

Singapore Company Guide

Singapore Exchange

Version 16 | Bloomberg: SGX SP | Reuters: SGXL.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

27 May 2020

FULLY VALUED (Downgrade from HOLD)

Last Traded Price (26 May 2020): S\$9.90 (STI : 2,530.30)

Price Target 12-mth: S\$7.40 (-25% downside) (Prev S\$10.00)

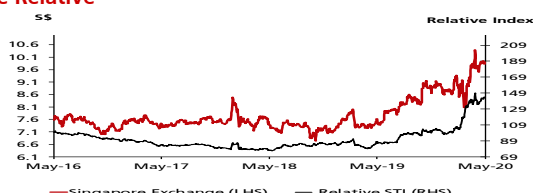
Analyst

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What's New

- SGX reduces licence agreement with MSCI from February 2021; only MSCI Singapore Index products will be retained
- MSCI ex-Singapore products contributed c.15%/12% of equity derivative contract and total derivative contract volumes
- Management expects NPAT impact to range from 10-15% for FY21F; FY22F likely to be worst hit
- Downgrade to FULLY VALUED, revised TP to S\$7.40

Price Relative



Forecasts and Valuation

FY Jun (\$m)	2019A	2020F	2021F	2022F
Revenue	910	1,030	1,014	1,009
EBITDA	511	547	508	477
Pre-tax Profit	473	548	508	477
Net Profit	391	454	420	394
Net Pft (Pre Ex.)	391	454	420	394
Net Pft Gth (Pre-ex) (%)	7.8	16.0	(7.3)	(6.2)
EPS (S cts)	36.4	42.3	39.2	36.7
EPS Pre Ex. (S cts)	36.4	42.3	39.2	36.7
EPS Gth Pre Ex (%)	8	16	(7)	(6)
Diluted EPS (S cts)	36.4	42.3	39.2	36.7
Net DPS (S cts)	37.5	30.0	30.0	30.0
BV Per Share (S cts)	102	114	123	130
PE (X)	27.2	23.4	25.3	27.0
PE Pre Ex. (X)	27.2	23.4	25.3	27.0
P/Cash Flow (X)	25.5	21.7	24.7	26.3
EV/EBITDA (X)	19.5	18.0	19.3	20.4
Net Div Yield (%)	3.8	3.0	3.0	3.0
P/Book Value (X)	9.7	8.7	8.0	7.6
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	35.8	39.2	33.1	29.1
Earnings Rev (%):		0	(11)	(19)
Consensus EPS (S cts):		42.5	41.3	42.2
Other Broker Recs:		B: 1	S: 6	H: 7

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P

Unexpected dent to medium-term thesis

Reduction of MSCI licence agreement dents medium-term thesis in the interim, downgrade to FULLY VALUED, TP S\$7.40.

We downgrade SGX to FULLY VALUED, as we believe the expiry of all other non-Singapore MSCI products in February 2021 dents the medium-term thesis for SGX's derivatives volume growth. Collectively, these contracts contributed c.15%/12% of equity derivatives contract and total derivative contract volumes. Management is guiding for net profit impact to range from 10-15% for FY21F, while we believe that FY22F is likely to be worst hit. Beyond the immediate earnings impact, we believe SGX will see more competition from Hong Kong Exchange (HKEX) going forward in the derivatives space following the latter's new offerings with MSCI of up to 37 equity index futures contracts, announced on 27 May 2020.

Where we differ: SGX's volume growth in derivatives in the last few years is testament to its execution capabilities. While SGX has the prerequisites to power growth in the identified segments of Fixed Income, Currencies and Commodities (FICC) and Data, Connectivity and Indices (DCI) in the medium term, we believe the reduction of licence agreement with MSCI has derailed SGX's medium-term thesis in the interim.

Potential catalysts: Lower-than-expected decline in net profit arising from exit of MSCI ex-Singapore contracts. Higher-than-expected growth in securities daily average value (SDAV) is a near-term re-rating catalyst.

Valuation:

Downgrade to FULLY VALUED with revised TP of S\$7.40. We downgrade SGX to FULLY VALUED on the MSCI licence developments. Our revised TP of S\$7.40 is based on the dividend discount model ($k=7\%$, $g=3\%$, $ROE=35\%$) as we revise our ROE assumption from 39% to 35% and lower our long-term growth forecast from 4% to 3%. We have cut FY21-22F earnings by 11-19% but left FY20F estimates unchanged.

Key Risks to Our View:

Competition in derivatives business. SGX may see potential earnings downside as it faces competition from HKEX which has entered into new offerings with MSCI. HKEX has also announced in March 2019 that it is planning to launch futures contracts. These may compete with SGX's FTSE China A50 Index Futures, which accounts for c.40% of SGX's total derivatives volume.

At A Glance

Issued Capital (m shrs)	1,070
Mkt. Cap (\$m/US\$m)	10,592 / 7,479
Major Shareholders (%)	
SEL Holdings Pte Ltd	23.4
Free Float (%)	76.6
3m Avg. Daily Val (US\$m)	36.0
GIC Industry : Financial / Diversified Financials	



Live more, Bank less

WHAT'S NEW

Impact of reduced MSCI licence agreement

Licence agreement for MSCI ex-Singapore products will expire in February 2021. On 27 May 2020, SGX announced that its licence agreement with MSCI will be reduced going forward. Except for MSCI Singapore products, all other MSCI products listed on SGX will expire in February 2021. MSCI Singapore futures and options will remain listed on SGX with both SGX and MSCI working to extend them well beyond 2021.

Impact of reduced MSCI licence agreement. April FY-to-date, Ex-MSCI Singapore products contributed ~15% of equity derivatives contracts volume and ~12% of total derivatives contracts volumes. Amongst these volumes, MSCI Taiwan contracts, being one of SGX's top four traded equity contracts, contributed ~12%/ 10% of equity and total derivatives contracts volumes. MSCI Singapore products contributed another ~5% to total derivatives contracts volumes. According to management, there is a "potential 10-15% impact on FY2021 NPAT" based on its estimates, assuming that there will be zero trades in all other MSCI products from July 2020.

Management has stressed that its assessment is conservative at this point, as some contracts are still likely to trade between July 2020 and February 2021 and it excludes cost and technology expenses associated with the contracts and hence FY21F could see a smaller-than-expected decline. We have cut FY21-22F earnings by 11-19% but left FY20F estimates unchanged. There may be potential upside in FY21F estimates should trading continue from July 2020 to February 2021 in the interim as investors mitigate the changes.

Contract	April FY-to-date Daily Average Volume ('000)
MSCI Taiwan	97
MSCI NTRs	22
Total	119
Nifty 50	97
MSCI Singapore	47
FTSE China A50	368
Nikkei Options	45
Nikkei Futures	110
SSFs- India	12
Other – Equities	3
Total Equity Derivatives	801
Total Currencies	112
Total Commodities	94
Total Derivatives	1007

Source: Company

Competition in derivatives space likely to heat up. Meanwhile, HKEX has entered into a major licensing agreement with MSCI with plans to introduce 37 futures and options contracts, subject to regulatory approvals and market conditions. We note that on top of plans to offer MSCI Taiwan products, MSCI Singapore contracts are in the plans as they are not exclusive to SGX and there might be some movement in volumes from SGX to HKEX.

In March 2019, HKEX announced that it was planning to launch futures contracts. These may compete with SGX's FTSE China A50 Index Futures, which accounts for c.40% of SGX's total derivatives volume. We believe HKEX's move further bolsters its ambitions in the derivatives space, an area it has been keen to grow in. The reduction of licence agreement with MSCI has derailed SGX's medium-term thesis in the interim, which has been powered by derivatives' growth.

SGX's mitigation plans. SGX continues to build on its multi-asset solutions as it believes margin efficiencies across various asset classes will continue to allow it to seek growth in the derivatives business. According to SGX, it will continue to engage with its stakeholders to manage their open interest as SGX gradually discontinues the relevant MSCI products. In our view, it could be difficult for SGX to recreate similar products to its existing MSCI offerings. However, SGX has reiterated on its continued push to broaden and deepen Asia coverage by developing more derivative products on its own or seeking collaboration with other partners.

Outlook and recommendation

Downgrade to FULLY VALUED with revised TP of S\$7.40. We downgrade SGX to FULLY VALUED on the MSCI licence developments and intensifying competition in the derivatives space. Our revised TP of S\$7.40 is based on the dividend discount model ($k=7\%$, $g=3\%$, $ROE=35\%$) as we revise our ROE assumption from 39% to 35% and lower our long-term growth forecast from 4% to 3%.

CRITICAL DATA POINTS TO WATCH

Critical Factors

Market activity

1) Securities

SGX derived about 20% of its total revenue from the Securities segment in FY19, down from 46% in FY10. Average daily turnover value (SDAV) for this segment has been hovering slightly above the S\$1bn mark in the last few years, from c.S\$1.5bn in FY10. SGX has already implemented several initiatives to boost liquidity in the securities market, including Market Maker and Liquidity Provider (MM/LP) programmes and new offerings such as Daily Leverage Certificates (DLCs) offered in July 2017. More recently, DLCs with higher leverage were also introduced. Other measures in the pipeline include: 1) Shorter settlement cycle to reduce credit risk exposure to the settlement system and improve efficiency, and 2) Short position reporting requirements to improve transparency. We note that SDAV has been a critical factor driving SGX's share price.

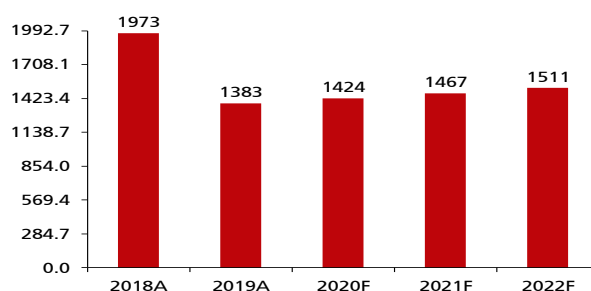
2) Derivatives

More product offerings. Contribution to total revenue from the Derivatives segment increased from about 21% in FY10 to c.51% in FY19. The mainly institutional-driven Derivatives business has been the key growth driver in recent years; derivatives revenue had overtaken that of the Securities market since 1QFY15. We expect this trend to persist as SGX continues to introduce more derivatives products, such as growing the market for currency futures. In FY19, SGX also benefitted from higher open interest and margin balances, in part due to higher interest rates which drove derivatives' collateral management income.

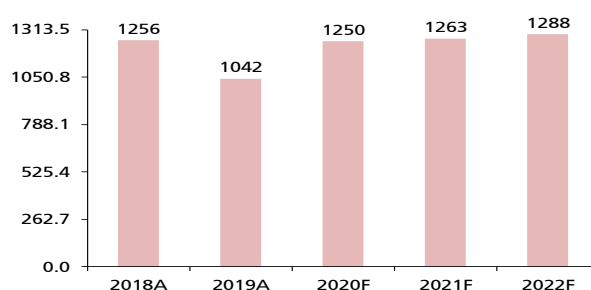
Diversifying business mix. SGX is also looking to diversify into other areas and reduce its reliance on the derivatives business by a) developing into a regional fixed income platform, with the launch of its bond trading platform – SGX Bond Pro; and b) growing its market data and index businesses.

M&A to drive earnings. The acquisition of the Baltic Exchange for £77.6m (S\$137m) in cash was completed at the end of 2016. This purchase should enable SGX to boost its plans to diversify revenue streams from the Securities market and reduce reliance on the Derivatives market. SGX is also looking to expand its global presence in shipping and has been developing Asian pricing benchmarks for commodities such as iron ore, liquefied natural gas and coking coal. In FY20, SGX announced the acquisition of Scientific Beta for EUR186m; Scientific Beta will be earnings accretive based on its historical annual revenues of c. EUR20m.

Average Daily Volume (m)



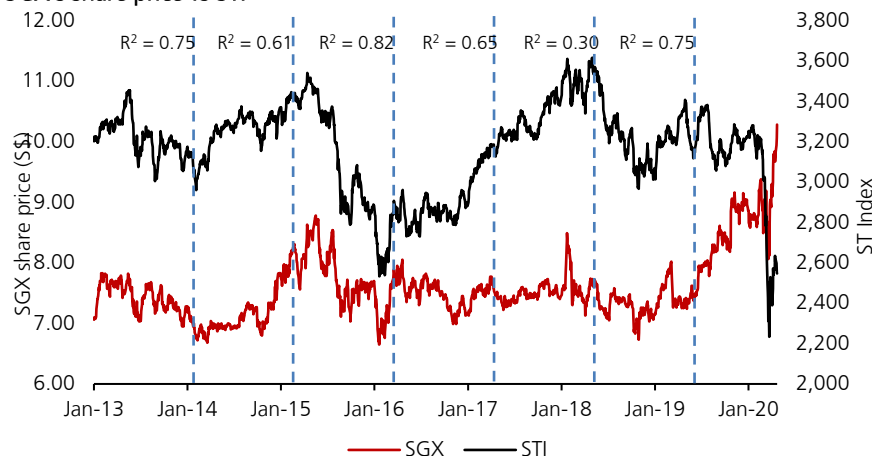
Average Daily Value (\$m)



Source: Company, DBS Bank

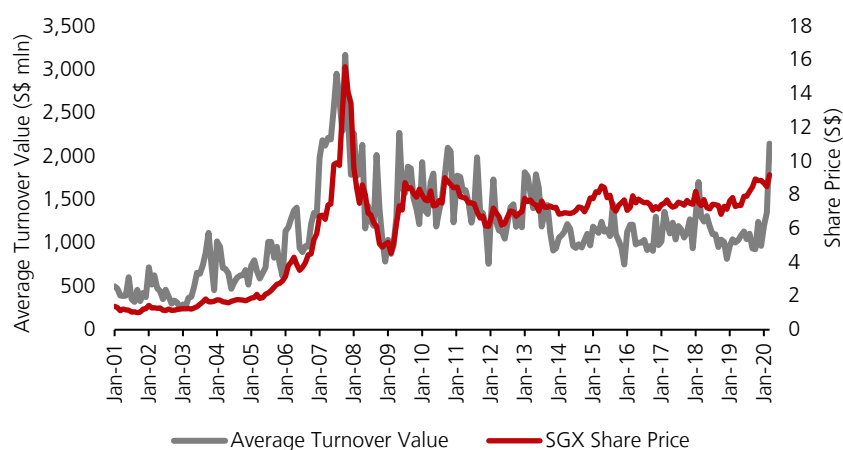
Appendix 1: A look at Company's listed history – what drives its share price?

SGX's share price vs STI



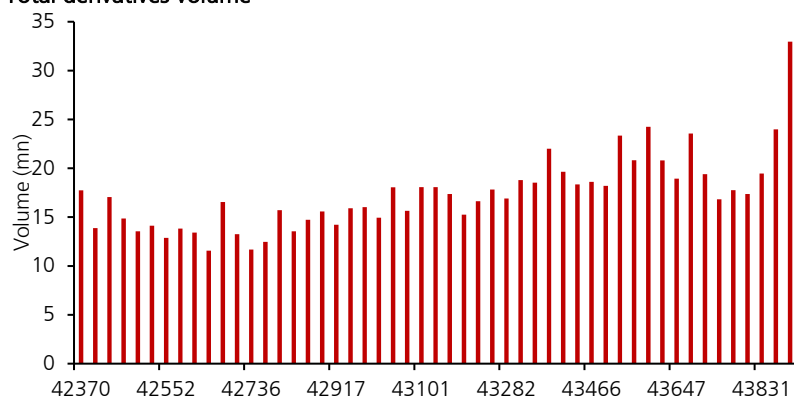
SGX's share price has generally been tracking in the same direction with the STI Index. Correlation between SGX's share price and STI has weakened tremendously, as derivatives business continues to drive SGX's performance.

SGX's share price vs average trading value for the market



SGX's share price and trading value for the market are more closely related, with correlation coefficient of ~0.8 from January 2001 till today. As at FY19, the Securities segment accounted for 20% of total revenue.

Total derivatives volume



Derivatives volume has grown at a 5-year CAGR of 15%. In terms of contribution to the group's revenues, this had increased from c.30% in FY14 to c.51% in FY19.

Source: DBS Bank, Bloomberg Finance L.P.

Singapore Exchange

Balance Sheet:

Cash and liquid assets account for almost half of the total assets as SGX needs to set aside at least S\$500m for working capital requirements. SGX expects to maintain healthy cash flows going forward. In FY18, SGX announced its new dividend policy of an absolute dividend of 7.5 Scts per quarter (dividends are paid on a quarterly basis).

Share Price Drivers:

New derivatives products to drive growth but gestation period may be long. The addition of new products should continue to drive growth for the Derivatives segment. The FTSE China A50 Index futures, which is the top index futures in terms of volume and accounts for about 40% of total volume for index futures in CY19, took about three years before seeing a ramp-up in volume.

Key Risks:

Competition in derivatives business. The top four index futures – FTSE China A50, Nikkei 225, SGX CNX Nifty and MSCI Taiwan – accounted for about c.70% of the total monthly volume in the derivatives market for CY19. SGX may see potential earnings downside as it faces competition from HKEX which has entered into new offerings with MSCI. MSCI ex-Singapore contracts on SGX will expire in February 2021 and we expect the volumes to shift to HKEX. HKEX has also announced in March 2019 that it is planning to launch futures contracts. These may compete with SGX's FTSE China A50 Index Futures, which accounts for c.40% of SGX's total derivatives volume.

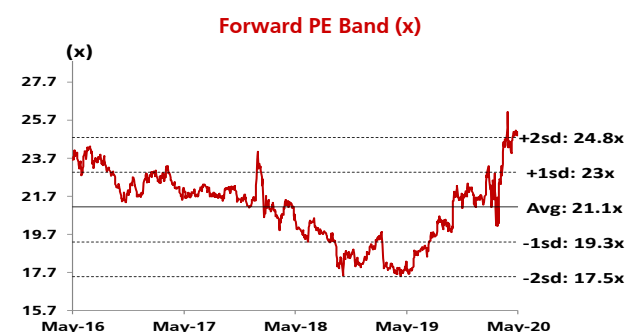
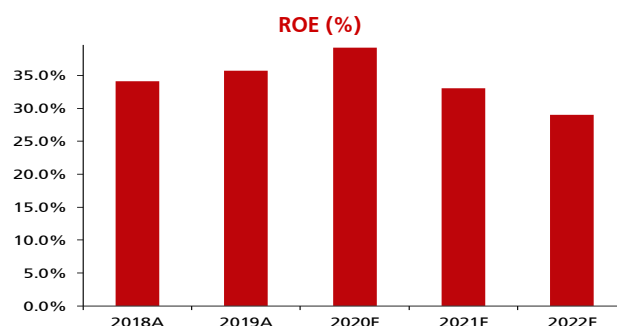
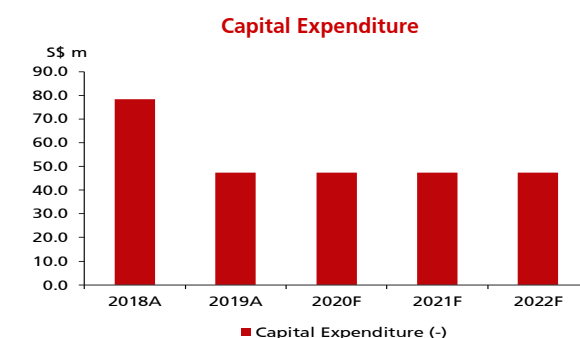
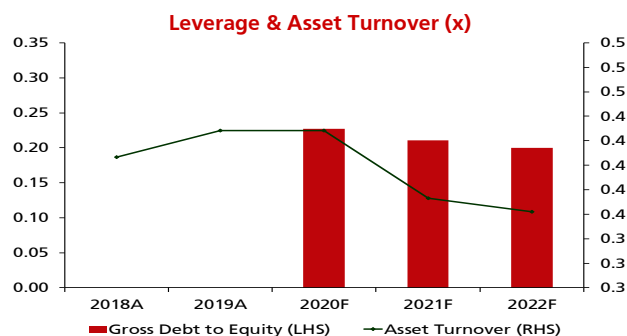
Sustainability of market liquidity. SGX's earnings are reliant on market volumes and capital market activities, which are sentiment-driven and influenced by the direction of foreign fund flows. Negative market sentiment resulting in lower liquidity could dampen market volumes and values.

Environment, Social, Governance:

SGX's Bloomberg ESG disclosure score had improved over the last few years to reach 26.0 (FY18), as SGX continues to improve its sustainable practices and advocates transparency and accountability as part of its sustainability agenda. SGX remains as a constituent stock of major sustainability indices.

Company Background

Singapore Exchange Limited (SGX) owns and operates Singapore's Securities and Derivatives Exchange and related clearing houses. The company also provides ancillary securities processing and information technology services to participants in the financial sector.



Source: Company, DBS Bank

Key Assumptions

FY Jun	2018A	2019A	2020F	2021F	2022F
Average Daily Value (\$m)	1,256	1,042	1,250	1,263	1,288

Income Statement (\$m)

FY Jun	2018A	2019A	2020F	2021F	2022F
Revenue	845	910	1,030	1,014	1,009
Cost of Goods Sold	(420)	(449)	(489)	(512)	(538)
Gross Profit	425	461	542	502	471
Other Opng (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Operating Profit	425	461	542	502	471
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	1.27	(1.5)	(5.0)	(5.0)	(5.0)
Net Interest (Exp)/Inc	10.9	13.5	11.0	11.0	11.0
Exceptional Gain/(Loss)	0.44	(0.1)	0.0	0.0	0.0
Pre-tax Profit	437	473	548	508	477
Tax	(74.3)	(81.9)	(93.7)	(87.7)	(82.4)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	363	391	454	420	394
Net Profit before Except.	363	391	454	420	394
EBITDA	476	511	547	508	477
Growth					
Revenue Gth (%)	5.5	7.7	13.2	(1.6)	(0.5)
EBITDA Gth (%)	5.6	7.2	7.0	(7.1)	(6.1)
Opg Profit Gth (%)	5.7	8.5	17.5	(7.3)	(6.3)
Net Profit Gth (Pre-ex) (%)	5.5	7.8	16.0	(7.3)	(6.2)
Margins & Ratio					
Gross Margins (%)	50.3	50.7	52.6	49.5	46.7
Opg Profit Margin (%)	50.3	50.7	52.6	49.5	46.7
Net Profit Margin (%)	43.0	43.0	44.0	41.5	39.1
ROAE (%)	34.1	35.8	39.2	33.1	29.1
ROA (%)	17.5	18.4	18.9	15.5	14.2
ROCE (%)	32.1	33.7	33.6	26.1	23.2
Div Payout Ratio (%)	88.4	102.9	71.0	76.6	81.7
Net Interest Cover (x)	NM	NM	NM	NM	NM

SGX's guidance for operating expenses increased to S\$485-495m on higher activity-related costs, launch of SGX care package (S\$5m) and acquisition of Scientific Beta

Losses expected for SGX's portfolio of companies

Source: Company, DBS Bank

Quarterly / Interim Income Statement (\$5m)

FY Jun	3Q2019	4Q2019	1Q2020	2Q2020	3Q2020
Revenue	229	248	248	231	296
Cost of Goods Sold	(111)	(125)	(113)	(112)	(133)
Gross Profit	118	123	135	119	163
Other Oper. (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Operating Profit	118	123	135	119	163
Other Non Opg (Exp)/Inc	3.05	3.31	4.58	1.91	5.26
Associates & JV Inc	(0.6)	(0.3)	(0.5)	(0.8)	(2.4)
Net Interest (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	121	126	139	121	166
Tax	(21.0)	(22.0)	(24.6)	(21.5)	(28.2)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	99.7	104	114	99.0	138
Net profit bef Except.	99.7	104	114	99.0	138
EBITDA	121	126	139	121	166

Growth

Revenue Gth (%)	2.1	8.4	(0.2)	(6.7)	28.1
EBITDA Gth (%)	3.5	4.3	10.3	(13.2)	37.5
Opg Profit Gth (%)	4.0	3.9	9.7	(11.4)	36.4
Net Profit Gth (Pre-ex) (%)	3.3	4.2	10.0	(13.3)	38.9

Margins

Gross Margins (%)	51.7	49.5	54.4	51.7	55.1
Opg Profit Margins (%)	51.7	49.5	54.4	51.7	55.1
Net Profit Margins (%)	43.6	41.9	46.1	42.9	46.5

Balance Sheet (\$5m)

FY Jun	2018A	2019A	2020F	2021F	2022F
Net Fixed Assets	71.8	61.0	98.2	135	171
Invt in Associates & JVs	8.63	79.1	74.1	69.1	64.1
Other LT Assets	354	415	415	415	415
Cash & ST Invt	832	667	1,064	1,124	1,160
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	827	885	1,003	987	982
Other Current Assets	22.0	25.0	25.0	25.0	25.0
Total Assets	2,115	2,132	2,679	2,755	2,817
ST Debt	0.0	0.0	278	278	278
Creditor	891	912	1,032	1,016	1,010
Other Current Liab	95.4	90.0	107	101	95.2
LT Debt	0.0	0.0	0.0	0.0	0.0
Other LT Liabilities	32.7	40.0	40.0	40.0	40.0
Shareholder's Equity	1,096	1,091	1,223	1,321	1,393
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Cap. & Liab.	2,115	2,132	2,679	2,755	2,817
Non-Cash Wkg. Capital	(137)	(91.0)	(111)	(105)	(99.0)
Net Cash/(Debt)	832	667	786	846	882
Debtors Turn (avg days)	354.7	343.5	334.5	358.1	356.1
Creditors Turn (avg days)	880.0	827.4	741.2	746.0	701.6
Inventory Turn (avg days)	N/A	N/A	N/A	N/A	N/A
Asset Turnover (x)	0.4	0.4	0.4	0.4	0.4
Current Ratio (x)	1.7	1.6	1.5	1.5	1.6
Quick Ratio (x)	1.7	1.5	1.5	1.5	1.5
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	N/A	N/A	17.0	17.0	17.0
Z-Score (X)	8.1	7.9	6.1	6.0	5.9

Source: Company, DBS Bank

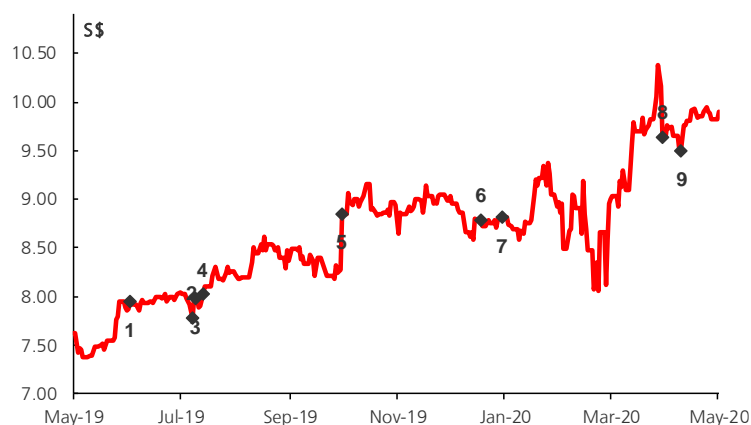
Cash Flow Statement (\$m)

FY Jun	2018A	2019A	2020F	2021F	2022F
Pre-Tax Profit	437	473	548	508	477
Dep. & Amort.	50.2	51.3	10.1	10.6	11.0
Tax Paid	(71.4)	(82.4)	(77.2)	(93.7)	(87.7)
Assoc. & JV Inc/(loss)	(1.3)	1.50	5.00	5.00	5.00
Chg in Wkg.Cap.	(31.1)	(40.9)	3.45	(0.5)	(0.2)
Other Operating CF	42.9	15.1	0.0	0.0	0.0
Net Operating CF	427	417	489	430	405
Capital Exp.(net)	(78.5)	(47.4)	(47.4)	(47.4)	(47.4)
Other Invt.(net)	(25.5)	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	(1.5)	(71.7)	0.0	0.0	0.0
Div from Assoc & JV	4.94	0.0	0.0	0.0	0.0
Other Investing CF	11.0	(41.2)	0.0	0.0	0.0
Net Investing CF	(89.5)	(160)	(47.4)	(47.4)	(47.4)
Div Paid	(300)	(401)	(322)	(322)	(322)
Chg in Gross Debt	0.0	0.0	278	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(2.3)	(20.7)	0.0	0.0	0.0
Net Financing CF	(302)	(422)	(44.0)	(322)	(322)
Currency Adjustments	0.01	0.0	0.0	0.0	0.0
Chg in Cash	35.2	(165)	398	60.2	35.4
Opg CFPS (\$ cts)	42.7	42.7	45.2	40.1	37.7
Free CFPS (\$ cts)	32.5	34.5	41.1	35.6	33.3

Technology-related capex guidance of S\$45-50m

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	27 Jun 19	7.95	7.05	HOLD
2:	01 Aug 19	7.78	8.30	BUY
3:	03 Aug 19	7.98	8.30	BUY
4:	07 Aug 19	8.02	8.30	BUY
5:	25 Oct 19	8.85	8.90	BUY
6:	12 Jan 20	8.79	8.90	BUY
7:	24 Jan 20	8.81	9.60	BUY
8:	24 Apr 20	9.64	10.00	HOLD
9:	05 May 20	9.50	10.00	HOLD

Note: Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

Analyst: Rui Wen LIM

DBS Bank 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*

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Sources for all charts and tables are DBS Bank unless otherwise specified.

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