

GICS: Financials/Asset Management & Custody Banks

Business Summary: Hotung Investment Holdings' (Hotung) primary businesses are venture capital investment and fund management.

Country of Incorporation: Bermuda

Head Office Location: 10 Floor, 261 Sung Chiang Road, Taipei, Taiwan, R.O.C.

Place of Operations: Taiwan

Website: www.hotung.com.tw

IR Contact: Frieda Tseng | frieda@equity.com.tw | 886-2-2500-6700

Analyst: Apurva Patel



Key Stock Statistics

52-week Share Price Range (SGD)	0.12 - 0.15
Avg Vol - 12 months ('000 shares)	523.6
Price Performance (%)	
- 1 month	-0.7
- 3 month	-6.1
- 12 month	-4.8
No. of Outstanding Shares (mln)	1,046.6
Free Float (%)	70.1
Market Cap (SGD mln)	144.4
Enterprise Value (SGD mln)	59.4
Major Shareholders (%)	
Tai Lung Capital Inc.	18.8
Mega International Commercial Bank Co. L	5.8
Overseas Asset Management (Cayman) Ltd	5.3

Per Share Data

FY Dec.	2011	2012E	2013E
Book Value (TW cents)	653.64	666.82	689.98
Cash Flow (TW cents)	26.4	29.4	34.5
Reported Earnings (TW cents)	26.4	29.4	34.5
Dividend (TW cents)	25.8	23.6	27.7
Payout Ratio (%)	97.2	80.0	80.0
PER (x)	12.6	11.3	9.7
P/Cash Flow (x)	12.6	11.3	9.7
P/Book Value (x)	0.5	0.5	0.5
Dividend Yield (%)	7.8	7.1	8.3
ROE (%)	3.8	4.5	5.1
Net Gearing (%)	0.0	0.0	0.0

Decent results in a choppy environment, solid cash position

- 2Q12 results decline as volatile equity markets pose a challenge.** Sales fell by 42.2% QoQ (56.2% YoY) as gains on sale of AFS investments decreased, while net profit declined by 23.7% QoQ (40.0% YoY). The results were fairly in line with expectations. Despite the volatile equity markets over the past few months, Hotung experienced lower impairment losses (TWD23.9 mln, led by non-current assets and escrow account receivable).
- Operating margin was better than expected.** Hotung reported 2Q12 operating margin of 51.3% as management kept a tight grip on operating expenses (management, audit, legal, and incentive fees), combined with lower impairment losses. Going forward, we project management may continue to keep a lid on expenses.
- Strong balance sheet:** Hotung purchased TWD372 mln worth of investments (HFT: TWD177 mln and AFS: TWD195 mln) in cash. Still, the company maintains a cash rich position, which is ammunition to capitalize on investment opportunities without the need to source new capital or exit an investment prematurely. At the end of 2Q12, it had no gearing and cash per share balance of TWD1.54 or SGD0.06.
- FY12/FY13 sales and net profit will increase:** For FY12 and FY13, we have lowered our sales and net profit estimates to reflect the volatile equity markets. For FY12 and FY13, we project sales will increase by 2.0% (down from 11.5%) and 7.5% (down from 9.4%), respectively, as we believe the equity markets will favor asset sales. Therefore, we believe Hotung's net profit will expand faster than sales due to lower impairment losses. We forecast net profit will expand by 16.3% (down from 31.5%) and 16.1% (down from 18.3%) in FY12 and FY13, respectively.
- Diversified and balanced portfolio:** Hotung maintains a disciplined and balanced investment strategy with a sound emphasis on the expansionary stage, which offers slightly less volatile returns, overlaid with the start-up stage (for alpha generation) and mature stage to reduce volatility.
- Key risks:** The primary risks are related to portfolio risks (unable to liquidate investments due to unfavorable equity markets), economic risks (slower economic growth will decrease equity investor risk appetite), and technology product cycles (mis-execution by investee companies may result in a severe financial loss).

Earnings Outlook**Revenue Drivers:**

- Given the challenging macro environment, we now expect revenue will increase by 2.0% YoY (down from 11.5% YoY) in 2012. In 2H12, we expect market conditions to improve as risk appetite increases, which will allow divestments of available-for-sale (AFS) investments. Gains from the sale of AFS investment should continue to make up the lion's share of Hotung's revenue.
- Increases in global share prices should also see a rise in the sale of short term trading investments ("investments held-for trading or HFT").
- Dividend income, which makes up around 10% of total revenue, has continued to recover from the 2009 low. We believe this reflects decent underlying profit performances by its investee companies. Given the stable to slightly positive outlook for companies in Asia, we expect dividend income to continue growing.

Margin Outlook:

- Profit margins will remain dependent on the magnitude of AFS sales. As long as Hotung's revenue is around TWD900 mln, we expect operating margin to come in around 30%. Revenue in excess of TWD900 mln should translate to sharply higher margins since Hotung's costs consist mainly of fixed salaries.
- Due to our revised revenues, our operating profit margin estimates decline to 34.9% (from 38.6%) in 2012 and 37.9% (from 42.0%) in 2013, which are higher compared to 32.2% in 2011. We see limited pressure on fixed costs over these next two years and as such, projected revenue expansion should filter through to increased profits.

Bottomline:

- After the recent slump in the global equity markets, we believe markets will recover in 2H12 and see a sustained uptrend in 2013. Recent leading economic indicators suggest the recovery will be led by Asia (i.e. China), but the slope of the recovery will be gradual. Based on our revised sales growth, we have reduced our net profit assumptions for Hotung by 16.2% in 2012 and 17.7% in 2013. This is based on our projection for Asian and U.S. average share prices to rise 10%-15% in 2012 and around 10% in 2013.

Earnings Performance

FY Dec. / TWD mln	2Q12	2Q11	% Change
Reported Revenue	114.2	260.5	-56.2
Reported Operating Profit	58.6	116.7	-49.8
Depreciation & Amortization	0.0	0.0	NA
Net Interest Income / (Expense)	0.0	0.0	NA
Reported Pre-tax Profit	59.0	123.9	-52.4
Reported Net Profit	64.4	107.4	-40.0
Reported Operating Margin (%)	51.3	44.8	-
Reported Pre-tax Margin (%)	51.7	47.6	-
Reported Net Margin (%)	56.4	41.2	-

Source: Company data

Profit & Loss

FY Dec. / TWD mln	2010	2011	2012E	2013E
Reported Revenue	980.5	908.8	927.1	996.8
Reported Operating Profit	562.2	292.3	323.5	377.8
Depreciation & Amortization	0.0	0.0	0.0	0.0
Net Interest Income / (Expense)	10.0	5.5	5.5	5.5
Reported Pre-tax Profit	583.6	319.4	352.2	408.8
Effective Tax Rate (%)	10.4	13.0	13.0	13.0
Reported Net Profit	522.6	277.9	306.3	355.6
Reported Operating Margin (%)	57.3	32.2	34.9	37.9
Reported Pre-tax Margin (%)	59.5	35.1	38.0	41.0
Reported Net Margin (%)	53.3	30.6	33.0	35.7

Source: Company data, S&P Equity Research

Key Financial Performance

FY Dec.	2010	2011	2012E	2013E
Revenue Growth(%)	5.5	-7.3	2.0	7.5
Operating Profit Growth(%)	23.8	-48.0	10.7	16.8
Net Profit Growth(%)	20.9	-46.8	10.2	16.1
EPS Growth(%)	25.9	-46.4	11.6	17.2
EPS 3-Year CAGR(%)	10.0	NM	-9.0	-11.2

Source: Company data, S&P Equity Research

Key Fundamentals

FY Dec.	2008	2009	2010	2011
Asset turnover (x)	0.1	0.1	0.1	0.1
Receivables turnover (x)	73.6	12.3	12.6	29.4
Inventory turnover (x)	NA	NA	NA	NA
Current Ratio (x)	20.3	25.0	9.7	11.9
Quick Ratio (x)	NA	NA	NA	NA
Net Gearing (%)	0.0	0.0	0.0	0.0
Debt/Capital (%)	0.0	0.0	0.0	0.0
Interest coverage (x)	NA	NA	NA	NA
ROA (%)	-6.5	5.8	6.5	3.6
ROE (%)	-6.7	5.9	6.7	3.8
Payout ratio (%)	0.0	62.2	95.5	97.2

Source: Company data, S&P Equity Research

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