

Blockchain

Key message

Madison Holdings (8057 HK) has made several investments in blockchain-related companies since April, aiming to transform from a wine trader into a one-stop blockchain service provider. The firm has invested in cryptocurrency exchange BitPoint (JP; unlisted) and cryptocurrency miner Diginex (HK; unlisted). We expect Madison to benefit from a cryptocurrency market rebound in the future, and become a key beneficiary if blockchain technology is adopted by the financial sector. We currently do not offer a rating on this counter.

Madison Holdings – From wine trading to blockchain

Event

In view of the great potential of blockchain technology to become a mainstream technology within the financial market, Madison Holdings (8057 HK), a wine trading company, has invested in a number of blockchain-related companies since 1Q18, aiming to become a one-stop blockchain service provider. These investments include: (1) 20% equity interest in cryptocurrency exchange BitPoint (JP; unlisted), and (2) 51% equity interest in cryptocurrency mining company Diginex (HK; unlisted).

Impact

Invested in Japanese cryptocurrency exchange BitPoint. In March, Madison agreed to acquire a 20% equity interest in BitPoint from Remixpoint (JP) for HK\$362mn, with the option to acquire an additional 40% equity interest. BitPoint is one of 16 licensed virtual currency-trading platforms in Japan, with net assets of JPY41.5mn (HK\$3.0mn), and a net loss of JPY188mn (HK\$13.6mn) in FY17 (FY ends March). The firm has seen operations greatly improve since a virtual currency-trading platform license was obtained in September 2017. For the ten months ending January 31, 2018, BitPoint posted revenue of JPY2.6bn (HK\$187mn) and net profit of JPY1.8bn (HK\$131mn). Assuming no profit was made in the remaining two months ending in March, the acquisition implies FY18F PE of 13.8x, which we believe is reasonable. According to CoinMarketCap, cryptocurrency market capitalization fell from over US\$800bn in January to below US\$300bn in June, due to stricter regulatory measures. Although 1H18 BitPoint operating performance is expected to be dragged down by bearish sentiment, the acquisition serves as a foundation to ride long-term cryptocurrency market growth. As additional time is needed to carry out due diligence and valuation review, the deal completion date has been amended from May 14 to July 14.

Entered cryptocurrency mining industry to potentially benefit from market rally.

In May, the company acquired a 51% equity interest in Diginex for HK\$471mn. With data centers located in Sweden and Switzerland, Diginex primarily mines Ethereum (ETH) using GPU mining rigs. The company currently has over 7,000 GPU rigs (over 40K GPUs), equivalent to around 8MW. If ETH price reaches US\$675 (ETH price was US\$497 on June 15), Diginex is estimated to generate annualized EBITDA of US\$23mn. However, even if ETH price falls, the company can shift to mining other profitable cryptocurrencies. In the long term, ETH will migrate from proof-of-work to proof-of-stake, and Diginex can also deploy its GPUs for advanced computing applications, such as machine learning and artificial intelligence. In FY18 (FY ends March), Diginex reported a net loss of HK\$1.25mn (the firm commenced operations from in June 2017).

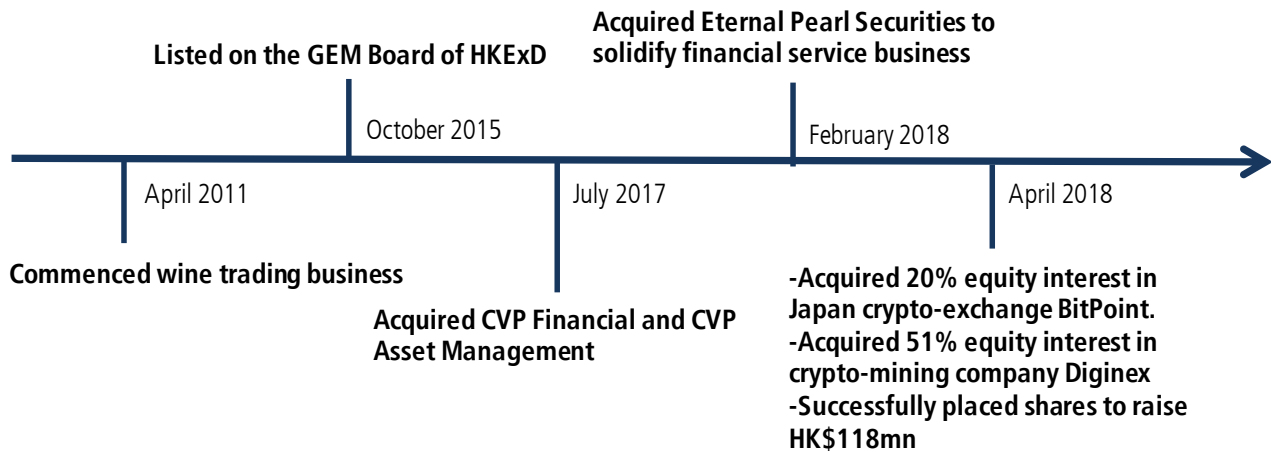
Stocks for action

Madison posted an adjusted net loss of HK\$14mn in March-December 2017 (FY ends March). With investments in several blockchain companies, the firm is expected to benefit from a potential cryptocurrency market rebound and blockchain adoption by the financial sector.

Risks

Cryptocurrency market crash; lower-than-expected profit from acquired companies.

Figure 1: Corporate milestones



Source: Company data; KGI Research

Figure 2: Breakdown of Madison Holdings FY14-FY17 results (FY ends March)

Rmb mn	FY14	FY15	FY16	FY17
Revenue	70.0	145.7	126.7	139.6
Cost of sales	(45.4)	(105.6)	(93.7)	(111.6)
Gross profit	24.7	40.1	33.0	28.0
Operating expenses	(15.7)	(22.1)	(26.5)	(43.2)
Operating profit	9.0	18.0	6.5	(15.2)
Finance costs	0.0	0.7	0.0	0.0
Others	(0.3)	(1.4)	(13.6)	0.0
Profit before tax	8.7	17.3	(7.1)	(15.2)
Income tax expenses	(1.5)	(3.0)	(2.2)	0.4
Profit after tax	7.2	14.3	(9.3)	(14.8)
Less: MI	0.0	(0.2)	(0.1)	0.2
Net profit	7.2	14.2	(9.4)	(14.6)
Margin (%)				
Gross margin	35.3	27.5	26.0	20.0
Op. margin	12.8	12.3	5.1	(10.9)
Net margin	10.3	9.7	(7.5)	(10.5)
YoY growth (%)				
Revenue	-	108.0	(13.0)	10.2
Gross profit	-	62.4	(17.8)	(15.2)
Operating profit	-	99.9	(64.0)	(335.0)
Net profit	-	96.5	(166.7)	54.7

Source: Company data; KGI Research

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Total return = (12M target price - current price) / current price

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