

China / Hong Kong Company Update

HK Exchanges & Clearing

Bloomberg: 388 HK EQUITY | Reuters: 388.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

12 Nov 2020

BUY

Last Traded Price (11 Nov 2020): HK\$365.40 (HSI : 26,227)

Price Target 12-mth: HK\$426 (17% upside) (Prev HK\$414)

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What's New

- **3Q2020 results in line with expectations**
- **Higher risk appetite following the conclusion of US presidential election and favorable vaccine development**
- **Fine-tuned FY20/21F earnings by +7%/+3% to reflect better trading volumes**
- **Maintain BUY with higher TP at HK\$426**

Price Relative



Forecasts and Valuation

FY Dec (HK\$m)	2019A	2020F	2021F	2022F
Turnover	16,261	18,177	20,411	22,670
EBITDA	11,645	13,552	15,550	17,603
Pre-tax Profit	10,901	12,685	14,683	16,736
Net Profit	9,341	10,870	12,581	14,341
Net Profit Gth (Pre-ex) (%)	0.3	16.4	15.7	14.0
EPS (HK\$)	7.52	8.75	10.13	11.55
EPS Gth (%)	0.3	16.4	15.7	14.0
Diluted EPS (HK\$)	7.50	8.73	10.11	11.52
DPS (HK\$)	6.73	7.83	9.06	10.33
BV Per Share (HK\$)	35.56	35.56	35.56	35.56
PE (X)	48.6	41.8	36.1	31.6
P/Cash Flow (X)	40.7	40.4	34.9	30.8
P/Free CF (X)	45.2	44.2	37.9	33.0
EV/EBITDA (X)	38.0	32.4	27.7	24.0
Net Div Yield (%)	1.8	2.1	2.5	2.8
P/Book Value (X)	10.3	10.3	10.3	10.3
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	22.0	24.6	28.5	32.5
Earnings Rev (%)		7	3	NEW
Consensus EPS (HK\$)		8.75	10.10	11.29
Other Broker Recs:		B:22	S:2	H:4

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Can HKEx fly higher?

Investment Thesis

More to go. The recent historical high share price has yet to fully reflect the structural increase in trading activities taking place.

New growth drivers. Secondary listings, potential relistings, rising stock connect contributions, MSCI derivatives, and higher global liquidity all support a further increase in trading activities. GBA policy initiatives will further cement HKEx's role as China's premier international exchange.

Rise in Average Daily Turnover (ADT) → increase in earnings and share price. We forecast ADT to be HK\$139bn/HK\$158bn for FY21/22F. Our TP of HK\$426 reflects the promising factors above.

Valuation:

We lifted our target price (TP) to HK\$426, based on 42.1x FY21F PE, pegged to +2 S.D. of its 10-year mean given the bright outlook.

Where we differ:

Despite strong YTD performance, HKEx has not yet fully factored in structural changes from secondary listings, MSCI derivatives and generally higher liquidity in the market.

Key Risks to Our View:

Trading volume coming in below expectations due to weak market sentiment; geo-political risks that may cause loss of popularity of IPOs seeking to list on the HKEx.

At A Glance

Issued Capital (m shrs)	1,261
Mkt Cap (HK\$m/US\$m)	460,769 / 59,419
Major Shareholders (%)	
The Hong Kong SAR Government	5.9
Free Float (%)	94.1
3m Avg. Daily Val. (US\$m)	225.28
GLCS Industry: Financials / Diversified Financials	



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WHAT'S NEW

Strong 3Q2020 results in line with market expectations

Strong 3Q2020 earnings - in line. HKEx's net profit increased by 51.4% y-o-y to HK\$3,339m in 3Q2020, on track to achieve consensus earnings expectations for the full-year 2020. Revenue increased by 33.2% y-o-y to HKD5,309m, mainly due to the overall higher market participation during the period that led to strong performances from its cash and clearing business segments (+26.9% and +14.1% respectively). Average daily turnover (ADT) of the Stock Exchange in 3Q2020 jumped c.83% y-o-y to HK\$141bn (9M2020: HK\$126bn). The significantly increase was due a higher participated market, and also partly the function of the low trading volume in the same period last year during the social unrest in Hong Kong. Stock Connect Northbound and Southbound ADT reached record nine-month highs of RMB90.0 billion and \$23.2 billion respectively. EBITA margin was stable at 77%.

Bright outlook. Barring extreme events, Biden should be the next US president, removing a major market overhang. It is widely anticipated that Biden will take a more moderate stance towards China, though the overall confrontational tone between the two countries is likely to remain. We believe this event is a short-term catalyst for risk appetite in the market to improve after months of uncertainty. Meanwhile, Pfizer has announced phase 3 data of its COVID-19 vaccine trial. The good news should underpin positive trading sentiment. The recent regulatory scrutiny on new economy behemoths in China should provide ample reason to take profit on these high-flying names. This development is creating the necessary push for investors to rotate to other sectors with a better risk-reward ratio. We expect the trading momentum to sustain at these high levels for the rest of 2020.

Moving into 2021, we remain positive on HKEx's earnings growth outlook with structural developments taking place. We continue to see robust pipelines for secondary listings of US-listed Chinese companies, and IPO of new economy and biotech

companies. We also expect rising contribution from the Stock connect programme. The expansion initiative on Bay connect and STAR connect should continue to further cement HKEx's role as China's premier international exchange. The MSCI futures and options indexes taken from Singapore were launched in 3Q2020. Although revenue should not be significant in 4Q2020, the collaboration with MSCI should boost HKEx's derivatives segment to grow in the long term. The A-share derivative platform, which is currently awaiting regulatory approval, will be a positive catalyst for HKEx's share price, as CEO Charles Li is determined that this initiative to materializes.

Raised FY2020/2021F earnings by c.7.4/3.0% to reflect better market sentiment. As YTD Northbound and Southbound trading momentum has significantly increased vs the same period last year, we have revised up our Northbound ADT and Southbound ADT estimates for FY21F by c.22% and c.18% to RMB127bn and HK\$34bn. Overall, we revised up our ADT projections from HK\$118bn to HK\$125bn for FY2020; and HK\$136bn to HK\$139bn for FY2021F, on expectations that trading turnover is maintained at HK\$120-130bn level for the rest of the year. FY21F earnings revision is mainly due to better outlook on the stock connect programme, but HKEx's structural changes are largely in line with our previous expectations. Therefore, we have upgraded our TP to HK\$426.00, based on a 42.1x FY21F PE, pegged to +2 S.D. of its 10-year mean.

Company Background

Hong Kong Exchanges & Clearing Limited (HKEx) owns and operates the stock exchange, futures exchange, and their related clearing houses in Hong Kong. The company provides the trading platforms for a range of cash and derivatives products and the facilities for processing trades.

Quarterly Income Statement (HK\$m)

	2019 3Q A Sep	2020 2Q A Jun	2020 3Q A Sep	YoY change	QoQ change
Revenue	3,987	4,773	5,309	33.2%	11.2%
Cost of Goods Sold	0	0	0		
Gross Profit	3,987	4,773	5,309	33.2%	11.2%
Other Operating Income	0	0	0		
Staff costs and related expenses	(649)	(695)	(752)	15.9%	8.2%
Information technology and computer maintenance expenses	(144)	(157)	(150)	4.2%	-4.5%
Premises expenses	(32)	(30)	(32)	0.0%	6.7%
Product marketing and promotion expenses	(11)	(7)	(17)	54.5%	142.9%
Legal and professional fees	(21)	(32)	(29)	38.1%	-9.4%
Other	(92)	(124)	(152)	65.2%	22.6%
Other Operating Expenses	(949)	(1,045)	(1,132)	19.3%	8.3%
EBITDA	3,038	3,728	4,177	37.5%	12.0%
Depreciation and amortisation	(271)	(271)	(282)	4.1%	4.1%
EBIT	2,767	3,457	3,895	40.8%	12.7%
Interest Expense	(173)	(47)	(43)		
Share of Associates' or JV Income	11	20	15		
Exceptional Gains/(Losses)	0	0	0		
Pretax Profit	2,605	3,430	3,867	48.4%	12.7%
Tax	(400)	(448)	(528)		
Minority Interests	2	(5)	8		
Net Profit	2,207	2,977	3,347	51.7%	12.4%
Preference Dividend for the period	0	0	0		
Net Profit after Preference Div	2,205	2,971	3,339	51.4%	12.4%
Revenue (HK m)					
Cash instruments	887	1,091	1,384	56.0%	26.9%
Equity and Financial Derivatives	717	740	873	21.8%	18.0%
Commodities	352	346	358	1.7%	3.5%
Clearing	1,584	1,877	2,142	35.2%	14.1%
Platform and Infrastructure	203	231	219	7.9%	-5.2%
Corporate Items	244	488	333	36.5%	n.a.

Source: Company, DBS HK

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Key Assumptions

FY Dec	2018A	2019A	2020F	2021F	2022F
ADT on the Stock Exchange (\$bn)	107.4	87.2	125.1	139.0	158.2
ADV of derivatives (Stock options and Futures)	1,202,521.0	1,066,000.0	1,529,717.9	1,699,205.1	1,934,255.8
ADT of Northbound Trading	20.4	41.7	90.0	130.0	162.7
ADT of Southbound Trading (HK\$bn)	13.0	10.7	24.0	34.7	45.4
Number of newly listed companies on Main Board	143.0	168.0	185.0	185.0	185.0

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Revenues (HK\$ m)					
Cash instruments	3,855	3,646	4,413	4,868	5,454
Equity and Financial Derivatives	3,503	2,988	4,154	4,535	5,247
Commodities	1,415	1,399	1,440	1,416	1,410
Clearing	6,168	6,226	6,840	7,528	8,461
Platform and Infrastructure	678	746	813	878	948
Corporate Items	248	1,256	516	1,186	1,151
Total	15,867	16,261	18,177	20,411	22,670
Gross margin (HK\$ m)					
Cash instruments	3,271	3,043	3,695	4,088	4,593
Equity and Financial Derivatives	2,930	2,437	3,398	3,721	4,318
Commodities	698	731	755	744	743
Clearing	5,356	5,402	5,953	6,572	7,407
Platform and Infrastructure	508	551	602	653	707
Corporate Items	(1,006)	49	(498)	124	189
Total	11,757	12,213	13,906	15,903	17,956
Gross margin Margins (%)					
Cash instruments	84.9	83.5	83.7	84.0	84.2
Equity and Financial Derivatives	83.6	81.6	81.8	82.1	82.3
Commodities	49.3	52.3	52.4	52.6	52.7
Clearing	86.8	86.8	87.0	87.3	87.5
Platform and Infrastructure	74.9	73.9	74.1	74.3	74.5
Total	74.1	75.1	76.5	77.9	79.2

Source: Company, DBS HK

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Income Statement (HK\$ m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Revenue	15,867	16,261	18,177	20,411	22,670
Cost of Goods Sold	0	0	0	0	0
Gross Profit	15,867	16,261	18,177	20,411	22,670
Other Opng (Exp)/Inc	(4,872)	(5,092)	(5,315)	(5,552)	(5,758)
Operating Profit	10,995	11,169	12,862	14,859	16,912
Other Non Opng (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	2	32	1	1	1
Net Interest (Exp)/Inc	(114)	(300)	(177)	(177)	(177)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	10,883	10,901	12,685	14,683	16,736
Tax	(1,592)	(1,561)	(1,817)	(2,103)	(2,397)
Minority Interest	21	1	1	1	1
Preference Dividend	0	0	0	0	0
Net Profit	9,312	9,341	10,870	12,581	14,341
Net Profit before Except.	9,312	9,341	10,870	12,581	14,341
EBITDA	11,531	11,645	13,552	15,550	17,603
Growth					
Revenue Gth (%)	20.4	2.5	11.8	12.3	11.1
EBITDA Gth (%)	23.5	1.0	16.4	14.7	13.2
Opg Profit Gth (%)	25.6	1.6	15.2	15.5	13.8
Net Profit Gth (%)	25.8	0.3	16.4	15.7	14.0
Margins & Ratio					
Opg Profit Margin (%)	69.3	68.7	70.8	72.8	74.6
Net Profit Margin (%)	58.7	57.4	59.8	61.6	63.3
ROAE (%)	23.9	22.0	24.6	28.5	32.5
ROA (%)	3.2	3.5	3.9	4.5	5.1
ROCE (%)	22.5	20.8	22.7	26.3	29.9
Div Payout Ratio (%)	89.7	89.5	89.5	89.5	89.5
Net Interest Cover (x)	96.4	37.2	72.7	83.9	95.5

Source: Company, DBS HK

Balance Sheet (HK\$ m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Net Fixed Assets	1,625	1,589	1,521	1,510	1,470
Invts in Associates & JVs	63	95	70	72	75
Other LT Assets	18,477	22,172	22,172	22,172	22,172
Cash & ST Invts	11,180	11,684	16,169	23,184	32,624
Inventory	0	0	0	0	0
Debtors	18,341	25,791	18,341	18,341	18,341
Other Current Assets	206,262	217,720	219,743	215,547	208,720
Total Assets	255,948	279,051	278,014	280,825	283,398
ST Debt	1,005	338	338	338	338
Creditors	18,369	22,447	21,371	24,182	26,757
Other Current Liab	194,207	208,152	208,152	208,152	208,152
LT Debt	161	80	121	121	121
Other LT Liabilities	1,303	3,533	3,533	3,533	3,533
Shareholder's Equity	40,729	44,173	44,173	44,173	44,173
Minority Interests	174	328	327	326	325
Total Cap. & Liab.	255,948	279,051	278,014	280,825	283,398
Non-Cash Wkg. Capital	12,027	12,912	8,561	1,554	(7,848)
Net Cash/(Debt)	10,014	11,266	15,711	22,726	32,165
Debtors Turn (avg days)	401.5	495.3	443.1	328.0	295.3
Creditors Turn (avg days)	(8,281.7)	(7,135.0)	(7,659.7)	(7,963.1)	(8,904.6)
Asset Turnover (x)	0.1	0.1	0.1	0.1	0.1
Current Ratio (x)	1.1	1.1	1.1	1.1	1.1
Quick Ratio (x)	0.1	0.2	0.2	0.2	0.2
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	73.8	261.0	212.8	225.4	219.1
Z-Score (X)	1.7	1.6	1.6	1.7	1.7

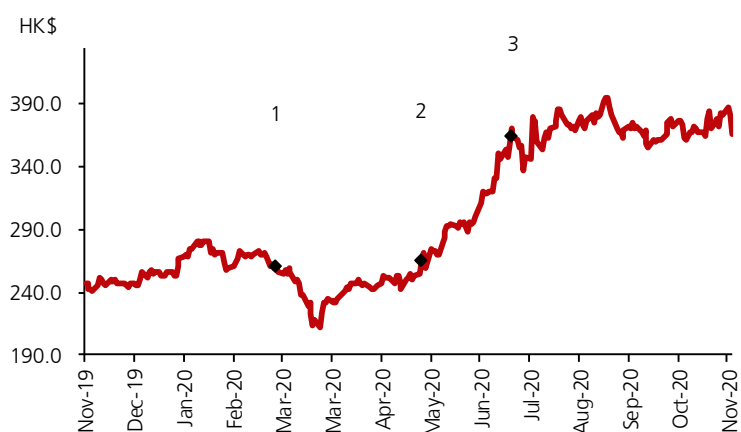
Source: Company, DBS HK

Cash Flow Statement (HK\$ m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Pre-Tax Profit	10,883	10,901	12,685	14,683	16,736
Dep. & Amort.	762	1,044	1,045	1,046	1,047
Tax Paid	(1,323)	(431)	(1,817)	(2,103)	(2,397)
Assoc. & JV Inc/(loss)	(2)	(32)	(1)	(1)	(1)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg. Cap.	(288)	65	(150)	(107)	(120)
Other Operating CF	(552)	(404)	(523)	(523)	(523)
Net Operating CF	9,480	11,143	11,240	12,996	14,743
Capital Exp.(net)	(860)	(1,091)	(976)	(1,033)	(1,004)
Other Invts.(net)	(4,467)	(2,435)	0	0	0
Invts in Assoc. & JV	0	0	26	(3)	(3)
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	0	41	0	0	0
Net Investing CF	(5,327)	(3,485)	(950)	(1,036)	(1,007)
Div Paid	(5,427)	(5,785)	(4,399)	(3,537)	(2,888)
Chg in Gross Debt	(1,185)	(1,121)	(1,230)	(1,230)	(1,230)
Capital Issues	0	0	0	0	0
Other Financing CF	93	(248)	(177)	(177)	(177)
Net Financing CF	(6,519)	(7,154)	(5,805)	(4,944)	(4,294)
Currency Adjustments	0	0	0	0	0
Chg in Cash	(2,366)	504	4,485	7,016	9,441
Opg CFPS (HK\$)	7.86	8.92	9.17	10.55	11.97
Free CFPS (HK\$)	6.94	8.09	8.26	9.63	11.06

Source: Company, DBS HK

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	27-Feb-20	HK\$259.80	HK\$316.00	Buy
2:	19-May-20	HK\$254.80	HK\$316.00	Buy
3:	10-Jul-20	HK\$370.60	HK\$414.00	Buy

Source: DBS HK

Analyst: Dennis LAM

Byron LAM

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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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