

China / Hong Kong

Flash Note

Refer to important disclosures at the end of this report

BS Group Research . Equity

19 May 2020

HK Exchanges & Clearing (388 HK) : BUY

Mkt. Cap: US\$41,676m | **3m Avg. Daily Val:** US\$172.6m

Last Traded Price (18 May 2020): HK\$254.80

Price Target 12-mth: HK\$316.0 (24.0% upside)

Analyst

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Company Guide



Summary of our point of view, and highlights the relevant data points, which are actively tracked

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Beneficiary of WVRs and secondary-listed companies' inclusion in HSI

- **WVRs and secondary-listed companies' inclusion in HSI strengthen Secondary listing theme**
- **New Greater Bay Area Financial Support Guideline set to strengthen HKEx's position**
- **Adjusted FY20/21F earnings down by 10% on declining investment returns**
- **Maintain BUY with TP at \$316**

Forecasts and Valuation

FY Dec (HK\$ m)	2018A	2019A	2020F	2021F
Turnover	15,867	16,261	16,529	18,268
EBITDA	11,531	11,645	11,815	13,207
Pre-tax Profit	10,883	10,901	10,948	12,340
Net Profit	9,312	9,341	9,381	10,574
EPS (HK\$)	7.50	7.52	7.55	8.51
EPS Gth (%)	24.3	0.3	0.4	12.7
Diluted EPS (HK\$)	7.48	7.50	7.54	8.49
DPS (HK\$)	6.73	6.73	6.76	7.62
BV Per Share (HK\$)	32.79	35.56	35.23	35.40
PE (X)	34.0	33.9	33.7	29.9
P/Cash Flow (X)	33.4	28.4	32.5	28.8
P/Free CF (X)	36.7	31.5	36.1	31.8
EV/EBITDA (X)	26.6	26.2	25.7	22.6
Net Div Yield (%)	2.6	2.6	2.7	3.0
P/Book Value (X)	7.8	7.2	7.2	7.2
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	23.9	22.0	21.3	24.1
Earnings Rev (%)			(10)	(10)
Consensus EPS (HK\$)			8.10	8.93
Other Broker Recs:		B:18	S:0	H:5

Source: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

What's New

WVRs and secondary-listed companies' inclusion in HSI strengthen Secondary listing theme. Hang Seng Indexes Company Limited (HSI Company Ltd) has published the conclusions reached on consultation on the "Eligibility of Weighted Voting Right (WVR) Companies and Secondary-listed Companies for Inclusion in HSI and the HSCEI" yesterday. The WVRs and secondary-listed companies from the Greater China region can be included in the HSI and the HSCEI universes. This decision is strongly supported by the market, with more than 90% of respondents in favour. The eligible WVR and secondary listing companies include Alibaba (9988 HK), Xiaomi (1810 HK) and Meituan (3690 HK), based on their current market values and turnover. These individual companies will be subject to a 5% weighting cap if they are selected for inclusion.

We believe this is positive to HKEx as the new rule for WVRs and secondary-listed stocks will boost the attractiveness and provide another incentive for US-listed Chinese companies to seek a secondary listing in Hong Kong. Although share price performance has been mixed after individual stocks were added into the index, the trading volume of the added stocks will generally improve by 10% to 40% compared with the 3M average trading volume before and after the addition. Together with trade war tensions reigniting and well-performed Alibaba in term of IPO fund raised and share price after listing, we expect to have a great homecoming this year.



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Given that Alibaba's secondary listing is widely considered to be successful, Netease (NTES US), Ctrip (TCOM US), JD.com (JD US), Yum China (YUMC US) and Baidu (BIDU US) have reportedly shown interest in a secondary listing in HK. That said, we have shortlisted 20 US-listed China companies keeping in mind secondary listing requirements, and US-to-HK turnover conversion assumption based on Alibaba. We estimate these companies could contribute HKD\$3.2bn to average daily turnover (ADT) of HK Stock Exchange after their IPOs and directly increase HKEx's earnings potential in the next couple of years. This HK\$3.2bn ADT from the potential secondary listing companies has already been factored into our FY21 ADT forecast of HK\$113bn.

Top IPO destinations set for a reason According to HKEx, there is 13% of 2019 ADT was contributed by the five largest IPOs in the last three years. It indicates the major IPOs in HK can easily draw attention from the investors, giving good motive for companies to IPO in HK. Hong Kong is able to draw leading Chinese and international issuers. It attracted the world's 2nd and 4th largest offerings in 2019 (Alibaba and Budweiser APAC). Facilitated by the listing reform in 2018, it extended connection to cover WVRs companies like Xiaomi, Meituan. Wide range of products and risk management tools also help broaden the ecosystem for the underlying issuers.

New Greater Bay Area Financial Support Guideline strengthen HKEx's China-international gateway position.

China has issued a financial support guideline for the development of Greater Bay Area. The guideline outlines supportive guides for financial sectors like banks, brokers, insurers and fintech, as well as HKEx's role in GBA and its supportive measures on offshore RMB development.

Measures related to HKEx include:

1. Allow Hong Kong and Macao RMB clearing banks to participate in the inter-bank lending market in the Mainland;
2. Optimise and improve the interconnection arrangements for financial markets such as Stock Connect and Bond Connect;
3. Support financial institutions and non-financial enterprises to issue financial bonds, corporate bonds and debt financing instruments
4. Strengthen Hong Kong's global offshore RMB business hub position and provide support to Hong Kong to develop more offshore RMB, commodities and other risk management tools.

The guideline enhances as well as ensures Hong Kong's entrenched position as the China-international gateway as well as the offshore RMB hub. HKEx will benefit from the increasing cooperation with China's stock market. The company will also continue to benefit from the healthy pipeline in the foreseeable future due to the listing regime introduced and secondary listing theme, after Alibaba's

mega success. Since WVRs and Secondary-listed companies are now able to be included into the HSI, it also increases the likelihood of Alibaba and other secondary listing companies in the future to be included in the Stock Connect and Bond Connect programmes, which provide extra incentive to US-listed Chinese companies.

Net investment income recorded a loss of HK\$47m in 1Q2020

: HKEx's 1Q2020 major drag came from a HK\$521m loss of net investment income in corporate funds' external portfolio due to the market sell-off caused by COVID-19 in 1Q2020. This is a huge contrast with the HK\$390m gain in the same period last year. HKEx has de-risked its external portfolio by HK\$1.4bn in March and did a HK\$1.9bn cash redemption exercise for downside protection. The redemption proceeds have been prudently placed in money market funds and internally managed cash deposits. The average fund size of corporate funds was HK\$29.4bn in 1Q2020, 13% higher y-o-y.

Core trading tariff & fee division recorded a gain despite COVID-19

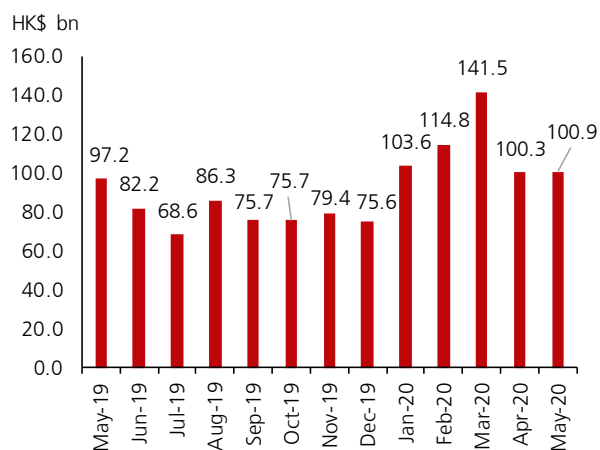
: Income from the core trading and clearing business gained 19% y-o-y in 1Q2020 underpinned by the 18% increase in ADT in the Hong Kong Stock Exchange. This was supported by trading volume of the recent popular IPOs and secondary listings, like Alibaba and Budweiser, as well as the market sell-off in 1Q2020 amid the global pandemic and recession concerns. The ADT in 1Q2020 was HK\$120bn and 2020 YTD is at the HK\$150bn level. 1Q2020 Stock Connect revenue also reached a quarterly record high of HK\$404m, a 74% gain from 1Q19. Northbound and Southbound ADT reached quarterly highs of RMB78.0bn and HK\$21.6bn respectively.

Lowering FY20/2021 earnings by 10% as we lower our estimate on net investment income, given the unexpected loss in 1Q2020. We have lowered our net investment income estimates on HKEx's of FY20/21. For FY20, mostly due to investment losses in 1Q. In addition, we have also lowered our assumption on HIBOR to reflect the downward drifting trend due to lower expected interest rates from "infinite QE". HIBOR is the benchmark of HKEx's margin funds.

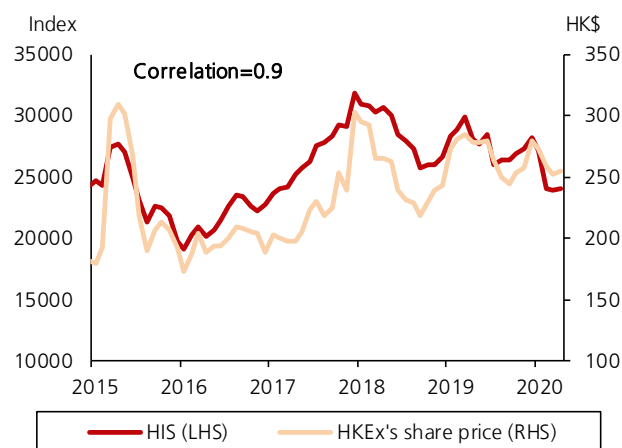
However, our ADT estimates overall remain unchanged as we are positive on HKEx's core business and the theme of US-listed Chinese companies seeking secondary listings given that there are now more incentives. The aim to be a top global IPO destination status should uphold market sentiment and IPO pipeline, leading to higher ADT and core business earnings. We expect ADT to deliver c.14% CAGR in FY19-21 despite the global pandemic and rising economic uncertainties. We have rolled over our target price to base on 37.1x FY21F PE (previously FY20), pegged to +1std of its 10-year mean. We maintain BUY with TP of HK\$316.00.

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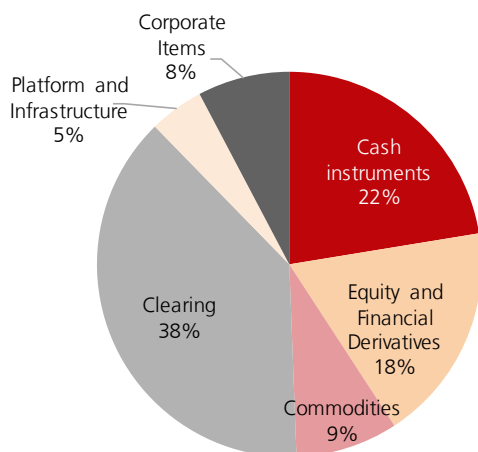
Average daily turnover of HKSE, 1Y



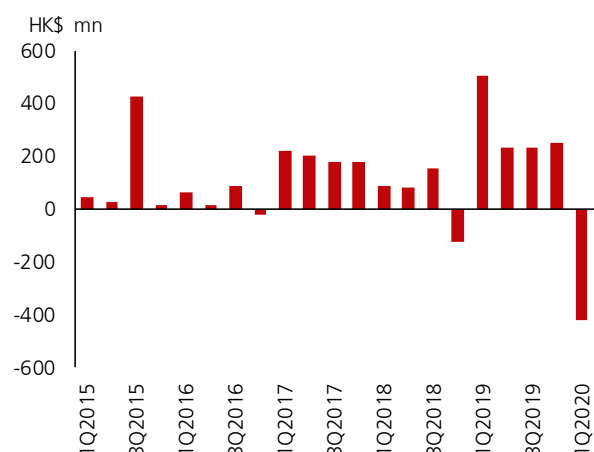
HSI & HKEx's share price correlation, 5Y



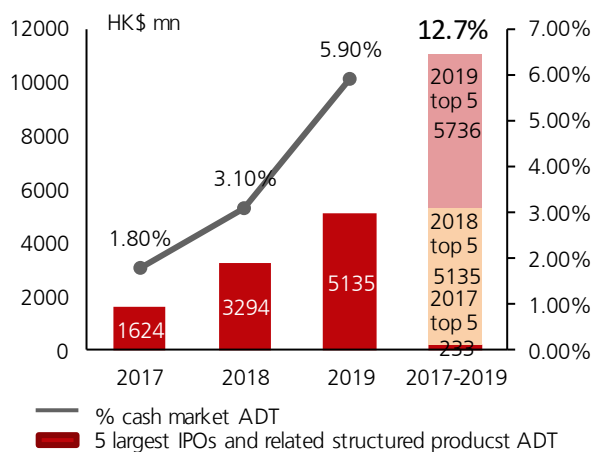
Core business vs non-core business in FY19



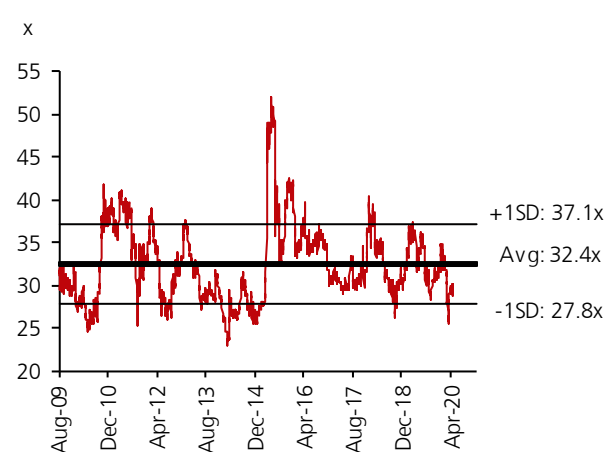
Net investment income



ADT contributed by the five largest IPOs in the last 3Y



HKEx's PE band



Source: Bloomberg Finance LP, Thomson Reuters, HKEx

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Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	2-Jul-19	HK\$280.00	HK\$329.00	Buy
2:	15-Aug-19	HK\$235.20	HK\$316.00	Buy
3:	12-Sep-19	HK\$246.00	HK\$316.00	Buy
4:	27-Feb-20	HK\$259.80	HK\$316.00	Buy

Source: DBS HK

Analyst: Dennis LAM

Byron LAM

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DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 19 May 2020 18:45:05 (HKT)

Dissemination Date: 19 May 2020 19:00:14 (HKT)

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