones.

While the trading volume generated by funded accounts fluctuates based on sentiment, recent market returns, and other difficult-to-predict factors, aggregate quarterly trading volume has generally increased over time, from zero to $63 billion in the third quarter of 2020.

Tiger Brokers: Surging Trading Volume

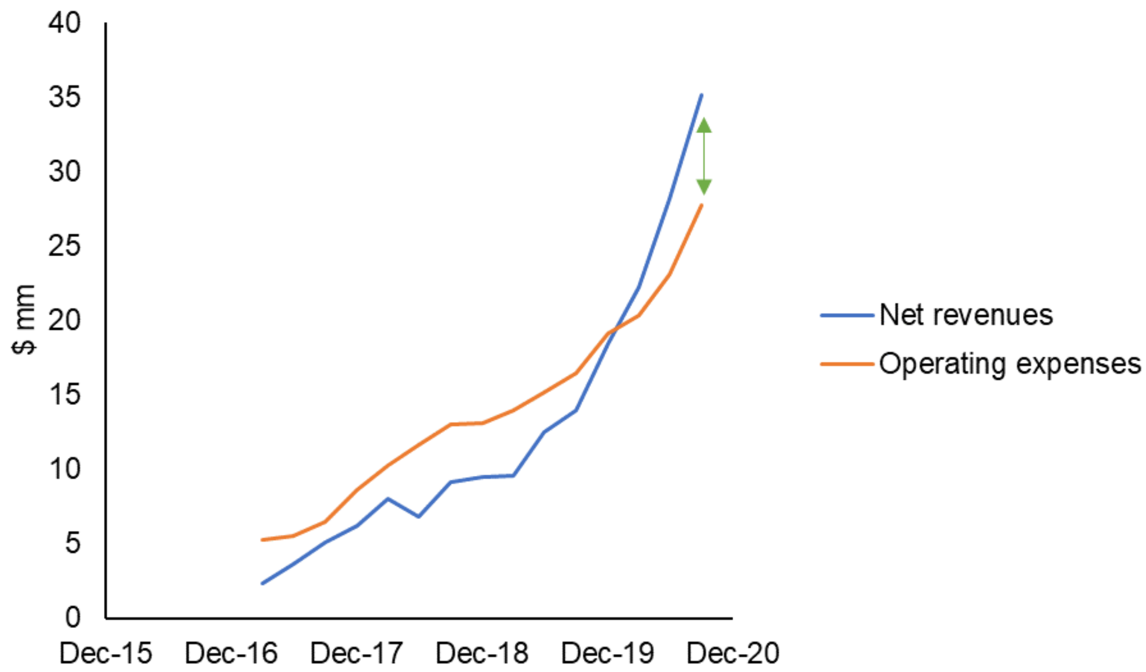


Source: company filings, Kerrisdale analysis

We expect this strength in trading volume to persist into the fourth quarter and beyond. Interactive Brokers, for instance, recently [reported]() that in the fourth quarter its DARTs (daily average revenue trades) increased 165% year-over-year. COVID-19-related market volatility, increased time spent at home, and strong recent returns have all combined to foster greater enthusiasm for trading across the world.

Of course, given Tiger's strategy of enticing customers with convenience and low cost, it takes a lot of trading volume to generate meaningful revenues; at an average commission rate of only 3 basis points, scale is essential. But Tiger has already proven that it can produce not only revenue but profit. Unlike many publicly traded start-ups that never seem to achieve operating leverage, Tiger has begun to generate consistent and growing profits even while continuing to invest in personnel and technology:

Tiger Brokers: Ramping to Profitability



Source: company filings, Kerrisdale analysis
Note: operating expenses for 2018 Q2 exclude $32.4 million in one-time share-based compensation expense in order to better illustrate the long-term trend.

We believe that Tiger's operating margin – already at 21% in the third quarter of 2020 – can continue to expand over time. The experience of the American online brokers illustrates the possibilities. Despite intense competition for customers (including bonuses for opening new accounts and constant pressure on fee levels), as well as the negative impact of low interest rates, in recent years both E*TRADE and TD Ameritrade managed to consistently produce ~40% operating margins on billions of dollars in revenue:

Online Brokers in the US Have Achieved High Profit Margins

	2015	2016	2017	2018	2019	2015-19 average
TD Ameritrade						
Net revenues	3,247	3,327	3,676	5,452	6,016	
Operating income	1,325	1,318	1,466	1,998	3,001	
Op. margin	41%	40%	40%	37%	50%	41%
E*TRADE						
Net revenues	1,370	1,941	2,366	2,873	2,886	
Operating income	504	838	1,064	1,418	1,319	
Op margin	37%	43%	45%	49%	46%	44%

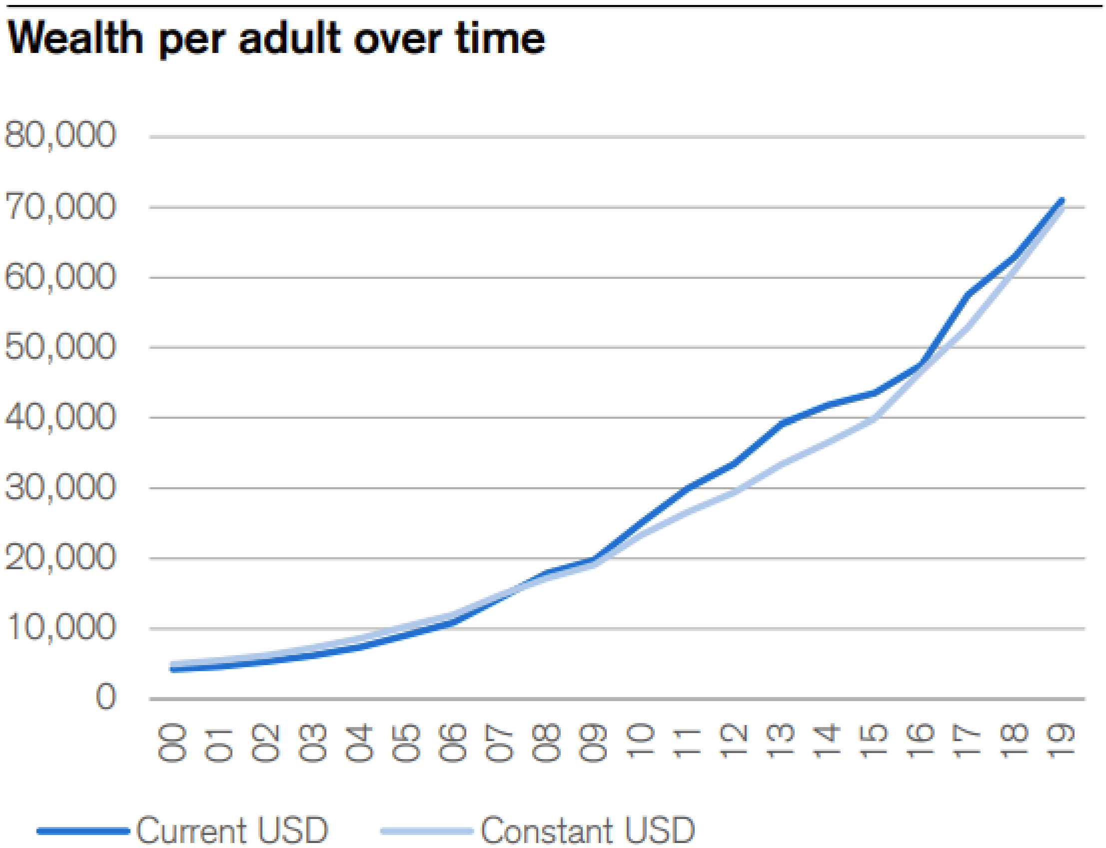
Source: company filings, Kerrisdale analysis
*Note: E*TRADE operating income for 2015 excludes $413 million pre-tax charge on the termination of legacy wholesale funding obligations.*

We see the same margin potential for Tiger because of the basic nature of the online brokerage business model: although creating reliable and user-friendly infrastructure for self-directed retail trading is difficult and costly, each incremental trade that flows through that infrastructure incurs little to no expenses (especially as Tigers shifts toward self-clearing). Increased revenue from increased trading can then drop straight to the bottom line – and if Tiger continues to succeed at reaching the huge, underserved market for global securities trading by Chinese investors, revenue will continue to increase.

Tiger Is Tapping into a Massive and Fast-Growing Addressable Market

While it's become a cliché to wax poetic about the size of the Chinese market for various products and services, some clichés happen to be true, and the addressable market for Chinese securities trading truly is vast. At the most basic level, traders aim to put their money to work, and rapid economic growth means that the Chinese population has more and more money to deploy. According to Credit Suisse's *Global Wealth Report*, China is now home to the second largest amount of aggregate household wealth in the world (after the United States), and average wealth per adult has increased exponentially over the past two decades:

Average Household Wealth in China Is Rapidly and Steadily Increasing



Source: Credit Suisse

In fact, without making any heroic assumptions but simply by extrapolating from recent secular trends, we expect that total household wealth in China will exceed that in the US within the next 10 years, at which point household wealth in China will be more than $200 trillion – almost double what it is the US today:

Illustrative Estimates of Chinese and American Household Wealth over Time

	2000	2020	2000-20 CAGR	2030E	2020-30 CAGR
Household wealth (USD T)					
United States	44	115	5%	187	**5%**
China	4	78	16%	202	**10%**

Source: Credit Suisse, Kerrisdale analysis

However, Chinese households have historically allocated their wealth quite differently from their American counterparts, investing heavily in real estate and, within the realm of financial assets, in simple bank deposits, not stocks and bonds. But that behavior is changing – a trend that has attracted much attention from observers of the global asset-management industry. Deloitte, for instance, recently estimated that by 2023 China's "total addressable retail financial wealth is expected to reach US$30.2 trillion" – yet only a tenth of that is expected to be managed by local Chinese investment funds. The potential for Chinese households to rebalance their ever-growing portfolios into a wider range of financial assets is clearly vast, and there will be opportunities for many large players to carve out their own niches. Tiger is well positioned to be one of them, just as online discount brokers in the United States have created tens of billions of dollars of shareholder value even in the face of competition from more traditional brick-and-mortar brokers – and each other. With a hundred-trillion-dollar market up for grabs, the runway for growth can extend a long way indeed.

An additional tailwind for Tiger is that its initial brand focus on giving Chinese traders access to US stocks aligns well with Chinese investors' long-term need to diversify globally. The local Shanghai and Shenzhen stock exchanges that have been by far the easiest for Chinese citizens to access contain just ~10% of global equities by market value; in contrast, the NYSE and Nasdaq contain nearly half. In the long run, Chinese investors, whether conservative indexers or aggressive speculators, won't be content with exclusively local stocks; they will seek to broaden their portfolios globally, and Tiger will make it easy for them to do it.

Conclusion

What's remarkable about Robinhood's $20 billion value is not just that it was created in a short period of time; it's also that it emerged within what appeared to be a mature, saturated market. E*TRADE was founded in 1982 and went public in 1996; the concept of low-cost, online stock trading was hardly a new one in 2015. Yet Robinhood proved that the amount of tradeable wealth in the hands of relatively young and tech-savvy Americans was large enough to accommodate a new $20-billion player. Given the rapid growth in China's wealth and the more nascent state of its retail investing industry, the opportunity that lays before Tiger is, if anything, larger. In the old Disney animated movie, Robin Hood is a fox – but we think a tiger is even better.

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