

TAIWAN

China Development FHC

16 June 2009

2883 TT **Neutral**

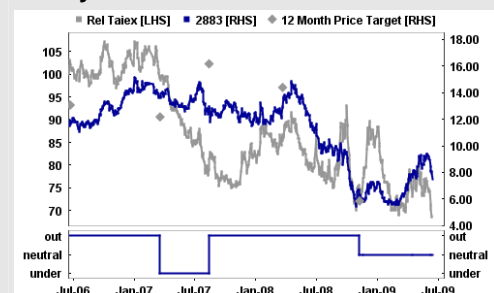
Stock price as of 15 Jun 09	NT\$	7.46
12-month target	NT\$	7.41
Upside/downside	%	-0.7
Valuation	NT\$	3.45-10.20
- ROE-g / COE-g		

GICS sector		banks
Market cap	NT\$m	83,783
30-day avg turnover	NT\$m	443.4
Market cap	US\$m	2,556
Foreign ownership	%	11.9
Number shares on issue	m	11,231

Investment fundamentals

Year end 31 Dec		2008A	2009E	2010E	2011E
Net interest inc	m	2,589	2,218	2,637	2,939
Non interest inc	m	992	8,285	10,703	13,533
Underlying profit	m	-1,600	5,916	8,317	10,453
Reported profit	m	-7,056	3,229	5,171	7,375
Adjusted profit	m	-7,056	3,229	5,171	7,375
EPS rep	NT\$	-0.62	0.29	0.46	0.66
EPS rep growth	%	0.0	0.0	60.1	42.6
PE rep	x	nmf	25.9	16.2	11.4
Total DPS	NT\$	0.00	0.10	0.08	0.17
Total div yield	%	0.0	1.3	1.1	2.3
ROA	%	-2.2	1.1	1.7	2.3
ROE	%	-5.5	2.8	4.4	6.0
Equity to assets	%	39.4	38.6	38.5	38.0
EV/EBITDA	x	-1.2	2.4	1.5	1.1
Price/book	x	0.7	0.7	0.7	0.7

2883 TT rel Taix performance, & rec history



Source: FactSet, Macquarie Research, June 2009 (all figures in NT\$ unless noted)

Analyst

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Tech sector proxy

Event

- China Development will attend our regional financials conference on 17–18 June in Singapore and Hong Kong. In this note, we update our model for 2008 audited results and introduce our 2011 forecasts. We maintain our Neutral rating given a weak 2H09 outlook for its tech-focused VC business.

Impact

- Earnings/balance sheet revisions.** CDFHC reported an audited net loss of NT\$7.1bn for 2008, including NT\$5.2bn in impairment charges and a separate NT\$3.1bn in losses on asset divestments. We attribute much of the losses to CDOs, which we believe were marked on the preliminary 2008 balance sheet at around NT\$11.8bn, of which about NT\$4.4bn was US subprime mortgage credit risk. The silver lining to this is that net US subprime exposure has fallen to US\$26m (NT\$860m) following the 2008 losses, according to management. We hope to obtain clarity on any remaining toxic assets at our conference.
- Earnings and balance sheet volatility.** As implied above, CDFHC's earnings are extremely volatile and difficult to forecast with confidence. Revenues from the VC business are dependent on asset divestments, which are in large part a function of market conditions. CDFHC has been trying to steer towards more sustainable revenues, but this has not been reflected in net income so far. Even forecasting the balance sheet is difficult given market-to-market accounting and a persistent lack of transparency.
- Risks aplenty.** In our view, CDFHC is a high-risk investment that is not suitable for the faint-hearted. In addition to the earnings volatility, we see execution risks for the company's strategy going forward given the top level management's reported legal issues and potential acquisition of retail brokers or even a commercial bank in order to more easily do business in China.

Earnings and target price revision

- We revise up 2009E earnings from NT\$857m to NT\$3.3bn following the larger-than-expected asset writedowns reported in the 2008 audited results. We raise our target price to NT\$7.41 from the previous NT\$5.8.

Price catalyst

- 12-month price target: NT\$7.41 based on a P/BV methodology.
- Catalyst: Weakening outlook for tech and therefore the VC business.

Action and recommendation

- Maintain Neutral.** CDFHC's core venture capital business makes it a proxy on the outlook for the Taiwan/Greater China technology industries. Macquarie's Taiwan head of research, Daniel Chang, recently downgraded his tech sector weighting from Overweight to Neutral due to 2H09 margin compression and a peak in the earnings revisions cycle (for details see Dan's 9 June note, *Will we see a repeat of 1H08?*). In light of this top-down view, the operating outlook for CDFHC should remain tough in 2H09 given tepid expected investment returns and underwriting profitability.

Please refer to the important disclosures and analyst certification on inside back cover of this document, or on our website www.macquarie.com.au/research/disclosures.

Fig 1 China Development FHC – financial statements

INCOME STATEMENT (NT\$m)	FY07A	FY08A	FY09E	FY10E	FY11E
Interest Income	7,463	6,113	4,082	4,913	5,625
Interest Expense	4,029	3,525	1,864	2,276	2,686
Net Interest Income	3,434	2,589	2,218	2,637	2,939
Fees & Commissions	2,114	1,498	2,047	2,275	2,341
Investment Related Income	0	0	0	0	1
Other non-interest Income	13,246	-506	6,238	8,428	11,191
Total Non-Interest Income	15,360	992	8,285	10,703	13,533
TOTAL INCOME	18,793	3,581	10,503	13,340	16,472
Personnel Costs	6,564	5,181	4,587	5,024	6,019
Occupancy Costs	0	0	0	0	0
Other Expenses	0	0	0	0	0
Total Operating Expenses	6,564	5,181	4,587	5,024	6,019
Pre-Provision OP	12,230	-1,600	5,916	8,317	10,453
Loan Loss Provision Expense	308	892	473	624	365
OP after Provisioning	11,922	-2,491	5,443	7,692	10,088
Associate Profit / (Loss)	0	0	0	0	0
Other non-operating Inc. / (Loss)	-3,596	-5,034	-1,595	-1,805	-1,853
Exceptional Gain & Loss	0	0	0	0	0
PROFIT BEFORE TAX	8,326	-7,525	3,848	5,888	8,235
Taxation	628	-437	651	746	887
Minority Interests	87	-33	-33	-29	-26
Preference Share Dividends	393	0	0	0	0
NET PROFIT	7,612	-7,056	3,229	5,171	7,375
Net Profit (Incl Extraordinaries)	7,698	-7,089	3,197	5,142	7,348
PER SHARE DATA	FY07A	FY08A	FY09E	FY10E	FY11E
EPS (NTD)	0.7	(0.6)	0.3	0.5	0.7
EPS Growth (%)	(50.8)	(190.2)	145.2	60.1	42.6
PER (X)	10.6	(11.7)	25.9	16.2	11.4
BVPS (NTD)	13.0	10.2	10.4	10.7	11.2
Price to Adj Book (X)	0.6	0.7	0.7	0.7	0.7
Dividend Yield (%)	2.6	0.0	1.3	1.1	2.3
Payout Ratio (%)	28.3	0.0	35.0	17.5	26.3
GROWTH DATA (%)	FY07A	FY08A	FY09E	FY10E	FY11E
Net Interest Income	45.0	(24.6)	(14.3)	18.9	11.4
Non-interest Income	(27.2)	(93.5)	735.0	29.2	26.4
Total Revenue	(19.9)	(80.9)	193.3	27.0	23.5
Operating Expense	4.5	(21.1)	(11.5)	9.5	19.8
Pre-provision Operating Profit	(28.9)	(113.1)	469.8	40.6	25.7
Pre-tax Profit	(46.5)	(190.4)	151.1	53.0	39.9
Net Profit	(49.3)	(192.7)	145.8	60.1	42.6
Total Loans to Customers	17.1	(5.1)	(12.8)	5.8	6.3
Total Deposits	197.8	36.5	31.5	22.1	25.1
Avg. Earning Assets	(16.1)	(19.2)	4.2	3.2	5.8
Total Interest Bearing Liabilities	(35.0)	21.1	2.0	11.9	8.0
Risk-weighted Assets (CDIB only)	(66.9)	(14.0)	(5.0)	5.0	6.0

Source: Company data, TEJ, Bloomberg, Macquarie Research, June 2009

Fig 2 China Development FHC – financial statements

BALANCE SHEET (NT\$m)	FY07A	FY08A	FY09E	FY10E	FY11E
Total Loans to Customers	83,029	78,784	68,716	72,680	77,269
Cash & Equivalent	14,891	12,988	11,971	12,896	12,871
Due from CBC, other fin. Inst	29,444	22,157	29,023	29,894	30,792
Marketable Securities	46,622	32,275	35,174	37,431	39,901
Receivables	25,980	15,424	23,465	20,815	22,991
Total Current Assets	116,936	82,844	99,634	101,037	106,555
Long Term Investment	143,689	107,662	111,443	117,320	124,783
Total Earning Assets	343,654	269,290	279,792	291,037	308,607
Total Fixed Assets	4,134	4,450	4,355	4,380	4,410
Non-Earning Assets	17,477	16,217	17,461	18,055	18,678
TOTAL ASSETS	365,265	289,957	301,608	313,472	331,694
Total Customer Deposits	13,778	18,813	24,734	30,203	37,775
Total Current Liabilities	138,912	80,480	95,497	92,411	99,438
Long Term Liabilities	44,583	57,185	49,707	50,167	50,898
Other Liabilities	25,664	19,246	15,339	20,093	17,546
TOTAL LIABILITIES	222,938	175,724	185,276	192,874	205,657
Common Stock	109,621	112,309	112,309	112,309	112,309
Preferred Stock	0	0	0	0	0
Capital Reserve	9,164	9,120	9,120	9,120	9,120
Treasury Stock	1,943	2,704	3,027	3,544	4,282
Retained Earnings	24,187	-4,668	-2,891	858	5,559
TOTAL SHAREHOLDERS EQUITY	144,915	119,466	121,565	125,831	131,270
CORE RATIOS	FY07A	FY08A	FY09E	FY10E	FY11E
ROAA (%)	2.1	(2.2)	1.1	1.7	2.3
ROAE (%)	5.1	(5.5)	2.8	4.4	6.0
NPL / Total Loans (Gross) (%)	0.8	1.5	0.9	0.9	0.8
LLR / Non-performing loans (%)	245.3	97.9	130.0	130.0	130.0
LLR / Total Loans (Gross) (%)	1.9	1.5	1.2	1.2	1.0
Net Interest Income / Rev (%)	18.3	72.3	21.1	19.8	17.8
Fee Base Income / Rev (%)	11.2	41.8	19.5	17.1	14.2
Forex Income / Rev (%)	(0.8)	(25.8)	(8.8)	(6.9)	(5.6)
Cost / Income (%)	34.9	144.7	43.7	37.7	36.5
Expenses / Avg Assets (%)	1.8	1.6	1.6	1.6	1.9
Revenue per Employee (NT\$m)	10.9	2.2	6.8	8.7	10.7
Net Profit per Branch (NT\$m)	230.7	(252.0)	115.3	184.7	263.4
Net Interest Spread (%)	0.8	0.9	0.8	1.0	1.1
Net Interest Margin (%)	1.8	1.6	1.4	1.6	1.7
Avg Loans / Avg Earn Assets (%)	69.0	89.7	78.5	72.9	73.1
Avg Loans / Avg Dep. (LDR, %)	836.4	496.5	338.7	257.4	220.6
Avg Earning Assets / Avg Assets (%)	30.3	27.5	31.8	31.5	31.8
FHC level CAR (%)	108.6	131.1	131.2	131.2	131.0
VALUATION (%)					
CURRENT PRICE	7.46				
	Price (NTD)	+ / -	Key Assumptions		
TARGET PRICE: Price to Book	7.41	-1%	based on:	0.7	10 PBV
Target Price: PER	3.45	-54%	based on:	12.0	10 PER
Target Price: DDM	8.47	14%	Perp. Growth	2.0	%
FAIR VALUE: ROE-g / COE-g	3.98	-47%	2009-12 ROE-g / COE-g by subsidiary		

Source: Company data, TEJ, Bloomberg, Macquarie Research, June 2009

China Development FHC (2883 TT, Neutral, Target price: NT\$7.41)

Quarterly Results					Profit & Loss						
	1Q/09A	2Q/09E	3Q/09E	4Q/09E		2008A	2009E	2010E	2011E		
Net Interest Income	m	485	584	554	594	Net Interest Income	m	2,589	2,218	2,637	2,939
+ Loan Fees	m	299	542	491	714	+ Loan Fees	m	1,498	2,047	2,275	2,752
+ Trading Income	m	229	-231	-231	-691	+ Trading Income	m	-923	-923	-923	-923
+ Insurance Income	m	0	0	0	0	+ Insurance Income	m	0	0	0	0
+ Other Income	m	582	1,826	1,790	2,963	+ Other Income	m	417	7,161	9,351	14,740
Non Interest Income	m	1,110	2,138	2,051	2,986	Non Interest Income	m	992	8,285	10,703	13,533
Total Operating Inc	m	1,595	2,722	2,605	3,580	Total Operating Inc	m	3,581	10,503	13,340	16,472
+ Staff expenses	m	1,193	1,179	1,147	1,068	+ Staff expenses	m	5,181	4,587	5,024	6,019
+ Other expenses	m	0	0	0	0	+ Other expenses	m	0	0	0	0
Total Operating Exp	m	1,193	1,179	1,147	1,068	Total Operating Exp	m	5,181	4,587	5,024	6,019
Pre-Provision Profit	m	402	1,543	1,458	2,513	Pre-Provision Profit	m	-1,600	5,916	8,317	10,453
Loan Provisions	m	-190	102	104	457	Loan Provisions	m	892	473	624	365
Post Provision Profit	m	592	1,441	1,354	2,055	Post Provision Profit	m	-2,491	5,443	7,692	10,088
Other Profit	m	0	0	0	0	Other Profit	m	0	0	0	0
- Amortisation	m	0	0	0	0	- Amortisation	m	0	0	0	0
- Non Recurring Items	m	0	0	0	0	- Non Recurring Items	m	0	0	0	0
- Associates	m	0	0	0	0	- Associates	m	0	0	0	0
Pre-Tax Profit	m	590	1,051	940	1,267	Pre-Tax Profit	m	-7,525	3,848	5,888	8,235
- Taxation	m	-32	163	163	358	- Taxation	m	-437	651	746	887
Net Profit After Tax	m	622	888	777	910	Net Profit After Tax	m	-7,089	3,197	5,142	7,348
- Minority Interests	m	-2	0	0	-30	- Minority Interests	m	-33	-33	-29	-26
Reported Profit	m	624	888	777	940	Reported Profit	m	-7,056	3,229	5,171	7,375
Adjusted Profit	m	624	888	777	940	Adjusted Profit	m	-7,056	3,229	5,171	7,375
Attributable Profit	m	624	888	777	940	Attributable Profit	m	-7,056	3,229	5,171	7,375
EPS (rep)		0.06	0.08	0.07	0.08	EPS (rep)		-0.62	0.29	0.46	0.66
EPS growth pcp (rep)	%	39.3	642.0	nmf	nmf	EPS growth yoy (rep)	%	nmf	nmf	60.1	42.6
EPS (adj)		0.06	0.08	0.07	0.08	EPS (adj)		-0.63	0.29	0.46	0.66
EPS growth pcp (adj)	%	39.3	642.0	nmf	nmf	EPS growth yoy (adj)	%	nmf	nmf	60.1	42.6
DPS		0.00	0.00	0.00	0.10	DPS		0.00	0.10	0.08	0.17
						Payout ratio	%	nmf	35.0	17.5	26.2
						Book Value p.s (wgted)		10.0	10.4	10.7	11.2
						Tangible Book Value p.s (wgted)		10.0	10.4	10.7	11.2
						Weighted average shares	m	11,371	11,231	11,231	11,231
Key Ratios					Key Ratios						
	1Q/09A	2Q/09E	3Q/09E	4Q/09E		2008A	2009E	2010E	2011E		
Interest Spread	%	0.22	0.38	0.40	0.47	Interest Spread	%	0.58	0.78	1.00	1.08
Net Interest Margin	%	0.55	0.69	0.71	0.72	Net Interest Margin	%	1.43	1.34	1.54	1.64
Non Int Inc / Total Inc	%	69.6	78.5	78.7	83.4	Non Int Inc / Total Inc	%	80.3	77.6	80.3	82.2
Cost to Income	%	74.8	43.3	44.0	29.8	Cost to Income	%	144.7	43.7	37.7	36.5
Cost to Assets	%	0.86	0.84	0.80	0.71	Cost to Assets	%	1.79	1.52	1.60	1.81
Provisions / Loans	%	-0.49	0.27	0.29	1.31	Provisions / Loans	%	1.11	0.68	0.84	0.47
Tax Rate	%	-5.4	15.5	17.3	28.2	Tax Rate	%	5.8	16.9	12.7	10.8
Loan Deposit Ratio (LDR)	%	nmf	nmf	nmf	204.5	Loan Deposit Ratio (LDR)	%	418.8	204.5	183.0	nmf
NPLs	%	1.62	1.55	1.48	1.29	NPLs	%	1.57	1.29	1.28	1.06
Reserve Cover	%	98.0	104.1	111.3	130.0	Reserve Cover	%	97.9	130.0	130.0	130.0
Tier 1 Capital Ratio	%	130.8	130.5	130.3	130.0	Tier 1 Capital Ratio	%	131.1	130.0	130.0	130.0
Total Capital Ratio	%	132.0	131.8	131.5	131.2	Total Capital Ratio	%	132.3	131.2	131.2	131.1
Equity to Assets	%	41.9	41.7	41.5	38.6	Equity to Assets	%	39.4	38.6	38.5	38.0
ROA (ave)	%	0.40	0.59	0.53	0.64	ROA (ave)	%	-2.15	1.09	1.68	2.29
ROE (ave)	%	1.0	1.4	1.3	1.6	ROE (ave)	%	-5.5	2.8	4.4	6.0
ROTE (ave)	%	1.0	1.4	1.3	1.6	ROTE (ave)	%	-5.5	2.8	4.4	6.0
					Growth rates						
						2008A	2009E	2010E	2011E		
Income Growth						%	-81.1	193.3	27.0	23.5	
Cost Growth						%	-21.1	-11.5	9.5	19.8	
Pre-Prov Profit Growth						%	nmf	nmf	40.6	25.7	
PBT Growth						%	nmf	nmf	53.0	39.9	
Loan Growth						%	-5.1	-12.8	5.8	6.3	
Ave Int Earning Assets						%	-17.5	-8.7	3.7	4.5	
					Valuation data						
						2008A	2009E	2010E	2011E		
P/E (rep)	x					nmf	25.9	16.2	11.4		
P/E (adj)	x					nmf	25.9	16.2	11.4		
P/B (wgted)	x					0.7	0.7	0.7	0.7		
P/TB (wgted)	x					0.7	0.7	0.7	0.7		
Dividend yield	%					0.0	1.3	1.1	2.3		
					Balance Sheet						
						2008A	2009E	2010E	2011E		
Cash & Equivalent	m	82,844	99,634	101,037	106,555						
Net Loans to Customer	m	78,784	68,716	72,680	77,269						
Other Interest Earning Assets	m	0	0	0	0						
Other Assets	m	128,329	133,259	139,755	147,870						
Total Assets	m	289,957	301,608	313,472	331,694						
Customer Deposits	m	18,813	33,597	39,717	0						
Other Int Bearing Liab	m	80,480	86,633	82,897	137,214						
Other Liabilities	m	76,431	65,046	70,259	68,444						
Total Liabilities	m	175,724	185,276	192,874	205,657						
Ordinary Equity	m	118,901	119,224	119,741	120,478						
Retained Earnings	m	-4,668	-2,891	858	5,559						
Reserves	m	0	0	0	0						
Minority Interests	m	0	0	0	0						
Total S/H's Funds	m	114,233	116,332	120,598	126,037						

All figures in NT\$ unless noted.

Source: Company data, Macquarie Research, June 2009

Important disclosures:

Recommendation definitions	Volatility index definition*	Financial definitions
<p>Macquarie - Australia/New Zealand Outperform – return >5% in excess of benchmark return Neutral – return within 5% of benchmark return Underperform – return >5% below benchmark return</p> <p>Macquarie – Asia/Europe Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie First South - South Africa Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie - Canada Outperform – return >5% in excess of benchmark return Neutral – return within 5% of benchmark return Underperform – return >5% below benchmark return</p> <p>Macquarie - USA Outperform (Buy) – return >5% in excess of benchmark return Neutral (Hold) – return within 5% of benchmark return Underperform (Sell) – return >5% below benchmark return</p> <p>Recommendations – 12 months</p> <p>Note: Quant recommendations may differ from Fundamental Analyst recommendations</p>	<p>This is calculated from the volatility of historical price movements.</p> <p>Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p>High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p>Medium – stock should be expected to move up or down at least 30–40% in a year.</p> <p>Low–medium – stock should be expected to move up or down at least 25–30% in a year.</p> <p>Low – stock should be expected to move up or down at least 15–25% in a year.</p> <p>* Applicable to Australian/NZ/Canada stocks only</p>	<p>All "Adjusted" data items have had the following adjustments made: Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests</p> <p>EPS = adjusted net profit / efpowa* ROA = adjusted ebit / average total assets ROA Banks/Insurance = adjusted net profit / average total assets ROE = adjusted net profit / average shareholders funds Gross cashflow = adjusted net profit + depreciation *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>

Recommendation proportions – For quarter ending 31 March 2009

	AU/NZ	Asia	RSA	USA	CA	EUR
Outperform	40.44%	49.55%	44.83%	38.49%	67.19%	43.84%
Neutral	38.60%	15.57%	39.66%	46.43%	28.12%	39.04%
Underperform	20.96%	34.88%	15.52%	15.08%	4.69%	17.12%

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